

Permanent establishments of non-residents in Ukraine: tax risks for foreign companies

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1. What is a permanent establishment in Ukraine?

Ukrainian tax authorities have significantly intensified their scrutiny of foreign companies operating in Ukraine, particularly where non-residents have local personnel, representative offices, dependent agents or other forms of economic presence in the country.

Ukrainian legislation has been substantially amended under the influence of international rules developed by the Organisation for Economic Co-operation and Development to combat base erosion and profit shifting.

In practice, this has resulted in much stricter scrutiny of foreign companies and permanent establishments in Ukraine. Tax authorities increasingly analyse not only the formal existence of a representative office or office premises, but also the actual nature of the

non-resident's activities, the functions of local personnel, and the degree of the company's economic presence in Ukraine.

A permanent establishment is a fixed place of business through which a non-resident's business activities are wholly or partly carried out in Ukraine. This includes, in particular, a place of management; a branch; an office; a factory; a workshop; an installation or structure for the exploration of natural resources; a mine, oil or gas well, quarry, or any other place of extraction of natural resources; a warehouse or premises used for the delivery of goods; or a server.

For tax purposes, the term "permanent establishment" includes:

- a construction site, construction, assembly or installation project, or related supervisory activities, provided that the total duration of work connected with such site, project or activities performed by a non-resident through employees or other personnel engaged for such purposes exceeds 12 months;
- the provision of services by a non-resident (except personnel provision services), including consultancy services, through employees engaged by the non-resident for such purposes, where such activities are carried out in Ukraine for a period or periods whose total duration exceeds 183 days in any 12-month period;
- persons who, on the basis of an agreement, another transaction or in fact, have and habitually exercise authority to negotiate the material terms of transactions (as a result of which the non-resident enters into agreements/contracts without substantial modification of those terms) and/or to enter into agreements/contracts on behalf of the non-resident. Such activities must be carried out by the person in the interests of, at the expense of and/or for the benefit of exclusively one non-resident and/or non-resident related parties;
- persons who, on the basis of an agreement, another transaction or in fact, have and habitually exercise authority to hold (store) stocks (goods) belonging to the non-resident, from which such stocks (goods) are supplied on behalf of the non-resident. An exception applies to residents operating temporary storage warehouses or customs warehouses.

2. Types of permanent establishments in Ukraine

In practice, a permanent establishment may arise not only through a formally registered representative office or branch, but also through construction projects, local personnel, dependent agents, warehouses or operational activities carried out in Ukraine on behalf of a foreign company.

Tax authorities increasingly analyse not only the formal structure of the non-resident's activities, but also actual operational control, corporate communications, the role of local personnel, and the foreign company's economic presence in Ukraine.

In particular, the non-exhaustive list of indicators of a permanent establishment includes:

- Mandatory systematic instructions: the non-resident issues instructions that must be followed (including by electronic means of communication), and the person complies with them;
- Corporate communication tools and domains: the person has and uses the non-resident's corporate e-mail address for communication with the non-resident and/or with third parties with whom the non-resident has entered into or will enter into agreements or other transactions;
- Asset management: the person exercises the right to possess or dispose of the non-resident's assets in Ukraine on the basis of the non-resident's relevant instructions;
- Actual operational control: the person exercises the right to possess or dispose of stocks (goods) or other assets of the non-resident in Ukraine, or a significant share thereof, on the basis of the non-resident's relevant instructions;
- Lease of premises for the non-resident's business: the person leases premises in its own name for storing the non-resident's property to be transferred to third parties on the non-resident's instructions, or for other purposes determined by the non-resident.

3. Activities that do not create a permanent establishment

Not every activity of a foreign company in Ukraine automatically creates a permanent establishment. Preparatory or auxiliary activities, independent intermediary arrangements and certain support functions may fall outside the scope of permanent establishment rules.

In particular, a permanent establishment of a non-resident does not arise where the non-resident acts in Ukraine through an independent intermediary - a resident acting within the ordinary course of its business and on market terms - and where the intermediary independently organises its activities, is not subordinated to the non-resident, and does not perform the non-resident's management functions.

For example, if a Ukrainian distribution company purchases goods from a non-resident and then sells them in its own name and at its own risk, such activity generally does not create a permanent establishment. However, the situation changes if the intermediary in fact works exclusively for one non-resident, follows its instructions, and does not bear its own commercial risks. In that case, the tax authorities may treat the intermediary as a dependent agent.

The use of premises or a presence in Ukraine also does not create a permanent establishment if the activity is exclusively preparatory or auxiliary in nature.

Examples may include market analysis, collection of information, technical support, administrative assistance, or other auxiliary functions not directly related to entering into contracts or generating income for the non-resident.

At the same time, the boundary between auxiliary and core activity is assessed in light of the actual role of that function in the group's

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business. If preparatory activity effectively becomes a key part of the operating process or is performed in the interests of several related non-residents within a single business model, the tax authorities may regard the structure as a permanent establishment.

For example, if a Ukrainian office provides marketing services but in fact agrees contract terms, communicates with customers, and influences the conclusion of deals, such activity may go beyond the scope of auxiliary activity.

4. Registration requirements for permanent establishments in Ukraine

Foreign companies carrying out business activities in Ukraine through a permanent establishment are generally required to complete tax registration with the Ukrainian tax authorities and comply with local tax reporting obligations. The application for registration must be filed within 10 calendar days from the date of registration of the representative office.

The application must be accompanied by documents confirming the non-resident's legal status in its country of incorporation, its identification details, and the authority of the person representing the non-resident in Ukraine. In the case of a permanent establishment, a document confirming its accreditation or registration in Ukraine must also be submitted. All foreign-origin documents must be duly legalised and translated into Ukrainian, unless otherwise provided by Ukraine's international treaties.

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Ukrainian legislation also follows an approach under which the registration obligation may arise when a non-resident performs certain economically significant actions in Ukraine.

In particular, this applies to the acquisition of real estate or property rights to real estate, the opening of accounts or electronic wallets in Ukraine, and investment transactions involving corporate rights in Ukrainian companies. In such cases, the obligation to register arises before the relevant transaction is completed or before the first payment is made.

Particular attention should be paid to situations where signs of a non-resident's activities in Ukraine are identified during tax control without prior registration. In such cases, the controlling authority may initiate an audit of the actual activities, including where residents carry out activities in the interests of a non-resident through separate divisions or other structures that may have signs of a permanent establishment.

5. Taxation of permanent establishments in Ukraine

Permanent establishments of non-residents in Ukraine are generally taxed under corporate income tax rules based on the arm's length

principle and functional analysis of activities performed in Ukraine.

This principle means that the profit of a permanent establishment should correspond to the profit of an independent enterprise carrying out similar activities under comparable conditions and not controlled by the non-resident. Under this approach, a functional analysis of the establishment's activities is performed, taking into account the functions performed, assets used, and risks assumed.

6. Tax risks of operating without registration

If Ukrainian tax authorities identify a hidden permanent establishment, foreign companies may face tax reassessments, penalties, documentary audits and disputes with the tax authorities.

If information is obtained indicating that a non-resident conducts business through a permanent establishment in Ukraine, the controlling authority carries out an unscheduled documentary audit of such activities.

It should be noted that audits of non-residents conducting business activities in Ukraine and required to be registered, as well as audits of their separate divisions, including registered permanent establishments, may be initiated from 1 July 2021.

If an audit establishes that a non-resident starts and/or carries out business activities through a permanent establishment in Ukraine without tax registration, an administrative arrest of the taxpayer's property may be applied as an exceptional measure to secure the taxpayer's compliance with its obligations.

Tax legislation provides for financial liability for such violations. In particular, a fixed penalty of UAH 100,000 applies where a non-resident conducts activities through a separate division, including a permanent establishment, without registration.

In practice, there are cases where the UAH 100,000 penalty is imposed on representative offices whose activities show signs of being auxiliary or preparatory, including during scheduled audits. At the same time, such a sanction may be applied only if the controlling authority properly proves that the activities conducted in Ukraine are indeed business (commercial) activities, and not merely auxiliary functions that do not independently generate income.

In practice, however, the consequences are much broader than the penalty itself. If the actual operation of a hidden permanent establishment is established, the controlling authority usually proceeds to a comprehensive tax reassessment. A separate risk is the application of penalties connected with the reassessment of tax liabilities by the controlling authority, in particular where an understatement of the tax base is established.

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Following an audit, the tax authorities decide to register the non-resident as a corporate income tax payer if they establish that the non-resident has carried out activities through a permanent establishment without the required registration.

7. Practical recommendations for foreign companies

International businesses operating in Ukraine should regularly assess permanent establishment risks, analyse the role of local personnel and counterparties, structure contractual relationships properly and ensure compliance with Ukrainian tax regulations.

In practice, particular attention should be paid to situations where Ukrainian personnel or local counterparties in fact participate in negotiations on key contractual terms, interact with the non-resident's customers, or provide operational support to the business in Ukraine. These are the factors that tax authorities increasingly analyse during audits of international corporate groups.

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Specific tax risks may also arise in connection with long-term construction, engineering, service, or infrastructure projects in Ukraine, as well as the use of warehouses, local offices, or dependent agents. In such situations, international businesses are advised to conduct a preliminary tax and legal analysis of their structure in Ukraine before commencing operations.

DLF attorneys-at-law

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