

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Taxation of Non-resident Entities

I. Tax Jurisdiction over Non-residents

Non-resident entities are subject to taxation on two types of income in Ukraine:

- a) ***Business income*** derived from carrying out business in Ukraine; and
- b) ***Non-business income*** received from Ukrainian sources.

Importantly, the taxation of both business and non-business income is subject to the provisions of various international double taxation treaties between Ukraine and other countries. Therefore, preferential tax treatment or provisions may be available to a non-resident taxpayer under an appropriate double taxation treaty of their respective domestic jurisdictions.

II. Taxation of Business Income

Business income of a non-resident obtained through a permanent establishment situated in Ukraine is subject to taxation that is similar to the taxation of Ukrainian residents. The term “permanent establishment” has a similar meaning under the domestic tax legislation to the term defined in Article 5 of the OECD Model Income Tax Convention. Therefore, a non-resident’s income, attributable to Ukraine via the activities or assets of its permanent establishment, is subject to taxation in Ukraine on a net basis at a rate of 25 percent.

A. Permanent Establishment

In Ukraine, the permanent establishment of a non-resident is defined as a permanent place of business through which a non-resident partially or completely performs its entrepreneurial activities. The term permanent establishment includes branches, places of management, offices, factories, workshops, mines, oil or gas wells, open-cast mines or any other place of extraction of natural resources.

It is important to mention that under domestic tax rules, the activities of any resident agent with the authority to conclude contracts on a non-resident’s behalf lead to the creation of a permanent establishment for the non-resident, irrespective of whether the agent has a dependent or independent status.

B. Calculation of Attributable Income

▪ *Direct Method*

This method is used when the entity can easily determine the amount of income attributable to the activities or assets of its permanent establishment. Allowable expenses are deducted from gross income, and the difference is reported as taxable income. Interestingly, such expenses are deductible irrespective of whether they are incurred within or outside of Ukraine, provided that they are supported by proper documentation.

▪ *Split Balance Sheet Method*

This method is used for nonresident companies with activities in multiple countries that do not have readily available gross income figures that can be allocated to their operations in Ukraine.

As a result, a special formula is applied to calculate attributable taxable income. It uses the Ukrainian share of the resident's worldwide gross income, deductible expenses, number of employees, and book value of its assets to determine the taxable income.

▪ *Indirect Method*

The indirect method is used by companies who could not feasibly determine the amount of attributable income under the direct method, and could not provide necessary documents under the split balance sheet method.

To calculate attributable taxable income, a 25 percent profit margin is applied to gross income attributable to the permanent establishment.

III. Taxation of Non-Business Income

Non-business income from Ukrainian sources is normally subject to withholding tax on a gross basis, provided such income is not attributable to a non-resident's permanent establishment in Ukraine. Withholding is made by a resident taxpayer when income is paid to a non-resident.

A. Ukrainian Source Income

For withholding tax purposes, the following items of income are treated as received from a Ukrainian source:

- *Interest Income* - interest on debt obligations issued by a resident entity;

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