

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Questioning Ukrainian Tax Authorities

I. Introduction

Increasingly, Ukraine has found itself looking towards Poland for foreign (or Western) investment and towards Russia for Russian capital. Investment bankers and venture capitalists refer to such moves as the creation of a “converging Europe.” As the edges of the European Union expand, the investment spillover into new the EU border states expands as well. While Ukrainian tax and investment law must come a long way before they will be in close enough compliance with Western standards to allow accession into the European Union, already we see the first steps in this direction.

In mid-February 2001, President Kuchma signed the Law of Ukraine No. 2181-III “On the Procedure for Discharging Taxpayers’ Obligations before the Budget and State Target Funds,” dated December 21, 2000 (the “Law”), as lastly amended on November 30, 2006. While not a laughing matter, the majority of this new legislation took effect on April 1, 2001, at which point it began to regulate basic relations between taxpayers and government tax agencies (including the Pension Fund of Ukraine and the social insurance funds).

The Law also introduced changes to a dozen other laws, including the laws on profit taxation of businesses and value added tax, the Law “On the State Taxation Service,” the Arbitration Procedure Code, etc. The Law is significant because it offers fundamentally new definitions of such key terms as “taxpayer,” “tax debt,” “penalty,” “tax declaration,” etc. Altogether, more than 17 new definitions have been added to the Ukrainian tax legislation as a result of this Law.

II. New Provisions

Importantly, the Law replaces the previous notion of uncontested recovery of tax debts as determined by the tax authorities. In other words, it suspends further action by the tax administration for the duration of the appeal process and provides Ukrainian residents and resident companies a legal methodology with which they may dispute their tax liability, including liabilities before the Pension Fund and the social insurance funds. At long last, gone are the days when the tax administration could indisputably debit your account.

Because the Law introduces a new procedure, which allows a taxpayer to appeal the tax administration’s determination of tax liability, it weakens the tax administration’s stranglehold on

the Ukrainian population and brings Ukrainian tax policy into closer conformity with Western concepts and practice. Ultimately, policy shifts such as this may lead to greater faith in the Ukrainian tax collection system and a reduced rate of tax evasion.

To say that a taxpayer's assets can be forcefully recovered only as a result of a court decision, however, would be a bit of an exaggeration because such court proceedings must be undertaken at the taxpayer's initiative. Still, the very possibility of initiating court action enables taxpayers to apply pressure against the tax administration.

III. Adjustment of Liabilities

The adjustment of a taxpayer's tax liability comprises a key component of the Law, and serves as a starting point in the process of discharging tax liabilities. If a taxpayer calculates everything correctly, and in a timely fashion, then his or her tax liability is considered to be adjusted and such taxpayer is responsible for his or her calculations. Should the tax administration find any irregularities with these calculations or should they simply believe that irregularities exist, the adjustment process will begin. What course this process takes thereafter depends largely upon the taxpayer's approach to the adjustment process.

During the first stage of the adjustment process, the tax administration will determine its own calculation of the taxpayer's tax liabilities and will seek recovery of same. Should the taxpayer disagree with this calculation, he or she must initiate the procedure of appellate adjustment: the taxpayer files a complaint with the tax administration and they must respond within tight deadlines. It is important to remember that during the appellate adjustment procedure, the tax administration must comply with the newly-introduced "conflict of interests" rule, which states that in the event of legal ambiguities, the tax administration must decide in favor of the taxpayer.

Please note that if a taxpayer fails to file his or her complaints within the established deadlines, then the appellate adjustment procedure ceases and the taxpayer's tax liabilities are deemed adjusted, i.e., payment is considered due and pending. By the same token, if the tax agency fails to comply with the deadlines or to notify the taxpayer of the review extension, then the taxpayer's complaint is deemed satisfied. The tax debt will not be forgiven, but the taxpayer may win some time.

The following tax liabilities can be adjusted:

- 1) tax liabilities, as determined by a taxpayer in his or her tax return, provided the tax return reflecting such adjustments is accepted by the tax agency as filed;
- 2) if a dispute arises regarding a taxpayer's tax return, then the tax liabilities, as calculated by the tax agency, will be considered adjusted in the following circumstances:

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