Implementation of the BEPS plan in Ukraine to counteract aggressive tax planning

Упровадження плану BEPS в Україні для протидії агресивному податковому плануванню

Yaroslav Hretsa

Key words:

tax, tax planning, controlled foreign companies, Automatic Exchange of Information, low tax jurisdictions.

Ключові слова:

податок, податкове планування, контрольовані іноземні компанії, автоматичний обмін інформацією, територія з низьким рівнем оподаткування.

Problem formulation. Over the last decade we have seen a trend towards globalization of business that seeks to go beyond national boundaries. This trend is only increasing over time and we can safely assume that in the future we will see its growth. Going beyond national borders, business is in a situation where its activity has become regulated by the laws of different states, which is not harmonized and coherent. Consequently, corporations and other businesses began to take advantage of this situation, especially in taxation, as tax planning possibilities have significantly expanded. The pace of cross-border cooperation is significantly ahead of the work of states and international organizations on the harmonization of their tax legislation and defining common rules for the game.

Central and Eastern European countries are actively involved in these processes. For Ukraine, they became relevant in connection with the accession to the World Trade Organization in 2008, and especially after the signing of the Association Agreement between Ukraine and the European Union in 2014.

State of research. The issues of international tax planning and prevention of tax abuse were investigated in the works of such scholars as D. Aksionov, I. Andrushenko, O. Zorina, I. Halkin, D. Hetmantsev, D. Kosse, N. Moskalenko, Y. Sorokin. However, there is still a lack of sound scientific research on the implementation of the BEPS Project in Ukraine.

The purpose of this article is to identify the positive and negative consequences of the implementation of the basic BEPS Actions in the legislation of Ukraine.

Presentation of the main material. Expanding cross-border business opportunities is an extremely positive thing for any country's economic development. On the other hand, difference in tax regulation in different countries, a large number of low-tax jurisdictions, offshore or the so-called "tax havens" creates the opportunities for business entities to shift their profits to countries with loyal taxation using aggressive tax planning; at the same time, those countries where the economic activity actually takes place, added value is created and the real profit would have to be obtained and taxed are often left with nothing. The high tax burden that exists in some economically advanced countries (such as the UK, Italy, Germany, the United States, France and Japan) forces taxpayers to seek certain tax-saving instruments[1]. The well-known examples are Google, Apple, Starbucks and Amazon, which, through structuring activities using loopholes in international tax law, have artificially lowered the tax base by accumulating profits on accounts in low-tax jurisdictions. These trends have created increasingly serious challenges, and the global community has been unable to stay out of the way, recognizing the need to develop effective instruments to counteract the artificial erosion of the tax base and minimizing of tax payments. In response to this challenge, G20 leaders turned to OECD (Organization for Economic Co-operation and Development) experts in 2012 to develop an action plan to address the problem of erosion of the tax base and profit shifting. The OECD presented its first report on the subject and proposed an Action Plan on Base Erosion and Profit Shifting or abbreviated: BEPS Project[2].

---

[1] Leshchenko, R.M. (2018). Financial and legal regulation of offshore mechanisms: a monograph. Kyiv: Yurincom Inter, 2018, 316 p.

[2] Implementation of the BEPS plan in Ukraine: problems and prospects (2017). Retrieved from: https://lhs.net.ua/wp-content/uploads/woocommerce_uploads/2017/12/2_3_Jak-Ukraina-vprovadzhuie-plan-BEPS.-REShETNIK-Olga-radnik-Ario-Law-Firm.pdf.

To date, 116 countries have joined the project, accounting for over 93% of world GDP[3].

Ukraine is not at the forefront of these processes. Let us only take into account the fact that the legislation on transfer pricing appeared in 2013 only, but it did not give an opportunity to fully solve the problem of abuse of law in the implementation of international tax planning. According to the NBU, more than a third of all foreign direct investment that came to Ukraine as of the end of 2017 comes from low-tax countries, and almost 100% of foreign direct investment from Ukraine is directed to low-tax jurisdictions. A fifth of all foreign direct investment that came to Ukraine during 2010–2017 was round-tripping of domestic capital, which was taken out of Ukraine by domestic companies through various instruments (transfer pricing, loss of foreign exchange earnings, etc.), and returned in the form of direct equity investments from abroad and loans from a direct investor[4].

From January 1, 2017, Ukraine has also joined the OECD Enhanced Cooperation Program and committed itself to implementing the so-called BEPS Minimum Standard of the Action Plan – a mandatory four actions out of the fifteen proposed. These are Action 5 "Counter harmful tax practices more effectively, taking into account transparency and substance", Action 6 "Prevent treaty abuse", Action 13 "Re-examine transfer pricing documentation" and Action 14 "Make dispute resolution mechanisms more effective".

On July 23, 2018, Ukraine signed the Multilateral Convention on the Implementation of Measures Concerning Tax Treaties to Combat the Erosion of the Tax Base and Profit Shifting (Multilateral Instrument (MLI). This Agreement is Action 15 of the BEPS Action Plan. By signing and ratifying the Multilateral Convention, Ukraine simultaneously implements Actions 6 and 14 of the BEPS Action Plan, which are within the minimum standard of the BEPS Project.

However, the Ukrainian legislator really intends to go ahead and implement a wide range of activities of the BEPS. The Government considers effective steps to combat tax abuse as a prerequisite for full liberalization of the currency system and free movement of capital (a law providing for such liberalization came into force in Ukraine this year). [5]

Currently, the Parliament is considering bill No. 1210 "On Amendments to the Tax Code of Ukraine Aimed at Improving Tax Administration, Removing Technical and Logical Mismatches in the Tax Legislation". In addition to the minimum BEPS standard mentioned above, additional measures are envisaged, such as taxation of controlled foreign companies (Action 3), limitation of expenses on related party financial transactions (Action 4), avoidance of permanent representation status and taxation of permanent representative offices (Action 7); control of transfer pricing (Actions 8–10).

Ukrainian entrepreneurs are facing the adoption of the rules that are unusual for them. Adoption of the law they will have to declare and pay taxes on the income of controlled foreign companies (in which a resident of Ukraine has a stake of more than 50% or which are under its actual control), if they are in low tax jurisdictions (where the rate of income tax is 5 percentage points lower than in Ukraine) or in jurisdictions with which Ukraine has not concluded a double taxation agreement.

Measures are also planned to prevent the artificial avoidance of permanent establishment status.

There are new requirements for transfer pricing documentation. Today, it is mandatory to submit a report on controlled transactions only (the so-called local file) to the tax authorities. With the entry into force of the amendments to the tax code, international corporations with a consolidated income of over 50 million Euros will submit an additional global file (master file), which gives an overview of the activities of the entire group and provides the analysis of its key operations and indicators. Corporations with consolidated revenue of more than € 750 million will submit country-by-country reporting, which is a comprehensive document that provides disclosure by multinational corporations of their separate entities (subsidiaries, branches, representative offices) by country where they do business.

The new legislation also provides restrictions on the application of double tax agreements. The application of any international agreement of Ukraine will not be applicable if the main or overriding purpose of conducting

---

[3] Stepaniuk, Y. (2018) BEPS Action plan in Ukraine: managing the world or choosing a place on the sidelines. Retrieved from: https://dt.ua/macrolevel/plan-diy-beps-v-ukrayini-283563_.html

[4] Ibid.

[5] Zakon Ukrainy No. 2473-VIII (2018) Law of Ukraine On currency and foreign exchange transactions of 21.06.2018. Retrieved from: https://zakon.rada.gov.ua/laws/show/2473-19

a business transaction with a non-resident is to obtain, directly or indirectly, the benefits provided by the international treaty in the form of a tax exemption or a reduced tax rate.

The legislator aims to consolidate in the conduct of controlled transactions such doctrines as the overriding of the essence over the form (a situation where the content of an economic transaction does not meet the formal provisions of the contract); the reality of the business transaction (when documents will not be taken into account for tax purposes if the business transaction did not actually take place); business purpose (for tax purposes, a business transaction will be assessed for reasonable economic cause; it will not be taken into account if the sole or primary purpose of the transaction was to obtain tax benefits). It must be emphasized that in the current Ukrainian judicial practice such doctrines are actively used, even without being legally binding.

Another pressing challenge for Ukraine is accession to the Common Reporting Standard (CRS). A single standard for the automatic exchange of tax information is a document providing for the annual automatic exchange of information between the states that have implemented the Multilateral Convention on Cooperation between Competent Authorities for the Automatic Exchange of Information under the CRS Standard.[6]

According to the OECD, 49 member states have already made their first financial information exchange in 2017, with 4 more jurisdictions joining them in 2018, and in 2019-2020, they plan to exchange another 3 new jurisdictions. So, according to official information, 56 countries are members of the CRS standard; however, Ukraine has not joined them yet.[7]

What are the consequences of these major innovations for Ukraine? There are both positive and ambiguous points. On the one hand, Ukraine, like the entire civilized world, must combat tax abuse and artificial reducing of tax base. The government should ensure fair taxation for all entities, otherwise the interests of honest payers, which may bear competitive losses, will suffer. The introduction of generally accepted rules of the game will also improve the image of Ukraine internationally. On the other hand, introducing complex and rigid BEPS rules will pose some risks. First of all, the tax authorities will receive a broad new instrument, their discretion will be significantly expanded, which could threaten certain abuses on their part, especially given the fact that the tax service reform in Ukraine is only at the start of implementation. Secondly, the new rules will make life much more difficult for the taxpayers, since it will be more difficult to administer primarily the income tax. This will result in additional costs for taxpayers, so tax advisers will certainly not remain without work. Also, Ukraine will have to forget about any ideas of creating special economic zones with preferential tax regimes, which is promoted by some experts as a way of attracting foreign investment. This idea is quite popular in business circles of Transcarpathia, because the biggest investors, including the Skoda carmaker, came to the region at the time when such economic zone was established in the region.

While attracting foreign investment is vital for the economy of Ukraine, we will probably not be able to lure investors by significant tax benefits. Many steps have already been taken to improve Ukraine's tax system. One of the biggest successes has been the introduction of an electronic VAT administration system that eliminated corruption and embezzlement of budgetary funds, as well as ensured timely VAT refunds, which had been a major problem before. At present, there is a very large debate in Ukraine about the prospects of replacing income tax with capital deduction tax, which involves taxing only that part of income that is deductible in the form of dividends or equivalent payments. It should be noted that the introduction of this tax was one of the points of the current presidential election program, as this topic is very popular in Ukrainian business circles. On the one hand, such a move will help to attract domestic and foreign investment and thus promote economic growth. On the other hand, according to experts, it will lead to huge financial losses of the budget. The financial system of our country is not ready for this, especially during the period of maximum budgetary burden due to the foreign debt payment.

Conclusions. The implementation of the BEPS Action Plan into Ukrainian legislation, which is expected in the near future, has certain advantages and disadvantages, which have been described above. But it seems that for Ukraine there is hardly any other choice, since we cannot be isolated from global processes and ignore these realities. For businesses, this leads to a new quality of tax planning, which means abandonment of artificial schemes, taking into account financial monitoring, and actual restriction of banking secrecy. In addition, the

---

6 Drach, S. (2019) Automatic exchange of tax information: what to expect in Ukraine. Retrieved from: http://yur-gazeta.com/dumka-eksperta/avtomatichniy-obmin-podatkovoyu-informacieyu-chogo-chekati-ukrayini.html

7 Bets, N. (2019) Introduction of automatic financial information exchange in Ukraine in 2020: how should business prepare for the first exchange. Retrieved from: https://eba.com.ua/article/vvedennya-avtomatychnogo-obminu-finansovoyu-informatsiyeyu-v-ukrayini-v-2020-rotsi-yak-pidgotuvatys-biznesu-do-pershogo-obminu/

main task for Ukraine in the near future will be high-quality legislative consolidation of these steps, an effective tax administration reform and other necessary reforms, as well as fight against corruption. This should provide the necessary balance of interests of the state and business. One way or another, we all need to get used to living and working under the new tax rules, which are tougher but more transparent and fair.

Summary

The article describes the prerequisites for the development and implementation of the BEPS plan, the state of its implementation in Ukraine, the positive and negative consequences of its implementation for business. It is emphasized that implementing these actions will promote tax transparency and fairness; at the same time, it will complicate the tax administration process. The implementation of the BEPS plan leads to the transition of the tax planning process to a new quality level.

Анотація

У статті наведені передумови для розвитку та впровадження плану BEPS, стан його реалізації в Україні, позитивні та негативні наслідки виконання плану для бізнесу. Наголошується, що впровадження таких дій сприятиме податковій прозорості та справедливості. Водночас це ускладнить процес управління оподаткуванням. Реалізація плану BEPS призведе до переходу податкового планування на новий якісний рівень.

References:

1. Leshchenko, R.M. (2018). Financial and legal regulation of offshore mechanisms: a monograph. Kyiv : Yurincom Inter, 2018, 316 p. [in Ukrainian]
2. Implementation of the BEPS plan in Ukraine: problems and prospects (2017). Retrieved from: https://lhs.net.ua/wp-content/uploads/woocommerce_uploads/2017/12/2_3_Jak-Ukraina-vprovadzhuie-plan-BEPS.-REShETNIK-Olga-radnik-Ario-Law-Firm.pdf. [in Ukrainian]
3. Stepaniuk, Y. (2018) BEPS Action plan in Ukraine: managing the world or choosing a place on the sidelines. Retrieved from: https://dt.ua/macrolevel/plan-diy-beps-v-ukrayini-283563_.html [in Ukrainian]
4. Zakon Ukrainy No. 2473-VIII (2018) Law of Ukraine On currency and foreign exchange transactions of 21.06.2018. Retrieved from: https://zakon.rada.gov.ua/laws/show/2473-19 [in Ukrainian]
5. Drach, S. (2019) Automatic exchange of tax information: what to expect in Ukraine. Retrieved from: http://yur-gazeta.com/dumka-eksperta/avtomatichniy-obmin-podatkovoyu-informacieyu-chogo-chekati-ukrayini.html [in Ukrainian]
6. Bets, N. (2019) Introduction of automatic financial information exchange in Ukraine in 2020: how should business prepare for the first exchange. Retrieved from: https://eba.com.ua/article/vvedennya-avtomatychnogo-obminu-finansovoyu-informatsiyeyu-v-ukrayini-v-2020-rotsi-yak-pidgotuvatys-biznesu-do-pershogo-obminu/ [in Ukrainian]

Yaroslav Hretsa,
Candidate of Law,
Associate Professor of Department of Economic Law of the Faculty of Law
of the Uzhhorod National University