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PETRO KORNIIEV*, IVAN YATSKYEVYCH**

DIIA CITY: AN INNOVATIVE LEGAL REGIME. CAN UKRAINE'S LEGAL INNOVATION SHAPE THE GLOBAL TECHNOLOGICAL LANDSCAPE?

Abstract

This article analyzes the innovative legal framework of Diia City in Ukraine, designed to foster technological ecosystem growth and attract international investment. The study evaluates its impact on residents and identifies challenges within the current legal system. The hypothesis posits that Diia

* PhD Student of Interdisciplinary Doctoral School of Social Sciences, Nicolaus Copernicus University in Toruń. He is the author of numerous scientific articles and has been a speaker at various national and international conferences.

Contact e-mail: p.kornieiev@doktorant.umk.pl; ORCID: 0000-0003-4683-242X

** Associate Professor of Labour Law, Chair of Private Law Department, Faculty of Law, National University of Kyiv-Mohyla Academy, Kyiv, Ukraine, specializing in labor law, social security law and labour rights as human rights, social dialogue and collective bargaining. Author of chapters in 3 books and over 40 research papers, published on reviewed journals. Local expert in CoE project, member Kyiv Region Bar Association, practicing lawyer. *The co-author's participation in this paper's publication was accomplished within the research project Just Transition: Right to Work after War. Towards Decent Work in Ukraine's (Post)War Economy (No. 0124U003120, dated 24/05/2024) funded by the Ministry of Education and Science of Ukraine within the framework of international scientific and technological bilateral cooperation following the Protocol of the Fourteenth Meeting of the German-Ukrainian Working Group on Scientific and Technological Cooperation between the Ministry of Education and Science of Ukraine and the Federal Ministry of Education and Research of Germany of 09.11.2023 and its annex of 01.02.2024.*

Contact e-mail: ivan.yatskevych@ukma.edu.ua; ORCID: 0000-0002-9734-0671

City, with its preferential tax policies and streamlined regulations, could become a global benchmark for tech ecosystems. Legal stability and regulatory predictability are highlighted as critical for its success. A comparative methodology examines taxation structures and regulations affecting individual entrepreneurs (FOPs) and gig contracts. The hypothesis is verified through case studies and assessments of IT solutions in Ukraine. The analysis includes a literature review and examination of legal acts, offering a comprehensive evaluation of the reform's innovations and benefits, with potential applicability to other European countries. Findings suggest Diia City shows promise as a global model but faces challenges affecting legal certainty. While regulations aim to protect both employees and employers, further evaluation is needed, especially amid war and economic fluctuations. This article provides insight into legal stability's role in fostering innovation and contributes to the debate on legislative reforms influencing the labor market and Ukraine's technological development.

Key words: Diia City, Gig contacts, tax system, IT law, IT business, tax residents, innovative technological solutions

JEL Classification: K34, O38

1. Introduction

The global information technology market is experiencing steady and dynamic growth, characterized by continuous development in response to ongoing digitalization and the increasing demand for advanced technologies¹. Development of the IT sector today is not only a key element in modernization of the economy but also a significant driver of economic growth [Melnik, Hrynko 2021: 5]. As technology becomes increasingly integrated into daily life and business operations, investments in IT innovations yield tangible financial benefits for the national budget. From an economic standpoint, expanding

¹ Forecasts indicate that the global information technology (IT) market will reach a value of approximately \$12 trillion by 2027. According to a report by The Business Research Company, in 2023, the market was estimated at around \$8.5 trillion, with projected growth to \$12 trillion by 2027, corresponding to a compound annual growth rate of 7.9%. This dynamic expansion is primarily driven by the growth of cloud services, advancing digitalization, and the increasing adoption of advanced technologies, such as artificial intelligence and blockchain, which are transforming business structures and processes worldwide.

Source: GlobeNewswire. Information Technology Global Market Report 2023, <https://www.globenewswire.com/news-release/2023/04/21/2652000/0/en/Information-Technology-Global-Market-Report-2023.html>, accessed: August 3, 2024.

the IT sector has the potential to create new jobs and enhance business productivity and efficiency. It can also open new markets and investment opportunities.

The information technology sector in Ukraine is one of the key pillars of the country's economy. By enhancing its innovative potential, Ukraine is consistently strengthening its position on the international stage as a leading hub for innovation and IT outsourcing. The combination of a highly specialized workforce, competitive costs, and close collaboration with global technology leaders enables the delivery of advanced IT solutions.

According to the report *Digital Tiger: The Power of Ukrainian IT*, the IT sector in Ukraine has become one of the key drivers of the national economy. Particularly noteworthy is the impressive growth in the number of IT experts, which serves as a clear indicator of the industry's dynamic development. In 2023, the number of specialists increased by 2.7%, reaching 346.2 thousand individuals, highlighting the growing importance of this sector within the context of a knowledge- and innovation-based economy. From an economic standpoint, the information technology sector in Ukraine plays a crucial role in the national economy, contributing approximately 4.9% to GDP. Its impact extends beyond GDP and influencing other areas of the economy², particularly through export statistics. Additionally, it contributes to increasing tax revenues.

However, it's important to note that the share of the IT sector in Ukraine's GDP is lower compared to leading European countries. For example, in Malta, the IT sector contributes 10.26%; in Bulgaria, the IT sector contributes 7.47%; and in Latvia, the IT sector contributes 6.12%. In countries such as Estonia, Hungary, and Switzerland, this share is also significantly higher, reflecting

² Approximately 90% of Ukraine's IT sector activities are export-oriented, making it highly dependent on global economic trends. Due to its focus on international clients, the sector is vulnerable to changes in global markets, which are currently grappling with recession and a decline in employment at major tech companies. This presents additional challenges for Ukraine's IT industry, as the global economic slowdown could lead to reduced demand for outsourcing services and innovative solutions, which are critical for the sector's growth. Despite these challenges, the tech sector remains one of the key pillars of Ukraine's economy, playing a significant role in generating substantial foreign currency revenues. IT services account for 41.5% of total service exports, slightly down from 45.5% the previous year, yet still representing the largest share among all service export categories. In 2023, the IT sector's share in overall goods and services exports was between 12% and 13%.

a stronger role for the ICT sector in their economies and highlighting Ukraine's potential for further growth in the IT sector³.

It is important to note that the challenging political and economic conditions, along with the full-scale Russian invasion of Ukraine⁴, have had a significant impact on the finances of the IT sector. For the first time in twelve years, the Ukrainian IT sector did not record growth, marking a significant departure from its previous trajectory, which, up until 2022, had been characterized by impressive annual growth rates of 25-30%. This downturn has been reflected in a decline in tax revenues, which dropped from \$1.02 billion at the beginning of 2022 to \$982.6 million at the start of 2024⁵. Despite these challenges, the IT sector remains a critical component of Ukraine's long-term development, playing a fundamental role in job creation and driving economic growth, making it one of the most important engines for the country's future recovery.

Over the past few decades, many countries have focused their developmental efforts on heavy industry and other traditional sectors, which have significantly contributed to economic growth and budget stability. Now, in the face

³ Based on 2021 statistical data presented in the Eurostat database, the contribution of value added by ICT sector enterprises to GDP in selected European countries shows significant variation. In Malta, it accounted for 10.26%, in Bulgaria 7.47%, and in Latvia 6.12%. Estonia and Hungary recorded identical shares of 5.81%, while Switzerland reached 5.49%, and the Netherlands 5.29%. Croatia and the Czech Republic reported 5.26% and 5.10%, respectively, while Bosnia and Herzegovina achieved 5.03%. Germany recorded 5.00%, Slovakia 4.71%, and both Portugal and Romania registered 4.47%. Slovenia noted 4.41%, France 4.32%, Denmark 4.26%, and Belgium 4.29%. Lithuania had a share of 4.18%, Poland 3.99%, Austria 3.87%, Norway 3.52%, and Greece 3.45%. These results highlight the diverse impact of the ICT sector on national economies across Europe, demonstrating its significant role in many countries, albeit to varying extents.

⁴ On February 24, 2022, in response to the Russian invasion of Ukraine, the President of Ukraine declared martial law under Decree No. 64/2022, which came into effect at 5:30 AM on the same day. Initially set for 30 days, martial law has been extended until November 10, 2024. The imposition of martial law has significantly impacted the IT sector, introducing restrictions on business operations, disruptions in access to technology, and delays in project execution. The armed conflict has hindered innovation, limiting investment opportunities and weakening the stability of IT infrastructure. As a result, the IT industry faces numerous challenges, including the need to adapt to changing conditions and find ways to continue operations amid wartime uncertainty.

⁵ The Digital Tiger: The Power of Ukrainian IT report confirms the immense potential of Ukraine's tech industry, which, despite difficulties, continues to expand its role in the global market.

Source: <https://itukraine.org.ua/en/digital-tiger-the-power-of-ukrainian-it-2023/>, accessed: August 5, 2024.

of rapid technological changes and increasing digitalization, the IT sector is beginning to play a key role as a foundation for economic and budgetary development. The contemporary knowledge and innovation-based economy requires that investments in information technology become a central element of national development strategies. The growing importance of the IT sector regarding job creation, enhancing operational efficiency, and attracting foreign investment indicates its potential in building modern, sustainable, and resilient economies. The shift from traditional industries to the IT sector reflects the changing needs of the market and economy, offering new opportunities for development and growth. Adapting to digital innovations has become crucial for sustaining competitiveness and achieving success in today's globalized world.

In the face of intensifying global competition and dynamic changes in the technology sector, Ukraine is beginning to recognize the immense potential offered by a digital economy based on innovation and advanced technologies. Consequently, the IT sector is becoming one of the key investment areas in its development strategy and is now ranked alongside key sectors such as agriculture, energy, and the military-industrial complex. Although Ukraine has long been regarded as a key player in the European IT outsourcing market, it has encountered significant barriers that have hindered the growth of domestic enterprises and the attraction of technological investments. Insufficient support for local innovators and a lack of appropriate structures to assist investors have been identified as major obstacles preventing the full utilization of the country's intellectual and technological potential. Furthermore, legal instability, excessive bureaucracy, and ambiguities in tax regulations further complicate development processes. As Tarasiuk aptly points out, the Ukrainian economy continues to struggle with the legacy of the planned economy of the USSR. This struggle is evidenced by pervasive bureaucracy, high levels of corruption, low competitiveness in the real sector, and populism [Tarasiuk, 2022: 133].

In response to the growing economic challenges, Ukraine has implemented a key legislative initiative through the [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX], which established the Diia City project as part of this initiative.

This article aims to comprehensively examine the impact of the new legal regime on the IT sector and assess its potential role as a model for innovative

approaches to managing information technologies. The hypothesis of the article posits that the innovative legal regime of Diia City, through favorable tax conditions and regulatory facilitation, could become a global standard for technological ecosystems and attract international investments. To verify this hypothesis, the authors will employ a methodology that includes comparative analysis, case studies, and an assessment of the effectiveness of implemented IT solutions in Ukraine. This analysis will incorporate a review of relevant literature and legal acts, allowing for a holistic approach to evaluating the innovation and potential benefits arising from the Ukrainian reform in the context of its implementation in other European countries.

2. Diia City: A revolutionary legal regime for the IT sector or just an eye-catching label?

In light of the increasing significance of the IT sector to the economy, the Ukrainian legislator has recognized the economic potential and developmental opportunities it presents. The contemporary global economy is evolving into an integrated system [Kononenko, Nazarowa, Szyszkina, 2022: 110], in which innovative approaches are becoming essential for the competitiveness of nations. In response to the challenges posed by the development of the IT sector, a legal framework has been established to effectively address these issues.

Achieving the intended objectives would be difficult without appropriate regulations that laid the foundation for establishing an innovative regime. [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX] on Stimulating the Development of the Digital Economy in Ukraine introduced the Diia City regime. This innovation is the result of collaboration between representatives of the Ministry of Digital Transformation of Ukraine and the IT sector, who jointly sought to create regulations conducive to the modernization of the national economy.

Diia City is not merely a new regime but also a complex legal-economic system with the goal of transforming Ukraine into one of the Europe's leading technological hubs. A key element of this transformation involves attraction investments and the stimulation of IT sector development through modern legislative solutions. Collaboration between public administration, entrepreneurs, and research institutions forms the foundation for

effectively addressing challenges, thereby accelerating the implementation of innovations.

Under the Diia City framework, modern legal regulations have been introduced to enhance the stability of business operations. Favorable tax provisions and a special legal status create an attractive environment for investment. This program supports the development of technological startups and integrates Ukraine into the global technology market, which is critical amid rising international competition. The IT sector has benefited from advantageous tax conditions, effective tools for attracting investments, and additional mechanisms for the protection of intellectual property rights. Furthermore, a new form of collaboration with specialists has been introduced as gig contracts, which combine the flexibility of freelancing with social guarantees.

According to reported statistical data, the number of residents within the Diia City system is continually increasing⁶. In the first seven months of 2024, the number of companies registered in this system rose from 807 to 1,355. During this period, residents contributed 8.7 billion UAH to the budget, which includes value-added taxes, personal income taxes, and corporate income tax. In comparison, at the beginning of February 2023, there were only 430 companies operating within Diia City. Last year, residents paid over 8.5 billion UAH in taxes, which represented more than double the amount from 2022. These dynamic changes underscore the growing significance of Diia City within the Ukrainian economy.

Without a doubt, Diia City can be characterized as a kind of “state within a state”, representing a unique regime designed specifically for specialists and enterprises in the IT sector. In analyzing this subject matter, it is impossible to overlook the key aspects concerning the entities that are meant to operate within this new infrastructure. First and foremost, it is essential to highlight the special legal regime established by the legislator to facilitate the functioning of this system. For the ecosystem to operate effectively – much like any other state – it requires economic capital, which, in this case, encompasses the creation of an appropriate economy. In the context of Diia City, this capital consists of the so-called Diia City Residents. A crucial element for the functioning of this system is human capital, represented

⁶ Boom in Diia City: The Number of Resident Companies More Than Doubled in Six Months. Source: <https://mind.ua/news/20277775-bum-u-diya-city-kilkist-kompanij-rezidentiv-zroslo-bilshe-nizh-udvichi-za-piv-roku>, accessed: August 19, 2024.

by the so-called gig specialists. In order for the cooperation between these entities to be regulated and compliant with existing legal provisions, appropriate regulations have been created, such as gig contracts. These regulations, which will be discussed in further detail later in this study, aim to ensure the legality and efficiency of cooperation within Diia City.

In summary, Diia City is an ambitious project aimed at creating a modern and dynamic environment for the IT sector in Ukraine. Its implementation is crucial for the continued development of the digital economy, attracting investments, and integrating Ukraine into the global technological market. Despite its ambitious objectives, the ongoing full-scale armed conflict in Ukraine has limited the opportunities for fully harnessing the potential of Diia City. Ultimately, addressing the conflict will be essential for realizing the project's full benefits and ensuring a thriving future for Ukraine's IT sector.

3. New regulations, breakthrough opportunities: Is Diia City a worthwhile gamble?

The Act of December 1, 2022, on Stimulating the Development of the Digital Economy in Ukraine represents a groundbreaking normative act that introduces innovative legal solutions aimed at supporting and regulating the rapidly developing IT sector in Ukraine. Analyzing the individual provisions of this act reveals a clear legislative intent to establish a legal environment conducive to enhancing innovation and adapting to global trends in modern employment and business practices. The introduction of a range of new concepts by the discussed Act, previously unknown in legal circulation, redefines the relationships among entities in the digital sector. The [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 1] includes a so-called glossary of terms, which distinguishes, among others, the concept of a gig contract. This is an innovative form of a civil law agreement whereby a gig specialist commits to performing specific tasks or providing services according to the needs of a resident of Diia City, acting as the client. In return for the services rendered, the resident of Diia City is obliged to pay remuneration and ensure appropriate conditions for the gig specialist to carry out their tasks, as well as provide social guarantees. The introduction of such a solution marks a significant step toward the formalization and regulation of the labor market based on the gig economy model, which is gaining popularity on a global scale, particularly in the IT sector.

It is important to emphasize that, unlike a traditional employment contract, a gig contract constitutes a civil law agreement governed by the provisions of the [Civil Code of Ukraine: No. 435-IV]. According to [Civil Code of Ukraine: No. 435-IV, art. 901] a service agreement obligates the contractor to provide services to the client within a specified timeframe, while the client is obliged to pay remuneration. Simultaneously, [Civil Code of Ukraine: No. 435-IV, art. 837] defines a work contract as an agreement in which the contractor undertakes to perform specific work at their own risk, and the client commits to paying for the completed result. The [Labour Code of Ukraine: No. 322-VIII] does not apply to this type of contract. According to the regulation set forth in [Labour Code of Ukraine: No. 322-VIII, art.3] the Labor Code does not cover the relationships between gig specialists and residents of Diia City, which are regulated by the [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX].

A significant voice in this matter is Tarasiuk, who notes that a gig contract does not fit within the traditional categories of an employment contract or a business activity. This indicates that the legislator has introduced a new, specific form of legal regulation that must meet certain requirements to be classified as a gig contract. According to Tarasiuk, these requirements include: the ability to conclude the contract in both written and electronic form; the necessity of explicitly stating that the agreement constitutes a gig contract; the requirement to refer to the internal regulations of the client, which must be communicated to the gig specialist with a 30-day notice; and the option for the contract to encompass services or work corresponding to the functions of a specified position [Tarasiuk, 2022: 137].

Based on this, it can be stated that the gig contract represents a new form of employment that combines features of civil law agreements, contracts for work, and employment contracts. Despite the integration of these specific elements, the gig contract maintains its distinct characteristics, setting it apart from other forms of employment, which makes it an innovative and unique solution in the labor market⁷.

⁷ Before the adoption of the legislation regulating employment matters, the predominant form of collaboration in the IT sector was civil law contracts established with individuals conducting business activities. This model of cooperation allowed companies to engage qualified specialists for specific projects while providing advantageous tax aspects, such as a simplified taxation system. From the specialists' perspective, these contracts offered a degree of flexibility in choosing work schedules and locations. However, despite the benefits associated with this approach, significant drawbacks were also present.

It is worth noting that the term “gig-specialist” refers to an individual who performs services or undertakes work based on a gig contract. This form of agreement flexibly adapts to the dynamics of the labor market, offering specialists greater freedom in task execution while ensuring social security standards, which significantly distinguishes this form of collaboration compared to the previous standards in place. In recent years, prior to the enactment of the legislation, the predominant form of collaboration in the IT sector was civil law contracts entered into by companies with individuals conducting business activities (i.e., sole proprietors – FOP). This form of collaboration enabled companies to engage specialized experts for specific projects while providing a favorable tax regime, including a simplified taxation system. From the perspective of specialists, such a work model offered a degree of flexibility regarding schedules and locations for performing duties.

However, specialists employed under these arrangements were effectively deprived of social guarantees, such as the right to days off, vacation, meal breaks, or sick leave. Furthermore, contracts with FOP could be classified by tax authorities as a means of concealing employment relationships, which carried the risk of imposing financial penalties. Consequently, the business model based on entering into contracts with FOP significantly failed to support the stability of enterprises, protect specialists, and create favorable conditions for attracting investments. Thus, it follows that the legislative change, in a sense, allows for a reevaluation of the civil law relationships that existed prior to its introduction. Establishing social guarantees for employees engaged under gig contracts, as well as transferring the responsibility for administering their taxes and social contributions to employers, i.e., the residents of Diia City, represents a step towards greater legal protection and employment stability within the industry.

Nevertheless, gig contracts are not without certain shortcomings, the most significant of which is the dominant role of the employer in this relationship. Employers often impose conditions that may be unfavorable for the employee.

Specialists employed under civil law contracts were effectively deprived of statutory social guarantees, such as days off, vacation, meal breaks, or sick leave. Additionally, there was a risk that tax authorities could classify these contracts as a means of “concealing employment relationships,” which carried the possibility of imposing financial penalties. As a result, the business model based on contracts with self-employed individuals proved to be significantly ineffective concerning the operational stability of companies and the protection of employed specialists. Moreover, it did not contribute to creating conditions conducive to attracting investments.

According to [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 18] a gig contract is concluded for an indefinite term unless the parties to the contract or the law stipulate a different duration. This could lead to abuses related to the conclusion of short-term contracts, posing a significant challenge for the effective enforcement of workers' rights within this employment model.

Another notable drawback of gig contracts is their close association with the signing of Non-Compete Agreements (NCA) and Non-Disclosure Agreements (NDA)⁸ which may restrict the freedom to change employers.

It is also important to highlight that the loss of a legal entity's status as a resident of Diia City results in the termination of the gig contract, effective on the last day of the third calendar month following the month in which the entry regarding the loss of that status was recorded in the Diia City register, unless a shorter period is specified in the gig contract itself. However, it should be noted that holding an employment contract with a resident of Diia City who has lost their resident status does not automatically lead to the termination of that contract.

Meanwhile in our opinion gig contracts with gig specialists may serve as a legal trap for the Diia City residents. The point is the relationships between the gig contract parties have many features of employment relationship regardless the clear statement and legal definition of such a contract as civil law contract, to which the employment law provisions are not applicable. Nevertheless, there is relationship of subordination between the Resident of Diia City and Gig-specialist (see article 20-21 of the [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX]). So potentially a gig-contract may be transformed to the employment contract since it contains many features and essential aspects of employment relationships. For instance, applying the two-part employee test for the Gig economy by Alex Kirven we could easily reach a conclusion in favour of qualifying relationships under gig contract as employment contract, based on the very essence (not legal determination) of these relationships [Kireven, 2018: 254]. In the context of European integration and further harmonization of legislation

⁸ Such agreements are always concluded separately and cannot be incorporated into the gig contract, as they address entirely distinct legal matters. The prohibition against including them in the gig contract stems directly from the provisions of the [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX], which clearly outlines independent requirements for these types of agreements.

of Ukraine with European Union law, the proposals, practice and case law⁹ on presumption of employment relationships¹⁰ will highlight the hybrid and artificial nature of gig contract. The novelty and progressiveness of this new reality in employment under special legal regime is attractive but the same time quite risky for investors in the IT industry in Ukraine. Besides that there are other new introductions to the labour law of Ukraine proposing more freedom for the parties to employment contract in regulation of working conditions (for example, the regime of simplified regulation of employment relationships). In addition to that the residency of Diia City requires certain conditions to be met by an entity willing to become a Diia City Resident.

An essential element of the regulation is the introduction of the term Diia City Resident. The status of a Diia City resident¹¹ can only be obtained by a legal entity registered on the territory of Ukraine, regardless of its location or place of business, provided that it meets the requirements specified in the provisions of the law and is entered into the Diia City Register. According to [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 5] a legal entity must fulfill certain criteria to acquire the status of a Diia City resident. From the moment the status is granted, the average monthly salary of employees and specialists employed by the company¹² must correspond to at least the equivalent of 1,200 euros based on the exchange rate set by the National Bank of Ukraine. The qualified salary defined in the law, as a key condition, will unequivocally limit

⁹ See e.g.: Deliveroo Drivers Are Employees, Not Self-Employed: A New Ruling from the Netherlands, *Ius Laboris* (blog), Available at: <https://preprod.iuslaboris.com/insights/deliveroo-drivers-are-employees-not-self-employed-a-new-ruling-from-the-netherlands/>, accessed: 12th August, 2024; Uber Drivers Are Employees: New Ruling from the Netherlands, *Ius Laboris* (blog), Available at: <https://iuslaboris.com/insights/uber-drivers-are-employees-new-ruling-from-the-netherlands/>, accessed: 23rd September, 2024.

¹⁰ Platform Work: First Green Light to New EU Rules on Employment Status | News | European Parliament, Available at: <https://www.europarl.europa.eu/news/en/press-room/20240318IPR19420/platform-work-first-green-light-to-new-eu-rules-on-employment-status>, accessed: 19th March, 2024.

¹¹ It is important to highlight that residency within the Diia City framework is not equivalent to residency as defined by the [Tax Code of Ukraine: No. 2755-VI]. The term "residency," as used by the legislator in Law No. 1667-IX, is much more narrowly defined than the one found in the [Tax Code of Ukraine: No. 2755-VI]. Residency in Diia City, and the eligibility for associated tax benefits, depends exclusively on fulfilling the specific requirements set forth in this law.

¹² A Diia City resident has the option to choose one of three forms of employment for IT specialists, which include: an employment contract, a gig contract, and a civil law contract (the latter being available only to individual entrepreneurs).

the application of the gig contract exclusively to highly paid specialists in the IT sector. The introduction of this requirement serves as a significant selection mechanism aimed at directing this form of employment towards the most valuable employees while simultaneously eliminating the possibility of its application in less demanding or lower-paid roles¹³. This approach not only emphasizes the prestige and high professional value of individuals covered by gig contracts but also introduces elements of elitism and high standards that may influence the perception and functioning of the labor market in the field of modern technologies. This approach not only emphasizes the prestige and high professional value of individuals covered by gig contracts but also introduces elements of exclusivity and high standards, which may influence the perception and functioning of the labor market in the field of modern technologies. Such a salary threshold aims to ensure attractive working conditions and attract top-tier specialists. Additionally, the company must maintain an average number of employed workers and gig specialists at a level no lower than nine individuals, fostering employment stability and operational efficiency.

Regarding financial requirements, the first three calendar months following the acquisition of Diia City resident status require that the company's qualified income constitutes at least 90% of the total income for that period. This ensures that companies remain financially balanced and active. In each subsequent calendar year, qualified income should continue to represent no less than 90% of the company's total income, reflecting long-term stability and commitment to operations within Diia City. This allows us to conclude that the status of a resident in Diia City aims to provide not only more favorable and flexible conditions for conducting business, including the flexible employment of Ukrainian IT specialists, but also, crucially, the introduction of a beneficial tax system¹⁴.

¹³ The State Statistics Service has released a report on the average salary levels for officially employed specialists, revealing that the average salary in Ukraine for 2024 is 20,964 UAH, equivalent to approximately 450 euros. Source: https://www.ukrstat.gov.ua/operativ/operativ2017/gdn/snzp/snzp_ek/smzp_ek_u.htm, accessed: September 11, 2024.

¹⁴ As a result of the armed conflict, the Ministry of Digital Transformation has decided to simplify the residency criteria within the Diia.City program. According to the new regulations, residents of this system are exempt from the obligation to submit a compliance report and an independent audit opinion until January 1 of the year following the year in which the state of martial law ends. During the martial law period, the Diia.City resident status will not be revoked from companies that do not meet specific criteria, such as the number of employed workers or the average level of salaries. This regulation

In accordance with the provisions of the law, the Diia City Register has also been established, which is maintained in electronic form. This register contains detailed information about entities that have obtained or held the status of Diia City resident. It thus serves as a fundamental tool for monitoring and overseeing the activities of units operating within this special legal regime. Its electronic format ensures efficiency and transparency in data management, enabling effective tracking of compliance with statutory requirements and monitoring adherence to applicable regulations.

A key premise of the new law is the establishment of the legal regime of Diia City, which defines the norms governing the rights and obligations associated with obtaining, losing, and changing resident status. An analysis of the relevant literature reveals various approaches to defining this concept. O. Yakovlev suggests studying the legal regime through the analysis of methods, techniques, and categories of legal regulation [Yakovlev, 2015: 82]. In contrast, Kuznichenko views the legal regime as a formal structure regulating a specific area of social life, which encompasses a set of legal measures ensuring order and dynamism in these relationships over time and space, and which delineates the directions of regulation [Kuznichenko, 2007: 73]. Tyshchenko notes that a characteristic feature of the legal regime is the presence of relevant legal means—phenomena, forms, and legal tools—that impact social relations to achieve favorable social outcomes [Tyshchenko, 2022: 32]. It should be emphasized that the introduced regime not only regulates specific rules regarding relations involving residents but also addresses issues related to the share capital, which has direct implications for shaping corporate governance within firms operating under Diia City.

The regulation provided in [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 3] states that the legal regime of Diia City is established for an indefinite period, but not shorter than 25 years from the moment of registration of information about the first resident. The state ensures not only the durability of this legal regime for Diia City residents but also the stability of its conditions, which are defined in the law itself and in other regulations of Ukraine regarding the specifics of taxation for Diia City residents. Additionally, a significant aspect is the assurance of compliance with the rights and legitimate interests of both the residents

applies both to current residents and to entities aspiring to join this special regime. It is important to note that the tax rules applicable within the Diia.City framework remain unchanged.

and the specialists employed by them. In this context, it can be observed that such regulation aims not only to attract investments and innovations to the IT sector in Ukraine but also to create a stable legal environment that supports the long-term development of the digital economy. The guarantee of legal regime stability is crucial for building trust among investors and specialists, which can, in turn, contribute to strengthening Ukraine's position as an attractive technological hub in the region. This approach fosters a conducive environment for technological advancement and economic growth, ensuring that the benefits of the digital economy are realized in a sustainable manner.

In summary, [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX] constitutes a comprehensive normative act that introduces an innovative legal-economic model to support the development of the digital sector in Ukraine. The regulations contained within it, including the establishment of the special regime known as Diia City, aim to create a favorable legal environment for enterprises and professionals in the IT industry, facilitating the implementation of flexible forms of employment, such as gig contracts. Analyzing this law from both legal and economic perspectives reveals that it introduces mechanisms tailored to meet the needs of modern work arrangements typical of the digital economy. These mechanisms enable the formalization of employment relationships within rapidly evolving technological sectors, while simultaneously promoting innovation and the adaptation of global labor market trends.

The introduction of instruments such as gig contracts and defined employment conditions for residents of Diia City not only promotes the stability and growth of enterprises operating in the IT sector but also facilitates the selection of highly qualified specialists. Moreover, favorable tax regulations and the mandatory salary threshold aim to attract valuable employees, aligning with Ukraine's strategy to create a modern labor market based on the gig economy model. From a long-term perspective, this law could strengthen Ukraine's position as a key technological hub in the region by providing integrated legal frameworks that support the growth of the digital economy and enhance the country's appeal for investment in innovative technologies.

4. Comparative analysis of tax burdens for employees and residents of Diia City

On December 14, 2021, the [Law on Amendments to the Tax Code of Ukraine and Other Laws of Ukraine to Stimulate the Development of the Digital Economy in Ukraine: No. 1946-X] was adopted, aimed at stimulating the development of the digital economy in Ukraine. This law introduced significant modifications to the [Tax Code of Ukraine: No. 2755-VI].

These reforms pertain to both employees employed under various contracts and employers, allowing for a detailed analysis of tax burdens and the potential benefits arising from different forms of employment. In the context of employment contracts, civil law agreements, self-employment, and gig contracts, it is crucial to understand how the structure of the agreement influences the level of taxes and the burdens associated with social and health insurance contributions. The conducted analysis reveals differences in taxation and contributions that can significantly impact decisions regarding employment forms. Diia City defines special taxation conditions for the income of both employees and businesses, which may contribute to further growth in innovative sectors in Ukraine. In light of these changes, a comparative analysis of tax burdens across various forms of employment becomes essential for understanding their impact on the labor market and the development of the digital economy.

The comparative table below illustrates the key differences in the taxation of employees providing services to residents of Diia City.

Table 1. Comparative analysis of tax burdens and social security guarantees in different employment forms in the IT sector

Category	Employment Contract	Civil Law Contract	FOP (group 3)	Gig contract
Income Tax	18% (on salary)	18% (on salary)	5% (on salary)	5% (on salary)
Military Tax	1,5 % (on salary)	1,5 % (on salary)	None	1,5 % (on salary)
Unified Social Insurance Contribution	22% (on salary)	Optional	22% (from the minimum wage)	22% (from the minimum wage)

Category	Employment Contract	Civil Law Contract	FOP (group 3)	Gig contract
Social Guarantees	Guaranteed	Depends on the contract	None	Limited
Tax Administration	Administered by employer	Self-administered	Self-administered	Administered by Diia City Resident
Pension Service Record	Full record	Paid unified social contribution – ensures record	Paid unified social contribution – ensures record	Partly covered by employer
Income Limitation	None	None	1167 minimum wages	For amounts up to €240,000, the tax rate is 5%.

Source: author's own elaboration.

The results of the comparative analysis of employment forms lead to the conclusion that both entrepreneurial activity (FOP) and gig contracts offer favorable conditions for workers. However, in terms of social security guarantees, gig contracts may surpass FOP regarding the protections provided. It is important to note that alternative forms of taxation are not as attractive due to relatively high tax burdens. Gig contracts provide greater flexibility and a broader range of social security protections, which is crucial in the context of a rapidly evolving labor market. A notable advantage of the gig model is the transfer of responsibility for administering taxes and social insurance contributions to the employer, designated as a Diia resident. As a result, specialists working within the gig economy can focus on their professional tasks, which practically enhances their efficiency. Moreover, the gig economy, as a modern phenomenon, promotes an innovative approach to employment, which has the potential to attract young professionals seeking flexible work arrangements. In the context of developing the digital economy, such flexibility becomes essential, allowing for quicker adaptation to the changing market needs. In summary, while both forms of employment have their unique advantages, gig contracts stand out from FOP by offering more favorable social security guarantees and simplified administration. It is noteworthy

that, in the context of analyzing FOP and gig contracts, the tax burden is only 1.5% higher due to the obligation to pay a military tax.

As previously mentioned, the legislator is consistently striving to limit cooperation between Diia City residents and entrepreneurs operating under the simplified form of business activity, namely individual entrepreneurs (FOP). The aim of these efforts is to gradually eliminate FOP from the legal landscape and replace them with gig specialists. However, this approach presents numerous difficulties and challenges in practice. These restrictions are broad in scope, encompassing not only cooperation with FOPs providing IT services to Diia City residents but also other industries. Examples include marketing firms, consulting companies, and equipment rental enterprises that also operate under the FOP framework. Consequently, these limitations may negatively impact the extensive collaboration between Diia City residents and companies offering various types of services. Such a policy reduces the freedom to utilize external services provided by FOPs, potentially hindering the operations of Diia City residents, especially those who have previously relied heavily on collaboration with FOPs offering services across multiple dimensions. As a result, these changes compel entrepreneurs to seek new models of cooperation that comply with the current regulations, which may be less advantageous in terms of flexibility and costs.

As previously noted, under [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 3], the legislator has committed to ensuring the stability of the legal regime of Diia City and the inviolability of the conditions arising from this law for a period of 25 years from the date of registration of the first resident in the Diia City registry. This law introduces guarantees of stability, particularly concerning the taxation of Diia City residents, and provides protection for the rights and legitimate interests of these entities and the specialists they employ. However, despite the existing protection period, the legislator is seeking to amend the taxation conditions just two years after the regime's implementation, including an increase in the military tax rate from 1.5% to 5%, as outlined in the [Draft Law on Amendments to the Tax Code of Ukraine and Other Laws of Ukraine Regarding Taxation Specifics During Martial Law: No. 11416]. In justifying these changes, the legislator refers to the extraordinary situation of the ongoing state of war, indicating that the proposed solutions are temporary and limited to the duration of the conflict.

Nevertheless, the authors contend that these changes represent a direct violation of the constitutional principles of legal certainty and the guarantees established in [Law on Stimulating the Development of the Digital Economy in Ukraine: No. 1667-IX, art. 3]. The principle of legal stability, which is rooted in the constitutional protection of individual rights, requires that tax regulations be predictable and stable, especially concerning long-term guarantees intended to create a favorable environment for entrepreneurs operating within Diia City. The legislative actions taken in connection with the [Draft Law on Amendments to the Tax Code of Ukraine and Other Laws of Ukraine Regarding Taxation Specifics During Martial Law: No. 11416] appear to contradict the commitments made by the state in establishing the legal regime of Diia City. This ultimately undermines trust in the stability and predictability of legal and economic policy.

Table 2. Gradual limitation of cooperation between Diia City residents and FOP (sole proprietors)

Cooperation with FOP			
	Form of taxation		
	On Special Terms		On General Terms Applies to taxpayers with an annual income > 40 million UAH.
until 2023	No limitations		No limitations
from 2024	No more than 50% of the total expenditures of the resident	In the case of exceeding this limit, the exceeding amount will be taxed at a rate of 9%.	Increase in taxable financial results. This applies when a resident's expenditures on FOP exceed 50% of the resident's total expenses.
from 2025	No more than 20% of the total expenditures of the resident		Increase in taxable financial results. This applies when a resident's expenditures on FOP exceed 20% of the resident's total expenses.

Source: author's own elaboration.

As part of the Diia City project, innovative taxation models for residents have been introduced, aimed at establishing a favorable and stable legal regime.

Table 3. Comparative analysis of corporate for Diia City residents

Corporate tax for Diia City residents		
General principles	Under general rules	Special rules
Tax rate	18%	9%
Tax base	Enterprise income	Withdraw capital. Specified operations arising from Tax Code of Ukraine
Dividend distribution	+5% (PIT) + 1,5 % (military tax)	Exempt from tax if the payout is made no more frequently than once every 2 years
Choice of taxation form	During registration in the Diia City system, the tax form is automatically assigned, unless the resident does not select the special system. In case of resignation from the special system conditions, the resident automatically switches to general taxation rules.	When applying for registration as a resident in the Diia City system, there is an option to submit an application for the special tax system simultaneously. The resident of Diia City also has the right to switch from the general taxation system to the special conditions. The application must be submitted no later than 15 calendar days before the start of the new calendar quarter.
Change of taxation form	The form of taxation can be changed only once a year	

Source: author's own elaboration.

The enacted law allows residents of Diia City to choose their form of taxation. It is important to note that, depending on the financial strategy of the enterprise, residents can opt for either a 9% capital withdrawal tax or an 18% income tax.

Analyzing these rates, it can be concluded that the standard rate of 18% is competitive in the European market, while the special rate of 9% presents a particularly advantageous solution for companies, potentially fostering

their growth and investments. For residents taxed under special conditions, the tax object is not the financial result but the amounts from individual business transactions. It is rightly observed that this method of taxation is very similar to a capital withdrawal tax; however, the Tax Code does not use this term, only indicating that it is an income tax under special conditions [Nazarova, Kononenko, 2023: 385].

At first glance, the application of a 9% tax rate, as provided under special conditions, may seem like an optimal solution. However, a thorough analysis indicates the necessity of considering several significant legal and economic aspects. The legislator, as outlined in [Tax Code of Ukraine: No. 2755-VI, art. 141] precisely defined the activities subject to taxation at this preferential rate. Such activities include, in particular: dividend payments, amounts paid to the owner in connection with the liquidation of the enterprise or their withdrawal from the list of participants, transfers under joint venture agreements, payments of interest, commissions, remuneration, and compensations. Additionally, the law covers the gratuitous transfer of assets, the provision of services, the execution of works, the granting and return of financial assistance, as well as the transfer of assets to specific entities, payment of royalties, transfers of funds to foreign accounts, and payments to flat-rate taxpayers, as well as certain investments.

The above enumeration indicates that the legislator has adopted a rigorous approach to taxing such financial operations, specifying concrete actions that qualify for the special rate. Thus, comparing these regulations to general taxation leads to the conclusion that the choice of taxation system requires a detailed verification concerning the nature of the enterprise's operations and its investment plans. In the case of numerous capital operations, taxing each of them at the 9% rate may, in practice, prove to be less advantageous compared to general taxation.

Furthermore, the choice of taxation under special conditions involves potential difficulties in tax management. Due to the novelty of these regulations, a clear interpretive line or judicial precedent concerning certain aspects of their application has not yet developed. Consequently, opting for this method of taxation may not always be the optimal solution. On the other hand, it should be emphasized that if an enterprise operating under special conditions does not carry out any of the activities leading to capital withdrawal specified in the Tax Code, it is not obliged to pay tax due to the absence

of a tax liability. While this solution may serve as an incentive for some entities, it should always be considered in the context of potential risks and the enterprise's development plans.

Regarding dividend payments by residents of Diia City, the situation is particularly favorable compared to the general rules of taxation. Operating under special conditions, a Diia City resident can benefit from an exemption from income tax on personal income and military tax for dividend payments. The condition for this exemption is that the resident has not paid dividends for two consecutive calendar years. This means that dividend payments made at a later date will be exempt from the aforementioned taxes, but only if the Diia City resident meets this significant temporal requirement. This exemption applies solely to dividends paid by Diia City residents who are taxed under preferential conditions at the 9% rate and pertains to payments to individuals. Thus, this regulation aims to provide capital support to Diia City residents by offering them the opportunity to utilize a preferential tax regime, provided they meet the specific requirements regarding their dividend policy.

5. Conclusion

Based on the conducted analysis, it can be concluded that the innovative Diia City regime has the potential to become a global standard for technological ecosystems, attracting international investments. However, it will be crucial to address certain shortcomings that exist not only within this regime but also in the context of broader state conditions presented in the analysis.

The intentions of the Ukrainian legislator can be considered partially successful, as a new, transparent legal regime has been created, allowing both foreign and domestic entities to operate. The new structure appears to be more comprehensible and rational, facilitating international cooperation.

It is worth noting the attempt to phase out FOP (individual entrepreneurs) from the legal framework by gradually reducing their share of the costs borne by Diia City residents. Additionally, the two available forms of taxation from which residents can choose from are also significant. However, due to the short time these solutions have been in place and the ongoing war, their effectiveness remains to be verified, particularly in terms of taxation under special conditions related to capital withdrawal.

The establishment of new regulations regarding gig contracts deserves recognition, as it protects both workers and employers while simultaneously curbing previous abuses related to hidden employment relationships. Amid dynamic changes, the Diia City regime is emerging as a step toward modern solutions that can support Ukraine's technological development.

For this regime to serve as a model for a global standard, the Ukrainian legislator must adopt an approach that is both rational and consistent. The introducing of legal provisions and their subsequent interpretation must adhere to the principle of legal certainty. This principle not only ensures the stability of the legal system but also forms the necessary foundation for public trust. A lack of respect for this principle would prevent any state that violates it from being regarded as a model on the international stage. Therefore, all legislative actions must be carried out with the utmost diligence, enabling not only the construction of durable institutions but also the legitimization of their functioning in the eyes of citizens and the international community.

In summary, the success of the Diia City regime requires not only appropriate regulations but also their consistent implementation and adherence to the rule of law, which in the long term could strengthen Ukraine's position as an innovative technological hub on the global stage.

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