



The Business & Law Readers Digest

Investments

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Summary

Ukraine has enormous economic potential, bordering as it does the European markets. The economy is based on industry and agriculture, which account for more than 70% of its gross domestic product.

Despite occasional political instability, Ukraine still remains attractive for for-

ign investment capital and within the past four years has witnessed direct investment grow at a rate of 30-40%. In 2007 the general amount of attracted foreign investment in Ukraine constituted around USD 29 billion, mainly from Germany, Holland, Austria, Cyprus, the USA and Russia.

Foreign investment

Generally, foreign investors, Ukrainian legal entities and individuals are equal in their rights and obligations. However, the Law of Ukraine "On the Regime of Foreign Investment" provides certain guarantees to foreign investors. This Law defines "foreign investment" as investment by foreign investors in compliance with Ukrainian law with the aim to gain profit or to achieve a social effect. A Ukrainian legal entity is recognised as a company with foreign investment if it has at least 10% foreign ownership in its charter capital (i.e. share capital); no minimum/maximum foreign capitalisation requirements are stated. Registration of foreign investment with the local authorities is required in order to benefit from the foreign investment guarantees.

Foreign investment can take the form of a contribution of fixed assets in re-

turn for an ownership interest in the share capital of a Ukrainian company. Currency transfer can be easily executed whilst contribution in kind requires that certain special procedures are undertaken by foreign investors. Under current Ukrainian legislation, foreign investment in kind (i.e. fixed assets) is exempt from import duties. However, if the investment assets are disposed of within three years after the date upon which they are recorded in the books of the Ukrainian entity, all applicable import duties should be paid to the Ukrainian budget.

Some of the guarantees for foreign investors that are set out in Ukrainian legislation are:

- 10 year grandfathering clause, permitting any qualified investor



to enjoy favourable treatment and guarantees contained in the Law in the event of a subsequent change in legislation

- foreign investment is exempted from nationalisation, except for cases of natural disaster
- foreign investors may seek damages (lost profit and moral damages) resulting from negligent acts or failure to perform by the state (if confirmed, compensation is payable in hard currency)
- when terminating its activity, an investor has six months to return its investment in kind or in cash without payment of customs duties, as well as any profits

earned in kind or cash at their real market value, and

- foreign investors are guaranteed unhindered and immediate rights to repatriate their profits abroad after complying with the withholding tax regulations.

Ukrainian legislation on foreign investment sets out effective protection for foreign investment in Ukraine against state confiscation, except for cases of national emergency. Such cases include evacuation or rescue measures in connection with disasters, accidents or epidemics. Foreign investors are eligible to be compensated for losses caused by government bodies with respect to the above cases.

Taxation

In Ukraine during 2007 there were no changes in the taxation sphere which were of vital importance for business. However, in order to keep you updated, below are our comments regarding the current tax system of Ukraine.

Ukrainian corporate income tax law distinguishes between domestic and foreign companies based on their place of incorporation. Domestic companies (those incorporated in Ukraine) are taxed on their worldwide income whilst

foreign companies are subject to corporate income tax on profits from business activities carried out in Ukraine through a permanent establishment as well as certain other profits subject to withholding tax (interest, dividends, etc.) unless exemption is available under the applicable international tax treaty on the avoidance of double taxation and tax evasion.

Non-residents engaging in business activities through a Permanent Establishment (PE) in Ukraine are subject to



Ukrainian corporate profits tax. However, there are several methods of tax treatment for a PE, including the direct method, split balance method and gross income method.

Taxable profit is determined based on adjusted gross income reduced by tax deductible costs and tax depreciation. For corporate income tax purposes, adjusted gross income means gross income (i.e. a company's worldwide income) received (accrued) during the reporting period either in cash or in kind. Gross income includes total income from the sale of goods (work, services), fixed assets and receipt of gratuitous transfers.

Ukraine uses aspects of both accrual and cash methods to record expenses. Income is recognised upon the earlier event; the goods or services being supplied, or cash being received (e.g., if there is a prepayment).

The existing law generally allows reasonable business expenses as tax deductible, with the exception of expenses explicitly disallowed or restricted by the law.

The effective corporate income tax rate is 25%. Special tax rates may apply to certain types of income (e.g., income earned from Ukrainian sources by non-residents not engaged in business activities in Ukraine through a permanent establishment). Corporate tax liabilities are self-assessed by taxpayers. Tax is payable on a quarterly basis.

The Statute of limitations for tax liabilities is generally three years, but this may be extended in instances of willful tax evasion and/or if a relevant tax return was not filed. If the tax authorities identify additional liabilities relating to past periods, they may assess penalties in addition to the liability.

Transactions between related parties should be executed on the basis of "fair market" prices, consistent with what would be paid under similar conditions to third (non-related) parties.

In order to be deductible, expenses should be supported by documentary evidence. In respect of payments to individuals or entities associated with the taxpayer, the law explicitly states that the absence of documentary evidence concerning payments for services rendered can lead to disallowance. In practice, this requirement becomes particularly important in respect of management fees, payments under secondment contracts, and other inter-group cost re-allocations.

Interest payments on loans required for the taxpayer's business are deductible. The Corporate Profit Tax Law of Ukraine restricts the tax deduction available for interest paid by companies resident in Ukraine to non-resident shareholders or their related parties. In general terms, this restriction is set at 50% of the available taxable profits of a taxpayer, adjusted for any interest received, interest paid and tax depreciation charges. Interest



expense thereby disallowed can be carried forward to subsequent periods indefinitely. Some double taxation treaties may override this domestic provision, but each case should be examined separately. Also, this restriction does not apply if the parties are unrelated (e.g., if the loan is provided by an unrelated financial institution).

The following are not included as taxable profits:

- capital contributions in return for a share in the equity (i.e., in return for corporate rights)
- contributions in cash or in kind under joint activity agreements in Ukraine without the creation of a legal entity
- share premium received by a share issuer (the difference between the price of a share and its nominal value)
- dividends received, provided that they were taxed upon distribution in accordance with the Corporate Profit Tax Law (apart from dividends received from non-residents).

A tax credit system exists to avoid double taxation of income derived from abroad. Credit may be allowed for foreign taxes paid up to the amount of the Ukrainian tax due on such income, provided that there is a tax treaty with the state in which

the tax was paid (and proof of taxes paid can be provided).

Certain Ukrainian source income of non-resident legal entities is subject to withholding (repatriation) tax. Ukrainian source income includes the following: dividends, interest, royalties, rents, lottery winnings (except for those from the state lottery), real estate sales proceeds, remuneration for certain cultural, entertainment and sports activities, charitable donations, freight payments, proceeds from sales of securities and other corporate rights, brokerage fees, commission and agency fees and certain other income of non-residents. Income received as consideration for goods provided to a resident is excluded from the definition of Ukrainian-source income.

In general, the 15% withholding tax rate is applied to the majority of Ukrainian-source income, with the exception of (a) freight income, which is taxed at six percent, (b) certain insurance-related income, which is taxed either at zero percent or 15% rate depending on the financial criteria of the insurer, (c) income from advertising services provided in Ukraine (taxed at 20%), and (d) interest or discount income received from certain securities issued by the state that are exempt from taxation.

The tax is levied on the so-called repatriation of income (hence, it is often referred to as the "repatriation tax"). The resident Ukrainian payer of such income is required to withhold and remit to the



state the amount of the tax before the actual payment to a non-resident is made. The applicable withholding rate for dividends, interest and royalties is usually reduced by the double tax treaties entered into by Ukraine.

Group/consolidated tax returns are allowed for resident taxpayers and their branches or other units without legal entity status. There is no group relief for losses and profits of separate Ukrainian legal entities. An application to switch to payment of tax on a consolidated basis should be filed before the new reporting year. Detailed procedures for the payment of consolidated tax are established by the State Tax Administration of Ukraine.

Dividends distributed to Ukrainian legal entities or individuals are taxed in the form of advance payments of profits tax. An advance payment is made by a taxpayer who distributes dividends; currently a 25% tax applies for the full amount of dividends declared for distribution, which means that the tax is withheld at source. This tax is paid prior to, or at the moment of, distribution of dividends and can be offset against the taxpayer's liability arising in the reporting period in which the tax is paid.

The VAT law provides for the uniform treatment of both production and merchandising entities: under the VAT law, VAT due to the State is assessed as the difference between VAT collected from customers and VAT paid to suppliers.

The law distinguishes between the following major types of transactions, which are:

- subject to VAT and are taxed at the standard rate of 20%. This applies to all goods and services apart from the exceptions set out below
- subject to zero-rate VAT. The list of transactions primarily includes: sales of goods outside Ukraine (export of goods)
- transactions not eligible for VAT, such as: transfer of property for leasing from a Ukrainian lessor to a lessee and its return to the lessor upon the termination of the lease; rent payments under financial leases; insurance and reinsurance transactions, social and pension insurance; most banking services, and
- VAT-exempt transactions: export of certain services; education services; artistic and cultural services; healthcare services; certain mass media services; privatisation services, etc.

In general, VAT is payable by an entity with a volume of transactions eligible for VAT in excess of UAH 300,000 (approximately USD 60,000) for any preceding 12 months of operation and an importer of goods, services or works.



VAT registration is compulsory for all Ukrainian companies and individuals who qualify as VAT payers. A voluntary registration as a VAT payer is also possible under the current legislation. Foreign legal entities engaged in production or other commercial activity in the territory of Ukraine are considered to be VAT payers and are required to register for VAT purposes. Foreign legal entities registered as VAT payers are required to collect and remit VAT to the budget in the same manner as Ukrainian enterprises.

Foreign companies terminating their activities in Ukraine are obliged to file a final tax return with the relevant tax authorities.

Under Ukrainian law, VAT is recoverable provided that the goods (works, services) are meant for business purposes. VAT incurred on business expenses may normally be recovered as a credit against output VAT or as a refund, with the exceptions of VAT on

inputs corresponding to exempt supplies.

There is no clear or effective mechanism for a VAT refund to foreign entities that are not registered as VAT payers in Ukraine. That the government rarely provides cash refunds for VAT credits is currently a significant issue.

Usually the reporting period for VAT is monthly. In certain limited cases, a taxpayer can at its discretion use either monthly or quarterly reporting periods for the future calendar year. If a taxpayer chooses a quarterly reporting period, they are obliged to inform the tax authority of this approach one month prior to the new calendar year.

For VAT payers whose reporting period is one month, VAT returns are required to be filed no later than the twentieth day of the subsequent month. For those VAT payers whose reporting period is quarterly, VAT returns are required to be filed within forty days of the end of that quarter.

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