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# New Developments In The Implementation Of Double Tax Treaties In Ukraine: A New Era?

BY ALEXANDER MININ

Near the end of 2008, taxpayers were surprised by the rulings of the National Tax Office of Ukraine dealing with taxation of dividends under the double tax treaty between Ukraine and the Netherlands. Under Article 10 of the said treaty, if a Dutch shareholder makes an investment matching certain criteria, the dividends payable to such shareholder shall be relieved from withholding tax in Ukraine. Yet, through its rulings, the Ukrainian tax authorities effectively significantly reduced the scope of implementation of this clause. For instance, the authorities stated that a whole investment making up at least 50 percent of the capital of the company paying the dividends and equalling not less than $300,000 should be done in just one instalment, and that the right for zero withholding tax is not applicable if the shares were transferred to a shareholder different from the one who actually made the investment. It is important to note that such implementation rulings were issued by the Ukrainian tax authorities unilaterally; even the Article states that the mode of application of relevant paragraphs shall be settled by mutual agreement of the competent authorities of Ukraine and the Netherlands respectively.

The above case was widely discussed in Ukraine, as a number of foreign companies have established their corporate presence in Ukraine via Dutch holdings.

While the these rulings are not pleasant for taxpayers, even more important is that it seems to be the start of a new era of the Ukrainian tax authorities probating what may be reasonably disallowed when using the tax treaties. It looks rather as the starting point of the tax authorities searching for and introducing into the Ukrainian practice the approaches or measures that might significantly reduce double tax treaty benefits. Who knows whether this motion is caused by the increased technical competence and learning curve of the Ukrainian tax authorities, or merely by increasing fiscal needs in crisis?

The Ukrainian tax authorities only recently started paying attention to those nuances, which had been overlooked for decades. An example of this new trend is illustrated by other rulings – for example, the circular of the National Tax Office # 23790/7/15-0517 of 29 October 2009 'On Specific Tax Questions', dealing with taxation of interest under syndicated credits. The circular looks beyond merely formal recipients of respective payments and tends to operate with a beneficiary ownership concept, although presently under the narrow scope of syndicated loans.

The circular states that it has been common practice until now that interest on syndicated loans is not taxed because the bank formally issuing the loan is located in a tax treaty jurisdiction which provides for zero or very low withholding tax on interest (the example of the double tax treaty between Ukraine and the UK is cited in the circular). The circular further stipulates that such use of the treaty is not appropriate, and that no relief shall be granted based merely on the residency of the physical recipient of the payment. Rather, proper implementation of the tax treaty will take into account who the beneficial owner of the portion of the interest income is. Therefore, it seems that the beneficial owner concept is launched for actual use by the Ukrainian tax authorities, even though this matter was previously given no attention (even though the respective clause was in place in interest, dividend and royalty related provisions in the majority of Ukraine's tax treaties).

The number of restrictive implementation measures is not limited to the use of the beneficial owner concept or to the measures envisaged in the double tax treaties. For example, the tax authorities requested, in tax audits this year, information on how non-residents' income paid from Ukraine is taxed at the recipient's end. This request is justified, in some cases, by the need to check whether there is compliance with the purpose of the tax treaty.

The purpose of the double tax treaty is indicated in its standard name – for the avoidance of double taxation and the prevention of fiscal evasion. As such, the question could be raised whether it would be in line with the purpose of the treaty to apply treaty relief to an income, which thus may be relieved from taxation both in the state from which the income is paid (such relief achieved by virtue of literal implementation of the treaty) and in the state of residence of the recipient of income (by virtue of the domestic tax law in that state or other reasons). In this way, the treaty may lean more towards no taxation at all (or even fiscal evasion in some cases), rather than providing for avoidance of double taxation. The issue then arises whether providing relief under this condition is still justified and, as a result, whether such use of the tax treaty should be halted?

Such question seemed to be more of a theoretical nature until 1 January 2010, when the new general anti-avoidance clause came into effect. Namely, para. 17.1.6 (1) was added in 2009 to the Law # 2181 'On the Procedure of Settling of Taxpayers' Liabilities Towards State Budget and State Special Purpose Funds' with effect as of 1 January 2010.

The said clause stipulates that taxpayers' (respective officers of the taxpayer) use of a tax relief not for the aim and/or not in line with conditions or purposes for which such relief is provided under the law on respective tax, as well as any other persons' use of tax relief not intended for their use, shall be qualified as intentional tax evasion. In such case, in addition to the penalties that may be applied under the other clauses of the Law, the taxes which were due without relief shall be paid, as well as a penalty in the amount of 200 percent of the tax due. Payment of the penalty does not provide release from liability for intentional tax evasion.

As yet, there is no actual practice regarding implementation of the clause. But given the trends of increasing activity by the tax authorities and the questions being raised during tax audits, one may expect that the use of treaty benefits may also be verified from the perspective of compliance with the named purpose of the treaty (i.e., whether respective income, if relieved from taxation in Ukraine under the treaty, is actually taxed at least at the recipient's end).

To sum up, it seems that the era of easy use of double tax treaties in Ukraine is over.

The new approach of the tax authorities implies much more scrutiny and restrictive intentions. The above are examples of issues that now to be checked when an issue of implementation of the double tax treaty in specific situation is considered.

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In 1999, he and several colleagues founded their own law firm. It has already been several years that firm "KM Partners" is recognised as the best law firm in the area of tax, and Alexander Minin is included into 25 the most famous practicing lawyers. Since 2005 Alexander Minin has been constantly recognised as the best tax lawyer in Ukraine by Ukrainian Law Firms - A Handbook for Foreign Clients, an annual independent research of Yurydychna Praktyka Publishing house.