GIDE

GIDE LOYRETTE NOUEL

newsletter

MONTHLY LEGAL UPDATE | UKRAINE | 20 JANUARY 2015

IN THIS ISSUE:

TAX REFORM

On 28 December 2014, the Parliament approved a set of laws for implementation of the tax reform which is aimed at reducing the number of taxes and simplifying the tax system as well as legalizing 'cash-in-hand' salaries. Upon signing by the President of Ukraine and official publication made on 31 December 2014, the laws came into effect on 1 January 2015.

Value Added Tax ("VAT")

New VAT Administration Rules

Starting from 1 January 2015, all VAT payers in Ukraine will be required to use special VAT accounts for VAT payment purposes. VAT accounts were automatically opened with the State Treasury Service of Ukraine in December 2014 and will be communicated to the tax payers by the Fiscal Service of Ukraine.

Taxpayers will not be able to make any transfers from their VAT accounts to the state budget or their own bank accounts. Any transactions will be completed by the State Treasury Service of Ukraine upon request of the Fiscal Service of Ukraine.

Tax payers will be allowed to make deposits into their VAT accounts and receive funds exceeding the amount of the declared VAT to be paid. It will not be possible to credit such VAT

accounts with money from customers and VAT refund. The monies deposited on VAT accounts cannot be used for payment of other taxes.

Information about the net balance of the VAT account of each tax payer will be regularly transmitted by the State Treasury Service of Ukraine to the Fiscal Service of Ukraine. Tax payers will have the right to request information about the actual balance of the VAT account online.

The new rules would also apply to agricultural VAT tax payers. However, upon filing a VAT return the amount of the declared VAT liability shall be transferred from the VAT account of the agricultural tax payer to its special account (instead of the state budget).

If the VAT registration of the tax payer is cancelled (e.g. due to absence at the registered address), the VAT account will be closed and the available balance will be transferred to the state budget. The monies which should be refunded to the tax payer can be repaid from the state budget upon its application according to the general procedure of VAT refund.

VAT reporting will be made only in the electronic form.

Obligatory Registration of VAT invoices

Any VAT invoice must be registered by the tax payer in the Unified Register of Tax Invoices. Such registration can be completed if the amount of the VAT invoice does not exceed the net VAT balance, which is calculated as the total sum of the input and import VAT as well as monies credited to the VAT account reduced by the sum of the output VAT, VAT refund and VAT liability.

According to the aforesaid rule the tax payer will not be able to register the VAT invoice as long as its amount exceeds the net balance of the VAT account. As the customer will not have the right for VAT credit, supply of goods without a registered VAT invoice will be problematic.

Based on the above, companies will have to credit monies to their VAT accounts in order to guarantee payment of their VAT liabilities.

The VAT amount paid due to purchase of goods or services specified in the VAT invoice will be recognized as VAT credit upon registration of the respective VAT invoice, but not later than in 180 calendar days upon execution of the VAT invoice.

For delayed registration of the VAT invoice the tax payer will pay the following fines:

- 10 per cent of the VAT concerned, if the delay is up to 15 calendar days;
- 20 per cent of the VAT concerned, if the delay is from 16 to 30 calendar days;
- 30 per cent of the VAT concerned, if the delay is from 31 to 60 calendar days;
- 40 per cent of the VAT concerned, if the delay is from 61 to 180 calendar days;
- 50 per cent of the VAT concerned, if the delay is over 180 calendar days.

VAT Refund

The new law provides for automatic and non-automatic VAT refund. Automatic VAT refund will be available only to taxpayers that simultaneously meet the following requirements:

- they are not undergoing bankruptcy proceedings;
- they are registered in the Unified State Register of Legal Entities and Private Entrepreneurs and there are no records of unconfirmed status of information, absence at the registered address, liquidation or corporate re-organization, invalidation of the constituent documents or cancellation of the tax payer's registration according to the aforesaid register;

- the residual value of their non-current assets as of the reporting date exceeds three times the amount of the claimed VAT refund, or they received a bank guarantee from the banks specified by the government, and
- their export supplies comprise at least 40% of the taxpayer's total supplies for the preceding 12 months, or they have invested at least UAH 3 million into non-current assets within the last 12 months;
- they have no tax debt.

All other tax payers will have the right for non-automatic VAT refund. After 1 July 2015, VAT refund will not require any tax audit or inspection.

The new VAT refund rules will apply to VAT credit accumulated after 1 February 2015.

Under the new rules, VAT credit for the reporting month is immediately subject to refund in the amount not exceeding the net balance of the VAT account as soon as the VAT return is filed.

Transition Rules

The liability for a delay in registration of VAT invoices will not apply till 1 July 2015. Before this date VAT invoices can be registered even if their amount exceeds the net balance of the VAT account.

On 1 July 2015, the net balance of the VAT account will be increased by the average amount of VAT declared and paid for the preceding 12 months. The amount of such increase will be recalculated on a quarterly basis and adjusted accordingly.

Any amounts of VAT overpayments will increase the net balance of the VAT account accordingly. Such overpayments will not be subject to refund.

The amounts declared by the tax payer for VAT refund for the reporting periods before 1 February 2015, will, upon the tax payer's choice, either increase the tax payer's VAT credit and the net balance of its VAT account, or be subject to VAT refund according to the rules existing before 1 January 2015. The VAT credit of the tax payer and the net balance of its VAT account can be increased without a prior tax audit.

Threshold for Mandatory Registration as a VAT Payer

The VAT registration is mandatory as soon as the turnover from taxable operations for the preceding 12 months exceeds UAH 1 million. In the past this threshold was set at UAH 300,000.

VAT Tax Base

Starting from 1 January 2015, the VAT tax base of the purchased goods or services cannot be lower than their purchase price, tax base of the produced goods or services should be at the level of the production costs at least, the tax base of the non-current assets should be at their book value as of the last reporting date or higher.

VAT Special Regime for Agricultural Business

In 2015 - 2017 the following transactions will be exempt from the value added tax:

- supply of grains of commodity items 1001-1008 (save for commodity item 1006 and commodity sub-category 1008 10 00 00); and
- supply of industrial crops of commodity items 1205 and 1206 (per the UCGFEA),

except for supply of such grains and industrial crops by producers and companies, which purchased such grains and industrial crops from producers.

Export of such commodities is not subject to VAT. Unlike the previous year, this exemption will not apply to exports by producers of such grains and industrial crops grown on agricultural land which is owned, or perpetually used, or leased.

Corporate Profit Tax ("CPT")

Reporting

Tax payers will be obliged to report only for the periods during which there arise any tax objects or financial indicators subject to reporting. Tax payers which hold valid (including suspended) licenses for trading goods subject to excise duty must report on a regular basis irrespective whether or not they conduct any business activity.

Enforcement of tax obligations

Tax obligations, if declared by the tax payer, can be enforced upon application of the tax authority. The court decision is not required for opening the enforcement proceedings in such cases.

The regulations on the corporate profit tax were drastically changed by the Parliament this year.

Definition of tax payers

According to the revised definition only business entities which conduct business activity in Ukraine or abroad are considered resident tax payers, while their local branches and representative offices cannot be treated as separate tax payers.

Besides, government-financed institutions and non-profit organizations (such as civil and religious organizations, charities and pension funds, and political parties) will not be treated as payers of the corporate profit tax provided that they are registered as non-profit organizations with the State Fiscal Services of Ukraine in accordance with the established rules.

The legislator has also expanded the definition of a permanent establishment. According to the effective regulations, a permanent establishment will cover computer servers that may, in particular, host online gambling business and other internet services rendered in Ukraine.

According to the previous rules, only a resident authorized to *conclude* agreements exclusively on behalf of a non-resident was considered a permanent establishment, whereas under the current rules also a resident, authorized to *negotiate* substantial terms of an agreement exclusively on behalf of a non-resident can be considered as a permanent establishment.

Tax Rate and Reporting Period

The general tax rate will remain at 18 per cent. The reporting period will be one calendar year starting on January 1 and ending on 31 December of the relevant year. Quarterly reporting will not be required. Agricultural producers (whose sales of own agricultural products exceed half of their total annual turnover) may opt for a reporting period that starts on 1 July and ends on 30 June of the next calendar year.

Tax Base: Profit

The tax base of the CPT will be determined according to national or international accounting standards subject to adjustment according to a limited number of tax adjustments as specified in the Tax Code of Ukraine.

Tax adjustments cover the following areas:

- Depreciation and Amortization;
- Bad Debts; and
- Financial Operations (including trade with receivables; loan interest, investments, royalties).

Tax payers with total annual turnover of up to UAH 20 million (excluding VAT and excise duty) may once refuse to apply all tax adjustments (save for the carry forward of losses) and follow the same approach in subsequent years. As soon as the tax payer's total annual turnover exceeds the aforesaid threshold, tax adjustments shall apply starting from such year. If the total annual turnover is below the aforesaid threshold in one of the following years, the tax payer may again decide to apply the tax adjustments.

Other Tax Novelties

Thin capitalization rule

Thin capitalization rule was significantly changed as stated in the Banking and Finance section '*Taxation of Interest: Thin Capitalisation Rule*' hereof.

Carry forward of losses: transition rules

The transitional regulations of the revised Tax Code provide for the rules on carry forward of losses which are basically taken over from the General tax consultation on accounting of losses for the purposes of the corporate profit tax, approved by the Order of the State Tax Service of Ukraine No. 575 dated 05.07.2012.

Restrictions on deductibility of expenses for goods and services

Starting from 1 January 2015, 30% of expenses for goods and services purchased from non-profit organizations (save for government-financed institutions) and non-residents (including related parties) located in offshore jurisdictions (as specified by the government) will not be deductible. This restriction will not apply if the goods are purchased in the controlled transactions and/or the tax payer proves that the contractual price is set at the market level.

Increased tax rate for insurance companies

Starting from 1 January 2015, insurance companies will pay the general rate of the CPT (18%). Along with the general CPT rate mentioned above insurance companies will additionally pay 3 per cent of the *income* received under most insurance agreements (save for life insurance, voluntary medical insurance and private pension plans). Both basic and additional tax rates are part of the corporate profit tax.

Taxation of gambling business

Despite an effective ban on gambling in Ukraine, the Parliament declared its intention to legalize gambling business in Ukraine to increase revenues to the state budget.

Along with the general CPT rate gambling operators will have to additionally pay:

- 10 per cent of income received from lotteries and slot machines;
- 18 per cent of income received from betting and gaming (casino).

The income should be reduced by the amount of payments to the player. Both general and additional tax rates are part of the corporate profit tax.

Taxation of IT business

According to the wording of the law the parliament reinstated the decreased tax rate (5%) for IT companies which apply special taxation regime. However, regulations on special taxation regime have been cancelled. Currently, it is unclear how these provisions will apply.

Transfer pricing

Tax liabilities of the tax payer must be adjusted by the difference between the market and contractual prices of the goods in the transactions that are subject to transfer pricing control. Detailed information on the transfer pricing is set forth in the section below.

Transfer Pricing

Along with other changes the parliament amended the transfer pricing rules which went into effect on 1 January 2015. The new law introduced the arm's length principle for all controlled transactions and extended the scope of transfer pricing rules as well as increased penalties for their violation.

The taxable income derived from a controlled transaction is calculated in accordance with the established arm's length principle, if the terms of such transactions do not differ from those used in comparable transactions with unrelated parties.

Controlled Transactions

The following transactions are deemed as controlled:

- transactions with the related non-residents;
- sale of goods through non-resident intermediaries;
- transactions with the non-residents registered in low tax jurisdictions.

Transactions made between related parties through non-related parties is subject to transfer pricing control, if such non-related party involved does not fulfil any substantial functions on sale of goods, does not use any significant assets and/or does not assume any significant risks in the transaction.

Such transactions are subject to transfer pricing control if the annual volume of the controlled transactions with one contracting party exceeds UAH 1 million (excl. VAT) or 3 per cent of its total annual turnover, and the total annual turnover of the tax payer and/or its related parties exceeds UAH 20 million.

Related parties

The list of related parties is expanded by persons (legal entity or individual) where the total amount of all credits and loans granted or secured by such person to or in favour of the company exceeds the equity of the latter by 3.5 times (or 10 times for financial institutions or leasing companies).

The law also provides for clearer regulation on calculation of the indirect share of the person in the company through different chains of control relations.

Sources of information

The new law does not provide for an officially approved list of sources of information which can be used for justification of the contractual prices. Any information which is generally accessible and refers to comparable transactions (including transactions of the tax payer and its contracting party with non-related parties) can be used by the tax payer. The tax authority may not use sources of information which are not accessible to the tax payers.

Reporting and tax audit

The tax payer must report the controlled transactions when filing the annual income tax return (as an annex thereto). If the tax payer has controlled transactions with one contracting party for over UAH 5 million, the report on the controlled transactions can be submitted until May 1 of the following year.

The duration of the tax audit on compliance with the transfer pricing rules should not exceed 18 months. In exceptional cases, the tax audit can extended for additional 12 months.

Liability

The effective law provides for the following penalties for violation of transfer pricing rules:

- for non-submission of a report on controlled transactions - 100 minimum salaries (current equivalent of about EUR 6,000);
- for non-reporting a controlled transaction - 5 per cent of the volume of the undisclosed transactions;
- for non-submission of the transfer pricing documentation upon request of the tax authority - 3 per cent of the volume of the transactions concerned, but not more than 200 minimum salaries (current equivalent of about EUR 12,000).

The limitation period for liability for breach of transfer pricing rules is 2,555 calendar days (i.e. 7 years).

Personal Income Tax and Military Duty

The rate of the personal income tax (PIT) which is applicable to the income exceeding 10 minimum salaries (UAH 12,180 in the year 2015) will be increased from 17 to 20 per cent.

The tax rate for dividends payable by companies (CPT payers) will be kept at 5% level. Other residual income (including royalties and deposits) will be tax at the increased rate of 20%.

Military duty in the amount of 1,5 per cent will apply in 2015. Military duty will apply not only to salary and labour revenues, but also to other income.

Single Social Contribution

Legalization of 'cash-in-hand' salaries

Among other laws on tax reform the Parliament adopted a legislative incentive for legalization of 'cash-in-hand' salaries and raising official salaries in Ukraine.

The currently applicable rate payable by the local companies varies from 36,76 to 49,7 per cent. According to the new law employers will pay in 2015 the single social contribution at the decreased rate (40% of the currently applicable rate), provided that they meet all of the following requirements:

- the total base for accrual of the single social contribution in the reporting month exceeds by 2.5 times or more the average monthly base for accrual of the single social contribution in the year 2014, or if this not the case, the tax payer can apply another factor calculated by dividing the average monthly base for accrual of the single social contribution in the year 2014 by the total base for accrual of the single social contribution in the reporting month;
- the average salary in the company is increased by 30 per cent as compared to the average salary in 2014;

- the average payment per person (after application of the aforesaid factor) will amount to UAH 700 at least;
- the average salary in the company will amount to 3 minimum salaries at least.

Starting from 1 January 2016, the rate of the single social contribution payable by all companies will be decreased to 60% of the currently applicable rate.

As before, the maximum base for accrual of the single social contribution amounts to 17 minimum living wages (current equivalent - about EUR 1,060).

Other changes

The minimum base for single social contribution payable in case of employment is a minimum salary (current equivalent - about EUR 60).

Reform of Mandatory Social Insurance

The Fund of State Mandatory Social Insurance against Accidents at Work and Professional Deceases and the Fund of State Mandatory Social Insurance against Temporary Loss of Working Capacity will be merged into a newly established Fund of State Mandatory Social Insurance. The latter will be a legal successor of the two merged funds.

The Fund of State Mandatory Social Insurance will administer insurance against accidents at work and temporary loss of working capacity as well as medical insurance. The draft law on state mandatory medical insurance has to be developed and submitted to the Parliament by the Cabinet of Ministers within 6 months.

New employment regulations

According to the amendments to laws, employers may not give actual access to work before conclusion of an employment agreement (signing an employment order) and notification of the competent authority (currently - State Fiscal Service of Ukraine) on employment. The “actually hired” employee may claim for establishment of the employment relation and determination of its duration before court. If the claim is upheld, the court should order the employer to pay the average salary for the particular type of business in the respective region, including the PIT and the single social contribution, reduced by the fee actually paid to the employee.

For giving actual access to work without conclusion of an employment agreement the employer will pay a fine in the amount of 30 minimum salaries for each employee concerned. The penalty may be applied on the basis of the respective court decision.

For non-compliance with the minimum salary requirement the employer will pay a fine in the amount of 10 minimum salaries for each employee concerned. For a delay of salary payment over 1 month the employer will pay a fine in the amount of 3 minimum salaries. For other breaches of labour laws the employer has to pay a fine in amount of 1 minimum salary. The above penalties may be applied by the agencies of the Ministry of Labour and Social Protection of Ukraine.

Corporate officials of employers may be also penalized for giving actual access to work without conclusion of an employment agreement (fine of up to UAH 17,000 (about EUR 870)) and delay of salary payment (fine of up to UAH 1,700 (about EUR 87)).

Criminal penalty for unlawful dismissal of an employee for personal reasons or due to notification about a breach of anti-corruption laws was significantly increased. The penalty for this crime cannot be less than UAH 34,000 (about EUR 1,750) and more than UAH 51,000 (about EUR 2,625). The previously applicable maximum penalty was UAH 850 (about EUR 43).

The requirement of registration of an employment agreement with an employer - individual was abolished.

Law on Tax Compromise

The Ukrainian Parliament adopted the Law on Tax Compromise (the "***Law"***) offering taxpayers an opportunity to settle their tax liabilities before the state at 5% of their amount. The Law came into force on 17 January 2015.

The idea standing behind the Law is to bring businesses out of the shadow and allow them 'starting off with a clean slate' by settling tax obligations and pending tax disputes out of court. Perhaps it would be an exaggeration to say that the Law offers a tax amnesty, however, its implications are of a great significance for many taxpayers in Ukraine who are facing rigorous tax sanctions and long-lasting tax disputes.

According to the Law, the tax compromise stands for a regime offering taxpayers and their management a relief from the responsibility for tax law violations upon condition that taxpayers acknowledge their tax understatements. The compromise option is available for VAT and corporate profit tax. The tax compromise allows taxpayers to settle their tax liabilities at 5% of their amount, while 95% will be treated as settled and forgiven, and no penalties will be charged. Notably, pending criminal or administrative charges against a taxpayer's management will be dropped.

The **eligibility criteria** for applying the tax compromise are as follows.

The tax compromise may be used for tax periods prior to **1 April 2014**, taking into account the applicable statute of limitations that is 1,095 days.

The tax compromise applies to unpaid taxes, i.e. those that have been (presumably) understated in violation of the tax laws, including situations where:

- Tax authorities have carried out a tax audit and documented certain tax law violations by issuing a tax notice (*'podatkovi povidomlennia-rishennia'*).
- Taxpayer appeals against such tax notice through an administrative or a judicial procedure and the tax dispute is ongoing.
- Tax audit is still pending however the taxpayer acknowledges tax law violations in good faith.
- Taxpayer acknowledges in good faith tax law violations committed in periods not covered by the tax audit. In this case, however, tax authorities are entitled to carry out an extraordinary tax audit in order to determine whether the tax understatement declared by the taxpayer is accurate and true.

This being said, considering the low rate of 5%, even law-abiding taxpayers challenging tax audit results may choose to acknowledge their tax liabilities and to pay 5% of the tax, rather than pursue tax litigation, which is often time-consuming and sometimes even more costly.
The wording of the Law is rather ambiguous and leaves it unclear whether a taxpayer can make use of the tax compromise if there are already decisions of the first instance and appellate courts, and the tax dispute is under review by the court of cassation. The Law reads that the tax compromise extends to **non-agreed** tax liabilities. The tax liability is considered to be agreed when there is a court decision that has entered into legal force, which is usually the case once there is a decision of the appellate court.
Should the Law be construed within this strict meaning, all tax disputes currently pending at the Higher Administrative Court of Ukraine will not be eligible for the tax compromise unless this court overturns earlier court decisions and remands the cases for a new trial. Whether or not

the Law is to be read in this strict manner would largely depend on subsequent official comments from the State Fiscal Service of Ukraine.

Taxpayers willing to use the compromise should submit updated tax returns for fiscal periods preceding 1 April 2014, acknowledging tax understatements. Tax authorities may carry out an extraordinary tax audit in order to check whether the declared tax understatement is accurate. No new audits apply in cases where the tax authorities have already audited the respective tax period and issued tax notices. In this case a taxpayer can simply submit a written motion with the local tax office claiming application of the tax compromise. The idea of the Law is that application of the tax compromise is up to taxpayers and is purely declaratory; while the tax authorities may not dismiss a motion to apply the compromise.

The Law received a lot of criticism for the attempts to legalize enormous tax law violations and tax-evading schemes. The Law has been also criticized for a number of technical and legal shortcomings that may render its practical application troublesome. Some good-faith taxpayers also apprehend that by applying for the tax compromise they admit tax law violations they have never committed and may face additional risks. As a matter of fact, we do not see reasons for such apprehensions; nor do any such risks follow from the wording or idea of the Law.

The option to use the tax compromise will be open **during ninety (90) days** from enactment of the Law. In other words: the Law offers a one-time opportunity, and taxpayers must now promptly decide whether or not they want to make use of it. A thorough eligibility and feasibility analysis of applying the tax compromise option would be advisable in each particular case.

REAL ESTATE

Taxation of Immovable Property

The tax reform initiated by the Government of Ukraine and approved by the Parliament of Ukraine breathed a new life to the real estate taxation, which was the subject to heated debate several years ago. The Law of Ukraine on Amendments to the Tax Code of Ukraine and Certain Laws Regarding the Tax Reform (the “Law”) reflects a completely different state approach to real estate taxation which will see a significant increase in the number of taxpayers.

In particular, real estate taxes will be paid not only by owners of residential real estate but also by owners of non-residential real estate irrespective of their residency status. At the same time, industrial buildings (warehouses, shops, production buildings) as well as buildings used by agricultural producers for agricultural purposes will not be subject to taxation.

Similarly as before, the tax base will be calculated on the basis of the total area of buildings/structures/apartments or their shares.

The dates when taxes are due also remain the same - individuals will have to pay real estate taxes within 60 days upon receipt of a tax notification while legal entities will make advance payments each quarter till the 30th of the month following the reporting quarter. Advance payments made by legal entities will be reflected in annual tax returns.

The tax concessions incorporated into the Law as the result of a political compromise were scaled down. Furthermore, tax concessions will be applied only to owners of residential real estate provided that such real estate is not used for commercial purposes. The tax base for apartments and buildings will be decreased to 60 and 120 sq.m., respectively, while in the event of concurrent ownership of various types of residential property the tax base will be decreased to 180 sq.m. Prior to the amendments, the concessions amounted to 120, 250 and 370 sq.m., respectively.

The Law also changed the tax rates and set the maximum amount applicable to any type of real estate and any taxpayer. In particular, the tax rate will be fixed by a decision of a city/village council, however, it may not exceed 2% of the minimum wage fixed as of the 1st of January of the taxable period for 1 sq.m. In 2015 the maximum tax rate will constitute UAH 24.36 for 1 sq.m.

Local councils now have to set the tax rates, introduce tax concessions by their decisions and inform tax authorities on the tax concessions till the 1st of February.

INTERNATIONAL TRADE

Introduction of extra customs duties: the WTO-consistency issue

On 30 December 2014, the President signed the Law of Ukraine "On Measures for Stabilization of the Balance of Payments of Ukraine under Article XII of the General Agreement on Tariffs and Trade 1994" dated 28 December 2014 No. 73-VIII which was officially published on the same day.

The Law is designed to introduce, temporarily (for one year), extra customs duties applicable to virtually all goods imported into Ukraine:

- 10% for food and agricultural products, alcoholic and non-alcoholic beverages and tobacco products as well as goods brought into Ukraine by individuals in excess of the maximum permitted value (€ 1,000 for goods brought in personally as luggage by air transportation and € 500 for goods brought in by other means of transportation);
- 5% for all other goods, such as consumer goods, motor vehicles, home appliances and equipment, textiles and footwear.

The exception is made for "vitally important goods" exhaustively listed in the Law, importantly, oil, natural gas, electric power, coal, petrol, diesel fuel, mazut, medical devices for hemodialysis and cancer treatments. Also, the extra customs duties will not apply to goods which are already exempt from customs duties (e.g., international technical assistance, imported goods which are brought back to Ukraine after repair abroad; state security related equipment, humanitarian aid; goods imported by the Red Cross, etc.).

The Law is declared to be based on Article XII of the GATT 1994 and the Understanding on the Balance-of-Payments Provisions of GATT 1994 which allow any contracting party, notwithstanding its obligation to generally eliminate quantitative restrictions, in order to safeguard its external financial position and its balance of payments, to restrict the quantity or value of merchandise permitted to be imported. In doing so, the contracting party, however, must comply with the consultations procedure and prefer price-based measures which have the least disruptive effect on trade, including, *inter alia*, import surcharges applied in excess of the duties inscribed in the Schedule of that Member.

One of the earlier drafts of this Law which intended to implement extra duties immediately upon its adoption attracted considerable criticism as potentially WTO inconsistent (disregarding the consultations procedures) and capable of triggering suspension by the European Union of its trade preferences unilaterally granted to Ukraine under the Ukraine – EU Association Agreement (such as zero customs duty applicable to Ukrainian goods). However, the final text of the Law introduces the duties upon publication of a resolution of the Cabinet of Ministers on completion of consultation with international financial organizations (implying, primarily, the IMF, the international body with a mandate to identify the balance of payment problems).

Notably, no official EU feedback with regard to a possibility to suspend unilateral EU trade preferences has been given so far.

BANKING AND FINANCE

Toxic Assets Act

The Law on Measures Directed at Facilitation of Capitalization and Restructuring of Banks was approved in the night of 28 December 2014 (effective as of December 30) enacting a moratorium on payment of dividends by banks in 2015-2016 - earlier in 2014 this initiative was adopted by the National Bank as a regulatory measure. Profitable banks will only be able to re-capitalize and replenish their reserves. Therefore, the new law prompts the hypothesis that all Ukrainian banks require recapitalization (even major banks after the stress-testing by the NBU).

The law provides a number of exemptions for banks from the procedures required by the Law on Joint-Stock Companies. Even though the pre-emptive rights of the shareholder remain, the elimination of quorum requirements and simple majority for the voting do raise doubts as to the possible abuses. For example, requirement that the bank's prospective investor must freeze the funds on the special accounts with the National Bank of Ukraine gives less flexibility to the regulator to rescue the institution: institutional investors may be unable to freeze such money for indefinite time and, therefore, will opt out of the opportunity while this option of settlement could have been entailed long before the law.

Very short terms for the anti-crisis measures are entirely innovative: for example, increase of the bank's charter capital provides for registrations and issue of permits within days; competition authorities must make a decision within 2 days (compared to 45 days in usual circumstances). The law even introduces the filing principle for the securities' regulator: the registration is deemed to have been received on the date when the submission is made; the same is true for approval of the charter by the National Bank of Ukraine and state registration.

Throughout 2014, the National Bank was active in closing undercapitalised banks putting as many as 30 into external administration, in 18 cases followed by the liquidation; 8 banks were determined by the regulator as system-forming or, in other words, too important to fail. The law of 28 December will revive the government's programme of acquisition of banks on the principles that closely follow the 2008 Law on Priority Measures for Prevention of Negative Consequences of the Financial Crisis (expired in 2011). This premise is supported by the Law on the 2015 State Budget of Ukraine - the Cabinet of Ministers has the right to issue unlimited number of treasury bonds denominated in UAH for acquisition of shares in banks (Article 16) and financing the Deposit Guarantee Fund (Article 17); the preliminary aggregate face value of such bonds would be UAH 56.5 billion.

The anti-crisis measures will allow ignoring certain creditors' rights, including those of lenders and depositors during the decrease of the charter capital. However, the law did not introduce new institutions - such as irrevocable proxies to the government; and the requirement of the law to "*ensure the state's right to dispose of and use at least 75 per cent of the bank's shares*" can be established, thus, only through the ownership of the government or the asset management agreement between the legal owner (government as a trustee) and the beneficial owner - ultimate shareholder. We still doubt that the Ministry of Finance is the correct agency to supervise banks, as the most suitable would be the State Property Fund of Ukraine.

A general impression is that the law will be used primarily by the Deposit Guarantee Fund to establish bridge banks and conduct simplified recapitalization.

The law of 28 December 2014, bestowed on the National Bank a wide discretion to suspend banking activities, in whole or in part: withdrawal of deposits, payments, borrowings, transactions with foreign currency, etc., without visible limits as to the scope and the number of the market players affected. The only check on possible discrimination of the property rights is a new agency, the Financial Stability Council; apparently, the competence of the Council will be determined by the Decree of the President. The Financial Stability Council will not be a

check on the NBU in foreign currency regulations, however, and non-banking corporate entities as well as individuals will remain at the mercy of the central bank. Moreover, there is no criteria for concepts of "*unstable financial situation in the banking system*" or "*threats to the stability of the financial system*" - a pre-requisite of the NBU excessive power; both of them, therefore, may become a term of convenience.

Critical Indicators in the Banking System

The National Bank of Ukraine re-enacted its pardon to the banks for non-compliance with the number of ratios during 2015 - 2018, i.e., 4 years (Resolution No.859 dated 25 December 2014). In exchange, the banks must observe numerous restrictions. It must be noted that in comparison with the foregoing Resolution No. 529 dated 26 August 2014 (expired on 1 January 2015), the NBU had expanded the list of normatives that can be ignored and narrowed down the self-restricting undertakings by the banks. In particular, the banks can give small loans to individuals (up to UAH 50,000), enter into a short-term (up to 30 days) foreign currency swap agreements, redeem own shares when required by law, invest into securities issued by the National Bank of Ukraine, municipalities or listed companies and, invest into the real estate “in order to avoid losses”. Besides, government-owned banks are allowed to enter into active transactions with insiders. The affected banks are requested to provide the action plans for financial recovery by beginning of February 2015 the latest; NBU intends to approve such plans by 1 March 2015.

Taxation of Interest: Thin Capitalisation Rule

Borrowings and quasi-borrowings (*zapozychennia*) have now a simplified rule to cap a deductible interest in restated Article 140 (*Differences Arising from Financial Operations*). If the interest is owed to the non-resident affiliate, the amount of interest deductible from taxable corporate income will depend on the Debt-to-Equity ratio. If the debt exceeds the equity (at least) by 3.5 times, the interest is not deductible for the amount (positive value) calculated as EBITDA : 2 - Interest. For example, if the EBITDA is EUR 100,000 and the interest payable to non-resident affiliate is EUR 55,000, only EUR 50,000 can be deducted from the taxable base. Financial institutions and leasing companies can use leverage (debt-to-equity ratio) 10:1.

Disallowed interest amounts can still be carried forward to subsequent profitable periods but, in comparison to the previous rule, such amounts must be discounted by 5 per cent on the annual basis. We also note that before new law became effective, the Tax Code allowed additional deduction of the amount equal to the interest income received by the borrower.

The thin capitalisation rule motivates the companies to update the value of their equity; however, they do not reflect or limit the value of security received as in the laws of other jurisdictions, such as Hong Kong. Generally, adjustment to those factors can be made under the “arm’s length” rule - see the Tax section ‘*Transfer Pricing*’ of this newsletter for more details. However, the Tax Code can be amended to set the ratio or refer to industry risk management standards (e.g. NBU regulation on bank reserves) thereby promoting the use of equity in line with the practices of other states. Otherwise, the cap is easily circumvented through the back-to-back loans or non-transparent ownership structure of the lender.

Taxation of Interest: Income from Savings

In the night of 28 December 2014, the Verkhovna Rada revamped taxation of passive income. The list of passive income sources was significantly revised to include *any* interest, royalty and dividend. Effective as of January 2015, such income, particularly, bank deposits and royalties, will be taxed at the rate of 20 per cent (rather than 15 per cent introduced in March 2014). Please note that dividend on shares paid by Ukrainian issuers - both limited liability and joint-

stock companies - will be taxed at the 5 per cent rate; however, dividend payable by the mutual investment funds will still be taxed at 20 per cent.

Per Section 170.4 of the Tax Code a servicing bank is a withholding agent (*podatkovyi ahent*) for the purpose of taxation of interest and will deduct the tax upon accrual of interest on a monthly basis. In case a deposit agreement is early terminated the bank is supposed to make a re-calculation of taxes paid. The reporting to the fiscal service on the taxed interest and dividend is made on the aggregate basis (Sub-Section 170.4.2) so that the banking secrecy is not compromised.

Taxation of Currency Conversion

The law on Toll for the Mandatory State Pension Insurance was amended to repeal the tax on the non-cash purchase of the foreign currency; the purchase of the currency in cash by private individuals remains taxable but for the conversions necessary to repay the loans denominated in the foreign currency.

CORPORATE

The Law on Decrease of the Quorum of JSC

On 13 January 2014, the Parliament approved the law on decrease of the quorum for joint stock companies. The law has not yet been signed by the President and published.

According to publicly available information placed on the Parliament's web-site the quorum for joint stock companies with the state-owned share will be decreased to 50% + 1 vote, as soon as the law comes into effect. The decreased quorum will apply to all other joint stock companies starting from 1 January 2016.

ANTITRUST

Changes in Procedures of Authorization of Mergers and Concerted Actions

On 9 December 2014, the Antimonopoly Committee of Ukraine adopted Resolution No.612-r amending the Procedure for Obtaining Mergers Control Authorizations and the Procedure for Obtaining Authorizations for Concerted Actions. The important novelty is that publications on the official AMC website of respective AMC authorization decisions (or extracts therefrom) will have official nature. The AMC has the right to publish its decisions also in other printed or electronic media. ■

RESIDENT PARTNERS

BERTRAND BARRIER
barrier@gide.com

DR JULIAN RIES
julian.ries@gide.com

DR OLEKSIY FELIV
oleksiy.feliv@gide.com