BRIEFING

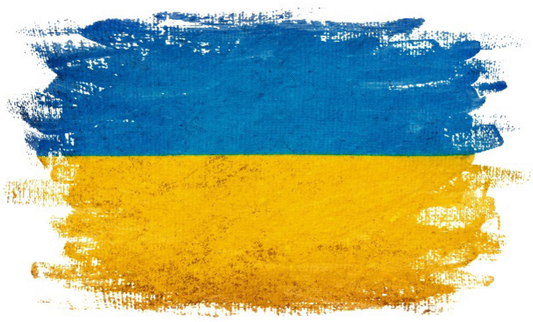
Tax treatment of Ukrainian refugees

SUMMARY

Since the start of the Russian invasion in February 2022, more than eight million men, women and children have fled Ukraine, looking for safety in Europe. Amidst the uncertainty regarding the future of the war and the tragic and extremely difficult circumstances, many Ukrainians have sought to build a new life in their 'host countries'.

Concerns have been raised by the Ukrainian government, however, as to how the host countries will treat the income gained by Ukrainian refugees outside Ukraine for tax purposes, citing concerns over potential double taxation.

This briefing looks, in particular, at the tax treatment of Ukrainian refugees who continue to perform their duties for their Ukrainian employer through teleworking. It also considers the measures taken by the Ukrainian government on this issue, and the wider participation of Ukraine in global/EU initiatives to improve overall tax compliance.



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Treaties for the avoidance of double taxation

When discussing the tax treatment of Ukrainian refugees, the **bilateral tax treaties** signed by Ukraine with other countries (for example, France, Italy, Poland) are key. These treaties lay down the rules regarding the division of taxing rights on income streams between the signatories, and the applicable mechanisms to eliminate double taxation. The negotiation and conclusion of such bilateral tax treaties are the **exclusive competence** of the countries themselves. While there is no strict EU or global template that countries are legally obliged to adhere to, European countries do tend to use the OECD's Model Convention on Income and Capital as the basis for treaty negotiations.

A key issue in tax treaties is the tax residence of an individual. In short, once you are considered to be resident for tax purposes in a certain country, you are usually chargeable to tax on your worldwide income in that country. In order to determine tax residency, countries tend to apply the so-called **'183-day rule'**, meaning that, if you spend 183 days or more in a country during a given year, you are considered a tax resident of that country for that year. Countries may also have other national criteria in place that act alongside or replace the 183-day rule: tax authorities may consider you a tax resident based on whether you have a permanent home in the country or bank accounts, whether your parents, spouse and children are residing in the same country, etc. Even if you are not considered to be a tax resident in a country, you can still be subject to tax on local income gained in that country (for example, income gained from employment carried out within that country's territory).

However, regarding the tax treatment of Ukrainian refugees – i.e. if and when they would be considered as tax residents of the host country, the division of taxing rights on income gained by the refugee (whether or not this income was sourced from abroad or domestically), and the likelihood of double taxation – there is no straightforward answer. Outcomes will vary depending on **the facts and circumstances of each individual case**, the national criteria concerning tax residency, and the applicable tax treatment for the different categories of income (dividends, rental income, pensions, etc.), as laid out in the bilateral tax treaties.

As this has given rise to many questions, the Ukrainian Ministry of Finance sent a questionnaire to other European countries' tax authorities seeking clarification on a series of potential tax scenarios faced by Ukrainians abroad. As of 24 May 2023, the Ministry of Finance had received and uploaded the answers (in Ukrainian) from Austria, Belgium, Czechia, Denmark, Germany, Italy, Latvia, Lithuania, Poland and Portugal.

A closer look: Taxation of employment income gained through teleworking

A 2022 survey by the European Business Association – one of Ukraine's largest business interest groups – revealed how nearly all of the companies surveyed (96 %) had seen some of their employees leave the country.[1] At the same time, most companies (56 %) responded that (at least one of) their employees continued to work remotely from abroad.

Article 15 of the OECD Model Convention provides, as a general principle, that **employment income is taxable in the place of activity**, where physical employment is carried out. More specifically, the Model Convention states that, when an individual performs paid work in the territory of a country and their remuneration is paid by an employer – who is resident in another country and who does not have a permanent establishment in the first country – the individual is obliged to pay tax on that income in the first country if their stay there exceeds 183 days.[2]

This means that those Ukrainian refugees who are working remotely from another country for a company resident in Ukraine are likely to face a change in their tax situation after 183 days. The right of taxation would arise in the country from which the teleworker is working (the host country), with tax revenue raised in that jurisdiction rather than Ukraine.[3]

Aside from the clear consequences for Ukraine's revenue-raising capabilities, there could be a number of administrative complications, which may give rise to **double taxation** for the Ukrainian teleworker. This may seem counterintuitive, as Ukraine has bilateral tax agreements in place to avoid double taxation with each EU Member State, but reality can often prove to be (administratively) **complex and challenging**, especially in the current context. The employer in Ukraine may continue to withhold taxes on the employee's income for Ukraine's tax purposes, despite the fact that the income will be taxed in the host country. In that case, in order to avoid double taxation, the Ukrainian teleworker may need to ask the Ukrainian tax authorities for a refund/credit, backed up by documentation showing that taxes have indeed already been paid in the host country.

However, the finalisation of such a procedure can be difficult and time-consuming and, above all, disputes between the tax authorities may arise. The level and number of difficulties are very dependent on each person's unique set of circumstances and on countries' national laws. Moreover, with tax obligations arising in the host country, it would also be up to the Ukrainian teleworker to declare their income in a tax return to the local authorities (possibly in a language with which the refugee is not familiar). This would, in turn, increase pressure on the host countries' tax administrations to ensure that dedicated guidance is provided (for example, in Ukrainian).

Depending on the host country's national law, wage withholding tax obligations may apply on the employer's side too. If so, then the employer would need to pay wage withholding taxes in the host country.

International developments

In July 2022, the chair of the Ukrainian Parliament's Finance and Tax Committee stated that he hoped to see the issue of the tax treatment of Ukrainian refugees resolved 'by the end of 2022' with support from the OECD. Renegotiating individual bilateral tax treaties would take too long, and therefore it was hoped that one all-encompassing initiative from the OECD would render a speedier and more effective solution.

In August 2022, the Ukrainian government noted that it would send a letter to the governments of the EU Member States asking them to apply the **'COVID precedent'** for taxation. This refers to the dedicated actions taken during the height of the COVID pandemic on the tax treatment of cross-border workers.

The COVID precedent

During the COVID pandemic, the OECD issued guidance regarding the impact of the pandemic on bilateral tax treaties. The lockdowns, flight cancellations and the advice or obligation to work from home raised questions regarding the tax consequences of such measures for the taxation of employment income. In particular, cross-border workers who used to travel to their office five days per week were suddenly forced to telework full-time from home in their country of residence, rather than in the country of usual work activity. The guidance also looked at the tax treatment of workers who were posted abroad but were unable to return to their usual country of employment, due to months-long flight cancellations.

The OECD argued that 'where an employee is prevented from travelling because of COVID-19 public health measures of one of the governments involved and remains in a jurisdiction, it would be reasonable for a jurisdiction to disregard the additional days spent in that jurisdiction under such circumstances' for the calculation of the 183-day rule.

EU Member States took action to ensure that the unusual work circumstances did not suddenly lead to double taxation for the employees. For example, Belgium signed **'Memoranda of Understanding'** with France, the Netherlands, Germany and Luxembourg to clarify that days on which cross-border workers were teleworking could be considered as being spent in the country where the work would have been carried out without the pandemic, as long as the health authorities continued to advise to work from home. In this way, the usual 'pre-COVID' division of taxing rights could remain intact. A non-exhaustive overview of such measures can be found here.

The issue of the tax treatment of Ukrainian refugees was discussed at EU level in the high-level Council working party on taxation on 27 October 2022, where Member States held an exchange of views on the subject. There is no public information regarding the outcome of this discussion.

In September 2022, Ukraine signed an agreement with the European Commission to join the EU's **Fiscalis programme**. This programme is open to all EU Member States, as well as candidate countries, potential candidates and members of the EU's Neighbourhood Policy. Within Fiscalis, countries' tax authorities and the Commission share best practises and IT tools in tax administration and take initiatives to increase (digital) cooperation and administrative efficiency. The cooperation aims to strengthen both the (international) fight against fraud and evasion, and decrease the overall compliance burden faced by taxpayers so that taxes (and refunds) can be paid swiftly and correctly.[4]

While the decision to join pre-dates the war, Ukraine will also start participating in the OECD's **Common Reporting Standard** (CRS) in 2023. The CRS has frequently been dubbed 'the end of bank secrecy', as it ensures the automatic exchange of information on financial accounts between CRS participants (which includes all EU countries). Under the CRS, the Ukrainian tax authorities will receive notification when Ukrainian residents open a bank account abroad. This should make it more difficult for people who are abusing the war situation to avoid declaring income and stay hidden.

ENDNOTES

1 90 % of surveyed companies were either large or medium-sized businesses.

2 While the calculation of the 183-day threshold may seem straightforward at first, countries can have divergent views as to whether it includes the date of arrival, half-days, national holidays, etc. Countries may also have a different approach as to whether the 183-day threshold needs to be exceeded within a fiscal year, a calendar year, or during any twelve-month period. It therefore remains of key importance to check the relevant treaties.

3 While the right of taxation switches after day 183, the tax charge would cover the income earned as of day 1.

4 Tax revenue in Ukraine decreased by (only) 14 % compared to 2021, even though the country's economy shrank by almost 30 %. Press reports have highlighted the remarkably swift and honest declaration of taxes in Ukraine as a sign of the Ukrainian people's patriotic duty during the war.

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