

# Taxation

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## Introduction

The general principles of the taxation system in Ukraine, including duties and obligatory fees, are presently determined by the law 'On the System of Taxation' of 2 February 1994 (the Tax Law). Under the Tax Law, Ukraine imposes two types of taxes: state and local. In addition, numerous 'fees' are provided for, but are not called taxes even though they are mandatory and are collected by the tax authorities.

State taxes, duties and payments are established by the Parliament of Ukraine (Verkhovna Rada) and apply for the entire territory of Ukraine. The Tax Law provides for the following state taxes, duties and obligatory payments:

- business profits tax;
- individual income tax;
- value-added tax (VAT);
- excise tax;
- customs duty;
- state duty (fees for notarial services, court proceedings, marriage, divorce etc);
- real estate tax (tax on immovable property);
- land tax;
- rent payments;
- tax on automobiles and other vehicles;
- tax on trade;
- payments for benefits from geological exploration previously conducted at state expense;
- tax on the special use of natural resources;

- tax on pollution of the environment;
- payments to the Chernobyl Fund (for measures to mitigate the consequences of the Chernobyl accident);
- payments to the mandatory Social Insurance Fund;
- payments to the mandatory State Pension Fund;
- payments to the Innovation Fund;
- trade permit fees.

One of the positive results of subsequent amendments to the Tax Law is that those previously created taxes and fund contributions not listed in the Tax Law are effectively eliminated, no longer considered to be mandatory payments, which simplifies the system by effectively eliminating all these other charges. To the extent that double tax treaties and other international treaties of Ukraine provide for different tax rules, such international treaty rules prevail.

In accordance with the Tax Law, local taxes and duties, their rates and the procedure for their payment are established by village and city councils. In addition, the Decree of the Cabinet of Ministers of Ukraine 'On Local Taxes and Duties' (20 May 1993) specifies the persons and entities subject to tax, and the maximum rates and procedure for payment of local taxes. Under the Tax Law, local taxes and duties include levies as diverse as those on hotel registration, dog ownership, advertising and retail trading.

The Parliamentary committee responsible for Ukrainian tax legislation has declared its intention to create a more unified tax system and one closer to internationally accepted taxation principles. The new laws on value-added tax, business profits tax and payments to state funds (Social Insurance, State Pension and the Chernobyl Funds) have already been adopted as part of this revision. New individual income tax and excise laws, the last major laws in this package of revisions, are expected to be adopted and come into force in 1998.

In addition, instructions and other interpretations are issued on a regular basis to fill in the many gaps in this tax code, which has only been developed over the last five years. Application of these supplemental interpretations is often complicated because of inconsistencies with older application rules that have not been formally withdrawn.

The principal taxes in Ukraine that affect foreign investors and their employees are described below.

## **Business profits tax**

### ***Background***

The tax on business profits was originally introduced in Ukraine by the

law "On Taxation of Profits of Enterprises" of 28 December 1994, as subsequently amended.

A new law substantially amending this profits tax law was adopted by the Parliament of Ukraine on 22 May 1997 and came into force on 1 July 1997. In general, the new business profits tax law abolishes the cost of production concept and establishes a procedure according to which taxable profits are calculated based on the difference between gross income and gross expenses. Depreciation is allowable at rates that vary depending on the category of asset involved.

In some cases, however, the new law still applies tax not on profits but on gross income. This holds, for example, for Ukrainian insurers or for some non-residents who do not carry out their activity in Ukraine through a permanent establishment and who are not excused from tax under a tax treaty.

### **Taxpayers**

Taxpayers include all Ukrainian legal entities and their branches, representative offices and other structural divisions, as well as foreign legal entities and individuals involved in entrepreneurial activity<sup>1</sup> that receive income from Ukrainian sources.

### **Rates**

The general profits tax rate applicable to residents and the Ukrainian permanent establishment of non-residents is 30 per cent. Income of Ukrainian insurers is taxed at a 3 per cent rate on gross income.

In most cases, non-residents are subject to a 15 per cent withholding tax on any income obtained from sources in Ukraine, including when paid by a permanent establishment to its non-residents home office. The new law broadly defines as 'income obtained from sources in Ukraine' any kind of income received by residents or non-residents as a result of any kind of activity conducted in Ukraine. This withholding tax is deducted at the time such income is paid.

The Tax Law also provides for numerous special tax rates. These special tax rates apply to areas such as insurance provided by non-residents (30 per cent of gross income), reinsurance by non-residents (15 per cent of gross income), dividend payments (special withholding rates) and vehicle freight, securities trading by non-residents (15% of profits), and bonds redemption by non-residents (30% of interest or profit margin).

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<sup>1</sup> The reference to an individual involved in 'entrepreneurial activity' is understood to mean the sole proprietor of a business, including someone self-employed who registers as an entrepreneur.

**Rates under double tax treaties**

Under double tax treaties entered into by Ukraine, or USSR treaties that Ukraine still applies as a successor of the USSR, the following rates apply.

Table 32.1 Withholding tax rates for treaty countries

Country	Income paid from Ukraine		Royalties (%)
	Dividends (%)	Interest (%)	
Austria*	0	0	0
Armenia	5/15	0/10	0
Belgium*	15	0/15	0
Belarus	15	10	15
Bulgaria	5/15	0/10	10
Canada	5/15	0/10	0/10
Czech Republic*	0	0	0
Cyprus*	0	0	0
Denmark	5/15	0/10	0/10
Estonia	5/15	0/10	10
France*	15	0/10	0
Finland	0/5/15	0/5/10	5/10
Germany	5/10	0/2/5	0/5
Hungary	5/15	0/10	5
Italy*	15	0/NA	0
India*	15	0/15	15/20
Japan*	15	0/10	0/10
Kazakstan	5/15	0/10	10
Latvia	5/15	0/10	10
Malaysia*	15	0/15	10/15
Moldova	5/15	0/10	10
Mongolia*	0	0	0
Netherlands	0/5/15	0/2/10	0/10
Norway	5/15	0/10	5/10
Poland	5/25	0/10	10
Slovak	10	10	10
Spain*	18	0/NA	0/5
Sweden	0/5/10	0/10	0/10
Switzerland*	NA	NA	0
UK	5/10	0/NA	0
USA*	NA	0/30	0

\* USSR double tax treaty. Many of these countries have either negotiated a new treaty that is not yet in effect (as is the case for the USA, which has suspended ratification), or are still in negotiations, like Austria and Cyprus. (NA means either not specified, or that the treaty rate does not apply in certain circumstances.)

As indicated, there are for most countries a variety of rates that apply depending on the particular circumstances.

### **Calculation**

Taxable profit is determined as the difference between gross income made (the total income from all revenue sources) and allowable gross expenses incurred in connection with the taxpayer's production or other activities. The law lists types of expenses that can not be included in such gross expenses. These include expenses for the acquisition and reconstruction of fixed assets, and expenses not supported by relevant accounting documents.

The Tax Law establishes an unusual rule regarding expenses. If a Ukrainian taxpayer concludes contracts in respect of certain goods or services with a non-resident from a country officially described as being "off-shore", then only 85 per cent of the expenses incurred by the Ukrainian party in connection with such contracts can be included as allowable gross expenses. The list of such "off-shore" countries is to be annually established by the Cabinet of Ministers, and is expected to be made up of jurisdictions - thought of in the West as being "tax havens."

### **Accounting procedures**

The profits tax must be accounted for quarterly and paid by the 20th of the month following the accounting quarter. Advance payments, based on the results of the first and second months of the quarter, must also be made by the 20th of the second and third months of the quarter respectively.

### **Taxation of representative offices**

Traditionally 'representative offices', those set up as non-trading branch offices, carried on their activities in Ukraine without paying tax. Recently, however, the tax inspectorate has begun trying to tax some representative offices based on their deemed income, claiming that they are in fact trading and making profits and should be paying tax. Representative offices that trade have always been taxed at the usual 30 per cent rate for Ukrainian source profits (which taxes can be reduced in respect of taxes paid abroad on their income), and such branch offices must register as taxable permanent establishments.

For most representative offices in Ukraine there should be little risk of such taxation because a tax that overrides the Ukrainian tax law will apply, and will 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 rep-

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.

For companies from tax treaty countries, it is important to limit the power of attorney required to authorise the local management to act and the internal regulations on the functions of the representative office. This is achieved by excluding profit making trading and by limiting the office's activities to those listed in the relevant treaty as those being permissible without creating a permanent establishment.

## Personal income tax

### General

Issues of personal income taxation are primarily regulated by the Decree of the Ukrainian Cabinet of Ministers 'On Personal Income Tax', adopted on 26 December 1992, as subsequently amended (the 'Personal Tax Decree').

A draft of a new law on individual income tax is currently being discussed by the Ukrainian Parliament and is expected to come into force in 1998. Unlike the current Personal Tax Decree, which is often inconsistent with newly adopted tax legislation, the draft law will be coordinated with the new business profits tax, VAT and other tax laws.

### Taxpayers

The Personal Tax Decree provides for the taxation of the following individuals:

- residents - defined as citizens of Ukraine and foreign individuals who are physically present in Ukraine at least 183 days in a calendar year;
- non-residents - defined as all individuals who do not qualify as residents.

### Taxable base

Taxable income is the difference between a taxpayer's total annual income and the total exemptions available to the taxpayer, less applicable deductions. The Personal 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 free market prices, though as a practical matter it may be difficult to establish prices. Residents are taxed on their total world-wide income.

Taxes paid outside Ukraine may be taken as a credit toward 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 are not eligible to receive 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 entrepreneurial activity is taxed at a 20 per cent rate.

### **Exemptions**

The Personal Tax Decree provides for the following principal exemptions from taxable income:

1. social insurance payments;
2. alimony payments;
3. pension payments under the state pension plan or under a voluntary pension programme;
4. income received from the sale of personal property sold pursuant to a notarised sale-purchase agreement where state duty for the sale was paid, provided that this sale was not carried out as part of an individual's entrepreneurial activity;
5. in general, money received as a gift or as an inheritance;
6. interest derived from personal bank accounts, deposit certificates, government bonds and government lotteries;
7. income reinvested in shares or in the reconstruction or expansion of companies;
8. payments made to employees for injuries to health at work;
9. income of individuals who are performing seasonal or temporary agricultural or construction works in rural areas.

### **Deductions**

Ukrainian legislation permits the following deductions from taxable income:

1. the amount of one minimum non-taxable income unit for each applicable calendar month of the year (one unit is currently worth approximately \$9 per month);

2. the amount of one minimum non-taxable income unit per month for each child of the taxpayer (deduction can only be claimed by one parent); and
3. deductions for certain categories of individuals (eg disabled individuals and veterans).

In addition, individuals who are registered as entrepreneurs (sole proprietors of a business) may partially utilise the depreciation rates and allowances applicable for Ukrainian legal entities. Ukrainian legislation does not permit an individual who is not a registered entrepreneur to take any depreciation or other allowances for property or other assets.

### ***Regime for expatriates***

All foreign individuals physically present in Ukraine for at least 183 calendar days in a given 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 individuals. In addition, the following two specific provisions are applicable to foreign individuals only.

1. Amounts paid to an expatriate resident 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.
2. The taxable income of expatriate residents does not include payments made by an expatriate's employer to any social security and pension fund and reimbursements for housing and automobile and other expenses for business trips.

### ***Tax rates***

The Personal Tax Decree establishes the following schedule of tax brackets. The amounts are based on minimum non-taxable income units earned monthly and may vary as the minimum income is increased:

- 0 per cent tax bracket - monthly income up to one minimum nontaxable income unit (\$0-\$9 at current income values and exchange rates);
- 10 per cent tax bracket - from 1-5 minimum non-taxable income units (\$9-\$45);
- 15 per cent tax bracket - from 5-10 minimum non-taxable income units (\$45-\$90);
- 20 per cent tax bracket - from 10-60 minimum non-taxable income units (\$90-\$540);

- 30 per cent tax bracket - from 60-100 minimum non-taxable income units (\$540-\$900);
- 40 per cent tax bracket - for more than 100 minimum non-taxable income units (over \$900).

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 - this is taxed at a rate which is twice the schedule rates, up to a maximum 70 per cent rate;
2. income received by Ukrainian residents as dividends on shares or other corporate ownership interests, which is taxed at a 30 per cent rate;
3. income derived from a source other than a taxpayer's principal place of employment is taxed at a 20 per cent rate.

### ***Payment procedure***

Ukrainian citizens who are residents are currently not required to file tax returns if their only source of income is their principal place of employment. Instead, employers are required to withhold taxes due on wages each month. If a Ukrainian citizen who is a resident has income from sources other than his principal place of employment, then that individual must file a personal tax return by 1 March of the year following the taxable period.

Where an individual engages in an entrepreneurial activity, he or she has to register specially to be taxed as an entrepreneur and file an initial tax return based on an estimated annual income. An 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.

Payments to individuals by legal entities or by other entrepreneurs for goods or services are subject to 20 per cent withholding unless the individual is registered as an entrepreneur and has so notified the payer.

Under the Personal Tax Decree foreign individuals who are residents are required to prepay their Ukrainian taxes quarterly and to file a final tax return by 1 February of the year following each tax year. Ukrainian or foreign non-residents receiving Ukrainian source income are taxed at the source of income through withholding.

## **Value-added tax (VAT)**

### ***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 (sales VAT) and imports (import VAT).

On 3 April 1997 the Ukrainian Parliament passed a new law 'On Value-added Tax' (the New VAT Law) in an attempt to move closer towards European VAT norms. This law went into general effect on 1 October 1997, though some provisions are suspended until 1 January 1999.

### ***Taxpayers***

The New VAT Law effectively broadens the category of taxpayers to include:

1. any legal entity or individual if the total amount of its, his or her taxable transactions exceeds 600 minimum non-taxable income units (about \$5,400) over the most recent 12-month period;
2. any entity or individual that imports goods into Ukraine or receives works (services) from non-residents for usage or consumption in Ukraine;
3. any entity or individual that trades in Ukraine for cash, irrespective of the amount of its taxable transactions; and
4. any entity or individual that provides transit services through Ukrainian territory.

### ***Taxable transactions***

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

1. disposal of goods and provision of services carried out in Ukraine;
2. importation of goods into Ukraine and receipt of services from abroad;
3. exportation of goods and provision of services for their consumption outside Ukraine.

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

1. issuance, placement and sale of securities as well as derivatives issued by legal entities and the government of Ukraine;
2. rental payments under finance leasing, transfers by a resident creditor of the object of a mortgage loan to the ownership or usage of a borrower, and payment of principal and interest under a mortgage loan agreement;

3. provision of insurance and reinsurance services;
4. transfers of fixed assets as a contribution to the authorised capital fund of a legal entity;
5. carrying out works for construction of residential premises at the expense of individuals and transfers of premises to the ownership of such individuals;
6. sale of goods and provision of services designated for the needs of diplomatic representations, consular divisions of foreign countries and representations of international organisations in Ukraine, as well as for their diplomatic personnel and family members in residence. This provision also applies to imports, except for goods subject to excise tax.

### **Rates**

Where VAT is not applied at the standard 20 per cent rate, a 'zero rate' applies effectively allowing a complete exemption. The zero rate applies, for example, to the sale of coal and electricity, as well as to most sales for export.

### **Calculation**

The New VAT Law introduces a single procedure for calculation and payment of VAT for all categories of payers, independent of the currency used for transactions. Hard currency transactions are no longer exempted.

VAT liabilities are calculated based on actual invoices. The law provides that VAT liability arises at the earliest occurrence of (a) the shipment of goods or the fulfilment of services or (b) the receipt of actual payment. Application of this provision, however, was suspended until 1 January 1999. Until then only the actual payment method of VAT calculation (upon receipt of cash or the equivalent) will be used.

Tax liability for VAT on goods imported into Ukraine arises when an import Customs declaration is submitted. The VAT is paid together with import duty when the goods cross the Customs border of Ukraine. A Ukrainian VAT taxpayer can also choose not to pay VAT at the border, but instead issue a bill of exchange that is redeemed at the end of the relevant accounting period for the taxpayer.

When importation of services takes place, the VAT liability arises on the occurrence of either (a) payment by the taxpayer or (b) execution of a document confirming the fulfilment of the services, whichever occurs first. Payment of VAT on imported services is based on withholding by the Ukrainian purchaser.

Special rules for calculation of VAT apply to barter, sale of goods and provision of services where credit cards and cheques are used for payment, and certain other transactions.

The New VAT Law establishes rules for calculation of VAT credits. Generally, if the supplies on which VAT should be paid are included in the VAT payer's gross production expenses, or constitute fixed or intangible assets, then the tax payer may claim an input VAT credit. The credit cannot be obtained for non-business related purchases or for non-taxable and exempt transactions.

### ***Accounting procedures***

Taxpayers must file on a monthly basis, unless the annual taxable turnover is below 7,200 minimum non-taxable income units (currently approximately \$65,000), in which case the taxpayer may request to file quarterly. Returns and payments are due not later than on the 20th of the month following the relevant accounting period. If a total VAT credit exceeds the sums of VAT liabilities of a taxpayer during the accounting period, then the VAT payer is eligible for a refund, which is supposed to be made within the month following the accounting period.

Late refunds are stated to accrue interest at an annual rate of 120 per cent of the National Bank of Ukraine discount rate. This is important since, in the past, VAT refunds have only been made in exceptional cases and subject to delays and, as a rule, overpaid amounts of VAT were only applied against future VAT liabilities. The New VAT Law no longer leaves this to the discretion of the state tax administration, but instead allows the VAT payer the option to receive a refund or to request that refunds be carried over and credited to the next accounting period. Care should be taken to keep all invoices and records in respect of VAT carefully, because no VAT credit can be given if the claim is not supported by invoices or other evidence.

### ***Registration***

The new VAT Law introduced special registration for both existing and new VAT taxpayers. They must register with the state tax administration and receive a certificate of registration and an individual VAT taxpayer number.

## **Excise tax**

### ***Background***

Excise tax is imposed by the Decree of the Cabinet of Ministers 'On Excise Duty' of 26 December 1992. The Ukrainian Parliament determines which goods are subject to excise tax under this Decree. Currently the list includes alcohol and tobacco products, furs, cars, jewellery, electronic

equipment and certain food products. The rates are calculated either as a percentage of the sale price or as a fixed amount in ECU 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 that are produced within Ukraine, as well as the import of excise goods into Ukraine. Both producers and importers are subject to excise tax.

### ***Exemptions***

Excise tax is not levied on goods imported or purchased for 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 (for handicapped people, ambulances and police cars). Other exemptions exist for goods in transit, temporarily imported goods (subject to an obligation to export them), and samples of tobacco and alcoholic beverages imported for non-commercial purpose. If any of these exempt goods are 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 subsequently the excise duty is paid either three times per month or monthly depending on the average monthly excise tax liability incurred by the taxpayer in the previous year.

A new draft law 'On Excise Tax' is currently being considered by the Parliament of Ukraine.

## **Other taxes**

### ***Customs duty***

Goods imported into Ukraine are subject to Customs duties in accordance with the General Customs Tariff of Ukraine. There are three types of Customs duty rates imposed under the tariff: preferential, privileged, and full. Goods from most countries are subject to rates ranging from 5-10%. (For further information on Customs duties see Chapter 00.)

### ***Land and real estate***

The land tax is levied under the Law of Ukraine 'On Payment for Land' of

19 September 1996. The tax is paid by owners and users of land, and is calculated as a percentage of the value of the land, as determined by government established formulas. Profits earned by the commercial activity of the owner or user have no bearing on the amount of the tax.

A draft law 'On Real Estate Tax' was submitted by the Cabinet of Ministers of Ukraine for the consideration of Parliament at the end of 1996. However, no decision on this law has yet been taken. (For additional information on real property see Chapter 00.)

### ***Payroll taxes***

Employers are required to contribute to the Ukrainian Social Security, State Pension and Chernobyl Funds, with total contributions to these funds amounting to 47.5 per cent of wages, as follows:

Social Security Fund	5.5%
State Pension Fund	32%
Chernobyl Fund	10%

In addition Ukrainian employees must make a 1 per cent contribution to the State Pension Fund and a 0.5 per cent contribution to the Social Security Fund. These rates reflect decreases made in 1997 pursuant to the government's stated intention to reduce taxes on wages. [For additional information on employer responsibilities see Chapter 34.]

### ***Other miscellaneous taxes***

The taxes described above are generally of most interest to foreign persons investing, doing business in or residing in Ukraine. There are, however, numerous other taxes and fees one should be aware of. These include the state duty payable on bringing legal proceedings (usually 5 per cent of the amount at issue, which may be recoverable), duties on certain securities and commodities transactions and fees to permit certain trading activities. There are also special taxes on assets such as the automobile tax, and taxes on certain activities like the rental fee, geological fee and natural resources use tax for oil and gas production.

## **Conclusions**

The tax law revisions reflected in this discussion represent a great step in the difficult transition from gross revenue, production-based tax and accounting to a generally profits-based tax system founded on more realistic rates and generally accepted international principles. Much remains to be done, especially to develop detailed regulations as exist

in the west, to address remaining ambiguities and to further lower tax rates.

For general business planning purposes local professional advice should always be sought, both when preparing to conduct business in Ukraine and thereafter on a continuing basis to keep up with developments. This review of taxation legislation should be read for general guidance only, as many special rules and exceptions apply and the application of tax laws is being continuously revised.