

Changes to CFC Rules in Ukraine: Time to liquidate Cyprus or other offshore companies?



11th May 2021

Recent legislative changes in Ukraine exempt individuals from personal income tax on income received from liquidation of foreign companies, and may be the catalyst forcing many Ukrainian business people to re-evaluate the future of their Controlled Foreign Companies (“CFCs”). Coupled with the recently introduced Register of beneficial owners in Cyprus, not to mention the increasingly stringent Cypriot banking compliance requirements, liquidation may just be the most appealing route to take advantage of new tax incentives and provide the best possible exit route for offshore companies.

Tax Free Liquidations

The Law on Amendments to the Tax Code of Ukraine Purposed to Improve the Administration of Taxes, Eliminate Technical and Logical Inconsistencies in the Tax Legislation (the “Law”) which came into force in Ukraine on 23rd May 2020 introduced not only significant changes to tax reporting and administration, but also new rules for CFCs, primarily aimed at preventing the shifting of profit from Ukraine to offshore low-tax jurisdictions.

The CFC Rules, which will apply with effect from 1 January 2022, introduce taxation of income received from CFCs by Ukrainian ‘controlling’ persons with an ownership interest in a foreign entity of (i) more than 50%, or (ii) more than 10% (25% in 2022-2023) provided Ukrainian nationals jointly own at least 50% or (iii) in case of established de facto control over a foreign entity.

Although the Law does provide for a number of tax exemptions, profits earned by a CFC will need to be included in the aggregate taxable income of a Ukrainian resident and be subject to 18% personal income tax plus 1.5% military tax for individuals and 18% corporate tax for legal entities.

For those reconsidering the future of their CFCs, provided certain conditions are met, liquidation of these companies may present the best option, inter alia resulting in an exemption of 18% personal income tax. To benefit from the tax-free liquidation rules, the liquidation of a CFC must have commenced after 1 January 2020 and be completed by 31 December 2021. Additionally, Ukrainians who own or control a CFC will be required to file a tax return in 2022 where they shall disclose assets received through the liquidation, submit documentation confirming the value of the CFC including copies of past financial statements and simultaneously apply for tax exemption from the Ukrainian tax authorities.

For those ready to declare their CFC’s assets, liquidating their CFC now (if the liquidation commences imminently there may still be sufficient time to dissolve the company and meet the 31st December 2021 deadline) could mean significant tax savings. Other routes are also available; a CFC may move the place of its effective management to Ukraine and recognise itself as a tax resident of Ukraine, nevertheless stricter tax administration rules including increased penalties for violation of

procedures and the obligation to publish annual audited financial statements, may still mean the tax-free liquidation path is the favoured route.

Cyprus UBO register

Another factor which may make liquidation an attractive option for those with CFCs registered in Cyprus is the recently introduced requirement for disclosure of ultimate owners of Cypriot companies to be registered in a centralised system. The submission of relevant information by companies including detailed information on the natural persons who ultimately own or control a legal entity has recently been extended to 12th March 2022. Although entities registered from 16 March 2021 (new entities), have 30 days from the date of their registration to file the required information.

This information will need to be confirmed annually and failure to comply will result in penalties. The Registrar of Companies will maintain the UBO Register which will, initially be accessible by the competent supervisory authorities (the police, tax authorities, CySEC etc) and will eventually be made available to the public at large at a fee of €3.50.

Cyprus entities which are exempt from these disclosure obligations include listed companies, and companies which already commenced liquidation at the time of entry into force of the disclosure law.

Liquidation routes

When considering liquidation of Cyprus and other common law jurisdiction companies the key question will be: **Which type of liquidation process is most appropriate?**

Is it Members' Voluntary Liquidation ("MVL"), a solvent liquidation process through which all liabilities must be settled, including liabilities which may arise as a result of unreasonable assessments issued by the Director of Revenue and Taxes in Cyprus or, alternatively Creditors' Voluntary Liquidation ("CVL"), an insolvent liquidation process meaning creditors will only be paid to the extent that the company itself owns assets available to settle them, the balance will remain unpaid and the company is dissolved. The latter route is often not fully explored or utilised in appropriate circumstances, leading to possible adverse consequences and the UBOs ultimately paying the price.

CRI Group is the island's leading firm on corporate restructuring and insolvency with undisputed credentials, specialising not only in MVLs and CVLs spanning across all common law jurisdictions, but also complex cross border insolvencies and asset tracing. Our insolvency expertise means we can fully explore all restructuring and liquidation options whilst working closely with local tax advisors to maximise possible benefits for the client.

Our directors Chris Iacovides and Andri Antoniou, known in Ukraine amongst many local professionals from their tenure as joint Liquidators of Mriya Agro Holding PLC, once one of the largest Ukrainian agroindustrial groups, were recognised in respect of their efforts and the successful restructuring of Mriya by the former Governor of the Central Bank of Ukraine, Valeria Gontareva who commented: *"We very much welcome what Mriya has been able to do. I think that this is a really huge breakthrough. I can say that this is the first story of its kind on our territory, so the national bank very much welcomes Mriya's restructuring"*.

Chris Iacovides is a Certified Public Accountant and a Licensed Insolvency Practitioner, Andri Antoniou is a solicitor, Member of the Law Society of England and Wales and a Licensed Insolvency Practitioner - both Directors of CRI Group www.crigroup.com.cy which specialises in all aspects of corporate and personal insolvency.
