

# *Tax Newsletter # 1*

## *Changes to the Tax Code – 2017: Corporate profit tax and TP rules*

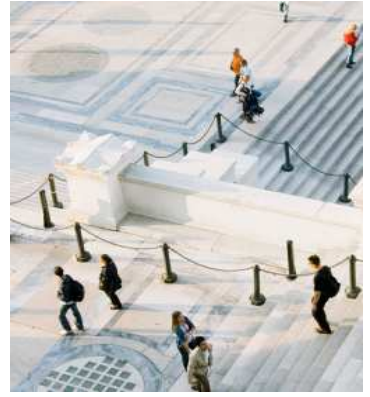
10 January 2017



# Changes to the Tax Code - 2017

In December 2016 Verhovna Rada of Ukraine adopted laws\* amending the effective Tax Code of Ukraine.

Below is a summary of the most significant changes in Corporate profit tax and Transfer pricing that are become effective on January 1, 2017\*\*.



## I. Corporate profit tax (CPT)

### Tax rate, incentives and benefits

- The general tax rate remains at the level of 18%. Principles of tax base calculation remain unchanged.
  - Crediting of tax on immovable property other than land against CPT liabilities is abolished (starting from 2017 reporting year).
  - A special 5% withholding tax rate on Eurobond yield is introduced.
  - “Tax holidays” until 2021 are introduced for taxpayers with annual income less than UAH 3 million provided they meet the requirements on (i) payroll amount (not less than two statutory minimum wage monthly per each employee), (ii) defined average number of employees in the previous periods (for the entities established prior to January 1, 2017), and (iii) are compliant with limitations on types of activities (according to the specific list).
  - The application of a reduced statutory minimum useful life to machines and equipment purchased during the period between January 1, 2017 and December 31, 2018 year is allowed, on the condition that the taxpayer employs such assets in its business activity and applies the straight-line method of depreciation thereto.
  - It is stated that if the amount of paid advance CPT payment on dividends distribution exceeds the amount of the accrued CPT of the taxpayer-issuer of corporate rights, the excess amount will be applied to reduce the taxpayer’s CPT obligations in the following periods. In case the taxpayer suffers losses the said amount will be applied to reduce the CPT obligations in the following periods until it is fully utilised. Collective investment schemes are released from such advance payments.
- ✓ residual value of written-off non-production equipment and intangible assets as per accounting data;
  - ✓ expenses on repairs and reconstruction of non-production fixed assets and intangible assets;
  - ✓ non repayable financial aid (goods, services), which was provided free of charge for the benefit of its recipients (other than duly registered non-profit organisations) that are not CIT-payers or which are taxed at 0% CPT rate;
  - ✓ losses from fines, penalties, forfeits, which were accrued in accordance with civil legislation for the benefit of entities that are not CIT-payers (except for private individuals), or which are taxed at 0% CIT rate;
  - ✓ income received as payment for goods (works, services) shipped (provided) while the taxpayer used the simplified tax system.
- From now on it is established that:
    - ✓ “thin capitalization” rules apply to interest accrued under debts **only** from non-resident related parties;
    - ✓ revenues and expenses included in the taxable income of a taxpayer before January 1, 2015 and reflected in the financial statements after January 1, 2015 according to the accounting rules, should not be **doubled** in the tax base, thus such amounts decrease (for income) or increase (for expenses) net profit before tax;

### Tax differences

- Starting from the 2017 year activities results, net profit before tax is increased by amount(s) of:

\* Law of Ukraine “On changes to the Tax Code of Ukraine regarding improvement of investment climate in Ukraine” # 1797-VIII dated 21.12.2016 and Law of Ukraine “On changes to the Tax Code of Ukraine regarding securing of budget revenues on 2017” # 1791-VIII dated 20.12.2016.

\*\* For certain provisions special enforcement period shall apply (see in the text of this newsletter).

- ✓ the net profit before tax can be reduced by the amount of written-off debts that qualify as bad debts under the Tax Code (including the write-off, performed within the amount of bad debts provision).
- Royalties paid to non-beneficial owners and in other special cases (see para. 140.5.7 of the Tax Code) are no longer deductible at all (even if the payments satisfy the “arms length” criteria). This limitation does not apply when beneficial owner grant the right to receive the royalties to other parties.

### **Taxation of banks and insurance companies**

- Disputed issues regarding the creation and use of loan loss provisions (“LLPs”) have been resolved to a degree. In particular, starting from January 1, 2017:
  - ✓ the credit risk criteria for the calculation of LLPs of banks and financial institutions no longer applies;
  - ✓ the application of the 25% limit for calculation of tax deductible LLPs is extended additionally for the period of January 1, 2016 to January 1, 2018;
  - ✓ loans (in part or in whole) in arrears for more than 360 calendar days can be declared as bad and written-off as such by reducing LLPs, except debts of related parties or those of current and/or former employees of the creditor.
- Insurance contributions, premiums and payments, received under reinsurance agreements are not to be included into the tax base of the insurer that is subject to 3% tax on revenue.

## **II. Transfer Pricing**

### **Controlled transactions**

- The value criteria for recognizing transactions as controlled were increased as follows:
  - ✓ annual income – UAH 150 millions;
  - ✓ The value of transactions with a single counterparty – UAH 10 millions.
- The list of controlled transactions for TP purposes was expanded, in particular, the following transactions were added:
  - ✓ foreign economic transactions involving purchase of goods/services through non-resident commissionaires;
  - ✓ transactions with non-residents that do not pay CPT (corporate income tax) and/or which are

not tax residents of the state where they are registered as legal entities (the list of such legal organizational forms of non-residents will be approved by the Cabinet of Ministers of Ukraine).

- Transactions with a resident of the state, which is included in the list of countries (territories) determined by the Cabinet of Ministers of Ukraine, are considered to be controlled from January 1 of the fiscal year following the year of placement of such state in the above-mentioned list.
- It is clarified that the transaction is considered as controlled in cases of occurrence of chain transactions in respect of not only the transfer of ownership rights on a subject of the transaction, but also its result.
- Criteria for grouping several controlled transactions for TP purposes have been prescribed.

### **Economic analysis**

- The list of information sources for the TP purpose was supplemented by the following paragraphs :
  - ✓ other sources from which information was received by the taxpayer in compliance with the law, if such information was provided to the tax authorities,
  - ✓ information received by the tax authorities under international agreements concluded by the Parliament of Ukraine.
- In order to calculate the profitability range when using multiple tax periods, it is required to use the weighted average rate of profitability.
- It is possible to determine the profitability rates on the basis of the financial information of the legal entities in case of the absence or lack of information on specific comparable noncontrolled transactions, also have been introduced the selection criteria for such entities.
- It is possible to use forwards or futures exchange quotations for the certain goods for the decade preceding the date of conclusion of the respective forward or futures contract and forward or futures prices closest to the date of the relevant futures or a forward contract date (for goods that do not have stock quotes), if the taxpayer notifies the State Fiscal Service of Ukraine about the conclusion of such contracts in a respective way.

### **TP report submission and self-adjustment**

- The deadline for submitting the report on controlled transactions has been changed to October 1 of the year following the reporting one.
- Self adjustments can be made to maximum or minimum values of the range of prices (profitability), not to the median, as it was previously envisaged.

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- If the specifying calculation to the CPT declaration for the previous (reporting) year with the purpose to make relevant self-adjustments until May 1 of the year following the reporting submission, a penalty in the amount of 3% is not applicable.

## TP documentation

- The list of information that must be included in the TP documentation was expanded, in particular:
  - ✓ information on entities, corporate rights of which 20 percent or more are owned by the taxpayer either directly or indirectly;
  - ✓ information on entities, which the taxpayer provides with local management reports (names of the countries in which these entities hold their head offices);
  - ✓ description of the management structure of the taxpayer, its organizational structure scheme;
  - ✓ information about the taxpayer's participation in business restructuring or transfer of intangible assets during the reporting or preceding year, with an explanation of the aspects of those operations that had or still have an impact on the operations of the taxpayer;
  - ✓ copies of the agreements (contracts);
  - ✓ information about the payments actually made in the controlled transaction (amounts and currency of payment, date, payment documents);
  - ✓ description and calculation of comparability adjustments of terms and financial results in a controlled and not controlled transaction;
  - ✓ description of an algorithm of allocating supplier's costs incurred during the performance of the transactions that are considered when calculating the profit level indicator.

## Tax audits on TP issues

- From now on the only grounds for a TP audit can be (1) filing TP documentation, or (2) non submission or submission with infringements of the report on controlled transactions or TP documentation.

## Penalties for violations of TP legislation

- Base for calculation of penalties for non-compliance with TP legislation was changed from the statutory minimum wage, which is UAH 3,200 as at January 1 2017, to the subsistence minimum (SM), which is equal to UAH 1,600 as at 1 January 2017.
- New penalties were added, including :
  - ✓ in case of non submission of the report on controlled transactions (specifying report) and/or TP documentation within 30 calendar days following the last day of the fine (for non submission of the report on controlled transaction/TP documentation) - 5 SMs for each calendar day;
  - ✓ 2 SMs for each calendar day, but no more than 200 SMs - in case of late submission of TP documentation;
  - ✓ 1 SM for each calendar day, but no more than 300 SM - in case of late submission of the report on controlled operations or late declaration of the controlled transaction in such report when submitting an adjusting report.