Global tax guide to doing business in Ukraine

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Overview

Ukraine's taxation system continues to develop and has become relatively complex. Tax legislation is amended often and sometimes retroactively. Tax law is still characterized by a lack of precise policy or exhaustive explanation. A number of government bodies and different bodies of the state tax authorities issue their own interpretations of tax legislation, which may be contradictory. Many issues remain in need of clarification and require a unified approach. All these factors lead to the risk of inconsistent application of tax law by state tax authorities and taxpayers.

In 2011, Ukraine's first tax code (tax code) came into force and consolidated many (but not all) Ukrainian tax laws into one document. The new tax code eliminated some ineffective taxes and introduced a number of important changes into the taxation system, with the goal of simplifying and updating it. However, there remains a degree of uncertainty around the application of tax code provisions and how it adapts to practical and economic realities.

In 2014 and then in 2017, Ukrainian tax authorities announced tax reforms with several objectives: decreasing the number of taxes, simplifying the administration of taxes, decreasing the tax burden on salaries and decentralizing tax administration. The main goals were to simplify tax administration, motivate taxpayers to conduct business transparently and make Ukraine more attractive for investment purposes. A new round of tax reform is currently on the Ukrainian government's agenda.

Recent changes relate to the Organisation for Economic Cooperation and Development (OECD) base erosion and profit shifting (BEPS) requirements. There were changes in the following areas: information exchange, tax on withdrawn capital tax administration procedures, transfer pricing rules, principles of accounting and tax adjustments, reform of the State Fiscal Service of Ukraine, introduction of a "single window" for efficient customs clearance, reduction of the value-added tax (VAT) rate to 7% for medical goods and deferral of VAT for import of certain goods, among other incentives. In 2020 new anti-BEPS provisions were developed by the government bodies, but the provisions have not come into force yet.

In this chapter

Legal system

Ukraine operates under a civil law system. A well-recognized system of precedents does not exist. Courts will not necessarily enforce the laws as written or accessible, and may issue varying opinions, decisions and interpretations of the same law. In addition, courts in Ukraine lack established experience in commercial dispute resolution. Many of the procedural remedies for enforcing and protecting legal rights typically found in Western jurisdictions are not available in Ukraine.

Taxation authorities

In 2020 the State Fiscal Service of Ukraine (SFS) was divided into two state bodies: the State Tax Service of Ukraine (STS) and the State Customs Service (SCS) of Ukraine. Both report to the Cabinet of Ministers of Ukraine through Ministry of Finance of Ukraine.

The tax system in Ukraine is administered by STS, which interprets and executes effective tax legislation. STS operates directly through its regional offices. There are tax police units within STS and its regional bodies.

The customs system in Ukraine is administered by SCS, which interprets and executes effective customs legislation directly through its regional offices.

Since 2020, STS has been the central body of executive power that implements state tax policy in the areas of state tax and contributions to the obligatory state social insurance (united social contribution). SCS implements state customs policy.

Business vehicles

A non-resident may either establish a Ukrainian legal entity to carry on business in Ukraine or operate directly through a representative office in Ukraine.

Under Ukrainian law, companies may be incorporated in one of the following forms:

i. Limited liability companies
ii. Joint stock companies, either private or public
iii. Additional liability partnerships (companies)
iv. General partnerships
v. Limited partnerships.

The limited liability company (LLC) and the joint stock company (JSC) are the most commonly used forms of business organization in Ukraine.

The contribution of assets (noncash contributions) into the charter capital of a Ukrainian legal entity are subject to VAT at a rate of 20%. Cash contributions are not subject to VAT.

Limited liability companies

An LLC is a company founded by one or more persons (legal or physical persons) with charter capital divided into participation interests (without the issuance of the shares) according to its charter. The LLC's charter capital is formed by its founders or members in cash, securities or other assets contributed in the first six months starting from the date of state registration, unless otherwise stipulated by laws or the LLC's charter. There are no limitations to the contribution amount of founders/members of the LLC and no limitations to the number of founders/members.

Joint stock companies

A JSC is a company in which the charter capital is divided into a certain number of shares with an equal nominal value. The JSC is liable for its obligations only to the extent of its assets. Under the Law of Ukraine "On Joint Stock

Companies," dated September 17, 2008, as amended, (the JSC Law), there are two types of JSCs: (i) public joint stock companies (publichne aktsionerne tovarystvo), of which the shares are publicly listed; and (ii) private joint stock companies (pryvatne aktsionerne tovarystvo), the shares of which are distributed among the founders.

Partnerships

Ukrainian law recognizes three types of partnerships:

i. An additional liability partnership is an entity in which the charter capital is formed from the contributions of its founders. The founders of an additional liability partnership jointly carry additional responsibility for partnership's obligations with their property in the amount set by the partnership's charter; the amount of such additional liability depends on the amount of the contribution made by each founder. From a tax law prospective, this type of partnership is considered a company. Also, the liability is not limited to the contribution of each participant, but is computed pro rata to the contribution of each participant
ii. A general partnership is an entity in which the founders do business jointly and are held jointly liable for the obligations of the partnership with respect to all their property, beyond their contributions. A person may be a participant in one general partnership only
iii. A limited partnership is an entity in which founders do business on behalf of the partnership; at least one founder is liable to the extent of all their property, beyond their contribution; and the liability of other founders is limited to their respective contributions to the partnership's charter capital. The founders limited to their contributions do not participate in the activity of the partnership.

Representative offices

Under Ukrainian law, a representative office has no independent legal status separate from its foreign sponsor or parent company. It can be considered an "arm" of the parent company, and the parent company is liable for the obligations of its representative office. Based on the current taxation regime in Ukraine, the representative offices may be of two types: a non-commercial representative office and a commercial representative office.

A commercial representative office is a taxable permanent establishment that represents the parent company's interests in Ukraine and that engages in commercial activities taxable in Ukraine. The commercial representative office may be subject to Ukrainian taxes (including excise taxes) depending upon the type of activities performed.

A non-commercial representative office normally is not subject to Ukrainian corporate income tax (CIT) due to provisions of applicable double-taxation treaties between Ukraine and the state of residence of the foreign parent company. Such treaties exempt from taxation the income of non-commercial representative offices.

Financing a company subsidiary

Contributing to the charter capital

Limited liability company

There are no legal restrictions on how the participation interests of an LLC may be distributed. This issue remains entirely within the discretion of the LLC's founders and participants. There is no legislatively established minimum amount of the charter capital for an LLC under current Ukrainian law. Participants in the LLC can make their contributions to the charter capital in cash or in kind. The advantage of a cash contribution is that it is not subject to VAT.

The LLC is entitled to increase or decrease the amount of its charter capital. The charter capital may be decreased upon written notice thereof to all creditors of the LLC. In this case, the creditors may demand early termination or performance of relevant obligations from the LLC, such as securing relevant obligations by means of security agreement, or conclusion of a different agreement with the LLC. In the event an LLC fails to carry out any of the above demands, creditors may seek early termination or performance of LLC`s obligations through judicial means.

The charter capital of the company may be increased by means of additional contributions from the LLC`s participants or from third parties. Each participant has a preemptive right to make additional contribution in proportion to their existing interest in the charter capital.

Joint stock company

A minimum capitalization of 1,250 times the officially established minimum monthly salary as at the date of the formation of the JSC is required to establish a JSC. The JSC law requires 100% of the total amount of shareholders' contributions to be made prior to the date when the results of the first placement of shares are approved. An issuance of shares by both a private and a public JSC should be registered with the Ukrainian National Commission on Securities and Stock Market (the Securities Commission) by registering a report on the results of the placement of the shares and issuing a certificate for the registration of shares being issued.

A JSC's share capital may be increased by increasing the nominal value of shares or placing additional shares under the procedure established by the Securities Commission. A JSC may increase its share capital after registration of reports on the placement of all previously issued shares. An increase of the share capital of a JSC involving additional contributions can be made by placing additional shares. All shareholders enjoy a preemptive right to acquire shares in the process of issuance by the JSC of additional shares, unless a decision not to exercise this right was made at the general meeting of shareholders. Increases of the share capital of a JSC not involving additional contributions must be made by increasing the nominal value of shares. An increase in a JSC's share capital is not permitted for the purpose of covering losses. A JSC's share capital may be decreased using the procedure set out by the Securities Commission by reducing the nominal value of shares or by cancelling the shares that were previously redeemed by the JSC and reducing their total number, if this is provided for in the JSC's charter.

Debt financing

Tax and regulatory implications

Ukrainian corporations are permitted to borrow funds from related or third parties. Furthermore, there are no Ukrainian tax implications on the repayment of the principal amount of such debt. Interest payments (other than participating interest) made by a Ukrainian resident corporation to a non-resident with which it deals at arm’s length are generally subject to a withholding tax of 15% unless a tax treaty provides for a reduced rate or rate of zero. As previously mentioned, the withholding tax rate can be reduced or eliminated under an applicable double-taxation treaty.

Certain limitations (the thin capitalization) are established with respect to interest payments; the ratio is set at 3.5 to 1. Should the total aggregate amount of the borrowings received from related parties non-residents or non-related if amount of the borrowing exceed the equity of the borrower by 3.5 or more times (by 10 times for financial institutions and leasing companies), the borrower is allowed to recognize as expenses interest payments in an amount not exceeding 50% of earnings before interest, taxes, depreciation and amortization (EBITDA). The non-deductible portion of interest can be carried forward to future periods subject to the same limitation, but the balance carried forward is reduced annually at 5% of the interest amount until the interest deduction is fully utilized. Interest includes liabilities on loans, deposits, REPO transactions, financial lease agreements and other borrowings. If the debt-to-equity ratio is less than 3.5 to 1, interest is deductible in full. REPO is a financial operation between market participants on the sale (purchase) of securities with an obligation to repurchase (purchase) such securities within a specified period of time or at the request of one of the parties, at the preliminary agreed price.It is anticipated that starting from 2021,certain additional limitations on deductibility of interest may apply for corporate income tax taxpayers having a debt-to-equity ratio of more than 3.5. The limitations are defined by the anti-BEPS law, which has not come into force yet. According to the unofficial text of the anti-BEPS law, thin capitalization rules will no longer apply to lease companies and financial institutions. Further, Ukrainian law canceled interest rate limitations for borrowing in a foreign currency from a non-resident lender. Starting February 2020, the limitations below should no longer apply:

- 11% per annum for loans with a maturity of over three years
- 10% per annum for loans with a maturity of one to three years
- 9.8% per annum for loans repayable in less than one year
- LIBOR plus 750 basis points per annum for floating-rate loans.

Stamp tax

Ukraine does not impose a stamp tax in respect of debt or equity financing.

Corporate income tax

Income tax rate

For 2020, the corporate income tax rate on general active business income is 18%. As a general rule, all expenses are deductible if they constitute expenses under financial accounting standards, unless they are defined as expenses having limited deductibility under the tax code. Certain adjustments also may be required in accordance with transfer pricing laws. Expenses are reported as deductible for tax purposes according to the Ukrainian Accounting Standards (UAS) or International Financial Reporting Standards (IFRS).

No special provisions limit the deductibility of costs to a Ukrainian subsidiary for remuneration of goods and services, unless the payment is performed to a company registered in the low-tax jurisdictions, defined by the tax code, or if the operation falls under transfer pricing rules or is subject to other limitations defined in the tax code (e.g., thin capitalization, royalty, etc.).

If the payment is performed with foreign companies established in a low-tax jurisdiction, or in specific legal forms, or with foreign counterparties that are not payers of corporate tax (the criteria and lists are defined by the applicable legislation), the payment might only receive limited tax deductibility (i.e., 70%).

It is anticipated that a number of operations with a non-resident-seller and / or non-resident purchaser may be specifically regulated by the anti-BEPS law, if the law is adopted. New regulations will come into force in three phases - some of them after publication, others starting from July 1, 2020, and the last, on January 1, 2021. Such regulations include the principal purpose test (PPT), which introduces the concept of “deemed dividends”; thetaxation of capital gains earned by non-resident from sale of shares / corporate rights in Ukrainian companies; and some other novelties. As of today the law has not been signed by the President and it is not clear when the law will be signed and become effective.

Capital gains

A Ukrainian resident corporation, including a Ukrainian subsidiary of a foreign corporation, must include all capital gains in its taxable income. Taxable capital gains are taxed in the same manner as ordinary income.

A non-resident corporation is only taxed on gains arising from the disposition of “taxable Ukrainian property,” other than gains exempted under an applicable double-taxation treaty. Taxable Ukrainian property includes all of the following:

i. Real or immovable property situated in Ukraine
ii. Property (including goodwill) used or held by a taxpayer in a business carried in Ukraine
iii. Inventory forming part of a business carried in Ukraine.

It is anticipated that the mechanism to collect capital gains tax from non-resident-sellers may be introduced by the anti-BEPS law, if the law is adopted. In this case starting fromJuly 1, 2020, profits derived by non-resident sellers from the disposition of shares, interests, corporate or other similar rights at any time during the 365 days prior to the disposition will be subject to 15% withholding tax (WHT). The mechanism contemplates that non-resident buyers will act as tax agents with respect to the income of non-resident sellers and pay withholding tax from the seller’s capital gain to the Ukrainian treasury.

Taxation of dividends

Generally, dividends are not treated as taxable income for Ukrainian resident companies. Dividends payable by a Ukrainian resident company are generally subject to advance corporate tax (ACT), to be charged on dividends at the standard corporate tax rate of 18%. ACT is not withheld from the amount of dividends, but must be paid from a taxpayer's own funds without reduction of such amount by the amount of ACT. The ACT is computed as the excess of the amount of dividends to be paid over the taxable object computed for the period (tax year) for which such dividends are paid out, and which monetary obligations are discharged. At the end of the year, ACT can be offset against a taxpayer's corporate profit tax liability.

However, ACT does not apply to dividends that are paid by holding companies out of dividend income received from subsidiaries, such as dividends paid out of tax-exempt profit and dividends paid to individuals.

Ukrainian withholding tax applies to Ukraine-sourced income (including dividends, interest, capital gains and royalties)

received by a nonresident company, unless an applicable double-taxation treaty provides otherwise. The income received by a non-resident company from the sale of goods, works and services (subject to certain exceptions) does not qualify as Ukraine-sourced income subject to withholding tax. Withholding tax at the standard rate is 15%.

It is anticipated that additional limitations may be introduced by the anti-BEPS law, if the law is adopted. In this case starting from January 1, 2021, the concept of deemed dividends (payments equated to dividends) may be introduced. For corporate income tax purposes, the following would be deemed to be to dividends:

i. Payment in monetary or non-monetary form made by the Ukrainian legal entity in favour of its founder and/or participant(s) in connection with distribution of net profits
ii. Incomes in the form of payments due for securities (corporate rights), paid in favor of a non-resident under controlled transactions, exceeding arm's length price
iii. Compensation for goods (works, services), purchased from a non-resident under controlled transactions, exceeding the amount that complies with the arm's length principle
iv. Understatement for goods (works, services), sold to a non-resident under controlled transactions that does not comply with the arm's length principle.

As a result, the company should pay 15% withholding tax, or a lower rate if provided by an effective double taxation treaty (DTT), from such deemed dividends.

Computation of taxable income

Taxable base

A taxpayer is subject to tax on its profits from carrying on its business. Profit is generally considered to be its revenues less its deductible expenditures.

The tax code provides general rules for determining taxable income for taxpayers in Ukraine. Profit and loss before tax is calculated as the difference between income and expenses for the reporting period determined in accordance with UAS or IFRS, as appropriate.

According to the Law "On Statutory Accounting and Financial Reporting," the company and/or commercial representative office (i.e., the permanent establishment, or PE) should make a decision on the applicable standards (UAS or IFRS), unless the law directly requires the application of IFRS, which relates to companies of public interest, public joint stock companies, companies that perform extraction of subsoil resources of national standing or other types of activities specified by the Cabinet of Ministers. Public interest companies operating as issuers of securities listed on stock exchanges include banks, insurance companies, non-state pension funds and other financial institutions.

Deductions

Generally, taxable profit is determined as income less expenses and depreciation charges computed based on financial accounting standards (UAS or IFRS), subject to adjustments and limitations defined by the tax code. Gross worldwide income includes income from all types of activity in any form, except for specifically exempt items of income. A taxpayer can generally deduct reasonable business expenses, unless such expenses are specifically disallowed, restricted or limited by law.

There are limitations with respect to interest payments (thin capitalization rules) as described above. Also, in certain cases, limitations with respect to deductibility of royalty payments exist. As a general rule, the deductibility of royalty is restricted to 4% of the previous year`s taxable profit increased by the current year's income of a taxpayer from royalties, provided that the payment is made to a non-resident company and the transaction does not fall within the scope of the transfer pricing rules. Certain types of royalty payments are non-deductible.

It is anticipated that additional limitations may be introduced by the anti-BEPS law, if the law is adopted. In this case, starting from the day after the publication of the anti-BEPS law, the concept of PPT may be introduced. It will be established that for tax purposes, a transaction made with non-residents with no rational economic reasonwill lead to negative tax consequences, (i.e., not allowed for tax purposes), if:

i. The principal goal of such transaction is the non-payment (incomplete payment) of taxes and/or reduction of the taxable amount of the tax payer's profit and
ii. In comparable conditions, a person/entity would not have purchased from (or sold to) non-related parties, the respective works (services), intangible assets, or other items of business transactions, which are different from

goods.

Income tax reporting

Ukrainian resident corporations and non-resident corporations that carry on business in Ukraine through permanent establishments are required to file quarterly (in certain cases annual) corporate income tax returns. Tax returns must be submitted on a quarterly basis, with all returns being compiled cumulatively within 40 days following the quarterly reporting period. Companies that are newly established, agricultural producers, or entities with annual income less then UAH 20 million are allowed to file annual tax returns within 60 days following the annual reporting period.

Cross-border payments

Transfer pricing

For corporate profit tax purposes, transfer pricing regulations apply to control transactions that must be performed at arm's length and that are subject to control by tax authorities.

In 2020, the following transactions are deemed to be controlled if the volume of transactions with each counterparty exceeds UAH 10 million and the annual income of the Ukrainian taxpayer exceeds UAH 150 million.

i. Business transactions with foreign entities and/or related parties
ii. Business transactions structured through agents (commissioners) and/or foreign companies
iii. Business transactions with foreign companies residents of low-tax jurisdictions"
iv. Business transactions with foreign companies that are not payers of corporate tax
v. Business transactions between a foreign entity and its Ukrainian permanent establishment.

As of January 1, 2019, the tax code specifies the definition of business transactions.

i. As of January 1, 2019 the "substance over form" principle has been introduced for transfer pricing purposes. According to this principle, in the case of chain operations (export and import), the controlled/ non-controlled status of the transaction is to be determined in accordance with the essential conditions of the transaction performed between the parties and/or participants of such chain transaction. Under transfer pricing rules, the taxable profit for the controlled transaction should be computed on the basis of the principles of the arm's length value, determined based on one of the five transfer pricing methods (similar to those used by the OECD): Comparable uncontrolled price method
ii. Resale price method
iii. Cost plus method
iv. Transactional net margin method or
v. Profit split method.

There are specific requirements regarding the selection of comparable transactions for benchmarking studies. Taxpayers that perform controlled transactions during the reporting year should file a report on such transactions. The report should be filed before October 1 of the year after the reporting year. There are penalties for failure to file such report.

Certain taxpayers may apply the Advance Pricing Agreements (APAs) mechanism and enter into a preliminary agreement with tax authorities related to arm's length pricing and apply the agreed principle in determining and reporting arm's length prices. In order to qualify for an APA, a taxpayer needs to be a large taxpayer. Tax authorities are authorized to conduct specialized transfer pricing audits. The audit may last for 18 months, and extend for another 12 months; the total audit period may last up to seven years.

It is anticipated that additional requirements may be introduced by the anti-BEPS law, if the law is adopted. In this case starting from January 1, 2021, the concept of international group of companies (IGC) will be introduced for transfer pricing purposes. IGC means: two or more legal entities, that are tax residents of different countries and are related to each other due to the criteria of ownership or control (one legal entity is directly and/or indirectly (through related parties) owning the corporate rights of another legal entity in the amount of 25% and more). A three-level model of reporting related to the controlled transactions of the Ukrainian residents, members of the IGC, will be introduced: i) Report on the controlled transactions; ii) Master-File; and iii) Country-by-Country Reporting. An inquiry

regarding Master-File may be applied to a company, if a total consolidated income of the international group of companies is equal to 50 million euros and more. The Country-by-Country Report must be submitted by a company, if a total consolidated income of the international group of companies is equal to 750 million euros.

Withholding tax

Ukrainian withholding tax applies at the standard 15% rate to Ukraine-sourced income (including dividends, interest, capital gains and royalties) received by a non-resident company, unless an applicable double-taxation treaty provides otherwise. Certain types of income are subject to a 20% WHT payable by the Ukrainian resident from out of its own funds (i.e., not withheld). A special tax rate is established for freight income (6%).

The amount of Ukrainian withholding tax payable on income derived by a non-resident from Ukrainian sources may be reduced or eliminated by tax treaties Ukraine has entered into with certain countries, which prevail over Ukrainian domestic law. Ukraine has a fairly extensive tax treaty network and has entered into double-taxation treaties with more than 70 countries (including the US, the UK, CIS countries and the majority of EU countries), most of which follow the OECD Model Convention. Ukrainian domestic law does not provide for unilateral double-taxation relief.

Ukrainian resident companies can claim foreign taxes as a credit on income received abroad against corporate profit tax due on such income in Ukraine, if it is provided for under an applicable double-taxation treaty. However, the amount of this credit is generally limited by the amount of corporate profit tax due on the foreign income (i.e., the ordinary credit method).

On December 1, 2019 the Multilateral Convention to Implement Tax Treaty Related Measures (MLI) became effective in Ukraine. Certain provisions, including PPT will come into force as of January 1, 2020. PPT contemplates that tax benefits under double taxation agreements are not applied if the main objective of the business transaction was direct / indirect receipt of such benefits - exemption from taxation or the application of a reduced rate of repatriation tax.

Withholding tax on service fees

Income received by a non-resident company from the sale of goods, works and services (subject to certain exceptions) does not qualify as Ukraine-sourced income that is subject to withholding tax.

Payroll taxes

Ukrainian legal entities and/or permanent establishments act as tax agents in Ukraine with respect to their employees. Employers are required to withhold from an employee’s gross salary 18% for personal income tax (PIT) and 1.5% for temporary military tax (TMT). In addition, the employer pays tax authorities an amount equal to 22% of the employee’s gross salary as the Uniform Social Tax (UST).

Ukrainian legal entities and/or permanent establishments are required to withhold and remit the these taxes to the state budget as of the date when the payment of remuneration is executed. The taxable base for 22% of the Uniform Social Tax contribution is capped. For 2019, the cap is set at 15 times the minimal salary; from January 1, 2020, through December 31, 2020, the cap is UAH 70,845 per month per employee.

Indirect taxes

Value-added tax (VAT)

Ukrainian VAT at a rate of 20% applies to domestic supplies of goods or services and imports of goods into Ukraine. The VAT rate of 7% applies to supply of pharmaceuticals and health care products. The export of goods from Ukraine is taxed at a 0% VAT rate. Generally, VAT payers must submit VAT returns on a monthly basis.

VAT due to the budget or the state treasury is calculated as the positive difference between VAT liability (output VAT collected from the customers for goods, works and services sold) and VAT credit (the VAT paid to Ukrainian suppliers of goods, works or services and import VAT). The taxpayer has the right to report VAT credit if an electronic VAT invoice is issued and duly registered by the subcontractor in the electronic unified register of VAT invoices.

For VAT purposes, the taxable base should be determined based on contract value taking into account all of the

mandatory state taxes. In certain cases, the taxable base should be determined based on usual prices, balance value, etc.

Stamp tax

There are no stamp taxes in Ukraine, but a stamp duty is imposed on certain actions, such as notarizing contracts and filing documents with courts. In most cases, the amount of stamp duty involved is nominal. Operations on commodity exchanges and real estate sales incur a stamp duty of 1%.

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