



Tax and Legal Newsletter for August 2012

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Amendments to legislation

Cabinet of Ministers of Ukraine approves Procedure for calculating the adjusting coefficient applicable to rent payments in case of changes to oil, oil products, and ammonia transportation rates

On 1 August 2012 the Cabinet of Ministers adopted Resolution No. 687. It approves the Procedure for calculating the adjusting coefficient that applies to rent payments in case of changes to rates for transportation of one ton of oil via main pipelines and one ton of oil products via main pipelines; and for transit transportation of one ton of ammonia per each 100 kilometers of distance of the relevant route.

The Ministry of Economic Development and Trade will calculate the coefficient for each reporting period within three days after receiving the information about a change.

The determined value of the adjusting coefficient shall be published on the Ministry's official website on a monthly basis by the 10th day of the following reporting (tax) period. The Ministry shall also submit the relevant information to the Ministry of Finance and the State Tax Service of Ukraine (STSU).

The Resolution took effect on 8 August 2012.

Cabinet of Ministers of Ukraine approves Procedure for concluding and performing transfer pricing agreements

On 22 August 2012 the Cabinet of Ministers adopted Resolution "On Approval of the Procedure for Conclusion and Performance of Transfer Pricing Agreements for Tax Purposes" No. 787 (hereinafter - "Procedure No. 787").

Procedure No. 787 mandates that, to conclude an agreement, a large taxpayer must submit to the STSU the following documents:

- an application for conclusion of a transfer pricing agreement in the established form;
- two copies of the draft agreement in the established form;
- copies of the charter, the articles of association, supply agreements (with certain exceptions) and other agreements pursuant to Procedure No. 787;
- information on related parties according to the form approved by the Ministry of Finance.

The draft transfer pricing agreement should provide for the arm's length price method applicable to goods (works, services).

Under Procedure No. 787 the arm's length price of goods (works, services) shall be determined based on one of the methods envisaged by the Tax Code in the established sequence - each subsequent method may be employed only if the arm's length price cannot be determined based on the previous method.

We note that the mechanism for applying arm's length price methods envisaged by Procedure No. 787 does not comply with the Tax Code. The Tax Code does not oblige taxpayers to apply arm's length price methods in any sequence.

The Resolution takes force on 1 January 2013. This is also the date when Article 39 of the Tax Code, establishing the transfer pricing methodology and the procedure for applying the arm's length price, takes effect.

Cabinet of Ministers of Ukraine amends Procedure for VAT accumulation by agricultural enterprises

On 22 August 2012 the Cabinet of Ministers adopted Resolution "On Amending Resolution of the Cabinet of Ministers of Ukraine dated 12 January 2011 No. 11" No. 779. It amends the Procedure for VAT accumulation by agricultural enterprises in special bank accounts.

The Law of Ukraine "On Amending the Tax Code of Ukraine Regarding Improving Certain Provisions" dated 24 May 2012 No. 4834-VI amended the procedure by which agricultural enterprises accumulate VAT that is not payable to the state revenue but that remains fully at the enterprises' disposal. According to the amendments, agricultural enterprises will be able to accumulate VAT not only in special bank accounts but also in special accounts that they open with the treasury authorities.

To bring the Procedure for VAT accumulation by agricultural enterprises in special bank accounts in line with Law No. 4834-VI, the Cabinet of Ministers adopted Resolution No. 779. It took force on 31 August 2012.

Clarifications from the tax authorities

Tax authorities clarify approach to tax accounting of negative financial result

related to security and derivative transactions in 2012-2015

In its Letter No. 320/0/71-12/15-1217 dated 9 August 2012, the STSU has concluded that taxpayers should recognize only 25% of the negative financial result related to transactions with securities and derivatives declared as of 1 January 2012 in their corporate profit tax returns for 2012-2015 reporting periods (starting from 1st half 2012). This limitation applies only to taxpayers whose taxable income in 2011 exceeded UAH 1 million.

We have already commented on the validity of equating the negative financial result from security and derivative transactions to the negative corporate profit tax base in our Tax and Legal Newsletter dated 13 August 2012.

To reiterate, this STSU directed this Letter to the subordinate tax authorities for consideration for control and audit purposes.

State Tax Service of Ukraine clarifies procedure for completing VAT invoices in view of amendments to the Tax Code

The list of mandatory requisites for VAT invoices was expanded by the Law of Ukraine "On Amending the Tax Code of Ukraine Regarding the State Tax Service and In Connection with the Implementation of Administrative Reform in Ukraine" No. 5083-VI dated 5 July 2012 (effective starting 12 August 2012). In response to that development, the STSU has published Letter No. 1272/0/71-12/15-3117 of 21 August 2012 "On Supplementing Mandatory Requisites of VAT Invoices."

The STSU has stated that the additional mandatory requisites for VAT invoices (i.e. "the date and the number of the customs declaration which confirms the customs clearance of goods imported to the customs territory of Ukraine") should be indicated on invoices after the relevant central governmental body makes changes to the VAT invoice form and these changes take effect.

Tax authorities comment on VAT taxation of services rendered to a non-resident mobile operator

In its Letter No. 16165/7/15-3417-26 dated 11 June, the STSU clarified VAT taxation of services that are rendered by a Ukrainian resident to a non-resident mobile operator. Such services include:

- information technical support services,
- service support of mobile subscribers,

- promotion of the operator's products and services, and
- other services.

The STSU views the place of the above services supply to be determined under the general rule, under which the place of services supply is the place of the service provider's registration.

On this basis, the STSU concludes that information technical support services; services for arranging service support of mobile subscribers and for promoting products; services on the territory of Ukraine; and other services rendered to a non-resident mobile operator are subject to 20% VAT.

In our view, this conclusion is disputable and does not fully comply with the Tax Code, pursuant to which the place of supply for consulting services, data processing and consulting on informatization, provision of information and other services in the area of informatization is deemed to be the place where the service recipient is registered as a business entity.

State Tax Service of Ukraine expresses its vision for tax accounting of repair costs and expenses incurred from transactions with related parties

In August 2012 STSU Letter No. 12372/6/15-1216 dated 9 July 2012 became available in the public domain. The Letter clarifies the tax accounting of fixed assets repair and improvement costs and expenses incurred from the sale of goods to related parties.

Tax accounting of fixed assets repair and improvement costs

As follows from the Letter, taxpayers are entitled to choose one of the below options for tax accounting of fixed assets repair and improvement costs:

- to deduct repair and improvement costs in an amount not exceeding 10% of the total balance value of all groups of the depreciated fixed assets and to attribute the sum in excess to the relevant fixed asset undergoing repair or improvement;
- or
- to attribute total repair and improvement costs to the fixed asset undergoing repair and improvement even if the 10% limit was not used in full.

We note that the Tax Code does not expressly entitle the taxpayer to apply the second option for

tax accounting of fixed assets repair and improvement costs.

Tax accounting of expenses incurred from sale of goods to related parties

The STSU opines that expenses incurred from the sale of goods to related parties should not exceed sales income and may only include the cost of sales net of other expenses (in particular, distribution expenses).

We believe that the STSU's conclusion that "expenses incurred from the sale of goods" should include only the cost of sales does not fully comply with the Tax Code's provisions, whereby the cost of sales is understood as expenses directly related to production and/or acquisition of goods, but not to their sale.

By their definition and economic substance "expenses incurred from the sale of goods" should, in our view, qualify as distribution expenses that, inter alia, include "expenses related to the sale of goods."

Draft tax legislation amendments

Draft amendments to the Tax Code of Ukraine proposed, providing for implementation of a range of tax system reform initiatives

We have obtained draft changes to the Tax Code of Ukraine (the official publication and discussion of which have not yet started) ("Draft") that provide for implementation of a range of tax reform initiatives.

Inter alia, the Draft envisages:

- Introduction of additional VAT (a turnover tax, in reality);
- A progressive scale for personal income tax;
- Abolishing numerous VAT and CPT incentives;
- Changing the VAT refund procedure;
- Lowering the unified social tax rate and simultaneously abolishing the maximum tax base for the unified social tax;
- A duty on obligatory state pension insurance for foreign currency exchange.

This Newsletter will offer you an overview of the major changes the Draft envisages.

VAT at an additional rate ("turnover tax")

The Draft introduces VAT at an additional (separate) rate, which in substance constitutes a turnover tax.

All VAT-able transactions will be subject to this tax.

The turnover tax will be introduced on 1 January 2013. It will be 2.5% until 30 June 2013; from 1 July 2013 it will be 2%.

The turnover tax should be added to the value of goods/services. It will be deductible for corporate profit tax purposes.

Miscellaneous changes to VAT

The Draft envisages that VAT refund for tax periods before 1 January 2013 is to be conducted via the issue of domestic government bonds.

Changes to PIT rates

The Draft establishes the following scale for personal income tax (PIT):

- If the PIT base does not exceed 20 minimum wages in the calendar month, the PIT rate will be 10%;
- If the PIT base does not exceed 30 minimum wages in the calendar month, PIT will be 15% on monthly income in excess of 20 minimum wages;
- If the PIT base exceeds 30 minimum wages in the calendar month, PIT will be 20% on the amount exceeding 30 minimum wages.

The minimum wage as of 1 January of the year in question should be used in order to calculate PIT base.

Changes to the unified social tax regime

The suggested amendments to the Law of Ukraine "On Collection and Accounting of the Unified Tax for Obligatory State Social Insurance" provide for the following changes:

- Establishment of a blended 15% unified social tax rate;
- Abolishment of the maximum value of the base for assessing the tax and application of the tax rate to the appropriate base without restrictions.

Duty on obligatory state pension insurance for foreign currency exchange

The Draft amends the Law of Ukraine "On the Duty on Obligatory State Pension Insurance" and establishes a duty for purchase of foreign currency.

- Payers of this duty shall be legal entities that purchase foreign currency with Ukrainian hryvnyas;
- The duty rate is 3%;
- The duty is levied on transactions to purchase foreign currency for acquisition of goods and/or repayment of loans that were used to acquire goods;
- The charge is not assessed in cases of “redemption of foreign currency which was received as currency proceeds and sold to meet the requirement of the National Bank of Ukraine.”
- Import and supply of machinery, equipment and facilities defined by the Law of Ukraine “On Alternative Kinds of Fuel” (paragraph 2 of subsection 2 of section XX);
- VAT exemption for the aircraft industry (paragraph 4 of subsection 2 of section XX);
- VAT exemption for the publishing industry (paragraph 5 of subsection 2 of section XX);
- VAT exemption for national film production and distribution of national films and Ukrainian-dubbed films (paragraph 12-13 of subsection 2 of section XX);
- VAT exemption for transactions on supply (including import) of waste and ferrous and non-ferrous metal and wood scrap (paragraph 23 of subsection 2 of section XX).

The wording of some of these provisions is obscure. Editorial changes are required to make clear the authors' proposals.

Abolishment of tax incentives

The Draft abolishes numerous VAT and CPT incentives.

Below are the most important incentives that will be abolished.

VAT:

- Supply of infant food (197.1.1.);
- Supply of dwelling (197.1.14.);
- Granting charity aid (197.1.15.);
- Supply of payable state services to individuals or legal entities (197.1.18.);
- Supply (subscription) of periodical publications in printed media and book form (197.1.25.);
- Supply of pharmaceuticals (197.1.27.);
- Transactions involving import of cultural values into the customs territory of Ukraine (197.7.);
- Transactions of banks and other financial institutes on supply of pledged (mortgaged) property obtained from persons that are not VAT-payers (197.12.);
- Transactions of banks involving sale (transfer) or purchase of deposit liabilities (197.13.);
- Transactions involving import into the customs territory of Ukraine of facilities that work using renewable energy sources, energy saving equipment and materials, facilities, components used for manufacturing appliances that work on renewable energy, energy saving equipment, etc. (197.16.);
- The specifics of VAT payment by processing entities are abolished (paragraph 1 of subsection 2 of section XX);

Abolishment of CPT incentives is envisaged for the following:

- For biofuel manufacturers - exemption for profits from the sale of biofuel (paragraph 15 of subsection 4 of section XX);
- For profits from generating energy with the help of biofuels (paragraph 15 of subsection 4 of section XX);
- For profits of manufacturers of machinery, equipment and facilities defined by the Law of Ukraine “On Alternative Kinds of Fuel” (paragraph 15 of subsection 4 of section XX);
- For profits from rendering hotel services (paragraph 17 of subsection 4 of section XX);
- For profits from the main activity of light industry entities (paragraph 17 of subsection 4 of section XX);
- For profits from the main activity of electro-energy entities that produce electric energy exclusively from renewable sources (paragraph 17 of subsection 4 of section XX);
- For profits from the main activity of shipbuilding industry entities (paragraph 17 of subsection 4 of section XX);
- For profits from the main activity of aircraft industry entities and from their performance of research scientific and research design works (paragraph 17 of subsection 4 of section XX);
- Abolishment of incentives for publishing houses, publishing organizations and cinematography and multiplication entities (paragraph 18-19 of subsection 4 of section XX).

Two drafts of amendments regarding transfer pricing issues are proposed

We have obtained two substantively similar drafts of amendments (the official publication and discussion of which have not yet started) proposed by the Ministry of Finance and STSU respectively. These aim to regulate transfer pricing matters (hereafter collectively referred to as “the Drafts” and separately as “the Draft”).

The Draft that the Ministry of Finance has suggested proposes to change the Tax Code directly. The STSU’s draft provides for the adoption of a separate law; this, however, does not exclude changing the Tax Code.

Although these Drafts vary to a certain extent, they duplicate each other in a number of provisions.

In this Newsletter, we offer you a brief overview of these Drafts’ essential provisions.

Specifically, the Drafts provide for:

- A procedure for determining controlled transactions;
- Broader definition of related parties;

- Five principal methods for determining the arm's length price;
- A determined list of information sources used for determining arm's length prices;
- Mandatory submission of reports on controlled transactions/records on monitoring of agreements and provision of other information on controlled transactions;
- Procedure for proportional adjustment of tax indicators;
- Agreeing with the tax authorities prices for controlled transactions/concluding transfer pricing agreements;
- The grounds and procedure for investigating controlled transactions and conducting transfer pricing audits.

We will not at this time make technical comments on the Drafts, as they may be subject to material amendments in the course of their preparation for adoption by the Verkhovna Rada.

We will keep you updated on further progress in this area.

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