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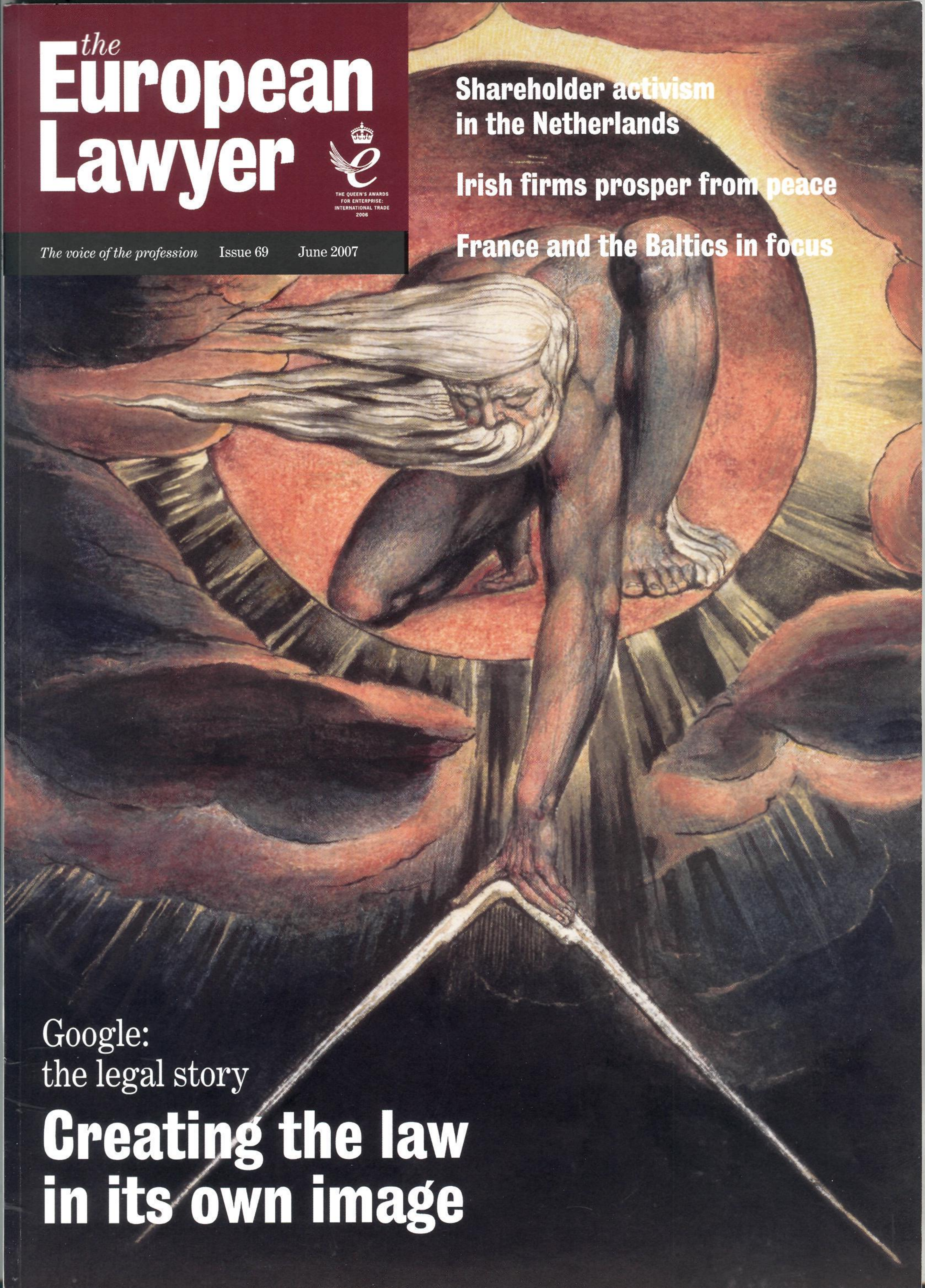

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General tax environment in Ukraine

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The main elements of the legal framework of the current tax system of Ukraine were formed basically in three shifts: modern tax laws for major business taxes such as corporate profit tax and VAT became effective in 1997, then in 2001 the new law governing procedural aspects of relationship between the taxpayers and the tax authorities, and then new personal income tax law in 2004. Not to forget some earlier and other tax acts and continuous further modifications of the tax laws throughout the period with some major changes at spring 2005.

Corporate profit tax at the standard rate of 25 per cent is normally viewed as quite acceptable by the businesses, while 20 per cent of VAT rate is often regarded as somewhat excessive. Personal income tax is applied generally at the flat rate of 15 per cent with special rates applicable to certain types of income. Some other taxes exist as well including excise, royalty for extraction of certain mineral resources etc, but those taxes are usually more specific to certain type of business activity. Practically all important taxes are national, while role of local taxes is quite limited for the moment.

Ukraine has now effective tax treaties with more than 60 states and actively develops the treaty network.

If merely be based on the above, Ukraine might be considered as a state with quite modern and generally acceptable for business tax system. Yet, such a view is not fully adequate as the sore feature of the Ukrainian tax environment is still administration of taxes.

Continuous significant changes in the tax laws and regulations, not rarely inconsistent, make life difficult. While the law 'On The Tax System of Ukraine' prohibits amending tax laws later than 6 months before the budget year in which such amendments shall become effective, this rule, while being formally in place, is practically disregarded.

Real implementation of laws also quite often deviates from what is on paper. As an example, only a quite naive person may think that VAT refund may be easily provided in a way and terms written in the VAT Law. Recent decision of the European Court on case Intersplav vs. Ukraine (full text is revealed on January 9, 2007 and may be found at web-site of the European Court) is a sound witness how the issue is actually dealt with. Yet, still one should admit that some big taxpayers may get VAT refund easier, depending upon their relationship with the authorities.

The case of Intersplav also demonstrates that the issue itself may be not merely lack of certainty on technical points but rather unwillingness of the fiscal authorities to accept the position even if it is proved by the courts. That's why the tax authorities may try and try again the same approach being guided not so by the laws, but rather by own vision of what is 'better'. As far as not all the taxpayers have courage and ability to dispute with the stated approach of the tax authorities, the forced (e.g., by repetitive use of the same wrong models despite of the court awards on similar cases) by the tax authorities position may become in a number of cases the 'final truth' for the taxpayers.

Another trick, which is to certain extent revitalised recently, is claiming by the state agencies almost any significant tax dispute a criminal case. While it is not often that such case finally results in criminal court award, merely the threat of being under criminal investigation for a significant time period causes a number of taxpayers taking unreasonably conservative position. In other words, implied threatening with criminal investigation is largely used not really for preventing tax avoidance, but rather as a technical tool for causing the actual behaviour of the taxpayers to drift from their reasonable expectations under the law itself towards the models suggested by the fiscal authorities.

Currently the government considers putting together tax legislation into Tax Code, which might be submitted for consideration of the parliament soon. The draft Tax Code as it stands today witnesses an attempt of the government to 'trade' some reduction of the tax rates (especially VAT), but not of all the taxes as the rates of local taxes are basically suggested to be increased, against significant further increase of the power and administrative rights of the tax authorities and overall increase of administrative burden levied onto taxpayers. Yet, as the Ukrainian practice may suggest, such 'exchange' is not equal and would likely to be more in favour of the state than for the benefit of business. Therefore, while the draft Tax Code is mainly promoted by the government, the business is rather not happy with such anticipated development. Hopefully, with the current conflict between the President and the parliament and a volume of internal political affairs under consideration into which all the branches of the state power are engaged, there would be no possibility in practice for the government to promote the noted draft into law.

Well, if the above middle part of the article is not really 'cheering', the final part would be more encouraging. Despite the above risks, the tax and judicial system in Ukraine in fact normally provides sufficient possibilities for keeping reasonable tax position and protecting taxpayer's rights in Ukraine. This may be achieved also through administrative appeal or judicial procedures. Upon due attitude and efforts of the taxpayers the disputable issues are usually resolved in favour of taxpayers. As far as the general provisions of the tax laws of Ukraine, to reiterate, by substance they are quite normal and acceptable in general.

Also while the tax authorities might be quite aggressive, they tend to remain generally in line with law and trying to act in civilised way, which is not just 'words' for the tax authorities. Although the tax authorities are sometimes rather brutal and pragmatic: if taxpayer did not object suggested additional tax assessment seriously with real efforts, then probably there was 'something wrong' and that's while the taxpayer accepts this, or probably respective money were not really badly needed by the taxpayer and thus it is not damaging to take them to the state. Also attitude of the tax authorities depends a lot upon actual performance of the state budget and of the collection tasks levied on the fiscal authorities. Sometimes, when the performance is really good, the tax office may be even quite liberal. Thus 'instant' tax environment depends not so much on the laws as on the above said factors.

We are ready to confirm that while dealing on a number of tax matters requires sometimes unreasonable efforts of the taxpayers, with such efforts it is finally possible to cope with such situation. The difficult task is to find proper balance between the position taken, possible risks and efforts that might be required for substantiating such position. Also with the discussed shifts back and forward we should admit that finally the actual long-run trend is probably to make life easier for the taxpayers.

As such, the current assessment of the tax environment in Ukraine may be: in general comparatively good principal laws, which are however quite often not properly implemented, a lot of 'manual control' and administration of the tax authorities, sometimes with direct or indirect threats, but still possibility for the taxpayers (if they are ready to deal seriously) to cope with these issues, even this would require really a lot of effort. ■