

Diia City in Ukraine: tax aspects

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On 1 January 2022, the Law of Ukraine "On Amendments to the Tax Code of Ukraine and Other Laws of Ukraine on Stimulating the Development of the Digital Economy in Ukraine" (the so-called "tax part" of the legal framework Diia City, hereinafter – the "Law") came into force.

The Cabinet of Ministers of Ukraine, as well as ministries and other central executive bodies, have 3 month period from the date of entry into force of this Law to adopt regulations necessary for the implementation of the Law and to bring its regulations in line with the Law.

1. Taxation of income of a Diia City resident

1.1. Income tax rates

Diia City residents will be able to choose one of the two options for taxation of their income – income tax on a special or general basis.

A Diia City resident pays corporate income tax on a special basis (which is analogous to the withheld capital tax) if he/she has chosen or switched to the appropriate tax scheme in the manner prescribed by the Tax Code of Ukraine.

1.1.1. Income tax rate 9%

For Diia city residents who are special basis taxpayers the tax rate of 9% is set.

The law defines a list of operations of a Diia City resident that are taxed at a rate of 9%:

- payment of dividends;
- payments due to the withdrawal of the corporate rights' owner from the list of members/shareholders (over the value of the contribution and (or) the acquisition of bonds/shares/stocks);
- payment of funds/return of property within the joint activity (over the amount of funds/value of the property provided for joint activities);
- payment of interest, commissions, and other funds for the fulfillment of debt obligations related to the raising/use of funds, including in favor of non-residents – related parties or non-residents who are residents of offshore jurisdictions or do not pay income tax (corporate tax);
- payment of royalties in favor of non-residents who are residents of offshore jurisdictions or do not pay income tax (corporate tax), and in favor of collective investment institutions;
- contributions to the authorized capital of a person who is not a Diia City resident – special basis taxpayer, in joint activities or the trust management of such a person;
- other operations defined by the Law.

In the case of transactions that are subject to taxation, in a form other than cash, the tax base is the value of such transaction, determined at a level not lower than the normal price.

1.1.2. Income tax rate 18%

The following operations of the Diia City residents-special basis taxpayers are taxed at a rate of 18 %:

- controlled business transactions – in the amount of non-compliance with the arm's length principle;
- adjusted profit of the controlled foreign company (if the resident is a controlling person).

Diia City residents who don't choose (don't transit) the appropriate tax scheme, pay corporate income tax on a general basis (at a base rate of 18%), and are considered residents of Diia City who are not taxpayers on a special basis.

1.2. Transition to a special basis taxation

For transition to taxation as a resident of Diia City – taxpayer on a special basis, a legal entity submits an application in electronic form:

- to the Ministry of Digital Transformation of Ukraine during the application for acquiring the status of a resident of Diia City; in this case, the resident of Diia City becomes a taxpayer on a special basis from the 1st day of the month following the quarter in which the legal entity is entered in the register of Diia City;
- to a controlling body at its tax address (not later than 15 calendar days before the beginning of the next calendar quarter); in this case, the resident of Diia City is considered a taxpayer on a special basis from the 1st day of the month following the quarter in which the application is submitted.

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The form of the application, the procedure for its submission, and consideration by the supervisory body shall be established by the Ministry of Finance of Ukraine.

A resident of Diia City, who is a payer of corporate income tax on a general basis, may make the transition to a special basis of taxation once a calendar year.

2. Salary taxation

A tax agent of the taxpayer – a Diia City resident's specialist at the time of accrual (payment) of income due to employment or the performance of a gig contract is a resident of Diia City.

Personal income tax rate 5%

The tax rate is 5% for a taxpayer-specialist's income obtained from a Diia City resident in the form of:

- a) salary;
- b) remunerations under gig contracts, including remunerations for the creation and transfer of rights to works made by the order;
- c) royalties for the creation of an official work and the transfer of rights to official works.

Personal income tax rate 18%

If the amount of such income exceeds the equivalent of EUR 240 thousand per calendar year at the official exchange rate of hryvnia to euro, set by the NBU as of 1 January of the reporting tax year, the amount of such excess is taxed by the general rate of 18%. The taxpayer is obliged to reflect the amount of such excess in the total monthly (annual) taxable income for the relevant reporting year, submit an annual declaration of property and income (tax return), and pay tax on the amount of such excess.

A tax agent — resident of Diia City is obliged to self-assess the tax at the rate of 18% on the income of specialists paid during such a calendar month and pay it before submitting the tax calculation if:

- the tax agent didn't meet the requirements for the average number of employees and gig specialists in a calendar month of at least 9 people and (or) for the amount of their average monthly remuneration not less than the equivalent of 1200 euros, or
- the tax agent lost his status as a resident of Diia City by court order.

Military duty

A military duty of 1.5% is charged on the income of the specialists of the Diia City resident.

Single social contribution

Single social contribution (SSC) for a payer – resident of Diia City is paid from the

salary or remuneration under gig contracts in the amount of the minimum insurance premium, i.e. 22% of the minimum wage (such minimum insurance premium is currently UAH 1,430 (approx. USD 50)).

SSC in the amount of the minimum insurance premium may be paid by a resident of Diia City, whose average number of employees and gig specialists in a calendar month was at least 9 people with an average monthly salary of at least the equivalent of EUR 1,200 at the official exchange rate of hryvnia to euro, set by the NBU as of the 1st day of the relevant calendar month.

Individual entrepreneurs and persons engaged in an independent professional activity are exempt from paying SSC for the months of the reporting period for which the employer (resident of Diia City) paid an insurance premium for such persons in the amount not less than the minimum insurance premium.

3. Benefits for individuals

3.1. Preferential taxation of dividends and insurance premiums

The following is not included in the calculation of the total monthly (annual) taxable income of the taxpayer (and, accordingly, are not subject to personal income tax and military tax):

- dividends accrued by an issuer of corporate rights who is a resident of Diia City – taxpayer on a special basis;

This benefit is applied provided that such a resident of Diia City has not paid dividends on shares or other corporate rights for 2 consecutive calendar years.

Diia City residents – taxpayers on a special basis are exempt from the obligation to pay advance payments of income tax in the event of dividends.

- the amount of pension contributions and insurance payments paid by the resident employer/resident of Diia City at its own expense under private taxpayer pension and/or voluntary health insurance contracts within 30% of the accrued salary to such employee/remuneration to such gig specialist.

3.2. Tax deduction

The personal income tax payer has the right to include in the tax deduction for the reduction of taxable income his/her actual costs during the reporting tax year to purchase shares (other corporate rights) issued by a legal entity that has acquired the status of a Diia City resident, provided that such costs were incurred by the taxpayer:

- before the issuer has acquired the status of a Diia City resident or
- during the period when the amount of income of a Diia City resident didn't exceed the maximum amount of income set for businesses of the third group of single taxpayers (1167 minimum wages, which currently amounts to UAH 7,585,500 (approx. USD 266,700)). In this way, the Ukrainian legislator creates a tax incentive to invest in startups.

The total amount of tax deduction in the reporting tax year may not exceed the

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amount of annual total taxable income of the taxpayer, accrued as salary and received in the form of dividends (except for dividends not included in the calculation of total monthly/annual taxable income).

4. Restrictions on transactions with single taxpayers

Starting from 1 January 2024, expenses related to the purchase of property, works, services (except royalties) from single taxpayers exceeding 50% of expenses from any activity for the previous annual reporting (tax) period,

- are included in the tax base of a Diia City resident – payer of corporate income tax on a special basis;

increase the financial result of a Diia City resident– payer of corporate income tax on a general basis (this rule is not mandatory for residents with income for the last annual reporting period not exceeding UAH 40 million (approx. USD 1,406,000)).

From 1 January 2025, these transactions with single taxpayers will be taxed in excess of 20% of the expenses from any activity for the previous annual reporting (tax) period.

Thus, residents of Diia City will be encouraged at the tax level to gradually reduce the volume of cooperation with individual entrepreneurs.