New and Improved Draft Tax Code in Ukraine

By Tatyana Dzyadok:
(Frishberg & Partners)

The latest news on the legal front is that the Parliament of Ukraine passed the first reading of draft Tax Code of Ukraine (Draft Code), which may be adopted in as early as July. 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.

First, the good news: the Draft Code will decrease the profit tax from the current 25% to 17% and abolish ten local taxes and duties. Now there will 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 to the maximum).

Second, the Draft Code provides for the introduction of tax holidays for small-scale businesses. These holidays call for a 0% unified tax for natural persons, who carry out commercial activity and render personal services with revenue not exceeding 300,000 (three hundred thousand) Ukrainian Hryvnias per year, as well as for legal entities with income that does not exceed 100,000 (one hundred thousand) Ukrainian Hryvnias per year. If ultimately implemented, such holidays will run from January 1, 2011 until December 31, 2015.

The third, and perhaps most important, development concerns all legal entities with revenues of up to 2.7 million Ukrainian Hryvnias per year, who should apply for a unified tax rate of only 6%.

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The bad news for everyone, including employers and employees, is the increase in the personal income tax rate. The Draft Code will increase the income tax of persons, whose monthly income exceeds 13,000 UAH, placing this category of taxpayers under a 20% 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 a more recent further push by the employers toward fully legalizing payment of salaries. Thus, while an increase to 20% was intended to put money into the state's coffers, it may prove to result in just the opposite effect.

Further, the Draft Code proposes an introduction of a 5% tax on income from deposits and savings on current and bank-card accounts. Clearly, the legislators are trying to find the any way 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 of principal investors, this measure may lead to further mistrust in the banking system and a deterioration in banks' relationships with their core customers.

How will the above novelties look in practice? That is, excuse the pun, the 1,000,000 Hryvinas question.

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