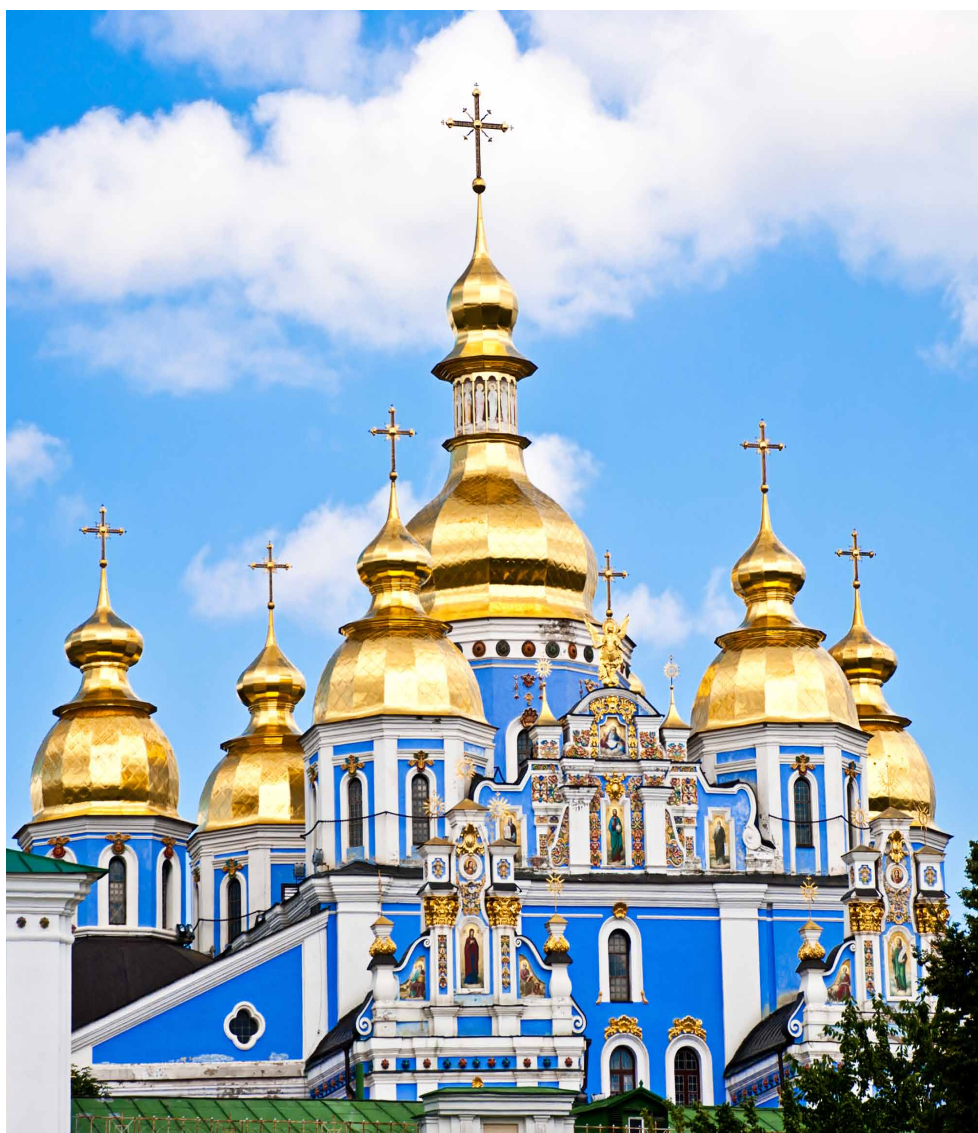


Ukraine:  
Tax guide 2013





# Introduction

Ukraine today represents one of the most exciting emerging markets for international companies. Situated at the crossroads of Eastern Europe, Russia, Central Asia and the Middle East, the country benefits from a consumer market of 45.5 million people, a favorable climate, rich natural resources, a relatively cheap labor force and well-developed infrastructure. Ukraine has established a reputation as a major exporter of grain, machinery and rolled-metal products.

The country's growth rates in the pre-crisis period and its industrial and agricultural potential attracted the attention of investors from across the globe. Euro 2012, the football tournament held in Ukraine last year, has increased the visibility of the nation's tourism industry, mostly due to improvement of its transport infrastructure.

The weakening of the hryvnia during the crisis had a beneficial effect on the competitiveness domestic manufacturers' products on overseas markets. Imports and exports of goods account for the vast majority of favorable economic figures coming out of Ukraine. The country's main import partners are Russia, China, Germany, Belarus and Poland while its main export partners are Russia, China, and Turkey.

The nation's main imports are energy, mineral products, automobiles, machinery, transportation equipment, chemicals, and textiles, while its main exports are grain, ferrous metals and metal products, transport and mechanical equipment, chemicals, fuel and petroleum products, vehicles and food products.

Despite the country's excellent prospects, several factors have restrained the inflow of investments into Ukraine. Like any growing transitional economy, there are several ongoing problems, including structural and political issues (mainly related to overcoming the global and local financial crises), along with issues related to the privatization (or re-privatization) of enterprises and a lack of clear guidance on taxation issues. Other factors include inconsistency in the most crucial economic decisions (such as the regulatory approval system and legislation), the shortcomings of the judicial system, the instability of the national currency and weak liquidity in the stock market.

Ukrainian GDP experienced a recovery in 2011, rising 5.2%. However, growth stagnated again in 2012, amounting only to 0.2%. Experts predict no growth in 2013.

Loans from world's financial organizations helped Ukrainian economy to survive also helping the banking system to escape crash. As a result, the size of the national debt owed to the IMF amounts to USD 8 billion. Ukraine's national debt has been gradually increasing over the past several years, and now amounts to USD 64.4 billion. Business activity, which was recovering during 2011, slowed down in 2012 in line with the overall European recession.

# Regulatory environment

One of the major problems of the Ukrainian business climate is the very complex and not always favorable tax legislation, which is a major reason for the suspension of investment projects or for international companies to refrain from entering the Ukrainian market. The adoption of a Tax Code that, for the first time since independence, brings together Ukrainian tax legislation in its entirety was a breakthrough event. The Code adjusts the rates and benefits, as well as the process of tax imposition. At the same time, the adoption of the Tax Code will hopefully help resolve one of the main problems companies operating in Ukraine encounter, i.e., the issue of timely VAT recovery.

The fact that the document was adopted during economic stabilization also raises hopes. Companies have started recovering ground in the wake of the crisis – in 2012 industrial production volumes increased by over 10%, export operations have grown by nearly 30%, and investment volumes have also increased (the volume of private investments into Ukraine over 2012 was about USD 6 billion). The labor market has seen a slight improvement and the currency stabilized. Manufacturing, transportation and telecommunications have all managed to adapt to the new realities, and are recovering their positions.

However, it is the agricultural sector that has demonstrated the most dynamic growth, with a couple of agro companies even having listed their shares on western stock exchanges.

Yet, despite all the good news, the current economic recovery remains quite shaky. Much will now depend on how Ukraine copes with the transitional stage following the introduction of its new tax legislation.

We will need to see how the rules and regulations of the Tax Code work in practice, whether representatives of the international business community have faith in the rule of law in Ukraine, and whether new developments are consistent and see the widespread adoption of regulatory documents.

Please note that the information included in this publication is not exhaustive, and is based on the laws of Ukraine as of 01 July 2013. There is new legislation still pending while this document is being prepared, but which may come into force at the moment of publication. The new law on transfer pricing was signed by the President on 31 July 2013. Some amendments on payroll taxes and personal income tax rates are being discussed. Please contact our professionals to get the latest update.



## Investment in Ukraine

### General rules governing investment activities in Ukraine

This guide will start by outlining the provisions of Ukrainian legislation that concern investment activities in Ukraine. In particular, we provide the definition of the term “foreign investment” and describe the types of foreign investment that may be made in Ukraine, as well as detailing the formal procedure for registering foreign investments. This guide will also outline the general privileges and state guarantees available to companies that receive foreign investment.

### Definition of a foreign investment, types of investments and methods of investing

Ukrainian legislation defines the term “foreign investment” as a direct contribution by a foreign investor to an investment target, with the aim of receiving income or “having a social effect” (e.g., non-profit organizations). A company in receipt of foreign investment is any company or organization, established in accordance with Ukrainian legislation in any organizational or legal form, with 10% or more of its authorized share capital made up of foreign investments.

The law also provides for investors to make several types of investments in Ukrainian companies, which include, but are not limited to, investments in the form of foreign or local currency, movable and immovable property and related proprietary rights, shares, bonds, other securities and corporate rights expressed in foreign currency. Foreign investors usually choose one of the following options when entering the Ukrainian market:

- acquisition of shares in an existing company owned by Ukrainian legal entities and/or individuals;
- acquisition of shares in a company that is already wholly-owned by foreign investors;
- establishment of a representative office or another form of separate subdivision of a foreign legal entity.

### State registration of foreign investments

In most cases, Ukrainian legislation requires that foreign investors make investments through investment accounts opened with authorized Ukrainian banks. It is important to note that foreign currency contributed into Ukraine as an investment must be converted into local currency.

If the share of a non-resident in the authorized share capital of a Ukrainian company exceeds 10%, the company may obtain the status of a “company with foreign investments”, provided that it completes the appropriate formalities with regard to registration. Foreign investors are entitled to certain privileges and guarantees that under Ukrainian legislation are granted to companies with foreign investments, provided that all foreign investments contributed to their authorized share capital are registered with the state administrations and the tax authorities.

<sup>1</sup> For additional information on joint-stock companies, please refer to the Types of Legal Entities section of this guide.

Table 1

Popularity	Type of business	Primary characteristics/requirements
1	Limited liability company	Charter required, limited liability, capital divided into shares (units), may be established by one person
2	Public or private joint-stock company <sup>1</sup>	Charter required, limited liability, issues shares, may be established by one person
3	General partnership	Unlimited personal liability, partnership agreement only, at least two partners (very rarely used in practice)
4	Limited partnership	Limited liability partners and at least one general partner (unlimited liability), at least two partners (very rarely used in practice)
5	Company with additional liability	Personal liability limited by foundation documents, charter, may be established by one person (very rarely used in practice)
6	National and local state enterprise	Owned by local and state governmental bodies
7	Sole proprietorship, private enterprise, family enterprise, other entities	Single owner and single employee; single owner and multiple employees; multiple related owners

### Types of businesses

Ukrainian legislation provides for a number of different forms of a legal entity for carrying out business activities, which we have summarized in table 1 above. Foreign companies doing business in Ukraine most commonly take the form of:

- legal entities (primarily, limited liability companies, public and private joint-stock companies);
- joint ventures (especially in the oil and gas exploration sector);
- representative offices (common for foreign companies that are only looking to perform marketing, promotional and other auxiliary activities).

Foreign investors that plan to carry out active business operations may choose to establish a legal entity in Ukraine, instead of merely a representation.

If a foreign investor chooses to do business in Ukraine in a form other than a legal entity, it is important to determine whether that foreign company's presence in Ukraine would lead to the creation of a permanent establishment (PE) under Ukrainian tax and foreign currency legislation. For an additional discussion of PEs, please refer to the Taxation of Non-Resident Entities section of this guide.

### Representative offices

A representative office of a foreign business in Ukraine is not a legal entity, but rather an "extension" of its parent company. A representative office may either represent its foreign parent company on the market and carry out various auxiliary activities, or carry out business (commercial) activities that may give rise to a taxable permanent establishment.

It is also possible to perform certain types of business activities in Ukraine without establishing a representative office or any other formal presence in the country. Examples of this would include one-time contracts or joint production agreements with Ukrainian partners. Representative offices that do not carry out business activities and simply function as the representation of a legal entity ("non-commercial representative offices") are only required to register with the Ministry of Economic Development and Trade of Ukraine (hereinafter, the "Ministry of Economy" or "MEU"). However, in practice, non-commercial representative offices also do register with the tax authorities and social security funds. Unlike non-commercial representative offices, PEs ("commercial representative offices") are required to register with the local tax authorities and social security funds. Due to some ambiguity in the legislation, PEs are usually registered with the MEU as well.

### Registration procedure

Representative offices are legally obliged to register with the MEU, while they may also choose to register with the tax authorities.

The registration process for representative offices involves the following steps:

#### • MEU;

- filing of a set of registration documents, as required by law, and payment of a state registration fee (USD 2,500);
- examination of the documents by the MEU (within 60 working days);
- approval or rejection of the registration (may be appealed in court);
- upon approval, inclusion into the Unified Register of Representative Offices and issuance of a Registration Certificate;
- if a representative office constitutes a taxable PE, then it is obliged to register with the tax authorities (if this has not been done already) and State Statistics Service of Ukraine within 10 days;
- approval of a design of the official company seal and opening of bank accounts for the company.

Upon completion of the above formalities, a registered entity has the right to apply to:

- the respective departments of the Ministry of Internal Affairs to obtain visas for and register the passports of its employees;
- traffic police offices to register vehicles owned by the representative office.

#### • State tax authorities

- a representative office must file the required documents with the tax authorities in the region/district in which it is located;
- within five days of submitting the documents, a tax officer will examine them for compliance with legal requirements and make a decision on whether to approve or reject the registration;
- within 20 days of a positive decision, the tax authorities will issue a tax registration number to the representative office and include it in the Unified State Register of Enterprises and Organizations;
- the tax authorities issue a Certificate of Registration for a corporate income taxpayer;
- after registration with the state tax authorities, the representative office will also be required to register with the pension fund, open a bank account and obtain a seal.

### Legal entities

The two most common types of legal entities envisaged under Ukrainian law are limited liability companies and joint-stock companies. The latter may be public or private.

The main legislative acts regulating these types of legal entities are the Civil and Commercial Codes of Ukraine and the Laws of Ukraine “On Business Entities” and “On Joint-Stock Companies”.

The Law of Ukraine “On Joint-Stock Companies” was adopted on 17 September 2008, and came into effect on 30 April 2009. The law introduced new terminology, such as the use of the terms public and private to describe joint-stock companies, instead of open and closed. According to the law, open and closed joint-stock companies should have reregistered as public and private joint-stock companies within two years of this law coming into force (i.e., by 30 April 2011).

<sup>2</sup> Starting from 1 December 2013, the minimum wage will be UAH 1,218

The main legislative requirements for joint-stock companies remained intact. However, the law also introduced a number of procedural issues and mechanisms to protect shareholders. Moreover, according to the law, when establishing a public joint-stock company, a private joint-stock company should first be established, which is then reorganized into a public joint-stock company by way of a public share issue.

A Ukraine-based company or partnership is considered to be a legal entity upon its state registration. A Ukrainian business is established and operates on the basis of the constituent (foundation) document, i.e., the Charter. A constituent document should contain the specific information required by law for each type of business. It should be noted that a Ukrainian entity (either a limited liability company or a joint-stock company) may not have a sole founder, if 100% of the founder is owned by single company.

Generally speaking, Ukrainian legislation does not contain any restrictions or limitations on the level of foreign investments or shared membership by a foreign investor in a Ukrainian business. However, there are some restrictions on foreign ownership in certain highly regulated businesses (e.g., insurance companies, publishing companies, television, etc.). These restrictions should be accounted for prior to investing in Ukraine.

### **Public joint-stock companies (Publichne Aktsionerne Tovarystvo)**

The main difference between public joint-stock companies and private joint-stock companies is that the shares of private joint-stock companies are distributed exclusively among the founders, while the shares of public joint-stock companies are offered for public subscription or may be sold publicly on the stock market.

A public joint-stock company (PJSC) may have an unlimited number of shareholders. Subject to elaborated disclosure requirements, PJSCs are the only form of a legal entity whose shares may be openly traded and, thus, are similar to “public” companies in the usual sense.

The minimum authorized share capital for these companies is set at 1,250 minimum monthly wages (as at 1 January 2013, the minimum monthly wage is fixed at UAH 1,147)<sup>2</sup>.

### **Private joint-stock companies (Pryvatne Aktsionerne Tovarystvo)**

The most common type of a joint-stock company is a private joint-stock company (PrJSC). According to effective legislation, an owner of shares in a PrJSC is limited in terms of transferring its shares to a third party, unless consent has been obtained from the PrJSC’s other shareholders.



PrJSCs are among the most popular corporate vehicles for foreign investors in Ukraine, along with limited liability companies. The main features of these companies are:

- shareholders are not liable for the obligations of the company, and bear the risk of losses only to the extent of the value of their shares (limited liability);
- prJSCs may be involved in any type of activities, provided that the activity in question is not directly prohibited by law;
- the minimum authorized share capital of a PrJSC is determined in the same way as for a PJSC;
- the frequency of shareholders' meetings is established by the charter, but must be at least once a year. Among other things, the shareholders' meeting is responsible for electing a Supervisory Board to represent shareholders' interests;
- the company is established for an indefinite period, unless otherwise stipulated by the charter;
- the day-to-day management functions of a PrJSC are performed by the entity's Board of Directors (or Director). There are no legislative limitations on the number of members of the Board of Directors;
- the founders have to pay at least 50 % of the value of the authorized share capital, in order for the company to be allowed to perform activities other than those linked to its foundation. According to the Law of Ukraine "On Joint-Stock Companies," shareholders may use cash funds, property, property and non-property rights, securities (except for promissory notes or any debt securities issued by the PrJSC) as a means of paying for their share in the authorized share capital of the PrJSC;
- an Audit Committee controls the activities of the Board of Directors;
- net (after-tax) profits of a PrJSC are normally distributed between its shareholders on a pro rata basis, according to the company's shareholding structure.

Both public and private joint stock companies may issue ordinary and preferential shares. Unlike ordinary shares, there may be various classes of preferential shares that grant different rights to their owners. All ordinary shares issued by JSC have equal voting and distribution rights.

Unlike shares (participation) in the LLC, shares in a joint stock company, as securities, may be effectively pledged.

If a joint stock company (either public or private) has more than 10 shareholders, establishment of a Supervisory Board is obligatory.

#### Limited liability companies (Tovarystvo z Obmezhenoju Vidpovidalnistyu)

Along with PrJSCs, limited liability companies (hereinafter, "LLCs") are among the most popular forms of doing business in Ukraine. As with PrJSCs, the shares of an LLC cannot be transferred without the consent of the other shareholders. At the same time, the financial and reporting requirements to an LLC are less burdensome than those to a PrJSC.



The main features of an LLC are as follows:

- participants in an LLC have limited liability, which does not exceed their contribution to the company's authorized share capital;
- the founders of an LLC have to pay at least 50 % of the company's declared authorized share capital prior to its state registration. Contributions to an LLC's authorized share capital can be made in cash, property, securities, property or other alienable rights that have a monetary valuation;
- the highest management authority of an LLC is its General Meeting of Participants. The frequency of meetings of the participants should be stipulated by an LLC's Charter. At the same time, the effective legislation stipulates that meetings of the participants should be held at least twice a year. Additional meetings may be held when required. Responsibility for the day-to-day activities of an LLC rests with its General Director/Director;
- shareholders are obliged to pay the full value of their shares within one year of the company's state registration;
- net (after-tax) profits of an LLC are normally distributed among its participants on a pro rata basis, according to the stake of each participant in the company;
- there are no legal restrictions on the amount of authorized share capital of an LLC.

### Special regulation regarding the acquisition of land plots

Ukrainian law has regulations aimed at protecting land (which is considered to be the property of the Ukrainian people, in accordance with the Ukrainian Constitution) and its designated usage. First of all, the current Moratorium on the Sale of Agricultural Land prohibits any sale of agricultural land until the law on land market comes into force, but no earlier than 1 January 2016. Second, according to Ukrainian legislation, foreign legal entities are entitled to purchase any plot of land situated in Ukraine (which is for sale) subject to the following conditions:

- in inhabited areas, if the plot of land in question is purchased along with any associated real estate assets, or if the land is purchased with a view to the construction of real estate assets that will be used in the course of business activities;
- outside of inhabited areas, if the plot of land is purchased along with any associated real estate assets.

Meanwhile, Ukrainian legal entities (those established by Ukrainian citizens or legal entities) are entitled to purchase any plots of land except when forbidden by the abovementioned Moratorium.



### Currency control

The hryvnia (UAH), the Ukrainian currency, has limited convertibility. Residents and non-residents may hold hard currency and UAH accounts with authorized banks, and may import and exchange currency in accordance with the procedures established by the National Bank of Ukraine (NBU). However, currency operations that take place in Ukraine fall under the state currency control regulations, a key feature of which is the concept of residency.

For the purposes of currency regulations and control requirements, a resident of Ukraine is defined as follows:

- any person, including foreign citizens, permanently residing in Ukraine;
- legal entities, representative offices or other structural subdivisions thereof, located and performing business activities on the Ukrainian territory;
- Ukrainian diplomatic, consulate, trade and other official governmental institutions abroad that enjoy diplomatic privileges and immunity;
- representative offices or other structural subdivisions of Ukrainian companies and organizations abroad, if these subdivisions perform representative functions only and are not engaged in business activities.

Any other person or structural subdivision that is not a resident of Ukraine is treated as non-resident for exchange control purposes. Stricter currency restrictions are imposed on residents than on non-residents.

In particular, foreign currency control regulates the following relations:

- in general, only local currency may be used in business transactions between residents;
- the means of payment between residents and non-residents involved in international transactions, in connection with trade and investment activities, is generally taken to be foreign currency;
- foreign currency proceeds received by a company from its foreign clients must be credited to a local bank account within 90 days of the export date of the services or goods in question. Failure to comply with this provision will result in the Ukrainian company being liable to pay a penalty of 0.3% of the non-received proceeds for each day of the delay;
- Goods must be imported into Ukraine within 90 days from when prepayments were made by a Ukrainian company to its suppliers. Failure to comply with this provision will result in the Ukrainian company being liable to pay a penalty of 0.3% of the non-received proceeds for each day of the delay.

Certain other transactions involving local and foreign currency are subject to licensing by the National Bank of Ukraine (e.g., settlements made in foreign currency on Ukrainian territory). Ukrainian residents are also required to obtain an individual license to make investments abroad. Investing abroad includes purchasing securities issued by foreign entities, opening an account with a foreign bank and issuing or taking out foreign-currency loans. If one party to a currency transaction has obtained the required license, the other party is also treated as having acquired it.

These licenses are issued for a limited period, and with a limited amount of foreign currency specified. The procedure for obtaining an individual license is quite onerous, and requires a specific set of documents to be submitted to the NBU for approval. Normally, a license can be obtained within 4-6 weeks of filing the required set of documents with the NBU, unless the NBU finds sufficient grounds to reject the application.

The NBU establishes the exchange rates of UAH to other currencies on a daily basis.

## Labor issues

### Immigration requirements.

#### **Visa and Temporary residency permit**

Depending upon the purpose of a foreign citizen's visit to Ukraine, they may normally apply for the following types of visas:

*Transit B-type* visa is issued to expatriates for transit visits through the territory of Ukraine.

*Short-term C-type* visa is issued to expatriates for short-term visits for single-, double-, multiple-entries for private, tourist, educational purposes. This visa enables expatriates to enter Ukraine for a period of 90 days within 180 days after the day of the first arrival. The C-type visa can be obtained subject to an invitation letter issued either by a Ukrainian company or a Ukrainian national, and duly registered with the State Migration Service of Ukraine.

*Long-term D-type* visa is issued for a period of 45 days, is single-entry, and serves as the only basis on which a foreign national may apply for a Temporary Residence Permit (TRP), which provides for the right to stay in Ukraine for more than 90 days. During the visa validity period, which is 45 days, an expatriate has to obtain a TRP. The following documents serve as the grounds for applying for a D-type visa: work permit, duly approved invitation letters from a hosting company (e.g., an invitation from the Ukrainian subsidiary of an international bank approved by the National Bank of Ukraine; invitation from a representative office, which is registered in Ukraine, approved by the Ministry of Economy of Ukraine, etc.).

Generally, citizens of the EU, USA, Japan and Canada do not require a visa to enter Ukraine, unless they stay longer than 90 days within a 180-day period. Since 2009, control over the Ukrainian immigration

rules has increased significantly. As a result, a stay of longer than 90 days in a 180-day period requires an individual to complete registration procedures with a special body of the Ukrainian Ministry of Internal Affairs called State Migration Service of Ukraine (hereinafter, the "Immigration Authorities").

All companies or representative offices wishing to invite and employ foreign individuals should be registered with the Immigration Authorities and have to receive a work permit or service card, respectively, for every expatriate. Based on the obtained work permit/service card and long-term D-type visa, foreign individuals are eligible to apply for a Temporary Residence Permit.

After obtaining a TPR, the holder of a long-term D-type single-entry visa will need no visa to travel freely in and out of Ukraine.

Family members accompanying foreign individuals during their assignment in Ukraine are also eligible for obtaining a TRP on the basis of the expatriate's documents.

The TPRs are issued in special circumstances, mainly in cases of permanent immigration to Ukraine.

The above provisions are subject to further development. An active dialog between the business community and the Ukrainian government on this issue is still in progress.

### **Work permit**

Foreign individuals working in Ukraine are required to obtain a work permit from the Ukrainian Employment Center. The only exceptions to this rule are employees of representative offices, who are required to obtain a Service Card from the MEU.

Work permits are issued for one year and can be renewed for the same period. The law states that, prior to the start of employment, a Ukrainian employer should apply for a work permit and provide the relevant set of documents. A special Employment Center committee will examine the documents and decide whether or not to issue a work permit at a meeting that takes place once every two weeks. If the committee refuses to issue an employee a work permit for specific reasons, the employer is entitled to re-submit the documents once the reasons for the refusal have been addressed.

Strict penalties may apply in cases where a foreign individual is working in Ukraine without a work permit. In particular, an employer might be subject to fine in the equivalent of 20 minimum wages (approx. UAH 18,820 or USD 2,350), which is subject to change during a calendar year, for each foreign national working without a work permit. The company could also be deprived of the right to employ foreigners for at least one year.

A foreign individual, who works without a valid work permit, might be subject to:

- administrative penalties – may reach from 30 up to 50 non-taxable minimums;
- as an extreme measure – deportation at the employer's expense, with no right to enter Ukraine for up to 6 years following the date of deportation. However, this type of liability is rarely used in practice.

A foreign individual working in Ukraine should also be registered with the state immigration authorities and be in possession of a long-term D-type visa (please see details in the Regulatory Environment section above).



# System of taxation

## General principles

Ukraine adheres to the European (continental) legal system. The Ukrainian parliament (the Verkhovna Rada) is the only authority that has the right to establish laws. There is no court precedent doctrine in Ukraine and, therefore, court decisions may be regarded as recommendations and references only.

As required by the Ukrainian Constitution, any taxes or levies envisaged under the Ukrainian tax system, including sanctions for tax violations, may only be established as a result of legislation enacted by the Verkhovna Rada. The Verkhovna Rada may not delegate its constitutional powers to establish a tax system, taxes or levies, or sanctions for tax violations, to the government or any other authority.

In accordance with the Constitution, all laws, and tax laws in particular, only come into effect after being published in accordance with due procedure (i.e., after having been approved in a third reading by the Verkhovna Rada and signed by the president).

Tax laws that fundamentally amend the tax regime come into effect from 1 January of the year following that in which they were adopted, provided that this occurred before 1 June. However, this rule is often violated. Furthermore, newly adopted tax laws are not retroactive, unless they increase benefits for taxpayers and their application to previous tax periods is clearly stipulated.

In December 2010, the Tax Code of Ukraine (the "TCU" or the "Tax Code") was adopted and officially published. The TCU became effective on 1 January 2011, although some of its provisions came into force at a later date (the most important of these being Section III, which deals with corporate income tax, and which came into effect on 1 April 2011). The Tax Code made essential changes to the existing Ukrainian tax rules, introducing a number of concepts common in other jurisdictions (e.g., beneficial ownership, substance over form) to various degrees.

In addition to codifying existing tax principles, the TCU introduced a new property tax, which had not previously been levied in Ukraine. For more detailed description of the rates and tax base for property tax, please refer to the section Personal Income Tax below.

## Tax System

The list of Ukrainian taxes, levies, and general tax principles is established by the TCU. In accordance with the Tax Code, all taxes and levies are classified as either state or local. State taxes are payable to state budgets, while local taxes are payable to local municipalities (city, regional or specific district councils).

As a basic legal principle, taxes and levies, as well as all rates, tax collection procedures and incentives, may only be established in accordance with the TCU (as amended from time to time).

The Tax Code provides for the following major taxes and duties (obligatory payments):

- corporate income tax (CIT);
- fixed agricultural tax (FAT, applicable to agricultural producers only, as an alternative to CIT and certain other taxes and duties);
- value-added tax (VAT);
- personal income tax (PIT);
- excise duties (including a special duty in respect of securities);
- customs duties;
- state duties;
- land tax;
- property tax;
- payments for licenses/patents;
- other taxes and duties (including local taxes and duties, such as the unified tax, parking duties, recreation duties, etc.).

In addition to the duties outlined in the Tax Code, Ukrainian taxpayers are required to remit obligatory Unified Social Security Contributions.

Control over compliance with tax legislation is exercised by the tax authorities, based on the provisions of the TCU. Control over compliance with legislation on the Unified Social Security Contributions is vested in the Ukrainian Pension Fund, on the basis of the Law "On Collecting and Accounting for Unified Social Security Contributions to Compulsory State Social Insurance".

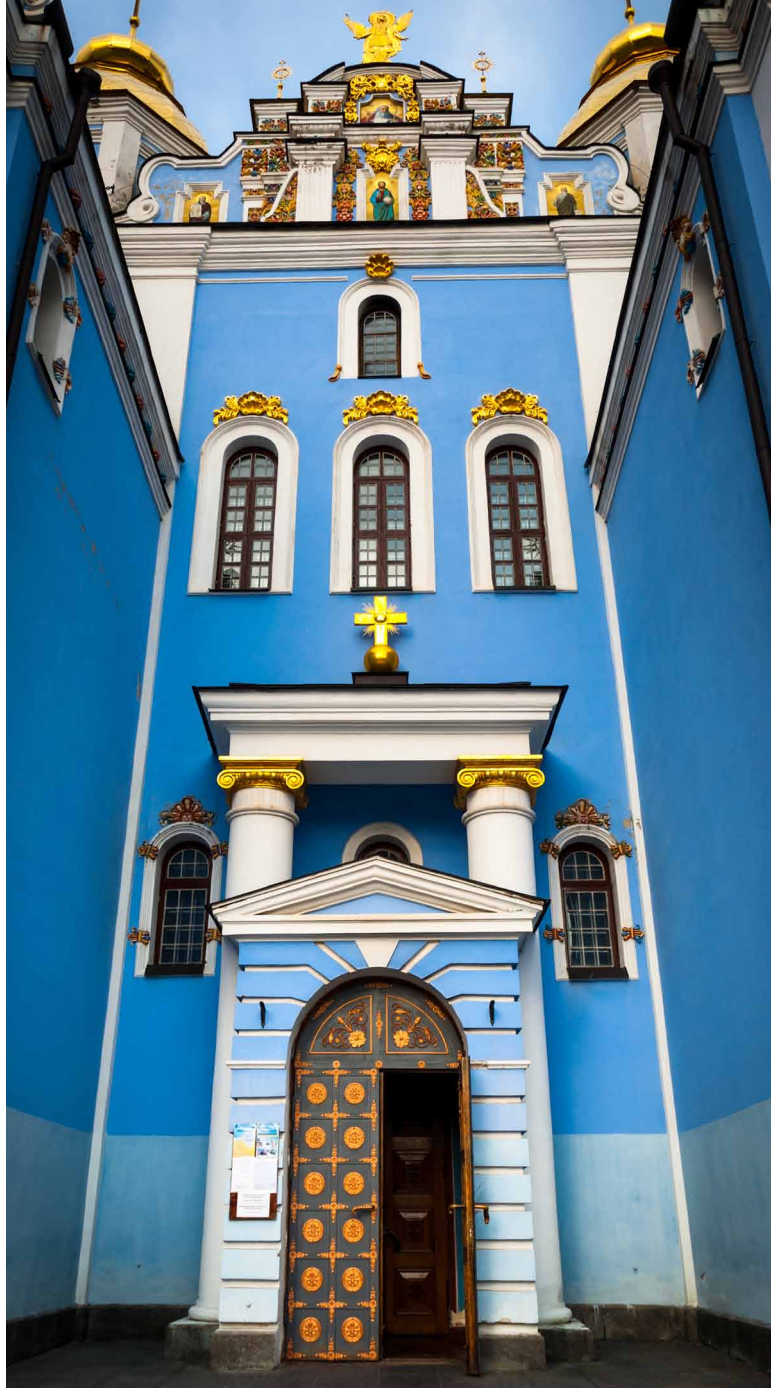
Tax returns are filed on a monthly (VAT), quarterly or annual (CIT) basis, either in person, by mail (at least 10 days prior to the filing deadline), or electronically (electronic filing is compulsory for large and medium-sized taxpayers).

Ukrainian tax legislation states that any disputed provisions of the tax legislation should be interpreted in favor of the taxpayer. If any provision of the TCU or related regulatory acts, or provisions of other laws or regulatory acts, contain an ambiguous/conflicting interpretation of the taxpayer's or the tax authorities' rights and obligations, which could result in a decision in the taxpayer's or the tax authorities' favor, respectively, any decision is to be made in favor of the taxpayer. However, please note that court decisions are often required to resolve such disputes.

### **Beneficial owner concept**

The TCU also introduced the concept of a beneficial owner of Ukrainian-sourced income. In order to qualify as the beneficial (actual) owner (recipient) of Ukrainian-sourced income (dividends, interest, royalties, fees, etc.) for a non-resident, they should be legally and factually entitled to receive the income in question. The actual entitlement may be analyzed by the tax authorities in each particular case.

A legal entity or individual who acts as an agent or nominee/nominal owner, or who is recognized as an intermediary, may not be regarded as the beneficial owner of income, even if they are entitled to receive the income in question.



# Tax administration

## Tax rulings

Tax advice/rulings may be provided by the tax authorities upon an individual request from a taxpayer within

30 calendar days. This advice will set out the tax authorities' opinion on the way a tax law should apply in that particular taxpayer's case, and in relation to a specific regime or circumstances only. Thus, no tax advice from the authorities should be cited or relied upon as a precedent.

A tax ruling safeguards the taxpayer from the application of fines and penalties in cases where tax authorities have wrongly interpreted provisions of the Tax Code. However, it does not safeguard the taxpayer from tax liabilities.

The taxpayer may challenge the tax advice provided in court, where a decision in favor of the taxpayer would serve as grounds for the tax authorities to change their conclusion and reissue the tax ruling.

## Penalties and late-payment interest

The penalties for violations related to the accrual, withholding and payment of taxes depend on the frequency of violations during a period of 1,095 consecutive days (statute of limitations for tax purposes), as follows:

- 25% for the first violation;
- 50% for the second violation;
- 75% for the third and any subsequent violation.

The same fines (25%, 50%, and 75%) apply in cases of overstatement of VAT receivables, VAT refundable or net tax losses, during the abovementioned 1,095-day period (i.e., fines may be imposed even in cases where no tax liabilities are accrued).

The fines for the correction of self-identified errors are as follows:

- 3%, if an error from a previous period is corrected by filing an amended tax return (filing an amended tax return is a basis for the tax authorities to perform an unscheduled field tax audit);
- 5%, if an error from a previous period is corrected by amending the tax return for the current period.

The fines for the violation of tax payment deadlines are as follows:

- 10%, if tax is overdue for less than 30 days;
- 20%, if tax is overdue for 30 days or more.

During administrative appeal proceedings, the obligation to substantiate decisions of the tax authorities lies with the tax authorities themselves, and not with a taxpayer.

Taxpayers have the right to challenge tax authorities' decisions to accrue tax liabilities and impose penalties up to the highest level of the tax authorities and/or the courts. When an appeal is made to the highest level tax authorities, there is no obligation to pay penalties, while an appeal to a court will result in the settlement of any penalties. When a court decision is issued in favor of a taxpayer, penalties paid by the taxpayer will be regarded as a tax overpayment and returned to the taxpayer's bank account or settled against its existing tax liabilities.

Late payment interest (LPI) is applied to the period during which a taxpayer challenges the tax authorities' decision in court or to higher tax authorities. Upon a decision in favor of the taxpayer, the accrued LPI is cancelled.

## Tax audits

The durations of the most common types of tax audits are outlined in table 2 below:

Table 2

Type of tax audit	Large taxpayers	Small taxpayers	Other taxpayers
Scheduled	30 business days, with a possible extension of up to 15 business days	10 business days, with a possible extension of up to 5 business days	20 business days, with a possible extension of up to 10 business days
Unscheduled	15 business days, with a possible extension of up to 10 business days	5 business days, with a possible extension of up to 2 business days	10 business days, with a possible extension of up to 5 business days
Factual	10 calendar days, with a possible extension of up to 5 calendar days		

Types of tax audits:

- desk audits;
- regular audits (scheduled or unscheduled; field, in-house and electronic);
- factual audits (at the location where a taxpayer actually performs its business activities; may be carried out without providing the taxpayer with prior notice).

Electronic audits shall be conducted for the following taxpayer categories:

- from 1 January 2014 for taxpayers that use the simplified tax regime;
- from 1 January 2015 for micro-, small and middle taxpayers;
- from 1 January 2016 for other taxpayer categories.

The frequency of scheduled regular audits depends on the risk level of the company's activities (as of 1 January 2011, the TCU provided no risk assessment criteria):

- high – once per calendar year;
- medium – once every 2 calendar years;
- low – once every 3 calendar years.

In accordance with the current Ukrainian legislation, the statute of limitations for tax purposes in Ukraine is three years (1,095 days), starting from the deadline for submission of the respective tax return or a later date when the tax return is actually submitted.

In general, periods that have been audited by the tax authorities are considered "closed", and may not be

reopened for further tax audits in the future (unless criminal proceedings are initiated against a tax officer who conducted the tax audit of the entity, or against an official of that entity).

The statute of limitation period does not apply to tax periods for which a tax return was not filed or deliberate tax evasion was committed, as proved before a court.

## Tax liens

Tax liens are applicable when:

- a taxpayer fails to pay the self-assessed amount of tax liabilities stated in the tax return within the timeframes specified in the TCU, starting from the day that follows the specified deadline; and
- when a taxpayer fails to pay the tax liability assessed by the tax authorities within the timeframes specified in the TCU, starting from the day the tax debt arises.

Tax liens may be applied to any property that is owned by a taxpayer (is under the taxpayer's economic management or operating control), on the day when the tax lien becomes applicable, and where the book value of the property in question corresponds to the amount of the tax owed by the taxpayer, as well as to other property that the taxpayer will acquire the title to in the future.

The seizure of property should be confirmed by a court decision within 96 hours, while funds should only be collected from the taxpayer's bank account on the basis of a court decision.

# Corporate income tax (CIT)

Please note that all of the tax rules described in this section are applicable from 1 April 2013.

## Tax jurisdiction

Legal entities incorporated and operating in accordance with the provisions of Ukrainian legislation are normally treated as tax residents, and are taxable on their worldwide income.

Legal entities incorporated abroad and operating according to the laws of another country are normally treated as foreign tax residents (non-residents), and are taxable on two sources of income:

- business income received in the course of carrying out trade or business activities in Ukraine;
- other non-business income from Ukrainian sources.

Resident companies shall pay corporate income tax (CIT). Currently, CIT is calculated at a flat rate of 19%. The rate of 16% will be in effect from 1 January 2014. Lower rates apply to certain types of businesses (e.g., insurance, agriculture, IT industry, etc.).

A special 10% CIT rate applies to transactions on the sale, exchange or other disposal of securities, and transactions with derivatives.

## Taxation of resident entities

### Tax accounting rules

According to domestic tax accounting rules, taxable items are normally recognized on the accrual basis. In accordance with this method, taxable income is generally recognized in the reporting period in which it was earned, pursuant to relevant accounting standards.

In general, deductible expenses are recognized when they are incurred (i.e., upon receipt of goods or services), regardless of the period of payment. However, certain types of taxable income are recognized on a cash basis.

These include fines and repayable financial aid received from non-residents (unless financial aid is provided by the company's shareholders and returned within 365 days).

## Reporting periods

The CIT reporting period is a calendar year. CIT is paid by means of monthly advance payments if taxable income for the previous year exceeds UAH 10 mln.

In 2013, taxpayers are obliged to make CIT advance payments as follows:

- In January-February: not less than 1/9 of the CIT liability reported in the tax return for 9 months of FY12;
- In March-December: not less than 1/12 of the CIT liability reported in the annual CIT return for 2012.

Advance CIT payments shall be made within 20 days following the reporting month.

If a taxpayer reported annual taxable income of less than UAH 10 mln or incurred tax losses for the previous year, such taxpayer shall submit quarterly CIT returns in the following year and shall be exempt from advance CIT payments.

If a taxpayer that was profitable in the previous year incurs losses in the first quarter of the reporting year, such taxpayer shall be entitled to submit quarterly CIT returns and shall be exempt from advance CIT payments in the second, third and fourth quarters of the reporting year. Quarterly tax returns must be submitted within 40 days of the last calendar day of each reporting period (i.e., 10 May, 9 August, 9 November, 9 February). Quarterly tax payments should be made within 50 days of the end of a reporting period.

If the filing deadline falls on a holiday or a weekend, it is automatically moved to the next business (i.e., banking) day.

### **Taxable income**

Resident entities are taxed on the worldwide income they receive or accrue within the reporting period.

The amount of taxable income is determined by subtracting the cost of sales and other allowed deductible expenses from taxable income.

Depreciation charges are included in deductible expenses. A taxpayer shall maintain separate accounting for transactions with listed securities and for transactions with securities that are not listed on the stock exchange. Income from transactions with listed securities cannot be decreased by expenses or losses from unlisted securities and principal activities, and vice versa.

### **Gross taxable income**

Gross taxable income is defined as any income from domestic or foreign sources that is received or accrued by a taxpayer in the course of conducting any activities. Such income may be in monetary, tangible or intangible form.

**Specifically included income** – The following items are specifically included in taxable income (please note that the list is not exhaustive):

- sales or exchanges of goods and services;
- income of banking institutions, insurers and other financial services providers; currency sales, and sales of securities and debt instruments
- property and services provided free of charge, non-refundable financing (except for financing provided to non-profit organizations), and refundable financing received during the reporting period from non-CIT payers, which is not repaid by the end of that period;
- dividends from non-resident companies (except for dividends received from non-resident entities controlled by taxpayers who are not located in offshore jurisdictions);
- interest income and royalties;
- any contractual fines and penalties incurred;
- foreign exchange gains, estimated according to National Accounting Standards.

**Specifically excluded income** – The following items are specifically excluded from gross taxable income (please note that the list is not exhaustive):

- advances and prepayments;
- VAT assessed by taxpayer on supplied goods/services;
- dividends received from resident companies as well from certain qualifying non-resident companies;
- cash or in-kind contributions to an entity or partnership, in exchange for an equity interest therein, irrespective of whether or not the investor acquires a controlling interest following this contribution;
- cash or property received upon the complete liquidation of a company or partnership, as long as the value of the cash or property received does not exceed the initial acquisition cost of the shares held in the liquidated entity;
- share premiums received.

### **Tax cost of sales and other deductible expenses**

The Tax Code provides for gross taxable income to be reduced by the tax cost of sales and other deductible expenses to calculate taxable income.

**Specifically included expenses** – The following items are specifically included in deductible expenses (please note that the list is not exhaustive):

- operating expenses, including:
  - tax cost of goods (work and services) obtained by/ provided to a taxpayer for subsequent use in business activities (direct material costs, direct labor costs, depreciation and maintenance of productive fixed and intangible assets, cost of acquired services related to business activities, and other direct costs);
  - banking expenses (i.e., interest expenses, commission fees, forex losses, etc.);
  - fixed manufacturing overhead costs;
  - administrative costs (any expenses related to “startup, management and carrying out business activities,” administration salaries, rental costs, depreciation and maintenance of business premises);
  - marketing and advertising expenses;
  - other operating costs, including taxes and obligatory payments accrued during the reporting period (except for CIT, VAT input and certain other taxes), and foreign exchange losses;
- financial expenses, including interest on loans, leased items and debt securities.

**Generally non-deductible expenses** – Deduction of the following expense items is specifically prohibited by the Tax Code (please note that the list is not exhaustive):

- any expenses not related to business activities;
- expenses for receptions and celebrations;
- advances and prepayments made;
- CIT payments and VAT on purchased goods and services;
- fines and penalties;
- dividend payments;
- losses resulting from exchanging or selling goods and services to related parties at the price that is below fair market value.

#### Expenses, for which deductibility is limited

##### Deductibility of interest expenses

Any interest expenses incurred by a taxpayer in the course of carrying out business activities are generally deductible. However, interest deductibility limitations do apply to resident taxpayers in the following circumstances:

- a taxpayer is an entity with 50% or more of its statutory capital owned or managed, directly or indirectly, by a non-resident;
- a loan is provided by the non-resident entity in question, or by a related party of the non-resident.

In this case, the deduction of interest expenses is limited to the amount of interest income plus 50% of net non-interest taxable income. Excess interest expenses can be carried forward without limitation and deducted in subsequent tax periods, subject to the same limitations.

##### Offshore restrictions

As an anti-avoidance measure, Ukraine has established restrictions on the deductibility of expenses incurred by resident taxpayers as a consideration for goods or services received from or provided by non-resident entities located in offshore jurisdictions.

The restriction applies to expenses incurred in making payments to non-residents with offshore status, or settlements made through such non-resident/its bank accounts. If a payment is made to a resident of an offshore jurisdiction, then only 85% of the expenses incurred are deductible or depreciable/amortizable.

The official list of offshore countries is published by the Verkhovna Rada, and is updated periodically.

The official list of offshore jurisdictions was last updated on 1 April 2011 and currently includes the following jurisdictions:

- Alderney (UK);
- Andorra;
- Anguilla;
- Antigua and Barbuda;
- Aruba;
- Bahamas;
- Bahrain;
- Barbados;
- Belize;
- Bermuda;
- British Virgin Islands;
- Cayman Islands;
- Cook Islands;
- Dominica;
- Dutch Antilles;
- Gibraltar;
- Grenada;
- Guernsey (UK);
- Isle of Man (UK);
- Jersey (UK);
- Liberia;
- Marshall Islands;
- Monaco;
- Montserrat;
- Nauru;
- Niue;
- Puerto Rico;
- Republic of Maldives;
- Samoa;
- Seychelles;
- St. Lucia;
- St. Vincent and Grenadines;
- St. Kitts-Nevis;
- Turks and Caicos Islands;
- Vanuatu;
- Virgin Islands (USA).

### Other restrictions and limitations

The Tax Code establishes limitations on the deduction of the following expenses:

- royalties paid to non-residents up to 4% of prior year sales revenue (royalties are not deductible if paid to non-resident companies that are located in offshore jurisdictions, or are not beneficial owners of royalty payments; moreover, outbound royalty payments for IP rights that were initially registered in Ukraine and later sold abroad may not be deducted);
- engineering services up to 5% of the customs value of the imported equipment (fully non-deductible where the non-resident in question is located in an offshore jurisdiction or is not the beneficial owner of the income from the respective services);
- expenses related to purchases of consulting, marketing and advertising services from non-residents (except for purchases from PEs of non-residents) are deductible up to 4% of prior year sales revenue. The Code imposes a total ban on the deduction of expenses related to purchases of the above services from non-residents located in offshore jurisdictions.

### Depreciation and amortization allowance

Expenses associated with the acquisition, construction and/or improvement (in excess of 10% of the total book value at the beginning of a tax year) of capital assets for business purposes may not be deducted immediately. Instead, these expenses should be capitalized and depreciated or amortized over a fixed period.

Generally speaking, depreciation allowances are permitted for all capital assets, including both fixed and intangible property, except for land, goodwill, fixed assets under conservation, and non-business-related capital assets.

### Fixed assets

Fixed assets are defined by the Tax Code as tangible assets (including mineral resources) intended for use in a taxpayer's business activities for a period exceeding one year or operating cycle, and with a cost exceeding UAH 2,500 from 1 January 2012.

According to the Tax Code, fixed assets are divided into 16 groups according to their minimum useful life for tax depreciation purposes.

Table 3

Groups	Fixed assets included in the group	Minimum useful life, years
Group 1	Plots of land	-
Group 2	Capital expenditure on land improvements unrelated to construction	15
Group 3	Buildings	20
	Facilities	15
	Transmission devices	10
Group 4	Machinery and equipment	5
	Computers and other automatic data processing equipment; related information read-out and printing equipment; related computer programs (except for payments for programs that are classified as royalties and/or programs treated as intangible assets); other information systems; switch boxes, routers, modules and modems; uninterrupted power supplies and means connecting them to telecommunications networks; telephones (including satellite phones), microphones and portable radio transmitters worth over UAH 2,500	2
Group 5	Motor vehicles	5
Group 6	Instruments, devices, furniture	4
Group 7	Animals	6
Group 8	Perennial plants	10
Group 9	Other fixed assets	12
Group 10	Library funds	-
Group 11	Low-cost non-current tangible assets	-
Group 12	Temporary facilities	5
Group 13	Natural resources	-
Group 14	Reusable containers	6
Group 15	Rented assets	5
Group 16	Long-term biological assets	7

### **Tax accounting**

For tax purposes, fixed assets are depreciated during their useful lives using one of the following five methods:

- straight line method;
- reducing balance value method;
- accelerated reducing balance value method (applicable to Groups 4 and 5 only);
- cumulative method;
- units of production method.

The Tax Code stipulates certain rules and limitations on which methods may be applied to particular groups of assets.

Depreciation is accrued on a monthly basis. The quarterly amount of depreciation is defined for the purposes of the CIT return as the sum of the depreciation amounts for each month in the respective quarter.

Each fixed asset is accounted for separately and depreciated over its useful life, as defined in the taxpayer's tax policy, but which should not exceed the maximum useful life period indicated in the Tax Code. The tax depreciation method used should correspond to the taxpayer's UAS (Ukrainian Accounting Standards) policy.

Ukrainian tax legislation also allows taxpayers to increase the book value of fixed assets (indexation), provided that the annual inflation rate for the respective calendar year exceeds 10%. Indexation is calculated, as below, as the product of the book value of fixed assets at the end of the calendar year in question and the amount, by which the inflation rate exceeds 10%:

$$ITBV = TBV + TBV * (II - 10\%)$$

#### **Where:**

**ITBV** is the indexed tax book value

**TBV** is the tax book value prior to indexation

**II** is the annual inflation rate calculated by the Ukrainian State Statistics Committee

Since the book value is the basis for calculating future depreciation charges, indexation allows taxpayers to increase the amount of their future tax depreciation without incurring any expenses.

**Table 4**

<b>Groups</b>	<b>Fixed assets included in the group</b>	<b>Minimum useful life, years</b>
Group 1	Rights to use natural resources	According to the entitling document
Group 2	Rights to use property	According to the entitling document
Group 3	Rights to use commercial branding (trademarks, etc.)	According to the entitling document
Group 4	Industrial property rights	According to the entitling document, but no less than 5 years
Group 5	Copyrights and related rights	According to the entitling document, but no less than 2 years
Group 6	Other intangible assets	According to the entitling document

### **Intangible assets**

According to the Tax Code, intangible assets are divided into six groups. Each intangible asset should be accounted for separately and amortized using one of the abovementioned methods over its useful life, taking into consideration the minimum useful life established by the Tax Code.

### **Operations involving land and capital improvements**

Separate accounting must be maintained for transactions involving land. Expenses associated with purchasing land cannot be deducted or amortized. Any profits from future sales of land should be included in taxable income. However, losses incurred upon the sale of land may not be included.

### **Taxation of dividends**

Dividends paid by Ukrainian companies are subject to advance corporate income tax, which is calculated based on the statutory tax rate. The tax is accrued on top of dividend payments and is paid from the funds of the distributing company. The advance CIT is due prior to or upon the payment of dividends.

Ukrainian companies may use advance CIT they have paid to reduce their CIT liabilities for future periods. If a taxpayer does not have sufficient CIT liabilities for a period, then this advance CIT credit may be carried forward indefinitely.

The advance CIT does not apply to dividends paid by the following entities:

- Ukrainian holding companies, whose income mostly (more than 90%) consists of dividends received from other Ukrainian legal entities;
- insurance companies and investment funds;
- agricultural companies registered as FAT payers.

### **Tax loss carry forward**

Under the general rule, taxpayers' tax losses may be carried forward without any limitations on term or amount, and should be reported in CIT returns for subsequent periods as a separate item of deductible expenses.

However, the Ukrainian parliament from time to time introduces restrictions on carry-forward of tax losses. Thus, taxpayers whose income in 2011 exceeded UAH 1 million were allowed to utilize tax losses accumulated as of 1 January 2012 in four equal parts during the next four years (2012-2015). There are no restrictions on utilization of tax losses incurred in 2012-2013.

### **Taxation of non-resident entities**

#### **Sources of income**

Non-resident entities are subject to taxation on two types of income in Ukraine:

- business income (i.e., active income) derived from carrying out business in Ukraine;
- non-business income (i.e., passive income) received from Ukrainian sources.

Taxation of both business and non-business income may be subject to the provisions of international double taxation treaties. Therefore, preferential tax treatment or provisions may be available for non-resident taxpayers under the appropriate double taxation treaties signed between Ukraine and their respective jurisdictions.

#### **Taxation of business income**

Business income of non-residents, obtained via a permanent establishment (PE) situated in Ukraine, is taxed in a similar way to income earned by regular corporate taxpayers in Ukraine. The term "permanent establishment" in domestic tax legislation is similar to the definition of a PE stated in Article 5 of the OECD Model Tax Convention on Income & Capital. Therefore, a non-resident's income that is attributable to Ukraine via the activities or assets of its PE is subject to taxation in Ukraine on a net basis, at the general tax rate.

### **Permanent establishments (PEs)**

The definition of a PE in Ukrainian legislation is very similar to that provided by the OECD Model Convention. A PE of a non-resident is defined as a fixed place of business through which the non-resident carries out all or part of its business activities. The term PE includes headquarters, branches, offices, factories, workshops, mines, oil or gas wells, quarries and any other places where natural resources are extracted.

Activities carried out by a non-resident company in Ukraine for the purpose of providing assistance or preparatory services with regard to that non-resident company's activities (e.g., conservation, demonstrations, delivery, data gathering, etc.) do not lead to the creation of a PE.

The net income attributable to a PE is calculated using one of the three methods below. These methods are applied in the order in which they are listed below (i.e., if the first method cannot be applied, the second should be used, and so forth).

### **Calculation of attributable income**

#### ***Direct method***

This method should be used when a non-resident entity maintains a separate profit and loss statement with respect to the PE's activities. Allowable expenses are deducted from gross taxable income and the difference is reported as taxable income.

These expenses are deductible, regardless of whether they were incurred inside or outside Ukraine, provided that they are supported by the appropriate source documents.

#### ***Split balance sheet method***

This method is used for non-resident companies with activities in multiple countries that do not have readily available gross taxable income figures that may be allocated to their operations in Ukraine. It uses the Ukrainian share of the resident's worldwide gross taxable income, deductible expenses, number of employees, and book value of its assets to determine taxable income. This method involves significant practical issues and is almost never used in practice.

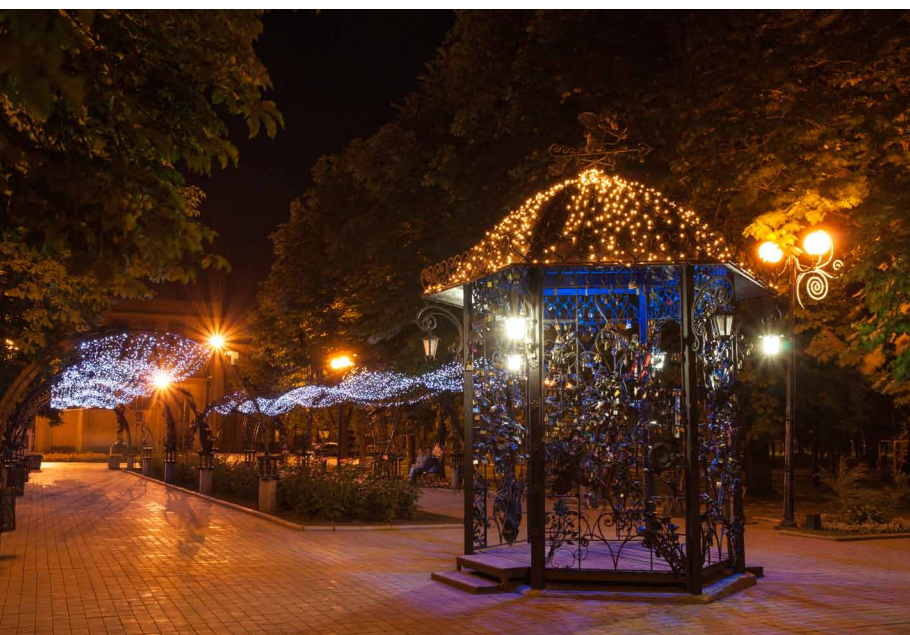
#### ***Indirect method***

The indirect method is used for PEs for which the amount of attributable income cannot be practically determined using the direct method, and which cannot provide the information required to use the split balance sheet method.

In order to calculate net taxable income of a PE, a 30% profit margin is applied to the gross taxable income attributable to the PE.

#### **Taxation of non-business income**

Non-business income from Ukrainian sources is normally subject to withholding tax, provided that it is not attributable to a non-resident's PE in Ukraine. Taxes should be withheld by a resident taxpayer prior to or upon payment of income to a non-resident.



### Ukrainian-sourced income

The following types of the Ukrainian-sourced income are subject to the withholding tax:

- interest income – interest on debt obligations issued to a resident entity;
- dividend income – dividends from a resident entity;
- royalty income – royalties received from a resident entity;
- rental income – rental/lease income received from a resident entity;
- income from immovable property – income from the sale of immovable property located in Ukraine;
- insurance income – premiums for insuring or reinsuring against risks in Ukraine or the risks to resident entities operating abroad;
- winnings – income from lotteries (except for the state lottery), casinos and other gambling activities, as well as income from the operations of gambling businesses;
- commissions, brokerage or agent fees – income received from residents or PEs of non-residents for services provided by a non-resident (or its PE) in Ukraine;
- other types of income – freight, engineering services, profits from trading in securities, donations, and so on.

### Withholding tax rates

The withholding tax rates provided in Table 5 normally apply (unless more favorable rates are provided for by a relevant double taxation treaty). In order to benefit from any applicable treaty relief, a non-resident should provide the Ukrainian taxpayer with a tax residency certificate issued annually by the tax authorities of their country of residence. The amount withheld should be remitted to the government when the income is paid to the non-resident.

Non-business-related income may be paid to non-residents from Ukrainian sources, provided that it is not attributable to a non-resident's PE in Ukraine.

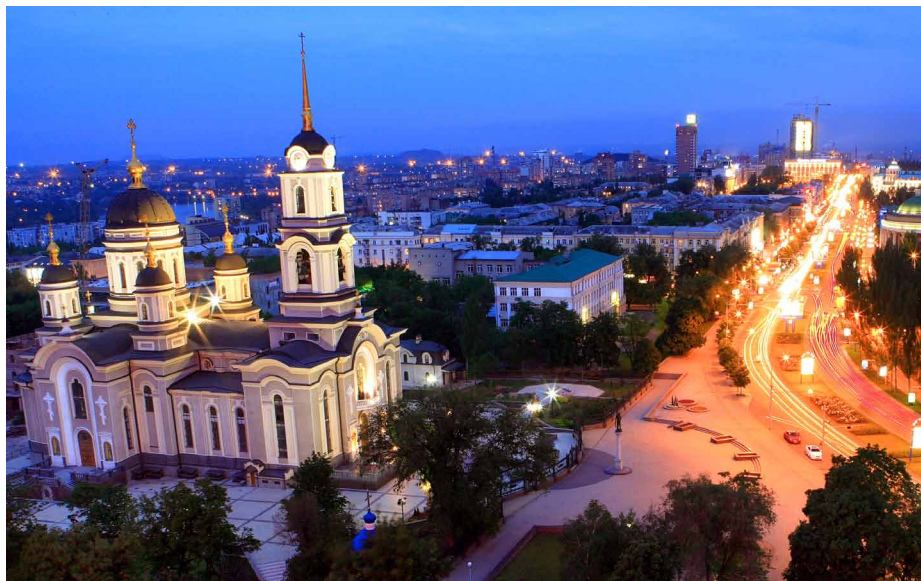
Table 5

Income from Ukrainian sources	Withholding tax rate
Dividends	15%
Interest	15%
Royalties	15%
Income from international freight transportation	6%
Interest income from certain state securities	0%
Other Ukrainian-source income	15%

A special tax is levied on insurance and advertising income payable from Ukraine to non-residents. The tax should be accrued on top of the payment (i.e., the gross amount) at the below rates, and is non-recoverable for a taxpayer (see table 6 below).

Table 6

Income from Ukrainian sources	Tax rate
Insurance income	0%/4%/12%
Income from advertising services	20%



# Value-added tax

## Taxable transactions

In accordance with Ukrainian legislation, value-added tax (VAT) is imposed on:

- supplies of goods and services within the customs territory of Ukraine;
- imports of goods into the customs territory of Ukraine;
- exports of goods from the customs territory of Ukraine;
- supplies of services involving the international transportation of passengers and luggage by rail, road, sea, river, and air transport.

For VAT purposes, supplies of goods to/from the customs territory of Ukraine are considered as movement of the goods to and out of the territory of Ukraine under any customs regime established by the Customs Code of Ukraine.

VAT is currently levied at a rate of 20% of the taxable value of domestic supplies and imported goods. The VAT rate will be reduced to 17% from 1 January 2014. The VAT rate for goods transferred under the regime of export, re-export, duty-free, and free customs is 0%.

With respect to taxation of services, Ukrainian legislation applies the concept of "place of supply." In general, services rendered within the customs territory of Ukraine are taxed at the general VAT rate, regardless of whether they are rendered to/by residents or non-residents. However, there are certain exceptions to this rule, which are examined in more detail in the Tax base section below.

According to the Tax Code, a taxable base for VAT is defined as the contractual value of the goods or services supplied, but not less than the fair market value of these goods or services. VAT base for the imported goods is the contractual value, however, not less than the customs value of these goods. From 1 January 2013, new transfer pricing regulations came into effect to ensure fair price estimation.

## Exempt transactions

Transactions specifically exempt from VAT

Certain transactions are exempt from VAT. Below is an extensive, but not exhaustive list of exempt transactions:

- supplies/imports of medical or medical-related products, provided that these products are registered in Ukraine as medical products in accordance with the list approved by the Cabinet of Ministers of Ukraine;
- supplies of domestically produced baby food products, in accordance with the lists of foodstuffs adopted by the Verkhovna Rada;
- supplies of periodicals and books, students' notebooks and textbooks, study books and supplementary study materials;
- provision of educational services by institutions with special permission/license to provide such services
- supplies of special-purpose goods for disabled individuals;
- provision of pensions and monetary assistance to the general population within the framework of approved social programs;
- provision of healthcare services by licensed institutions;
- public transportation services (except for taxis) within an inhabited area;
- religious organization services and supplies (with the exception of excisable goods);
- transfers of land, except for plots of land under buildings, the cost of which is included in the cost of buildings;
- privatization of state and municipal property;
- supplies of apartments (housing stock) on the secondary market and supply of affordable housing and housing built with state funds;
- charitable contributions to qualifying non-profit organizations;
- provision of services to foreign and domestic vessels engaged in international transportation of passengers, luggage and cargo;
- research and development activities performed at the expense of the State Budget of Ukraine and carried out by an individual who receives funding directly from the State Treasury;
- provision of software products (temporarily, until 1 January 2023).

### Transactions not subject to VAT

According to the Tax Code, certain transactions are not subject to VAT. These include the following:

- issue of securities by enterprises, the National Bank of Ukraine, the central state authority responsible for implementation of financial policy, and local authorities;
- insurance services provided by institutions specially licensed to provide such services, including social and pension insurance, and intermediary services;
- currency exchange (both national and foreign currency), bank metals, banknotes, and coins;
- circulation of lottery tickets and monetary prizes/winnings;
- transfers of property under an operating lease by a resident lessor to a lessee, and return of the leased property by the lessee to the lessor;
- transfers of property for storage or return from storage, including leasing (but except for financial leasing arrangement);
- cash payments of salaries, pensions, and subsidies;
- payments of dividends and royalties in cash or in the form of securities;
- provision of commission/brokerage and dealer services in connection with the sale or management of securities;
- payments of arbitration duties and the reimbursement of other expenses in relation to arbitration court rulings;
- agent and freight services rendered to a marine commercial fleet by shipping agents;
- reorganization of legal entities;
- export from or import into the customs territory of Ukraine of goods with the customs value less than EUR 100;
- import of goods via international mail, express shipments or in unaccompanied baggage with a total invoice value less than EUR 300.

### Taxpayers

If entities meet certain criteria, they may be subject to mandatory registration as VAT payers, in particular, if the volume of taxable supplies of goods/services during the previous 12-month period exceeds a taxable threshold of UAH 300,000 (approximately USD 37,500).

Entities may also opt for a voluntary registration if they perform VAT-able supplies, without any other requirements to be met.

The abovementioned requirement to register for Ukrainian VAT purposes applies to both resident and non-resident entities. Although the Tax Code does not stipulate a special procedure for non-resident entities to register for Ukrainian VAT purposes, the only feasible way of registering a non-resident as a VAT payer in Ukraine is via a representative office and/or permanent establishment of the non-resident in Ukraine.

If an entity imports goods into Ukraine in taxable volumes, it is obliged to pay VAT during the customs clearance process, without the need to register as a VAT payer.

### Tax base

#### Domestic supplies

As a general rule, the tax base for VAT is defined as a contractual value of goods/services, including customs duties, excise and other obligatory taxes/payments, but can not be lower than the fair market prices for the goods/services in question.

In certain cases, there are special rules for determining the tax base, in particular:

- in the event of non-cash settlements and free-of-charge supplies, the taxable base is the fair market price;
- the contractual value of goods imported into the customs territory of Ukraine is considered the tax base, but may not be less than the declared customs value determined in accordance with the Custom Code of Ukraine (including excise tax and import duties, but except for VAT, which is included in the price of goods);
- for financial lease purposes, the VAT base is determined on a contractual basis, but may not be less than the purchase price of the object of the financial lease;
- if a taxpayer is involved in the trading of used goods that have been purchased from entities that do not pay VAT, the tax base is defined as the taxpayer's commission fees.

## **Place of supply**

### ***Place of supply of goods***

According to the Tax Code, the place of supply of goods is their actual location at the moment of supply, except for the following cases:

- for goods been transported, the place of supply is their location at the beginning of their journey;
- for goods been assembled or installed by a supplier, the place of supply is a place where assembly or installation takes place.

### ***Place of supply of services***

The general rule states that the place of supply of services is defined as a place of the supplier's registration. However, the Tax Code sets specific rules for defining the place of supply of certain types of services, in particular:

- services related to movable property – where the services are actually provided;
- services rendered by real estate agents and services related to immovable property – the location of the real estate;
- cultural, sports, educational, scientific services – a place where the services are rendered.

The TCU also stipulates that the following services are deemed as being supplied where the buyer is registered and, therefore, are not subject to Ukrainian VAT when rendered to non-residents:

- transfer or assignment of copyrights, patents, licenses, and related rights, including trade marks;
- provision of advertising services;
- provision of consulting, engineering, legal, accounting, and audit services, as well as services related to the development, delivery and testing of software, and similar services;
- provision of personnel;
- telecommunication services, including: transfer and extension services; the transmission of signals, words, images and sounds, or any type of information via cable, satellite, cell, electronic, optical or other electronic communications systems; provision of a right to transfer, extend or accept; and provision of access to global networks
- provision of freight forwarding services;
- leasing of movable property (including banking safes);
- provision of agency services in respect of the abovementioned activities on behalf of another entity in its own name or in the name of such other entity.

## **VAT administration**

### **Remittance**

VAT on domestic supplies of goods and services is administered by the tax authorities, while VAT on the importation of goods is administered by the customs authorities.

Any taxable person should assess the amount of VAT to be remitted to the government by reducing ("crediting") their VAT output (VAT accrued/collected on taxable supplies) with VAT input (VAT payable on purchased goods and services, including import VAT). VAT on imported goods is payable by the importer, in cash, at the customs border. Taxable entities are responsible for paying import VAT.

### **VAT input**

In general, any VAT input paid or incurred by a taxable entity may be set off against VAT output liabilities, provided that the VAT input in question was incurred in relation to the following:

- purchasing or producing goods/services with a view to their use in taxable operations in the course of a taxpayer's business activities;
- purchasing fixed assets with a view to their use in taxable operations in the course of a taxpayer's business activities.

The tax treatment of VAT included in the price of goods/services depends on the status of a company's supplies. In general, when the company's supplies qualify for exemption, the incurred VAT is not included in the VAT input, but is instead regarded as a deductible/depreciable expense, depending on the type of expenses.

When the company's supplies qualify as taxable (at 20% or 0% tax rate), the VAT incurred is included in the VAT input and is offset against the company's VAT output.

If produced and/or acquired goods (work or services), non-current assets are only partially used in taxable transactions, VAT input may include the amount of VAT that relates to taxable transactions in a reporting period. The VAT input that may be creditable in a given year is calculated based on the ratio of prior year VAT-able sales over prior year total sales. The coefficient so calculated is applicable throughout a calendar year.

At the end of the year, the coefficient is re-calculated based on the actual volume of VAT-able and non-VAT-able supplies.

VAT input on fixed assets is recalculated at the end of the 1st, 2nd and 3rd calendar years following the year, in which they were put into production.

In general, VAT credit is determined based on the contractual value of goods/services, which may not be higher than their fair market value.

Ukrainian tax legislation states that VAT input will only be recognized if it is confirmed by an appropriately issued VAT invoice. VAT invoices must be issued by a supplier at the moment a VAT liability arises.

If a VAT invoice is unavailable, a purchaser may not recognize VAT input with respect to such transaction (which does not eliminate the supplier's obligation to report VAT liability with respect to such transaction).

VAT invoices received with a delay may be included in the VAT input within 365 days of their issue date, except in cases of the transfer of ownership of pledged property, under which the right to recognize VAT input is retained until the date the property is disposed of.

Following the introduction of the Tax Code, VAT invoices of more than UAH 1 million (from 1 January 2011) and more than UAH 10,000 (from 1 January 2012) must be registered in the Unified Register of Tax Invoices. If an incoming VAT invoice is not included in the register, a taxpayer will not be entitled to respective VAT input. Tax invoices should be registered in the Unified Register of Tax Invoices within 15 days calendar days following their issue. Any discrepancy between the data of the VAT invoice and the Unified Register of Tax Invoices serves as a basis for an unscheduled tax audit of both the seller and the purchaser.

For import transactions, a customs declaration is used as supporting documentation, instead of a VAT invoice.

### **Reverse-charge VAT mechanism on services provided by non-residents**

If a non-resident renders services to a resident taxpayer with a place of supply in Ukraine, such supply is subject to VAT at 20%. Unless a non-resident has a permanent establishment in Ukraine, a Ukrainian taxpayer is liable for accruing and paying the respective VAT liabilities using the reverse-charge mechanism, whereby the taxpayer must self-assess VAT on the value of the services provided by the non-resident.

A unique feature of the reverse-charging in Ukraine is that VAT input is recognized by a taxpayer in the next reporting period after the respective VAT output has been reported, thus creating a cash flow gap.

### **VAT refunds**

Under the general rule provided for by the Tax Code, the amount of VAT payable to the government or subject to refund is determined as the difference between the amounts of VAT output and VAT input for a tax reporting period.

If VAT input exceeds VAT output, the difference may be used to offset VAT debt accumulated in previous tax periods. If a taxpayer does not have any VAT debt, the difference is included in VAT input for the following reporting period. If the taxpayer's VAT input exceeds VAT output in the next reporting period as well, the difference (VAT receivable) can be claimed for refund from the government. However, any VAT refund is limited to the VAT actually paid to suppliers and the State Budget of Ukraine, as well as on services imported (if operations involving non-residents take place on the Ukrainian territory) in previous and current tax periods.

The remaining portion of VAT receivable is carried forward to the next reporting period. Alternatively, a taxpayer could opt to offset all or part of the VAT receivable against its future VAT liabilities.

A taxpayer who intends to claim a qualifying VAT refund must follow specific procedures. Chiefly, it must have the VAT refund confirmed by the tax authorities through a VAT audit.

According to Ukrainian legislation, certain categories of taxpayers are not entitled to obtain a VAT refund from the government. This affects the following types of taxpayers:

- entities that have been registered as VAT payers for a period of less than 12 months prior to the month for which a VAT refund is claimed (as an exception to this rule, a VAT refund may be claimed with respect to fixed assets);
- entities, whose revenue from VAT-able transactions for the preceding 12 months is lower than the reported VAT refund (this does not apply to VAT input related to the purchase or construction of fixed assets).

Taxpayers may also obtain an automatic VAT refund provided that all of the below criteria are met, such as:

- an entity is not subject to a bankruptcy or closing procedure;
- an entity does not have any tax debt;
- an entity does not have any taxable loss for the previous reporting year;
- an entity is included in the State Register of Legal Entities and the information does not contain any discrepancies with the actual details;
- total amount of transactions with 0% VAT tax rate exceeds 40% of the total sales for the past 12 months;
- variances between taxpayers' VAT input and counterparties' VAT liabilities for the past 3 months does not exceed 10% of the claimed VAT refund;
- average monthly salary for the past 12 months should exceed at least 2.5 times the minimum wage (approx. EUR 100);
- one of the following criteria is met:
  - total quantity of employees for the past 12 months exceeds 20 persons;
  - net book value of fixed assets as of the reporting period exceeds the total amount claimed for VAT refund for the past 12 months;
  - tax liabilities (i.e., CIT payable divided by total income) are higher than the average tax burden in the sector for the past 12 months.

The procedure of the automatic VAT refund is similar to the ordinary VAT refund with the following exceptions:

- the tax authorities will perform a simplified tax audit;
- the overall period to obtain the VAT refund is much shorter compared to the general procedure.



# Transfer pricing

Ukrainian transfer pricing regulations were changed significantly starting from 01 September 2013. Prior to that date existing rules were very concise, without the necessary level of detail and guidance regarding the way the regulations should be applied. There were no documentation requirements.

The regulations that came into effect starting from 1 September 2013 are based on the OECD transfer pricing guidelines. They provide for the same methods, principle and approach.

## Hierarchy of methods

In particular, the taxpayers can choose one of the following methods to substantiate the arm's length nature of their controllable transactions:

- comparable uncontrolled price method (CUP);
- resale price method;
- cost plus method;
- transactional net margin method (TNMM);
- profit split method.

Taxpayers may choose the method that they deem to be most suitable. However, if CUP can be applied along with any other method, preference should be given to CUP.

## Controllable transactions

The controllable transactions are defined as follows:

- transactions with non-resident related parties;
- transactions with resident related parties that:
  - have declared income tax losses for the previous reporting year;
  - enjoyed a special tax regime at the beginning of the current reporting year;
  - applied a non-standard income tax or VAT rate at the beginning of the current reporting year;
  - were not corporate income tax or VAT payers at the beginning of the current reporting year.
- transactions with a non-resident entity registered in a country with an income tax rate at least 5% lower than the rate applicable in Ukraine, or which pays corporate income tax at a rate at least 5% lower than the rate applicable in Ukraine.

Only controlled transactions that exceed the stipulated limit are subject to the transfer pricing regulation. According to the Draft Law, the limit amounts to UAH 50 mln (approx. EUR 4.5 mln) per year with one counterparty.

## Reporting requirements

The reporting period is defined as a calendar year.

A report on controlled transactions for the previous calendar year must be submitted by 1 May.

Taxpayers must submit transfer pricing documentation (special documentation aimed at confirming that transactions were carried out in compliance with the rules) at the request of the tax authorities.

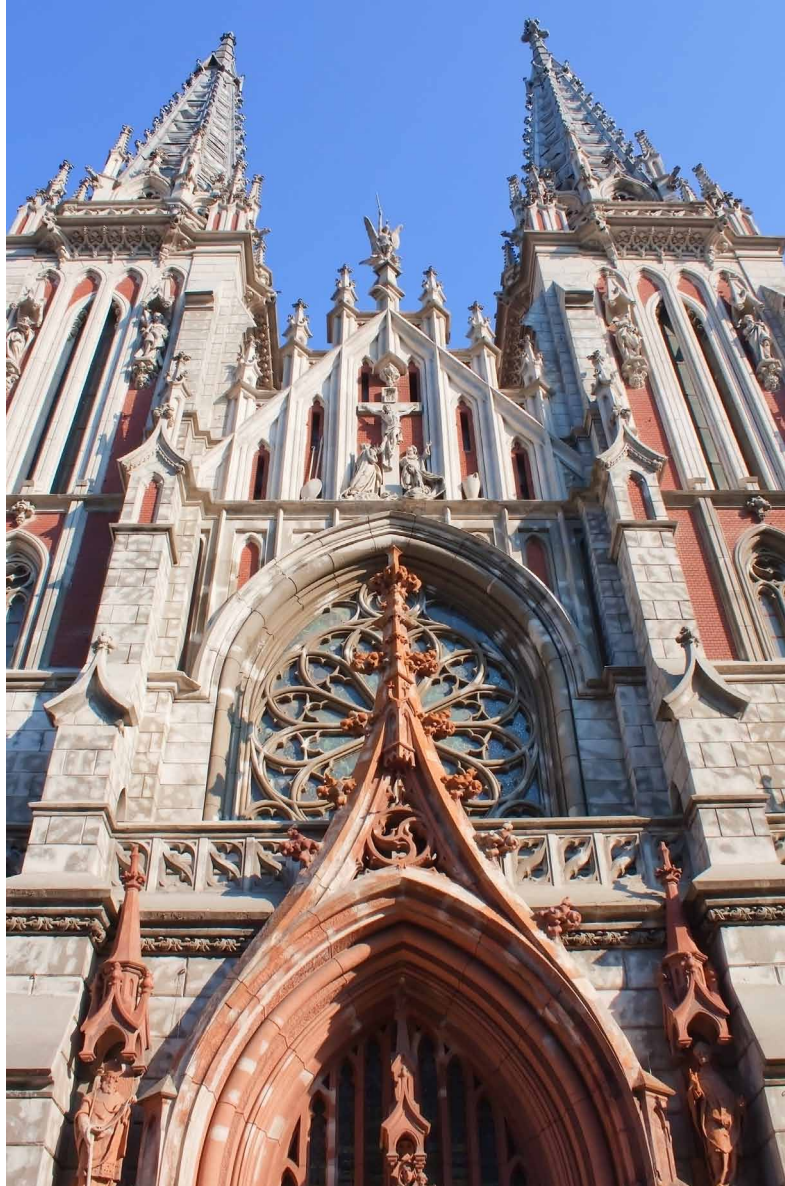
## Advanced pricing agreement with tax authorities

Only major taxpayers may enter into advance pricing agreements with the tax authorities in respect of the pricing approach to controlled transactions. The subject may include a broad range of transactions, data sources, etc.

## Tax liability adjustments

Both individual adjustments by taxpayers (before tax audits) and pro rata adjustments based on audit results are stipulated.

In the event that the tax authorities detect deviations from market prices in a taxpayer's controlled transactions, the other party of these transactions (related party) is entitled to pro rata adjustments to its tax liabilities. In order to make these adjustments, a notice from the Ministry of Revenues and Duties will be required.



### Penalties

The following penalties are foreseen by the transfer pricing legislation:

- up to 50% of underpaid tax liabilities in the event of adjustments by the tax authorities;
- 5% of the controlled transaction amount in the event of failure to submit the transfer pricing report;
- 100 tax exempt minimum amounts in the event of failure to submit the transfer pricing documentation;
- for violations from 1 September 2013 to 1 September 2014, a fine of UAH 1 shall be applied.

### Specific transition rules

Until 1 January 2018, specific rules may be applied to determine conventional export/import prices on certain commodities in the agriculture, metallurgy, chemical and oil & gas industries (which are considered as budget-forming industries meaning companies contributing significantly amount of taxes to the local state budgets).

According to these rules, a conventional price will be determined within a range of +/-5% from the indicative prices established by the Cabinet of Ministers of Ukraine and defined in accordance with stock market quotes or reference prices derived from specialized data sources.

This rule shall apply to transactions with non-residents from countries with an income tax rate at least 5% lower than the rate applicable in Ukraine.

In the event that the prices of the above controlled transactions differ from the conventional prices established by the Cabinet of Ministers of Ukraine, taxpayers shall be entitled to apply conventional methods when determining transfer prices.

# Excise tax

## General rules

Generally, the excise tax is imposed on taxable items produced in, or imported into, Ukraine but there is also a special excise applied to transactions with securities.

The excise tax is not imposed on export sales, return of previously exported goods to Ukraine (goods with defects that hinder their import to other countries), transactions with state and municipal securities, contributions to share capital and emission of securities, transactions of the issuer of the investment fund securities, transactions with securities performed by clearing companies, or transactions of the NBU on the over-the-counter market.

For items produced domestically, the excise duties are normally imposed when a taxable item is sold. When excisable goods are imported, excise duties are due and payable during the customs clearance of the goods.

The excise tax is imposed on ethyl spirit and other distillates, alcoholic drinks (including beer), tobacco products, oil products and condensed gas, motor vehicles.

After the introduction of the Tax Code, the increased excise tax rates came into effect.

## Taxable goods

### Alcohol

An excise tax is imposed on all alcoholic items classified under the Ukrainian Goods Classification in Foreign Economic Trade – УКТЗЕД (UGCFET), i.e., items 2203 (malt beer), 2204 (wine from fresh grapes), 2205 (vermouth and other flavored wines), 2206 (other fermented beverages), 2207 (non-denatured ethyl alcohol, vol. 80% and more; ethyl alcohol and other alcoholic distillate, denatured), and 2208 (non-denatured ethyl alcohol, spirits and liqueurs). The excise tax on alcoholic products is levied at various rates in UAH per liter, or per liter of 100% spirits.

### Tobacco

The excise tax is imposed on tobacco items classified under the UGCFET, i.e., items 2401 (tobacco materials), 2402 (cigars, cheroots and cigarettes), 2403 (other processed tobacco and tobacco substitutes, tobacco extracts and essences). The excise tax on tobacco products is levied at:

- various flat rates in UAH per 1,000 items or per kilogram; or
- as a percentage of sales turnover with minimum flat rates in UAH per 1,000 items.

### Oil products and condensed gas

The excise tax is imposed on certain oil products and condensed gas classified under the UGCFET, i.e., items 2710 (diesel, gasoline, aviation and jet engine fuel, fuel oil), 2711 (condensed gas), several separate commodity subcategories: 2707 10 90 00 (coal-bearing raw benzol), 2905 11 00 00 (methyl alcohol), 3824 90 98 00 (biodiesel and its blends). The excise tax for oil products and condensed gas is levied at various rates in EUR per 1,000 kg.

### Motor vehicles

The excise tax is imposed on motor vehicles classified under the UGCFET, i.e., items 8703 (cars and other passenger vehicles), 8711 (motorcycles), 8716 (trailers and semi-trailers), and 8707 (passenger carts/ attachments for motor transport vehicles). The excise tax on motor vehicles is levied at various rates, normally in EUR per item or per cm<sup>3</sup> of the vehicle's engine capacity (for trailers and semi-trailers weighing more than 3,500 kg, the tax is levied per vehicle).

## Special excise tax on transactions with securities and derivatives

Effective from the 1 January 2013, the special excise tax is levied on the sale, exchange and other alienation of securities at the following rates:

- 0% on the sale of securities, which are used for stock exchange rates calculation, through the stock exchange;
- 0% on transactions with derivatives through the stock exchange;
- 0.1% on transactions with listed securities on the over-the-counter market;
- 1.5% on transactions with non-listed securities on the over-the-counter market;
- 5 non-taxable minimums for transactions with derivatives on the over-the-counter market.

# Taxation of cross-border transactions

## Customs duties

### Taxable goods/tax rates

Customs duties are imposed on most goods imported into and certain goods exported from Ukraine. Customs duties are normally levied on the customs value of taxable goods.

For customs clearance purposes, imported and exported goods are classified into 97 groups, according to the Ukrainian Classification of Goods for Foreign Economic Activities (hereinafter, the "Ukrainian Harmonized System"). The Ukrainian Harmonized System is based on the 2007 version of the International Harmonized System.

The applicable customs duty rates are based on the ten-digit classification code given to goods under the Ukrainian Harmonized System.

Customs duties are usually an "ad valorem" rate (i.e., a percentage of the customs value of the imported goods). However, in rare cases goods are subject to a specific duty, which can be based on the quantity of goods, measured as set by the law, while others may be subject to a compound duty (a combination of both ad valorem and specific rates). Customs duties are normally levied at rates of up to 60%, but most rates fall between 0% and 20%.

Since 16 May 2008, when Ukraine joined the World Trade Organization (WTO), the applicable import customs duty rates on goods originating from WTO member states were lowered in comparison to the general rates applied to goods from non-WTO member states. At the same time, Ukraine has signed free trade agreements (FTAs) with the CIS countries, Macedonia, Montenegro and EFTA (European Free Trade Organization that unites four non-EU member states: Norway, Liechtenstein, Switzerland, and Iceland). Ukraine is also negotiating FTAs with Turkey and Serbia.

Goods originating from states covered by an FTA may benefit from duty exemption upon their import into Ukraine, excluding certain goods listed as exceptions.

A foreign investor's contribution to the share capital of Ukrainian foreign investment companies in the form of goods may be exempt from customs duties, provided that the goods in question will not be alienated for three years after contribution.

Pursuant to the Customs Code of Ukraine, effective since 1 June 2012, the import and export of certain goods is fully exempt from customs duties. These goods include:

- transport vehicles of commercial use in international transportation, and materials required for normal operation of such vehicles;
- materials for Ukrainian ships and ships chartered by Ukrainian companies, and products of their sea fishery activities;
- currency (Ukrainian and foreign), securities, banking metals;
- imported goods, if the title thereto will be acquired by the state of Ukraine;
- goods owned by individuals who are entitled to exemption under international agreements;
- goods transported in the framework of international technical support;
- temporary exported or imported goods (previously customs-cleared);
- documents, publications transferred as part of the international exchange between scientific, educational, and cultural institutions (the list of institutions is set by the Ukrainian Cabinet of Ministers);
- materials used for the construction of the Chernobyl cover;
- materials transferred under product sharing agreements
- archive documents;
- pharmaceutical products and compounds for their production if they are not produced in Ukraine (classified as groups 28, 29, and 30 of the Ukrainian Harmonized System; the list of such products and compounds is set by the Ukrainian Cabinet of Ministers);
- renewable and/or alternative energy based equipment, materials and products (the list is set by the Ukrainian Cabinet of Ministers). The benefit is available only if the goods are used by taxpayers in their own production activities and no identical goods are produced in Ukraine;
- goods, materials, tools, etc. transferred by the intelligence agency of Ukraine for its own use;
- biofuel based technologies (import of such goods is regulated by the Ukrainian Cabinet of Ministers);
- blanks of the TIR carnets;
- goods paid out of grants of the programs of the Global Fund to Fight AIDS, Tuberculosis and Malaria in Ukraine.

Below we provide a description of the existing rules for determining the customs value.

### Procedure for determining the customs value

The Customs Code introduces six methods for determining the customs value, which are taken from Article VII of the General Agreement on Tariffs & Trade.

The customs value of imported goods is generally defined as the value actually paid or payable for the imported goods, calculated in accordance with the provisions of the Customs Code of Ukraine.

The basic method for establishing the customs value of imported goods is transaction value method (according to the contractual value of the imported goods). However, a number of conditions must be fulfilled in order to use the transaction value method and, if it is not possible to use this method to assess the customs value, a price paid or payable for the imported goods may be subject to adjustment, thus leading to an increase in the amount of customs duties payable.

Where the price paid or payable cannot be used as a basis to assess the customs value, the following alternative methods may be used:

- transaction value method: uses the contract price of goods sold for export to Ukraine;
- value of identical goods method: uses the transaction value of identical goods sold for export to Ukraine;
- value of similar goods method: uses the transaction value of similar goods sold for export to Ukraine;
- deductive value method: uses the sale price in Ukraine of imported, identical or similar goods. Such price must be adjusted for costs and expenses incurred in the course of the transportation, customs clearance and sale of the goods in Ukraine;
- computed value method: is based on production, general expenses, other costs and profits related to the imported goods;
- fall-back method: uses a combination of all the above methods and other relevant information, unless in conflict with existing legislation.

### Most-favored nations

Ukraine has formed special custom unions and signed most-favored-nation treaties with a number of countries. If imported goods originate from one of these countries, or from a WTO member country, then preferential customs duty rates are applied to these goods.

In addition to WTO members, the following countries have most-favored-nation status:

Algeria	Lebanon
Azerbaijan	North Korea
Bosnia & Herzegovina	Serbia
Belarus	Syria
Guinea	Taiwan
Iran	Turkmenistan
Kazakhstan	Uzbekistan

Libya

### Customs fees

According to Ukrainian customs law, customs fees are collected for carrying out customs clearance procedures on goods, with extra fees payable for customs clearance procedures carried out outside of regular office hours and at locations other than the premises of the customs authorities (in a customs control zone located at the premises of an enterprise that is storing the goods).

The clearance fees (EUR per hour) are as follows:

- customs clearance procedures carried out at locations other than the premises of the customs authorities:
  - EUR 20 during regular working hours;
  - EUR 40 during overtime, at night and on weekends;
  - EUR 50 on public holidays.
- customs clearance procedures carried out at customs authorities locations outside regular office hours:
  - EUR 40 during overtime, at night and on weekends;
  - EUR 50 on public holidays.

Also, according to Ukrainian customs law, expenses for storage of goods at the warehouses managed by the customs authorities should be reimbursed by the goods owner starting from the 11th day of the storage.

# Special tax regimes

<sup>3</sup>Where more than 66% of income is generated from the sales of plants/crops grown on indoor soil

## Taxation of agricultural companies

Ukrainian tax legislation allows agricultural producers to choose between special tax regimes and the general system of taxation.

Agricultural companies should meet certain criteria to qualify for the benefits provided by special tax regimes.

### CIT

Subject to general CIT rules described in the Corporate Income Tax section, an agricultural company may benefit from the following:

- possibility to decrease the amount of CIT payable by the amount of land tax paid;
- a year as a reporting period.

Agricultural producers may opt into this special regime, provided that at least 50% of their annual income is made up of revenue from the sale of agricultural products.

### Fixed Agricultural Tax (FAT)

In order to be registered as a FAT payer, an agricultural producer must comply with the following conditions:

- the company must be incorporated as an "agricultural enterprise," in any legal form allowed by the law; and
- the company must be engaged in the production/ cultivation, processing, and distribution of agricultural products.

If a FAT payer's income from agricultural products it produced makes up less than 75% of its annual gross income, the company can no longer qualify for a FAT payer status in accordance with the general rules, starting from the next tax year. Transition from one tax system to another (CIT payer to FAT payer, and vice versa) within a reporting year is prohibited.

The amount of FAT payable to the government is calculated based on the total area of land and its value. All land taken into account should be used for agricultural production purposes and should be either owned or rented by the taxpayer. The effective FAT rates are presented in table 7.

The deadline for the submission of FAT reporting is 1 February of a reporting year that ends on 31 December (i.e., the report is submitted in advance). FAT payments should be made regularly over the course of a year, with the following quarterly allocation:

- Q1 = 10%;
- Q2 = 10%;
- Q3 = 50%;
- Q4 = 30%.

Payments must be made on a monthly basis, within 30 days of the end of the reporting month, with each monthly payment to equal one-third of the total payable for the respective quarter.

Table 7

Types of land plots owned or used by a taxpayer	FAT rate, % per value of hectare
Plough lands, haying lands and pastures	0.15
Plough lands, haying lands and pastures in mountainous regions	0.09
Plots of land subject to a perennial planting regime	0.09
Plots of land subject to a perennial planting regime, located in mountainous regions	0.03
Underwater plots of land used for fishery purposes	0.45
Plough lands, haying lands and pastures, owned or rented by agricultural producers, which are set up to grow plants or crops (including vegetables) indoors <sup>3</sup>	1

## VAT

Agricultural producers can take advantage of a special VAT regime until 1 January 2018. In order to be entitled to use this regime, agricultural companies must report revenue from the last 12 calendar months' sales of agricultural products they have produced amounting to at least 75% of their total sales revenue.

According to the rules governing the special VAT regime, VAT collected from agricultural producers is not payable to the government, but should instead be retained by these companies and transferred to special bank accounts. These funds may only then be used for the development of agricultural production.

Within the framework of a different subsidy, until 1 January 2015, reprocessing companies that sell re-processed milk and meat products must transfer the respective VAT (which would otherwise be payable to the government) to a special governmental fund. Subsidies will then be paid from this fund to the producers who sold their milk and meat products to the reprocessing companies in question.

Generally, no VAT refunds are allowed under the special VAT regime, except for net VAT input generated by export sales.

## Unified tax system

Starting from 1 January 2012, a new special regulation of simplified taxation and reporting system came into force.

The Tax Code provides for six main groups of taxpayers. Basic parameters are described in table 8 below.

Table 8

Group	Legal status	Number of employees engaged	Gross income, UAH/USD	Activities allowed	Rate
1	Entrepreneurs	none	UAH 150,000/ USD 18,750	- Market trade (retail) - Domestic services provision to population	From 1 to 10% of statutory minimum wage established on 1 January of the reporting year
2	Entrepreneurs	not more than 10	UAH 1,000,000/ USD 125,000	- Services provision to population - Manufacturing and/or sale of goods - Catering activities	From 2 to 20% of statutory minimum wage established on 1 January of the reporting year
3	Entrepreneurs	not more than 20	UAH 3,000,000/ USD 375,000	All except not allowed activities	3% of income (with VAT registration) OR 5% of income (without VAT registration)
4	Legal entities	not more than 50	UAH 5,000,000/ USD 625,000	All except not allowed activities	
5	Entrepreneurs	not limited	UAH 20,000,000/ USD 2,500,000	All except not allowed activities	5% of income (with VAT registration) OR 7% of income (without VAT registration)
6	Legal entities	not limited	UAH 20,000,000/ USD 2,500,000	All except not allowed activities	

## Taxation of IT companies

### CIT

In general, a 5% CIT rate is applied to the profits of companies falling within the Tax Code's definition of an IT company.

In terms of the TCU, an IT company is a business entity that has qualified for the following criteria during the last four quarters:

- no less than 70% of the company's gross income is derived from its IT operations;
- initial value of fixed and intangible assets exceeds 50 minimum monthly salaries (UAH 57,350 /USD 7,175) as of 1 January of the reporting year;
- the company does not have outstanding tax debts; and
- no bankruptcy proceedings are initiated against the company.

IT operations include:

- software release (including sale, letting and/or licensing of the system software);
- translation and adaptation, computer programming and related activities;
- IT consulting (including IT systems planning);
- computer hardware management;
- network development;
- data processing and data base creation.

In order to apply a lower CIT rate, a qualifying company should additionally register with the tax authorities as an IT company.

A 5% CIT rate is applied to profits received from IT operations only (i.e., only income and expenses related to IT operations shall be accounted in taxable income calculation) from 1 January 2013.

Companies entitled to the special CIT rate must maintain separate accounting systems for their IT operations and other operations. Expenses that are directly attributable to IT operations (including depreciation of the assets used in IT operations) should be recognized in the IT operations accounting. General and administrative expenses are allocated between the two accounting systems on a pro rata basis.

### VAT

All supplies of software are exempt from VAT for the next 10 years (from 1 January 2013 to 1 January 2023). The wording of this exemption is somewhat ambiguous and results in differences in treatment between taxpayers and the tax authorities.

## Taxation of hotels

### CIT

Starting from 1 January 2011, income from the provision of hotel services by 5, 4 and 3 star hotels is exempt from CIT for 10 years. The exemption is applicable if income received from the provision of accommodation exceeds 50% of the gross income for a particular period.

Effective Ukrainian legislation exempts qualifying taxpayers from paying CIT liabilities to the government, however, provides for certain requirements in respect of the amounts so saved. Specifically, such amounts should be:

- allocated for modernization of technical facilities, sales volume increase, new technology implementation, and/or loan repayment;
- used in a taxpayer's business activities generating profit that is exempt from CIT;
- recognized as taxable income simultaneously with recognition of deductible expenses incurred and paid with such funds. The taxable income recognized must be equal to expenses incurred.

The funds received from the above tax benefit should be directed to the development of the hotel business. However, if the taxpayer fails to direct the costs so saved during the previous 1,095 days, it should add them to its taxable income and pay the tax at the usual rate and pay late payment interest.

Taxpayers qualifying for CIT exemption should maintain separate accounting systems for their hotel services operations and other operations.

## Taxation of banking institutions in Ukraine

### CIT

#### **Definition of taxable income**

Taxable income (or “gross income”) is defined as any income, from any source, earned/accrued by a taxpayer in the course of carrying out any activity. Taxable income may be in monetary, tangible, or intangible form. With regard to banking activities, the following items are usually included into taxable income:

- interest and commission income;
- income from trading in securities;
- release of loan loss provisions;
- profits from sales of foreign currency;
- factoring income;
- income from sales of collaterals;
- dividends received from non-residents (except for dividends from foreign subsidiaries and associates controlled by a taxpayer that is not a resident of an offshore jurisdiction);
- foreign exchange gains arising as a result of the revaluation/settlement of foreign currency, as well as from receivables and payables denominated in foreign currency.

#### Interest and commission income

The Tax Code provides for commission/interest income to be recognized on an accrual basis, pursuant to the rules envisaged by the Ukrainian Accounting Standards (UAS).

If a borrower is late in paying interest, a lender has the right to use the mechanism for settling doubtful/bad debts. If the taxpayer is subject to this mechanism, the accrual of gross income is suspended in relation to the delinquent loans until they are settled or written off. When bad debt settlement procedures are not initiated, interest income accrued on bad debts will increase taxable income, irrespective of whether the accrual of interest has been suspended in financial accounting.

#### **Transactions involving securities**

Transactions with securities are taxed based on the pooling principle, according to which taxable results from transactions involving different types of securities (e.g., shares, bonds, promissory notes, derivatives, etc.) are accounted for separately.

At the same time, a taxpayer should not trace the taxable result for each individual security, inasmuch as the taxable profit/loss is determined for each basket of securities of the same type.

Therefore, the costs of securities should be reported as expenses within each basket for the period in which the securities are purchased, while revenues from the sale of securities are reported as income in the period in which they are sold. If positive, the balance at the end of each quarter is taxable at 25% CIT. If it is negative, it is not immediately deductible, but may be carried forward to subsequent periods, when it can be used to offset income from the sale of the relevant type of securities.

In addition to the above, the Tax Code provides for income/expenses from transactions involving securities to be recognized on a cash-or-accrual basis (the so-called “first event rule”), as follows:

- income is recognized when the cash is received or when securities are transferred, whichever occurs earlier;
- expenses are reported when the cash is paid out or when securities are received, whichever occurs earlier.

There is no time limit on the carry-forward of losses from transactions involving securities.

#### **Definition of deductible expenses**

Any business-related expenses are deductible from taxable income, unless such a deduction is specifically restricted or prohibited by the Tax Code. In the banking industry, deductible expenses normally include the following items:

- interest and commission expenses;
- loan loss provisions;
- payments to the Deposit Guarantee Fund;
- foreign exchange losses arising as a result of the revaluation/settlement of foreign currency, as well as from receivables and payables denominated in foreign currency;
- operating expenses related to carrying out banking activities (e.g., leasing premises, IT costs, support for electronic payment systems, etc.).

### **Loan loss provisions**

Banks are allowed to establish deductible loan loss provisions up to 20% of the gross book value of the loan portfolio extended by issued guarantees.

The provisions made to set up loans, guarantees, nostro accounts, securities, and other asset transactions may be deducted from taxable income, along with accrued interest and commissions – both standard and non-standard. Loan loss provisions for off-balance-sheet items (except for issued guarantees) are expressly prohibited.

### **VAT**

The majority of banking operations are not subject to VAT (except for cash and debt collection services). Meanwhile, sales of collateral are normally subject to VAT, unless the bank repossessed the collateral in question from non-VAT payers.

In general, Ukrainian banks are not entitled to obtain VAT credit in relation to purchases of goods/services, even those purchased with a view to use in their business activities.

### **Taxation of insurance companies in Ukraine**

#### **CIT**

In general, insurance companies are taxable on their profits from all types of business activities.

Insurance companies that do not provide life insurance are taxable at the following rates:

- 19% in 2013;
- 16% from 1 January 2014.

Life insurance companies are taxable at a 0% CIT rate on long-term life insurance contracts. Meanwhile, their non-insurance profits are subject to the regular CIT rates as stipulated above.

With respect to insurance activities, the Tax Code stipulates, inter alia, the following items of taxable income:

- gross written premiums (less ceded premiums);
- releases of insurance reserves (less reinsurance share);
- investment income from the placement of life insurance reserves;
- interest income on banking planned/advance deposit premiums;
- forex gains on insurance reserves and reserve placements (non-life-insurance only);
- reinsurance bonuses receivable, fronting income;
- claims recovered from policyholders or third parties;
- profits from trading in securities;
- in accordance with the Tax Code, the following items are specifically included into insurance expense;
- increases in insurance reserves (less reinsurance share);
- gross claims incurred (less claims recovered from reinsurers);
- policy acquisition costs;
- services purchased from third parties (medical assistance, actuarial services, licensing costs, forensic services, claim adjustment services, legal services, advertising and promotional services, etc.);
- payroll expenses for personnel involved in insurance activities;
- reinsurance bonuses payable, fronting expenses;
- forex losses on insurance reserves and reserve placements (non-life insurance only);
- interest expenses on banking planned/advance deposit premiums.

When paying insurance/reinsurance premiums/compensation to non-residents, the payer will accrue and pay additional tax at its own expense, as follows:

- 0% for obligatory types of insurance for non-residents and within the framework of international “Green Card” agreements;
- 0% for insurance/reinsurance of risks by an insurance company with a high financial reliability rating (including agency activities by reinsurance brokers);
- 4% for the insurance of risks arising outside of Ukraine;
- 12% in other cases.

## Taxation of leasing companies in Ukraine

### Operating lease

Transferring property under an operating lease will not generally result in CIT consequences, either for the lessor or for the lessee. The property in question is not included in the fixed assets of the lessee and remains among the fixed assets of the lessor. Meanwhile, the lessor continues to receive tax depreciation for property transferred under the operating lease.

The operating lease fee is included in the lessor's taxable income, and represents a valid CIT deduction for the lessee. According to current legislation, the lease fee is subject to VAT at a rate of 20%, whereas the transfer of property under the operating lease is not subject to VAT.

### Financial lease

The Tax Code defines financial lease as a business transaction between individuals/legal entities, whereby property defined as a fixed asset, in accordance with the Tax Code, is purchased or produced by a lessor and subsequently transferred to a lessee, along with any risks and benefits associated with the right to use and possess such property.

The Tax Code envisages specific criteria for the qualification of a lease transaction as a financial lease. Notwithstanding these criteria, the parties may elect to treat any lease transaction as an operating lease for tax purposes.

From a CIT perspective, the transfer of property under the financial lease will be treated as the sale of the property in question at the moment of transfer. Therefore, the leased property should be included in the fixed assets of the lessee following the transfer, for CIT purposes. Land cannot be subject to the financial lease.

According to current legislation, only the interest element of a lease payment is subject to CIT on an accruals basis. Where leased property is returned to the lessor, this return will be treated as a return of this property for CIT purposes.

Transfers of property under the financial lease are subject to 20% VAT at the moment of transfer. The lessee will become eligible for the respective amount of VAT input at the moment of transfer as well.

For financial lease purposes, the VAT base is determined on a contractual basis, but should not be less than the purchase price of the object of the financial lease.

The interest portion of a financial lease installment is exempt from VAT.

### Tax benefits

The Tax Code provides for the following benefits:

- tax exemption is available for 80% of income earned by a company from the sale, within the customs territory of Ukraine, of energy-saving equipment and materials produced by the company, as specified by the Verkhovna Rada;
- tax exemption is available for 50% of the income derived from the implementation of energy-saving and energy-efficient projects by companies included in the State Register of Enterprises, Institutions and Organizations Engaged in Implementing Energy-Saving and Energy Efficiency Projects.

### Tax holidays

Small enterprises that meet certain criteria (e.g., an annual income less than or equal to UAH 3,000,000/ USD 375,000, and an average salary paid to staff of no less than two minimum wages, as established by the effective legislation) are entitled to a 0% CIT rate from 1 April 2011 until 1 January 2016.

# Personal income tax (PIT)

## Tax base for individuals

The PIT base for Ukrainian and foreign nationals, as well as stateless persons, depends on their tax residency status. It is important that tax residency is different from nationality, citizenship and residency for currency control purposes.

Ukrainian tax residents are subject to PIT on their worldwide income, whereas non-residents are only subject to taxation on the Ukrainian-sourced portion of their income. Ukrainian-sourced income means income received for the work on behalf of Ukrainian entity/ business regardless of which entity pays the income – Ukrainian or foreign.

The reporting period is a calendar month and year. Depending on their tax position for the year, individuals may be required to file annual tax return for the respective year; while companies and tax agents are required to file quarterly reports (1 DF Form) and keep monthly payroll.

## Tax residency

The Tax Code establishes the following rules for determining the tax status of an individual:

- an individual is considered to be a tax resident of Ukraine if he/she has a permanent home in Ukraine (“permanent residency test”);
- if an individual has a permanent home in more than one country, he/she is considered a tax resident in the country, with which he/she has the closest personal and economic ties (“center of vital interests test”);
- if it is impossible to determine the country of residence using either the permanent residency or center of vital interests test, the individual is considered a Ukrainian tax resident if he/she is present in Ukraine for at least 183 days, cumulatively, during a particular reporting year, including the days of arrival and departure counted as separate days;
- if tax residency cannot be determined based on the 183-day test, the individual is considered a Ukrainian tax resident if he/she has Ukrainian citizenship.

In addition, the Tax Code sets a self-recognition procedure, according to which an individual can voluntarily elect to be a Ukrainian tax resident.

While it is important that domestic laws provide tax residency rules, these provisions may be overruled by the respective provisions of double tax treaties (DTTs). Please note that the domestic rules used to define tax status are, in many ways, similar to those suggested by the Model OECD Tax Convention. Since Ukraine is not a member of the OECD, Ukrainian tax authorities may ignore the Commentary to the Model Tax Convention.

## Tax rates

The following PIT rates are generally applied:

- 15% on the worldwide income of tax residents and the Ukrainian-sourced income of non-residents up to the monthly threshold of 10 minimum monthly wages (UAH 1,147 – approx. USD 144 as of 1 January 2013). Calculated for every month;
- 17% on the worldwide income of tax residents and the Ukrainian-sourced income of non-residents above the monthly threshold of 10 minimum wages (counted for every month);
- 30% on income from winnings and prizes;
- 10% on income of certain types of employees (e.g., mining workers);
- 0% on inheritance from immediate relatives, income from the first sale of qualifying residential property and plots of land not exceeding the limit for free land transfers (provided that the property has been in ownership for more than 3 years).

- 5% for tax residents on: income from the sale of commercial property; income from the second and any further sale of residential property within one reporting year; income from the sale of movable property by its owner, other than the first sale of a vehicle; income from the sale of plots of land over of the maximum area for free land transfers; on dividends issued by a resident issuer; and on inheritance paid to non-relatives;
- 15%/17% for tax non-residents on: income from the sale of commercial property; income from the second and any further sale of residential property within one reporting year; income from the sale of movable property by its owner other than the first sale of a vehicle; income from the sale of plots of land over the maximum area for free land transfers; on dividends issued by a resident issuer; and on inheritance paid to non-relatives.

Income from the single sale of a vehicle during a reporting period is not subject to tax.

#### Tax base for tax residents

As mentioned above, residents are taxed on their worldwide income, i.e., on income received from both domestic and foreign sources. Income is taxed, irrespective of whether it is received in-cash or in-kind. In the event that an individual receives benefits in-kind, the amount of taxable income is determined on the basis of the fair market value of the property, services or other benefits received.

The following benefits received by an individual are specifically exempted from inclusion in the tax base:

- income received in the form of interest on investments in securities issued by the Ministry of Finance of Ukraine;
- alimony received from residents, as defined by a respective court ruling, or in accordance with the Family Code of Ukraine;
- principal amount of deposit in Ukrainian banks and non-banking financial institutions, as well as principal amount of credit received by an individual;

- shares received from the capitalization of retained earnings, provided that the allocation ratio of shares between shareholders remains unchanged;
- compensation of apartment and car rental costs for employees, where such benefits are envisaged by an employment agreement or collective agreement;
- amounts received from employers for certain types of medical treatment and services;
- income of a private entrepreneur who has opted into the simplified system of taxation;
- insurance payments under agreements other than life insurance or non-state retirement insurance agreements, in accordance with the conditions prescribed by law.

#### Exemptions

The Tax Code provides for a list of deductible items that are specifically included into an individual's taxable income. These include, among other, gifts, insurance contributions and premiums, rental income, and fringe benefits. Contributions to unqualified pension plans made on behalf of a taxpayer by another person/an employer will also be included in an individual's taxable income.

The Tax Code allows for the following deductions:

- interest on Ukrainian mortgages (with certain conditions);
- contributions to registered charities;
- qualifying education expenses for the taxpayer and his/her immediate family;
- medical expenses for the taxpayer and his/her immediate family paid in favor of medical establishments;
- insurance expenses, within the limits defined by the Tax Code;
- certain specific allowances.

A special annex to the tax return should be submitted in order to apply for these deductions.

### **Taxation of proceeds from sale of the real estate**

Income received from the sale of real estate is not taxable if the property in question is sold once during a tax reporting year and provided that the property has been owned for longer than 3 years.

Income received from the sale of inherited real estate property is not taxable if such property is sold only once during a tax reporting year. Revenue earned from the sale of a house, apartment, part of an apartment, room or cottage (including the plot of land, on which it is located) is subject to a 5% tax, which is levied on the amount received for second and any further sale of the property within a tax reporting year.

### **Real estate property tax**

Starting from 1 January 2013, the provision of the TCU on a tax on real estate property came into force. The owners of the apartments with living area exceeding 120 m<sup>2</sup> and houses with living area exceeding 250 m<sup>2</sup>, or owners of two or more apartments are subject to tax on real estate property.

The part of area exceeding 120m<sup>2</sup> or 250m<sup>2</sup> respectively serves as the base for the tax on real estate property.

Tax rates are:

- 1% of the minimum monthly wage on every 1m<sup>2</sup> of the apartments with living area up to 240 m<sup>2</sup> and for houses with living area up to 500 m<sup>2</sup>;
- 2.7% of the minimum monthly wage on every m<sup>2</sup> exceeding the aforementioned threshold.

If an individual owns two or more apartments, one of them will be the subject to the tax. In such a case, the tax base will be determined as the total living area of one of the apartments at individual's choice. The tax on real estate property is calculated by the tax authorities on an annual basis and has to be settled by an individual within 60 days after receipt of the respective tax notification.

Please note that legal entities are also subject to real estate property tax; however, they should independently calculate and pay property tax on a quarterly basis.

### **Taxation of foreign individuals who are residents of Ukraine**

Foreign individuals who are considered Ukrainian tax residents are taxed in the same manner, and according to the same rules, as Ukrainian nationals.

### **Taxation of foreign individuals who are non-residents of Ukraine**

The Tax Code states that non-residents are taxed on their Ukrainian-sourced income only. Non-resident tax rates and procedures are the same as for residents, except for the taxation of certain transactions.

In general, a 15%/17% rate applies.

Employment/salary income, including that received from the Ukrainian employer, is taxed at the same rates, and according to the same rules, that apply to residents.

It is no longer necessary to obtain a special tax residency certificate, issued by the tax authorities, in order to apply the same rates to Ukrainian salary paid to foreign assignees.

### **State registration of taxpayers**

Individuals who qualify as Ukrainian taxpayers should be registered with the State Tax Administration of Ukraine.

Registration is confirmed by obtaining a personal tax ID number, which is used for the following activities: incorporation of a legal entity in Ukraine, opening and operating a bank account, submission of a personal tax return, payment of PIT, claiming tax credit, and entering into civil agreements that provide for the payment of tax/state duties.

### Tax agents

In general, Ukrainian employers (companies, other legal entities and representative offices of foreign companies) are considered tax agents with regard to the income they pay to individuals.

Tax agents are responsible for withholding PIT and Unified Social Security Contributions from the income they pay to their employees, and for remitting this tax to the government when paying income (in accordance with the PAYE principle).

When income is paid in kind or in cash, a tax agent is required to remit the relevant tax to the government on the first banking day following the payment/provision of the income to the individual. The tax is calculated using gross-up.

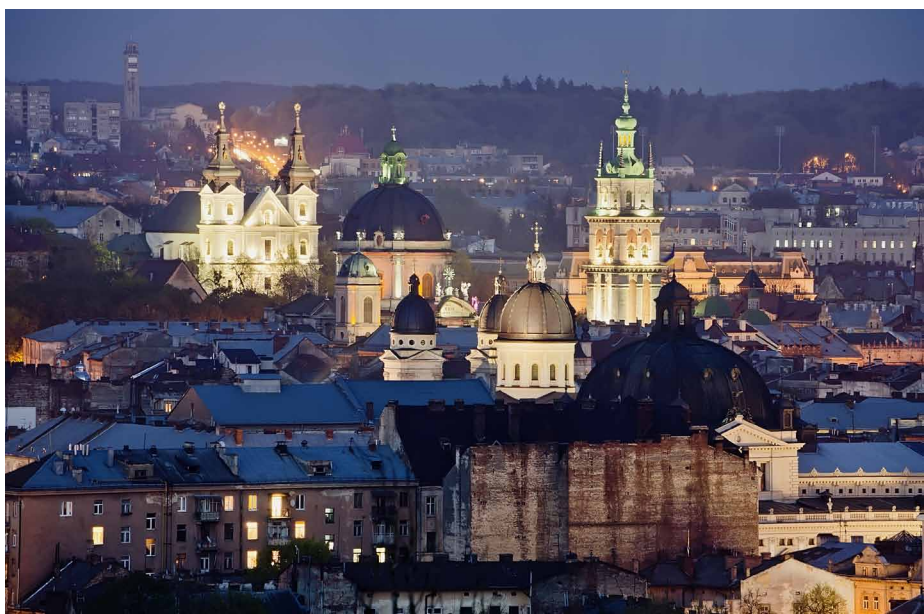
If income is accrued by an employer but not paid to an employee, the relevant tax is required to be remitted to the government within 10 days following the month, in which such income was accrued.

The payment of PIT on salaries and other taxable compensation items is the responsibility of the tax agent. Tax agents are required to remit the tax to the government in a timely manner, in order to avoid financial penalties, which can be significant (up to 75%).

### Reporting requirements for individuals

Tax agents are generally obliged to file personal income tax reports to the tax authorities on a quarterly and monthly basis. At the same time, in order to claim a tax credit with regard to certain expenses incurred during a calendar year, individual taxpayers need to file annual tax return.

In certain cases, an individual is required to submit a tax return, such as when they receive taxable income from sources other than a tax agent (e.g., foreign income), or from two or more tax agents, where the individual in question's total annual income exceeds the threshold of 120 minimum wages, and also when claiming a tax credit. Annual PIT return should be submitted to the Ukrainian tax authorities by 1 May of the year following the reporting year. The respective tax (if any) must then be paid by 1 August of the same year.



# Unified Social Security Contributions

## General principles

Unified Social Security Contribution (USSC) is regulated by the Law of Ukraine "On Collecting and Accounting for Unified Social Security Contributions to Compulsory State Social Insurance". The law provides for the consolidation of all social insurance functions within the Pension Fund of Ukraine and for the payment of the USSC using a single payment order.

The base for USSC is capped at seventeen minimum monthly cost of living and stands at:

- UAH 19,499 from 1 January 2013 to 30 November 2013;
- UAH 20,706 from 1 December 2013 to 31 December 2013.

Effective laws set the amount of the USSC as a percentage of the accrual base between the minimum amount of the USSC payment and the abovementioned maximum accrual base, depending on the category of a payer.

The minimum USSC amount is calculated as the minimum wage multiplied by the USSC amount established by the Law for the respective category of payers. For example, as of 1 January 2013, if the 34.7% accrual base rate is applied, the minimum amount of the USSC is UAH 398.

If the income is drawn from different sources (e.g., principal and secondary employment), the USSC will be accrued on the total income of the insured individual within the set limits.

USSC rates are summarized below in table 9.

Table 9

Type	Unified Social Security Contribution rate	
	Employer's contribution	Employee's contribution
Enterprises and PEs using a hired labor force (labor contracts)	36.76-49.7% <sup>5</sup>	3.6%
Employers paying remuneration under civil law contracts	34.7%	2.6%
PEs registered as taxpayers under the simplified tax system	34.7%	
Individuals engaged in independent professional activities	34.7%	

# Duties for use of natural resources

## Types of duties

The Ukrainian tax system imposes a number of duties on the use of natural resources. These include:

- rental duty on transportation of oil and oil products through oil trunk pipelines and oil product pipelines, natural gas and ammonia transits through the territory of Ukraine (applicable to only few entities, including "Naftogaz Ukrainy");
- duty on subsoil use;
- duty on the special use of water;
- duty on the special use of forest resources;
- duty on the development of viticulture, horticulture and hop-growing;
- surcharge on the effective tariff on electric and heat energy, except for electrical energy produced by qualified cogeneration facilities;
- surcharge on the effective tariff on natural gas for consumers of all types of ownership.

## Duty on subsoil use

The duty is imposed on (i) mineral resources extracted from the territory of Ukraine, including its continental shelf and exclusive economic zone, (ii) mineral resources extracted from mining waste, and (iii) mineral reserves used.

The duty base is the value of each type of mineral resources extracted.

The value of mineral resources is calculated under basic supply terms, at the higher of:

- the selling price of mineral resources; and
- the estimated cost of mineral resources, except for crude hydrocarbons.

The amount of the duty payable is calculated according to the formula, and depends on the volume of the appropriate type of mineral resources, its value, the applicable duty rate, and the adjusting coefficient.

The reporting period is a calendar quarter.

## Duty on the special use of water

The object of the duty is the actual water volume utilized by water users taking into account the normal loss of water in their water supply systems.

Where water is used without the extraction from water objects, the duty is calculated as follows:

- hydroelectric power producers – the actual volume of water pumped through pipelines during the production process;
- water transport – the tonnage per day for cargo and passenger-seat per day for passengers;
- fisheries – the actual water volume required to replenish water resources for fish farming purposes.

The duty rates vary from UAH 13.17 to UAH 78.84 per 100 m<sup>3</sup> (for surface water), depending on the water basin, and from UAH 34.48 to UAH 82.09 per 100 m<sup>3</sup> (for underground water), depending on the region.

Preferential rates apply to specific business activities.

The amount of the duty payable is calculated based on the actual use of water, water use limits, applicable duty rates and coefficients.

The basic reporting period is a calendar quarter.

## Duty on the special use of forest resources

The objects of the duty are timber and other wood materials stored up for a wide range of purposes by users of forest resources.

The rates of the duty vary, depending on the type of forest resources, region and the transportation distance.

The basic reporting period is a calendar quarter.

**Surcharge on the effective tariff on electric and heat energy, except for electric power produced by qualified cogeneration facilities**

The objects of the surcharge are:

- for wholesale suppliers of electric power – the value of electric power supplied, net of VAT;
- for legal entities – the value of electric power sold in the market, other than the wholesale market, less the value of electric power produced by qualified cogeneration facilities and/or from renewable energy sources.

The surcharge rate is 3% of the value of electric energy sold, net of VAT.

The basic reporting period is a calendar month.

**Surcharge on the effective tariff on natural gas for consumers of all types of ownership**

The object of the surcharge is the value of natural gas sold to consumers on a contractual basis.

The surcharge rate is 2% of the volume of natural gas supplied to:

- heat power plants, power stations, boiler stations, etc.;
  - state-run institutions;
  - manufacturing companies and other business entities
- For the general public, the surcharge rate is 4%.

**Duty on the development of viticulture, horticulture and hop-growing**

This duty is imposed on alcoholic beverages sold by entities through wholesale and retail chains or public catering networks. Producers of alcoholic beverages pay the duty if they sell these products directly to consumers. Where producers supply a wholesale or retail chain, they do not pay the duty.

The duty is levied at a rate of 1.5% of total sales of alcoholic beverages and should be paid on a monthly basis.

According to the Tax Code, the duty is effective until 1 January 2018.



# Other taxes

## Land tax

The land tax is imposed on owners and users of land. The amount of tax payable depends on the use (e.g., farmland) and location of the land.

For inhabited land, if there is a value estimate attached to the land, then the land tax payable is calculated as 1% of that estimate. Otherwise, the amount of land tax payable ranges from UAH 0.28 per square meter in towns with populations of less than 3,000 people, to UAH 3.95 per square meter in cities with over 1 million people. For regional centers, zone coefficients of 1.2 to 3 apply.

Agricultural land is taxed at a rate of 0.03-0.1% of the estimated value.

The land lease rate cannot be less than three times the land tax rate (with a few exceptions).

The land tax and land lease payments are due on a monthly basis, within 30 calendar days of the end of a reporting month.

## Duties for the initial registration of a vehicle

The Tax Code stipulates that legal entities and individuals should pay duties for the initial registration of vehicles in Ukraine. The amount of duties payable depends on the engine capacity of the vehicle in question, ranging from UAH 3.53 to UAH 70.50 per 100 cubic centimeters.

Duties must be paid prior to the registration of a vehicle. Legal entities should file copies of confirmatory documents with the tax authorities within 10 days from a vehicle registration.

## Local taxes

Ukraine imposes a number of taxes at the local level, including property tax, duties on certain business activities, parking duties, unified tax, and tourist duties. In general, local taxes and duties do not have a significant impact on a taxpayer's tax position.





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This manual was prepared by the professional staff of Deloitte Ukraine. It is designed to give potential foreign investors and Ukrainian businesses a reference tool for the numerous tax laws, regulatory issues and compliance requirements which they may encounter.

The legislative framework of Ukraine's tax system continues to transform itself. However, there are instances where unclear statutory language and explanatory instructions may allow more than one interpretation of the law. As a result, we advise the readers of this manual to confer with professional accountants, attorneys and consultants before taking any formal action.

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