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INTERNATIONAL TAX OPTIMIZATION FROM THE STANDPOINT OF UKRAINIAN LAW

Рассмотрены проблемы двойного налогообложения, а также описан процесс освобождения от двойного налогообложения путем составления соответствующих налоговых договоров, изучены причины возможных проблем, появляющихся при выполнении тех или иных налоговых конвенций общегосударственными предприятиями и теми предприятиями, которые не имеют статуса государственных, проведен анализ работы налогового договора в оффшорной зоне на территории Кипра.

A research urgency. Measures taken in recent years aimed at abolishing privileges, against tax evasion, capital flights, and limitation of deals with offshore companies decrease the variety of possible instruments and make schemes be more sophisticated, but still leave means for tax optimization. One of them is treaty on relief from double taxation, which is prior over national legislation. Traditionally they are used in payment of already paid taxes and decreasing revolving taxes and also for dealing with contracting country without registering a regular representative office and levying itself with taxes.

A research objective: investigation of some problems of double taxation, analysis of the process of relief from double taxation using tax treaties, stipulation of some possible problems that may arise when implementing this or that tax convention by permanent establishments and other enterprises without status of permanent establishment, analysis of how tax treaty works within offshore territory of Cyprus.

A body Due to Letter of the State Tax Agency of Ukraine of 11.01.2000 № 290/7/12-0107 "About implementation of tax treaties for a relief from double taxation" there has been a number of countries that Ukraine has signed a tax treaty, for example (later Convention) with: Great Britain (22.11.93), Poland (24.03.94), Belarus (30.01.95), Hungary (24.06.96), Moldova (27.05.96), Sweden (04.06.96), Canada (22.08.96), Germany (04.10.96), Slovakia (22.11.96), Latvia (21.11.96), Denmark (21.08.96), Norway (18.09.96), Estonia (24.12.96), Armenia (19.11.96), Kazakhstan (14.04.97), the Netherlands (02.11.96), Bulgaria (03.10.97), Rumania (17.11.97), Latvia (25.12.97), Uzbekistan (25.07.95), Finland (14.02.98), China (18.10.96), Turkey (29.04.98), Macedonia (23.11.98), Indonesia (09.11.98), Belgium (25.02.99), Croatia (01.06.99), Kyrgyz (01.05.99), Czech (20.04.99), Georgia (01.04.99), Austria (20.05.99), Turkmenistan (21.10.99), Russia (03.08.99), France (01.11.99). Besides, according to article 7 of Law "About law succession of Ukraine" those conventions on relief from double taxation signed by USSR still have power unless new Convention with this or that country is signed. By 12.31.2000 USSR Conventions take part in relations of

Ukraine with the following countries such as India, Spain, Italy, Cyprus, Malaysia, Mongolia, USA, Switzerland and Japan. Nowadays there are 43 conventions between Ukraine and other countries of the world on the relief from double taxation.

All Conventions deal with income taxation (and some of them with property) received by: a) residents of Ukraine abroad, b) nonresidents in Ukraine.

Description of terms for resident and nonresident is given in Law of Ukraine of 28.12.94 № 334/94 "About Income Taxation of Enterprises of Ukraine" (later Law about Income). So, according to this law under the term residents should be meant legal entities and subjects of economic activity, which were founded and operate in accordance with laws of Ukraine and reside on its territory (physical persons do not fit in the framework of this term). So, under the article 19 of Law about Income tax sums on income received from abroad, which were paid by these companies abroad, are taken into account when paying an income tax in Ukraine. Sum, which is taken into account, is computed under the rules set by this Law. It cannot be more than the sum, which is to be paid in Ukraine by this taxpayer during the certain tax term. In case the sum of paid taxes abroad exceeds that one which is to be paid in Ukraine, there is no opportunity to reimburse the difference. Besides, there is another limitation about the relief from double taxation, which depends on the tax type paid abroad, and to be paid in Ukraine. So, the following taxes are not the subject for lessening the tax obligations in Ukraine: (a) capital gains tax, (b) stamp duties, (c) turnover tax, (d) other indirect taxes, (e) tax sums paid from passive income (dividends, interests, royalty, others). And, finally, in order to get an advantage of Conventions on relief from double taxation resident company has to prove the fact of paying certain taxes abroad with written confirmation of tax body in a certain country. But it is necessary to note that rules named above may not be implemented in case other rules are defined by Convention. It may be true for a body competent for drawing written confirmation of paying certain taxes.

Nevertheless the procedure of using this or that advantage of certain Conventions has become recently more or less clear only for a second category of income – "income of nonresidents with the source from Ukraine". And speaking about income received from abroad by residents of Ukraine, one may say that there is a big "procedural gap", which may cause a number of difficulties in their practical implementation.

According to article 1 of Law about Income under the term nonresidents should be meant legal entities and subjects of economic activity, without status of legal entities (branches, representative offices, others) residing outside Ukraine, which were founded and operate in accordance with the regulation of other states. Diplomatic representative offices, consular bodies and other official representatives of foreign states, international organizations and their representatives, which have diplomatic privileges and immunity, and other representatives of foreign organizations, which do not perform economic activity according to legislation of Ukraine, are also defined as nonresidents.

Under the term income of nonresidents with the source from Ukraine should be meant any income of residents or nonresidents received from any business activity

on the territory of Ukraine, including interests, dividends, royalty and any other passive incomes paid by residents of Ukraine.

Besides, Law about Income outlines two categories of nonresidents-taxpayers, which: (a) perform economic activity on the territory of Ukraine through a regular representative office; (b) do not have such office.

In the first case, according to article 11 of Law about Income, representative office like that equates with income tax payer (instead of nonresident itself), which fulfils its activity independently from this nonresident and is levied with the tax in a common order.

In the second case for the sake of taxation some residents are equated with representative offices, in particular those ones, which transfer the income to nonresidents. The order of taxation of such residents is absolutely identical to the order of taxation of regular representative offices, with only one difference, concerning additional registration at tax bodies as an income tax payer – there is no need in this procedure for them.

Conventions foresee three ways of implementing this or that norm relatively to incomes with its source from Ukraine: a) exemption from taxation, b) tax credit, and c) tax deduction (all these ways are described in detail in chapter 1.4).

Whatever way was chosen the main document one will not be able to manage without is inquiry, testifying that nonresident is a resident of state-participant of Convention. If this inquiry is not presented, than taxation will be held due to Ukrainian legislation.

Due to Resolution № 825 of 18.05.2000 "About affirmation of Order of tax exemption (deduction) of income with the source from Ukraine due to international treaties of Ukraine about relief from double taxation" this inquiry has a special form, example of which is given in appendix B. Although company may grant inquiry of another form, than it should legalize in a competent bodies. In order to do this, company has to turn to consular body of Ukraine.

Period of validity of the inquiry is bounded by a calendar year in which it was given.

According to Conventions offshore territories of Cyprus, Great Britain, the Netherlands present a special interest for Ukrainian enterprises. One of the most popular and widely used is offshore territory of Cyprus. It allows exporting Ukrainian capital abroad with minimal tax obligations and reinvesting it in Ukrainian economy in the form of foreign direct investment. Between Ukraine and Cyprus there is a Convention on relief from double taxation, signed by USSR and Cyprus in 1982. To take an advantage of this Convention is possible only by dealing in Ukraine through independent agent. According to Convention Cyprus companies may perform some business activities without paying local taxes. These activities are:

construction-assembly works not longer than 12 months, including performing control of constructing the object or any other assembly works;

purchasing and storing of goods, delivery;

clinching deals via agent or other authorized person acting on the basis of letter of attorney or other written proxy if this kind of activity is not his

professional activity;

demonstration of products and goods, exposition, operations of selling products and goods after the exposition;

advertisement activity;

information collection and spreading;

marketing activity;

engineering;

other activities which have an auxiliary character.

A given example allows minimizing taxes in national deals as well as in international one. In case of import changes only an agent agreement. In latter case Cyprus firm will order its partner to buy goods and import it in Ukraine paying custom duties and levies. Reasons for minimization of taxes are in Convention between Ukraine and Cyprus: Cyprus company operating in Ukraine via Agent with independent status (commissioner's) has a legal right not to register permanent establishment in Ukraine and is not the subject of taxation in Ukraine and Ukrainian company agent taxes only its commissioners. More over according to the Convention purchasing, storage, supply, goods demonstration and some other activities also are not taxed in Ukraine. But there are some contradictory moments in Ukrainian legislation towards operations with offshore companies.

The conclusion. First of all Law about Income in article 18 proclaims: "In case of signing contracts which foresee payments for goods, services in favor of nonresidents, situated in offshore territories or executing payments through such nonresidents or their bank accounts… taxpayer's expenses for payments of such goods, services are included in structure of aggregate expenses in sum equivalent of 85 per cent. The list of offshore areas is annually proclaimed by the Cabinet of Ministers". From the point of view of the state this article should nip in the bud the leak of financial means and raise additional revenue for budget. Time has shown that neither one of these aims were reached. And the reason lies in rude violation of this article of international and national norms of law. Namely: a) in international internal taxation practice of imports goods another principle is applied (it is fixed in Law of Ukraine "About International Business Activity") – principle of country's birth of goods; b) this norm has a discriminative character and violets international Agreement "About Partnership and Cooperation" signed by Ukraine and European Community in 1994, and it is known that one country alone has no right to change the terms of international treaty, unless every country participant of this treaty brings in certain changes, c) national principle and principle of the most favorability is broken. Instead of positive effects this norm rained down a wave of malevolent saying to Ukraine's address, deteriorating the weak reputation of Ukraine at international political and economic arena. It made Ukrainian companies face again with the dilemma of either to pay or not. Any decision should be confirmed in the court. Such practice, naturally, cannot motivate companies deal with offshore areas, but once more put them in vice of dubious legislation.

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