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Tax Code of Ukraine:

Development, impact and application issues

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About the German Advisory Group

The German Advisory Group on Economic Reforms, which is active in Ukraine since 1994, advises the Ukrainian Government and other state authorities such as the National Bank of Ukraine on a wide range of economic policy issues and on financial sector development. Our analytical work is presented and discussed during regular meetings with high-level decision makers. The group is financed by the German Federal Ministry for Economic Affairs and Energy under the TRANSFORM programme and its successor.

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1. Brief Tax Code History

The tax system reforming processes, such as finding ways to improve the efficiency of the tax system and meet the requirements of the state finance, on the one hand; as well as search for ways to reduce the tax burden on the subjects of economy and to optimize expenses of the state, on the other hand are permanent in developed countries.

With the proclamation of independence Ukraine has taken the path of radical economic reforms. However, over 20 years of independence the single document, which would clearly define the status of the taxpayers, their rights, duties and responsibilities, as well as rights and duties of the tax administration subjects, was not accepted.

The previous tax system of Ukraine (before the Tax code) the majority of experts defined as inefficient, not conductive to a stable and adequate receipts to the state budget; the tax legislation instead of stimulating role had a negative impact on economic development.

Therefore the Tax code, the document that should settle the above mentioned issues and to become a ground for economic growth of Ukraine, has been developed and adopted by the Verkhovna Rada of Ukraine at the end of the year 2010.

The document was signed by the President on December 3rd 2010 and published on December 4th 2010. The majority of the Tax code provisions entered into force starting from January 1st 2011.

For the first time in Ukraine was adopted such a comprehensive and ambitious legislative act, thus the document was not perfect, and required improvement and clarification.

Since 2011 a lot of changes were implemented into the Tax code. The changes have improved some tax rules, settled many unclear questions of the Tax code, and eliminated a number of inaccuracies. However, to improve the investment climate and, consequently, to restore the Ukrainian economy, some changes still should be implemented into the current legislation.

The Tax code consists of 20 chapters and 357 articles (as of 20.05.2014 - the date of last changes implementation). The main changes introduced by the Tax code and its evaluation as well as changes and improvements that are expected to be made are described below.

2. General provisions and administration

Implemented by the Tax Code

- Reduction of the number of laws and regulatory documents via codification of several tax laws and regulations in a single document
- Reducing a number of taxes: state taxes from 29 to 18, local taxes from 14 to 5 via cancellation of inefficient minor taxes
- The attempt to align the tax and statutory accounting, specifically in terminology
- New type of tax introduction: real estate tax (starting from 01.01.2013)
- Vehicle tax changes (one time tax payment during the 1st registration instead of annual payments)
- Unification of definitions used for taxation purpose for all taxes
- Obligatory electronic reporting for big and middle-size tax-payers
- Changes in the procedure of tax returns corrections (application of 3% and 5% fines)
- Clear regulation of tax audits procedures (terms, mechanism, complaints, etc.)
- Unification of rules of fines on all types of taxes application (previously fines for Individual income tax violations were 200% of the amount surveyed during the tax audit)
- Tax audit without notification (only for limited cases) as a new type of tax check
- The possibility of receiving a binding individual consultancy from the tax authority
- The optional two-level system of administrative appeal introduction. Administrative (supervisory body of the higher level) and judicial level (there is no need to obtain a decision of the lower level tax authority)

Amendments done from 01.01.2011 till 31.05.2014

- Large tax-payers are obliged to provide documents for the tax check in electronic form (July 2011)
- The maximum penalty that may be applied reduced from 75% to 50% (July 2011)
- Cancellation of the obligatory informing of the tax authority by the tax-payers on opening and closing of bank accounts. Such information should be provided to the tax authority by banks (October 2013)
- Unification of VAT administration due to tax and customs service's merger (starting from 2013):
    - simplification and time reduction of custom declaration procedure;
    - common understanding of the legislation by both services;
    - full exchange of information between both services;
- Administration of a Unified Social Contribution is performed by the Ministry of income and charges (starting from October 2013)
- Taxpayers are not obliged any more to inform tax authorities about changes of their registration data in case such data are carried into the state register (from 01.01.2014)

- New type of tax audits introduction – electronic audit (from 01.01.2014).
    - In fact – it's a "free audit" performed by the tax authorities.
    - Available from:
        - 2014 – for PEs
        - 2015 – for other SMEs
        - 2016 – other tax-payers
- New exchange rate application rules are defined (April 2014)
- Transfer pricing rules implementation (September 2013) with the following changes (May 2014)
- Simplification of registration of tax payers (from 01.01.2014):
    - VAT certificate cancellation
    - Special single tax payer's certificate is cancelled

Changes and potential improvements

- Simplification of primary documents using a single primary document (similar to EU Invoice) which combines all required information about parties and transaction itself. Such simplification will enable to reduce:
    - Bureaucracy and mistakes related
    - Administrative cost
    - Violation of the legislation rules and corruption during the audit
- Fixing terms for tax audit in case of termination of business activity (as for example, not more than 3 months after submitting of the related application by a tax payer)
- To give the opportunity to the tax payers to return overpaid taxes from the state budget or a possibility to off-set such overpayments with their current obligations based on a written request. This issue has to be strictly regulated by the Tax Code in order to avoid corruption
- Financial responsibility for law violation should be foreseen by the Tax Code to the tax authority and personal responsibility for authorized state officers who executes tax audit. Without any responsibilities the authorized people will continue the practice of searching for any reason (even not existing) for additional tax and penalties accruals
- To reduce the number of reports and their administration, the United social fund report and the Individual income tax report should be combined.

3. Corporate Profit Tax

Implemented by the Tax Code

- Cancelled the rule of the 1st event in the tax accounting, advances received are not included in taxable income anymore, harmonization with statutory accounting (UA GAAP)
- Gradual reducing of the tax rate from 25% to 16% (as of today fixed on 18%)
- Zero-rate for newly established companies

- Tax exemptions for hotels and some other industries
- Unification of tax and statutory amortization methods (16 groups, methods and norms)
- Minimal terms for amortization are defined
- FX profit/losses and foreign currency revaluation in tax accounting are harmonized with UA GAAP
- Marketing service expenses are not limited (before it was not more than 2% of taxable income for the previous fiscal year)
- Fuel expenses are 100% tax deductible if related to economic activity (before it was 50% without a necessity to prove a commercial purpose of expenses)
- Representative expenses are 100% tax deductible instead of max 5% of the profit of the previous fiscal year
- Progress in business trips expenses issues: documentation, daily allowances, etc.

Amendments done within from 01.01.2011 to 31.05.2014

- The previously foreseen prohibition to include as tax deductible amounts related to goods/services received from PEs was canceled (November 2011)
- The annual-based reporting period implementation (July 2012)
- The monthly advance payments implementation for big tax payers (July 2012)
- Changes in taxation (and tax rates) for insurance activities (October 2012)
- Changes in taxation of operations with securities (December 2012)
- The software development companies are entitled to a reduced 5% CPT rate (January 2013)
- Fixing the CIT rate at 18%, no further reductions foreseen (March 2014)

Changes and potential improvements

- To use for the amnestied non-declared amounts of profit (a draft of law is currently discussed) the tax rate not lower 18%
- Real transactions are often defined by tax authorities as "unreal" with the following exclusion of such expenses from CPT calculation. The tax code should specify that the buyer is not obliged to investigate the tax history of a supplier and/or to be responsible for supplier's mistakes
- Warranty expenses for exporters have to be tax deductible expenses
- Allow tax deductibility of voluntary private health insurance for employees

4. Value Added Tax

Implemented by the Tax Code

- The preliminary obligatory VAT registration for planned transactions more than 600k UAH cancelled
- Limits for non-obligatory VAT registration (by own wish) (partially cancelled)
- Cancelling VAT registration after 12 calendar months, in case of the transactions below the minimum level (300k UAH) instead of 24 months before

- Tax authority has a right to cancel VAT registration if the tax payer does not provide the annual statement report to the State register
- 365 days limit from the date of VAT special document for VAT credit usage
- Cancelling 20% variation of price for defining VAT obligations in case the selling price is lower than the usual prices
- Changing the rules for VAT credit sharing between taxable and non-taxable transactions
- VAT credit paid for cars purchase reduces VAT obligations of the tax period
- Introduction of automatic VAT reimbursements for exporters
- VAT rules for commission and agent agreements were changed
- Changes in VAT agent obligations for import/export of services
- Responsibility (via penalty) of the state budget for VAT reimbursement delay introduction
- Special VAT regime for agro producers

Amendments done within from 01.01.2011 to 31.05.2014

- Changing definition of a place of delivery for some services (July 2011)
- Possibility of issuing of the VAT special document in electronic form only in case it is registered with the State VAT register (May 2012)
- Disabling the tax authority to cancel VAT registration in some cases (May 2012)
- Unification of VAT administration due to tax and customs service's merger (since January 2013)
- The transactions on delivery of software products are exempt from VAT (January 2013)
- VAT registration at the moment of a legal entity registration, special VAT-payer's certificate cancellation (October 2013)
- VAT-registration for newly established company (without taxable transactions) (May 2012, September 2013)
- It is possible to change the way of VAT reimbursement (October 2013)
- Fixing VAT rate at 20% - no further reductions as currently foreseen (March 2014)
- The introduction of the reduced rate of 7% for pharmaceuticals and medical products (not taxable in the past) (March 2014)
- Decrease to 150 EUR (from 300 EUR) of the non-taxable allowance for import via international mail of in one package to one recipient (March 2014)

Changes and potential improvements

- To cancel the VAT special document and include the necessary tax details in the form of invoice (act)
- To foresee rules for "unreal" and fraud transactions in connection with VAT credit (similar to tax deductible expenses in CPT block)
- To ensure reimbursement of VAT-credit

5. Individual Income Tax

Implemented by the Tax Code

- Two-level tax rate: 15% for 10 minimal salaries per month, +2% for exceeding amount
- Taxation of dividends (5%)

Amendments done within from 01.01.2011 to 31.05.2014

- Implemented changes into some definitions of objects of taxation (October 2012)
- Reducing fines for minor and formal mistakes if amount of tax is paid within reporting period (January 2014)
- Pensions that exceed 10k UAH per month will be included into the taxable base starting from July 1st 2014 (March 2014)
- Taxation of deposits' interest was postponed and changed, starting from July, 1st 2014 into the taxable base the amounts which exceed 17 minimum living-wages per year will be included (March 2014)
- Increasing of tax rates for passive income (dividends, etc.), grade from 15% to 25% depending on annual amount. In part of dividends the rule coming in force from January 1st 2015, the part related to deposit interest - from 1st of July 2014

Changes and potential improvements

- Any changes should come into force in subsequent periods only. Application of new rates for the passive income paid in Q1 2014 retrospectively initially was not correct and it was corrected via postponing of implementation date (new date is 01.01.2015)
- Amnesty for non-declared income and property at private persons (a draft of law which is currently discussed foresees only amnesty for legal entities) has to foresee the tax rate not lower 15%
- Control under expenses has to be implemented similar to European countries

6. Simplified Tax System

Implemented by the Tax Code

- Different SME group definition which depend on turnover, people employed and VAT registration
- Implementation of taxation for individuals depending on turn over for some groups instead of lump sums
- Decreasing of bureaucracy related to applying a simplified system (termless registration)
- Simplifying reporting process (annual reports for groups with a low turnover)
- Reduction of tax pressure for a small business

Amendments done within from 01.01.2011 to June 2014

- Numbers of groups increased (increasing of possibility of simplified taxation usage) (November 2011, July 2012, November 2012)
- Possible to choose a simplified tax system and VAT registration together with registration in the State register (October 2013)
- Possibility of changing the group (into group 3 and 5 (with VAT) from any other group) (October 2013)
- Cancellation of a paper registration certificate, extract is issued by request (October 2013)
- Simplifying of VAT registration procedure for simplified tax payers (October 2013)

Changes and potential improvements

- Please, see additional Policy briefing

7. Special regime for agricultural enterprises

Implemented by the Tax Code

- No significant changes in initial version of the Tax Code in comparison with the system applied before

Amendments done within from 01.01.2011 to June 2014

- VAT reflection methodology was changed, including implementation of obligatory use of VAT bank accounts
- It became possible to apply for VAT reimbursement in export of agro products (June 2012)
- Mechanism of special VAT regime cancelling was amended (October 2013)
- VAT exemptions: for some particular groups of grain products sales are not VAT taxable. Only agro producers and first trader apply 20% in the territory of Ukraine and 0% for export (last changes: December 2013)

Changes and potential improvements

- Abandon Fixed Agricultural Tax: Agricultural companies should pay taxes as usual business, the same tax systems have to be applied as for other companies
- Preferences that could be implemented are possibility to reduce taxable base on amount of re-investments and old loans repayments
- Such conditions will give a motivation for investments into this business, to return debts and not pay dividends
- Abandon special VAT-system for agricultural companies, since it does not foster agricultural development, but even leads to lower sales prices at producers in case big traders will not receive VAT-reimbursement

8. Impact of the Tax Code

The main goals of the Tax code are improvement of the business climate, creation of favourable conditions for investments inflow, development of entities and economic growth of the country.

As of today we may see the positive changes in legislation that took place after the Tax code adoption and amendments implementation. Many provisions of the Tax code aimed at acceleration of growth of the Ukrainian economy.

However the impact of the Tax code with all its positive changes and improvements is not so big. The biggest issue is not the legislation itself, but its stable violations and ignoring in practice, in absence of the rule of law and corruption by state authorities. As of today the practice of different interpretation of tax rules by the tax authorities is very common. Also a number of authority-internal (non-official) tax rules and regulations contradict not only the Tax code, but each other.

However, the replacing of the existing Tax Code and significant changes of the taxation rules is from our point of view not needed. The main priority would be to make the actual Tax code work properly, implementation of the existing standards in practice.

To improve the situation the following should be taken into account:

- Current Tax Code is not perfect and needs some improvements, but it might be done via amendments
- A teleological interpretation of norms should be mandatory instead of fiscal interpretations
- Reducing of bureaucracy is not a question of the Tax Code, all requirements are regulated and issued by the Ministry of Finance and Ministry of Income and Duties
- Administration of taxes is clearly described in the Tax Code and should be followed in practice
- Applying existing Tax Code would gain more trust in investment climate instead of discussing again a new Tax Code. Any significant changes require new investments into infrastructure, and for investors it is better having already known and working rules and gradually being confronted with (necessary) changes adopted to business processes and operations.

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