



Tax Planning International **Indirect Taxes**

Volume 7, Number 12 – December 2009

INTERNATIONAL INFORMATION FOR INTERNATIONAL BUSINESS

Ukraine's Tax and Customs Regime for Imports

Scott Brown

Frishberg & Partners, Kyiv

This article discusses the taxes, customs duties and certain other requirements applicable to imports into Ukraine.

Introduction

As in other European countries, Ukrainian import-export operations are subject to various taxes, including, but not limited to, customs duties and value-added tax. Further, depending on the specific product, excise tax and other official costs associated with obtaining licenses or necessary product labels may be applicable. The Cabinet of Ministers has also implemented a licensing system for the import of certain goods, such as chemical substances, fertilizers, pharmaceuticals, cosmetics and veterinary items, among others.

The various taxes associated with standard import operations are summarized below.

Value-Added Tax

Ever since December 26, 1992, when the Cabinet of Ministers executed its Decree No. 14-92, "On Value-Added Tax," the legislation governing value-added tax ("VAT") has changed frequently, arousing the ire of many companies, foreign and local, large and small.

Staying true to its reputation for constantly amending key legislation, on April 3, 1997, the Parliament approved a new and improved VAT law, which became effective on October 1, 1997 (as most recently amended on July 24, 2009). Subsequently, the Cabinet of Ministers passed Resolution No. 540, dated June 9, 1997, implementing a new VAT payment procedure.

Generally, the law continues to apply a 20% tax for all businesses and other legal entities (such as funds) providing goods and services on the territory of Ukraine, but the calculation mechanism has been liberalized somewhat. The new law finally closed one of the last loopholes by canceling tax holidays for non-profit "Chernobyl-type" organizations, but kept the exemptions for products used by underprivileged

children and the disabled, (e.g., children's food products, magazines and newspapers, etc.). The law also implemented a new mechanism for effectuating the payment of value-added tax: The importer simply posted a promissory note instead of effectuating a cash payment.

Ukrainian VAT legislation sets up a two-tier structure, designed to effectively protect domestic markets from foreign imports. Below we describe each of the two VAT tiers separately.

Import VAT

The VAT rate under Ukrainian law is 20%, as levied against taxable turnover, which does not include VAT. Taxable turnover for import VAT is calculated as the customs value of the goods, including customs duties and any applicable excise taxes. This import VAT is due and payable at the same time customs duties are being assessed (with a potential 30-day extension made at the discretion of the customs office).

VAT on Retail Sale in Ukraine

Of course, VAT is levied on all products and services manufactured and sold in Ukraine. Costs associated with obtaining/maintaining equipment that are reflected in the final price of the goods also are subject to VAT.

Any goods or services sold in Ukraine are subject to a 20% VAT, which is levied against the costs of the materials and is included in the sale/purchase price (i.e., sales turnover). Upon resale, sales VAT is levied on the total difference between customer-paid VAT and the VAT paid by the seller for all component materials.

Scott Brown is a Partner in Frishberg & Partners, Kyiv.

In the event that an imported product is re-sold in Ukraine, VAT is paid on the difference between the sale price and the customs value (including customs duties and any excise taxes) plus import VAT.

Excise Tax

The Ukrainian government has always levied excise tax on luxury items imported into Ukraine, such as alcoholic beverages and tobacco products, and the letter from the State Tax Inspection "On Excise Tax," No. 16-1221/10-7232, dated September 9, 1997, merely reaffirms this fact. Other legislation governing excise tax includes Decree No. 18-92 of the Cabinet of Ministers "On Excise Tax," dated December 26, 1992, and the Law of Ukraine No. 329/95-VR "On Excise Tax on Alcoholic Beverages and Tobacco Products," dated September 15, 1995.

In the past, there was no clear system of tracking the importation and distribution of cigarettes and liquor products. Naturally, the sale of unchecked contraband products resulted in a gold mine of tax-free opportunities for all types of traders, who supplied Ukraine with well-recognized vices with virtually no payment of taxes.

In an attempt to control the illegal importation and distribution of cigarettes and liquor, on July 12, 1995, the President executed Order No. 609/95, "On Excise Stamps on Alcoholic Beverages and Tobacco Products." Unlike the excise tax law, this order provided a new approach for collection of excise tax by requiring importers to purchase special customs stamps and place them on each bottle of alcohol and every individual cigarette pack. Without such stamps, no alcohol or tobacco products could henceforth enter or be sold in Ukraine and, if found in Ukraine, they are subject to confiscation.

Entirely too much legislative attention has been devoted to alcohol and tobacco, as evidenced by the Parliament's Resolution, dated September 15, 1995, "On the Procedure for Implementing the Law of Ukraine 'On Excise Tax on Alcohol Drinks and Tobacco Products';" the Cabinet of Ministers' Resolution No. 1755 "On the Term of Validity of Licenses for Carrying Out Certain Types of Economic Activity and the Procedure for Calculating the Payment Amount for the Issuance Thereof," dated November 29, 2000; Decree No. 666 "On Measures for Implementing Excise Stamps on Domestic Alcohol Drinks," dated June 20, 1996; Decree No. 493 "On the Temporary Procedure for Issuing Licenses for Import, Export and the Wholesale Trade of Ethyl Alcohol, Cognac Alcohol Drinks and Tobacco Products," dated May 13, 1996, among others.

Other luxury items are also subject to the excise tax, and they are identified in the Cabinet of Ministers' Resolution No. 1078, dated September 29, 1997, as caviar, crab, shrimp, chocolate, automobile tires, audio and video cassettes, televisions, among others. Interestingly, the minimum rates for television and video equipment imported by Sony and Panasonic were higher than for Daewoo and LG Electronics, but no official explanation was given.

The excise tax rates and the listed products tend to change constantly, which keeps the importers on their toes. On June 2, 1997, for instance, the Cabinet of

Ministers imposed minimum customs values for certain foodstuffs (*e.g.*, coffee, black caviar, frozen chicken and turkey legs, among others) and clothing (fur coats and leather jackets).

Customs Duties

As a rule, all imports are subject to payment of customs duty (and, of course, the much-hated value-added tax). The only exception applies to foreign investors who contribute qualified foreign investment into a Ukrainian resident company's authorized capital in exchange for the ownership rights in such company.

The Foreign Investment Law expressly provides that in-kind investment imported into Ukraine as a foreign partner's contribution to the authorized capital of any Ukrainian company, such as a joint venture or a 100% foreign-owned subsidiary, is exempt from customs duty, but is still subject to value-added tax. If, however, the above foreign investor's property is alienated within three years from the date it is credited to the Ukrainian company's balance, the Ukrainian company will need to pay customs duty thereon. Importantly, the registration of foreign investment is mandatory from June 23, 2009, until at least January 1, 2011.

The specific rates for various products may be found in various laws, starting with the Customs Code of Ukraine, effective on January 1, 2004, and the Cabinet of Ministers' Decree No. 4-93, "On Unified Customs Tariff," dated January 11, 1993. Other legislation evidencing that import duty rates are subject to constant changes include the Cabinet's Resolution No. 1648 "On Introduction of Amendments to and Recognition of Certain Resolutions of the Cabinet of Ministers of Ukraine Which Were Rendered Ineffective," dated December 13, 2001; Law No. 313/96-VR, "On Rates of Excise Tax and Import Duties on Certain Products," dated July 11, 1996, as amended on May 22, 2003; the Law of Ukraine No. 2097-XII "On Uniform Customs Tariff," dated February 5, 1992, among others.

On December 21, 2000, the Parliament adopted amendments to the Law "On the Unified Customs Tariff," according to which the Cabinet of Ministers no longer has the authority to establish rates of customs duties. Reacting swiftly, on January 12, 2001, the Cabinet of Ministers adopted Resolution No. 16 "On Amending the Rates of Import Duties for Certain Types of Products and Certain Resolutions of the Cabinet of Ministers of Ukraine," which was thereafter rendered ineffective by the Cabinet of Ministers' Resolution No. 1648 of December 13, 2001.

Currently, the Law "On the Unified Customs Tariff" bestows upon the Parliament the authority to have final approval over the Cabinet's proposals regarding the unified customs tariff. Additionally, the Law of Ukraine No. 2371-III "On Customs Tariff" was passed on April 5, 2001, which replaced the old Commodity Nomenclature for Foreign Economic Activity with the Ukrainian Classification of Goods of Foreign Economic Activity.

Miscellaneous Costs: Labels and Certification

Several categories of import products are subject to special licenses or “certifications,” such as pharmaceutical, agro-chemical and food products (e.g., the Cabinet of Ministers’ Resolution No. 1996 “On the List of Goods, the Importation and Exportation of Which is Subject to Licensing and On Which Quotas are Established”).

Naturally, cigarettes and alcohol are subject to a mandatory “certification” process under Orders Nos. 378 and 379 of the State Committee on Standards, Metrology and Certification, entitled “The Rules of Obligatory Certification of Tobacco Products” and “The Rules of Obligatory Certification of Alcohol Products,” both dated September 13, 1996.

Food products were the next in line for certification. As of January 1, 1997, all imported food products undergo a “certification” process, during which the required labels containing various information (in the Ukrainian language) must be affixed onto the product. The required information includes the product’s name, volume, chemicals and additives, expiration date, and calorie content, among others.

On November 4, 1997, the Cabinet of Ministers’ Resolution No. 1211 “On Approval of the Procedure of the Customs Clearance of Imported Goods (Products) Which Are Subject to Mandatory Certification in Ukraine” approved the procedure for the customs clearance of imported products subject to obligatory certification in Ukraine. Four years later, on December 13, 2001, the above procedure was slightly amended by the Cabinet’s Resolution No. 1671.

The practical implementation of the otherwise reasonable certification requirements continues to cause great anxiety among importers. Many foreign companies complain, and rightfully so, that clear and transparent compliance with this particular piece of legislation is often possible only after rewarding (in cash or in-kind) the state official(s) responsible for

granting the necessary permissions. Regrettably, this viewpoint has merit.

While product certification is designed to ensure consumer safety and quality standards, it can also become a good tool to protect domestic producers from importers. A good example of this dichotomy is provided by Procter & Gamble’s struggles with the Ukrainian authorities. On March 3, 1998, the State Committee for Standardization, Certification and Metrology (“DerzhStandart”) revoked Procter & Gamble’s laundry detergent certificates, which reportedly cost the company U.S.\$135,000 to acquire. The DerzhStandart asserted that the formula used to produce Procter & Gamble’s soap powder was of inferior quality and was aimed at the poor Ukrainian public.

Procter & Gamble disagreed wholeheartedly, and launched a counter-attack on March 20, 1998, by requesting that the Presidential Independent Chamber on Foreign Investments form an expert panel to resolve this conflict, and initiating a criminal investigation to trace its payment of U.S.\$135,000 for the certificates. In the meantime, the dispute had a negative side-effect on Procter & Gamble’s activities.

Conclusion

As a rule, in any import-export transaction, something can always go wrong at any moment. Even a miniscule degree of non-compliance with Ukrainian import rules may lead to significant delays, increased costs, additional efforts, and even lost profits (especially in case of perishable goods). As legislation in this area changes all too frequently, foreign business entities wishing to sell their products in Ukraine must inform themselves about the latest applicable import taxes and duties, certificates and licenses, contract formalities and related matters.

Scott Brown is a Partner in Frishberg & Partners, Kyiv. He may be contacted by email at: office@frishberg.com.ua.