

**GENERAL OVERVIEW OF TAXES, LEVIED IN UKRAINE****General information on the tax system of Ukraine**

For the purposes of further discussion we feel it appropriate to provide first brief overview of the tax system of Ukraine.

At present taxes in Ukraine are divided into two groups which are nation-wide taxes and local taxes. These categories combine the following taxes which are applied in Ukraine:

**Nation-wide taxes:**

- Corporate profit tax (CPT)
- Value added tax (VAT)
- Personal income tax
- State duty
- Land tax
- Excise duty
- Customs duty
- Tax for the use of natural resources
- Tax on car owners
- Other minor taxes

**Local taxes:**

- Municipal tax
- Advertising tax
- Local symbols use tax
- Other minor taxes

Please note that for your easy reference some of the listed above taxes (which are generally acknowledged as the principal ones) are succinctly outlined in the below Table 1:

**Table 1**

<b>Tax / Levy</b>	<b>Tax base</b>	<b>Rate</b>	<b>Reporting requirements</b>	<b>Terms of payment</b>
<b>Nation-wide taxes</b>				
Corporate profit tax (CPT)	Gross income less deductible expenses and depreciation. The tax base shall be determined in the CPT return.	25 %	CPT return shall be submitted to the tax authorities within 40 calendar days of the last calendar day of reporting quarter.	CPT shall be paid within 50 calendar days of the end of respective quarter.
Withholding tax	Income sourcing out of Ukraine and payable in favour of non-residents.	15%	Ukrainian legal entity paying income to non-residents shall submit to the tax authorities the respective report	Withholding tax shall be paid to the budget upon payment of respective income.

			on incomes paid and taxes withheld and paid to the budget. This report shall be filed within 40 days of reporting quarter.	
Value-added tax (VAT)	Contractual value of goods (services) but not less than arm's length prices (i.e. fair market price). Tax base shall be determined in the VAT return. In case of importation the tax base includes customs duty.	20%	VAT return shall be submitted to the tax authorities within 20 calendar days of the last calendar day of reporting month.	VAT shall be paid within 30 calendar days of the last day of reporting month. In case of importation during customs clearance of goods.
Customs duty	Customs value of imported goods which includes contractual value of goods and all other actual expenses related to importation of goods. Customs value of imported goods is stated by payer in the customs declaration.	Ukrainian laws establish rates of customs duty either as fixed amounts or as percentage of the customs value depending on the type of goods imported (the codes of goods according to the Harmonized System of Description and Coding of Goods) and country, of the goods origin. There exist full and preferential (privileged) types of customs duty. The type of applicable duty is determined basing on the country of the goods' origin.	Entity importing goods shall submit customs declaration during customs clearance of respective goods.	Customs duty is due upon import of goods and is payable during customs clearance procedures.

Personal income tax (PIT)	Taxable income includes, <i>inter alia</i> , salary (wage), payments and rewards as well as fringe benefits payable to employees.	15%  Double rate (i.e. 30%) for incomes of non-residents (with certain exceptions)  Specific rates for some other types of income	In the general order taxpayers shall file yearly tax return till April 1 <sup>st</sup> of the next calendar year.  In case of taxation of employees respective calculation of tax for each quarter shall be submitted by employer (acting as a tax agent of its employees).	PIT is payable to the budget when taxable income is paid. In case taxable income is not actually paid but accrued respective amount of PIT shall be paid within 20 calendar days of the last day of respective month.
<b>Local taxes and levies</b>				
Municipal tax	The rate <sup>1</sup> shall not exceed 10% of the payroll for a year, which is computed based on the assumption that each employee receives salary in the amount of one exemption limit (literally, 'non-taxable minimum of personal incomes'). As of today the maximum amount of this tax shall not exceed UAH 20.40 per each employee per year which approximately equals to EUR 3.05 <sup>2</sup> .			
Advertising tax	The rate shall not exceed 0.1 % of the value of placement of onetime advertisement and 0.5 % of placement of the long-term advertisement.			
Vehicle parking levy	The rate shall not exceed 3% of the exemption limit in the specially equipped places and 1% in the allocated places. This levy is payable by drivers on the place of parking.			

As for the general rules of tax reporting in Ukraine we find it necessary to apply to the Law of Ukraine "On the Procedure of Settlements of the Taxpayer's Obligations towards the Budgets and State Purpose Funds" (hereinafter – "the Law on settlements") which sets up the general procedures of payment of taxes and other mandatory payments to the budgets as well as procedure of declaring respective tax liabilities.

However, procedures of payment and reporting, specially established by the law which exclusively regulates levying of certain tax, take priority over general rules, set forth by the Law on settlements.

<sup>1</sup> Please note that the information regarding local regulations (except for Kyiv) is not available in legal databases we normally use, therefore the issues on specific rates of local taxes and levies shall be additionally addressed to the local authorities where the construction project is to be carried out.

<sup>2</sup> This amount is calculated at the exchange rate established by the National Bank of Ukraine for October 18, 2008, according to which EUR 1 equals to UAH 6.67.

According to the Law on settlements (item 1.11) tax return is the document which is to be submitted by taxpayer to controlling authorities and is purposed to inform the latter of the amount of tax due as well as of basic indicators of the tax payers' tax accounting. We note that there is no single (unified) form of tax return for all taxes and mandatory payments. However, relevant legal acts provide respective forms and procedures of submitting tax returns for each particular kind of tax or mandatory payment.

All reporting documents (tax returns and tax calculations) shall be signed by authorized officials of legal entity (basically, by the director and chief accountant) and shall be attested by seal. There is no requirement for taxpayers to undergo independent audit in order to prove accuracy of tax accounting prior to paying respective tax or mandatory payment.

In addition we note that officials, entitled to sign reporting documents on behalf of legal entity, shall be administratively and criminally liable for trustworthiness and completeness of information presented therein.

Below we find it appropriate to outline taxes which constitute the base of Ukrainian tax system and are of particular interest for the investors contemplating the possibility of doing business in Ukraine:

### **Corporate Profit Tax**

Basic legal act to regulate issues of taxation with CPT is Ukrainian Corporate Profit Tax Act (hereinafter – 'CPT Act').

Generally, CPT is payable by Ukrainian legal entities incorporated under the law of Ukraine and their separated branches as well as permanent establishments (commercial representations) of the foreign legal entities, and foreign legal entities that receive income from sources in Ukraine.

Ukrainian legal entities are taxable on their worldwide income and gains adjusted for the deductible expenses (if any). Ukrainian law does not provide for consolidation or group relief (grouping) for tax purposes with each legal entity within a group being recognized as a separate taxpayer.

The regular CPT rate for Ukrainian legal entities is currently 25 percent.

#### *Determination of gross income*

Ukrainian CPT Act does not operate with the term "ordinary income" for the purposes of taxation using the term "gross income" instead. Gross income is defined rather broadly by the CPT Act providing merely for the list of proceeds to be included in it. And for this reason the definition of income, contained in Ukrainian Personal Income Tax Act (hereinafter – "PIT Act"), is generally used for the purposes of CPT.

Thus, in Ukrainian PIT Act income is defined as moneys, value of tangible and intangible property as well as any other assets bearing value, received by or accrued for the benefit of taxpayer within the period of taxation.

As concerns determination of gross income in regard to the proceeds received in foreign currency we note the following.

Under general rule envisaged by the CPT Act (sub item 7.3.1) all proceeds in foreign currency, received by or accrued for taxpayer within the period of taxation as remuneration for goods (works, services), shall be converted into Hryvnias by official exchange rate (set by the National Bank of Ukraine) of respective foreign currency to Hryvnia on the date of such receipt or accrual (i.e., upon delivery of goods (works, services)). If the exchange rate of the foreign currency changes during respective period of taxation the taxpayer is disallowed to make respective adjustments of the proceeds in Hryvnias.

Moreover, the book value of the foreign currency, received under such transactions, is also determined in accordance with above exchange rate.

For the sake of completeness we note that the same mechanism might be used also for determination of expenses incurred by taxpayer in foreign currency as one of the prescribed mechanisms (sub item 7.3.2 of the CPT Act).

#### *Determination of taxable profit (tax base) and calculation of tax*

The taxable profit is generally defined as gross income, less gross (deductible) expenses, less amounts of depreciation. Gross income includes incomes (sales revenues etc.) from all types of activity received over the reporting period in the form of cash, tangible or intangible assets, with the exception of certain items specifically exempted.

The amount of tax is calculated via multiplying of taxable profit by 0.25.

Please note that that assets and funds received by Ukrainian CPT payers as direct investments (contributions made in exchange for equity share) are non-taxable. Share premium (if any) is also a non-taxable item for the Ukrainian CPT purposes.

#### *Deductible expenses and losses*

Ukrainian CPT Act principally allows deduction of all reasonable business expenses with the exception of those explicitly disallowed or restricted by the Act or subject to capitalization and subsequent depreciation for the tax purposes.

Among the disallowed or restricted expenses are the following:

- Contractual penalties and fines are not deductible.
- Representation and promotional expenses are deductible only in the amount not exceeding 2 percent of the taxpayer's taxable profit for the previous tax year in total.

- Fixed asset repairs and maintenance costs are deductible in an amount not exceeding 10 percent of the total book (residual) value of the fixed assets as of the beginning of the respective reporting period. The costs in excess of the said level are subject to capitalization.
- Certain timing limitations exist in respect of deductibility of interest payable by Ukrainian entities to their major shareholders or foreign controlling entities. Interest expenses thus disallowed can be carried forward to subsequent periods.
- Only 50 percent of the cost of operational lease and fuelling of personal cars owned or operated by a company is allowed for deduction.

A separate restriction on deductibility applies to payments made to non-residents in offshore locations. Such payments can only be deducted in the amount of 85 percent of their total amount. Offshore locations are defined in an exhaustive list, approved by the Cabinet of Ministers of Ukraine.

#### *Tax losses carry forward*

Currently, tax losses can be carried forward for an unlimited period of time.

For the sake of completeness we note that during the previous years there was a limitation to carry forward losses, accumulated on the January 1<sup>st</sup> of the preceding tax year into tax returns for the current year. Yet, starting from the present year (i.e. 2008) there is no such limitation.

#### *Tax depreciation*

Under Ukrainian legislation, for tax depreciation purposes fixed assets are classified into four groups for which the respective depreciation rates are outlined in the following chart. These rates are applied to the net book value (reducing balance method).

**Table 2**

<b>Group</b>	<b>Fixed assets</b>	<b>Quarterly rate</b>
1	Buildings, constructions, capital costs of improvement of the quality of the land, transmitting terminals	2%
2	Automobiles, furniture, electric equipment, other office equipment	10%
3	Other assets not included into groups 1, 2, 4	6%
4	Computers, software, phone sets, printers, etc.	15%

Intangible assets are depreciated separately from fixed assets under the straight-line depreciation method (i.e., in equal shares per each tax period). The depreciation period is to be determined by the taxpayer himself, but should not exceed ten years.

*Advance payment of CPT in case of dividend distribution*

Upon payment of dividends, the payer shall make an advance payment of CPT in the amount of 25 percent of the dividends, assessed in addition to the total amount of dividends for distribution. Such advance payment shall be made upon or before the actual payment of the dividends. Such advance tax payment is creditable against the future CPT liabilities of the taxpayer paying out the dividends.

No advance tax payment is required in case of reinvestment of dividends. No tax deduction of the accrued/paid dividends is allowed.

*Gains/losses on disposal of capital assets*

Gains on sale of capital (fixed) assets are subject to CPT at the general rate of 25 percent. Rules of calculating gains from the sale of capital assets listed in the first depreciation group (immovable property objects) differ slightly from those for calculating gains listed in all the other groups. As far as capital assets from the first depreciation group are concerned, taxable gains are calculated as the difference between the book (residual) value of the specific asset and the amount of sale. Capital losses on disposal of capital assets of the first group are deductible.

Upon sale of capital assets listed in other depreciation groups, taxable gains are calculated by deducting the amount of sale from the book (residual) value of the respective group of the capital assets. Taxable capital gains arise only if the amount of sale exceeds the book value of the respective depreciation group.

Please note that gains on *sale of land* are taxable at the regular CPT rate while losses incurred due to transactions with land are not allowed for tax deduction.

*Administration*

Taxpayers submit four returns in a year: for 3 month, 6 month, 9 months and annual return. The returns are due within 40 calendar days of the last date of reporting (tax) period. The taxpayer shall pay the amount of CPT shown in the tax return within 10 calendar days of the last date of the period, established for submission of such tax return.

As special rule, for the year 2008 the budget law requires also submission of tax returns for 11 months not later than December 20 and paying the tax for 11 months not later than December 30. Please be aware that this special rule is also present in the project budget law for the year 2007.

### *Tax accounting*

Under Ukrainian tax accounting regulations, taxable income and deductible expenses are generally recognized upon the earlier of two events: payment or delivery (so-called "the first event rule"). Certain exceptions apply to transactions of a taxpayer with non-residents, residents exempt from corporate profit tax, or those paying the tax at the reduced rate. In such case the deductible expenses shall be recognized only at the moment of delivery of goods (works, services), regardless of the moment of payment. It is a general rule that all expenses, claimed as deductible, are to be properly supported by respective primary documents (e.g., agreements, invoices, bills of lading, consignments, etc.). Expenditures not substantiated by the proper documentation shall be deemed as non-deductible.

### *Transfer pricing provisions*

The CPT Act provides for special transfer pricing regulations in respect of taxable transactions with related (affiliated) parties and non-residents.

Under the transfer pricing provisions of the CPT Act the tax authorities are allowed to adjust actual (contractual) prices to the market level for tax purposes in case the transactions are made at a price that is significantly different from the market prices. These clauses provide in general that for the buyer the deductible cost for the tax purposes might be decreased or increased to the level of arm's length price (i.e. fair market price).

The fair market price, to the level of which adjustment for the tax purposes can be made, is generally defined as the one existing at the market under comparable economic conditions.

### *Taxation of income derived by foreign entities from Ukraine (withholding tax)*

Foreign legal entities deriving incomes from Ukraine not through a Permanent Establishment in Ukraine are subject to withholding tax in respect of types of incomes that are specifically listed in the CPT Act. The general tax rate is 15%, while different rates may be applicable to other types of income (e.g. income from freight, income from advertising services, etc.). The said tax applies to dividends, interest, royalties, lease payments, engineering services and other types of income received by foreign entities from Ukraine.

The withholding tax is normally withheld at source of payment and payable to the state budget by the entity paying the income in favour of non-resident entity. Importantly, the tax is payable at the account of the foreign entity receiving income, i.e. the amount of income finally received by non-resident beneficiary (after tax) would be decreased for the amount of tax withheld.

The above tax is normally payable by non-residents unless otherwise provided by applicable international tax treaty.

## **Value Added Tax**

### *Object of taxation*

The following transactions are subject to VAT in Ukraine:

- Supply of goods (works, services) on the customs territory of Ukraine.
- Import of goods (works, services) into Ukraine (including importation of property under lease agreements).
- Export of goods (works, services).
- Barter transactions and disposals for no consideration.

The VAT Act also provides a list of transactions that are not subject to VAT such as the majority of bank transactions, etc. The VAT Act also establishes the list of transactions, which are VAT exempt; e.g., royalty is exempt from VAT.

Please note that foreign entities providing services to Ukrainian companies not through permanent establishments in Ukraine with those services being consumed in Ukraine are not considered to be VAT payers. In such case the obligation to pay VAT is levied on the Ukrainian recipient of respective services.

### *Payers of VAT*

- Legal entities and entrepreneurs with domestic supplies of goods (works, services), the value of which exceeded UAH 300,000 (approximately EURO 45,000) within any period in the last 12 calendar months.
- Legal entities and individuals that import goods (works, services) into Ukraine.

It shall be noted that entities registered as VAT payers, but which are not engaged in taxable supplies for a year, lose the status of taxpayer. Consequently, any VAT credit accumulated during preceding years will be lost.

### *Tax rates*

The tax rates might be either 20% or 0%. There are no rates "in between". Majority of transactions involving the domestic sale of goods (works, services), importation of goods into Ukraine, as well as supply of services by non-residents for consumption on the customs territory of Ukraine are subject to VAT at the standard rate of 20 percent. Export of goods from the territory of Ukraine and related services are taxed at zero rate.

### *Moment when tax arises*

The tax obligation on domestic supplies arises either upon receipt of payment for or upon dispatch of the goods, depending on which event occurs first. For services, the date of the execution of the document confirming the rendering of services determines the moment of supply under the mentioned "first event rule".

For imports, VAT obligation arises at the date of the execution of the customs cargo declaration. In respect of imported services, the tax obligation arises either on the date of payment for services or the date of execution of the document confirming the rendering of services by the non-resident, whichever date occurs first. The date of the advance payment for exported or imported goods is not deemed to be the date that VAT obligations arise.

#### *Calculation of VAT*

VAT due to the budget is calculated as the difference between VAT collected from customers for sold goods (works, services) and VAT paid to suppliers (VAT credit). A VAT credit is allowed for input VAT paid in connection with the acquisition of goods (works, services) to the extent that the expense is connected with business activity of the taxpayer.

Only those who are registered with the tax authorities as VAT payers are allowed to claim VAT credit. There is no VAT credit available in respect of VAT incurred while purchasing goods (works, services), which are not intended for business activity of taxpayer. VAT credit is also not available for taxpayers carrying out transactions not subject to or exempt from VAT pro rata to the volume of taxable/non-taxable operations (this is often the case for banking institutions, whose services are in large part not subject to VAT).

Any negative difference between VAT collected from customers and VAT paid to suppliers (VAT credit) is to be refunded from the state budget or offset against VAT liabilities of the current or following period(s). Any positive difference must be paid across to the state budget.

All VAT-able transactions are to be properly documented with tax vouchers (in particular, to be treated as a tax credit, VAT paid to suppliers should be properly supported with tax vouchers). Tax vouchers can only be issued by entities (individuals) registered as taxpayers for VAT purposes.

Services obtained from a non-resident entity for use or consumption on the customs territory of Ukraine are subject to VAT at 20 percent, to be paid by the Ukrainian recipient of the services under a reverse-charge mechanism. This VAT would subsequently be claimed as a credit (provided that the expenses for acquiring the services are tax deductible).

#### *Payment and filing procedures*

The tax period for VAT payers with VAT-able operations for the previous calendar year in excess of UAH 300,000 (approximately EURO 45,000) constitutes one calendar month. All other taxpayers may choose between monthly or quarterly tax periods. Separate divisions of an entity are not required to calculate and pay VAT. It is the liability of the head office.

#### *Payment of VAT upon importation of assets/ products into Ukraine*

VAT is also payable to the customs when assets/ products are cleared upon their importation into Ukraine. This rule is applicable to in-kind contribution to the chartered fund of Ukrainian legal entity.

Pursuant to VAT Act *any* importation of assets, *including those intended for contribution into the chartered fund of the Ukrainian legal entity*, shall be subject to regular Ukrainian import VAT at the rate of 20%.

Such import VAT shall be payable by the importing entity (i.e. Ukrainian recipient of the assets) at the customs upon customs clearance of respective assets being imported in Ukraine. Import VAT is applied on top of the customs value of the assets (goods) declared by the Ukrainian entity importing such goods subject to possible adjustments by customs authorities.

It is evident that such import VAT, being further allowed for recovery (under certain conditions), shall be viewed as a simple cash flow item rather than and tax expenses of the importing entity.

Also please note that instead of paying import VAT with cash the importing entity is entitled to issue a promissory note with 30 days maturity for import VAT amount due. As a result of this, delay of payment of import VAT can be achieved by the importer. Yet, we note that currently this opportunity does not work in Ukraine as Ukrainian customs authorities do not accept VAT promissory notes when customs clearance basing this on formal excuses.

### **Personal Income Tax**

The personal *income tax* has a flat 15% rate. Yet, incomes, received by non-residents, are taxable at the double (30%) rate. Moreover, there are special tax rates for certain types of income.

In most cases personal income tax is applied to entire revenue of the natural person with certain deductions allowed in the form of income tax credit. The personal income tax on the income of natural persons derived from transactions with investment assets (e.g. securities, investment certificates etc.) is applied to the profit from such transactions, computed as difference between expenses for purchase and revenue from sale of investment assets.

The residence, not nationality, of the worker governs the taxation of his incomes. Ukrainian residents should pay the tax on incomes of Ukrainian and foreign origin. Non-residents must pay Ukrainian income tax on the incomes of Ukrainian origin.

In general outline, incomes and benefits with respect to employment are subject of the tax withholding. The law provides for very few exemptions from the income tax in the context of employment. As to most benefits such as meals, telephones etc. if they are provided by an employer for employees' non-work purposes are taxed.

If it is the case that an employer provides above-mentioned recourses and facilities to an employee with the intention that the employee uses them for carrying out the duties of his or her employment the law exempts the value of such benefits from the tax. This rule equally applies to the social funds contributions.

If making payment in kind to an employee (i.e. one in goods or services – meals, transportation etc.), the employer must multiply the taxable amount by 1.176 in 2008 onwards. The due date for

payment the tax on non-cash incomes and benefits is the 20<sup>th</sup> day of the month following the month where the non-cash payments were made.

### *Due Payment Date*

The due date for the pension fund contributions payment as well as the income tax payment is the date when the employer withdraws pay-roll cash from its banking account but no later than the 20<sup>th</sup> day (income tax – the 30<sup>th</sup> day) after the pay-roll month ends. As to the other social contributions, their payment must be made on the date of the cash withdrawal.

### **Pay-roll Contributions**

There are different types of state purpose funds (e.g. payment, unemployment funds) in Ukraine to which the pay-roll related contributions shall be paid. The burden of such contributions is divided between employee and employer. The overall rate of remittances to state purpose funds to be paid at expense of the employer in 2008 makes 36% of the pay-roll subject to the personal income tax plus remittance to the Fund on state insurance from job-related injuries that vary from 0.66 to 13.6 % (depending on the class of professional hazard to be established by the Fund). The overall rate of remittances to state purpose funds which are paid at the expense of employee makes 3.5% (if salary exceeds the subsistence wage) and 1.5% (if salary is below the subsistence wage).

We note that the base for payroll-related charges (except for PIT) in Ukraine is capped at UAH 9 705 (starting from April 1, 2008); UAH 9 735 (starting from July 1, 2008) and UAH 10 035 (starting from October 1, 2008). That is, should the monthly income of an employee amount to UAH 8 000, the tax base is UAH 8 000, UAH 9 800 – the tax base is UAH 9 705, UAH 15 000 – the tax base is UAH 9 705.

For the sake of completeness please note that the payroll-related charges paid at the expense of employer are deductible for the profit tax purposes.

Please also note that the laws provide for tax exemptions and concessions for certain types of workers, e.g. disabled persons, retired employees and others. Our review does not cover such particulars.