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under the Draft Tax Code
of Ukraine

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Topic of the Issue:
**Taxation of non-residents
under the Draft Tax Code of Ukraine**

Taxation of non-residents under the Draft Tax Code of Ukraine



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On June 17 the Draft of the Tax Code (hereinafter referred to as a “Draft”) passed the first hearing in the Parliament. The Draft was filed to the Parliament by the initiative of the Cabinet of Ministers of Ukraine and its head Nikolay Azarov. It has been quite a while since the codification of tax legislation in Ukraine received a high priority.

The Draft contains 19 chapters. After brief analysis of the Draft we can conclude that the proposed novelties are designed to set up stricter rules for taxpayers which may play as an constraint for attraction of foreign investments into Ukraine and development of the country’s economy.

The present article is aimed at giving an overview of the new rules of taxation of non-residents by corporate profit tax (CPT).

First of all it is necessary to mention that according to the Draft non-residents are to carry out their business activity in the territory of Ukraine only through the permanent representative offices. Additionally ALL representative offices would be obliged to register with state tax service of Ukraine before running any commercial activity irrespectively of the fact that they might not be recognized as permanent representative offices in future.

At present time, non-residents are authorized to make business in Ukraine without establishing a permanent representative office (this, in particular, follows from the Law of Ukraine “On Foreign Economic Activity”). A non-resident’s office not engaged in commercial activity is to be registered with the Ministry of Economy of Ukraine whereas only permanent representative offices (i.e. those conducting commercial activity) are subject to registration with tax authorities. Yet, currently in practice registration is being required from all representative offices of non-residents. Their status for the purposes of taxation is determined later.

Royalty taxation

The Draft also introduces new fiscal rules for tax accounting of royalty. That is to say royalty will not be deductible for the purposes of CPT in case it is paid in favour of non-residents.

The same restriction applies if royalty is paid in favour of individuals, legal entities exempt from CPT or taxable at other than general/additional rate or to persons paying CPT as part of other taxes. At the moment such royalties are fully deductible if connected to the commercial activity of a taxpayer.

Interest taxation

Amendments concerning taxation of interest may also turn burdensome to taxpayers.

The restriction regarding deductibility of interest will apply to the taxpayers with 20 or more percent of foreign capital in the share capital. Currently limitation on tax deduction of such interests extends to companies with more than 50% of the share capital belonging to non-residents. According to the Draft the allowed for deduction amount of interest should not exceed the debt liabilities of the taxpayer before the non-resident and should be *within the amount of these non-resident’s participation in taxpayers own capital* determined according to the relevant accounting rules.



Such new rules on the accounting of interests for tax purposes may substantially diminish tax deductible costs. Interest not deducted according to the mentioned rules will be taxable at 15% rate. In contrast, the current Law of Ukraine "On taxation of Profit of Enterprises" ("Law on CPT") contains more liberal provisions on taxation of interests. In such a way, taxpayers are allowed to transfer non-deductible interest to the next reporting periods.

Taxation of non-residents income

The Draft mainly provides for the similar rules of non-residents taxation as exist now:

- The list of income originated from Ukraine remains almost the same;
- The applicable general tax rate is 15%;
- Taxation of marketing income, income from operation with non-interest bonds, freight income remains mainly the same.

Important! The Draft provides for the taxation of income received from the sale of intangible assets at the rate of 15%.

Taxation of operations with offshore companies

Another issue for consideration is the special provisions regarding the off-shore areas.

To start with, the Draft, instead of definition "off-shore zones" and "non-residents with off-shore status" used in the Law on CPT, introduces a definition "states with preferential regime of taxation", under which the following states fall:

- those with 50% or less of CPT rate than one in Ukraine;
- those which have adopted laws on confidentiality of financial information or company data enabling to conceal information on the beneficial owner of property or income; or
- those which fail to produce such information at the request issued by STAU.

It is likely that countries that are now not included into the list of off-shore areas approved by the Cabinet of Ministers may fall under the category of "states with preferential regime of taxation".

The rule would also apply to administrative subdivisions of states with the afore-mentioned regime of taxation.

In taxation of operations with non-residents with preferential regime of taxation the following rules apply:

- 85% limitation on tax deductibility of expenses incurred in favour of non-residents;
- 115% of income received from mentioned non-residents are subject to CPT.

Taxation of foreign subsidiaries

A taxpayer who directly or indirectly owns 10 or more percent of the share capital of a foreign company has to recognize the part of the profit received by its subsidiary.

This applies in case foreign subsidiary generates profit in states with preferential regime of taxation.

The proportion of such foreign subsidiary's profit is determined based on taxpayer's participation in its capital.

However, the Draft does not prescribe any procedures for tax authorities to make inquiries and control taxpayer's compliance with the said provisions.

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