

## Tax disputes in wartime Ukraine

### Introduction

#### 1. Confirming the impossibility of fulfilling tax obligations

#### 2. Cancellation of VAT payer status

#### 3. Liability for violating FX legislation

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After the start of the Russia's full-scale invasion in 2022, a number of tax benefits and reliefs were introduced for Ukrainian businesses.

However, from 2023, we have seen a trend of gradual revision and cancellation of such benefits. For instance, restrictions on tax audits were gradually lifted in August 2023.

This situation has led to an increase in the number of tax litigations. An analysis of the court practice in these disputes helps to prevent tax violations and to be ready to protect a company's interests from unreasonable claims of fiscal authorities.

#### 1. Confirming the impossibility of fulfilling tax obligations

In 2022, amendments to the Tax Code of Ukraine established the possibility of exempting a taxpayer from liability for a number of violations in case of inability to fulfil a tax obligation in a timely manner, namely:

- compliance with the deadlines for payment of taxes and fees;
- submission of reports and documents;
- registration of tax or excise invoices in the relevant registers;
- adjustment calculations, etc.

The Ministry of Finance of Ukraine regulated the procedure for confirming the possibility or impossibility of fulfilling tax obligations in July 2022. The same procedure established a list of documents to be submitted to confirm such impossibility.

This procedure affected almost all categories of tax disputes.

As a result, the court practice of appealing against fiscal authorities' decisions on the possibility of fulfilling tax obligations has been formed.

This practice is inconsistent and not always in favour of the taxpayer. Moreover, there is a growing trend of courts supporting the position of the fiscal authorities.

For instance, in 2023, the Supreme Court of Ukraine made clear conclusions that in order to be exempted from tax liabilities, the circumstances of impossibility must be real and objective, not formal.

In one of the cases, the taxpayer submitted a voluminous package of documents to prove the impossibility of fulfilling its tax obligations, including evidence of the destruction of production facilities, criminal proceedings regarding the destruction of the company's real estate, notifications to local authorities and self-government bodies, etc.

However, the court did not find these circumstances sufficient. The reason for this was the lack of evidence of business activity at the place of registration and storage of the destroyed equipment, insufficient evidence to confirm the loss of equipment or financial documents due to hostilities.

Also, the taxpayer failed to prove that it did not have sufficient funds to pay taxes. Moreover, the company registered tax invoices in 2022, and the court considered this to be evidence of the company's ability to meet its tax obligations.

Such trends in court disputes should be taken into account when deciding whether to file a declaration of impossibility to fulfil tax obligations. To do this, it is necessary to:

- carefully analyse the actual circumstances and compare them with the grounds stipulated by the regulations. It should be noted that not all circumstances that actually prevent a taxpayer from fulfilling its tax obligations may be deemed as such grounds;
- having identified such circumstances, it is necessary to clearly establish whether they can be confirmed by the documents listed in the relevant legislation. This is what the court will check first and foremost;
- carefully consider the substantiation of the causal relationship between the circumstances that the company considers to be the basis for the impossibility of fulfilling tax obligations and the actual impossibility. E.g., the mere fact of a city being shelled, if there was no destruction of production facilities or company documents, will not constitute such a basis.

## **2. Cancellation of VAT payer status**

Under Ukrainian law, if a VAT payer fails to file VAT returns for 12 consecutive tax months, this may be grounds for revoking the VAT payer status.

In the context of martial law, this may occur due to the objective inability of the taxpayer to fulfil its obligation, for example, due to shelling, destruction of property and documentation, occupation of the territory where the company or its facilities are located, or mobilisation of its director.

This situation is quite common, giving rise to a separate category of tax litigation.

The Supreme Court of Ukraine expressed the position that a taxpayer must take active steps - submit an application and supporting documents to the tax authorities to prove that it is impossible to fulfil its tax obligations. The Court noted that amendments to the tax legislation of Ukraine allow taxpayers to be released from liability for late performance of tax obligations in certain circumstances. At the same time, the law obliges the taxpayer to take a certain action - to submit a relevant application to the supervisory authority. If a taxpayer fails to do so, it cannot rely on exemption from liability.

Also, as follows from the court's decision, a taxpayer cannot refer to the absence of an authorised person if such a person registered tax invoices at the same time. The court drew attention to this and found that the company actually had the opportunity to file a VAT return since it was able to register tax invoices. Or at least it could have notified the fiscal authorities of its inability to fulfil its obligation.

It should be borne in mind that the courts take a comprehensive approach to investigating the circumstances of the impossibility of fulfilling tax obligations. To protect their interests effectively, companies need not only to establish the circumstances of their inability to fulfil their tax obligations. It is also necessary to determine whether the company had actual possibilities that it did not use. The absence of such possibilities must be confirmed by documents in accordance with the list established by law.

### **3. Liability for violating foreign exchange legislation**

This category of litigation is a vivid example of how the position of the courts can change dramatically even in a single year. When formulating a legal position to protect the company's interests or making decisions on actual actions by the company, it is necessary to update information on the courts' stance literally at the time of making management decisions.

In this case, we are talking about the application of a penalty for violation of the deadline for payments in the field of foreign economic activity under quarantine.

In February 2024, the Supreme Court concluded that the penalty established by the Tax Code of Ukraine is accrued in accordance with the procedure set out in the Law of Ukraine regulating foreign exchange transactions. At the same time, during the quarantine period, taxpayers are not charged a penalty for violation of the deadline for payments in foreign currency. The penalty accrued but not paid during this period is written off in accordance with the relevant provisions of the Tax Code of Ukraine.

However, in July 2024, the Supreme Court changed its stance.

A company filed a lawsuit to cancel the penalty imposed on it for violation of the terms of payments in foreign economic activity.

In considering the case, the Supreme Court noted that the Law of Ukraine regulating foreign exchange transactions in Ukraine is a special law. As a special law, it defines the legal basis for foreign exchange transactions and establishes liability for violating foreign exchange legislation.

This Law does not regulate the procedure for making a decision on imposing a penalty as a form of sanction for violating the deadlines for making payments in foreign currency. This procedure is established by the provisions of the Tax Code of Ukraine. However, in the court's opinion, this does not mean that all provisions of the Tax Code of Ukraine apply to legal relations in the field of foreign exchange transactions. Accordingly, the court concluded that the provisions of the Law of Ukraine regulating foreign exchange transactions apply to the calculation of penalties for late payments in foreign currency.

In turn, the penalty stipulated by this law for violation of the terms of payments for export-import transactions during the quarantine period is imposed on a general basis. Such penalties cannot be exempted from payment under the Tax Code of Ukraine.

Moreover, the Supreme Court noted that the introduction of martial law in Ukraine cannot be regarded as a force majeure circumstance for a non-resident counterparty's failure to transfer funds to the accounts of a Ukrainian company for the goods delivered under foreign trade contracts.

The above trends indicate an increase in control by the fiscal authorities, and this tendency is likely to continue through 2025.

In such circumstances, companies should actively protect their interests, not only by responding to the actions of the fiscal authorities. It is necessary to actively plan their actions taking into account the prospect of litigation to protect their interests.

With proper preparation of arguments and evidence, as well as taking into account the current case law in the conduct of daily activities, such defence will be truly effective.