

TAX & LEGAL AFFAIRS

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2005 BUDGET LAW

Amended version of the 2005 Budget Law (the law No. 2505 of 25 March 2005) introduced changes to 84 laws. We present below a summary of changes to tax laws that were introduced by the Budget Law. These changes take effect from 31 March 2005 unless another date is indicated.

Value Added Tax

Rules for application of VAT to cross-border supply of services

The VAT Law No 168 of 3 April 1997 has been fundamentally amended by removing export and import of services from the list of VATable transactions and introducing a definition of the place of supply (zero rate VAT is preserved for international transport services and services associated with exported goods i.e. services that are included to the customs value of the goods). Due to this amendment zero VAT (exemption with credit) cannot be applied to the supply of services by resident entity to non-resident customers. Instead, 20% VAT will apply to the supply of services where the place of supply is in Ukraine and if the place of supply is outside Ukraine, the transactions will be exempt from VAT (exemption without credit).

The amended VAT Law is not clear how VAT should apply to services supplied by a foreign service provider to a Ukrainian customer. In our interpretation, where the place of service supply is in Ukraine and the service provider has no Ukrainian agent or a permanent establishment in Ukraine, the Ukrainian customer may be responsible for settlement of 20% VAT liability on behalf of a foreign service provider as its tax agent. However, it is not clear from the law how the tax agent should settle the VAT liability (e.g. through withholding or via reverse charge mechanism) and whether input VAT can be computed as credit for the customer.

VAT registration

The threshold for mandatory VAT registration (volume of VATable transactions for last 12 months) has been increased to UAH 300,000.

Transactions exempt from VAT

Article 3.2.1 of the VAT Law has been amended such that sale of stock in a limited liability company qualifies for VAT exemption.

VAT exemption for contribution of fixed assets to the capital of a legal entity and return of such contribution has been cancelled.

The amount of interest under a financial leasing contract that is exempt from VAT has been limited to double the interest rate (prime rate) of the National Bank of Ukraine.

Services for transit of cargo and passengers through the territory and ports of Ukraine have been added to the list of VAT exempt transactions.

VAT base

According to the amended definition of the tax base, VAT should be computed based on contractual value, which cannot be lower than "usual" (i.e. fair market) price of goods or services. The new definition gives to the tax authorities the right to adjust VAT liabilities for any transactions if they can prove that the contractual price is lower than the market price for goods or services.

VAT recovery

The definition of VAT credit is amended such that the right for VAT recovery should not be linked to the deduction (depreciation) of underlying expenses in the corporate profits tax accounts. Instead a taxpayer can recover input VAT if the underlying expenses are incurred for goods or services that are intended for the use in VATable transactions within taxpayer business activities.

The amended law allows recovery of input VAT without the supplier's VAT bill in the following cases:

- Purchase of goods or services with payment in cash or by payment card within limits established by the National Bank of Ukraine (currently the limit for cash settlements is UAH 10,000 per day);

- Purchase of transport tickets;
- Settlement of hotel bills;
- Settlement of invoice for telecommunication services and other services where the value of services is determined based on the data of a measuring device (e.g. electricity);
- Purchase of sundry goods (services) for the amount of UAH 200 per day.

Input VAT incurred on the purchase of cars for the use in the taxpayer's business (except for cars to be used as taxis) cannot be recovered as a credit. However, such input VAT can be included to deductible expenses for corporate profits tax purposes.

VAT refund

New rules for VAT refund will be effective from 1 June 2005. If in the reporting period the balance of VAT liabilities and VAT credit is negative, such negative amount should be added to VAT credit in the tax return of the next reporting period. If in the next reporting period the balance is still negative, the taxpayer can claim refund for the amount of input VAT actually paid to suppliers in the previous reporting period and the negative balance (if any) should be computed as credit for refund in the future periods.

If the taxpayer opts for cash refund, it should submit to the tax office together with the tax return the application for refund and the following documents: (i) computation of the amount claimed for refund; (ii) copies of tax promissory notes (if any) and (iii) for export transactions hard copies of export customs declarations (5th sheet).

The tax authorities should check within a 30-day period the correctness of amounts claimed for refund and submit their approval for the refund to the State Treasury. Once the approval from the tax authorities is received, the Treasury must remit the relevant amount to the bank account of the applicant within 5 banking days.

The following persons cannot apply for VAT refund:

- A person who has been registered as a VAT payer for less than 12 months prior to applying for the refund and/or had volume of VATable transactions for last 12 months less than the amount of VAT claimed for refund, except for VAT credit in connection with the purchase or construction of fixed assets;
- A person who does not carry on business for last 12 months;
- Persons that use simplified tax regime or are relieved from the obligation to pay VAT.

Tax promissory notes

Restriction for payment of import VAT by promissory notes for enterprises with foreign investments has been removed. Use of promissory notes is restricted for (i) excisable goods;

(ii) goods classified under commodity headings 1-24; (iii) persons that were registered as a VAT payer less than 12 months prior to the date of import; and (iv) persons that do not qualify as VAT payers at standard rate. Promissory note must be secured by a bank.

International transport services

Zero VAT applies to international transport services. However, due to a change of the definition of international transport services, zero VAT can apply only in relation to transportation to/from customs check points (previously zero VAT applied in relation to transportation to/from place of customs clearance). Thus, carriers will need to apply 20% to transportation services between points of inland customs to/from customs check points at the border.

Special Tax Regimes

The Law No. 2505 has cancelled special tax and investment regimes in 16 Special Economic Zones for both existing and new investments and tax benefits previously granted to certain industries such as automotive and shipbuilding.

Single tax regime

Application of the single tax regime has been restricted with effect from 1 July 2005 for the following activities: (i) trade with drugs and medical goods; (ii) architecture; (iii) legal services; (iv) audit services; (v) renting out real estate; (vi) real estate agency.

Personal Income Tax

Effective from 31 March 2005 the Personal Income Tax Law is amended such that where entrepreneur-payer of single tax renders services to other persons for period longer than one calendar month during fiscal year, entrepreneur's fee should be treated as employment income with corresponding taxation of such income.

Exemption from tax for income from disposal of real estate has been extended to 1 January 2006.

Social Security Charges

Effective from 31 March 2005 the rate of employer's contributions to the State Pension fund is increased to 32.3% (from 32%) and simultaneously the rate of charge to the Unemployment Fund has been reduced from 2.9% to 2.6%. Thus, the total tax cost for the employer remains the same. The cap for the tax base remains UAH 4,100 per employee per month (the cap is effective from 1 January 2005).

Corporate Profits Tax

The rules described below apply based on results of the 1st quarter 2005.

Deduction for insurance expense is limited

Deduction for voluntary insurance expenses (except for expenses on medical and pension insurance) is limited to 5% of gross deductible expenses of the reporting period.

Insurers should compute deduction on re-insurance on cash basis

When computing tax on net premium, insurers can deduct amounts actually paid to re-insurers (previously deduction for the cost of re-insurance was available on accrual basis).

Software is treated as fixed asset rather than intangible asset

Definition of fixed assets of Group 4 (computers and other IT items) has been modified such that the cost of any software should be depreciated at the depreciation rates applicable to the Group 4 of fixed assets (previously it was understood that Group 4 depreciation rates were applicable to pre-installed software).

Deduction for reserves has been reduced

Limit for doubtful/bad debt reserves that banks and financial institutions can deduct is reduced to 10% (previously 20%) for banks and 15% (previously 30%) for non-banking financial institutions of total value of debt claims at the last business day of the reporting period.

Other taxes

The Law No. 2505 introduced changes in respect of: (i) tax on owners of transport vehicles; (ii) excise tax (applicable to tobacco products, cars, fuel, alcohol, beer); (iii) land tax.

(Law of Ukraine No. 2505 dated 25 March 2005, published in "Uriadovyi Kurier" newspaper of 31 March 2005)

Interest income from bank deposits remains free of tax

Exemption from personal income tax for interest on bank deposits has been extended till 2010.

(The Law of Ukraine No. 2273 dated 21 December 2004, published in "Uriadovyi Kurier" newspaper of 11 January 2005)

Deduction for education and training expenses

New rules for deduction of expenses in relation to education and professional training will take effect from 1 January 2006. Currently a taxpayer may deduct for corporate profits tax purposes expenses related to professional education of personnel (except individuals that qualify as related entity) in Ukrainian educational institutions. The deduction is limited to 2% of the amount of total salary fund. The key features of the new rules are:

- Limit for the amount of deduction in respect of expenses related to professional education will increase to 3% of the amount of total remuneration of the reporting period;
- The limitation will apply to expenses in relation to (i) professional education, study, re-training or skills development of personnel; (ii) professional education in Ukrainian educational institutions of individuals who committed to work 3 years after graduation at the company sponsoring education; (iii) arrangements in respect of the on the job training for students.

(The Law of Ukraine No. 2229 dated 14 December 2004, published in "Holos Ukrainy" newspaper of 11 January 2005)

Mandatory sale of export proceeds is cancelled

The National Bank of Ukraine has cancelled effective from 1 April 2005 the requirement to sell for Hryvnia 50% of export proceeds in foreign currency.

(Resolution of the Cabinet of Ministers of Ukraine and the National Bank of Ukraine No. 215 dated 30 March 2005)