



Permanent Establishment Issues for German Companies in Ukraine

■ Introduction

Making business in Ukraine is embedded into a quite unique market situation. On the one hand the country is associating itself towards the European Union by initializing reforms and rejuvenating its authorities. This atmosphere of change promises massive chances to capture a remunerative market. On the other hand the country conducts its heritage of the former Soviet Union including laws and regulations, specific local accounting standards, a variety of different authorities directly impacting the business world by a high level of bureaucracy and corruption.

Excellent personal relationships and creation of trust are essential to establish a successful joint venture or market presence. HWC is combining local expertise with Western European business manner and acts as the interface between you and this complex environment. Adapting your business to the Ukrainian market, consulting on business relevant decisions and supporting with business services is our core competence.

■ General information

A representative office (“RO”) of a foreign company is similar in concept to a branch, which is commonly accepted in the law of numerous jurisdictions. At the same time, the relevant Ukrainian legislation fails to provide any guidance as to the procedure, which must be followed by a foreign legal entity, in order to open its branch in Ukraine. As a result, in practice, foreign legal entities do not carry out their business activities through branches, but rather through their ROs or their owned subsidiaries, which, as a rule, established in the form of a limited liability company (“LLC”).

■ Main characteristics of LLC

- An LLC may be founded by a single founder, which can be an individual or a company that is either Ukrainian or foreign. However, a Ukrainian LLC cannot have a single investor (also referred to as a participant) that is a company with one equity holder. The share capital can be paid during the first year after the registration. After registration with the State Registrar, the newly established LLC is automatically registered as a taxpayer with local tax authorities and the State Pension Fund (Державний пенсійний фонд). The registration can take few days.
- There are no minimum share capital requirements for an LLC. Capital contributions can be in cash or in kind (but not in services). Under certain circumstances the contributions in kind are VATable. The share capital of an LLC may be increased but any such changes must be registered with the State Registrar.
- Company’s participants own equity in the limited liability company, their ownership is expressed in terms of a percentage of ownership. The company charter may restrict transfers of equity by a participant. Other participants have pre-emptive rights to purchase equity offered for sale by a participant.

Permanent establishment of German Companies in Ukraine

- Taxation of the activities of the foreign enterprises in Ukraine is governed by provisions of both the Ukrainian tax law and the international agreements signed by Ukraine.
- The main document, which regulate taxation of the profits resulting from the activities of the German enterprises in Ukraine, is the Double Tax Treaty (further – the DTT) between Ukraine and the Federal Republic of Germany of 1995. This is due to the fact that the DTT's provisions overrule the respective provisions of the Ukrainian tax law.
- For the purposes of the DTT, the term *permanent establishment* means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "permanent establishment" includes especially: (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; (f) a mine, an oil or gas well, a quarry or any other place of exploration or extraction of natural resources. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.
- Article 5 of the DTT contains the exhaustive list of the activities, which do not lead to the creation of a *permanent establishment* for the German enterprises carrying on business in Ukraine. Such types of activities include:
 - the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
 - the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
 - the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
 - the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (above), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
- Specific criteria of the *preparatory or auxiliary* character are contained in the Commentary to the OECD Model Convention on Income and On Capital (OECD Model Convention). The general concept is that, in general, there are two basic criteria for the recognition of the preparatory and auxiliary activity, namely:
 - such activity shall not coincide with any of the statutory activities of a non-resident company or represent a considerable part of such activity;
 - such activity shall not be carried out for any company other than the "parent" company, which maintains a permanent place of business.
- Although Ukraine is not a member of the OECD Model Tax Convention, in practice, Ukrainian tax authorities apply its provisions, for instance, when determining the criteria of a *permanent establishment*.

- Where a person other than an agent of an independent status (*i.e. broker, general commission agent or any other agent are acting in the ordinary course of their business*) is acting on behalf of a German enterprise and has, and habitually exercises, in Ukraine an authority to conclude contracts on behalf of the enterprise, or maintains a stock of goods or merchandise belonging to the enterprise, from which regular delivery of such goods and merchandise is carried on in the name of the enterprise, that enterprise shall be deemed to have a *permanent establishment* in Ukraine in respect of any activities, which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned as exceptional ones above
- Pursuant to Article 7 of the DTT, the profits of a German enterprise shall be taxable only in Germany, unless the enterprise carries on business in Ukraine through a *permanent establishment* situated therein. If the enterprise carries on its business through a permanent establishment, its profits may be taxed in Ukraine, but only in the part, which is attributable to the *permanent establishment*.
- Ukraine uses an accrual method for accounting. Income is realized in the period when the transfer of the title to goods takes place or when acts of acceptance of services/works are executed. Once the income is realized, the cost of sales may be reported for the accounting purposes. Other expenses may be reported in the period in which they occur.
- The Ukrainian tax law presumes three methods for a *permanent establishment* to calculate its Corporate Income Tax (CIT) liabilities, namely: “*direct*”, “*split balance*” and “*gross revenues*”.
 - “**Direct**” - the taxable base for CIT is calculated based on the taxpayer’s financial statements subject to adjustments and limitations provided by the Tax Code of Ukraine. The gross worldwide income includes any income from the sale of goods/works/services, capital gains, foreign exchange gains etc.;
 - “**Split balance**” - if this method is adopted, a *permanent establishment* should provide the tax authorities with financial and other data on the “parent” company’s activities world-wide and particularly in Ukraine (e.g. number of staff in all countries where the company operates, revenues from world-wide operations, expenses incurred world-wide, the company’s working capital and fixed assets, net profit, etc.). On the basis of this data the local tax office apportions some part of the net overall profit to the Ukrainian operations. Such deemed profit would be subject to the standard 18% corporate profits tax liability;
 - “**Gross Revenues**” - this method, instead of using actual gross expenditure for calculation of the taxable profits as described above, is based on figures of actual revenues received. A deemed profit is calculated as the difference between the actual gross revenues and gross expenses which are calculated as 70% of gross revenues received.
- To avail of benefits granted by the DTT (e.g. regarding taxation of the interests, dividends, royalties, etc.) a German enterprise-recipient of Ukraine-sourced income must, *inter alia*, comply with the beneficial ownership test. Under the Tax Code of Ukraine, the beneficial owner is a person who has the right to receive the relevant Ukraine-sourced income and is not an agent, nominee or intermediary (conduit). At the same time, the Tax Code does not define agents, nominees or intermediaries (conduits). There is currently very limited practice regarding interpretation of the concept of beneficial ownership.

- VAT registration (i.e. registration as a VAT payer) is compulsory for all Ukrainian companies, individuals and *permanent establishments* of non-resident companies the VAT-able transactions of which exceed UAH 1 million for any preceding 12 months of operation. Voluntary registration as a VAT payer is also possible under the current legislation.
- Services acquired from non-residents through a reverse-charge mechanism. This mechanism implies self-assessment and payment of the 20% VAT by the Ukrainian importer in (or for) the tax period (month) when services are imported to Ukraine. The paid VAT can usually be claimed by the Ukrainian importer as a VAT credit in the same tax period (month). If imported goods or services are used in transactions not subject to VAT or outside the business activity of the Ukrainian importer, the “import” VAT becomes a cost to the Ukrainian importer. The reverse-charge mechanism does not apply if a non-resident service provider has a permanent establishment registered as a VAT payer in Ukraine. In this case, the *permanent establishment* is in charge of assessing VAT liabilities, offsetting them against the input VAT, and transferring the positive difference to the state budget.

Please do not hesitate to contact us if any comments or questions regarding the above.

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The information above is general in nature and does not highlight the situation of any particular company or individual. Although no one should act and rely upon such information without appropriate professional advice provided after detailed investigation of the concrete situation.

In case of need for additional advice on the issues above, please contact us.

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Who we are?



Dipl.-Kfm. Sven Henniger
Partner

German

- 9 years experience as CEO in Ukraine and CIS
- Board member of the German Business Club in Ukraine (DWK)
- Head of working group “Tax and Accounting” at the German Business Delegation (AHK) in Ukraine (future AHK, 2012-2015), since 2016 Deputy Head
- German/ English/ Russian
- Hobbies: Sailing, Travelling



Dr. Thomas Winkelmann
Partner

German

- 20 years experience in leading position for different Global Companies in the Ukraine
- Last 15 years in leadership position in the Ukrainian subsidiary of leading global consulting company
- Board member of the German Business Club in Ukraine (DWK)
- German/ Russian/ English
- Hobbies: Diving, Travelling

Our Services

HWC LLC Outsourcing Services

- Accounting Outsourcing & Financial Services
- HR & Payroll Solutions
- Tax Compliance & Tax Advisory Service
- Interim Management
- Legal Address & Business Address
- Office Sublease, Co-Working
- Recruiting & Outstaffing
- Liquidation Services

HWC LLC Business Services

- Business Set Up
- Market Analysis & Research
- Business Planning
- Feasibility Studies
- Strategy Consulting
- Due Diligence & Transaction Services
- Restructuring



Making your business work – is what we do!

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