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THE NEW LEGAL FRAMEWORK FOR UKRAINIAN CROSS-BORDER TAXATION ENTERS INTO FORCE

On 21 May 2020, the President of Ukraine signed the Law of Ukraine "On Amendments to the Tax Code of Ukraine on Improvement of Tax Administration, Elimination of Technical and Logical Inconsistencies in Tax Legislation" (the "**Law**"), which was passed by the Parliament on 16 January 2020.

The Law was published on 22 May 2020, and since that date only the final text of the Law, as adopted by Verkhovna Rada, has become available to the public. For five months since the adoption of the Law, the "tsunami" type of changes to the Ukrainian tax law remained unclear.

Overall, apart from significant changes to the existing tax rules and procedures, the Law has introduced completely new tax concepts, such as the concept of Controlled Foreign Companies (CFC). The declared aim of the Law is at deoffshorization, ensuring tax transparency and implementation of certain provisions of the BEPS Plan in Ukraine.

Most provisions of the Law entered into force on 23 May 2020; however, certain important amendments and developments will enter into force gradually – on 1 July 2020 and on 1 January 2021. At the same time, on 25 May 2020, the Chairman of the Parliamentary Tax Committee, Mr. Danylo Getmantsev, announced that the date of certain provisions of the Law entering into force, including the CFC rules, may be shifted from 1 January 2021 to 1 January 2022. Therefore, businesses, particularly Ukrainians who own foreign companies regardless of whether or not these companies do business in Ukraine, should take the above dates into account to prepare themselves and to determine what relevant measures should be taken in response to the changes in the short-, mid- and long-term perspective.

Among others, the following are the most important and critical changes in the Ukrainian tax legal framework:

Effective starting from 23 May 2020:

- Permanent establishment: The definition of "permanent establishment" (PE) has been modified and extended. The rules for determining PE's taxable income have also been amended. In particular, "indirect" and "split balance" methods will no

longer be applicable to determine PE's taxable income - only a general method in combination with an arm's length method will be applicable.

- Introduction of a business purpose test: The deductibility of expenses in transactions with non-residents shall be restricted if such transactions lack a business purpose. The list of non-exhaustive cases, when a transaction is deemed to have no business purpose, has been introduced into the Tax Code.
- Corporate profit tax (CPT) adjustments: Annual threshold that requires CPT adjustments increased from UAH 20 million to UAH 40 million. The Law also provides for an upward adjustment of the taxpayer's financial result before tax by 30% of the value of goods, works or services sold to non-residents from low-tax jurisdictions or those incorporated in specific legal forms.
- Withholding taxation: The principal changes include, among others, the following:
 - amendments to the "beneficiary recipient" condition and introduction of the "principal purpose test", which, subject to certain exceptions, disallows benefiting from double tax treaties if obtaining benefits thereunder is one of the main purposes of a transaction;
 - it is allowed to "look through" the immediate recipient of taxable income and apply the double tax treaty with the beneficiary recipient instead;
 - introduction of the rules for calculation and payment of withholding tax in the event that a non-resident receives an in-kind income from Ukraine.
- Transfer pricing (TP) rules: The principal changes include, among others, the following:
 - introduction of three-tiered TP reporting, which consists of (a) local TP documentation (local file), (b) global TP documentation (master file) (provisions on master file will become effective on 1 January 2021), and (c) country-by-country report (subject to certain requirements, the first report shall be due for the year 2021);
 - requirement to submit notification of the taxpayer's participation in a multinational group of companies (the first notification shall be due in 2021 for the year 2020);
 - amendments to the rules on TP control in commodity transactions;
 - self-adjustment in respect of controlled transactions that lack a business purpose;
 - modification and extending criteria for recognition as a related person.

Effective starting from 1 July 2020:

- Non-resident's transactions with real estate: Prior to acquisition of real estate in Ukraine or obtaining property rights thereto, a non-resident will be required to register with Ukrainian tax authorities.
- Non-resident's capital gains: Introduction of new rules for taxation of non-resident's capital gains from the sale of shares of a foreign company, which directly or indirectly derives its main value from real estate in Ukraine or shares in a Ukrainian company. Subject to certain conditions and exemptions, such gains shall be subject

to Ukrainian withholding tax and the non-resident purchaser shall be required to register with Ukrainian tax authorities.

Effective starting from 1 January 2021 (the date of entering of certain changes into force may be shifted to 1 January 2022):

- Constructive dividends: Payment for goods, works, services or shares (corporate rights) through controlled transactions in excess of the arm's length amount will be treated as distribution of "constructive dividends" and be subject to Ukrainian withholding taxation.
- Controlled Foreign Companies (CFC) rules: Introduction of taxation of CFC profit for Ukrainian controlling residents (both individuals and legal entities). It will be deemed that the Ukrainian resident controls the CFC if it either (i) holds 50% of shares of CFC (in certain cases – 25% of shares (with reduction to 10% from 2023)), or (ii) has an ability (including together with other persons (individuals and/or legal entities) who are tax residents of Ukraine) to exercise significant or decisive influence over certain decisions of CFC.

The CFC profit calculated under the new rules (exemptions and cases when the CFC profit shall not be included in the controller's income are provided by the Law) shall be included in the tax base of Ukrainian tax residents controlling CFC, irrespective of whether or not such profit is distributed to controller(s). Depending on particular conditions, this profit may be taxable in Ukraine at a rate of 18%, 9% or 5%.

Ukrainian controlling residents will be required to report their control over CFC and the CFC taxable profit. Failure to do so shall be subject to significant penalties. The first report shall be due by 1 May 2022 (for the year 2021).

- New "thin capitalization" rules: Limitations for the deductibility of interest expenses will apply to liabilities in favour of all non-residents (not just related); no special rules will exist for financial companies and those exclusively providing financial lease services. Interest expenses will be limited to 30% (instead of 50%) of the CPT base for a respective period (rather than the financial result before tax), increased by financial expenses and depreciation.
- Foreign companies deemed Ukrainian tax residents: New rules will be introduced to identify a foreign company as a Ukrainian CPT-payer if such company's place of effective management is in Ukraine.
- TP rules: Provisions related to global TP documentation (master file) will enter into force. Taxpayers participating in multinational groups of companies with a total consolidated income amounting to EUR 50 million (or its equivalent) for the year preceding the reporting year, shall be required to prepare a master file (in Ukrainian). The first master file may be requested in 2022 for the year 2021.

- Tax statute of limitation: Tax statute of limitation for audits of tax agents in respect of personal income tax and military charge on employment-related payments will be extended to 2,555 days (7 years).
- Liability for violation of tax rules: For certain violations, a taxpayer shall be subject to financial liability provided (i) the taxpayer is guilty of committing the violation, and (ii) such guilt is proven by a tax authority (the Law does not require the tax authority to prove the guilt in court; however, if the taxpayer disagrees with the position of the tax authority regarding the existence of guilt, then the tax authority will need to prove the taxpayer's guilt in court).

The Law also establishes a list of circumstances that either release taxpayers from financial responsibility or mitigate it, as well as new types of tax violations, and modifies existing ones.

While the Law by itself represents a significant change of tax regime, particularly for Ukrainian tax residents, it will also have an effect on foreign companies that are not controlled by Ukrainian tax residents but complete transactions with non-Ukrainian companies controlled by Ukrainian tax residents. One may expect new specific tax related clauses to appear in agreements in M&A transactions.

Finally, while the Law may change, particularly with respect to the time when certain provisions become effective, further changes to the Ukrainian domestic and cross-border regime are expected.

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