

Interpretation of the VAT Law by the Higher Administrative Court of Ukraine

The Higher Administrative Court of Ukraine has its interpretation on specific provisions of the VAT Law.

This interpretation is important as lower courts will follow these instructions when considering tax issues.

Below we summarise the key issues analysed by the Higher Administrative Court of Ukraine in its interpretation.

I Confirmation of the right for VAT input and refund in case of the absence of a VAT invoice at the time of a tax audit

- Minor discrepancies in VAT invoices received from the supplier should not influence the right of a taxpayer to VAT input, providing it is possible to identify the seller.
- In case a taxpayer receives a VAT invoice after completion of a tax audit, it has a right to include such VAT invoice into its future VAT input.
- If VAT invoice/customs return is absent at the moment of the tax authorities' audit, the taxpayer could not use them to substantiate its claim in court.
- Availability of proper documents as well as cash flows is not sufficient grounds for substantiation of a right for VAT input. VAT input arises in case of actual purchase of goods, services or fixed assets to be used in taxable transactions within the business activity of a taxpayer.

II Application of market prices for determination of the tax base for VAT purposes

- The courts should consider the level of market prices ("usual price") for supplied goods (services) according to a general rule established by article 4.1 of the Law of Ukraine "On VAT". A 20% deviation rule should be considered.
- Customs value of imported goods and cost of goods purchased locally is not entirely a "usual" price. Other criteria should be considered.

III Sale below cost

- Courts should pay special attention to the review of economic grounds of unprofitable transactions carried out by the taxpayers.
- The following unprofitable transactions upon the absence of reasonable economic grounds may indicate the intentional understatement of VAT liabilities:
 - Unusual transactions for the regular business activity of the taxpayer;
 - regular participation in such transactions of entities that do not report on tax liabilities and do not pay taxes to the budget;
 - awareness of a taxpayer's officials about unfair business activity of their counterparties;
 - atypical payment structures within standard business activity that can trigger non-payment of VAT to the state budget;
 - clear discrepancies in the level of a taxpayer's sale price and the level of market prices for the goods or services upon the taxpayer's awareness of market conditions;
 - purchase of goods or services from intermediaries on less favourable conditions upon the existence of direct business relations with producers, and other similar circumstances.

In case the tax authorities prove a groundless understatement of the VAT liabilities due to an intentionally unprofitable transaction, the amount of VAT paid within such transactions may be excluded from the VAT input of the

Contacts:

Ron Barden

Partner & TLS Leader
ron.j.barden@ua.pwc.com

Marc-Tell Madl

Legal Partner
m.madl@ua.pwc.com

Slava Vlasov

Partner
Tax and Legal Services
slava.vlasov@ua.pwc.com

Svetlana Bilyk

Director
Tax and Legal Services
mail:svetlana.bilyk@ua.pwc.com

Viktoria Tymoshenko Manager

Indirect Tax Services
viktoria.tymoshenko@ua.pwc.com

PricewaterhouseCoopers Ukraine

75 Zhylyanska Street, Kyiv, 01032
Tel: +380 44 490 6777
Fax: +380 44 490 6738

IV Substance over form

- Proper documentation of the transaction (including duly formalised VAT invoice) as well as payment for goods/services are not an exhaustive criteria for obtaining a right for VAT input. In order to define a right of a taxpayer to VAT input in respect of a particular transaction, a principle "substance over form" should be applied.
- The fact that actual supply of goods/service took place could be challenged if there have been no actual delivery of such goods/services or there are evidences that such supply could not have been performed (i.e. volume of transaction exceeds production capacity of the supplier, absence of facilities to perform such supply, unrealistic time frames of the transaction).
- Intention to use acquired goods/services in a taxpayer's business activity (main criteria for VAT input) could be challenged if the acquired goods/services are not usual for the business activity of such taxpayer.

V Application of zero rate of VAT to the services auxiliary to export

- Supply of auxiliary services is subject to zero VAT rate in case the following conditions are met:
 - 1) the goods in respect of which auxiliary services are supplied should be actually exported;
 - 2) auxiliary services should be included to the customs value during the customs clearance of exported goods. Transportation, loading/unloading and insurance services could be included into the customs value of goods only in case they relate to deliver such goods up to customs border of Ukraine;

- 3) auxiliary services should meet the requirements stipulated in Article 274 of the Customs Code of Ukraine, namely:
 - a) they should actually be paid;
 - b) they should not be included into the contract price of exported goods.
 - c) they should qualify for expenses covered by paragraphs "a" - "v" of Article 274 of the Customs Code of Ukraine;
- The right to apply zero VAT rate applies regardless of whether the provider of services is an exporter of goods or not.

VI Taxation of settlements by means of promissory note

- For settlements by way of promissory notes, transfer of such a promissory note (own emission or previously issued by a third party) to the supplier does not lead to any VAT consequences.
- The taxpayer who paid for goods or services by means of a promissory note, has a right for VAT input under the general "first event" rule irrespective of the date of settlement of the promissory note. The right for VAT input should be supported by the VAT invoice. As payment by promissory note is not cash, it should not be considered in calculation of VAT refund.
- All VAT rules applicable to settlements by means of promissory notes should apply to settlements with other kinds of debt securities.

PwC will continue to monitor the situation and provide additional information as soon as it is available.

Should you have any questions or comments, please do not hesitate to contact the Indirect Tax Team.

This tax alert is produced by PricewaterhouseCoopers Ukraine' Tax and Legal Services Department. The material contained in this alert is provided for general information purposes only and does not contain a comprehensive analysis of each item described. Before taking (or not taking) any action, readers should seek professional advice specific to their situation from separate and independent legal entity. No liability is accepted for acts or omissions taken in reliance upon the contents of this alert.

© 2010 PricewaterhouseCoopers. All rights reserved.
PricewaterhouseCoopers and PwC refer to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL). Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm's professional judgment or bind another member firm or PwCIL in any way.