

11.08.2020

Development of TP control over PEs in Ukraine

New rules apply to profit calculations from May 2020



From May 2020, the special rules for calculating the profit of PEs in Ukraine were deleted from the Ukrainian Tax Code. The new rules stipulate that profit should be calculated following the arm's length principle. However, this change has not made the situation much clearer.

Transfer pricing rules before 2018

Transfer pricing (TP) rules were implemented into Ukrainian tax law from 2013. However, before 2018, [permanent establishments \(PEs\)](#) were a blind spot for TP control.

According to the Tax Code of Ukraine, non-residents that conduct business activity in Ukraine via a **PE pay corporate profit tax**. However, TP rules that were in force before 2018 did not provide any special rules for PEs. It was **unclear whether PEs in Ukraine are subject to TP reporting requirements** alongside regular corporate profit tax reporting, and what transactions of PEs in Ukraine may be recognised as being subject to TP control.

It was clear, however, that the Ukrainian TP rules lacked any legal basis to control dealings between PEs and non-residents establishing such PEs. This was due to the definition of [controlled transactions for TP purposes](#), which did not provide grounds to extend the control to dealings between parts of the same legal entity.

This ambiguity meant that **PEs of non-residents mostly ignored TP control in Ukraine**, even though, under the rules existing before 2018, some PE transactions might have been recognised as being subject to TP control: for instance, if a PE had dealings with a foreign related party of the non-resident that established the PE.

Introduction of TP reporting for PEs in Ukraine

Starting from 2018, [Ukrainian TP rules](#) were supplemented with the **new type of controlled transactions**, namely, transactions **between a non-resident and its PE** in Ukraine. The Ukrainian Tax Code prescribes a **special value threshold** for recognising such transactions as controlled, namely **UAH 10 million (roughly EUR 305,000)**, without applying the turnover-based threshold which is provided for enterprises.

Thus, 2018 became the first TP reporting period for PEs in Ukraine.

However, there was still some ambiguity due to the **lack of proper guidance** from the Ukrainian authorities on how PEs in Ukraine should conduct the analysis in practice and comply with the reporting requirements. Moreover, it was unclear how the results of such **TP analysis** may be applied to the corporate profit tax base calculation.

The Tax Code of Ukraine (sub-para.141.4.7) provided for the **following options to calculate profits** that non-residents derive through their Ukrainian PEs:

- The profit is calculated according to the **general rules** of the Tax Code, assuming that the PE is deemed a taxpayer separate from the non-resident and operates independently.
- If a non-resident operates both in and outside of Ukraine and does not determine profit derived from Ukraine, a **separate balance sheet** for its Ukraine-related activity should be prepared. This balance sheet should be approved by the tax authority at the location of the PE.
- If it is impossible to reliably calculate the profit sourced in Ukraine, then the profit is calculated as Ukraine-sourced income of the PE less costs, calculated by **applying a 0.7 coefficient** to such income. In other words, the profit is effectively calculated as 30% of the income received by the PE without needing to allocate and prove costs related to the PE activity.

PEs filed special reports to declare their profit tax liabilities using one of the mentioned methods. **Many PEs opted for the approach calculating profit as 30% of income due to its simplicity.**

After extending TP control to dealings between non-residents and their PEs in Ukraine, the above rules were supplemented with the reference that the profit under all such methods should be calculated with due regard to Ukrainian TP rules. It was not clear though how such rules should have been applied for the cases when the profit is calculated as 30% of income.

Recent changes to calculation of profit

The rules of profit calculation by PEs in Ukraine were changed once again by **Law #466-IX**, which came into force in **May 2020**. From this date onwards, the special rules of profit calculation by PEs, including the calculation method applying the 0.7 coefficient, were deleted from the Tax Code.

Instead, the **new rules stipulate that the profit should be calculated following the arm's length principle**. Such profit should be in line with the profits of independent entities carrying out the same or similar activity as if such PE operated separately from the non-resident. The amount of any profit should be calculated according to Article 39 of the Tax Code setting forth Ukrainian TP rules.

Two-step analysis recommended

Yet this change has not made the situation clearer. Ukrainian TP rules are primarily designed for application by enterprises and do not contain any special rules which may be followed by PEs to determine their profits. Also, there is no official clarification from the authorities so far.

We understand that the **only reliable way would be to follow the OECD-authorised approach to allocate profits to PEs**. It implies that the two-step analysis should be carried out:

- firstly, **hypothetical dealings** between the non-resident and its PE should be identified, and
- secondly, such **dealings should be priced** by applying TP methodology.

Ukrainian taxpayers are required to file corporate profit tax returns quarterly (with some special exceptions). Therefore, it is likely that the **forward-looking TP analysis should be implemented**, otherwise, in many cases PEs in Ukraine would lack the information necessary to draft the return.

Yet these are just preliminary thoughts on the matter. Hopefully, taxpayers will receive proper clarification from the authorities very soon.

Clarification still required

Such clarification is desperately required due to the **lack of appropriate transition rules** in Law #466-IX. This change occurred in the middle of the year and a lot of PEs have already reported their profits for the first quarter applying the previous mechanisms. So, the question arises of **how to file the reports** after the changes. Thus far, the tax authorities have just recommended filing the ordinary profit tax return instead of the report on

profit of the PE. However, the tax authorities have not shared their vision on how the data from previously filed reports should be transferred to such regular profit tax returns. This is especially important in the cases when the profit was calculated as 30% of income.

Hopefully, the authorities will very soon produce clear guidance that can be followed. Otherwise, **the only option for PEs in Ukraine would be to use the results of the TP analysis for previous years and adapt these for the current profit tax reporting.** If a PE has not conducted any such analysis, it is highly recommended to do so urgently.

If you would like to know more about the latest TP-rules for PEs in Ukraine, please visit the homepage of [WTS Tax Legal Consulting, LLC](#), the exclusive representative of WTS Global in Ukraine.

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