



Vladimir Didenko, partner at Magisters

Experts can help taxpayers find ways to minimize burden

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Ukraine's complicated tax laws mean companies need experts to guide them through the maze

It's no secret that Ukraine's tax system is one of the most burdensome in the world. According to the World Bank's Doing Business 2010 report, Ukrainian companies spend, on average, more than 700 hours per year on payroll tax compliance – almost four times more than in the United States and two times more than in Russia.

Tax planning for private individuals is becoming more and more of a challenge, given increasing global mobility and Ukraine's vague tax law environment. The situation also became more difficult with recent changes in the Ukrainian tax authorities' approach towards taxing foreigners in Ukraine.

But for every problem, there is a solution, lawyers insist. Tax optimization remains one of the leading practices for law firms and business consultancies. For a fee of Hr 1,000 to 3,000 euros, depending on whether it is a small local law firm or an international market leader, lawyers advise on how to optimize an individual's tax burden.

A lot of tax optimization schemes focus on tax residential status in Ukraine. Ukrainian tax residence status allows an individual to benefit from a more favorable tax rate, at 15 percent, in contrast to the 30 percent tax rate that non-residents face. To obtain Ukrainian tax residence status became much harder last year, however.

“The procedure for obtaining tax residence status became burdensome, and is sometimes almost impossible to complete,” says Dina Bokatova, tax and legal consultant for Ernst & Young Ukraine, one of the Big Four international accounting giants.

The Ukrainian tax authorities have recently made many changes to how they tax foreigners in Ukraine. A number of clarification letters were issued, only to be subsequently cancelled, meaning that the law “On personal income tax” now solely regulates the procedure for obtaining tax residence status. That law, however, Bokatova says, “can be ambiguous, meaning that we can expect new legislation from the tax authorities regarding taxing foreigners in Ukraine.”

In practice, the tax authorities tend to treat foreign individuals as Ukrainian tax residents only after they physically spend 183 days in Ukraine during a calendar year and can prove it.

Vladimir Didenko, partner for Magisters, one of the leading Ukrainian law firms, says there are many ways an individual can use his residency status to minimize taxes legally. “Classical tax optimization presumes that on the basis of the law it is possible to organize a deal in different ways, and the financial result of these deals will differ significantly,” he explained.

Take, for example, the transfer of property between relatives. If a citizen of Israel, a non-tax resident of Ukraine, gives his house in Odesa as a gift to his son, a citizen of Germany, then the son would have to pay tax at 15 or 30 percent, depending on his residential status in Ukraine. But if both citizens gain the status of a resident of Ukraine before the deed of conveyance is signed, the taxation rate of the gift would be 0 percent.

Another example is selling a business. If a citizen of the Netherlands founded a business in Ukraine with the aim of selling it to a strategic investor in 3-5 years, then the taxpaying scenario would be the following, Didenko said. If a citizen owns the shares of this company directly, after selling them he would have to pay 30 percent as a non-tax resident or 15 percent as a tax resident from the investment income, which is a difference between selling price of shares and the initial purchase price. If the ownership is transferred through international, offshore companies, a citizen won't be obliged to pay taxes in Ukraine after selling shares.

Ukrainians moving abroad can also take advantage of the difference in rates. One example is a Ukrainian citizen who plans to sell both of his cars – an expensive Mercedes and a more modestly priced Ford Fiesta – upon moving to Italy. If this individual sells both cars in the same calendar year, first the Ford and then the Mercedes, he would have to pay 1 percent on the first sale and 15 percent on the second. If the sale takes place after the change of tax status to non-resident, the rate of tax will be 30 percent of the selling price.

To minimize losses, it is sensible to sell the cars in different calendar years, while keeping tax residential status, Didenko said. If there is no possibility to wait, it is best to first sell the expensive car at the 1 percent tax rate, and then sell the cheaper one at a tax rate of 15 percent.

One piece of bad news, particularly for small businesses, is a number of draft laws recently registered in parliament. Some of them aim to tighten the simplified system of taxation, which allows individuals and companies to pay a single tax rate. Others laws provide for the introduction of taxes on luxury goods. The aim, experts say, is to fill the budget gap.

“The simplified system of taxation will become tougher in the near future,” says Svitlana Musienko, head of the tax practice at the Kyiv office for law firm DLA Piper. “Judging by the concept which the State Committee for Regulatory Policy and Entrepreneurship posted on its website, they are going to tighten the screws,” Musienko says, meaning that many will have to pay more taxes in Ukraine.

Oksana Faryna can be reached at faryna@kyivpost.com

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