

TO: Clients and Friends of the Firm

FR: Frishberg & Partners

RE: Unified Tax

I. Introduction

Ukrainian tax legislation has never been known for its consistency. In fact, most foreign investors doing business in Ukraine continue to marvel at the number of taxes Ukrainian companies must pay. Unable to supervise (i.e., tax) the activities of the ever-growing number of smaller companies, the taxation authorities had to unify the dizzying array of taxes in order to collect any money at all.

Faithfully following the Russian tax model, which has recently undergone liberal reforms, Ukraine implemented its own brand of tax reforms. As a result, like their Russian colleagues, today many Ukrainian small-size entrepreneurs have switched to the unified tax system, allowing them to pay a single, lower tax rather than the multitude of taxes prescribed by the general taxation system. This new approach is documented in the Presidential Edict No. 727 “On Simplified Taxation, Accounting and Reports of Small-Scale Entrepreneurs,” dated July 3, 1998, as amended on June 28, 1999 (the “Edict”).

And unified tax system means just that: one flat tax rate instead of VAT; profit tax; personal income tax (only for individual entrepreneurs); land tax; the fee for the specific use of natural resources; the innovation fund fee; the social insurance fee; fees for the construction, re-construction and repair of public roads; communal taxes; trade tax; pension fund fees; contributions to the social protection fund for disabled persons; contributions to the employment fund; and special patent payments, if any.

Since its implementation, the unified tax system proved to be fairly popular with all types of small-time businesses. Of course, the same taxation rules are extended to all Ukrainian resident companies, including joint ventures and 100% foreign-owned subsidiaries, provided they will: (i) employ less than 50 employees during a calendar year; and (ii) earn annual proceeds of less than one-million (1,000,000) Ukrainian Hryvnia.

Note that foreign investors, who establish Ukrainian resident entities in the following legal and organizational forms, may also enjoy the benefits of the unified tax system:

1. A private enterprise, formed by a single private entrepreneur (physical person). The benefits are obvious: such enterprises are not subject to a specific minimum capitalization

requirement. Therefore, a significantly minimal amount of funds is sufficient for a private entrepreneur to form the charter fund of a private enterprise. Conveniently, the founder enjoys the complete protection of corporate liability.

2. A limited liability company. This company form requires a minimum capitalization of 44,000 Hryvnias from July 1, 2007 and 46,000 Hryvnias from October 1, 2007 (or just over 8,712 USD and 9,109 USD respectively).
3. A closed joint stock company. This company form requires a minimum capitalization of 550,000 Hryvnias from July 1, 2007 and 575,000 Hryvnias from October 1, 2007 (or just over 108,910 USD and 113,861 USD respectively).

Please note that the above minimum capitalization requirements are based on the amount of the minimum monthly salary at the time of calculation of a company's authorized capital upon registration. Thus, the minimum capitalization requirement of a limited liability company is 100 minimum monthly salaries (or 100 x 440 from July 1, 2007 and 100 x 460 from October 1, 2007). Please note that the minimum monthly salary is subject to frequent change and should be verified before calculating the amount of a company's minimum capitalization prior to registration.

In sharp contrast, Ukrainian companies formed either by Ukrainian or foreign legal entities are prohibited from applying the unified tax system if the contributions of such legal entities exceed 25% of the total amount of the authorized capital of the created Ukrainian company. This is significant because, historically, 26% ownership gives an investor the right to exercise a minor degree of control over several so-called "fundamental" issues of a company.

For your convenience, below we provide you with the legislative analysis governing unified tax system.

II. Discussion

According to the Edict, only the following categories of Ukrainian entrepreneurs may file tax reports under the unified tax system:

- (i) individuals, who carry out business activities without registering a legal entity and who employ no more than ten persons during one calendar year (including family members). In this case, the individual's annual proceeds from the sale of products (goods, work or services) may not exceed five hundred thousand (500,000) Ukrainian Hryvnia; and
- (ii) legal entities, regardless of their organization forms, which employ no more than fifty persons during one calendar year, including part-time employees and employees

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