

2020 Tax Reform: Summary of Changes

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On 23 May 2020, the long-awaited Law No.446-IX (earlier Draft Law No.1210) "On Amendments to the Tax Code of Ukraine on Improving Tax Administration, Removing Technical and Logical Mismatches in Tax Legislation" (the "Law") has become effective. Some of the new rules would, however, take effect on 1 July 2020 and 1 January 2021, as we highlight further.

Importantly, it is expected that some of the Law's rules may yet be re-discussed and, potentially detailed, changed and/or postponed (due to COVID-19 lockdown), - as it follows from the comments about signing the Law at the President's web-site. The Cabinet of Ministers of Ukraine is to initiate discussion on this with the business community and experts.

We encourage you to review the new rules (both already in effect and upcoming ones), assess the impact of those on your business, and take part in the discussion on necessary revisions through a business association which represents you.

Below is our brief summary of changes that the Law makes in the Tax Code of Ukraine (the "Tax Code"):

Tax administration

Tax audits

- ▶ Changes to a schedule of documentary audits in the middle of the year are allowed not more than once in the first and second quarter of the reporting year.
- ▶ Special-purpose collegiate bodies will be created within the tax authorities to consider objections to tax audit materials.
- ▶ While the decision of the court (investigating judge) is excluded from the list of grounds for unscheduled tax audits, such list is supplemented with the following new grounds:
 - ▶ After a scheduled or unscheduled documentary audit of a taxpayer foreign public authorities provide information and/or documents suggesting that the taxpayer violated the law related to the issues covered by prior audits.
 - ▶ The tax authorities obtain information suggesting that a non-resident does its business through a permanent establishment in Ukraine with no registration with the tax authorities.

- ▶ The tax authority's powers during audits and reviews of audit results are enhanced, including the right to receive:
 - ▶ Written explanations from the taxpayer's officials on the subject of the audit and document support of such explanations
 - ▶ Explanations from employers, their employees and individuals whose labor is used with no due formalization during the audits, in respect of the employer's compliance with the law related to formalization of employment relations and due income taxation

Tax statute of limitation

- ▶ Tax statute of limitation is extended to 2,555 days for audits of tax agents in respect of personal income tax and military levy on employment-related payments.
- ▶ It is clarified that filing an adjusting calculation renews tax statute of limitation with respect to the scope of filed adjustments only.

Responsibility

- ▶ The Law introduces the taxpayer's responsibility for specific law violations prescribed by the Tax Code, provided the taxpayer is guilty and such guilt is proven by the tax authority.
- ▶ The Law establishes a list of circumstances that either release taxpayers from financial responsibility or mitigate it (in the latter case a 50% penalty is charged).
- ▶ The Law introduces new types of tax offences (e.g., failure to report CFCs) and modifies the existing ones.
- ▶ Penalties for tax offences are changed, including:
 - ▶ The base penalty under Article 123 of the Tax Code is decreased to 10% of the tax liability determined by the tax authority, while the penalty for willful / repeated willful violation is 25% / 50% respectively.
 - ▶ Changed penalties for violation of taxation rules: the base penalty for payment delay is decreased from 10% to 5% (if the delay is less than 30 days) and from 20% to 10% (if the delay is 30 days and beyond), also separate penalties for willful violation (25%) and willful repeated / willful violation if the delay is 90 days and beyond (50%) are introduced.
 - ▶ Increased penalties for certain law violations provided for by Articles 117, 118, 119, 120 etc. of the Tax Code.

Other changes

- ▶ The Law provides a new approach to identification of large taxpayers based on the amount of taxes and levies they contribute to the State Budget: the threshold is increased from EUR 1 million to EUR 1.5 million, disregarding the amounts of customs duties paid (if any).
- ▶ The Law requires taxpayers to submit adjusting calculations to annual CPT returns where the figures in the annual financial statements published together with the auditor's reports change as compared to those in the financial statements filed along with the CPT return (to the extent that the

published financial statements have an impact on CPT return figures).

- ▶ If a deadline for payment of tax liability falls on a non-business day or a holiday, the deadline is deemed a business day following such non-business day or a holiday.

Corporate profit tax

General changes

- ▶ The annual income threshold that requires application of tax adjustments is increased from UAH 20 million to UAH 40 million.
- ▶ New rules are introduced to identify a foreign company as a corporate profit tax payer if its place of effective management is in Ukraine.
- ▶ The Law introduces a business purpose test for transactions with non-residents, which limits the amount of expenses under such transactions if they lack a business purpose. The Tax Code will contain a non-exhaustive list of cases where a transaction is deemed to have no business purpose. The burden of proof regarding the absence of a business purpose lies on the tax authority.
- ▶ "Thin capitalization" rules (para. 140.2 of the Tax Code) are significantly changed as follows:
 - ▶ Limitation on tax deduction applies to interest expenses that exceed equity capital by 3.5 applies to liabilities in favor of any non-residents (not just related ones).
 - ▶ Allowed interest expenses are limited to 30% (instead of 50%) of the CPT base for the respective period (rather than the financial result before tax), increased by financial expenses and depreciation.
 - ▶ The tax base is calculated with all tax differences under section III of the Tax Code, except for the negative value of the tax object for prior periods and the adjustment itself under para. 140.2 of the Tax Code.
- ▶ Legal successors will be able to transfer tax losses from their reorganized predecessors, subject to certain conditions.
- ▶ Rules for tax depreciation of non-current assets are amended considerably, including the following:
 - ▶ Value requirement for asset recognition is increased to UAH 20,000
 - ▶ Accrual of tax depreciation is forbidden for the period when asset operation is suspended
 - ▶ Production method for calculation of tax depreciation is allowed
 - ▶ Accelerated depreciation for asset groups 3, 4, 5 and 9 is introduced for 2020-2030, subject to certain conditions
- ▶ The Law introduces an upward adjustment by 30% of the value of goods, works and services sold in favor of non-residents from low-tax jurisdictions or those incorporated in specific forms of business.
- ▶ The Law restricts deduction of expenses related to (1) fines and penalties imposed by tax and other authorities and (2) compensation for damages and lost profit.
- ▶ Rules for tax accounting of provisions for expected credit losses and related transactions are clarified.

Permanent establishment

- ▶ The Law extends and details the term "permanent establishment", particularly for representing of interests of a non-resident or a group of related non-residents in Ukraine, applying exceptions for auxiliary and preparatory activities, and for independent agents; specifies examples that may indicate that operations of a person in Ukraine may create a permanent establishment of a non-resident.
- ▶ The Law requires that a permanent establishment should be registered for tax purposes and introduces a fine of up to UAH 100,000 for evading such registration. The deadline for voluntary registration of existing (but not yet registered) permanent establishments is 1 October 2020.
- ▶ To determine taxable income of a permanent establishment, only a general method in combination with an arm`s length method will be available. An "indirect" method and a "split balance" method would no longer apply. Please also refer to "Transfer pricing" section hereof.
- ▶ The Law extends the powers of tax authorities in respect of unregistered permanent establishments of non-residents, including their forced tax registration, unscheduled tax audits, tax accruals, tax seizure of property. Such tax audits are expected to begin from 1 January 2021.

Withholding tax

- ▶ Conditions for benefiting from double tax treaties become more complicated: the Law details the "beneficiary recipient" condition and introduces the "principal purpose test" to this end. The "principal purpose test" should disallow benefiting from double tax treaties if obtaining such benefits was one of the main purposes of the transaction (with some exceptions).
- ▶ The Law should allow to "look through" the immediate recipient of taxable income and apply the treaty with its beneficiary recipient instead.
- ▶ There are new types of income subject to withholding tax:
 - ▶ Constructive dividends (e.g., profit withdrawal through controlled transactions in excess of the arm`s length amount)
 - ▶ Income from "indirect real estate disposal" - sale of shares of a foreign company, which derives its main value from real estate in Ukraine through a chain of foreign and Ukrainian companies
 - ▶ Income from alienation of rights to extraction and development of mineral deposits, mineral wells and other natural resources
- ▶ The Law introduces the non-resident buyers' responsibility to administer withholding tax upon purchase from another non-resident of Ukrainian companies, or foreign companies that derive their main value from real estate in Ukraine, and the rules of the relevant tax registration in Ukraine. This rule should take effect on 1 July 2020, unless postponed according to the President's proposal.
- ▶ There are some changes aimed to not apply a withholding tax in transactions between a non-resident and its permanent establishment in Ukraine.

- ▶ There are new rules for tax calculation and payment where a non-resident receives an in-kind income from Ukraine.
- ▶ The Law confirms responsibility of self-employed individuals and single tax payers to administer withholding tax when paying taxable income to non-residents.
- ▶ The Law introduces the rules on "mutual agreement procedure" that are intended to settle disputes on tax overpayment with the countries - parties of double tax treaties of Ukraine, and their residents.
- ▶ The Law should allow withholding tax exemption not only for the income from issuers of state securities, but also for the profit from resale of such securities (except for non-residents from low-tax jurisdictions).

Transfer pricing (TP)

- ▶ Three-tiered TP reporting are introduced, which consist of a Master File, TP Documentation (Local File) and a Country-by-Country Report.
- ▶ Taxpayers are required to send notifications of their participation in multinational groups of companies. The first such notification should be provided for 2020.
- ▶ Taxpayers participating in multinational groups of companies with the total consolidated income which is equivalent to or exceeds EUR 50 million for the year preceding the reporting year, are required to make the global TP documentation (Master File) in a national official language. The first global TP documentation may be requested in 2022 for the financial year ending in 2021 calendar year.
- ▶ Taxpayers participating in multinational groups of companies with the total consolidated income which is equivalent to or exceeds EUR 750 million for the year preceding the reporting year, and under certain additional circumstances in place, are required to file a Country-by-Country Report. The first Country-by-Country Report should be submitted for the financial year ending in 2021 calendar year.
- ▶ New penalties are introduced for a failure to submit the said notification (50 subsistence minimums for employable individuals), failure to submit a Master File (300 subsistence minimums for employable individuals) and failure to submit a Country-by-Country Report (1,000 subsistence minimums for employable individuals).
- ▶ Requirements to the contents of TP documents (Local File) are broadened.
- ▶ There are new rules on a reasonable commercial purpose (business purpose) in the context of transfer pricing:
 - ▶ A transaction between related parties may be deemed as to have no business purpose, among other, where, under comparable conditions, an individual would not be ready to buy (sell) goods, works (services), intangible assets or items other than goods from (to) non-related parties.
 - ▶ In TP documentation, taxpayers should, among other, prove reasonable commercial efficiency of a transaction and a business purpose available.
 - ▶ Taxpayers may perform a self-adjustment with regard to controlled transactions, which do not have the business purpose, using the same

adjustment procedure typically used to adjust the transactions not consistent with the arm's length principle.

- ▶ Rule regulating TP control over transactions with commodities is introduced in a new wording:
 - ▶ It is clarified which particular uncontrolled transactions may be selected as comparable.
 - ▶ The term "quoted price" is introduced, which would involve trading results, prices received from reputable agencies, statistical and government agencies.
 - ▶ The State Tax Service should publish the recommended (non-exhaustive) list of information sources of quoted prices on its official web-site by the beginning of the reporting year.
 - ▶ To have the right to compare the price of a controlled transaction with the quoted prices existing as of the date being nearest to the pricing date, taxpayers to be required to notify a regulatory authority thereof; the agreement itself would not be required to qualify for a futures / forward contract.
 - ▶ To use another TP method, taxpayers should additionally prove the impossibility to use a comparable uncontrolled price method and to provide information on the profitability of each counterparty in a chain of supply till a non-related party.
 - ▶ The Ministry of Finance now may determine, as per methods and requirements under Article 39 of the Tax Code, specific procedures to evaluate whether a controlled transaction with commodities is consistent with an arm's length principle. These procedures and their amendments should be approved by 1 July of the present year and to become effective not earlier than 1 January of the year following the year of their approval.
- ▶ Threshold of direct and / or indirect ownership for recognizing entities as related ones is increased to 25% and more.
- ▶ A list of business transactions for TP purposes is supplemented with a provision, under which the transfer of functions, assets, risks and benefits to a related party would come under control, if it results in the decrease of taxpayer's financial result.
- ▶ Income and expenses of a controlled foreign company in transactions with related non-residents and other persons listed in Article 39 of the Tax Code should be determined according to an arm's length principle.
- ▶ Taxable profit of a permanent establishment (PE) should be determined on an arm's length basis. The "indirect method", under which the PE's implied profitability was 30% of income, is canceled.
- ▶ TP documentation should be a reasonable ground for taxpayers to not make a 30% adjustment for transactions on the sale of goods (intangible assets, works, services) to non-residents included in the applicable CMU's lists as per Article 39 of the Tax Code (registered in low-tax jurisdictions or having legal forms that do not require payment of tax in the residence country).

Controlled foreign companies (CFC)

- ▶ The Law introduces taxation of profit of controlled foreign companies for Ukrainian residents controlling the CFCs, which should take effect starting 1 January 2021 (unless postponed according to the President's proposal).
- ▶ The CFCs' profit calculated under the new rules should be included in the tax base of Ukrainian controllers irrespective of whether such profit is paid to these controllers or not. This profit may be taxable at 18%, and in terms of dividends received by CFCs (directly or indirectly) from Ukrainian companies - CPT-payers / non-CPT-payers, the rates are, respectively, 5% / 9%.
- ▶ There are rules for calculation of CFC's taxable profit and the cases when the CFC's profit is not included into its controller's income, depending on the effective profit tax rate, a portion of passive income in the CFC's total income, adequate business substance at the CFC, and a double tax treaty between Ukraine and relevant country.
- ▶ Controllers will be required to report their control over shares in CFCs and the CFCs' taxable profit.

Personal income tax (PIT)

- ▶ 18% PIT rate is introduced for income from the third and subsequent sale / exchange of vehicles during the reporting year.
- ▶ The Law introduces special rules to determine income / expenses not lower / higher than the usual price in transactions of sale / purchase of investment assets which involve a related party non-resident or a non-resident incorporated in a low-tax jurisdiction.
- ▶ The Law clarifies that profit from transactions with foreign investment assets should be determined same way as profit from Ukrainian investment assets.
- ▶ The Law clarifies certain rules of accounting for income and expenses of those private entrepreneurs who use the general taxation system.

Value added tax (VAT)

- ▶ Deadlines for registration of tax invoices and/or adjusting calculations made under para. 198.5 and Article 199 of the Tax Code are extended to 20 (instead of 15) calendar days following the month of their preparation.
- ▶ Penalties for failed / untimely registration of tax invoices / adjusting calculations are amended, including the following:
 - ▶ Introduction of penalties for tax invoices / adjusting calculations prepared under sales transactions that involve goods / services subject to 0% VAT and exempt from VAT
 - ▶ Change in the amount of penalties for tax invoices and/or adjusting calculations prepared under para. 198.5 and Article 199 of the Tax Code and for transactions of continuous or rhythmic nature
 - ▶ In above-mentioned cases, the penalty equals to 2% of the supplied amount (but no more than UAH 1,020) for untimely registration, and 5% of the supplied amount (but no more than

UAH 3,400) for failure to register the invoice, based on the applicable tax notification - decision.

- ▶ The contractual value of the transaction that serves as a VAT base no longer includes compensation of lost profit based on decisions of international commercial and investment arbitration or foreign courts.
- ▶ The list of exceptions from application of the minimum VAT base is supplemented with supply of electricity where the price has been established in the electric power market.
- ▶ The Law clarifies the right of (sub-)contractors to use cash-based VAT accounting in construction.
- ▶ Quarter reporting period for VAT payers enjoying simplified taxation system is eliminated.
- ▶ The Law formalizes the obligation of private entrepreneurs to reverse-charge VAT on import of services with the place of supply in Ukraine, irrespective of their registration as VAT payers.
- ▶ The Law entitles taxpayers that use cash-based VAT accounting to recognize VAT credit within 60 calendar days from the date of payment or provision of other types of compensation, irrespective of whether 1,095 days have expired since the date the applicable VAT invoice was registered.
- ▶ Temporary exemption from VAT for export of soy beans (position 1201 under UKT ZED) and rape seeds (position 1205 under UKT ZED) is cancelled.

Excise tax

- ▶ Liquids used in electronic cigarettes should be subject to excise tax at the rate of UAH 3,000 per 1 liter.

- ▶ The Law introduces specific excise tax rates for cigarillos (UKT ZED 2402 10 00 90) and tobacco products for electric heating (UKT ZED 2403 99 90 10).

Rent

- ▶ Rent is increased for extraction of ferrous, non-ferrous and alloying metals (up to 6.25%) and iron ore (up to 11% or 12%, depending on the price of ore in world markets).
- ▶ Rent rates for special use of forest resources are changed.

Single tax

- ▶ The Law cancels exemption from land tax for single tax payers that belong to groups No. 1, 2 and 3 with respect to land plots which (or real estate facilities on which) are leased out. This change should take effect on 1 July 2020.

Tax on real estate other than land

- ▶ The list of items not subject to taxation is clarified. Inter alia, such list now includes industrial buildings attributed to "Industrial buildings and warehouses" group (code 125) of DK 018-2000 that are used as intended in business activities of legal entities which principal activities belong to sections B-F of KVED DK 009:2010, as long as they are not provided into lease or borrowing.

The Law also provides for quite a few other amendments to several Tax Code's sections (including to Section XIX "Final Provisions")

We go on following the news and keep you posted on any important developments.

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