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LEGISLATIVE CHANGES IN UKRAINE: ANALYSES, FORECASTS.

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Content

Land market opening:
What is there to know?

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The launch of the land market is a topic that has raised considerable public attention. Since 1 July 2021, a moratorium on the sale of agricultural land has been lifted in Ukraine. This means that every citizen of Ukraine has been enabled to buy and sell agricultural land freely.

The basic conditions for acquiring title to agricultural land are:

- citizens of Ukraine may purchase land, but not more than 100 hectares by one person;
- legal entities may not acquire title to land until 2024;
- access to the land market for foreign citizens shall be determined by referendum;
- sale of state and communal land is prohibited;
- selling price of land plots cannot be less than their normative monetary value;
- payments under all transactions on agricultural land are made in a non-cash form;
- the purchaser is to document the origin of the funds aimed at the acquisition of title to land.

With the opening of the market, the verification by landowners of the proper registration of land plots has become particularly relevant. Free circulation of land can lead to increase in raiding attacks. In addition, it is impossible to conclude any civil law transactions without correct information on land plots in the State Land Cadastre.

All owners of undistributed (unclaimed) land plots or their heirs must register the title to their land plots (units) by January 1, 2025. If this requirement is not met, the owners of the plots will be deemed to have refused to obtain the land and it will automatically become communal property of the territorial community.

Also at the end of May 2021, the Law on deregulation of land relations entered into force, which amends 6 Codes and 24 Laws of Ukraine and actually gives substance to land reform.

Thus, state land plots located outside of settlements within territorial communities have become communal land plots belonging to those communities. If the state has registered title to such land plots, the territorial community may apply to re-register these land plots as communal property. Other land and undeveloped land plots shall be transferred to the communal property automatically.

State ownership will still include lands used by state enterprises, institutions and organizations, military lands,

lands of the nature reserv fund, and lands under state-owned sites held by enterprises, institutions and organizations.

The state examination of land-use documentation and the approval of most types of land-use documentation by the territorial bodies of the StateGeoCadastre and other bodies have been cancelled.

In July 2021, the Law on sale of land through electronic auctions also came into force. At present, the sale and acquisition of state or communal land plots, such as leasehold rights, is subject to competition (through land tenders) in the form of an electronic auction for the purpose to eliminate any corruption risks.

This year has thus been decisive for the implementation of land reform. Today, despite all disputes, the land market is working. According to official data, the leaders in the number of land deals are Kyiv, Poltava and Sumy regions.

Since July 2021, the procedure for changing the targeted purpose of the land plots and the amount of documents necessary for that purpose has been considerably simplified. It is no longer necessary to obtain permission for the development of a land administration project to change the targeted purpose of private land.

Liability for not declaring and concealing the assets: What does the law provide for?

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Prosecuting officials for undeclared assets was almost the most scandalous topic of 2020-2021. It is only a matter of time whether Law No. 1531-IX of 29.06.2021 will be the last in a series of reforms, which are systematic and have been going on for many years. We now propose an analysis of the changes in legislation in this area over the past year.

The last wave of changes began with the resonant decision of the Constitutional Court of Ukraine No. 13-p/2020 of 27.10.2020, which declared Article 366-1 of the Criminal Code of Ukraine unconstitutional. In fact, as a result of this decision, criminal and administrative liability for declaring false information has been abolished in Ukraine.

The absence of domestic prosecutions for false declarations and their late submission have aroused resentment, not only within the country but also within the European Union. In particular, the existence of a visa-free regime with the countries of the European Union and co-operation with the International Monetary Fund have become risky issues. The Venice Commission also provided a negative assessment of the decision of the Constitutional Court of Ukraine.

As a result of the decriminalization of Article 366-1 of the Criminal Code of Ukraine, law enforcement agencies, in particular the National Anti-Corruption Bureau of Ukraine, and the courts had to close a significant number of criminal cases.

Within a few months, the Parliament resumed liability for the failure of officials to declare assets in the Criminal Code of Ukraine. Thus, on December 4, 2020, Law of Ukraine No. 1074-IX was adopted, which entered into force on December 30, 2020. The latter introduced two separate elements of crime: Article 366-2 "Declaration of false information" and Article 366-3 "Failure to submit a declaration by a person authorized to perform functions of the state or local self-government".

In contrast to Article 366-1 of the Criminal Code of Ukraine, according to Law No. 1074-IX, criminal liability is incurred under:

- intentional false information in declarations amounting to between 500 and 4000 minimum subsistence levels for able-bodied persons and is punishable by a fine of 2500 to 3000 non-taxable minimum incomes of citizens, or community service for a term of 150 to 240 hours, with deprivation of the right to occupy certain positions or engage in certain activities for a term of up to three years.

- intentional false information in declarations amounting over 4000 minimum subsistence levels for able-bodied persons and is punishable by a fine of 3000 to 5000 non-taxable minimum incomes of citizens, or community service for a term of 150 to 240 hours, with deprivation of the right to occupy certain positions or engage in certain activities for a term of up to three years.
- intentional failure to submit declaration which was punishable by a fine of 2500 to 3000 non-taxable minimum incomes of citizens, or community service for a term of 150 to 240 hours, with deprivation of the right to occupy certain positions or engage in certain activities for a term of up to three years.

In this way, the threshold of criminal liability has been lowered and the corresponding crimes have been defined as misdemeanor offense or non-serious crimes.

However, the introduced mechanism had a number of shortcomings, including:

- crimes under Articles 366-2 and 366-3 of the Criminal Code of Ukraine are subject of investigation by the National Anti-Corruption Bureau of Ukraine. However, the Code does not provide for the possibility of detectives to conduct investigation of misdemeanor offenses.
- the lack of a proper definition of the subjects of liability, which led to the exoneration of persons that has already been dismissed, but still submit declarations.
- short statute of limitations for misdemeanor offense and non-serious crimes;
- the absence of liability for a false declaration in a form of imprisonment, which is commensurate with the commission of such crimes, according to the findings of the Venice Commission.

In order to remedy the above-mentioned shortcomings, on 29 June 2021 the Verkhovna Rada of Ukraine adopted Law No. 1576-IX, which increased the penalties for the above-mentioned offences.

Thus, criminal offences under Articles 366-2 and 366-3 of the Criminal Code of Ukraine are no longer misdemeanor offenses and may be investigated by the National Anti-Corruption Bureau according to the standard procedure.

Henceforth, knowingly false declaration in the amount **of 500 to 3000 non-taxable minimum** incomes of citizens is punishable by **a fine of 3000 to 4000 non-taxable minimum** incomes of citizens, or imprisonment for a term of up to two years.

Knowingly false declaration in the **amount of 2000 non-taxable minimum** incomes of citizens is punishable by **a fine of 4000 to 5000 non-taxable minimum** incomes of citizens, or imprisonment for a term of up to two years, restriction of liberty for the same term.

Intentional failure to submit declaration is punishable also with **the restriction of liberty for two years or imprisonment for a term of up to two years.**

A subject of liability was also more precisely defined.

In addition, the law introduces the concept of "criminal offences related to corruption", to which Article 366-2 and Article 366-3 of the Criminal Code of Ukraine are referred to. The commission of these offences, together with corruption offences, does not provide for the possibility of avoiding liability if the person has genuinely repented, actively contributed to the detection of a criminal offence and fully compensated or repaired the damage caused; or if the person reconciled with the victim. In addition, he may not be sentenced to a lighter penalty than that provided for by law; nor may he be granted parole.

Thus, despite the fact that the authorities have adopted a number of changes to restore criminal liability for false declarations, changing the form of guilt, and taking into account the conclusions of the Constitutional Court of Ukraine, let us hope that they are final and will not cause problems in their application.

Taxpayers' liability: What has changed in 2021?

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In 2021, the amendments to the Tax Code (hereinafter the "Code") came into effect, which completed reform measures of taxpayers' liability commenced in 2020.

Guilt and intent as elements of a tax offence

You are most likely aware of the situation when, according to the results of the tax audit, the tax authority not only assesses tax liabilities, but also determines a fine of 25% of the amount of assessment. Starting from 2021 the situation has changed to a certain extent.

Thus, the total amount of this fine has now been reduced to 10%. However, if the tax authority decides to impose a fine of 25%, as in the past, **it must prove that the enterprise:**

(i) is guilty: i.e., acted imprudently, in bad faith and without due diligence; and

(ii) acted intentionally: purposefully created an environment aimed solely at tax evasion.

The Tax Code has expressly provided for these rules since 2021 and they may also refer to some other forms of liability.

Therefore, as it appears from new tax rules, it is essential for taxpayers to be able to prove their due care not only in the process of purchase or delivery of goods or services, in order to avoid the increased liability, but also at the conclusion of an agreement with certain counterparty.

What may be evidence of due care?

- Conducting the established internal counterparty selection procedure — a tender.
- Prior (before entering into an agreement) receipt from a counterparty of constituent documents, permits, papers and information proving the labour and financial resources, experience in carrying out similar activity.
- Analysis of information about the counterparty obtained from public sources and state registers.
- Setting mandatory warranties of the counterparty in the agreement.

It is clear that this list is not exhaustive.

Does the supervisory authority always have to prove the guilt and intent of a person?

No, not always — only in cases specifically defined by the Tax Code.

New amounts and types of liability

Some tax fines have now been reduced, but the vast majority of fixed fines were doubled as early as in 2020. In addition, the Code also introduced new types of tax offences and liability for such offences.

The transitional provisions of the Tax Code establish that the fines as the result of audits shall be applied **in the amounts prescribed by the law effective on the date of decision on imposition of such fines.**

In other words, for example, if you committed a tax offence in 2018, but you received the tax notice-decision in 2021, then you will have to pay the fine effective in 2021.

However, if the Tax Code now establishes liability for acts that have not previously entailed it, then, if such acts were committed by you, for example, as early as in 2019, **you cannot be liable for any of them.**

The legality or illegality of a person's conduct, in particular his/her compliance with the rules of tax law, shall be determined under the law effective at the moment of the person's respective acts or omissions.

This legal opinion was expressed by the Supreme Court. Similar position was also stated by the State Tax Service in the Generalized Tax Consultation as early as in 2012: if the event or fact was not defined as offence by the tax legislation, but in the new legislative act the same event, fact is defined as the offence entailing liability, in such a case legal liability shall not apply.

Moratorium on Tax Inspections

The first half of 2021 began not only with the entry into force of a large number of amendments to the Tax Code, but also with the resumption of scheduled and unscheduled audits of enterprises by the tax authorities.

So is the moratorium on tax audits still effective?

Since 2020, the Tax Code imposed a moratorium on the conduct of documentary and factual audits for the period **from March 18, 2020 to the last calendar day of the month (inclusive) wherein the quarantine ends** (now 31 December 2021), except for:

- documentary unscheduled audits carried out **upon the application of the taxpayer;**
- documentary unscheduled audits related to **the budgetary reimbursement of VAT**, reorganization/liquidation of the taxpayer;
- factual audits in respect of violations of legislative requirements relating to the production of and trafficking in **ethanol, alcoholic beverages, tobacco** and **fuel.**

The Code has not been amended and, therefore, the moratorium is in force.

Why did the tax authorities resume the audits?

In October 2020, in amendments to the Law of Ukraine "On State Budget of Ukraine for 2020", the Verkhovna Rada granted a right to the Cabinet of Ministers to reduce the effective period of restrictions, prohibitions, benefits and guarantees established by the relevant laws of Ukraine, adopted in order to prevent the spread of COVID-19 in Ukraine ("**Law No. 909-IX**").

In this regard, in February 2021 the Government adopted the Resolution No. 89 "On Reduction of the Period of Restrictions in Part of the Moratorium on Certain Types of Audits" ("**Resolution No. 89**"), which withdrew the moratorium on certain types of tax audits of **legal entities**, including the following:

- temporarily suspended documentary and factual audits, which were launched before March 18, 2020 and not completed;
- documentary scheduled audits;
- documentary unscheduled

audits on specific grounds.

Therefore, tax authorities actively started to conduct them yet in February 2021.

This, in turn, led to tax disputes and taxpayers' appeals against orders on carrying out of tax audits.

Is it illegal to carry out tax audits under the Resolution No. 89?

In our opinion — «Yes, it is»:

- According to the explicit provision of the Code, the provisions of the Tax Code may be modified only by means of amendments introduced into the Tax Code. The Code, for its part, has not been amended with regard to the effect and term of the moratorium on tax audits.
- In fact, the provisions of the Resolution No. 89 contradict to the provisions of the Tax Code. Under the explicit provision of the Code, if the provisions of other acts are contrary to the provisions of the Code, the provisions of the Code shall apply. The precedence of the provisions of codes (laws) over resolutions of the Government is also enshrined in the Constitution of Ukraine.
- The Verkhovna Rada may not delegate to the Government its powers to amend the laws (codes).

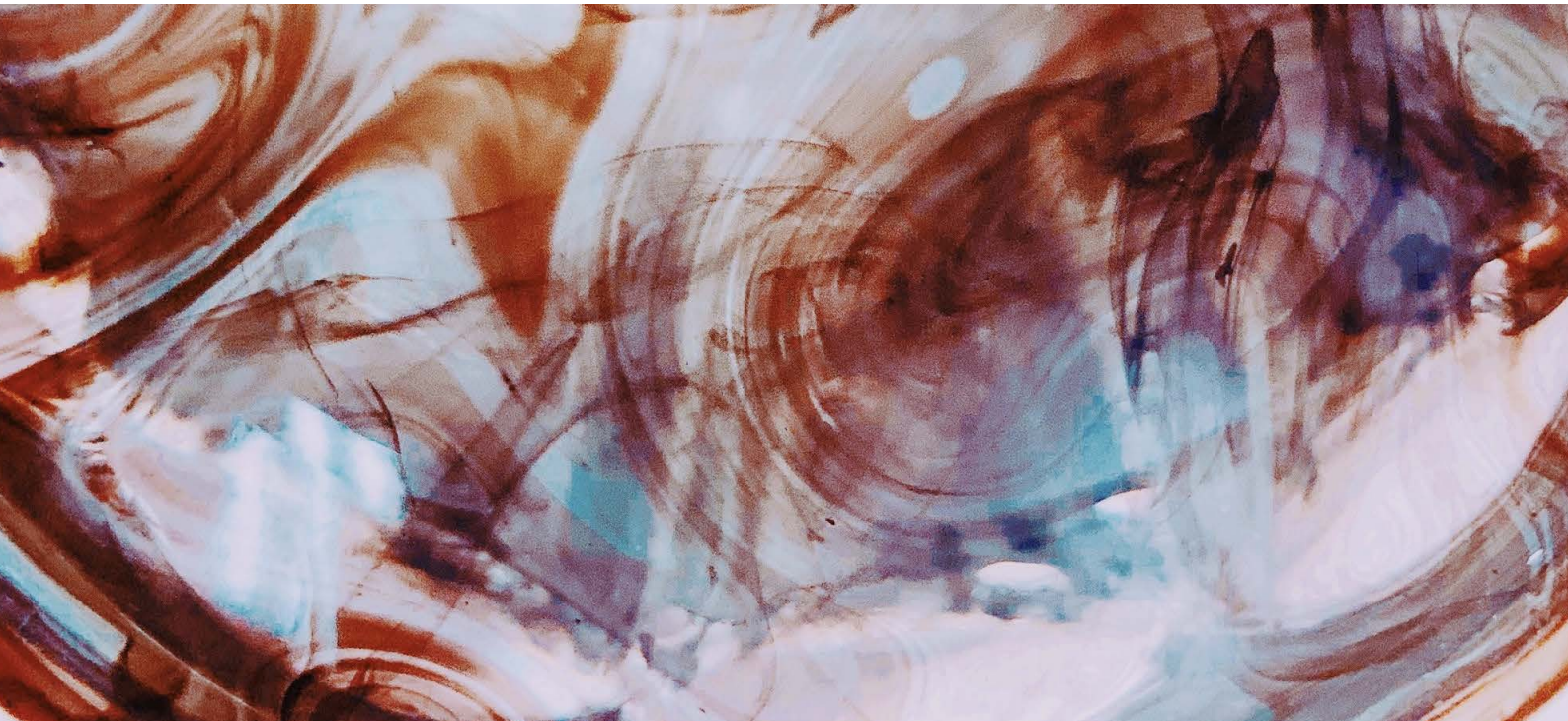
What do the courts state on the matter?

The positions of the courts on legality of orders on carrying out of tax audits issued under the Regulation No. 89 splited 50/50. Herewith, when taking the side of the tax authorities, the courts for some reason refer to the provisions of the Law No. 909-IX and note that the Resolution No. 89 has not been canceled, ignoring thereby the provisions of the Tax Code.

However, these are mostly rulings of the courts of first instance, so they will still be subject to appeal and possibly cassation review.

Therefore, if you have decided to appeal to the court against the order on carrying out of tax audits issued pursuant to the Resolution No. 89, we advise not to limit your legal position to a few general rules of the Tax Code and set it out to the fullest extent possible, referring to laws, rulings of the Constitutional Court, explanatory letters from state bodies, etc.

In addition, the legality of the Resolution No. 89 itself is currently under the court consideration, so we will see what the court will say to this respect.



Controlled foreign companies: Current status and future outlook

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The introduction of the taxation rules for the controlled foreign companies (hereinafter referred to as CFC) taxation is another step of Ukraine towards the automatic exchange of financial information scheduled for the launch in 2022-2023.

The CFC regulations contain some inaccuracies and raise questions about the definition of the CFC, reporting procedure, taxes payment by the ultimate beneficial owners ("controllers") of the CFC etc. We have identified key points that should be taken into account by the shareholders of the foreign companies and beneficiaries of trusts and foundations, as well as controllers of foreign entities:

When should the CFC report be submitted?

If the Ukrainian company or investor is the owner or the controller of the CFC, it is obliged to report for 2022, but the first report may be submitted in 2024.

Who deemed a controller of CFC?

Ukrainian investors will have to analyse their situation, even if they hold a minor share in foreign companies, since control is defined both by direct participation in the CFC capital and by indications of actual control. The Law provides for the broad definition of the actual control: management of the bank accounts of the company, conclusion of major transactions on behalf of the company, provision of mandatory instructions to the company's directors, etc. This is a source of risk and uncertainty for business, since actual control is established independently of the legal processing, but on the basis of facts.

Are there any special reporting requirements?

The CFC financial statements are prepared in accordance with international accounting standards or a foreign standard of the country of CFC. The tax authorities are entitled to demand the opinion of the foreign audit company confirming the financial statements of the CFC. Such requirements entail additional maintenance costs for foreign companies.

How the tax base is determined?

Profits are determined in accordance with the annual non-consolidated financial statements of the CFC, taking into account adjustments for differences determined by the law. Adjustments are similar to those used to determine the tax base for profit tax in Ukraine.

What tax rates apply?

1,5% – military levy
5% – tax for the profit from CFC received through dividends from Ukrainian companies
9% – tax for the profit received as dividends from Ukrainian investment funds or non-

payers of profit tax
9% – tax for the profit of CFC allocated prior to the submission of the CFC report by the controller
18% – in other cases.

The amount of personal income tax payable on the profits of the CFC shall be reduced by the amount of the corporate tax actually paid by the CFC in proportion to the share owned by the controlling entity. Surely there are conditions under which no taxes are due from the CFC.

What is the liability for non-compliance with the CFC rules?

A positive development for the owners of foreign companies was obviously the period of exemption from liability as of results of 2022-2023 reporting years. Upon the completion of the "grace period" the liability will be of significant amount (UAH 220,000 only for the failure to submit the CFC report). In 2021, the CFC rules need to be considered in a comprehensive manner, together with the tax amnesty and the possibilities for tax-free liquidation of the CFC.

The tax amnesty may be an alternative to a tax-free liquidation of controllers of the CFC. It is an opportunity to declare the corporate rights of foreign companies acquired in violation of the tax legislation and funds in foreign bank accounts for which no taxes were paid in Ukraine.

Tax-free liquidation offers a solution to the problem of the CFC, but given the terms and requirements of the procedure (until December 31, 2021), the tax-free liquidation may not be carried out by all owners of the CFC. Therefore, the CFC owners have the opportunity to take advantage of this opportunity in some jurisdictions where the procedure can be conducted on an on-going basis. As being obliged to declare the CFC and the automatic exchange of information in the future, the owners of the CFC will have to choose: either to amnesty their capital at 9% or to pay double in the future.

The CFC rules are the beginning of tightening tax control over foreign assets, so owners of foreign companies can not escape the problem of the CFC. It is recommended to analyze corporate structures now and adapt them to the new requirements.

Ultimate beneficial owners and corporate structures:

New disclosure requirements

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The full-fledged campaign to disclose the ultimate beneficial owners ("beneficiaries") and the ownership structure of the business has started on 11 July, when the regulation on the ownership structure took effect. However, as early as April 2020, the Law entered into force, establishing new rules for submitting and maintaining information on beneficiaries in the Unified State Register of Legal Entities, Individual Entrepreneurs and Public Organizations of Ukraine.

All Ukrainian companies must submit ownership structure and supporting documents by October 11.

In practice, there are already difficulties in submission of documents, during registration procedures and while updating information on beneficiaries.

The disclosure of the beneficiaries means the provision to a state registrar of the documented information about the real owners of the business in Ukraine and the ownership structure of the company. The ownership structure shall be submitted in a free form and shall be a schematic representation showing all the persons directly or indirectly owning a Ukrainian legal entity either independently or jointly with other persons.

Ukrainian companies should provide extracts from foreign trade registers for each foreign company in the ownership structure. Such documents should be representative of all participants of foreign companies, which will allow tracing the beneficiary. Duly executed copy of the beneficiary's passport also will have to be submitted. In practice, the requirements of Ukrainian and foreign legislation may complicate the process of executing documentation correctly and the process itself may take a long time.

In regards to the ownership structure, it may be difficult to identify the indirect decisive impact of a person on a business that cannot be documented. Such situations may

occur in corporate structures with funds or trusts, given the lack of guidelines from the Ministry of Finance of Ukraine, whereas the provided samples of structures do not cover the whole variety of structures.

If the ownership structure includes foreign participants, there is a need to provide some personal data, including all the citizenships of the investor and the tax residence. The rule applies to every foreign investor, even if he is not a beneficiary. This is an unquestionably tedious requirement, especially when dealing with foreign joint-stock companies with many shareholders.

The Law also provides for the obligation to disclose information on the ultimate beneficial owners at the state registration of a legal entity and at the registration of amendments to the information on a legal entity. Moreover, companies will be required to submit **an application and a set of documents confirming data of the ultimate beneficial owner each year starting from 2022**, within 14 calendar days of the next year following the date of state registration of the company.

Considering such legal discrepancies, management of Ukrainian companies is worried about liability for failure to provide information or false information about beneficiaries.

Indeed, it is the executive officers of the company or the representative of the company by the power of attorney who signs and submits the ownership structure. Liability may be administrative in the form of a fine of up to UAH 51,000 or even criminal (for submitting false information) — up to three years' of imprisonment.

While the procedure does not appear to be complicated at first glance, the existing requirements for disclosure of beneficiaries and ownership structure are now difficult to meet. That is why legislative initiatives are now emerging to extend the period of submission of the ownership structure to one year. Indeed, such a period would make it possible to eliminate regulatory shortcomings, and Ukrainian businesses would have enough time to collect and submit the necessary documents.

Any amendments to the ownership structure or data on a beneficiary must be reported to the state registrar within 30 business days.

New rules for the taxation of the property rich companies sale

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Since January 1, 2021 non-resident companies are obliged to pay taxes in Ukraine for direct and indirect sale of shares in the Ukrainian companies which own real estate. The new rules apply even to transactions concluded between two non-residents abroad.

Taxation applies to non-resident companies receiving profit from the alienation of the corporate rights of Ukrainian or foreign companies, which meet the following conditions:

- 50% or more of the value of the corporate rights of a foreign company is formed from the corporate rights in the Ukrainian legal entity;
- the value of the corporate rights of the Ukrainian company by 50% or more formed from the real estate located in Ukraine and owned (used) by such a Ukrainian company.

Value of the investment asset is calculated based on their highest balance sheet value for the last 365 days prior to the sale.

Considering the above-mentioned, when structuring M&A transactions, it is necessary to analyze whether the corporate structure of the target company contains also Ukrainian companies with the real estate and to take into account its value, since the withholding tax amounting 15% of the seller's profit applies. In its turn, the profit is calculated as a positive difference between the income derived from the sale of the investment asset and the documented costs of its acquisition.

If the seller fails to provide evidence of the investment asset's cost, the tax shall be deducted from the full value of the corporate rights (investment asset).

The buyer will be liable for the tax withholding and payment if the non-resident seller has no permanent establishment in Ukraine. Thus, a non-resident buyer may need to register in the tax authorities at the location of the Ukrainian property-rich company to make the appropriate payment.

Previously, such an indirect sale of real estate was customarily used for the tax optimization purpose. Under the new rules, the structure of such M&A transactions is bound to change, and in some cases will be irrelevant.

Note: Relevant amendments to the Tax Code of Ukraine were made by Laws of Ukraine No. 466-IX and No. 1117-IX.

Tax amnesty for individuals:
A chance or reason to prosecute?

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On 15 June 2021, the Verkhovna Rada of Ukraine (the Ukrainian Parliament) adopted the law, introducing the opportunity for individuals to legalize (declare) their property and assets acquired by the means of untaxed income, within the period from September 01, 2021 until September 01, 2022. In its turn, the State guarantees that such individuals will be exempted from the liability for the tax evasion under the law. This declaration session is one-time, completely voluntary, and covers only those assets (real property, currency, securities, etc.) that were acquired before January 01, 2021.

One-time levies offered to be paid to the budget are much lower than the respective tax rates. The assets located in Ukraine are proposed to be levied at 5% rate, and those located abroad, or in foreign banks at 9%. The minimal rate is 2.5% and concerns persons holding domestic government bonds acquired from during the period from September 01, 2021 till August 31, 2022.

From one hand, the rules for the “tax amnesty” provide an opportunity for individuals to legalize their “shadow” assets and avoid liability.

At the same time, the current regulation raises a number of unresolved issues which the potential declarants consider risky.

For instance, for the purpose of the tax amnesty of cash, such funds must be previously deposited to a bank account. In this case, banks are required to conduct financial monitoring, hence the deposited funds will be frozen until their source has been established, which does not provide a possibility to make the levies payment from such funds.

Furthermore, if an individual reveals the sources of its funds (e.g. hidden wage, etc.), the tax agent (who was obliged to withhold relevant taxes) will be also under the risk, as long as the exemption from the liability is not provided for by the law for such a tax agent.

Persons who, since 2005, submitted or had to submit declarations in accordance with the anti-corruption laws will not be able to use the tax amnesty, unless they have not been appointed or elected.

It is also worth noting some exceptions regarding the object of declaration. For example assets of an individual being under a pre-trial investigation or court proceeding on grounds of the tax or USC evasion, as well as the official forgery of tax records, official negligence in violating the tax and customs law may not be declared. In addition, in some cases the Criminal Code of Ukraine prohibits declaring assets that are subject of court proceedings.

Thus, the tax amnesty is not provided for the assets being subject of criminal offences.

Although the legislator guarantees that one-time voluntary declarations, and the information contained therein, may not be used as evidence in support of criminal offences under Articles 212, 212-1 of the Criminal Code of Ukraine, the declarants who since 2010 are the first and second degree relatives of persons who submitted or had to submit declarations since 2005 in accordance with the anti-corruption laws shall be careful, because their one-time voluntary declarations may become evidence in criminal proceedings.

Conclusions

Notwithstanding risks mentioned above and taking into account the global experience, and recent trends in the taxation such as transparency and strengthening financial monitoring rules, we should not exclude the possibility of the indirect taxation methods in Ukraine implementation in the nearest time. That is why the tax amnesty may be a reasonable measure that will allow avoiding liability (including criminal) for the tax evasion and provide an opportunity to confirm the legal origin of funds and assets.

The tax amnesty is also reasonable for the owners of the controlled foreign companies (“CFC”), as long as the year 2022 is the first reporting period in relation to CFCs. Thus, having legalised the income from CFCs based on the tax amnesty, an individual may avoid potential risks related to future inspections.

Another advantage of the tax amnesty is that the availability of “zero declaration” may be a proper confirmation of the funds origin both before Ukrainian and foreign banks.

Thus, despite some risks, the tax amnesty have some advantages, however, the decision whether to use such an instrument should be made in the light of particular circumstances and plans of the potential declarant.

Tax reform 2021:
What may business expect?

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In 2020, Ukraine carried out a major tax reform, which was embodied in the Law No. 466-IX and the Law No. 786-IX, with subsequent amendments and additions. In 2021, most of the amendments became effective and had already been implemented. In addition, 2021 was also marked by the adoption of new tax laws. The following are the amendments and legislative initiatives that we believe have the most significant impact on business.

1 Business purpose and principal purpose of the agreement

If in 2020 you had transactions with non-residents, or you are about to carry out such transactions in 2021-2022, any of these transactions may potentially be subject to control by the tax authorities for the compliance with the principle of business purpose.

Since the beginning of 2021, the business purpose is applied **exclusively to controlled transactions** for transfer pricing purposes (supplemented by para. 39.2.2.12 of the TCU). But already strarting **from 2022** the business purpose will apply also to **uncontrolled transactions** with "risky non-residents" and to **transactions on payment of royalties** to any non-residents (para. 14.1.231 and para. 140.5.4., 140.5.51 and 140.5.6. of the TCU).

It should be recalled that, according to the TCU, a transaction has no business purpose if:

- the main objective or one of the main objectives of the transaction is the non-payment (partial payment) of taxes and/or the reduction of taxable profit of the taxpayer;
- in comparable conditions, a person would not be ready to purchase (sell) such goods, works (services), intangible assets, other objects of economic transactions other than goods, from (to) unrelated persons.

Consequences of non-compliance with the principle of business purpose: the need to increase the taxpayer's financial result by the amount of the transaction which has no business purpose.

Our recommendation: in each transaction with non-residents falling within the business purpose principle, a report on existence of business purpose should be prepared which may be a separate document for uncontrolled transactions or may be executed as a part of transfer pricing documentation for controlled transactions.

The principal purpose of transaction differs slightly from the business purpose. **First, the principal purpose test applies** exclusively to transactions with non-residents and **if it is provided for by the relevant international convention** on avoidance of double taxation with the non-resident's country. These are, first and foremost, transactions in which a Ukrainian company shall pay withholding tax and wishes to reduce its rate by applying the international convention.

Second, it is considered that

the principal purpose test is not met if the **primary or overriding objective** of the respective economic transaction of a non-resident with a resident of Ukraine is to **obtain directly or indirectly advantages** provided for by the international convention in the form of tax exemption or reduced tax rate.

Consequences of failure to comply with the principal purpose test: no tax benefits in the form of tax exemption or reduced tax rate in a certain transaction with a non-resident.

Our recommendation: to prepare a report on the principal purpose of transaction with detailed and consistent arguments confirming that the object of the respective transaction is not the obtainment of tax benefits.

If your transaction falls under both business purpose and principal purpose, it is advisable to combine the reports on compliance with such principles in one document.

2

Registration of non-residents with the tax authorities of Ukraine and tax audits of them

In 2021, the provisions of the TCU came into force which oblige non-residents that have commercial or non-commercial representative offices in Ukraine to register with the tax authorities of Ukraine instead of their representative offices. At the same time, those non-residents that have specifically **commercial representative offices in Ukraine (i.e., permanent establishments) have to register as income tax payers** instead of their representative offices by means of submitting the application form No. 1-OPN to the tax office (Section IV of the Regulation No. 1588 on the accounting treatment for taxpayers and charges, approved by the Order of the Ministry of Finance of Ukraine No. 1588 dated of December 9, 2011).

Since the registration of non-residents had given a rise to several questions from the business community, the tax office issued its Informational Letter No. 20 and the Ministry of Finance of Ukraine approved by the Order No. 277 dated of May 19, 2021 the Generalized tax consultation on registration of non-residents with the controlling bodies and performance by non-residents of income tax payers' obligations in Ukraine, which provided for the answers to the most controversial questions of the business.

The main points are as follows:

- **If you have not registered the non-resident yet**, it is necessary not to delay because **the tax office will do it itself** on the basis of the results of the tax audit, which may be appointed already from July 01, 2021. In addition, you will be fined UAH 100.000 and the administrative seizure of the company's assets may be applied in case the non-resident carries out economic activities in Ukraine without tax registration. At the same time, it should be noted that such measures shall be applied taking into account the existing "quarantine" tax benefits due to COVID-19 — a moratorium on the conduct of tax audits during the period of quarantine covering the above-mentioned audits, as well as exemption from fines, penalties for tax offences committed during the quarantine.

- If a non-commercial representative office of a non-resident for any reason is technically registered as a permanent establishment, **the non-resident must first be registered as the income tax payer and then file its application on withdrawal of such a status** (Section V of the

Regulation No. 1588 on the accounting treatment for taxpayers and charges, approved by the Order No. 1588 of the Ministry of Finance of Ukraine dated December 9, 2011).

- Non-residents registered as income tax payers instead of their permanent establishments pay such a tax in Ukraine **exclusively from income related to their activities in Ukraine**. It means that non-residents do not have to file tax reporting regarding their foreign income and accrue taxes on it in Ukraine.

- The Ministry of Finance of Ukraine approved by its order No. 774 dated December 15, 2020 the **Procedure for the conduct of audits of non-resident's activities** through its separate divisions, including permanent establishment in Ukraine, without being registered with the controlling authority. To be noted that **such an audit may be carried out** in the event of receipt of **any information indicating that the non-resident is conducting economic activity through a permanent establishment in Ukraine** (para. 78.1.22 of the TCU).

- There are several sources of information for the tax authorities of Ukraine on non-residents' violations in tax registration. For example, such sources include **any public information that may indicate a person's actual authority** to carry out an activity for, at the expense of and/or in favour of a non-resident, which has the features of a permanent establishment, or information obtained in the result of tax control measures.

Therefore, the tax office does have a mechanism for monitoring the compliance of non-residents with legal provisions on tax registration. In this respect, we recommend to make sure that your company met the respective requirements and that the activity of your non-resident does not create in itself a permanent establishment in Ukraine.

> **In 2021, it became possible to use the mutual agreement procedure as an alternative mechanism for appealing against additional tax assessments related to the application of international conventions.**

3 Mutual agreement procedure in determination of tax obligations

The Procedure for consideration of the application (case) under the mutual agreement procedure and the requirements to the application were approved by the Order of the Ministry of Finance of Ukraine No. 820 dated December 30, 2020. Both a Ukrainian company and a non-resident may apply for this procedure if they consider that they are being or will be taxed in a way which is contrary to the provisions of international convention of Ukraine on avoidance of double taxation.

A few important nuances to keep in mind before initiating the mutual agreement procedure:

- it may be applied for **only if it is provided for by the relevant international convention** of Ukraine on avoidance of double taxation;

- it may be applied for both **before and after the tax audit**;

- the decision of the controlling authority on additional tax assessment **is deemed non-agreed** in respect of the matters addressed in the application until the date on which the application is considered;

- the application shall be **submitted to the Ministry of Finance of Ukraine** or to another body authorized by the Ministry;

- if the application is considered in favour of the taxpayer, the controlling authority either **cancels its tax notices-decisions** in full or issues new tax notices-decisions for the taxpayer up to a reasonably recognized amount of additional tax assessment;

- the mutual agreement procedure is **an alternative to the administrative appeal of tax notices-decisions**. It means that if you disagree with the decision made on the basis of the results of such a procedure, the tax notice-decision may further be appealed to court. The administrative appeal following the mutual agreement procedure is not allowed.

The shortcomings of the procedure include the length of the procedure (about 6 months) and the lack of practical implementation in Ukraine.

Our recommendation: to apply for such a procedure if there are relevant grounds because

when considering the application the Ukrainian tax authorities will consult with the representatives of foreign tax authorities. This significantly increases the chances of taking a well-considered decision in line with international practice.

4

"Google Tax" or VAT on e-services

On July 2, 2021, the Law No. 1525-IX, known as the "Google Tax" Law, came into force.

The Law imposes an obligation on non-residents which do not have a permanent establishment in Ukraine and provide electronic services in Ukraine to **individuals**, including **individual entrepreneurs**, not registered as value-added tax (VAT) payers, to register as VAT payers in Ukraine and pay the respective tax.

It should be noted that the Law does not apply to non-residents which cooperate exclusively with legal entities in Ukraine.

Electronic services mean services **supplied via the Internet, automatically, by means of information technologies and mainly without human intervention. For example, the Law includes to e-services the following:**

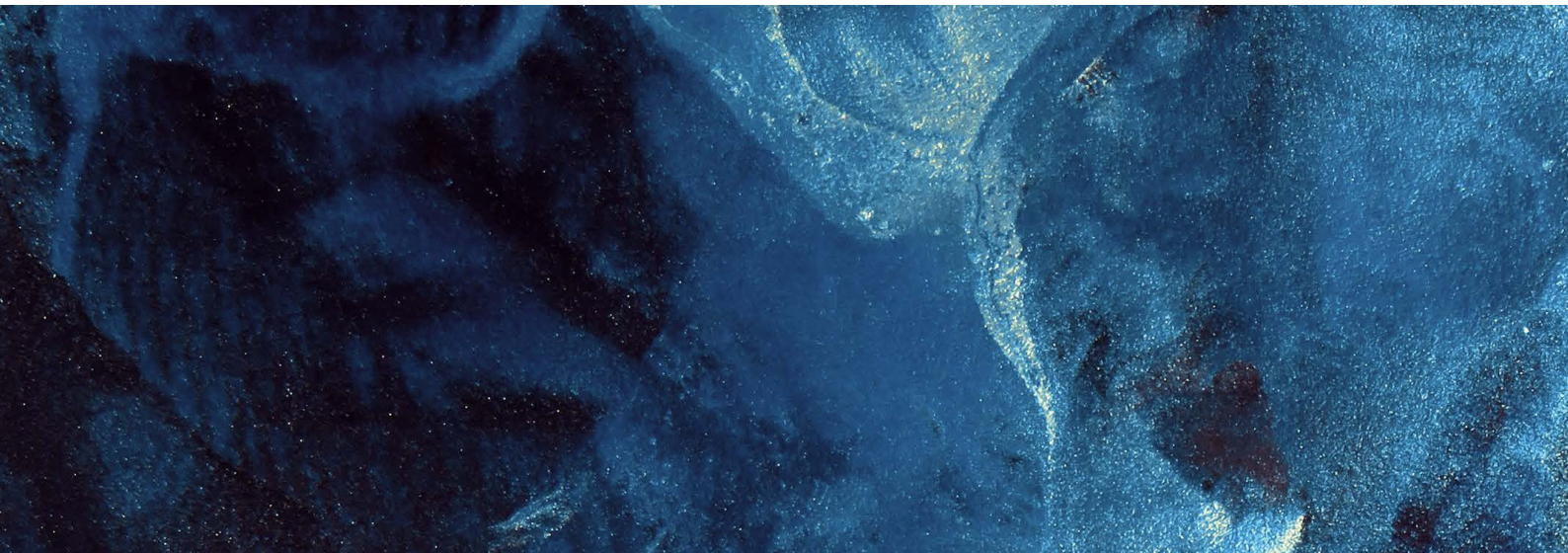
- supply of electronic copies, provision of access to images, texts and information (in particular, subscriptions to electronic newspapers, magazines, books);
- provision of access to databases, including the use of Internet search engines and catalogues;
- supply of electronic copies (digital information) and / or provision of access to audio-visual, video and audio works under order;
- provision of a cloud service when it comes to the provision of computing resources, storage resources or electronic communication systems using cloud computing technologies;
- delivery of software and its updates;
- provision of advertising services in the Internet, mobile applications and other electronic resources.

The Law defines the obligation of a non-resident **to submit, through a special electronic portal, an application for registration as a VAT payer** in Ukraine. This obligation arises if, on the basis of the results of the previous calendar year, the amount of supplies exceeds the equivalent of **UAH 1,000,000.00**.

The tax is equal to 20 % of the tax base (the cost of services) and **is added to the cost of electronic services**.

The rules on VAT taxation of transactions involving the delivery of electronic services to individuals by non-residents **apply to tax periods from January 1, 2022.**

For the delivery of electronic services **without the required registration as the VAT payer the fine is set at 30 minimum wages**.



Currency loans restructuring: What new opportunities does the law offer?

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In April this year, the Parliament adopted a number of laws introducing new procedures for individuals` mortgage debt settlement.

The strongest reaction in the business community was provoked by the Law of Ukraine "On the Introduction of Amendments to Certain Legislative Acts of Ukraine concerning consumer loans granted in foreign currency" (Law No. 1381-IX): the National Bank of Ukraine and representatives of financial institutions and banks also opposed it.

Law No. 1381 introduced mandatory restructuring of mortgage currency loans of individuals which were due and payable before 1 January 2014 and still not repaid.

Restructuring is in fact a reduction in the amount of debt by converting it into national currency at a reduced rate.

The restructuring procedure is defined in detail in Law No. 1381-IX: a number of prerequisites for its application are envisaged, as well as the procedure for debt recalculation is clearly defined. At the same time, the relevant application of a debtor is a basis for restructuring.

The Law also provides an opportunity to reduce substantially the amount of debt owed, if assigned to a new creditor, to the amount for which the debt was acquired. Such a reduction is permitted if the new creditor does not have full knowledge of the repayment history of the relevant loan.

The term set by the Law for applying to a creditor for restructuring expired on July 23, 2021, but it provides for cases in which this term is counted otherwise: for example, in case of court disputes over a loan or mortgage agreement. It is worth mentioning that before September 2021 the foreclosure of pledged immovable property on such loans is prohibited by the Law.

In turn, Ukrainian citizens who have outstanding mortgage loans received in early 2014 have a real opportunity to repay them without losing their

mortgaged assets. Since this Law was recently adopted, there is as yet no case law.

We note that at the beginning of 2021 41% of loans in Ukraine are non-performing , and the loan rate is quite high. Creditors are not interested in long-term loan relationships with borrowers, as almost every second loan is not repaid. This, among other things, has led to criticism of Law No.1381-IX for excessive protection of debtors by the state.

[1] *Article on the official website of the National Bank of Ukraine "The Nonperforming Loans (NPL) Ratio is High, but is Gradually Declining", accessible here: https://bank.gov.ua/ua/stability/npl*

Law No. 1381-IX is important for the financial services market: it aims to clear banks and financial institutions of non-performing loans, and creditors will receive repayment of the debt in the recalculated amount.

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