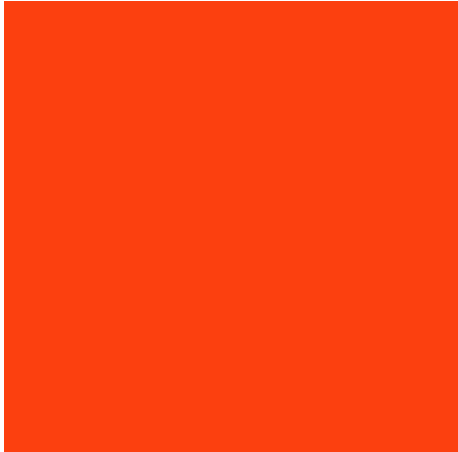


# Indirect Tax Newsletter

Ukraine • September 2009, No. 1



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## Dear readers

Indirect tax (customs, VAT, excise) issues continue to be a major area of focus for the Ukrainian authorities and our clients alike. Critical issues include ongoing VAT refund and input credit problems, customs audits in respect of royalties, changing place of supply rules, etc.

PwC Ukraine is proud to launch a series of occasional Indirect Tax Newsletters. These will cover updates on the most recent changes in VAT, excise tax and customs legislation. Do not hesitate to contact our Indirect Tax Team for a more detailed information or advice.

## In this edition

Our Indirect Tax Newsletter will seek to highlight the latest developments and provide proactive and practical advice or how to deal with critical issues.

In our first edition we will cover the following key amendments to the VAT legislation and regulations that occurred over the summer:

1. VAT place of supply rules.
2. VAT on temporary export of goods for repair.
3. VAT on export of leased goods.
4. VAT on international transport.
5. Methodology on accepting VAT input credit.
6. Potential deregistration of VAT payer.
7. President postponement of 5 and 6 above.

We then cover recent customs developments:

1. Documentation requirements.
2. Customs duty on disposal of foreign investment.
3. Packaging fee on import of goods.
4. Procedure of controlling customs value of goods.

It must be stressed that our Newsletter should not be considered comprehensive advice and you should need to seek expert advice from our Indirect Tax Team should specific questions arise.

This Customs/Indirect Tax Newsletter is produced by PricewaterhouseCoopers' tax and legal services department.

## I **Law No. 1451: important VAT and customs changes**

Law No. 1451 introduced a number of changes to the VAT and customs duty treatment of various transactions. The main changes are as follows:

### 1. **Place of supply**

The definition of taxable transactions was amended. Specifically, taxable transactions will include the supply of goods and services where the **place of supply** is within Ukraine (article 3.1.1 of the VAT Law). The previous wording of this provision referred to the "place of delivery of goods and services". The new wording brings this provision of article 3.1.1 of the VAT Law into compliance with articles 6.4 and 6.5 which determine the place of supply of goods and services. We generally support this change in the definition as it is now in line with relevant EU Directives.

Notwithstanding our support, the amendment may have a negative impact on Ukrainian companies operating abroad through unincorporated branches (permanent establishments). Technically, the supply of services through a foreign branch outside of Ukraine (to other non-residents) may be viewed as subject to VAT in Ukraine.

### 2. **Export of goods for repair and subsequent import of such goods**

The export of goods for processing (e.g., repair) is now clearly outside the scope of VAT.

The subsequent import of goods after repair abroad would be exempt from customs duties (but not VAT). Exemption from customs duties will apply provided the following conditions are met:

- Goods originate from other countries; and
- Customs duty was paid during initial import of these goods into Ukraine.

It follows that exemption will not apply if:

- Origin of goods is unknown or goods originate from Ukraine;
- The importer cannot document payment of customs duty during initial import of goods into Ukraine.

Import of goods after processing abroad (apart from transport vehicles imported after repair abroad) continues to be subject to VAT. However, the procedure of determining the customs value of such goods remains unclear.

### 3. **Leasing**

The law now provides certainty that the temporary export of goods under operating leasing contracts is outside the scope of VAT. However, there is a risk that in this case the tax authorities will be required to apply article 7.4.1 of the VAT Law. This article requires the recognition of a conditional sale of goods subject to 20% VAT where such goods begin to be used in transactions which are outside the scope of VAT.

In addition, the amendments ensure that VAT should not apply to the import of goods that are returned to Ukraine after temporary export under operating leasing contracts. Previously, such import was subject to VAT.

#### **4. International transport**

The amendments provide that zero VAT applies to international transport by truck and international delivery by express mail or by post regardless of the means of transport:

- From point of customs clearance within Ukraine to destination point outside of Ukraine;
- Between two points outside of Ukraine;
- From point outside of Ukraine to point of customs clearance within Ukraine.

Transportation within Ukraine from loading/unloading point to point of customs clearance is subject to 20% VAT.

*Source: The Law of Ukraine No. 1451 dated 4 June 2009*

#### **II New VAT regulations of Government and Presidential suspension**

Over the summer, the Cabinet of Ministers issued two resolutions that established new rules for VAT as follows:

- Input VAT can only be credited in a month when the supplier recognises the respective VAT liabilities. The tax authorities would treat as "high risk" amounts of VAT credit supported by VAT invoices issued in the previous month. According to the regulations, the maximum tolerance period is 2 months and therefore VAT credit recognised beyond this tolerance period could be lost;
- If a taxpayer adjusts VAT liabilities or VAT credit in an amount exceeding 10% of the total VAT liabilities/credit in the return, the tax police are empowered to carry out a tax audit of the entire chain of supply;
- If the taxpayer issues VAT invoices for the total amount of UAH 300,000 and does not recognise VAT liabilities, the tax authorities will nullify VAT registration. Thus, input VAT credit can be lost for all buyers from such a taxpayer.

In our view, these regulations are ambiguous and explicitly contradict the VAT Law. Regardless of this fact the tax authorities have recently begun vigorously implementing these provisions. (In fact the tax authorities have already issued two clarification letters confirming their intent).

The Tax and Customs Policy Committee of Verhovna Rada of Ukraine issued a letter requesting the Government to cancel these regulations. Finally, on 4 September 2009, the President of Ukraine postponed the Government's resolutions with respect to VAT regulations and applied to the Constitutional Court of Ukraine to clarify the legitimacy of such resolutions. There is no certainty how a Presidential Decree would impact Governmental regulations.

*Source: The Resolutions of the Cabinet of Ministers of Ukraine No. 757-p dated 1 July 2009 and No. 838-p dated 17 July 2009, the Letters of the State Tax Administration of Ukraine No. 14927/7/16-1517 dated 15 July 2009 and No. 16519/7/16-1617 dated 4 August 2009, the letter of The Tax and Customs Policy Committee of Verhovna Rada of Ukraine No. 04-27/794 dated 3 August 2009, the Decree of the President of Ukraine No. 706 dated 4 September 2009*

#### **III Customs developments**

##### **1 A customs declaration of exporting country is mandatory for submission to customs authorities during the import of goods**

The Cabinet of Ministers of Ukraine ruled that during the import of goods into Ukraine, the importer must submit to the customs authorities the following additional documents:

- Customs declaration of the exporting country; or
- Customs declaration that preceded export customs regime if goods were imported into the exporting country and placed under a customs regime that did not envisage the payment of taxes (e.g., goods were placed in the customs bonded warehouse).

This measure is aimed at strengthening control over the customs value of goods imported into Ukraine and will apply from 27 October 2009.

If the above documents are absent, the Ukrainian customs authorities will be entitled either to reject customs clearance of goods imported into Ukraine or to further scrutinise the declared customs value of imported goods.

*Source: The Resolution of the Cabinet of Ministers of Ukraine No. 767 dated 24 July 2009*

## **2 Customs duty on disposal of foreign investment - further amendment**

In January 2009 the customs authorities determined that customs duty could apply to the disposal of a foreign investment into Ukraine. Specifically, the customs authorities ruled that the disposal of corporate rights within three years of recording the imported property in the company's books, triggers repayment of customs duty for which exemption was claimed during import.

In July the customs authorities amended this ruling. They have now ruled that customs duty should not be paid if the underlying corporate rights are sold by the foreign investor to another non-resident, provided the latter acquires the status of foreign investor.

In our view, the original Order is not in line with legislation, but we are aware that the customs authorities are enforcing the Order.

*Source: The Order of the State Customs Service of Ukraine No. 701 dated 28 July 2009*

## **3 Packaging fee on import becomes payable again**

The authorities have ruled that imported goods can only be cleared through customs where the importer:

- Files computation of packaging fee and evidence of its payment to the state-owned company;
- Provides documentary evidence of collecting and destroying packaging independently.

These documents absent, the customs authorities will refuse customs clearance of imported goods.

Rates of packaging fee vary from UAH 0.15 to UAH 1.25 per kg of packaging depending on the type of materials.

As a separate issue, business entities can experience difficulties in deducting the packaging fee for corporate profits tax purposes and recovery of underlying VAT.

*Source: The Order of the State Customs Service of Ukraine, the Ministry of Environmental Protection of Ukraine and the Ministry of Economy of Ukraine No. 789/414/709 dated 30 July 2009*

#### 4 Amended procedure of controlling customs value

The customs authorities have issued an updated procedure in respect of control over the declared customs value of goods. Specifically, this procedure establishes the following provisions:

- If the customs value is accepted, the customs officer makes the relevant statement in writing in the declaration of customs value;
- If additional documents are required for determining customs value, the customs officer provides a list of these documents;
- In certain cases the customs authorities may issue a decision on customs value (e.g., where customs value is lower than production costs; the declarant rejected the customs value determined by the customs authorities, etc.);
- The importer may request to delay in determining customs value if customs value should be specified later or the importer disagrees with the customs value determined by the authorities.

The importer will have 90 days to provide additional information regarding the customs value of the goods in question. In this case the importer must provide guarantees in the form of a deposit. Within 90 days the customs office must take one of the following decisions on customs value: (i) accept the customs value determined by the importer; (ii) apply the customs value determined by the customs office; or (iii) determine customs value based on newly obtained information. Potentially, this latter method may be used by importers for the inclusion of royalties in the customs value of imported goods (e.g., in cases where royalties are computed based on net sales and amount of royalties can be available later, after release of goods into free circulation).

*Source: The Order of the State Customs Service of Ukraine No. 602 dated 24 June 2009*

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