

4.6

Ukrainian Tax Law

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Introduction

Ukraine has, in practice, a complex system of taxation. Most of the currently applicable tax legislation was adopted only in the mid and late 1990s, and the interpretation of these laws is still being developed by the courts and the State Tax Administration.

According to Article 92 of the Ukrainian constitution, taxes and duties may only be imposed by statutes adopted by the Parliament of Ukraine (called the *Verkhovna Rada* in Ukrainian). Previously many Ukrainian taxes were imposed by decrees of the President or the Cabinet of Ministers. The general principles of the Ukrainian taxation system are presently determined principally by the Law 'On the System of Taxation' of 2 February 1994 (the Tax System Law).

Under the Tax System Law, Ukraine imposes two types of taxes: state and local. In addition, numerous fees are provided for, which are not called taxes even though they are mandatory and apply like taxes, for example payments to social security funds, fees for exploration and production of natural resources, state duty on notarial acts and import and export duties. One of the positive achievements of the Tax System Law is that it provides that where double tax treaties and other international treaties of Ukraine provide for tax rules different from those created by domestic legislation, such international treaty rules prevail.

The state taxes, fees and duties established by the Parliament of Ukraine pursuant to the Tax System Law presently consist of 24 national and 14 local taxes and other charges. On the national level, the principal taxes are the enterprise profits tax, individual income tax, value added tax (VAT), excise tax, import and export duties, state duty (fees for notarial services, court proceedings, marriage, divorce, etc), various social security withholdings and land tax.

The local taxes and duties are of lesser importance. Their rates and the procedure for their payment are established by village and city councils within the limits provided in the Decree of the Cabinet of Ministers of Ukraine 'On Local Taxes and Duties' of 20 May 1993 (the Local Tax Decree) (a decree adopted during a temporary transitional period when Cabinet of Ministers' decrees were given, by law, the effect of statutes). The Local Tax Decree specifies the persons and entities subject to local taxes, as well as the maximum rates and the procedure for their payment. Under the Tax System Law and the Local Tax Decree local taxes and duties include levies as diverse as those on hotel registration, dog ownership, advertising, retail trading and tourism.

In addition, regulations, instructions and interpretations are issued on a regular basis by several state bodies, mainly the State Tax Administration and the State Customs Service, to fill in the many gaps in tax legislation. Application of these supplemental acts is often complicated because of inconsistencies with the statutes that they are supposed to implement as well as with older regulations and other administrative acts that have not been formally withdrawn. Moreover, regulations often go much further than the underlying statutes and establish additional burdensome requirements for taxpayers, some of which may be of questionable validity.

In general, Ukrainian tax law is becoming more sophisticated and the regulations more complicated as it evolves, largely to mirror Western practice. The Parliamentary Committee on Finance and Banking responsible for introducing Ukrainian tax legislation has declared its intention to create a more unified tax system and one closer to internationally accepted taxation principles. As part of this tax reform a revised Tax Code was drafted in 2000 aimed at a general decrease of tax rates, greater simplification of tax procedures and an increase in effective collection, but it has not been adopted yet and is unlikely to be adopted until mid-2002 at the earliest.

An interesting development over the past five years is the introduction of about 20 free economic zones (the exact number depends upon whether related zones in particular areas are counted separately). They vary in size and benefits, but all are characterized by some sort of privileged taxation regime. Their special tax benefits usually include a package of temporary exemptions, for qualifying investment projects, from business profits tax, VAT and import duties. To qualify, the investment project must meet a number of requirements, such as minimum investment criteria, and be in the areas of business activity covered by the privileged taxation regime. Ordinarily, both foreign and domestic investments can benefit from these privileges.

The principal taxes in Ukraine that affect companies and individuals are described below.

Business profits tax

Taxpayers and tax rates

Ukrainian companies are taxed on their worldwide profits. The basic profits tax rate is 30 per cent (special rates apply to certain types of income, eg from insurance and underwriting). Non-resident companies are taxed only on their Ukrainian source income at a rate of 15 per cent (subject to reduction based on tax treaties), unless they have a permanent establishment in Ukraine, in which case they are taxable as a Ukrainian resident.

Calculation

The tax base for calculation of profits tax is determined as the difference between gross income (the total income from all revenue sources, whether in cash or in kind) and allowable gross expenses plus depreciation deductions in connection with the taxpayer's production and other activities during the relevant period. The Law 'On Taxation of Profits of Enterprises' of 28 December 1994 (the Profits Tax Law) broadly lists the types of disallowed expenses that cannot be included, or can only be partially included, in the taxpayer's gross expenses. These include contractual penalties, expenses in connection with warranty repairs (deductibility is limited to 10 per cent of the total sales price of such goods when originally sold), representation expenses in connection with holding receptions, celebrations etc (deductibility is limited to 2 per cent of the taxpayer's taxable profit for the respective period), travel expenses exceeding the limits provided for business trips within Ukraine and abroad in legislation (which are relatively low), and many other expenses that are normally fully deductible in the West.

The Profits Tax Law also establishes an unusual rule regarding certain expenses from transactions with 'offshore' jurisdictions. If a Ukrainian taxpayer concludes a contract in respect of goods or services with a resident in a country officially listed as being an 'offshore' jurisdiction, then only 85 per cent of the expenses incurred by the Ukrainian party in connection with such a contract can be included as allowable gross expenses. The list of such offshore jurisdictions is published annually by the Cabinet of Ministers of Ukraine and generally includes countries often referred to in the West as 'tax havens'. The current list of these offshore states is shown in Table 4.6.1.

At the same time, Ukrainian law does not have any anti-avoidance provisions targeting treaty shopping and hidden beneficial ownership, or other similar issues involving tax havens that are often addressed in the West.

Table 4.6.1 The 2002 Cabinet of Ministers' list of offshore jurisdictions

British island regions	17. British Virgin Islands
1. Alderney	18. Virgin Islands (USA)
2. Guernsey	19. Monserrat
3. Jersey	20. Granada
4. Isle of Man	21. St. Lucia
Middle East	22. Netherlands Antilles
5. Bahrain	23. Turks and Caicos
Northern, Central and Southern America	24. Saint Kitts and Nevis
6. Belize	25. Saint Vincent
7. Commonwealth of Dominica	26. Grenadines
8. Panama	Africa/Asia
Europe	27. Liberia
9. Andorra	28. Republic of Maldives
10. Gibraltar	29. Seychelles
11. Monaco	Pacific
Caribbean	30. Vanuatu
12. Anguilla	31. Samoa
13. Antigua and Barbuda	32. Marshall Islands
14. Aruba	33. Nauru
15. Bahamas	34. Niue
16. Barbados	35. Cook Islands

Transfer pricing restrictions

The Profits Tax Law contains special provisions on transfer pricing. For transactions between related entities, the so-called 'usual prices' – the prices that would apply between unrelated entities – are supposed to be applied for the calculation of tax liabilities. For tax purposes, any income from an operation with a related entity must not be less than the income from the same operation calculated based on 'usual prices', and no expense with a related entity may exceed such expense based on 'usual prices'.

The purpose of such provisions, as in most jurisdictions in the West, is to avoid overstated expenses or understated income in operations between related parties resulting in understated profit. The application of this mechanism, however, is subject to the same restraints as encountered in other countries. In particular, it is often difficult to determine what are 'usual prices' on goods or services that are not traded in a public market. For example, what are appropriate licence fees on unique intellectual property normally cannot be determined by reference to any objective standard. The most relevant Ukrainian laws on transfer

pricing were only adopted in 1997, and there is as yet relatively little experience in administrative disputes or litigation over their application.

Tax periods

Based on the Profits Tax Law, the State Tax Administration requires corporate profits tax to be accounted for quarterly and paid by the 20th day of the month following the relevant accounting quarter. Advance payments, based on the results of the first and second months of the quarter, must be made by the 20th day of the second and third months of the quarter respectively.

Presently, however, there is an argument being publicly debated that, based on the conflicting provision in the more recent Law of Ukraine 'On the Procedure for the Settlement of the Debts of Taxpayers to Budgets and State Purpose Funds' of 21 December 2001, such quarterly profits tax only needs to be paid by the 50th day following each accounting quarter (this does not affect the due date for advance payments for the first and second months of the quarter). Such a new approach has been rejected by the State Tax Administration, but there have already been cases where taxpayers have won on this issue in the lower courts and are waiting for judgments on the appeals revised by the State Tax Administration. While for these appeals good arguments can be made in favour of either position, the ambiguity seems more likely to be resolved in favour of the State.

Taxation of representative offices

Traditionally 'representative offices', those set up as non-trading branch offices, carried on their activities in Ukraine without paying tax. Representative offices that trade, and therefore receive income for their activities, have always been taxed at the usual 30 per cent rate for Ukrainian source profits, and such branch offices must register as taxable permanent establishments.

Thus, where some of the profits of a non-resident may be attributed to the activities of its supposedly non-taxable representative office, tax liabilities may arise on the basis that the representative office is trading. For example, where a non-resident sells equipment to a Ukrainian purchaser, and employees of the non-resident's representative office handle the installation, then unless the relevant tax treaty exempts such installation work from taxation, the representative office would be liable to tax on these activities.

For most representative offices in Ukraine there should be little risk of taxation because a tax treaty overriding the usual Ukrainian tax law will apply and define its activities as not being those of a permanent establishment. Most tax treaties follow the Organisation for Economic Cooperation and Development (OECD) model tax treaty in allowing a

representative office to perform functions such as the gathering of information, marketing, storage, and other similar activities ancillary to the business of the main office without it becoming a taxable permanent establishment. However, if the activity is not in fact within the exemption, then the treaty exemption may be disallowed (for example where marketing is one of the main activities of the exempted foreign company having a representative office, and not an ancillary function, such as for a public relations firm).

For companies from tax treaty countries, it is important to limit the power of attorney that authorizes the local management to act (such a power of attorney is required to register a representative office) as well as the internal regulations on the functions of the representative office, so that activities that could be taxable are not authorized. This is usually achieved by excluding all trading and limiting the office's activities to those that are listed in the relevant treaty as being permissible without creating a permanent establishment.

Taxation of non-residents – 15 per cent repatriation tax

Certain Ukrainian source income of non-resident legal entities as well as individuals is taxed at a 15 per cent rate, as noted above, including dividend income, interest, royalties, rents, lottery winnings (except for state lottery), freight payments, real estate sales proceeds, remuneration for certain cultural, entertainment and sports activities, charitable donations, proceeds from sales of securities and other corporate rights, brokerage fees, commission and agency fees and certain other business income of non-residents.

This tax operates by requiring withholding from the repatriation of income (hence, it is often referred to as the 'repatriation tax'): the resident Ukrainian payer of such income must withhold and pay the tax before the proposed funds transfer can be made to a non-resident. This 15 per cent rate is usually reduced by the double tax treaties entered into by Ukraine or, in some cases where a new Ukrainian treaty has not been concluded, by those USSR tax treaties that Ukraine still applies as a successor of the USSR (see Annex 4.6.1 in the Appendices).

The procedure for the application of a treaty exemption or reduction in rates has been recently modified clearly to permit an outright elimination or reduction, as may be applicable, of the tax obligation. In order to benefit from a double tax treaty, a Ukrainian company paying a dividend needs to show a certificate from the tax authorities of the country where the recipient is located confirming that the recipient is a resident of this country that has a double tax treaty with Ukraine.

Previously the Law was ambiguous, and either: (1) the state tax authorities required the Ukrainian resident payer to obtain their preliminary

approval for each payment of a treaty reduced repatriation tax: or (2) they insisted on advance payment of the 15 per cent tax in full and required the payer then to claim reimbursement of the difference between the tax paid and the tax liability that should have arisen under the relevant tax treaty. Such claims had to be made under a burdensome procedure obliging the Ukrainian paying company to prove that each particular payment of dividends should benefit from the relevant double tax treaty provisions. The procedure is now more transparent, requiring only the annual filing of a certificate confirming the recipient's country of residence.

Individual income tax

General

Issues of personal income taxation are primarily regulated by the Decree of the Ukrainian Cabinet of Ministers 'On Individual Income Tax', adopted on 26 December 1992, as subsequently amended (the Individual Tax Decree). A draft of a new law on individual income tax has been discussed in the Ukrainian parliament for several years, but it is more likely that its provisions will eventually form a part of the proposed comprehensive Tax Code that is now under consideration.

Taxpayers

The Individual Tax Decree provides for the taxation of the following individuals: (1) residents – defined as both citizens of Ukraine and foreign individuals who are physically present in Ukraine at least 183 days in a calendar year; and (2) non-residents – defined as all individuals (whether or not they are citizens) who do not qualify as residents.

Taxable base

The taxable income of an individual is the difference between the taxpayer's total annual income and the total exemptions available to the taxpayer, less applicable deductions. The Individual Tax Decree provides that wages and other taxable income received are taxable whether paid in cash or in kind. The value of in-kind income is, as a rule, based on market prices, although as a practical matter it may be difficult to establish such prices. Residents are taxed on their worldwide income.

Taxes paid outside Ukraine may be taken as a credit towards Ukrainian taxes due if the taxpayer provides written proof from the foreign tax authority that such foreign taxes have been paid. Total foreign tax credits may not exceed the amount of the Ukrainian personal income tax due.

Non-residents are taxed on all income derived from sources in Ukraine. Because non-residents usually are not eligible to receive the exemptions or deductions available to residents they are effectively taxed on gross revenue. The Ukrainian source income of a non-resident who is not involved in registered entrepreneurial activity is taxed at a 20 per cent rate (except for those payments for which the 15 per cent repatriation tax applies, as discussed above).

Exemptions

The Individual Tax Decree provides principally for the following exemptions from a resident taxpayer's taxable income:

- some social insurance payments;
- alimony payments;
- pension payments to the State Pension Fund, as well as under voluntary pension schemes;
- income received from the sale of personal property sold pursuant to a notarized sale–purchase agreement where the state duty (presently 1 per cent) for the sale was paid, provided that this sale was not carried out as a part of an individual's registered entrepreneurial activity;
- in general, money received as a gift or as an inheritance (which must be received under a notarized instrument and is subject to a 1 per cent state duty);
- interest or profits derived from personal bank accounts, deposit certificates, government bonds and state lotteries;
- certain charitable gifts and other benefits received by the taxpayer;
- amounts donated to charity (but not to exceed 4 per cent of the individual's annual taxable income);
- income reinvested in shares or in certain reconstruction or expansion of companies;
- payments made to employees for health injuries at work;
- income of individuals who are performing seasonal or temporary agricultural or construction work in rural areas; and
- dividends, provided that the distributing company was taxed for the income based on which the dividends are paid pursuant to the Ukrainian Profits Tax Law.

Deductions

Ukrainian legislation permits the following deductions from the taxable income of an individual:

- the amount of 1 minimum non-taxable income unit for each calendar month of the taxable year during which the individual received income (one unit is currently equal to approximately US\$3);
- the amount of 1 minimum non-taxable income unit per month for each child of the taxpayer for each calendar month of the taxable year during which the individual received income (deduction can only be claimed by one parent, and only if the individual's monthly gross income does not exceed 10 minimum non-taxable income units, currently equal to approximately US\$30); and
- special deductions for certain categories of individuals (eg disabled individuals and veterans).

In addition, an individual who is registered as an entrepreneur (ie as the sole proprietor of a business) may utilize all types of deductions for expenses that are applicable for Ukrainian legal entities, as well as deduct the acquisition cost of property that would be subject to depreciation in the case of a legal entity. Ukrainian legislation does not permit an individual who is not a registered entrepreneur to take any depreciation or other allowances for property.

Regime for expatriates

All foreign individuals physically present in Ukraine for at least 183 days in a calendar year are deemed to be Ukrainian residents for tax purposes. As such, they are subject to Ukrainian tax on their worldwide income. Foreign individuals resident in Ukraine are eligible to receive the same deductions and exemptions as Ukrainian citizens who are resident in Ukraine.

In addition, the following two provisions are expressly applicable to foreign individuals:

- amounts paid to a foreign individual, who is resident in Ukraine, as hardship payments for working in Ukraine or for the education of his or her children, or for personal meals and travel expenses, are included in taxable income; and
- the taxable income of such a foreigner resident in Ukraine does not include payments made by the employer to any foreign social security and pension fund and for reimbursement for housing, automobile and other expenses for business trips (unlike for Ukrainian citizens, for whom strict limitations apply).

Tax rates

The rate of tax applicable under the Individual Tax Decree depends on the annual taxable income of the taxpayer. Originally the tax brackets

were based on multiple amounts of the minimum wage, up to a 50 per cent maximum tax rate. Subsequently, pursuant to the Presidential Decree 'On Increasing the Non-taxable Minimum, and the Rate of Progressive Taxation of, Income of Citizens', No. 519, of 13 September 1994 (Presidential Decree No. 519), the tax brackets were reorganized and the maximum rate was lowered to 40 per cent. In addition, the use of the minimum wage as a measurement was replaced with the 'non-taxable minimum income unit', which is the amount of income in Ukrainian currency that is not taxable (hereinafter referred to as a 'minimum non-taxable income unit'). Currently, the minimum non-taxable income unit is fixed at Ukrainian hryvnia (UAH)17 per month, which (as noted above) is approximately equal to US\$3.

The tax rates based on these monthly minimum non-taxable income units are as follows:

- 0 per cent tax bracket – monthly income up to 1 minimum non-taxable income unit (US\$0–approximately US\$3 at current income values and exchange rates);
- 10 per cent tax bracket – from 1 to 5 minimum non-taxable income units (US\$3–15);
- 15 per cent tax bracket – from 5 to 10 minimum non-taxable income units (US\$15–30);
- 20 per cent tax bracket – from 10 to 60 minimum non-taxable income units (US\$30–180);
- 30 per cent tax bracket – from 60 to 100 minimum non-taxable income units (US\$180–300);
- 40 per cent tax bracket – for more than 100 minimum non-taxable income units (over US\$300).

This schedule applies for almost all income except: (1) income derived by an author's heirs as a result of the inheritance of a stream of income paid in respect of authorship, which is taxed at twice the schedule rates, up to a maximum 70 per cent rate; and (2) income derived from a source other than a taxpayer's principal employment, which is initially taxed at a 20 per cent rate, and is recalculated at the end of the tax year based on the taxpayer's total annual income, thereby deferring payment of the balance of the full tax on such income until the year end.

The validity of Presidential Decree No. 519 is highly questionable, as it is in breach of the constitutional limits on the competence of the President of Ukraine to act by decree, because it purports to modify tax rates established by a statute (the original Individual Tax Decree establishing rates still has the force of a statute, as it was adopted as such by the Cabinet of Ministers pursuant to special temporary powers given

by an earlier statute). Nonetheless the common practice has been to apply the rates established by Presidential Decree No. 519, and the state tax authorities have rigorously enforced this.

However, in 2001 a taxpayer won a court case in which the judgment based his taxes on the Individual Tax Decree tax brackets rather than those established by Presidential Decree No. 519, resulting in a significant refund being due to the taxpayer. The refund resulted because the tax brackets based on the minimum monthly wage, currently UAH118 (approximately US\$21), are significantly wider than those based on the minimum non-taxable income units, currently UAH17 (approximately US\$3). The wider brackets raise the income level at which each higher rate applies, effectively reducing the taxes due.

Potentially, this judicial recognition of the priority of the Individual Tax Decree over Presidential Decree No. 519 may significantly alter the whole system of individual income taxation for several reasons. First, as noted, the current minimum wage, on which the tax is based under the Individual Tax Decree, is presently about seven times higher than the minimum non-taxable income unit introduced by Presidential Decree No. 519, resulting in much higher tax thresholds and lower taxes, if this is generally applied.

Second, this ruling may create a problem, with respect to past salary payments, for employers who are required to withhold income tax in respect of the salaries they pay (as explained below). Employees may on this basis claim from their employers the amount of the difference between the taxes erroneously withheld and paid under Presidential Decree No. 519 and the lower taxes that should have been withheld and paid under the Individual Tax Decree. If employers have to make refunds on this basis to their employees they will find it difficult to receive an appropriate refund from the state for the overpaid taxes.

Payment procedure

Ukrainian citizens who are residents of Ukraine are currently not required to file tax returns if their only source of income is their principal employment with a Ukrainian employer. Instead, Ukrainian employers are required to withhold the taxes due from their employees on the wages paid each month, applying tax brackets based on the assumption that their employees have no other income.

If a Ukrainian resident citizen has income from sources other than his or her principal employment, then that individual must file a personal tax return by 1 April of the year following the end of the calendar tax year (and pay any additional tax due or reclaim any over-payment due to withholding). All other payments to resident individuals by legal entities or registered entrepreneurs for goods or services are subject to the 20 per cent withholding, unless the individual recipient is registered as an entrepreneur and has so notified the payer.

Where an individual engages in entrepreneurial activity, he or she must register to be specially taxed as an entrepreneur and file an initial tax return based on an estimated annual income. The entrepreneur must then, on a quarterly basis, file returns and make tax payments, which are reconciled in an end-of-year filing and reconciliation payment. Such registered entrepreneurs are taxed as individuals except, as noted earlier, their business expenses may, in general, be deducted on the same basis as is permitted for legal entities.

Under the Individual Tax Decree foreign individuals who are residents of Ukraine are required to file tax returns and prepay their Ukrainian taxes quarterly, except to the extent the tax is withheld at source, with a final declaration due from the taxpayer 40 days after the end of the calendar year.

Non-residents receiving Ukrainian source income are taxed at the source of the income through withholding by the payer, as discussed earlier.

Value-added tax

Background

Value added tax, or VAT, is ultimately a tax on consumer expenditure, which is levied at a rate of 20 per cent on most business transactions, domestic retail sales and imports. The Law 'On Value-Added Tax' (the VAT Law), adopted on 3 April 1997, which presently governs VAT, represents an attempt by Ukraine to move closer towards European VAT norms.

Taxpayers

VAT taxpayers generally include:

- any legal entity or registered individual entrepreneur if the total amount of its, his or her taxable transactions exceeds 3,600 minimum non-taxable income units (about US\$11,000) over the most recent 12-month period;
- any entity or registered individual entrepreneur importing goods into Ukraine or receiving services (including all 'works', to use Ukrainian terminology) from non-residents for usage or consumption in Ukraine; and
- any entity or registered individual entrepreneur trading in Ukraine for cash, irrespective of the amount of its taxable transactions.

(As discussed below, no VAT may be payable separately if the taxpayer is instead only subject, as an alternative, to the 10 per cent small business single tax.)

Taxable transactions

Most business transactions involving the supply of goods or services are considered taxable, including:

- the sale of goods and provision of services carried out in Ukraine;
- the importation of goods into Ukraine and the receipt in Ukraine of services from abroad; and
- the exportation of goods and provision of services for consumption outside of Ukraine (although, as described below, a 'zero' VAT tax rate generally applies to such transactions presently).

A number of transactions are specifically excluded from VAT, including:

- the issuance, placement and sale of securities as well as derivatives issued by legal entities and the government of Ukraine;
- any transfers of funds;
- rental payments under finance leasing, transfers of property pursuant to lease and pledge agreements, and payments of principal and interest under mortgage loan agreements;
- the provision of insurance and reinsurance services;
- transfers of fixed assets as a contribution to the authorized capital fund of a legal entity (including the importation of such assets into Ukraine, provided that the assets are necessary for the business activity of the legal entity); and
- the sale of goods and provision of services designated for the needs of diplomatic and consular representations of foreign countries and representations of international organizations in Ukraine, as well as for their diplomatic personnel and family members in residence.

Rates

Only two VAT rates currently exist in Ukraine: 20 per cent and 0 per cent. Where VAT is not applied at the standard 20 per cent rate, the 'zero rate' applies, effectively allowing a complete exemption. There is a zero rate on most exports of goods and services by residents for use or consumption outside Ukraine (the application of VAT to exports of services can be controversial since the state tax authorities often treat services provided by Ukrainian residents to non-residents as being consumed in Ukraine even if the report or other advice is sent abroad – the relevant legislation and administrative practice is somewhat ambiguous on this point).

Calculation

General sales transactions

VAT liabilities are calculated based on actual invoices. The VAT liability for a sales transaction generally arises at the earliest occurrence of either: (1) the transfer of the goods or the fulfilment of the services (as evidenced by a document, usually an 'act of transfer-acceptance', confirming completion of the services); or (2) the receipt of actual payment.

As there is no legally mandated period within which the act of transfer-acceptance or other document confirming the completion of services should be executed it is, as a practical matter, often possible to postpone the date on which the VAT tax liabilities arise until the VAT taxpayer is actually paid for its services. Special rules for the calculation of VAT apply to barter and to the sale of goods and provision of services where credit cards or cheques are used for payment.

Importation of goods and services

The tax liability for VAT on goods imported into Ukraine arises when an import customs declaration is submitted to clear the goods through customs. Ordinarily the VAT must be paid, together with import duty and any excise tax, when the goods cross the customs border of Ukraine. However, a Ukrainian VAT taxpayer can also choose not to pay VAT at the border, but instead issue a promissory note that is redeemed at the end of the first relevant tax accounting period for the taxpayer (except for the importation of goods, such as vehicles, that are subject to excise tax).

When services are imported the VAT liability arises on the first occurrence of either (1) payment by the taxpayer; or (2) execution of a document confirming the fulfilment of the services. Payment of VAT on imported services is based on withholding by the Ukrainian purchaser.

Calculation of VAT liabilities

The amount of VAT to be paid at the end of each tax accounting period is determined as the general amount of such VAT liabilities, less the VAT tax credits that arose over this period. A VAT credit for a tax accounting period arises for the total amount of VAT paid by the taxpayer during such period for the purchase of goods or services, the value of which can be included in the taxpayer's gross expenses or capital or intangible assets subject to depreciation.

As a general rule, if the amount of such VAT credit exceeds the amount of the VAT liability for the relevant period (referred to as Excess VAT), the amount of such Excess VAT may be either returned to the taxpayer after a three-month period from the date of filing the VAT tax declaration in respect of this Excess VAT (after the deduction of the amount of this Excess VAT from any VAT liabilities that arise over this

three-month period) or, at the request of the taxpayer, this Excess VAT can be used to decrease future VAT or other tax liabilities (including corporate profits tax).

Presently, as a practical matter, it usually proves difficult for most taxpayers to obtain a cash refund of such Excess VAT. The state tax authorities are extremely reluctant to grant such refunds. Their refund procedure almost invariably involves a long, time-consuming process, starting with a preliminary examination of the taxpayer's accounts. Unless large amounts are involved it is generally not worth the trouble to pursue such claims.

The possibility of a refund usually also depends on the availability of funds for refunds by the State in the *oblast* or city involved. Taking this into account, VAT taxpayers in Ukraine need to be careful with their VAT planning to avoid, where possible, accumulating Excess VAT and, should Excess VAT accrue, to offset it against their future VAT and other tax liabilities as much as possible.

Tax periods

VAT taxpayers must file on a monthly basis, unless their annual taxable turnover is below 7,200 minimum non-taxable income units (currently approximately US\$22,000), in which case the VAT taxpayer may choose to file quarterly. Returns and payments are due not later than on the 30th day following the relevant monthly accounting period, or the 50th day following the relevant quarterly accounting period.

Excise tax

Background

Excise tax is imposed by the Decree of the Cabinet of Ministers 'On Excise Duty' of 26 December 1992, as amended (which has statutory force). The Ukrainian Parliament determines periodically which goods are subject to excise tax and at what rates under this decree. Currently the list primarily includes alcohol and tobacco products, gasoline and certain other fuels, vehicles and jewellery. The rates are calculated either as a percentage of the sale price or as a fixed amount in euro based on the type and quantity, volume or weight of the goods.

Taxable base

Taxable transactions include the sale or other transfer of ownership of any goods subject to excise tax ('excise goods') that are produced within Ukraine, as well as the importation of excise goods into Ukraine. Both resident and non-resident legal entities and individuals that produce or import excise goods are subject to excise tax.

Exemptions

Excise tax is not levied on excise goods imported or purchased for the production of other goods that will be subject to excise tax. Nor does it apply to the sale or other disposal of certain specially designed vehicles (eg for handicapped people, ambulances and police cars). Other exemptions exist for goods in transit, temporarily imported goods subject to an obligation for their re-export, and samples of tobacco and alcoholic beverages imported for non-commercial purpose. If any of these exempt goods are later sold or otherwise disposed of within Ukraine, then the excise tax must be paid.

Accounting procedure

Excise tax calculations must be filed on a monthly basis, and the excise duty is subsequently paid monthly, although certain special procedures exist for the producers of alcohol and tobacco products.

Other taxes**Customs duties on imports and exports**

Goods imported into Ukraine are subject to customs import duties in accordance with the Law of Ukraine 'On the General Customs Tariff of Ukraine' of 5 February 1992, with the actual rates being presently fixed in the Law 'On the Customs Tariff of Ukraine' of 5 April 2001. There are three types of customs duty rates imposed under the tariff: preferential, privileged and full. Goods from most countries are subject to privileged rates ranging from 5 to 10 per cent, provided that the ultimate origin of the goods can be proved.

Ukraine still retains customs export duties aimed at restricting the export of several types of goods, including in particular oilseeds (mainly sunflower seeds), livestock (eg cattle and sheep) and animal hides. Although this issue attracts great attention from both Ukrainian exporting companies and a number of international organizations it has so far proved politically impossible completely to abolish these export duties.

Social security payments

Social security payments are generally borne both by an employer (paid on the overall amount of its salaries and other remuneration disbursed to its employees (the Salaries)) and by its employees (withheld by the employer from the Salary of each employee). These payments are made to four separate state funds, and at rates (as a percentage of the Salaries), as described in Table 4.6.2.

Table 4.6.2 Social security payment rates

Social security payment rates	Paid by the employer (% of all Salaries)*	Paid by the employee (% of gross Salary to be deducted)*
Pension Fund of Ukraine	32	1–2
Social Security Fund for Unemployment**	2.5	0.5
Social Security Fund for Occupational Accidents and Professional Diseases**	0.84 to 13.8***	–
Social Security Fund for the Temporarily Disabled**	2.5	0.25–0.5

Notes:

* Only generally applicable rates are shown; the rates that apply for a particular category of employer or employee may, in certain cases, be different.

** Rates are subject to annual revision by the Ukrainian parliament (as part of the annual budget).

*** The rate depends on the type of business. Sample rates: finance, credit and insurance businesses – 0.84; trade and public catering – 1.02; and production of construction materials and the oil and gas industry – 2.24.

As shown in Table 4.6.2, the most important payments are those to the Pension Fund of Ukraine, which amount to payment by the employer of 32 per cent of the Salaries and payment by the employees of 1–2 per cent of the Salary (withheld from each Salary, with the actual rate dependent on the taxable amount of income involved for the individual).

All of these social security payments should be made prior to the payment of the Salaries. These payments (except for the withholdings from each employee's Salary) are included in the gross expenses of the employer and, thus, are deducted from its taxable income for the purpose of its business profits taxation.

In addition to the Pension Fund payments cited above that are collected as a percentage of Salaries, a number of specific transactions are also currently subject to a Pension Fund payment, with the applicable rate of such Pension Fund contribution based on a percentage of their value. These transactions, with the applicable rate, are those covering the sale of: (1) hard currency – 1 per cent; (2) jewellery – 5 per cent; (3) cars – 3 per cent; (4) immovable property – 1 per cent; and (5) mobile telecommunication services – 6 per cent. These five special payments were originally introduced in 1998 as a temporary measure to cover the Pension Fund's debts for the payment of state pensions. It is expected that these payments will be abolished in the future as the Ukrainian economy develops and the ordinary withholdings from Salaries becomes sufficient.

Land tax

The land tax is levied under the Law of Ukraine 'On Payment for Land' of 3 July 1992, as amended on 22 March 2001. The tax is paid by both owners and users of land. The land tax that is payable is determined based on a percentage of the monetary value of the land and according to government-established formulas. Such land valuation varies depending on the purpose of the land use, ie whether it is for agricultural, urban or recreational use. The amount of any profit earned from the commercial activity involving the land has no bearing on the amount of this tax.

Other miscellaneous taxes

The taxes described above are generally of the most interest to foreign entities and individuals investing, doing business or residing in Ukraine. There are, however, numerous other payments and fees that one should be aware of.

These include the state duty payable on the bringing of legal proceedings (1 per cent of the amount at issue, but no more than 100 non-taxable minimum income units, presently equal to approximately US\$300), duties on certain securities and commodities transactions and fees to permit certain types of trading activities. There are also special taxes on certain assets, such as the automobile tax, as well as taxes on certain types of activities, for example the rental and geological fees for oil and gas production activities and the fee for the use of natural resources.

The single tax option for small businesses

The Presidential Decree of 3 July 1998 introduced an option for small businesses to pay a single tax instead of most of the generally applicable taxes, including:

- business profits tax;
- individual income tax;
- VAT, except if the 6 per cent tax rate applies (see below);
- land tax;
- payments to the social security funds including all payments to the State Pension Fund (subject to issues, cited below, concerning new social security payments); and
- certain other obligatory payments specified by legislation.

This option is available to: (1) any legal entity engaged in business activity of any form of organization and ownership that employs no more than

50 persons per year and whose annual earnings from the sale of goods and services do not exceed UAH1 million (approximately US\$182,000), provided that the share of the charter fund (authorized capital) of their founders and owners that are not such small businesses must not exceed 25 per cent; and (2) any individual registered as an entrepreneur who employs no more than 10 persons per year and whose annual earnings from the sale of goods and services do not exceed UAH500,000 (approximately US\$91,000).

A qualifying legal entity additionally has the choice of two rates of the single tax, being either: (1) 6 per cent of the amount of earnings from the sale of goods and services, plus excise tax and VAT; or (2) 10 per cent of the amount of earnings from the sale of goods and services with VAT included, plus excise tax.

The tax rate for registered individual entrepreneurs is specified by the relevant local authorities as a fixed amount of between UAH20 and UAH200 (approximately US\$3.80–38), plus half of that amount for each employed person, irrespective of the individual's actual earnings.

A new social security payment was introduced in 2001 to the Social Security Fund for Occupational Accidents and Professional Diseases, and the issue of whether it should be covered by this single tax is currently controversial. Unless the current legislation is amended expressly to refer to this new social security payment, it appears that the new payment will have to be paid in addition to the single tax, although this is contrary to the announced purpose of the single tax. The single tax was intended to enable small businesses to pay a single amount and operate legally, instead of hiding their income to avoid an excessive tax and accounting burden.

While this new approach to taxation has largely proved successful, the future of the single tax remains unclear, as it allows small businesses, and especially individual entrepreneurs, to minimize their tax obligations significantly compared to the tax rates generally applicable to all other business entities in Ukraine. It has been criticized because it is allegedly being used by larger businesses to escape much tax by artificially operating as collections of small businesses. The situation will probably change with the adoption of the proposed new Tax Code that is supposed generally to introduce lower tax rates, and that is also expected substantially to reduce the number of taxpayers covered by the single tax regime.

Conclusions

Despite the difficulties of its transition to a market economy, Ukraine has now developed tax laws that resemble those found in developed countries. This represents a great step from the Soviet-style gross revenue,

production-based taxes to a generally profits-based tax system founded on international tax and accounting principles.

Much still remains to be done, especially to develop detailed regulations (as exist in the West), to address the many ambiguities in the relevant legislation. Many commentators believe that tax rates also need to be further lowered in order to encourage tax compliance of large and medium-sized businesses, rather than push them towards tax evasion. In the future, the Ukrainian system of taxation will likely follow Western trends, in particular by increasing indirect taxation and social security withholdings and developing further anti-avoidance measures.

NB: This review of Ukrainian tax law should be read for general guidance only, as many special rules and exceptions apply and the actual application of tax laws is subject to special practices and is being continuously revised. Professional tax advice should always be sought for specific transactions.

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