NEW TAXATION TRENDS FOR UKRAINE ON ITS WAY TO THE EU

Kyiv, 26 September 2014

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International Tax
The political chapter of the EU-Ukraine Association Agreement was signed on 21 March 2014.

The remaining Deep and Comprehensive Free Trade Area (DCFTA) section was signed on 27 June 2014.

To take a full legal effect, the deal has to be ratified by 28 EU member states (so far it has been ratified in 6 member states).
Ukraine has a tax system, which according to its structure is similar to the tax system in the EU, but has significant drawbacks and hampers the development of businesses and consumer demand.

Nowadays, Ukraine’s tax system includes these **main taxes** and mandatory payments:

**Number of Taxes**

- Corporate Income Tax
- Value-Added Tax
- Personal Income Tax
- Unified Social Tax
- Military Tax
- Excise Duty
- Customs Duty
- State Duty
- Land Tax
- Vehicle Owners’ Tax
- Payment for license/patent
- and more 11 taxes

**Germany and Holland** – 9

**China and France** – 7

**Norway and Sweden** – 4

**Ukraine** - 22
On 5 March 2014 the European Commission agreed on a financial assistance package for Ukraine of at least **EUR 11 billion** in loans and grants from the EU budget and EU financial institutions, to:

- Stabilize Ukrainian economic and financial situation
- Support transition
- Encourage political and economic reforms
- Support inclusive development

Financial assistance from the EU budget could amount to approximately EUR 3 billion for 2014-2020.
Highlights

- **EUR 3 billion** from the EU budget in the coming years
- **EUR 1.6 billion** in macro financial assistance loans (MFA)
- **EUR 1.4 billion** – an assistance package of grants
- Up to **EUR 8 billion** from the European Investment bank and the European Bank for Reconstruction and Development
- Potential **EUR 3.5 billion** leveraged through the Neighborhood Investment Facility
Until the **end of 2014** Ukraine with the help of EU Support Group (which was created on 09 April 2014 by European Commission) should stabilize its fragile situation by the means of:

- Planning and implementation reforms to boost growth
- Identify reform priorities

The medium term goal **(from 2015)** of the Support Group will be to further support of Ukraine in the elaboration and implementation of comprehensive reform programs.

The work of Support Group is based on “EU–Ukraine – European Agenda for Reform”
The main short and mid terms goals for Ukraine according to the European Agenda are as follows:

- Economic stabilization
- Improvement of business and investment climate
- Agricultural competitiveness
- Land reform
- Establishment of anticorruption authority
- Improve the business environment of companies
- Reform of the electricity and coal sectors
- Implementation of Visa Liberalization Action Plan
- Judiciary reforms

- Reform of the civilian security sector
- Protection of minorities
- Constitutional reform
- Energy security
- Membership in the Energy Community
- Renewable energy development
- Radioactive waste management
- Signature and implementation of EU-Ukraine Common Aviation Area Agreement
- Improve scientific, technological and innovative cooperation
- Academic cooperation, student and staff mobility etc.
Financial aid already received

<table>
<thead>
<tr>
<th>According to</th>
<th>№ of tranche</th>
<th>Amount</th>
<th>Date</th>
<th>Intended for</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Building Contract</td>
<td>1</td>
<td>EUR 250 million</td>
<td>12 June 2014</td>
<td>public policy, macroeconomic stability, public financial management, and budgetary transparency</td>
</tr>
<tr>
<td>Macro Financial Assistance Loan Program</td>
<td>1</td>
<td>EUR 100 million</td>
<td>20 May 2014</td>
<td>reducing the economy’s short-term balance of payments and fiscal vulnerabilities.</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>EUR 500 million</td>
<td>17 July 2014</td>
<td></td>
</tr>
<tr>
<td>Stand-By Program (IMF)</td>
<td>1</td>
<td>USD 3.2 billion</td>
<td>May 2014</td>
<td>fiscal consolidation, energy reforms and financial sector reforms</td>
</tr>
</tbody>
</table>
Macro Financial Assistance Program. The disbursement of the third and the fourth tranches will be performed jointly at the end of the year 2014.

State Building Contract. The second, variable tranche expected to be paid in the second quarter of 2015 for a maximum of EUR 105 million.

Stand-By Program (IMF). Next tranche is expected to amount USD 1.5 billion. The total amount, according to the two years Stand-By Program for Ukraine, constitutes USD 17 billion.
DCFTA - Deep and Comprehensive Free Trade Area

- Border opening of EU market
- Ukrainian exporters will save almost half a billion EUR annually due to reduced EU import duties
- Ukrainian agriculture will benefit from cuts in duties on agricultural and processed agricultural products of almost EUR 400 million
- Removal of non-tariff barriers

The European Union and Ukraine expect the DCFTA to enter into force by January 2016.
European programmes are financial instruments implemented by the European Commission. They offer co-funding to projects for the EU companies and firms, aiming at contributing to EU public policy objectives.

European funding mechanism for the 2014 – 2020 period are structured around 450 programmes which account for a EUR 960 billion budget of which:

- **Smart and Exclusive Growth** – EUR 147 billion;
- **Europe as a Global Actor** – EUR 87 billion;
- **Security and Citizenship** – EUR 13 billion;
- **Sustainable Growth** – EUR 387 billion.

**Company in Ukraine**

Funding from EU

**Apply**

**Receive**
EU Directives
[Tax and Legal Tools]
For the elimination of double taxation of dividends received by a parent company located in one Member State from its subsidiary located in another.

On June 20th 2014, the Council of the EU has agreed to amend the P/S Directive to close loopholes arising from the use of hybrid loan arrangements.

Conditions: Minimum shareholding of 10%

Member States may require that the parent company maintain a holding for an uninterrupted period of up to 2 years.

State A: EU Holding Co

State B: EU Sub Co

No withholding tax in State B

Dividends
The Directive is designed to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing:

- withholding taxes on royalty payments arising in a Member State, and
- withholding taxes on interest payments arising in a Member State.

Conditions: Direct or indirect shareholding of 25% for an uninterrupted period of 2 years

State A: EU Holding Co

State B: EU Sub Co

Interest / Royalties

No withholding taxes in State B
The objective of the Merger Directive is to remove fiscal obstacles to cross-border reorganizations involving companies situated in two or more Member States. The Directive fills an important gap in European company law by setting up a simple framework in which, as a general rule, each merging company is governed by the provisions of its national law applicable to domestic mergers.
New version adopted on 24 March 2014 by the Council of Ministers

The Directive applies to interest paid to individuals resident in an EU Member State other than the one where the interest is paid.

Member States had to transpose its provisions into national legislation.

The revised version strengthens the existing rules on exchange of information on savings income with the aim of enabling Member States to better clamp down on tax fraud and evasion.
AIFMD aims to increase investors protection and reduce systemic risk by establishing a harmonized EU framework for regulating alternative investment fund managers.

The scope of the AIFMD is broad and covers the management, administration and marketing of alternative investment funds (AIFs).

In order to be subject to AIFMD the entity should: (i) manage alternative funds in or from EU, regardless of fund domicile or (ii) market alternative funds in or into the EU regardless of found domicile.

AIFMD also presents some benefits for business: more consistency throughout the industry; potential cost savings by streamlining business model; and in due course there will be a level playing field for marketing funds and raising capital in the EU.
Before

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Group Company
Ukraine

Holding Co

Bulgaria
UK
France
Lux
Malta

- Company Registration
- Appointment of Directors
- Compliance
- Taxation of income
- Withholding taxes

IN ALL JURISDICTIONS

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Societas Europaea (SE)

- European Public limited Co (in any EU member state) regulated under EU Law
  - real seat principle applies
  - place of registration = place of central management and administration

- Subject to formation requirements
  - formation by merger: only for public Ltd Cos from different Member States
  - formation of SE holding co – (public or private) with subsidiaries or branches
  - formation of joined subsidiary – (public or private companies)
Group reorganization:
- Main company transformed into SE
- SE operating subsidiaries for different product lines
- Branches of the subsidiaries in other jurisdictions
- May be efficient for multinational companies
- The SEs can freely migrate to another EU jurisdiction
Operate freely in all EU countries – greater mobility
- No legal or other registration needed
- Pays tax in home country (No PE)
Winds of Change

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Believe me, it's all perfectly simple
Winds of Change

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- Base Erosion and Profit Shifting (BEPS) Action Plan
- Automatic Exchange of Information
- Tax Transparency
- Beneficial Ownership and Substance
**Base Erosion and Profit Shifting** (BEPS). The basic idea of BEPS scheme: shift profits across borders to take advantage of tax rates that are lower than in the country where the profit is made.

Three popular mechanisms for doing this are: (i) hybrid mismatches, (ii) special purpose entities (SPE), (iii) and transfer pricing.

The BEPS initiative aims to ensure that profits of companies are taxed where the economic activities generating said profits are carried out, i.e. in the place where value is created.
What do a multinational group require from a holding structure?

- To extract value by way of dividends or gains on disposal, FREE from or a reduced rate of WHT and/or CGT
- The domestic law to exempt such dividends and capital gains tax from local tax
- To take dividends OUT of the holding company without raising the tax position
- The point is always whether the BO is a resident of the state party to the Treaty AND whether it can receive the benefit of the reduced WHT
Companies/Hold Cos => subject to increased scrutiny by tax authorities and Courts in many jurisdictions

Beneficial Ownership test: A person ‘that has the full privilege to directly benefit from the income’ (Indofood case)

NOT a new one - used since the 1940’s in Tax Treaties provisions on interest, dividend and royalties

Paragraph 9 of the Commentary to Article 11 of the OECD Model explains:

“beneficial owner” is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purpose of the treaty, including avoiding double taxation and the prevention of fiscal evasion and avoidance.
Who is the “Beneficial Owner” of D/I/R?

1. Dividends
   a. The Cy/NL Co?
   OR
   b. The Foreign Co?

2. Interest

3. Royalties
Substance

Substance

Substance

Substance
WHAT IS SUBSTANCE?

- The level of the genuine economic activity of the corporate structure
- Lack of substance may result in:
  - Not obtaining the economic benefits of the relevant double tax treaties (through the limitation of benefits provision in the Treaty or through domestic anti-avoidance legislation);
  - Tax Authorities challenging the corporate structure of the group;
  - Increase in the effective tax burden of the group

- Substance is extremely important
A specialist tax adviser would help at evaluating/taking measures to add more substance

Lawyer acting as a director of an engineering company = BAD substance

Civil engineer acting as a director = GOOD substance

A mere registered office of a company in a lawyer’s office is BAD substance

A properly-equipped office with computers, office furniture and employees is GOOD substance
Practical Tips for Substance

- Qualified persons as members of the BoD
- Full and accurate Company documentation
- Company Seal – kept at the registered office and used sensibly
- Board Meetings – held in the place of registration
- Issuance of PoA – only for specific transactions
- Special attention – contract signing, invoicing, operating bank accounts, board resolutions
- Fully-functioning office
**USE NON-TRADITIONAL JURISDICTIONS**

**EU JURISDICTION:**

- **BULGARIA**
  - 10% CIT

- **DTT-Ukraine**
  - 5/15% dividends
  - 10% interest
  - 10% royalties

**NON EU JURISDICTION:**

- **MONTENEGRO**
  - 9% CIT

- **DTT-Ukraine**
  - 5% / 10% dividends
  - 0%10% interest
  - 10% royalties
Cyprus Holding Companies

Cyprus

Holding Company

Dividends

Investments

BVI Company

Dividends

No WHT in Cyprus

No taxation due to easily met participation exemption rules

No/Low WHTs due to EU Directives and DTTs

BEFORE
- Dividend income received from abroad is generally exempt (easily met participation exemption rules)
- No thin cap rules/no debt-to-equity restrictions
- Capital gains arising from the disposal of shares are exempt
- No WHT on distribution of dividends to shareholder
- Wide range of Double Tax Treaties
Cyprus Financing Companies

Before

- Loan
- Interest

Interest income 12,5% CIT
- No thin cap rules/no debt-to-equity restrictions

EU Directives and DTTS
No/Low WHTs

No WHT in Cyprus

Cyprus Financing Company
- UBO
- EU Co

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Interest income 12.5% CIT

No thin cap rules/no debt-to-equity restrictions

EU Directives and DTTs No/Low WHT

• Group Treasury Company
• Office
• Qualified staff
• Strategic decisions
• Day to day operations

No WHT
Before

IP Holding Company

Cyprus Company

EU Co

License

Sublicense

EU Directives and DTTs

No/Low WHT

Royalties

Royalty income 2,5% effective taxation

No WHT
Cyprus IP Regime

- 80% deduction from the royalty income
- 80% deduction in the capital gains arising from disposal of the IPs
- Capital expenses for acquisition or development of IPs capitalized and amortized over a 5 year period
- No withholding tax on payments abroad

2.5% effective tax
Investment Firms that can operate in Cyprus:

- Investment firms licensed in other Member States of the EU
- Investment firms authorised under CySec in Cyprus
- Credit Institutions
- Third country investment firms by establishing a branch in Cyprus
Alternative Investment Funds (AIFs)

- AIF is a collective investment undertaking which raises capital from a number of investors for the purposes of investing it in accordance with a defined investment policy for the benefit of the investors.

- The Alternative Investment Funds Law of 2014 was enacted by the Cyprus House of Representatives on 10/07/2014.

- The AIF Law introduces new structuring options which were not possible under the previous framework and strengthens the funds regime of Cyprus.
Governed by the International Collective Investment Schemes Law (ICIS)

Licensed and regulated by the Central Bank of Cyprus (CBC)

The new regulator will be the Cyprus Securities and Exchange Commission as per the proposed legislation

Sole object is the collective investment of funds of unit-holders
Accounting and assets calculations in Cyprus

Investors

Funds

Cyprus ICIS

Cy Resident

Investments in RE Cos, Securities, bonds, shares, debentures, other investments

Manager (Cy resident)

Professional Trustee Cy Resident

independent

Ukraine
China
India
Balkans
Latin America
Central Eastern Europe
Middle East

No WHT on distributions of dividends, interest, royalties (rights outside Cyprus)

Cyprus:
- Generally no tax on dividends
- Tax treaty network
- No Capital Gains Tax
Dividends Interest Royalties
No/low WHT
Croatia completely reformed its justice system over recent years, starting with the country's application for EU membership in 2003.

Croatia set up a body to fight corruption, the Conflict of Interest Commission.

The customs union was one of the EUs earliest milestones. It abolished customs duties at internal borders and put in place a uniform system for taxing imports. Customs officers are now found only at the EU’s external borders.

Member States removed restrictions on movement of capital and as a result the access to capital for Croatians entrepreneurs became much easier.
Implementation of free movement of people principles – citizens can benefit from the health and pension services in the entire union.

EU invested in Croatia through Human Recourses Development Operational Programme. Investments have focused on improving labor market performance, ensuring access for long-term unemployed and disadvantaged groups, supporting the social welfare sector, etc.

Croatia was covered by the Macroeconomic Imbalance Procedure (MIP), which aims to identify potential macroeconomic risks early on and prevent the emergence of harmful imbalances that are already in place.

Croatia received EU structural and cohesion funds for research and innovations, support for small and medium-sized businesses, sustainable jobs, support for the low-carbon economy.
An area of freedom, secure and justice

An internal market where competition is free and undistorted

Sustainable development, based on balanced economic growth and price stability

Highly competitive social market economy, aiming at full employment and social progress

The promotion of scientific and technological advance

The promotion of economic, social and territorial cohesion
Useful links on EU-Ukraine relations

i. European External Action Service: http://www.eeas.europa.eu/ includes all major press releases and statements from the EU’s foreign affairs institution.

ii. Europe Aid for Development and cooperation: http://ec.europa.eu/europeaid/index_en.htm European Commission’s Directorate–General (DG) responsible for designing EU development policies and delivering aid through programmes and projects around the world.


iv. EU-Ukraine cooperation projects: http://eeas.europa.eu/delegations/ukraine/projects/overview/index_uk.htm,

v. Virtual library, including EU-Ukraine agreements and a glossary of key EU concepts: http://eeas.europa.eu/delegations/ukraine/more_info/virtual_library/index_uk.htm

vi. Capacity for Development: is a global EU resource bringing together cooperation and communications professionals from around the world. All EU-funded programmes in Ukraine are encouraged to join: http://capacity4dev.ec.europa.eu
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- Tax advice surrounding transactions, disposals and spin offs
- Designing acquisition and holding structures
- Minimizing tax obstacles in real estate transactions
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- VAT planning & compliance
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