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Recent Developments in Taxation

Ukraine

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International taxation

Base Erosion and Profit Shifting Plan implementation in Ukraine

The year 2019 saw the implementation of significant changes in the national tax legislation of Ukraine, the majority of which were introduced by the Draft Bill 'On Amendments to the Tax Code of Ukraine regarding the improvement of tax administration, and the elimination of technical and logical inconsistencies in tax legislation'. On 20 January 2020, this bill was adopted by the Ukrainian Parliament, and on 23 May 2020, most provisions of this law entered into force (the 'Law').

The mentioned Law introduced a significant number of changes to the Tax Code of Ukraine based on the best tax experience throughout the world, especially on the Base Erosion and Profit Shifting (BEPS) Plan, which Ukraine has undertaken to implement. The Law prescribes novelties to transfer pricing rules (Actions 8–10 and 13); controlled foreign companies rules (Action 3); limitation of expenses on financial transactions with affiliated parties (Action 4); new rules for preventing double tax treaty abuse (Action 6); new rules for preventing the avoidance of the status of permanent establishments and taxation of permanent establishments (Action 7); and detailed rules for the application of the mutual agreement procedure (Action 14).

Along with this, provisions, which mainly relate to the taxation of controlled foreign corporations (CFCs), will enter into force on 1 January 2021 (this term will be extended with high probability).

Among the most important changes are the following:

- the introduction of CFC rules for the taxation of profits of CFCs at the level of the controlling person – individual or legal entity in Ukraine – that shall be regarded as the controlling person of such a foreign company;
- the definition of permanent establishment is to be elaborated in line with Action 7 of the BEPS Plan, thereby enabling the reduction of fragmentation processes;
- introduction of the three-tier approach to transfer pricing documentation for transnational groups of companies;
- clarification of the criteria for recognising persons as affiliated and the introduction of penalties proportionate to respective violations of the law;
- the mutual agreement procedure will be properly regulated;
- introduction the concept of 'constructive dividends', where certain payments to a non-resident are treated as dividends and shall be taxed with withholding tax (WHT);
- clarification of the definition and application of the concept of the 'business purpose test' for the purpose of transactions with non-residents, and the 'principal purpose test' for the purpose of double tax treaty application; and
- introduction of the 'look-through approach' upon double tax treaty application: in the case that the recipient of income is indeed not the beneficial owner of this income, then it is permissible to apply the double tax treaty between Ukraine and the country where the actual beneficial owner of the income is regarded as a resident.

Double tax treaties

The year 2019 and the beginning of 2020 were also marked by the ratification, and in some cases, the entry into force, of protocols on amendments to a number of bilateral agreements of Ukraine on the avoidance of double taxation. Generally, the main aim of such changes is to align double tax treaties to the requirements of the Model Tax Convention of the Organisation for Economic Co-operation and Development (OECD), to the latest OECD standards, and to the provisions of the Multilateral Instrument (MLI) Convention.

On 18 September 2019, the Ukrainian Parliament ratified the Protocol on Amendments to the Double Tax Treaty between Ukraine and Switzerland. The protocol envisages increasing tax rates for the taxation of interest and royalties – from zero per cent to five per cent. Moreover, it establishes better regulation of the mutual agreement procedure and provides the possibility to exchange tax information.

On 30 October 2019, the Protocol on Amendments to the Double Tax Treaty between Ukraine and Cyprus was ratified, and on 28 November 2019, it entered into force. The protocol toughened the requirements under which it is possible to use a reduced WHT rate of five per cent while paying dividends, and reduced the maximum WHT rate from 15 per cent to ten per cent. In addition, the protocol increased the WHT rate while paying interest from two per cent to five per cent. The protocol introduced new rules for income obtained from the alienation of corporate rights, the value of which forms 50 per cent of the value of real estate that belongs to the company.

In addition, the Protocol on Amendments to the Double Tax Treaty between Ukraine and the United Kingdom of Great Britain and Northern Ireland was ratified on 30 October 2019, and on 5 December 2019, it entered into force. In particular, the protocol established that a reduced WHT of five per cent can be applied if the beneficial owner of the dividend is a company that directly or indirectly owns at least 20 per cent of the capital of the company paying dividends. In other cases, the rate of 15 per cent will be applied instead of the previous ten per cent. In addition, the rate of taxation of interest and royalties has been increased from zero per cent to five per cent.

On 14 January 2020, the Protocol on Amendments to the Double Tax Treaty between Ukraine and Singapore was ratified, and on 4 March 2020, it entered into force. The protocol expands the capabilities of states in the process of exchanging tax information.

In addition, on 30 October 2019, the new Double Tax Treaty between Ukraine and Malaysia was ratified. As of June 2020, it had not yet entered into force. Among other things, such an agreement provides for the taxation of dividends at a rate not exceeding five per cent, if the company that is the actual owner of dividends owns at least 20 per cent of the company's capital that pays such dividends, and in other cases, the rate of 15 per cent shall be applied. Interest will be taxed at a rate of ten per cent and royalties at eight per cent.

Foreign Account Tax Compliance Act and Ukraine

On 29 October 2019, the Treaty between Ukraine and the United States for the improvement of the execution of tax rules and application of provisions of the Foreign Account Tax Compliance Act (FATCA) was ratified, and on 18 November 2019, it entered into force. The main purpose of the agreement is to strengthen control over taxpayers of the US and prevent them from tax evasion.

In accordance with the agreement, Ukraine will automatically carry out an annual exchange of information on all American accountable accounts opened in financial institutions of Ukraine with the US. The term 'American accountable account' in the agreement means an account opened in financial institutions of Ukraine by an American person, in particular citizens, residents of the US and companies created in or in accordance with the laws of the US, as well as accounts opened in Ukraine by non-American business entities with one or more controlling entities that are indicated as an American person.

The exchange will be conducted by the tax authorities of states under Article 27 of the Double Tax Treaty between Ukraine and the US, which specifically prescribes the procedure for the exchange of tax information.

Covid-19 tax measures

The introduction of quarantine around the world in connection with the pandemic of the coronavirus disease Covid-19 has substantially affected the financial condition of the population and the business community. Given that, Ukraine, like many other countries in the world, has adopted a number of legislative measures to ease the tax burden on its taxpayers. Among them are the following:

- exemption from liability for the violation of tax legislation (with some exceptions) committed by taxpayers in the period from 1 March 2020 to the last calendar day of the month (inclusive) in which the quarantine period expires (quarantine was extended to 22 June 2020), as well as an exemption for the same period from the accrual of interest for the late payment of tax obligations;
- establishment of a moratorium on documentary and actual tax audits (with some exceptions) from 18 March 2020 to the last calendar day of the month (inclusive) in which the quarantine period expires;
- exemption from the accrual and payment of land fees for land owned or used by individuals or legal entities, including under lease terms, and used by them in commercial activities for the period from 1 March to 31 March 2020;
- exemption from the taxation of real estate other than a land plot from 1 March to 31 March 2020; and

- local authorities authorised to establish certain single tax rates for the simplified taxation system are provided with a specific right to decide on the reduction of previously approved tax rates until the end of 2020.

In addition, a large number of introduced tax benefits are associated with the purchase of medicine, medical devices and equipment, and personal protective equipment, and the production of disinfectant, aimed at combating the spread of the coronavirus disease.