

09.03.2021

New rules on business purpose in Ukraine

Test introduced in 2020 has been revised with effect from 2021



Last year, the regulation of business purpose was changed two times in Ukraine. Law 466-IX, which supplemented the definition of reasonable economic purpose and **introduced the application of the business purpose test** to any purchases from non-residents, came into force in May 2020. With effect from 1 January 2021, these rules were amended later by Law 1117-IX. According to these amendments, now instead of targeting all transactions with non-residents, the test is applicable only to transactions that are subject to TP control, royalty payments and transactions with non-residents that fall under the list of "low tax" states (territories) or the list of organizational forms of non-residents. However, still a lot of Ukrainian taxpayers are targeted, especially Ukrainian affiliates of multinational companies.

Definition of business purpose according to Law 466-IX

Ukrainian Tax Code has contained the definition of the reasonable economic purpose (business aim) of transactions since its adoption back in 2010. Yet, this definition was unclear, and the ways of its practical application were limited.

Law 466-IX, which came into force in May 2020, introduced comprehensive changes into the Tax Code of Ukraine, including implementation of BEPS three-tier reporting standard. Alongside these important changes, the rules on business purpose were amended as well.

According to the definition, "reasonable economic purpose (business aim)" is the purpose that may occur on condition that a taxpayer aims at reaching certain economic goal in the result of business activity. Law 466-IX supplemented this definition with the explanation on what such economic goal may be and what transactions should be deemed as not having "reasonable economic purpose". **An economic goal (effect) particularly but without limitation should mean increase (saving) of the taxpayer's assets and/or of their value in future.**

At the same time, for taxation purposes, a transaction with non-resident is considered not have a reasonable economic purpose if:

- > its principal aim or one of them is non-payment (underpayment) of taxes and/or decrease of the profit tax base;
- > in comparable circumstances an entity would not be prepared to sell (purchase) such goods, works or services, intangible assets, or other items to (from) an unrelated party.

The Law 466-IX also specified how the business purpose test may impact the tax position.

Thus, **new adjustment of the profit tax base** was introduced into Article 140.5 of the Ukrainian Tax Code. According to it, the taxpayer shall increase the amount of taxable profit by the amount of expenses, incurred in transactions with non-residents if such transactions lack business purpose. The burden of proof in this case is levied on the tax office.

In other words, **in the version of Law 466-IX, the test was applicable to any purchases from non-residents.** And if the tax office challenges the reasonable economic purpose, such expenses may be disregarded when calculating the profit tax base.

Amendments by Law 1117-IX

However, such rules were amended by the **Law 1117-IX, which came in force on 1 January 2021.** According to these amendments, the **test is applicable only to transactions with non-residents subject to transfer pricing (TP) control**, transactions on **payment of royalty**, and transactions with non-residents that fall under the list of "low tax" states (territories) or the list of organizational forms of non-residents (covering fiscally transparent entities), adopted by the Cabinet of Ministers of Ukraine.

The Law also introduced the changes to the way of application of the test in Ukraine. Thus, in terms of TP control, the analysis of the business purpose was extended and now also implies analysis of the **alternative options available to the parties acting with commercial rationality if they were not related.** In addition to non-recognition of a transaction for taxation purposes, the tax authorities received the right to substitute the conditions of the transaction between related parties with an alternative transaction they deem commercially rational given the facts of the case.

New business purpose test rules for transactions with non-residents that fall under the list of **"low tax" states** (territories) or the list of **organizational forms of non-residents (covering fiscally transparent entities)** will be in force **from 1 January 2022.**

According to the current rules transactions with such non-residents are subject to **special 30% adjustment.** This adjustment means that the profit tax base should be increased by 30% of the value of the goods (services) purchased from or supplied to such non-residents unless taxpayers proves that the relations are at arm's length (although such transactions are not subject to standard TP rules).

From 2022 the Ukrainian tax authority will receive the right to also control the business purpose of such transactions. And in case the tax authority finds that a transaction lacks reasonable economic purpose, the profit tax base would be increased by the entire value of the goods (services) thus purchased or supplied. In other words, **absence of the business purpose would effectively mean 100% adjustment on transactions with such listed non-residents.**

It is advisable not to ignore these new rules and get properly prepared as the tax implications may be material.

If you would like to know more about the new business purpose test in Ukraine, please visit the homepage of WTS Tax Legal Consulting, LLC, the exclusive representative of WTS Global in Ukraine.

Author:

Ivan Shynkarenko
Partner
WTS Tax Legal Consulting, LLC, Ukraine



i.shynkarenko@wts.ua



A previous version of the article has been published in the **WTS Transfer Pricing Newsletter #1/2021.**

[Read it in PDF format!](#)

[View publication](#)

Related articles



Development of TP control over PEs in Ukraine

[Read more](#)



Implementation of BEPS and other TP-related changes in Ukraine

[Read more](#)



New Ukrainian TP rules introduced in 2019

[Read more](#)

Contact us!

Do you have any questions about WTS Klient Hungary or about our contents? Please let us know by filling in our short contact form. We will get in touch with you as soon as possible.

Contact

SERVICES

- > Accounting
- > Financial & accounting advisory
- > IT / Business Automation
- > Legal consulting
- > Payroll

ABOUT US

- > WTS Klient brochure
- > Our partners
- > Our awards
- > Press
- > Our experts

PUBLICATIONS

- > International WTS Publications
- > News
- > Newsflash
- > Newsletter
- > Tax and Investment Facts
- > Tax Bridge
- > WTS CEE News
- > WTS Klient Minutes – Videos
- > WTS Klient Research

Exclusive member of

wts global
in Hungary