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UKRAINE

Managing relationships with the tax authorities

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Although Ukraine has not seen any principal changes in the tax laws for the last year or so, the tax climate has changed drastically. This sharp change is the result of combination of two underlying factors: budget deficit caused by the notorious financial crisis and a forthcoming presidential election. The cash needed to finance state spending is being squeezed out of businesses already troubled by the crisis.

For these purposes, Ukrainian tax authorities use a combination of higher administrative pressure and direct threats. They also try to devise elaborate new approaches and put a fresh spin on a number of tax provisions.

A recent example of these new approaches is customs valuation, in particular, consideration of royalties and transportation costs incurred by importers through the value of imported goods under the transaction value method. Although the general rules provided in Ukrainian legislation are in line with WTO principles, until recently these matters have not been widely addressed by controlling authorities.

This situation has changed. Increased cooperation between tax and customs authorities resulted in a range of tax assessments based on the WTO rules. These rules are stipulated by law and must be complied with. However, the principal issue is that there is currently no appropriate technical guidance for the implementation of the rules. In addition, Ukraine's existing by-laws have an extremely fiscal bias and sometimes explicitly contradict global practice. For instance, according to existing by-laws, almost any royalty payable by an importer is considered part of the customs value of imported goods, regardless of whether or not the respective criteria are met.

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Continuing the royalty topic, the tax authorities have also worked out a new approach related to the moment from when a taxpayer is allowed to deduct royalties paid to a non-resident. Thus, under a strict interpretation of the law, the tax authorities try to force the position that the deduction is allowed only after the royalty is both paid and accrued. Previously, it was generally accepted that royalties were allowed for deduction only upon accrual.

In addition, the state has made some controversial decisions on tax matters which are hitting entire sectors. One example is the energy distribution business, which is impacted by the tax authorities' position that the cost of energy, within the value of so-called 'abnormal losses' of energy supplied to consumers, is not deductible for companies engaged in this business. This approach is rather doubtful but was confirmed by the Supreme Court of Ukraine. A similar situation is in respect of merchandising services rendered in retail outlets to the producers and importers of goods. This is the standard model of business for Ukraine. However, tax authorities started contesting deductibility of such services that resulted in substantial losses for producers and importers of goods. Yet widespread court practice over this issue has not yet formed.

The above illustrates new approaches taken by tax authorities. However, another recent trend is the Cabinet of Ministers (the highest executive body in Ukraine) regulating tax matters by its acts, which actually rewrite tax laws. Although such actions expressly contravene the Ukrainian system of tax law and are frequently revoked after less than a month from approval, tax authorities use this uncertainty against taxpayers.

In addition, it becomes more difficult to defend taxpayers in the courts. This may be explained by higher administrative pressure placed on courts by the state.

As evident from the above, Ukraine's tax climate has changed in a direction that is adverse for taxpayers, particularly for corporate taxpayers. Hence, companies are now deciding how to manage their tax affairs in such a puzzling tax world, in order to survive. New approaches by tax authorities demand new counter tools.

Against this backdrop it is strongly recommended that companies take a defensive stance from the beginning of the tax audit. Accordingly, one measure is to not admit the tax auditors into the company's offices whenever it is possible to find reasonable grounds for doing so. In particular, officials of a company should be ready to check the documents of auditors which they present as evidence that the audit is legitimate. For instance, auditors need to have a copy of the order for a tax audit of the company, issued by the head of the respective tax authority, as well as a referral to the audit. Quite frequently, such documents have material drawbacks, e.g., they may not have all requisites, or the auditors may be unable to present such documents at all. This provides clear grounds for not admitting the auditors. Also, legislation provides the list of grounds for tax audits, such as off-schedule field audits, and without such grounds the authorities are not allowed to launch the audit. However, tax authorities frequently tend to disregard this rule. Competent lawyers may use these drawbacks as the legal grounds to deny admission to auditors.

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In situations when there are no grounds to deny admittance to the auditors, it is advisable to ensure that the auditors are acting strictly within the limits stipulated by legislation. Thus, the auditors should be provided only with the documents they are allowed to request during audit under legislation. For instance, auditors are not allowed to request any calculations and data charts. Also, only appointed officers have the authority to communicate with the auditors and provide information at their request. To ensure this, it is advisable to adopt internal regulations containing the rules of conduct during a tax audit.

If upon the results of a tax audit a company faces tax assessments and sanctions, there is the possibility of contesting this decision of the tax authorities. Taxpayers are allowed to lodge a complaint against tax assessments to the tax authorities under procedure of administrative appeal. Also, taxpayers have the right to contest the decision of tax authorities in court. Contesting tax assessments may prove beneficial even if the legal position of the taxpayer is weak. Thus, if a taxpayer contests a tax assessment, the respective tax liability is deemed not agreed. Hence, payment of assessed taxes and sanctions is postponed. Tax liability is considered to be agreed after the court of appeal makes a decision against the taxpayer.

However, sometimes the optimal strategy is to find a new balance with the state. Thus, there are cases when it is advisable to make some balanced agreement with tax authorities during a reconciliation procedure, rather than apply to the court. For instance, tax authorities tend to accept proposals from taxpayers on immediate payment of a portion of assessed taxes and sanctions in return for abandoning assessments on other issues which are not so certain. Settling a dispute in this way frequently benefits both tax authorities and taxpayers.

When particular decisions of the state are hitting entire sectors, it is advisable to combine the efforts of all companies affected. In practice, such cooperation provides opportunities for lobbying activities. Frequently, only lobbying has the chance to solve tax issues. Although there is still no law on lobbying in Ukraine, related draft law and the necessity of its adoption are now being discussed. Moreover, some lobbying mechanisms are already working in practice. ■

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