ANTI-BEPS PACKAGE LAW OF UKRAINE: KEY TAKEAWAYS

Following the global trend for tax transparency and fighting harmful tax practices, Ukraine finally adopted its own anti-BEPS package law, known by businesses and tax practitioners as "tax bill 1210". Asters selected the key takeaways for businesses operating across the borders.

The law is in effect starting from 23 May 2020 with some provisions taking effect later.

I. CONTROLLED FOREIGN COMPANY (CFC) RULES

CFC rules are introduced to affect outbound investment by wealthy Ukrainians and undistributed profits kept on accounts of foreign entities.

Ukrainian tax resident company or individual owning shares in foreign companies (interest in foreign trusts etc.) will be required to pay tax at 18% and 19.5% rates respectively on undistributed foreign profits earned by their controlled foreign companies ("CFCs").

As a first step, Ukrainian taxpayers will be required to disclose all their foreign companies to Ukrainian tax authorities. Second step will be to pay tax in Ukraine on CFC's profits, if (1) CFC is based in a low tax jurisdiction (profit tax of 13% or less), and (2) 50% or more of income is passive income as opposed to active trading income, or (3) CFC is based in country not having tax treaty with Ukraine.

No Ukrainian tax shall be paid on total income of CFCs up to EUR 2 mln. per annum.

Effective date: 1 January 2021 (postponement possible). CFC rules are expected to apply to profit earned starting from 2021, but there is an expectation that these rules could be postponed at least until enactment of tax amnesty law.

For more information on new Ukrainian CFC rules please click here

II. WITHHOLDING TAX (WHT) AND DOUBLE TAX TREATIES

2.1. Principle purpose test (PPT)

Under new principle purpose test (PPT), the tax treaty benefits such as exemption or lower rate of Ukrainian 15% WHT shall not apply to payments of income by Ukrainian payor to foreign recipient, if obtaining tax benefit under the tax treaty was the main purpose for the underlying transaction.

Effective date: 23 May 2020

2.2. Beneficial Owner

Another criterion for zero or lower WHT is that foreign recipient of income paid from Ukraine is a "beneficial owner of income", rather than mere intermediary or conduit company. The definition of "beneficial owner" is significantly expanded with a focus on the recipient having proper level of substance in the country where it is registered (i.e. employees with proper qualifications, other assets and resources, own capital etc).

As a positive development, Ukraine adopts a "look through" approach for situation where there is an intermediary between Ukrainian payor of income and foreign beneficial owner. The tax treaty with country of intermediary's residence cannot apply, but instead there is a possibility to apply tax treaty with country of residence of the beneficial owner.

Effective date: 23 May 2020

2.3. Constructive dividends

Under a new concept of "constructive dividends", if any payment by Ukrainian company for goods or services to a related foreign entity or entity from low-tax jurisdiction exceeds the arms' length price, then any excess may be treated as payment of dividends and subject to standard 15% WHT or lower
WHT rate under tax treaty. Share repurchase, capital reduction and similar transactions between Ukrainian company and its foreign shareholder leading to hidden distributions of accumulated profits may have the same tax effect.

**Effective date: 1 January 2021**

2.4. Indirect disposals of Ukrainian real estate

Tax is introduced on indirect transfer of Ukrainian real estate where instead of buying property directly in Ukraine and paying profit tax on sales proceeds, the sale was structured as the sale of shares in a foreign company owning directly or indirectly such Ukrainian real estate.

Capital gains realized from the sale of shares in foreign companies owning directly or indirectly Ukrainian real estate will now be taxable in Ukraine even if both seller and buyer are foreign companies. The tax must be paid by Ukrainian permanent establishment of a foreign seller of shares, and if there is no such permanent establishment – then tax must be paid by the foreign buyer who must be registered for tax purposes in Ukraine and pay the tax prior to the purchase transaction.

**Effective date: 1 July 2020**

### III. CORPORATE PROFIT TAX

3.1. Business purpose test

Ukrainian companies are disallowed to deduct expenses on cross-border transactions lacking "business purposes". The burden to demonstrate lack of business purpose is on the tax authority.

The wording of the test is very close to **principle purpose test (PPT)** discussed above in relation to WHT, and includes "tax avoidance motive" for the transaction (i.e., if the "main or one of the main motives for transaction is tax underpayment" the deduction is disallowed) as well as transfer pricing aspect ("in comparable circumstances this taxpayer would not be ready to enter into similar purchase or sale transaction with unrelated party").

**Effective date: 23 May 2020**

3.2. Thin cap rules for interest deduction tightened

Amended thin capitalization rules further limit the deductibility of interest on foreign loans:

1. limitation applies if amount of the foreign loans received by a Ukrainian company (previous – only foreign loans from related parties) exceeds 3.5 times its net assets;

2. deduction of interest is limited to 30% of Ukrainian company's tax base for profit tax for current period (previously – 50% of EBITDA).

**Effective date: 1 January 2021**

### IV. FOREIGN COMPANIES OPERATING IN UKRAINE DIRECTLY

4.1. Permanent establishments (PE) of foreign companies

PEs are now required to calculate their profits only using direct method of calculation plus "arm's length" adjustments. The "split balance sheet" and "notional margin" methods are no longer available. PE definition is clarified and expended to included additional situations where PE may arise.

Tax office is now granted authority to audit and make assessments against unregistered permanent establishments of the foreign companies.

**Effective date: 23 May 2020**
4.2. Foreign company as Ukrainian tax resident

A foreign company with no registered presence in Ukraine can be treated as Ukrainian tax resident and pay Ukrainian corporate profit tax if its place of effective management is in Ukraine. Even if the company has place of management in the other country, it can be treated as Ukrainian tax resident provided that (1) its bank accounts are managed from Ukraine, (2) accounting is arranged from Ukraine; (3) employees are managed from Ukraine. Foreign company can be treated as Ukrainian tax resident, if relevant criteria are met.

Once treated Ukrainian tax resident, a foreign company is no longer be considered CFC under CFC rules.

Effective date: 1 January 2021