

January 6, 2011

Ukraine Adopts the First Tax Code

The First Tax Code of Ukraine was officially published on December 4, 2010. Below, we provide a brief overview of the major changes in tax system of Ukraine introduced by the Tax Code.

Summary

- The majority of the Tax Code's provisions will come into force on January 1, 2011. The provisions relating to the corporate profits tax will take effect on April 1, 2011.
- The Tax Code consolidated many Ukrainian tax laws into one document in order to simplify and update the taxation system of Ukraine. However, the language of the Tax Code still requires further improvement.
- The rates of the corporate profits tax and VAT will be reduced step-by-step during the coming years. For the personal income tax, a progressive scale of tax rates was introduced. The excise rates for the majority of items were increased.
- The computation of taxable profits becomes closer to financial accounting.
- New limitations on tax deduction of some expenses were established.
- Some categories of companies and industries will be able to enjoy tax holidays with respect to corporate profits tax.
- Registration of VAT invoices in the unified statutory register was introduced. If the incoming VAT invoice is not included in the register, the taxpayer will not be entitled to credit the respective input VAT.
- Potentially, the provision of consulting, engineering, legal, accounting, audit and IT services should not be subject to VAT anymore.
- Foreign individuals will be taxed according to the rules established for residents.

- During the transitional period from January 1, 2011, until June 30, 2011, the penalty for breach of tax law will amount to UAH 1 (approximately USD 0.125) for each offense. According to the Tax Code, if a taxpayer violates provisions of the Tax Code regarding the corporate profits tax during the second or the third quarters of the year 2011, no penalty will be applied. Generally, some penalties were decreased.

Additional Details

1. Tax administration

- A new type of tax audit (a "factual audit") was introduced. The tax authorities are entitled to conduct such an audit in specified cases without any preliminary notice to a taxpayer at its place of business.
- The tax authorities will have additional grounds for conducting non-scheduled audits.
- The administrative procedure for tax appeal will be shorter and consist of two stages (currently, three stages of the administrative procedure exist).
- Large and medium companies will have to file the tax returns solely in electronic format.

2. The corporate profits tax (CPT)

- During the next four years, the tax rate will be reduced from the current level of 25% to 16% as follows:
 - starting from April 1, 2011, to 23%,
 - starting from January 1, 2012, to 21%,
 - starting from January 1, 2013, to 19%,
 - starting from January 1, 2014, to 16%.
- The computation of taxable profits will be closer to financial accounting. In particular, taxable income and deductible expenses will be recognized mainly on an accrual basis. Accordingly, advances received and prepayment made will not continue to be included in taxable income and

deductible expenses respectively. Fixed assets will be depreciated according to the methods which are used for financial accounting (currently, the tax depreciation charges are calculated according to a special tax method).

- Companies will have to file the financial statements indicating the amounts of temporary and permanent tax differences along with tax returns. This provision will come into force on January 1, 2012.
- The concept of beneficial ownership was introduced.
- No tax deduction will continue to be allowed in respect of the following expenses:
 - Consulting, marketing, or advertising expenses incurred in favor of non-residents in an amount exceeding 4% of the prior year's sales income (this limitation does not apply to the expenses incurred in respect of the non-residents' permanent establishments). The tax deduction of the above-mentioned expenses incurred in favor of the residents of black-listed offshore countries is entirely prohibited.
 - Royalties accrued in favor of non-residents in an amount exceeding 4% of the prior year's sales revenue (this limitation does not apply to the expenses incurred in respect of the non-residents' permanent establishments). The tax deduction of the mentioned expenses is entirely prohibited if they are incurred in favor of the residents of the black-listed offshore countries, non-residents that are not beneficial owners, as well as in certain other instances.
 - Expenses on engineering services incurred in favor of non-residents in an amount exceeding 5% of the customs value of the imported equipment (this limitation does not apply to the expenses incurred in respect of the non-residents' permanent establishments). At the moment, it is unclear in what amount such expenses can be deducted (and whether the tax deduction is allowed at all) if engineering services are provided without importation of equipment. The tax deduction of the mentioned expenses incurred in favor of the residents of the black-listed offshore countries, or non-residents that are not beneficial owners is entirely prohibited.

- The expenses on purchase of goods and services (except for the IT services) from private entrepreneurs-unified tax payers.
- For the next 10 years, starting from January 1, 2011, profits of 5-, 4- and 3-star hotels, light industry (such as textile, clothing, leather, footwear industries, etc.) and certain other industries will be exempt from the CPT.
- For the period from April 1, 2011, until January 1, 2016, a zero tax rate can be applied by the companies annual income of which does not exceed UAH 3,000,000 (approximately USD 375,000) provided they meet a number of criteria (which relate to salary and number of employees, type of business, date of statutory registration, etc.) The companies engaged in cross-border operations will not be allowed to apply a zero tax rate in accordance with this rule.

3. The value added tax (VAT)

- The standard tax rate will remain at the level of 20% until January 1, 2014. Thereafter, the rate will be reduced to 17%.
- Unlike with the corporate profits tax, the advances received remain to be subject to tax.
- The tax base for the supply of goods and services will be computed based on an arm's length price.
- The list of operations exempt from VAT was extended. In particular, the provision of consulting, engineering, legal, accounting, audit and IT services should not be subject to VAT anymore (the respective wording of the Tax Code is vague).
- Registration of VAT invoices in the unified statutory register was introduced. A VAT invoice must be included in such register if it is issued for the following amount:
 - starting from January 1, 2011, for the amount exceeding UAH 1,000,000 (approximately USD 125,000),
 - starting from April 1, 2011, for the amount exceeding UAH 500,000 (approximately USD 62,500),

- starting from July 1, 2011, for the amount exceeding UAH 100,000 (approximately USD 12,500),
- starting from January 1, 2012, for the amount exceeding UAH 10,000 (approximately USD 1,250).

If the incoming VAT invoice is not included in the register, a taxpayer will not be entitled to credit the respective input VAT.

- An automatic VAT refund was introduced. However, to be entitled to it, the taxpayer will have to comply with a number of requirements. The real possibility to obtain the refund in cash remains very limited. The State will be obliged to pay interest for a late refund (at the rate of 120% of the National Bank of Ukraine effective discount rate which equals 7.75% p.a. at the moment).
- The tax authorities will have additional grounds for the annulment of the VAT registration. However, they will be unable to annul such registration if a taxpayer did not report any VAT-able sales during the last 12 months.
- Private entrepreneurs-unified tax payers will be unable to register as VAT payers any more.

4. The personal income tax (PIT)

- A progressive scale for tax rates was introduced. For income under 10 minimum monthly wages (which equals approximately USD 1,153 at the moment), the tax rate will remain at the 15% level. For the income exceeding 10 minimum wages, the rate will be increased up to 17%.
- Foreign individuals will be taxed according to the rules established for residents, that is, at 15% and 17% rates (currently, the 30% rate is applied).
- Income from interest on deposits and dividends will be taxed at 5% rate. For interest income, this rate will be applied starting from January 1, 2015.

5. The excise tax

- The excise rates for main items were established as follows:
 - for beer and motor vehicles - the rates remain unchanged,

- for alcohol, tobacco and cigarettes - the specific rates were increased by 7%,
- for petroleum products - the rates were increased by 38%-50%,
- for car bodies - the rates were decreased by 90%.

The brief summary above cannot address all-important changes implemented by the Tax Code and related issues. In our further newsletters, we will continue analyzing the impact of the Tax Code on business in Ukraine.

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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