

# International Tax and Business Guide

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## Ukraine

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## International Tax and Business Guide

Tax professionals of the member firms of Deloitte Touche Tohmatsu have created the Deloitte International Tax and Business Guides, an online series that provides information on investment conditions, tax regimes and regulatory requirements, along with information for executives working abroad. The Guides are supplemented by the Highlights series, an at-a-glance summary of basic information, including tax rates, for over 120 jurisdictions.

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## **1.0 The investment climate**

### **Political background**

Ukraine is an emerging democracy in which both the president and the parliament exercise power.

### **1.1 Economic structure**

Like much of the former Soviet bloc, independent Ukraine inherited an economy based on heavy industry and reliant on technology that had largely been superseded in the West. Ukraine's main challenge has been to diversify from many of the industries -- steel, chemicals, shipbuilding, coal, machine tools and weaponry -- that relied heavily on government subsidies.

The EURO 2012 Football Championship is expected to have a beneficial effect on the economy over the next few years with the need to improve the country's transportation links, including up to seven airports, express railway connections and improvements to the road network.

### **1.2 Banking and financing**

The Ukrainian banking sector has been the most developed and advanced part of the country's financial system. Aided by ongoing economic expansion and currency stability, the banking sector has grown rapidly, although it has been affected by the downturn in the global economy.

### **1.3 Foreign trade**

With over half of the country's GDP generated from exports, the Ukrainian economy is dependent on foreign trade. Ukraine became a full WTO member in mid-2008.

## **2.0 Business regulations**

### **2.1 Registration and licensing**

A license or permit may be required to perform certain business activities in Ukraine. A license must be obtained for mineral exploration, operations with gas, the production and sale of medicine, passenger and cargo transportation services, custom broker services, construction and engineering activities, etc. Licenses and permits will be issued after company registration but before business operations commence.

The National Bank of Ukraine issues licenses for banking activities and operations with foreign currency. An entity must obtain a licence from the State Commission on Securities and the Stock Exchange of Ukraine to carry out activities on the stock exchange.

Licensing procedures generally are time-consuming and require the submission of many documents. Licence fees depend largely on the type of licence.

### **2.2 Price controls**

As in other countries of the former Soviet Union, prices in Ukraine were generally liberalised after independence, although some restrictions remain. The Ukrainian authorities have traditionally regulated tariffs charged by the utility companies (gas, electricity and telecommunications), railways and local transport.

### **2.3 Monopolies and restraint of trade**

Ukrainian legislation provides an extensive definition of a monopoly. A business entity is deemed to have a dominant position in a particular market if it has no competitors in the market and/or faces no significant competition. An entity whose share of the goods market exceeds 35% also is considered to have a monopoly position if it fails to prove significant competition in this market. A monopoly position can exist for an entity with a market share of 35% or less when there is no competition due to the small market shares of other entities. When several entities are suspected of assuming a monopoly position, each entity is considered to be a monopoly if the total share of not more than three and five entities with the largest market shares exceeds 50% and 70%, respectively (unless there is proof of competition).

While the existence of a monopoly in Ukraine is not prohibited as such, monopolies are subject to fines (up to 10% of annual profits) if they are found to be abusing their dominant positions and engaged in anti-competition concerted actions. Abuse of a monopoly (dominant) position is defined as action or inaction leading to non-admission, elimination or restriction of competition.

## **2.4 Intellectual property**

Even though Ukraine is a party to the main international conventions in the area of intellectual property and has legislation in place, protection of intellectual property rights can be problematic. Part of the problem is the lack of coordination between various legal codes (ranging from the administrative code to the criminal and civil codes) and special laws that regulate intellectual property rights. Moreover, there is an ambiguous and controversial definition of the term 'royalty' in Ukrainian tax and civil law and tax treaties, which has had a negative effect on both existing and planned IP transactions forcing parties to essentially amend license agreements.

The law on copyright and related rights provides a legal basis for the protection of authors' rights related to the creation and use of works of science, literature and art (copyright), and rights of users of such works, including video producers and broadcasting organisations (related rights). These rights are valid for 70 years after the author's death for copyright and 50 years after the first release (publishing) for related rights. Penalties apply for violations.

Ukraine has a system for industrial property protection, including the protection of trademarks, which is generally consistent with internationally recognised norms and practices. Apart from the fundamental international treaties to which Ukraine is a party, trademarks in Ukraine are protected mainly under the law on the protection of marks for goods and services. Certain aspects of trademark protection, however, are regulated under the competition legislation.

The trademark law guarantees ownership rights with regard to trademarks and service marks through the issuance of certificates by a state body. Certificates are valid for 10 years following the date the application is filed and may be renewed for another 10 years. A certificate holder has the exclusive right to prohibit other parties from the unauthorised use of the registered mark, except for cases specified in the law (e.g. non-commercial use of trademarks). The law envisages the use of licence agreements for transfers of rights, but these agreements must include a requirement that the quality of goods (services) provided under the agreement will not be lower than that of the holder, and that the latter will exercise control over the implementation of this requirement. Amendments to the trademark law expand the definition of the effective use of a trademark to include the sale, offering for sale and import/export of trademarked goods.

## **2.5 Mergers and acquisitions**

Mergers and acquisitions are regulated by the competition law. The Anti-monopoly Commission (AMC) is charged with preventing monopolies from abusing their dominant position and/or restricting market competition. Prior permission from the AMC is required for mergers of business entities with a total book value (or total turnover) exceeding an equivalent of EUR 12 million, if the value of the assets held in the Ukraine and abroad by at least two concentration participants exceeds EUR 1 million. The same threshold is established for cases in which the assets are held in Ukraine by at least one participant (taking into account its control relations).

# **3.0 Foreign investment**

## **3.1 Foreign investment incentives and restrictions**

The main legislation regulating foreign investment in Ukraine is the Law on the Foreign Investment Regime, which provides equal business conditions for national and foreign investors. As a result, foreigners have the same rights to invest in Ukraine as Ukrainian legal entities and individuals, although there are certain areas where foreign investment is restricted or prohibited (e.g. publishing and broadcasting, weapons manufacturing).

The Foreign Investment Regime classifies a company as one with foreign investment where at least 10% of its authorized share capital is contributed by a foreign entity. Contributions are allowed in the form of foreign currency, local currency (in the case of re-invested profits), movable or immovable property, securities and valid debts denominated in foreign currency, as well as property and other rights (including intellectual property rights).

A foreign investment that is properly registered with the state authorities will qualify for the following incentives and guarantees:

- Protection for 10 years against adverse changes to the investment guarantees contained in the law;

- Investments may not be expropriated, except in the case of national emergency and with proper compensation;
- Compensation to cover losses incurred due to the negligence of state bodies; and
- The right to repatriate the original investment if the investment is terminated.

### **3.2 Exchange controls**

Ukraine maintains foreign exchange controls to combat illegal capital flight and “dollarisation” of the domestic economy. The main controls are exercised by the National Bank of Ukraine and are based on the following key legal provisions:

- Payments in foreign currency between residents are prohibited in Ukraine, with salaries to be paid only in Ukrainian currency;
- Ukrainian companies and private entrepreneurs must obtain a licence from the National Bank to open and use bank accounts abroad;
- Payments under foreign trade contracts between a resident and a nonresident entity may be made only in foreign currency unless a nonresident has an investment account in Ukrainian currency;
- Ukrainian companies generally must receive payment for exported goods or services, and obtain goods or services prepaid to a foreign supplier, within 180 days; and
- Foreign loans must be registered with the National Bank prior to their receipt.

Ukrainian law guarantees foreign investors the right to repatriate capital, proceeds, income and other funds relating to investments made in foreign currency without any restrictions, after the payment of applicable taxes. Conversion of funds for repatriation is executed through the Ukrainian Interbank Currency Exchange at the official national bank rate on the date of the transfer in compliance with exchange controls.

## **4.0 Choice of business entity**

### **4.1 Principal forms of doing business**

The Civil and Commercial Codes provide for various types of legal entities for business incorporation. Although the two codes are intended to complement each other, in some instances they overlap and even provide for conflicting norms. In addition, some issues are regulated by the law on business associations and the law on joint stock companies.

Under the Civil Code, foreign investors intending to conduct business in Ukraine may choose to conduct business in one of the following types of legal entity:

- Limited liability company (LLC);
- Open/public or closed/private joint stock company (JSC);
- General and limited partnership (rarely used in practice);
- Companies with additional liability (rarely used in practice); or
- Sole proprietorship, private enterprise, family enterprise, etc. (rarely used in practice).

It is also possible to open a representative office (subject to certain restrictions), which traditionally has been the simplest way for a foreign company to establish a presence in Ukraine.

The two most commonly used business vehicles are the JSC and LLC. A JSC is a legal entity whose authorised share capital is divided into a specified number of shares of equal nominal value. An LLC is similar to a JSC in that LLC investors (participants) are only liable for the obligations of a company to the extent of their authorised share capital contributions. However, an LLC structure entails participants’ ownership of a percentage in the company’s authorised share capital as specified in the company’s charter, rather than shares issued as securities.

The JSC is popular among foreign investors that tend to focus on partnerships with former state enterprises and local financial institutions, such as banks and insurance companies. Although the incorporation and operation of a JSC entails more administrative obligations than an LLC, the JSC is generally regarded as the most appropriate form of business organisation in Ukraine.

## Requirements for a JSC

A new JSC law that generally became effective on 30 April 2009 introduced new names for the types of JSC (i.e. a public and private JSC rather than an open and a closed JSC), as well as new rules for the formation and operation of JSCs. However, under a transition period from 30 April 2009 until 29 April 2011, both the new law (for newly created JSCs) and the previous law (for JSCs that existed before 30 April 2009 until they are re-registered under the new rules) will apply simultaneously. Existing open and closed JSCs should re-register as private/public JSCs by 29 April 2011. The new law will be fully applicable as from 29 April 2011.

The shares of an open/public JSC are freely transferable; those of a closed/private JSC are not. The shares of an open/public JSC may be offered to the public and traded on a stock exchange or transferred to existing shareholders if not prohibited by the company charter or any law. By contrast, the shares of a closed/private JSC must be distributed between its founding shareholders or to a predetermined and limited circle of shareholders. In both cases, however, the shares must be registered with the state regulator, the State Commission on Securities and the Stock Market of Ukraine, but reporting requirements on shares apply only to open/public JSCs. JSC shares can be bearer or registered and common or preferred, and may be issued either in documentary (paper) or non-documentary (electronic) form. Starting on 29 April 2011, shares will only be permitted to be issued in non-documentary form. The only quantifiable restriction is on preferred shares, the total nominal value of which may not exceed 10% (25% under the new law) of the company's authorised share capital.

JSCs are required to have four corporate bodies – a general shareholder's meeting, a supervisory board, management and an audit committee. The function of a supreme governing body of a JSC is to be performed by the general shareholder's meeting. At least 60% of the voting shares must be present for the general shareholder's meeting to be considered duly constituted. In terms of decision-making, general shareholder's meeting resolutions should normally be approved by a simple majority of the voting shares present. Amendments to the company's charter and decisions on termination of the company require a 75% majority of the voting shares present; under the new law, a 75% majority of the total voting shares is required to approve resolutions regarding the most important changes to and activities of a JSC.

The supervisory board is a governing body that represents the interests of the shareholders of a JSC in between the general shareholder's meeting and provides control over management activities. The appointment of the board is mandatory for a JSC that has at least 50 shareholders (10 under the new law).

The management is an executive body that is responsible for managing the day-to-day affairs of a JSC. The management can be established in the form of an institution or a sole person (director). Issues relating to the structure of the management and its administration must be specified in the company's charter.

The audit committee is a controlling body that performs financial and commercial control over the management of the JSC and prepares a summary of the annual reports and balances of the JSC. The shareholder's meeting is not authorised to approve the annual report and balances without the summary from the audit committee.

## Requirements for an LLC

While participants in an LLC generally have nearly the same rights as shareholders of a JSC, significant differences exist in respect of the following:

- A participant in an LLC may transfer his/her shares in the company's authorised share capital only upon the written consent of all other participants;
- A participant that withdraws from an LLC is entitled to his/her proportionate share of the assets of the company;
- A participant may be expelled from the LLC if he/she does not fulfil his/her obligations to the LLC; the a participant is entitled to his/her proportionate share of the company's assets at the time he/she is expelled;
- Creditor(s) of a participant may demand to withdraw a participant's share in the company's assets for settlement of obligations; and
- If the number of participants in an LLC exceeds 10, the company is required to convert to a JSC.

Unlike JSCs, LLCs are obliged to have three corporate bodies—the general meeting of participants, management and an audit committee. The general meeting of participants comprises the participants in the LLC, each of whom holds votes in proportion to his/her share in the company's authorised share capital. To be duly constituted, the meeting is required to have a presence of participants together holding at least 60% of the votes. Similar to the shareholders' meeting in a JSC, general meeting of participants resolutions are ordinarily approved by a simple majority of the votes present. However resolutions on amendments to the charter, as well as determination of the company's main activities and the exclusion of a participant, must be approved by 50% of the participants' votes.

Provisions regarding the structure and functions of the management and the audit committee of an LCC are almost identical to those of the management and the audit committee of a JSC.

#### **4.2 Establishing a representative office**

A representative office of a foreign business in Ukraine is not a legal entity, but an extension of its head office. A representative office may represent its foreign head office on the market, carry out various auxiliary activities or carry out business (commercial activities) that may give rise to a taxable permanent establishment (PE).

Representative offices that do not carry out business activities and only function as representatives of a legal entity must be registered with the Ministry of the Economy, but there is no legal requirement to register with the tax authorities and social security funds. If a foreign company has a PE in Ukraine, the PE must register with the tax authorities and social security funds, but there is no legal requirement to register with the Ministry of the Economy. As the practical matter, however, representative offices (whether or not PEs) register with the Ministry, the tax authorities and the social security funds (where necessary).

It may be possible to carry out certain types of business activities without establishing a representative office or any other formal presence in Ukraine (e.g. one-time contracts, joint production agreements with Ukrainian partners).

#### **4.3 Setting up a company**

The minimum authorised share capital to set up a JSC is the equivalent of 1,250 official minimum monthly wages in Ukraine (UAH 787,500 as at 1 July 2009).

The founders must pay at least 50% of the authorised share capital value before the JSC can engage in any activities not related to its registration. During the operational phase, the amount of authorised share capital defines a minimum level for the JSC's net assets. If, at the end of each financial year (except for the first year), the total value of these assets is lower than that of the authorised share capital, the authorised capital should be decreased accordingly (changes also should be reflected in the company's charter).

Setting up an LLC is a significantly less costly. The minimum authorised share capital is 100 Ukrainian minimum monthly wages (UAH 63,000 as at 1 July 2009).

LLCs must set up a reserve fund from net profits in an amount equal to at least 25% of their authorised share capital, while a JSC must form a reserve of 15% (under the new JSC law). No less than 5% of such profits may be transferred to the reserve fund each year until the fund is fully paid in.

JSCs and LLCs can be established with a single participant (with some exceptions).

Registration of companies is normally handled by the state district administrations, specifically their departments of company registration. To register a JSC and/or an LCC, the following documents must be filed:

- Minutes of the meeting of the founders regarding the company's establishment;
- Documentary evidence of the registration of the founder (if a legal entity);
- Evidence that the required minimum percentage of authorised share capital has been paid in;
- Evidence that the registration fee has been paid;
- A duly completed registration form; and
- A lease agreement, purchase agreement or other documents evidencing the legal address of the company.

In certain cases, consent from the anti-monopoly committee is required to establish a company.

## **5.0 Business taxation**

### **5.1 Overview**

Ukraine has an extensive tax system for the corporate sector, comprising more than a dozen separate taxes levied at the national and local level. The following main taxes and compulsory payments (all national) apply for businesses operating in Ukraine:

- Corporate income tax;
- Value added tax (VAT);
- Payroll tax;
- Excise tax;
- Import duties;
- Tax on motor vehicles; and
- Land tax.

Other applicable taxes and charges include stamp duties, royalties for the extraction of natural gas and oil, charges for the use of radio frequencies and on environmental pollution and charges to the guarantee fund for private banking deposits. There are several local taxes that apply to businesses and that may be levied at the discretion of the local authorities (e.g. advertising tax, municipal tax and charges for the use of local symbols).

### **5.2 Taxable income and rates**

Resident companies are taxed on worldwide income, while nonresident companies are taxed only on Ukraine-source income. A company is resident in Ukraine if it is established under Ukraine law.

The corporate income tax rate of 25% applies to taxable income (profits) earned by resident entities and PEs of foreign companies. Insurance companies are normally subject to a 3% corporate income tax on taxable insurance premiums (defined as gross premiums less the amount of payments to Ukrainian reinsurance companies), except for cases of long-term life insurance premiums and pension insurance premiums (taxed at 0%).

#### **Taxable income defined**

Ukrainian corporate income tax legislation defines taxable income (called "profits" in the law) as adjusted gross income less allowable deductible expenses (gross expenses) and depreciation charges.

Gross income includes any sales or non-sales income received or accrued within a reporting period (quarter). Gross income is recognised either on the date the goods and/or services are shipped and/or rendered, or on the date payment is received from the customer, whichever is earlier.

#### **Deductions**

Deductible (gross) expenses are defined as expenses actually incurred or accrued for the taxpayer's business needs and include any expenses in cash or in kind incurred by the taxpayer for the acquisition of goods and/or services and for operation of the business. These expenses are recognised either at the date of payment to a supplier (contractor) or when the goods or services were received, whichever is earlier.

Nondeductible expenses are specified in the law and include expenses that are not supported by appropriate documentation (such as a contract, receipt, etc.) or expenses for goodwill and business trips of the taxpayer's employees and members of its management bodies for purposes not corresponding to the taxpayer's business. Some expenses are partially nondeductible, including 50% of expenses incurred for the purchase of fuel and lubricants and expenses relating to operating leases for automobiles. Expenses relating to warranty services and insurance expenses are nondeductible for corporate income tax purposes if incurred in an

amount exceeding 10% of the total value of the warranted goods or 5% of total deductible expenses incurred in the reporting period, respectively.

As an anti-tax-avoidance measure, Ukraine has established restrictions on the deductibility of expenses incurred by resident taxpayers on goods or services received from or provided by nonresident entities located in offshore zones. This restriction applies to expenses paid to nonresidents with "offshore status" or settlements made through such nonresidents (their bank accounts). If a payment is made to a resident of an offshore zone, only 85% of the expenses incurred or paid are deductible or depreciable/amortisable.

### **Depreciation**

The declining-balance method is used for depreciation of the main types of fixed assets. For tax purposes, these assets are classified into the following groups:

- Group 1: Buildings, construction objects, premises.
- Group 2: Transport vehicles, furniture, office equipment, household equipment, and optical, electronic and electrical appliances. Information networks systems, computers, software and telephone sets are also included in this group if purchased before 1 January 2003.
- Group 3: All assets not included in Groups 1, 2 and 4.
- Group 4: Computer equipment and software, telephones, information systems and data handling equipment.

The above groups are subject to quarterly depreciation at rates ranging from 1.25%-2% (Group 1) to 15% (Group 4), depending on the date the asset was purchased.

The straight-line method may be used for intangible assets whose useful economic life does not exceed 10 years.

### **5.3 Capital gains taxation**

Capital gains are treated as ordinary income and taxed at the standard corporate rate of 25%. Special rules apply with regard to the tax accounting of transactions involving securities.

### **5.4 Withholding tax**

#### **Dividends, Interest and Royalties**

A 15% withholding tax is levied on dividends, interest, royalties and other passive income paid to nonresidents unless the rate is reduced by an applicable tax treaty.

### **5.5 Foreign income and tax treaties**

Taxes paid by business entities on foreign-source income (profits) can be used to reduce their tax liability in Ukraine, but the amount of taxes paid abroad within a reporting period may not exceed the amount of the tax liability for the same reporting period. Tax liabilities may not be reduced if the foreign tax paid involves property tax, capital gains tax, or postal, sales and other indirect taxes, as well as taxes on "passive profits" (i.e. dividends, interest and royalties). The determination of the actual amount of tax paid is made on the basis of a written confirmation from the tax authorities of the foreign country that the taxes were paid and whether there is a tax treaty between Ukraine and the foreign country.

Tax treaties normally regulate all conflicting matters relating to foreign-source income earned by business entities operating in Ukraine. To date, Ukraine has concluded treaties with more than 60 countries, but it also honours similar treaties of the former Soviet Union with respect to several countries with which new treaties have not yet been concluded.

The following table sets out the rates of withholding tax on dividends, interest and royalties under Ukraine's tax treaties. If standard domestic withholding rates are lower, treaty rates do not apply.

<b>Withholding tax rates under Ukraine's tax treaties</b>			
<b>Treaty Partner</b>	<b>Dividends</b>	<b>Interest</b>	<b>Royalties</b>
<b>Algeria</b>	5/15	10	10
<b>Armenia</b>	5/15	10	0
<b>Austria</b>	5/10	2/5	0/5
<b>Azerbaijan</b>	10	10	10
<b>Belarus</b>	15	10	15
<b>Belgium</b>	5/15	2/10	0/10
<b>Brazil</b>	10/15	15	15
<b>Bulgaria</b>	5/15	10	10
<b>Canada</b>	5/15	10	0/10
<b>China</b>	5/10	10	10
<b>Croatia</b>	5/10	10	10
<b>Cyprus</b>	0	0	0
<b>Czech Republic</b>	5/15	5	10
<b>Denmark</b>	5/15	0/10	0/10
<b>Egypt</b>	12	12	12
<b>Estonia</b>	5/15	10	10
<b>Finland</b>	0/5/15	5/10	0/5/10
<b>France</b>	0/5/15	2/10	0/10
<b>Georgia</b>	5/10	10	10
<b>Germany</b>	5/10	2/5	0/5
<b>Greece</b>	5/10	10	10
<b>Hungary</b>	5/15	10	5
<b>India</b>	10/15	10	10
<b>Indonesia</b>	10/15	10	10
<b>Iran</b>	10	10	10
<b>Israel</b>	5/15	5/10	10

<b>Withholding tax rates under Ukraine's tax treaties</b>			
<b>Treaty Partner</b>	<b>Dividends</b>	<b>Interest</b>	<b>Royalties</b>
<b>Italy</b>	5/15	10	7
<b>Japan</b>	15	10	0/10
<b>Jordan</b>	10/15	10	10
<b>Kazakhstan</b>	5/15	10	10
<b>Korea (R.O.K.)</b>	5/15	5	5
<b>Kuwait</b>	5	0	10
<b>Kyrgyzstan</b>	5/15	10	10
<b>Latvia</b>	5/15	10	10
<b>Lebanon</b>	5/15	10	10
<b>Lithuania</b>	5/15	10	10
<b>Macedonia</b>	5/15	10	10
<b>Malaysia</b>	15	15	10/15
<b>Moldova</b>	5/15	10	10
<b>Mongolia</b>	10	10	10
<b>Netherlands</b>	0/5/15	2/10	0/10
<b>Norway</b>	5/15	0/10	5/10
<b>Poland</b>	5/15	10	10
<b>Portugal</b>	10/15	10	10
<b>Romania</b>	10/15	10	10/15
<b>Russia</b>	5/15	10	10
<b>Slovakia</b>	10	10	10
<b>Slovenia</b>	5/15	5	5/10
<b>South Africa</b>	5/15	10	10
<b>Spain</b>	18	0	0/5
<b>Sweden</b>	0/5/10	0/10	0/10
<b>Switzerland</b>	5/15	0/10	0/10

<b>Withholding tax rates under Ukraine's tax treaties</b>			
<b>Treaty Partner</b>	<b>Dividends</b>	<b>Interest</b>	<b>Royalties</b>
<b>Syria</b>	10	10	18
<b>Tajikistan</b>	10	10	10
<b>Thailand</b>	10/15	10/15	15
<b>Turkey</b>	10/15	10	10
<b>Turkmenistan</b>	10	10	10
<b>United Arab Emirates</b>	5/15	3	0/10
<b>United Kingdom</b>	5/10	0	0
<b>United States</b>	5/15	0	10
<b>Uzbekistan</b>	10	10	10
<b>Vietnam</b>	10	10	10

## 5.6 Transfer pricing

Transfer pricing rules are used in Ukraine to regulate transactions between related entities and a taxpayer's transactions with entities that do not pay corporate income tax or that pay corporate income tax at a rate below the standard rate of 25%.

A related entity is defined as:

- A legal entity that exercises control over a taxpayer, is controlled by a taxpayer or is under common control with a taxpayer; or
- An individual or family member of the individual who exercise control over a taxpayer (both spouses, their children or parents); or
- A company official who is authorised to execute, on behalf of a taxpayer, binding legal agreements, or family members of this official.

The exercise of control over a taxpayer is defined as follows:

- Possessing, directly or indirectly through a number of related legal entities or individuals, the largest participating interest (shares) in the charter fund of the taxpayer; or
- Having the majority of votes in the governing body of such a taxpayer; or
- Holding a participatory interest (shares) of at least 20% of the charter fund of the taxpayer.

For tax purposes, the total sum of participatory interests (votes in the governing body) held by an individual in the charter fund of the taxpayer equals the total sum of corporate rights held by this person, his/her family members or legal entities controlled by this person.

The concept of the "normal" value (price) is used by the tax authorities for purposes of adjusting taxable income or deductible expenses of a taxpayer when there is evidence that the reported price does not represent a real (fair market) price. It is defined as a price stated in a contract between participating parties. To determine the normal price, the parties subject to a contract must use as a benchmark a contract involving transactions with similar goods and under similar market conditions. Unless proven otherwise, the contract price is deemed to be the "fair market price".

The fair market price is defined as the price charged to a purchaser of goods (and/or services) by a seller under conditions, according to which the seller sells and the purchaser purchases the goods (and/or services) freely and both parties are legally and factually independent of each other and have adequate information regarding the goods (and/or services) concerned and the market prices for identical (or similar) goods (and/or services).

### **5.7 Turnover and other indirect taxes and duties**

VAT is levied on the supply of goods and services where the place of supply is located in Ukraine, and the importation of goods and related ancillary services (the cost of which is included in the customs value of imported goods) into Ukraine. The following transactions are not subject to VAT:

- Issuance, sale and exchange of securities and corporate rights;
- Depository, clearing and registrar activities involving securities;
- Provision of financial loans and bank guarantees;
- Exchange of foreign currency;
- Insurance and reinsurance services, if supplied by licensed insurers and insurance agents and brokers;
- Payment of dividends and royalties in cash or securities;
- Brokerage and dealer services related to operations with securities;
- Transfer of assets of one taxpayer to another taxpayer in the course of a business transformation; and
- Transit of cargo and passengers through the territory of Ukraine.

VAT payers include entities whose combined volume of transactions taxable under the VAT law (i.e. turnover) exceed UAH 300,000 for the previous 12 months, entities that are registered as VAT payers voluntarily and importers of goods. The status of a VAT payer extends to both resident and nonresident entities.

A flat VAT rate of 20% is applied to domestic supplies of goods and services, as well as imports of goods into Ukraine. A 0% rate applies to exports of goods and international transport services. VAT zero-rating must be distinguished from a VAT exemption, since the former entails the right of a VAT payer to recover VAT and the latter does not. VAT generally can be recovered either by way of a credit against output VAT or as repayment if incurred on the purchase and/or importation of goods and services used for a taxpayer's business.

Most imported goods into Ukraine are subject to both VAT and import duties.

### **5.8 Other taxes**

Payroll taxes in Ukraine include mandatory employer contributions by to pension and social security funds on behalf of their employees. The combined tax rate is 36.2%, consisting of contributions to the state pension fund, excluding contributions to the accident social insurance fund. The rate for the accident social insurance fund ranges from 0.56% to 13.5%, depending on the industry.

As at 1 January 2009, the taxable base for payroll taxes is capped at UAH 10,035 per employee per monthly salary and/or other similar compensation.

Ukraine's excise taxes are levied primarily on controlled substances. Excisable goods are those imported into or produced in Ukraine and include alcoholic beverages, beer, tobacco and tobacco products, cars, petrol and diesel fuel.

The tax on motor vehicles applies to legal entities and individuals owning vehicles registered in Ukraine (e.g. lorries, passenger cars and motorcycles). Legal entities pay the tax quarterly at rates currently ranging from EUR 3 to EUR 350 per 100cc of the vehicle's engine size.

Land tax applies to both legal entities and individuals owning or using land in Ukraine, with the rate normally depending on the nature and location of the land. The tax is paid quarterly, by the 15th of the month following the reporting quarter.

### **5.9 Tax compliance and administration**

The tax year is the calendar year.

Both resident and nonresident taxpayers must file corporate income tax returns on a quarterly basis. The tax return is due within 40 calendar days following the last day of the reporting quarter. An additional reporting period of 11 months also applies with filing due within 20 calendar days following the end of November. Tax payment must be made within 10 calendar days following the date the tax return is due.

VAT returns are normally filed and VAT liabilities paid on a monthly basis. An exception is made for entities whose volume of transactions, taxable under the VAT law, did not exceed UAH 300,000 for the previous 12 calendar months. These entities may use a quarterly reporting basis. Depending on the reporting basis, there are two different requirements for filing VAT returns: monthly and quarterly returns are filed within 20 and 40 calendar days, respectively, following the last day of the reporting period. As in the case of the corporate incomes tax, VAT payment must be made within 10 calendar days following the date the tax return is due.

Payment of payroll taxes is done on a monthly basis.

Failure to file and pay taxes on time may give rise to fines. A fine in the amount of 10 nontaxable allowances (currently UAH 170) should normally be paid for each case of late filing or nonfiling of a tax return. Late payment fines include daily late payment interest, which is levied at a rate of 120% of the refinancing (discount) rate used by the National Bank of Ukraine. Nonpayment of taxes attracts fines imposed at rates ranging from 10% to 50% of the tax debt, depending on the length of the delay. An additional fine equal to 50% of the tax debt may be applied if the debt exceeds 1,000 minimum salaries, which at 1 July 2009 is UAH 630,000.

The statute of limitations period for the tax authorities to assess tax liabilities is three years after the day a tax return was filed.

## **6.0 Personal taxation**

### **6.1 Residency**

Resident individuals are subject to personal income tax on their worldwide income. Nonresidents are subject to Ukraine tax only in respect of income obtained from sources in Ukraine.

An individual generally is deemed to be a resident of Ukraine if he/she has a place of residence in Ukraine. If the individual also has a place of residence in a foreign state, he/she will be considered a Ukrainian resident if there is a place of permanent residence or closer personal and economic ties (i.e. centre of vital interests) in Ukraine.

### **6.2 Taxable income and rates**

A flat tax rate of 15% is applied to all taxable income of individuals. Exceptions are made for income received from interest on deposits at banks or non-bank financial institutions (excluding insurers) and savings (deposit) certificates (5% rate), and in other cases specified by law (relating mostly to income of nonresidents and from transactions involving movable and immovable property). Certain income derived by nonresidents is subject to double the standard rate.

#### **Determination of taxable income**

Taxable income comprises any income received or accrued to an individual during the reporting period. Technically, the legislation uses the term "total taxable income," which denotes the following income:

- Subject to final taxation at the time of receipt/accrual;
- Subject to taxation as part of total annual taxable income; and
- Taxable under other rules.

Ukraine-source income is income received from any activity carried out in Ukraine, including, but not limited to, the following:

- Dividends, interest and royalties paid by residents (including any other payment for the use of intellectual property rights);

- Investment profits from transactions with securities and corporate rights issued in forms other than securities;
- Employment income in respect of employment activities exercised in Ukraine, regardless of whether the individual is resident or nonresident;
- Income from the renting out (leasing) or sale of movable and immovable property if the ownership change is subject to state registration and/or notarisation under Ukrainian law;
- Income from the exercise of entrepreneurial or independent professional activities in Ukraine;
- Winnings and prizes (except for prizes from state lotteries), gifts and charity donations; and
- Assets received as an inheritance if such assets or the source of payment are located in Ukraine.

In addition, certain benefits and assets provided by employers to employees free of charge constitute taxable income (e.g. accommodation, vehicles, financial assistance, reimbursements, etc.).

The following are exempt from tax:

- Income from investments in securities issued by the Ministry of Finance and state lottery winnings;
- Alimony received from residents in an amount defined by court decision or set out in the Family Code of Ukraine;
- Interest income from deposits with qualified Ukrainian banks and non-banking financial institutions and from saving certificates. This exemption is available until 31 December 2009;
- Shares received from the capitalization of retained earnings, provided the allocation ratio of shares between shareholders remains unchanged;
- Compensation for apartment and car rent for certain categories of employees;
- Amounts received from employers in respect of certain types of medical treatment and services;
- Income of a private entrepreneur that has opted for the simplified system of taxation in accordance with the law;
- Insurance payments under agreements other than life insurance or non-state retirement insurance under conditions prescribed by the law.

Employers are required to withhold personal income tax and state pension and social insurance contributions from salaries at the time the salary is paid. Therefore, the above contributions are not included in the taxable annual income of an employee.

### **6.3 Special expatriate tax regime**

Most Ukrainian-source income earned by nonresidents is subject to a 30% rate, although the standard 15% applies to salary income paid by a resident employer.

### **6.4 Capital taxes**

Income earned in Ukraine by resident and nonresident individuals from dividends, royalties and other payments for the use of intellectual (including industrial) property rights, as well as investment profits from transactions with securities and corporate rights, attracts the standard rate of 15%. For income tax purposes, investment profits are defined as the positive balance between income from the sale of a separate investment asset (securities, corporate rights and banking metals) and its cost. Where an investment asset is inherited by or gifted to a taxpayer, the cost of the asset is considered to be zero.

## **7.0 Labour environment**

### **7.1 Employees' rights and remuneration**

Ukraine has yet to adopt a new labour code that would govern all labour relations. Instead, the 1971 Soviet code (KZOT), as amended, remains in effect. Work on the draft new labour code continues, although the final version is not expected to make any radical changes.

The KZOT provides that Ukrainian citizens' right to work, i.e. work compensated with remuneration in an amount not less than a certain minimum set by the state, and including the right of choice of profession, type of occupation and work, is ensured by the state.

In general, there is no legal requirement for a written employment agreement between an employer and employee, although such agreements are generally in writing. Certain employment arrangements, however, must be in writing (e.g. if an employee insists on a written agreement).

The principal rights of employees, as listed in the law, include the rights to:

- A limited work day and work week;
- Annual paid leave;
- Healthy and secure working conditions;
- Membership in trade unions;
- Resolution of collective employment conflicts through a procedure set by law;
- Social insurance, including pensions, sickness and disability pay;
- Unemployment benefits; and
- Appeal to a court for resolution of employment conflicts, irrespective of the nature of an employee's work or position.

### **Working hours**

The normal work week may not exceed 40 hours. Enterprises and organisations can set shorter working hours in collective employment agreements. The work week is less for minors and those engaged in hazardous occupations.

A five-day work week normally applies for all categories of enterprises and organisations. A six-day week is permitted for businesses where a five-day work week is inappropriate. Overtime work is allowed only in exceptional circumstances (as specified in the law) or in cases of unforeseen delay in finishing work within normal working hours.

### **7.2 Wages and benefits**

Ukraine legislation establishes a monthly minimum wage, which serves as a state social guarantee mandatory for all types of entities and individuals. The law defines the minimum wage as a legally set level of payment for simple non-qualified work, below which no payment may be made for an employee's monthly or hourly norm of work (amount of work). Payment for overtime and dangerous work is not included in the minimum wage. The minimum wage is reviewed annually, as part of the budget formulation process, and is used by the government for wage setting purposes (in respect of budget-funded organisations). The minimum monthly wage as at 1 July 2009 is UAH 630, and is subject to increase during the year.

Private sector wages in Ukraine are significantly higher than those established in the public sector.

### **Pensions**

Ukraine has a hybrid-type pension system. The key changes in the last several years include the establishment of two new pillars, in addition to the old and current pay-as-you-go or solidarity pension system. The first of these (in effect the second pillar) is a mandatory pension insurance scheme, which is based on capitalised individual pension accounts and the other new pillar (the third pillar) facilitates voluntary pension insurance through contributions to non-state pension funds. However, the two new pillars have yet to become operational, and the existing pension system is inefficient. Current pensioners continue to receive pensions of approximately UAH 560 on average.

Employers pay 33.2% of the salary fund to the State Property Fund, with employees contributing 2% of gross remuneration.

### **Social insurance**

All Ukrainian employees are entitled to social insurance benefits. The main benefits include paid sick leave and maternity leave, disability payments, insurance payments for accidents and loss of employment. In addition to pension contributions, Ukrainian employers and employees must make several types of social security contributions. The applicable charges (based on gross

remuneration) payable to the social security fund amount to 1.4% for employers and 1% for employees. Charges to the employment insurance fund are set at a rate of 1.6% for employers and 0.6% for employees. Employers also are required to pay contributions to the accident social insurance fund, at a rate ranging from 0.56% to 13.5%, depending on the level of risk of accidents at the enterprise. As in the case of pension contributions, the taxable monthly base for all of the above contributions at 1 January 2009 is UAH 10,035 per employee.

### **Other benefits**

Employees are entitled to mandatory annual vacations. Legislation sets the minimum annual vacation at 24 calendar days for every year of work (31 calendar days for employees under 18). During the first year of work, however, employees may use their annual vacation days only after six months of consecutive employment at an organisation. If dismissed, an employee is entitled to monetary compensation for every day of unused annual vacations.

Public holidays and days off are not included in annual vacations. Legally established public holidays in Ukraine are:

- 1 January—New Year;
- 7 January—Christmas;
- 8 March—International Women's Day;
- 1 and 2 May—International Spring and Labour Day;
- 9 May—Victory Day;
- 28 June—Constitution Day; and
- 24 August—Independence Day.

There are also two religious holidays with undefined dates – Easter and Trinity (one day off per each holiday is provided).

In addition to mandatory benefits, various fringe benefits are offered to employees by some local but mostly foreign companies (representative offices). These benefits typically include medical insurance (often extended to family members), mobile phones and, if needed for work, company cars. Some organisations (mainly banks) compensate the cost of borrowing for their employees in certain cases. Corporate pension funds and life insurance plans are in existence, but are confined to a small number of companies.

### **7.3 Termination of employment**

A change in status of an enterprise or in the accountability of an organisation does not require the termination of employment. The same is true for cases in which an enterprise undergoes a change in ownership or reorganisation (e.g. merger). In these cases, the termination of employment at the initiative of the owner of an enterprise may be possible only if there has been a reduction in the number of employees or staff positions in the enterprise.

Generally, it is difficult for Ukrainian employers to dismiss unsatisfactory staff. Cases of organisational changes aside, employers may terminate an employee only in the following cases:

- The employee's performance does not meet the requirements applied to the assigned position or work due to inadequate qualification or state of health, if this performance prevents continuation of the work in question;
- A systemic failure by an employee to fulfill the duties envisaged without justifiable reasons if the employee has previously been subject to disciplinary action;
- Absenteeism (including absence from work for more than three hours within a work day) without justifiable reason;
- Non-attendance of work for more than four consecutive months due to temporary health problems and work disability (excluding cases of pregnancy and childbirth) if the law does not envisage longer term requirements for mandatory preservation of an employee's workplace (position) in the case of certain illnesses;
- Intoxication at work; or
- Theft (including petty theft) of the company's property, when confirmed by a court ruling or resolution by a body authorised to impose administrative sanctions.

## 7.4 Labor-management relations

Trade unions in Ukraine have traditionally played a vital role in labour-management relations. Employees have the right to take part, through trade unions, in managing activities of their respective enterprises and organisations. Employers, in their turn, are obligated to create conditions necessary to ensure such participation of employees.

The elected body of a trade union (normally a trade union committee) concludes and reports on the execution of the collective employment agreement that forms the basis of labour-management relations in a given entity. Together with an employer, a trade union committee is engaged in decision-making with regard to the following issues:

- Standards of work as governed by the law;
- Remuneration, forms and systems of salaries, staff salary grades, premiums, bonuses and other compensation payments; and
- Working hours, work breaks and vacations.

Despite the legislative emphasis on trade unions/employees' rights, labour-management relations in general have not been strained or conflicting.

## 7.5 Employment of foreigners

There is no special regime for foreign nationals working in Ukraine, although there is a general requirement for work permits for foreigners who need to obtain visas to enter Ukraine. Ukrainian employers (all resident legal entities) must obtain work permits for foreign nationals who are either directly employed by them or seconded to Ukraine by foreign companies. The work permit requirement does not apply to the personnel of representative offices of foreign companies in Ukraine who are employed abroad or to foreign nationals who are registered as private entrepreneurs in accordance with Ukrainian law.

A work permit is issued for a maximum term of one year but can be renewed for a similar term(s). The overall time of a foreign citizen's employment in Ukraine is unlimited.

## Migration regime for foreign individuals

Control over the Ukrainian immigration rules has increased significantly. Generally, foreign individuals are allowed to stay in Ukraine for 90 days cumulatively within 180 days from the date they enter Ukraine (some exceptions may apply). An individual who exceeds this term must register with a special body of the Ministry of Internal Affairs of Ukraine, the UGIRFO. UGIRFO carries out three types of the registrations performed by UGIRFO:

- A simple temporary registration of a foreign individual: This type of registration, which applies to personnel of representative offices and members of families of foreign individuals, allows individuals to remain in Ukraine for a longer period but it does not guarantee free entry into the country once a foreign individual leaves Ukraine after exceeding the 90-day period;
- Issuance of a temporary residence permit: This applies to foreign individuals employed by local legal entities for which the company obtained a Ukrainian work permit. The residence permit will be issued for the term of the respective work permit and allows the individual to stay in Ukraine and travel in and out of the country; and
- Issuance of permanent residence permit: A permanent residence permit is not common.

## 8.0 Office locations

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