

Tax Newsletter

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Newsletter on draft Tax Code

On 3 August 2010, the new draft Tax Code (the "Draft") was made available for nationwide discussion. This new Draft in some cases significantly differs from the version adopted by the Parliament in the first reading. However, the main aim of the changes made in the new draft is to make it less tough and incorporate into its text provisions of current legislation where appropriate.

Following our Flash Report # 36, below we list the most important changes made in the draft Tax Code offered for public consideration in comparison to current legislation.

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I. Tax administration

- The Draft envisages stricter rules with respect to requirements of keeping documentation relating to business transactions. If there are documents that are not provided during the course of an audit, the taxpayer will not be able to use them when appealing an assessment resulting from that audit either in court or to the tax authorities. Such documents, however, may be utilised in subsequent tax periods.
- Large and middle-sized entities would be required to submit tax returns in electronic form.
- Introduction of indirect methods of tax assessments. In case of the taxpayer's disagreement with additional charges made based on such methods, the tax authorities would collect such tax upon court decision only.
- As a positive development, the draft introduces the obligation for the tax authorities to issue decisions when decreasing tax losses and accumulated negative VAT. Currently, the taxpayers are unable to claim against such decrease of future tax benefit because of absence of respective documents.

II. Corporate profits tax

- The main aim of the proposed provisions of the draft Tax Code is to make tax accounting closer to statutory accounting.
- The tax rate is 20% (a 25% rate will be applied for 2011, 24% for 2012, 22% for 2013 and 20% for 2014 and onwards).
- Rules for the recognition of items of income/expense for tax purposes will be largely based on financial accounting rules (Ukrainian Accounting Standards). The "first event" rule shall be cancelled.
- Taxable income shall be recognised on the date of the transfer of title of ownership from the seller to the buyer. The received advance payments shall not impact the tax accounting of the taxpayers.
- Deductible expenses are generally recognised on an accrual basis. Advances paid by a taxpayer shall not be deductible.
- Both material and non-material components of the cost of goods shall be deductible upon the sale of goods.
- Significant changes have been proposed regarding the taxation of entities with branches. The Draft introduces the notion of "reporting segment", which is a branch that meets the criteria set forth to qualify it as a separate taxpayer. This will result in an additional tax burden and increase in administrative costs being due to the prohibition of offsetting intra-company losses.

- Tax deduction of interest payable by subsidiaries of foreign companies to related companies is limited to 50% of EBITDA. However, the Draft Tax Code does not explicitly provide the possibility to deduct excessive interest in future tax periods.
- Royalties accrued on the license agreement with a non-resident may be deducted only within a limit of 3% of taxpayer's taxable profits of the previous year.
- Ukrainian companies may be rejected to account for foreign exchange (FOREX) losses incurred prior to 1 January 2011.
- Depreciation for tax purposes also represents incorporation to some extent of the statutory bookkeeping rules. There is an accelerated depreciation which could be applied to transport vehicles, machinery and equipment.
- The Draft envisages for mandatory reconciliation between statutory and tax profits for all taxpayers.
- It is proposed to apply 15% WHT to non-residents in relation to payments for purchased intangible assets. Also the provision on 20% tax in respect to payments for advertising services rendered by non-residents is proposed to change: if the Draft is passed, this tax would be applicable for all such payments, disregarding whether such services were provided within territory of Ukraine or not.
- Tax holidays envisaged by the Draft are applicable for newly established companies registered after the date that the Draft is enacted, by means of applying a reduced tax rate for a period up to five years. Only certain companies will qualify for tax holidays.

III. Simplified system of taxation (the single tax)

- Individuals under the simplified system receiving more than a half of their income from one customer during a reporting period should pay all the taxes envisaged by the common system of taxation.
- The threshold of annual proceeds allowing payment of the single tax for individuals would be dropped from UAH 500,000 to UAH 300,000.
- Individuals rendering services in the areas of IT, bookkeeping, law and some other professional services, are allowed to stay on the simplified tax system, but the tax rates for them would be increased to UAH 200-600 per month.

IV. VAT

- The Draft Tax Code is close to current VAT legislation.
- The VAT rate of 20% will be gradually reduced to 17% in 2013.
- Voluntary VAT registration is available only in case a person carries out VAT able transactions. Such restriction may impact companies engaged in construction of fixed assets and companies requiring investment in fixed assets prior to starting up of taxable operations.
- VAT output and VAT input should be calculated with consideration of the market prices. The 20% deviation rule was eliminated.
- The Draft Tax Code introduces the mechanism of payment of import VAT via promissory notes, which allows deferring payment of VAT for 30 days. However, it relates only to the fixed assets, which are not produced in Ukraine, and such promissory notes should be still settled in cash.
- A period of validity of VAT invoices is introduced. The VAT invoice could be included into VAT input only within 12 months from the date of its issuance.
- The list of services not subject to VAT in cases if provided to non-residents has been modified. In particular, this may result in an additional 20% cost for non-resident recipients of the following services:
 - Promotional services (Draft Tax Code refers to advertising services only);
 - The services of auditors and actuaries.

At the same time, the list has been extended in respect of the following services: banking, financial and insurance operations, telecommunication services, broadcast services and a wide range of services provided via electronic channels (including software development).

VAT treatment of such services does not depend any more on the existence of permanent establishment of such non-residents in Ukraine.

- In respect of imported services, the taxable base should be determined based on the exchange rate of the NBU effective at the moment of VAT liability accrual, with the consideration of the "first event" rule. Currently, the tax base is using the exchange rate of the NBU effective at the date prior to the date of the service acceptance statement signature.

The Draft Tax Code sets the methodology for pro-ration of input VAT in respect of goods/services used simultaneously in VAT able and non-VAT able supplies. Under this methodology, the amount of VAT input eligible for credit during the reporting period should be determined based on volume of taxable transactions in the overall volume of transactions of the previous calendar year. Such a ratio should apply within the full current calendar year. At the end of the current calendar year a taxpayer should recalculate eligible VAT input based on the volume of transactions of the current calendar year. In respect of fixed assets, such recalculation should be done annually for the first three years after the asset's acquisition.

V. Personal income tax

- All Ukrainians are considered tax residents. Foreign nationals qualify as Ukrainian tax residents if their presence in Ukraine is not less than 183 days in a current and/or preceding calendar year (simplified definition).
- Salaries paid to foreign nationals prior to the date when they qualify as tax residents should be subject to tax withholding at 30%.

- Tax recalculation should be performed by an employer or the tax authorities based on individuals' tax returns. Overpayment will be offset against future tax liabilities. No option for a tax refund is provided.
- Extension for tax return filing until 31 December of the year following the reporting one may be granted upon a taxpayer's request, if confirmation of foreign taxes is required to claim a foreign tax credit.
- A special labour inspection is authorised to decide whether relations between the company and individuals should be recognised as employment.
- Amount of expenses calculated using indirect methods (see comments on corporate profits tax), that exceeds individual's declared income, is taxable.
- Income from the sale of real estate once per year is not taxable. Income from the second and following sales is subject to tax at 5%.
- Housing allowance and a car provided by employer is a taxable benefit.

PwC is heavily involved in discussions on the Draft Tax Code and in delivering the opinions of the business community to the Government. We are continuing work on elaborating the provisions of the Draft to be submitted for Parliament's consideration. Should you have any comments to the draft Tax Code, please contact us.

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