



Volodymyr Kotenko, tax and legal partner at Ernst & Young

Ways exist to minimize taxes without becoming scofflaws

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Ukraine's heavy tax burden drives companies to pay less and there are legal ways of doing so

Ukraine's heavy tax burden drives most companies to look for ways to pay less.

For some this means simply evading taxes in violation of the law, others find legal ways to ease the load.

Industry experts say that nearly 40 percent of Ukraine's economy lives in the shadows, but that the government remains more concerned about how to fill in fiscal gaps using taxes and duties than by shining a light in the darkness. This is an impulse for those businesses wanting to work legally to strive even harder to optimize taxes.

Each company naturally wants keep their incomes either invested into operations or taken for profits. But taxation insiders say there is a very thin line between optimization and evasion. There is always a choice between hiding incomes and attempting to make tax payment more efficient.

"For companies with high moral standards, there is no such question," says Volodymyr Kotenko, taxandlegalpartner withErnst & Young, one of the Big Four international accountancy and professional services firms. "Everybody can complain about high taxes, but the best companies should pay all of them, while looking to benefit from available legal tools for tax optimization."

In the most recent Doing Business report by the World Bank, Ukraine ranked 181st for ease of paying taxes. Such a low rank is not only a signal that Ukraine's tax system and legislation needs an overhaul, but also a push for businesses to find ways to optimize their taxes.

Apart from imperfect legislation, it is difficult for businesses to count taxes, time-consuming and tiring to report taxes because of bureaucracy and also extremely difficult to communicate with officials in tax inspectorates, explains Kotenko.

The economic downturn cut into company earnings, and, in turn, tax receipts. But this only led tax officials to further squeeze businesses. As a result, it forced businesses to take a hard look at their expenses on taxes and strive for optimization.

"Currently, the most popular areas for tax optimization are salary taxes and value added tax," says Yaroslav Huseynov, manager of the tax department at PricewaterhouseCoopers, another of the Big Four.

"The employer has to bear the cost of paying from slightly under 37 percent to as much as 50 percent of the gross salary to social funds, in addition to levying from the employee's salary-related income of up to 3.6 percent and 15 percent of an individual's income tax., The total may come to as much as 68 percent of extra payment each month," said Hennadiy Voitsitskiy, partner at Baker & McKenzie law firm.

The most popular solution to this problem is simple evasion where the salary is declared at a very low level and the rest paid in an envelope.

A legal way to pay less tax is for employees to register themselves as private entrepreneurs, as a result paying a single fixed tax and working for a company as contractors. But this person often works under the same conditions as a fulltime employee, receiving paid vacation and other benefits.

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Voitsitskiy suggested that one solution to bring pay out of envelopes and onto the books would be a single tax on salary that would be regressive – the higher the salary, the lower the tax.

One of the most painful taxes for business is the 20 percent value added tax charged upon each sale of a good, better known as VAT. Optimizing this tax can be done within a big holding company by taking advantage of a refund through a complex scheme of intermediaries.

The leaders in tax optimization are Ukrainian private and publicly traded companies that are committed to transparency in their balance sheets.

Multinational and foreign companies don't use tax optimization widely, as basic tax rates are far more modest than in many other European countries. In Ukraine a company is obliged to pay 25 percent profit tax while individuals typically pay 15 percent.

"If such companies saved on taxes in Ukraine, they would have to pay in their home jurisdiction, where taxes are often higher," says Voitsitskiy of Baker & McKenzie.

For export companies the best way for optimizing taxes is to sell their goods from Ukraine at the lowest possible margin, preferable to a company registered in an offshore jurisdiction, which then sells the goods on. The margin covers basic expenses in Ukraine while the rest of profit from further sales is gained by the offshore reseller.

"In this case, it is very important to work with reputable offshore jurisdictions, those that are not on the list of offshore jurisdictions not approved by the government," advises says Igor Grygoriev, an associate at Volkov Koziakov&Partners law firm.

Companies that import goods to Ukraine suffer from the highest tax rates in customs duties and when selling their goods within the country. The main instrument for optimization in this case is to put the price for imported goods as low as possible if these goods require customs and excise duties. For goods that do not require duties, like medicine, the opposite is the rule: high import prices and lower margins, which are taxed.

Companies that have successfully placed shares on a foreign exchange and want to transfer the raised funds to the operating units of the group in Ukraine have two main options to optimize taxes. They can either make an equity injection, or lend funds to the operating companies at interest. The latter, according to Kotenko, is more advantageous tax wise.

In some areas, however, there are few opportunities for optimization. The government has made recent moves to increase excise duties on petrol, spirits and tobacco, as well as tax on land use and natural resources such as water.

Should this happen, the businesses would have to build that additional tax burden (or a part of it) into the price.

“Duties for surface usage and excise taxes are not areas where effective optimization structures can be utilized,” said Huseynov from PricewaterhouseCoopers.

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