Ukraine: New and improved Draft Tax Code

The latest news on the legal front is that the Ukrainian Government approved the Draft Tax Code ("Draft Code") of Ukraine, which passed the first reading in Parliament on June 17, 2010. As is usually the case with new laws, the Draft Code provides certain novelties that appear both interesting and disturbing for foreign investors and Ukrainian businessmen alike.

Firstly, the good news: the Draft Code decreases the profit tax from 25 percent to 17 percent, as well as abolish 10 local taxes and duties. There will now be four mandatory taxes on land, immovable property, advertising and trade patent; the rest of the taxes and duties will be deducted at the discretion of the municipal administration. As always, we note a significant risk that the discretion of the local administration may become excessive (after all, the main goal of local tax administrations is to fill their quotas).

Secondly, the Draft Code provides for the introduction of tax holidays for small-scale businesses. These holidays call for a 0 percent unified tax for certain categories of private entrepreneurs who carry out commercial activity in the sphere of consumer services and render personal services with revenue not exceeding UAH300,000 per annum, as well as for legal entities with an income that does not exceed UAH100,000 per annum. If ultimately implemented, such tax holidays will run from January 1, 2011 until December 31, 2015. Thirdly, and perhaps most importantly, development concerns all legal entities with revenues of up to UAH2.7 million per annum who should apply for a unified tax rate of only six percent.

The bad news is the increase in the personal income tax rate. The Draft Code increases the income tax of persons whose monthly income exceeds UAH13,000, placing this category of taxpayers under the 20 percent rate. This increase answers the question of whether there will be a return to the glory days of receiving salaries via "black cash envelopes" rather than the more recent push by employers towards fully legalising salary payments. Therefore, while an increase to 20 percent was intended to put money into the state's pocket, it may result in just the opposite.

Further, the Draft Code proposes an introduction of a five percent tax on income from deposits and savings on current and bank-card accounts. Clearly, the legislators are trying to find ways to replenish the Ukrainian budget. However, taking into account that the majority of the deposits are merely savings of average citizens rather than significant contributions from principal investors, this measure may lead to further mistrust in the banking system and deterioration in banks' relationships with their core customers.

However, after the Draft Code passed the first reading, the business community in Ukraine raised several questions about the draft's imperfections, which seem to be ineffective in light of their practical implementation, including the issues mentioned above. In fact, more than 5,000 amendments were initially provided to the working group which elaborated the Draft Code. Currently, all modifications to the Draft Code have been consolidated, collected and unified into 550 amendments. According to the decision of the Parliament Committee on Tax and Customs Policy, the working group will coordinate activities around public discussion of the Draft Code to ensure smooth work and efficient preparation of the Draft Tax Code to be returned to the Parliament before September 5, 2010.

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