

Do you have to work from abroad by force of circumstances? Are you getting financial assistance from the government of a foreign state? What is happening with taxation

According to the UN data, more than 6 million Ukrainians were forced to go abroad due to the outbreak of the full-scale war. But many of those people keep working for Ukrainian companies on a remote basis, getting salaries to their Ukrainian accounts, and paying taxes to the budget of Ukraine.

And taxes are paid by a Ukrainian employer of a natural person as a tax agent during salary accrual (payment), that is on a monthly basis.

And after a six-month period of stay in the territory of the EU host country, such persons may acquire the status of tax residents abroad (in the country of their stay), with the respective requirement to pay taxes in the country of their stay.

Moreover, the right of the host country to tax Ukrainian income may arise not just due to the acquisition of the status of the host country's resident by the person, but just after the stay of such person in that country exceeds 183 days.

The Government is now trying to regulate the problem with remote work of a large number of Ukrainians abroad. Thus, for instance, the Order aiming to approve the form of certificate for confirming the status of tax resident of Ukraine, that will confirm the person's residency, has been made public on the website of the Ministry of Finance of Ukraine.

Availability of such certificate and its submission in the country of the person's temporary stay are expected to help solve the problem of taxation of the person's income in the country of their stay.

Such suggested approach differs a bit from the previous practice, including judiciary practice, according to which the person's residency was determined by the actual circumstances of the respective year, and, hence, could not be pre-determined.

Below we will consider what is happening to taxation and whether it is possible to

avoid double taxation under such circumstances.

First of all, it should be mentioned that under ordinary circumstances a person with Ukrainian citizenship will be considered a tax resident of Ukraine, regardless of how long (s)he stays in the Ukrainian territory within a year.

Thus, the person's residency under the national legislation is determined under provisions of subparagraph 14.1.213 of the Tax Code of Ukraine (hereinafter referred to as the "TCU"), which presuppose taking a residency step test:

- 1) by the place of residence,
- 2) by the permanent place of residence,
- 3) following the criterion of the focus of the person's life interests,
- 4) following the criterion of the period of stay in Ukraine (no less than 183 days within a tax year).

And since during 2022 the persons in question resided both in the territory of Ukraine and abroad, in most cases the residency status of the persons will be determined following the criterion of permanent place of residence.

Permanent place of residence, in its turn, is determined in Art. 1 of the Law of Ukraine **On Foreign Economic Activity** as the place where the person lives for a year, and intends to live in the territory of this state over an indefinite period of time, not limiting such residence to a certain goal, and provided such residence is not the consequence of performance of functional duties or contractual commitments by this person.

Respectively, in most cases, since the stay of Ukrainians in the territory of foreign

states is now caused by a certain specific goal (preservation of their life and health as well as the life and health of their relatives) and most such people intend to get back to Ukraine after the war is over, it is not possible to say that such persons have their permanent place of residence abroad.

At the same time, due to availability of certain formal procedures a natural person must undergo while leaving the country for a permanent place of living abroad, established in Ukraine, there are all grounds to claim that the permanent place of residence of the persons who have not undergone such procedure still is Ukraine.

In practice, availability of registration in Ukraine comes as a certain signal about the availability of a permanent place of residence in Ukraine for tax authorities and courts.

That is why, though each specific case is unique and must be considered individually, now there are grounds to say that in most cases state authorities will consider natural persons who are citizens of Ukraine to be tax residents of Ukraine.

As the result, such natural person is obliged to declare (in cases determined by the TCU) and pay taxes in Ukraine.

However, according to local legislation of the country of the person's temporary stay, after the period of 183 days of stay expires, it is possible that such person will also get the tax residency of the country of their stay, with the respective duty to pay taxes in that country.

Almost all double taxation avoidance agreements, concluded by Ukraine, allow for taxation of the so called "dependent



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personal services” (that is salary) only in the country of the person’s residency (in Ukraine, in this case) provided hired work is performed beyond the boundaries of the country of stay, while the period of stay in a foreign country does not exceed 183 days.

For instance, under provisions of Art. 15 of the Double Taxation Avoidance Agreement between Ukraine and the Federal Republic of Germany concerning income and property taxes as of July 03, 1995, remuneration received by the resident of Ukraine for hired work performed in Germany shall be taxable only in Ukraine in case all the three conditions, envisaged by part 2, Article 15 of the Agreement, are met simultaneously, one of which is stay in Germany over the period shorter than 183 days.

Hired work is normally considered to be the one performed in the country of stay if the employee stays in this country over the whole period of work performance.

This means that, regardless of the fact that the person may be working for a Ukrainian company and at Ukrainian projects, it will be considered that this work is still performed abroad in the country of the person’s actual stay.

At the same time, income from activity carried out in the territory of a certain country is normally considered as received from that country. Thus, regardless of whether the person has acquired the status of the respective country’s resident, the income obtained for work in

this country may still be taxable in the country of their stay.

Due to the above, if the 183-day period of stay in the host country is exceeded, by analogy to the approach to taxation in case of availability of permanent representation, taxation of all income obtained over the whole period of stay in the host country (and not just the income obtained after the expiry of the 183-day period) may be required.

And some countries, in case there arises the duty to pay taxes in that country, even in case of annual income declaration, may require payment of taxes in advance on a monthly basis. Still other countries may even demand submission of the tax return on a monthly basis.

Thus, there may technically occur the situation of double taxation in practice since double taxation avoidance agreements do not provide any literal protection in such cases, either in the country of origin, or in the country of stay.

In particular, Ukrainian employers still have the tax agent’s duties of charging and paying income tax from natural persons’ salaries on behalf of their employees.

And applicable tax legislation of Ukraine does not presuppose the procedure and the grounds for revising the mechanism of tax charging and payment by the employer while accounting the employee’s income or charging it in the amount smaller than the one fixed by legislation.

In its turn, the duty to declare and pay taxes in the host countries lies personally with the natural person.

As the result, employees may face respective tax requirements in host countries.

Since such persons are in most cases considered to be the residents of Ukraine under the provisions of applicable double taxation avoidance agreements, offsetting of taxes paid under the respective agreement shall take place in Ukraine.

This means that the tax paid abroad should be offset against Ukrainian tax in Ukraine.

Therefore, since according to the Ukrainian legislation the employer as a tax agent has the duty to charge and transfer taxes from the employee’s salary, offsetting of taxes paid by the employee himself/herself abroad against the Ukrainian tax appears to be a complex procedure, if ever possible in practice.

The above is happening due to absence of legislative regulation of the procedures

- that would envisage an opportunity to reduce the amount of tax paid in Ukraine by the amount of tax paid abroad for the employer,
- that would envisage an opportunity to offset the amount of tax paid abroad against taxes paid from salary for a natural person in Ukraine.

It should be indicated that double taxation avoidance agreements somehow do

not correspond to real life circumstances now.

Thus, they don't take into account remote work opportunities that were gaining pace with the increase in global mobility of people and became particularly relevant since the beginning of COVID-19 times. The respective agreements do not take into account relevant realia of martial law in Ukraine either, when millions of people have been forced to leave the Ukrainian territory to save their life and health.

However, the above does not mean that a natural person will have to pay taxes in both countries and that double taxation cannot be avoided.

In particular, double taxation avoidance agreements concluded by Ukraine mainly envisage an opportunity to initiate the reconciliation procedure.

The TCU also envisages such opportunity, since in 2020 it was supplemented with Article 108-1 of the TCU that specifies and fixes a detailed reconciliation procedure initiation order.

At the same time, due to provisions of subparagraph 108-1.2.4 of the TCU, a person must have a certain document issued by the tax authority of the foreign state that would prove the demand to have the respective income taxed in the country of their stay in order to initiate the reconciliation procedure.

Such mechanism is rather new, while the issue of prospective double taxation of the income of natural persons is only becoming more relevant, therefore so far we don't know any cases of initiation of such procedures from practice, and it is also important to assess how such cases will be considered by the Ukrainian state authorities.

Ukrainian business and business associations are already becoming aware of this problem, and they are already directing their effort at solving it and are trying to urge the Government initiate negotiations with foreign states.

As we can see it from open sources of information, the issue has already been put to discussion by the Minister of Social Policy of Ukraine and the Chairman of the European Parliament's Committee on Employment and Social Affairs.

So far the European Parliament has only stated in public that taxation is mainly regulated by the national legislation of the EU Member States, but these issues can, in fact, be solved at the level of the European Union if they are linked to the effect of the Temporary Protection Directive.

However, as for now, no progress is shown by the European Parliament as far as regulation of this issue at the general European level is concerned.

Besides that, attention of the OSCE has also been drawn to the problem of double taxation of the income of Ukrainian refugees, and it has been urged to give a formal clarification or recommendations by analogy to the recommendations issued during the crises caused by the spread of COVID-19 which stated that persons' stay abroad due to acts of god shall not be taken into account for the purposes of application of the double taxation avoidance conventions.

And though OSCE's clarifications are not binding, they are still followed as certain guidelines on the application of the OSCE's Model Double Taxation Avoidance Convention. And almost all double taxation avoidance agreements concluded by Ukraine are based on this Model Convention.

In case the OSCE issues such recommendations, we may hope for some progress in Ukraine's bilateral relationship with other countries. And such recommendations will help solve the problems of double taxation at a more global level, including in relation to the Ukrainians staying in other, non-EU Member States.

Due to the above, we hope that the issue may be settled rather quickly. At the same time, the current situation may require more rapid response, due to local taxation requirements in some foreign countries that demand monthly payment of taxes and not payment of taxes on the basis of the yearly results.

That is why companies the employees of which are so far staying abroad should start their tax planning already now.

One of the ways to solve this problem is movement of an employee to another country prior to expiry of the 183-day period of stay, however, we do realize that such method will not be suitable for every company and every employee.

The issue of getting financial assistance abroad from the governments of the host countries remains unregulated so far.

Taxation of such assistance is not specially regulated by the Ukrainian legislation yet.

As the result, these payments must basically be considered as foreign income of such natural person, taxable in Ukraine.

This issue has already been raised to the state authorities. So far the representatives of the Ministry of Finance of Ukraine have announced that the law-maker is preparing a draft law aiming to regulate this issue and to make assistance received by Ukrainian refugees abroad exempt from taxation in Ukraine.

We hope that the law-maker will really do this at least by the end of the year. Since otherwise that may cause a wave of indignation among Ukraine's international partners financing Ukrainian displaced persons, but obviously having no intention to finance the state budget of Ukraine through such assistance provision.

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As we can see, there are a number of issues that still need to be solved.

Due to the above, we recommend Ukrainian companies and natural persons to start their tax planning as soon as possible in order to avoid facing more problems in some time.



Alexander Minin, WTS Consulting



Inna Taptunova, WTS Consulting



Yuliia Kryvomaz, WRS Consulting