



Tax issues and opportunities facing property investors in Ukraine

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Agenda



1. Ukrainian tax regime
2. Deal considerations
3. Cross-border structuring solutions

General rules



- Corporate profits tax rate: 25%
- Taxable income is normally recognized based on the “first event rule”
- “First event rule” does not apply to leasing/rent
- Generous depreciation rates (1.25 - 2% per quarter)
- Currently no restrictions on carry forward of tax losses
- Deductibility of interest on related party loans restricted to 50% of EBITDA
- Payments to tax havens have restricted tax deductibility
- Payment of dividends attracts 25% advance corporate tax
- Standard VAT rate: 20%
- 15% WHT on interest, dividends and capital gains – treaty relief available

Current developments in Ukrainian tax law



- Unlike in previous years, the 2008 Budget Law does not contain restrictions on carry forward of tax losses
- Tax losses incurred that were restricted for utilisation in previous years should be available for utilisation in 2008
- If the restriction is not reintroduced later, long term construction projects will have less tax risks
- Land tax (lease) rates were substantially increased (up to 5 times for certain types of land)
- The Pension Fund charge on the purchase of foreign currency reduced from 1% to 0.5%
- Liberalization of the VAT refund rules

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Deal considerations

Key tax issues



- VAT-related issues
- Transfer pricing
- Debt push down uncertainty
- Unsubstantiated expenses
- Assumed risk for pre-deal restructuring
- Sellers are reluctant to pay any taxes
- Lack of developed tax rules and judicial precedents
- Tax authorities are aggressive and fiscally oriented

Foreign exchange controls



- Acquisition of shares or equity investments in a Ukrainian SPV must be traceable through investments accounts in a Ukrainian bank
- The National Bank of Ukraine has revoked its previous liberal clarification exempting settlements between two non-residents from the above requirement (recent examples to convert currency for dividend payments)
- Non-compliance may result in difficulties with the remittance of funds abroad on dividend distributions or the sale of shares in SPV
- It is advisable to obtain a confirmation from the servicing bank that the sellers/target company have sufficient documentation in the early stages of deal negotiations

Net assets rule



- If the value of the net assets at the end of the second or each subsequent financial year is less than the share capital of the company, the company must decrease its share capital and make relevant amendments to its charter or shareholders should make additional contributions
- If the value of net assets falls below the minimum statutory capital, the law requires the company to be liquidated

Share vs. Asset deal



Share Deal

No tax payable by seller (if properly structured)

Easy deal to structure and close (legally)

Buyer assumes history and any contingent liabilities

High effective tax on yields due to low asset basis

Taking debt into the Ukrainian entity might be problematic

No transaction taxes

Asset Deal

Seller pays tax on gains

More complicated to close

Less contingent liability exposure

Debt financing at asset level means interest deductions against property income

Lower tax drag and easier distribution of cash (through debt repayment)

VAT problems may arise

Transaction taxes

➤ **The market currently dictates share deals, unless the buyer is willing to compensate for the seller's tax burden**



- No strict thin capitalization rules
- “Business purpose” test
- Limitation on interest deductibility for related party debt
- 0% WHT on interest under some DTTs
- Debt push down has not been extensively tested in practice
- Mandatory registration with the National Bank of Ukraine
- Maximum allowable interest rates on foreign loans
- 0.5 % pension fund charge on purchase of foreign currency



- Currently share premium is not taxable but rules are constantly changing
- Most investors keep equity to the statutory minimum (but consider “net assets rule”)
- 15% WHT on dividends – treaty relief
- 25% advance corporate tax (exemption available for holding companies) – no treaty relief
- 0.5 % pension fund charge on purchase of foreign currency

Deal considerations

Exit strategies



Sale of assets

- Gains on sale of real estate taxable at 25% for the seller
- 1% stamp duty
- 1% pension fund charge

Sale of shares

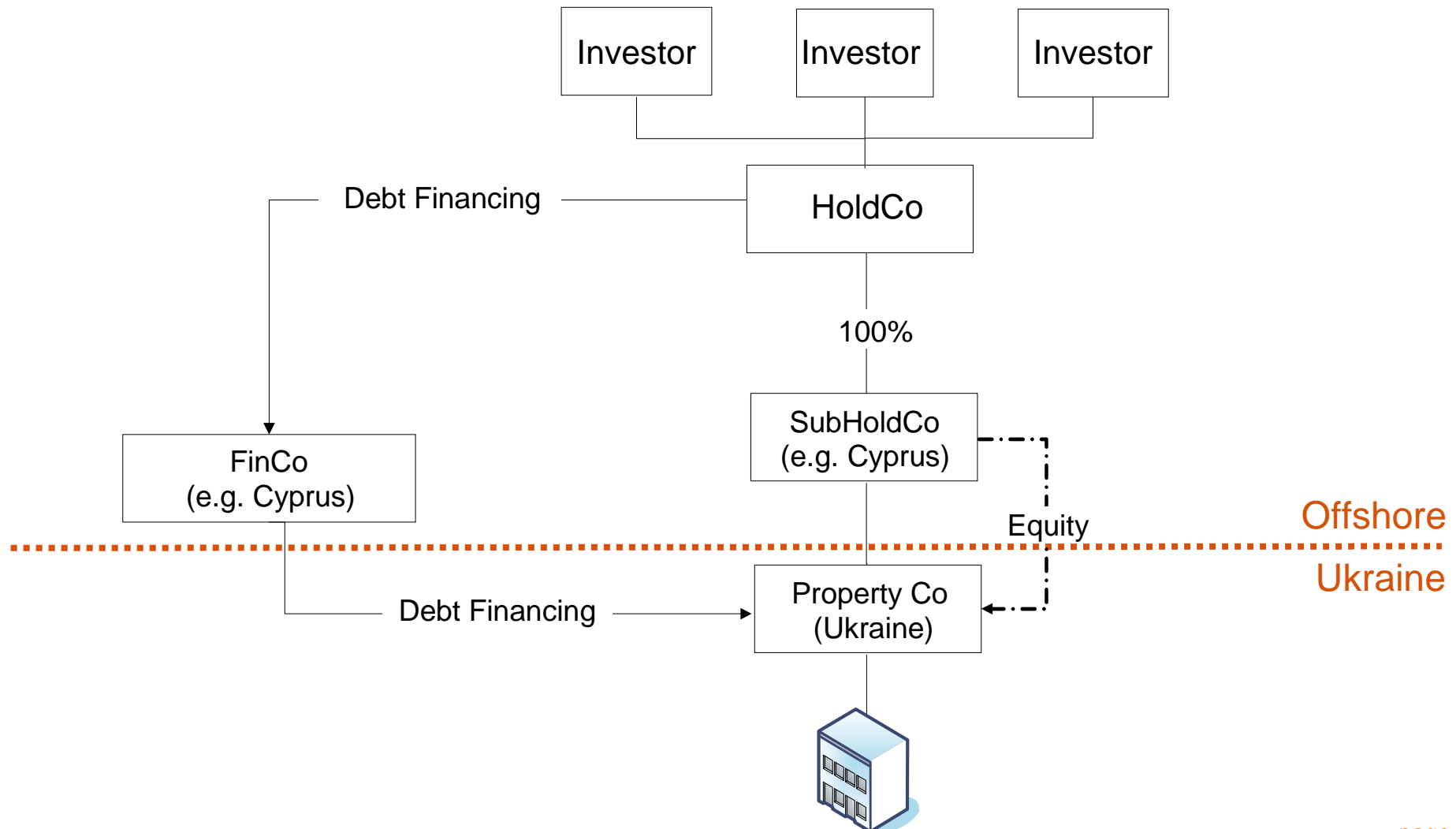
- Gains on sale of shares taxable, but some DTTs exempt foreign seller from tax
- No stamp duty

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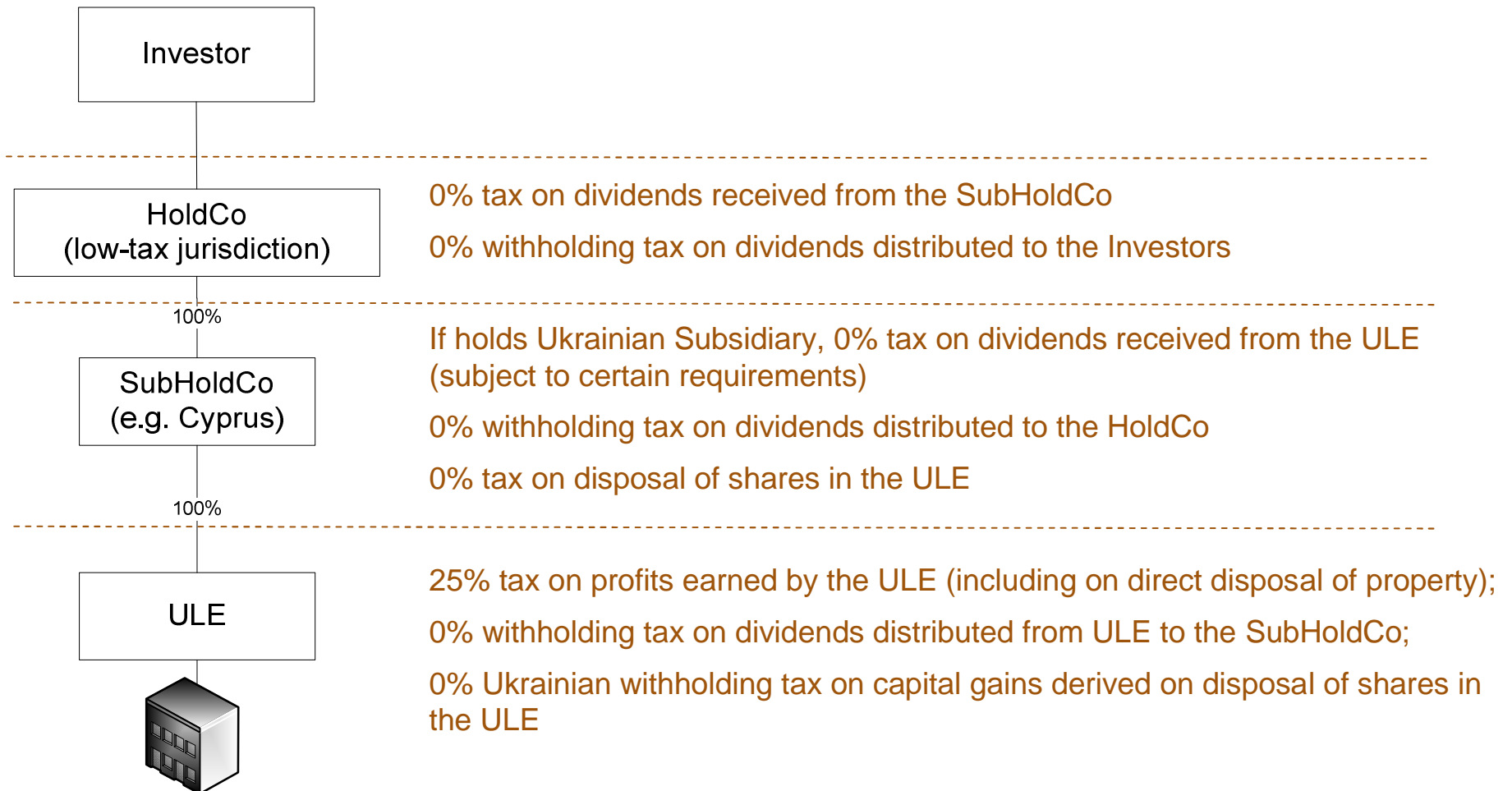


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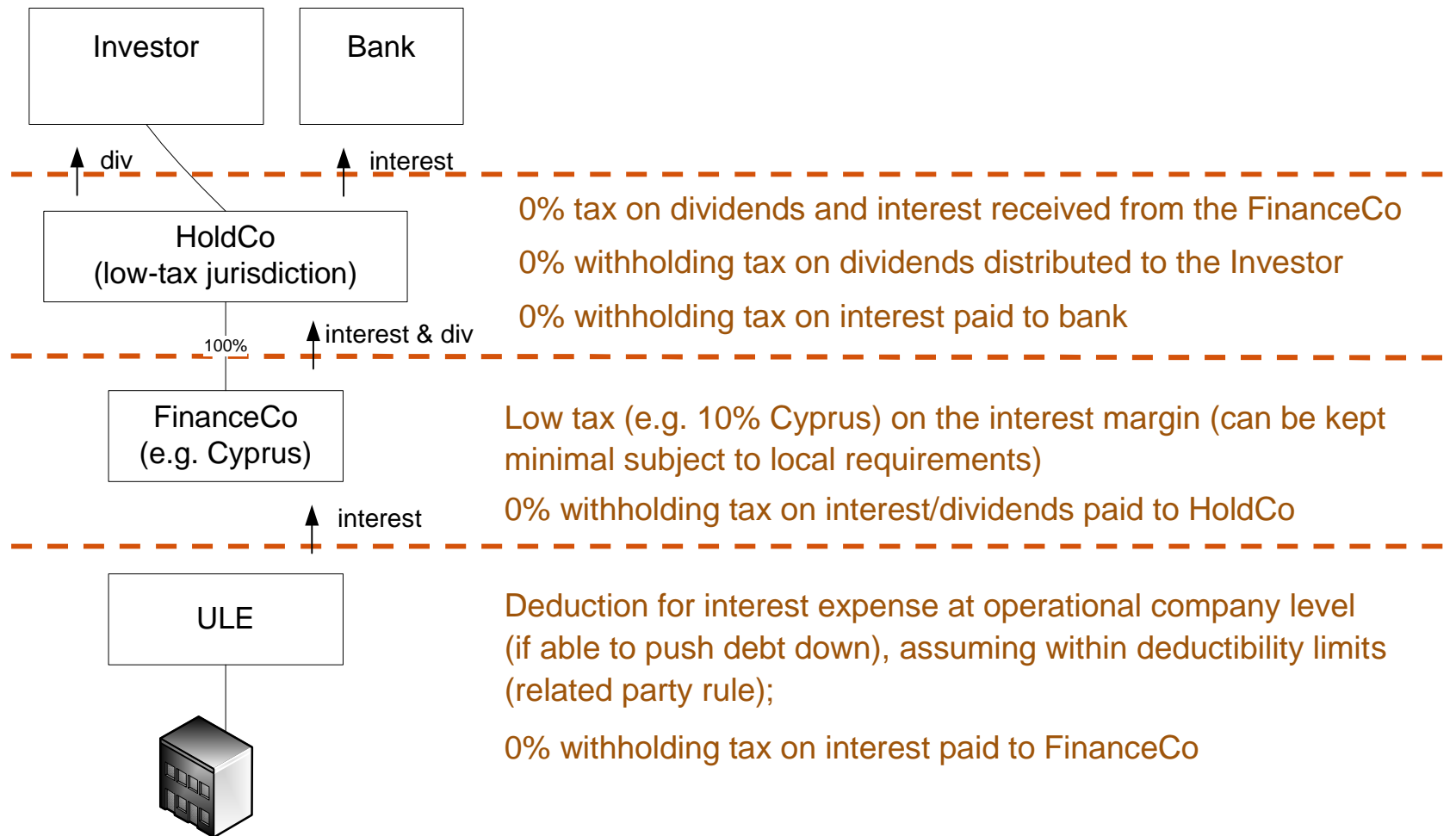
The Typical Holding Structure



The Typical Equity Holding Structure Tax Drag....



The Typical Financing Structure Tax Drag....





Cyprus is now the most preferred jurisdiction for investments in Ukrainian real estate due to favourable tax regime plus a unique DTT with Ukraine

Old USSR- Cyprus DTT

- Effective from 1982
- Dividends – 0%
- Interest – 0%
- Royalty – 0%
- Capital gains – 0%
- No beneficial ownership test

New Ukraine – Cyprus DTT

- May become effective from 1 Jan 09
- Dividends – 5% / 15%
- Interest – 10%
- Royalty – 10%
- Capital gains – 15%
- Beneficial ownership test

Debt push down will not be available under the new DTT - consider restructuring now!

Thank you