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What VAT rate should be applied in accordance with the Tax Code? What rate should be applied for deduction of VAT credit? The risks and the necessity to obtain tax consultations

One of the first questions, which occur at beginning of application of the Tax Code (TC) from January, 1, - what VAT rate is applied?

1.

According to Section V of the TC, which came into effect on January, 1:

"Article 193. Tax rates

193.1. Tax rates are calculated from **the tax base** at the following rates:

- a) 17 percent;**
- b) 0 percent".

So the VAT rate - 17 percent from January 1, 2011? That's how may be interpreted this clause of the TC, *which entered into force on January, 1.*

2.

One may argue that according to Paragraph 10 of Section 2 Peculiarities of levying value added tax Chapter XX "Transitional Provisions" states:

"10. To establish that for the tax liabilities in respect of value added tax arising: from January 1, 2011 till December 31, 2013 inclusive the tax rate shall make 20 percent, starting from January 1, 2014 - 17 percent".

If it were written that instead of VAT rate of 17% till December 31, 2013 (inclusive) 20% shall be applied, it would be clearer, and so under this provision it is not just a temporary replacement of rate by another one: this provision is more narrow, it is not about just a temporary replacement of certain rate, but about the tax rate "for the tax liabilities".

Let's try to understand what would mean this element of determination, - with respect to what till December, 31, 2013 inclusive the tax rate of 20% should be applied?

3.

If the above-mentioned point of transitional provisions concerns the issue of the tax rate "for tax liabilities", how then it relates to the tax credit?

According to respective provision of the TC:

"198.3. Tax credit of the reporting period ... consists of amount of taxes accrued (paid) by the taxpayer at the rate prescribed by paragraph 193.1 of Article 193 of this Code, during such reporting period in connection with: ..."

According to the above-mentioned clause of the TC, tax credit includes literally only the amount of tax which is accrued (paid) at the rate established by para. 193.1 (see above), that is 17 percent.

In case of payment of VAT at the rate of 20 percent, which is different from the rate prescribed by para. 193.1 of Art. 193 of the TC (17 percent), we shall come to the procedure according to para. 198.3 of the TC:

- a) the tax credit may include only the portion of actually accrued (paid) amount of tax which corresponds to 17 percent, i.e. only 85% (17/20) of actually assessed (paid) tax rate of 20 percent, or
- b) the right to tax credit did not arise because the tax is charged (paid) at a rate different from the one which is allowed for inclusion into the tax credit.

In other words, this reading leads to the conclusion that since January 1 in Ukraine is introduced something like alcabala¹ at a rate of either 3% (20% - 17%), or 20% - part of VAT that is not included into tax credit.

4.

Let's try to consider the clause of the transitional provisions from the other side, the definition of "tax liability" under which tax rate should be 20%:

We turn to the definitions of TC:

(i) "14.1.156. Tax liability - the amount of money that a taxpayer, including a tax agent shall pay to the appropriate budget as tax or duty on the grounds, in the manner and terms specified in tax legislation (including amount of funds determined by the taxpayer in the tax bill and not paid in the statutory term); "

or a different definition:

(ii) "14.1.179. Tax liability for purposes of Section V of this Code - the total amount of VAT received (accrued) by a taxpayer in the reporting (tax) period;"

¹ Material from Wikipedia:

Alcabala - the most important tax that existed in Castile, Spain and the Spanish colonies. All trade agreements were subject to this tax and it was a percentage of the amount of the contract, that was a turnover tax. This tax brought the most revenue of the royal treasury of Castile. Tithe brought more income, but was charged in favor of the Catholic Church, not the King.

The second definition seems the one that cannot be applied because it is set in section V "VAT" of the TC, and we operate by the regulations of another section - XX "Transitional Provisions".

However, even if no recourse to the literal definition of the scope specified (ii) understanding of the term, it still would not be possible to apply this definition for the purposes of the considered norm, since under such understanding we are speaking of the tax liabilities as of total amount of tax, *received (accrued) in the tax period*. Under this understanding the considered clause of the transitional provisions may be interpreted as follows:

in terms of **total** value added tax, *received (accrued)* by a taxpayer in the reporting (tax) period, from January 1, 2011 till December 31, 2013 inclusive, the tax rate shall be 20 percent

Looks more like nonsense. And again, even if we would not stress attention on the use of the term "total" but rather will apply it only to amounts of tax *received (accrued)* during the reporting period, then what about the tax credit, i.e. amounts of tax paid (accrued) as assumed in the previous section?

First (i) definition is not workable either and hence the transitional provisions would mean the following (taking into account the circumstance that the amount payable to the budget as VAT is defined as the *difference* between the amount of tax liability of such reporting (tax) period and the amount of tax credit of such period [Art. 200]):

For the **difference** between total tax received (accrued) by the VAT payer in reporting period² and the amount of the tax credit of such period, the tax rate makes 20%.

However, when calculating the tax (Article 29, 193) the tax rate (Article 25) shall be applied to the tax base (Article 29) and the difference between tax liabilities (tax liabilities = total amount of the received (accrued) tax in reporting period) and tax credit is not the base for VAT purposes. So, here is nonsense too.

5.

To conclude, regulations of the TC related to VAT rate, which should be applied from January 1, 2011 are not clearly determined, and allow multiple interpretations, including provisions on applying tax rate of 17%, as is directly stipulated by the *effective* clause 193.1, or on "cutting" part of the tax credit (up to 85%) or on general application of the rate of 20%.

6.

In our opinion, the rules of the TC do not give clear, without contradictions, answer to the questions (1) about the applied rates, and (2) in case of application of VAT at the rate of 20%, what portion of VAT paid (accrued) by taxpayer is allowed for crediting.

Based on the presumption of legitimacy of taxpayer³ postulated by TC as one of the principles

² Disclosure of the term "tax liability" that is used in Art. 200, within the meaning established for Section V "VAT" of the TC, which include Art. 200.

³"4.1. The tax legislation of Ukraine is based on the following principles:

...
4.1.4. presumption of legitimacy of decisions of tax payer in case if rule of law or other normative-legal act given out on the basis of law, or if the rules of different laws or different normative legal acts provide for ambiguous (multiple) interpretation of rights and duties of taxpayers or

of tax law in case of possible ambiguous (multiple) interpretation, different practice in respect of the applicable tax rate and recording tax credit, thus, may be formed in Ukraine.

Curiously enough, however, the most reasonable and integral position from the legal point of view is to apply tax at the rate of 17% for both determination of tax liabilities (within the meaning of the term for a section V "VAT") and for the formation of the credit under this rate in full scope.

It is possible that this position can be tempting both in terms of competitive advantage for the entities, which will go this way and, hence, will be able to reduce prices with VAT.

On the other hand, the application of VAT at the rate of 20% triggers the risk of non-inclusion of paid VAT to the tax credit in full scope.

7.

In view of the above-mentioned circumstances, in practice virtually any approach to the matter under consideration is a risk to VAT payers.

Unfortunately, this question cannot be resolved by means of providing with general tax explanations by the tax authorities, because this instrument does not exist now according to the Tax Code.

Thus, now only the so-called written tax consultations are available which may be suggested as an instrument to mitigate the risk in respect of the approach related to VAT rate chosen by the tax payer. However, we would like to remind that such consultations are individual⁴, and each tax payer is to apply to tax inspection individually on the matter.

As for the clear and uniform regulation for all, as it seems now, the only way to ensure it is making amendments to the TC. Until then – we do not exclude that in practice we can see different models of behaviour and payment of tax.

Sincerely yours,
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supervisory bodies, as a result there is possibility of making decision in favour of both taxpayer and supervisory bodies."

⁴ "52.2. Tax consultation has individual character and may be used solely by the taxpayer which has been provided with such consultation."