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UKRAINE SIGNS PROTOCOL TO TAX TREATY WITH THE UK

On 9 October 2017, the governments of Ukraine and the United Kingdom of Great Britain and Northern Ireland signed a new Protocol to Double Tax Treaty (DTT) of 1993. The Protocol, among other things, increases withholding tax (WHT) on all passive income by additional 5%, thereby potentially affecting existing and future cross-border financing structures involving UK lenders.

Increase of WHT rates

Under the effective 1993 DTT, dividends are subject to 10% WHT (5% for dividends on qualified shareholdings), while interest and royalties are exempt from taxation. Once the Protocol enters into effect, applicable WHT rates will change as follows:

- *Dividends:* 5% and 15%. Reduced 5% rate applies to dividends on qualified shareholdings of not less than 20% in a company paying the dividends. Otherwise, 15% rate applies;
- *Interest:* 5%;
- *Royalties:* 5%.

Reportedly, the protocol will also include new exchange of tax information clause. However, the text of the Protocol has not been made public yet.

The new Protocol is subject to ratification and exchange of notifications before it comes into force. If such procedures are finalized by the end of 2017, the protocol will apply from January 1, 2018.

Impact on Cross-Border Loans

One of the key changes potentially affecting existing and future cross-border financing transactions involving a UK creditor is introduction of 5% WHT on interest. Once the Protocol becomes effective, interest payments under such financing transactions will no longer be exempted from WHT, 5% rate will apply to such interest payments and Ukrainian borrowers will be obliged to deduct WHT from interest payments.

There is, however, an exemption under Ukrainian domestic tax rules still allowing full exemption from WHT. The exemption applies to interest payable under LPN-financed cross-border loans, depending on the date of the loan drawdown. Starting from 1 January 2017 interest payable by Ukrainian borrower under such loan is exempt from WHT if the loan is drawn down on or before 31 December 2018. 5% WHT will apply to interest on loans drawn down after 1 January 2019.

That said, Ukrainian borrowers and UK lenders, which do not fall under the above exemption, should carefully consider additional tax cost and implications of the new WHT rate on their contractual documentation and specifically on such clauses as Tax Gross Up, Increased Costs, Events of Default and other commonly used clauses of loan documentation as well as any other provisions potentially affected. For instance, a significant concern may arise due to, for instance, the rule of Ukrainian law prohibiting any contractual arrangement requiring a Ukrainian borrower to compensate a foreign lender for tax deducted in Ukraine (the known “gross-up prohibition rule”).

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