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Taxation with VAT



by Alexander A. MININ

A amendments made this year to the VAT Act changed in general the approach to taxation with VAT of export and import services. To start with, such categories as export and import services literally disappeared from the Act (though respective notions still remain in some clauses of the Act, they do not play any substantial role and shall be considered merely as 'remnants' of the preceding 'construction').

Instead of operating with categories of export and import services defined as such on the basis of the deemed place of use of the services (qualification of which was not clearly defined by the Act, thereby leaving a lot to the subjective approach), the Act has now shifted to taxation on the basis of the place

Alexander A. Minin is a senior partner of KM Partners law firm(Kiev)

of supply, where the rules are more clearly defined.

Such a shift follows the approach suggested by the 6th Directive of the European Union on the harmonization of laws relating to turnover taxes – the common system of value added tax: uniform basis of assessment. The respective origin of the amendments is especially clear when

it comes to the close comparison of the 6th Directive and the amendments made to the VAT Act this year.

Ukrainian version of the 6th Directive

It is interesting to note that when the 6th Directive is silent in respect of a



of export and import of services

certain issue (e.g., type of documentary support required for the confirming the right to a tax credit (tax deduction) leaving it up to the discretion of each specific state, the amendments to the *VAT Act* as made this spring were also silent. Only later did legislators additionally introduce some provisions specifying the right to a VAT credit under services received from non-residents were the implementation authorities (tax administration) set up the rules for the documentary support required for the tax credit in respective cases.

Yet, while the general attempt by legislators to copy the *6th Directive* provisions into the domestic *VAT Act* is quite clear, this is still done on a selective basis or at least not on the basis of the modern version of the *6th Directive*.

Consideration of the *6th Directive* by Ukrainian legislators as some kind of set of parts, out of which certain ones may be taken separately, rather than as a uniform mechanism, which will not work properly if some of the essential elements are lacking, still provides the basis for raising issues that were already solved in the European Union.

Taxation of telecommunication services

One of the issues that arise in the author's view due to the recent changes to the *VAT Act* is related to the taxation of telecommunication services provided to non-residents. Before the amendments were made this year such services were usually treated as 'export' ones, i.e., subject to zero rate taxation on the basis of the deemed place of use of such services by non-residents outside of Ukraine, currently they can be considered rather as subject to tax at the standard rate because of the place of supply of such service being on the territory of Ukraine on the basis of the definitions of the current version of the *VAT Act*. Just for comparison, the current version of the *6th Directive* (as amended respectively in June 1999) contains a specific clause on telecommunication services, which stipulates that in case such services are performed for non-residents, the place of supply shall be the place (jurisdiction) where

the customer (rather than the service provider) is located. As such, under the *6th Directive* telecommunication services to non-residents shall be deemed as supplied outside of the country where the service provider is located and, therefore, be not subject to VAT in the home country of the service provider. At the same time, in Ukraine the like services are now likely to be subject to VAT at the full rate. In other words, the discussed amendments seem to cause more trouble for the telecommunication companies compared with the preceding 'set up' of VAT regulations.

Taxation of consulting services

Another example of a worsening in the tax treatment may be given for services that visibly retained the status of not triggering VAT liability when provided to non-residents. Let's take an example of the services of consultants, lawyers and other similar services provided to non-residents. The author is sure that this example may be of interest to the readers of this magazine because of the nature of the magazine. Earlier such services, when rendered to non-residents, were treated as export services and subject to zero rate VAT. Respectively, 'input-related' VAT of consulting and law firms (like VAT paid on the lease fee in respect of the office used by the firm) was not affected. Currently, if such a service is not subject to VAT at all (rather than subject to VAT at zero rate as was the case before), the service is considered as not subject to tax. In such a case the service provider has no right in respect of tax credit deduction) in respect of VAT incurred in relation to the provision of such a service, which is not subject to VAT. In other words, if a Ukrainian law firm renders legal services only to non-residents (and such services are not subject to VAT because the deemed place of supply of such services is outside of Ukraine), then the law firm loses the right to treat VAT paid in relation to the lease of the office as VAT credit, i.e., such VAT becomes an additional expense of the law firm. Such an issue can also appear when a law firm provides services both to non-resident and resident customers. The relevant provisions of the *VAT Act* may be un-

derstood as requiring respective adjustment of input-related VAT also in such a case (pro-rata the services not subject to VAT in the total volume of services). Such an approach, if it is really taken in practice, in fact, provides disincentives to service providers to render services to non-residents compared with provision of services to non-residents. This is quite discriminatory, isn't it?

Deduction of the 'input related' VAT

Of course, as always the regulation is not crystal clear and arguments can be found to object to such an approach, but such arguments are also not entirely without doubt. To avoid such uncertainty the *VAT Act* requires the introduction of a clause similar to the one already contained in paragraph 3 of Article 17 of the *6th Directive* and providing the right to deduct (credit) 'input-related' VAT incurred in relation to transactions carried out (having deemed place of supply) in the other country (and because of this being not subject to VAT in the home country), which 'would be eligible for deduction of tax' (i.e. be subject to VAT) if they had occurred in the territory of the home country.

Existence of a similar provision in the *VAT Act* would clarify the latter issue and would provide an incentive for developing provision of services to non-residents.

Conclusions

The above considers only the general trend of development of Ukrainian VAT regulations and points out only a few issues related to the export and import of services that appear in view of the recent amendments to the *VAT Act*. As can be seen from the above, such issues to a large extent appear because of the approach of legislators still to adopt provisions of the *6th Directive* on a deliberate (specific) basis rather than as an entire mechanism as a whole. Inconsistency which appears in such a way might probably be resolved only with further amendments to the *VAT Act*. As such, the recent amendments are surely not the last on the issues considered in this article. ■