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Ukraine's tax cut worries market

Salman Shaheen

Ukraine's new draft code, which plans incremental cuts to corporate tax to 17%, passed its first reading in Parliament last week. However, while companies will welcome the proposed reductions in corporate tax rates, advisers are concerned by the new powers the code will give to tax authorities and the confusing nature of the code itself.

"It is a poorly structured, inconsistent and contradictory draft tax code," said Taras Koval, head of tax at Paritet, a law firm.

Under the new draft tax code, the uniform 25% corporate tax rate will be split into three categories. Starting in January 2011, the base rate will be set at 20% and will fall by one percentage point each year until it reaches 17% in 2014. Individual regions will be able to tax companies up to 2%, while district authorities will be able to set an additional rate of up to 3%.

If regions and districts charge the maximum allowable rate, then the overall corporate tax burden in 2011 will not be more than the present rate of 25% and by 2014 the maximum rate of corporate tax will be 22%.

The new rates will make Ukraine more competitive internationally, though Yevgeniya Derbal, head of tax at Konnov & Sozanovsky, points out that rates will still be higher than in neighbouring countries. Russia has a corporate tax rate of 20%; Poland's is 19%, while Hungary and Romania tax companies at 16%.

"Reduced rates of corporate tax are expected to have a positive effect on large companies," said Svitlana Musienko, head of tax at DLA Piper Ukraine. "The draft Tax Code may effectively abolish the existing simplified tax system for small business and private entrepreneurs, since the list of available fields of business where it could potentially apply is expected to be substantially shortened. Thus, the reform could definitely have a negative impact on small business."

One adviser, however, believes the new tax code will be a disaster for Ukraine.

"In our view, the main concern is with the almost unlimited powers to be granted to the tax authorities and a lot of technical possibilities for the tax authorities to manipulate a number of elements and procedures," said Alexander Minin, head of tax at KM Partners. "While the tax code is really threatening first of all in respect of the tax administration towards taxpayers, at the same time there is practically no responsibility for the tax authorities."

Minin's main concern is that the new tax code does not provide for a procedure of reconciliation of tax liabilities. Under the new rules, appealing against a tax notification would not release a taxpayer from the obligation to pay the amounts assessed by the authorities. After the receipt of a tax notification, a taxpayer will have to pay the entire amount of tax liabilities even if the assessment of these liabilities was completely groundless. Under the lengthy appeals process, it may take up to four years to reclaim unjustly paid tax.

Minin's other concern is that the new tax code provides for an increase in the grounds for tax audits and for additional types of tax audits. The taxpayer, meanwhile, does not have the right to deny the audits, even where the audit is groundless.

This year's **Doing Business report** from the World Bank ranked Ukraine third from last in terms of the ease of paying taxes.

"The new code is likely to push Ukraine down possibly even to the worst tax jurisdiction because of the abnormal tax administration burden," said Minin. "If made effective as it stands now, the tax code gives the state and the tax authorities abnormal powers. At the same time, based on the Ukrainian practice, when such power is not counterbalanced by the applicable procedures, it really becomes uncontrollable."

Another adviser believes that smaller businesses will be hit hardest by the changes.

"They won't be able to hire lawyers and accountants to help them," said Michael Kharenko, head of tax at Sayenko Kharenko.

More positive changes include corporate tax exemptions until 2020 for profits generated from alternative energy production, which should help to stimulate growth of the green economy, to reduce the country's dependence on fossil fuels and to tackle climate change.

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