

# Oleg Vysochan, Olesya Ostriychuk

---

## Taxation feature of tolling in foreign economic relations

---

Annales Universitatis Mariae Curie-Skłodowska. Sectio H, Oeconomia 46/4,  
851-860

---

2012

Artykuł został opracowany do udostępnienia w internecie przez Muzeum Historii Polski w ramach prac podejmowanych na rzecz zapewnienia otwartego, powszechnego i trwałego dostępu do polskiego dorobku naukowego i kulturalnego. Artykuł jest umieszczony w kolekcji cyfrowej [bazhum.muzhp.pl](http://bazhum.muzhp.pl), gromadzącej zawartość polskich czasopism humanistycznych i społecznych.

Tekst jest udostępniony do wykorzystania w ramach dozwolonego użytku.

OLEG VYSOCHAN, OLESYA OSTRIYCHUK

*Taxation features of tolling in foreign economic relations*

---

Cechy opodatkowania opłat tollingowych w ekonomicznych stosunkach międzynarodowych

**Key words:** tolling, give-and-take raw materials, tolling company, taxation, tax evasion

**Słowa kluczowe:** opłaty tollingowe, surowce oddane do przetworzenia, firma tollingowa, opodatkowanie, uchylanie się od podatków

## **Introduction**

Tolling operations, as a form of foreign economic activity, require organization of timely, efficient and continuous economic control at state level, including tax control, in order to minimize potential threats to the state economic interests. Studies of tax control over tolling operations implementation organization are especially important, taking into consideration the fact that income from collecting customs, duties and charges constitutes a significant portion of all tax revenues to the State Budget of Ukraine.

G. Bednarchuk, N. Vasilyuk, M. Kovenko, T. Lapenko, I. Shevchenko viewed tolling taxation problems in their writings. However, tolling operations in foreign economic relations have not been sufficiently discussed in the publications of researchers in the context of tax control over their implementation efficiency.

The aim of this research is to outline tolling taxation features in foreign economic relations. In order to achieve this goal, it is necessary to solve the following tasks:

- to give definitions of “give-and-take raw materials” and “tolling operation” in various national legislative and regulatory acts;
- to characterize the mechanism of tolling taxation;

- to analyze the shortcomings of the existing tax control system over tolling operations implementation and opportunities for shadow tolling schemes implementation;
- to consider tax compliance by entities, which carry out give-and-take raw materials processing in foreign economic relations;
- to examine the income tax features of tolling companies.

### Dynamics of give-and-take raw materials imports and finished products exports in Lviv Region

Significant specificity of tolling operations (long-term raw material processing, treatment processes complexity, the percentage of raw materials in the total value of finished products, etc.), and their considerable proportion in the structure of foreign trade cause taxation features of tolling operations.

Foreign customers imported in Lviv Region give-and-take raw materials to the tune of 294.5 million dollars in 2010, which made 9.3 per cent of national index (see Fig. 1). Exports of finished products manufactured from imported give-and-take raw materials in 2010 totalled 383 million dollars. Despite some volatility in both give-and-take raw materials imports and finished products (manufactured on tolling scheme) exports, a stable upward trend takes place in the balance between these indexes. This provides more tax revenues to Lviv Region budget and to Ukraine in general.

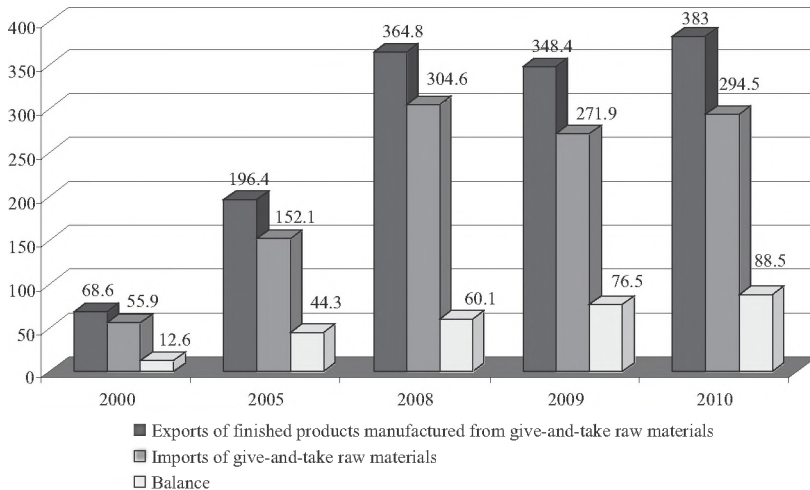


Fig. 1. Dynamics of give-and-take raw materials imports and finished products exports in Lviv Region, million dollars

Source: personal development on the basis of The State Statistics Committee data, Foreign Trade of Lviv Region: statistical collection. Lviv 2010, 78 pp.

## Legislative regulation of tolling operation in Ukraine

Implementation of tolling operations is regulated by the Law of Ukraine “On Tolling Operations in Foreign Economic Relations” adopted on 15.09.1995, № 327 (hereinafter the Law № 327). According to the Law № 327, under give-and-take raw materials one should understand raw materials, materials, semi-finished products, component parts, energy carriers imported into the customs territory of Ukraine by a foreign customer (or purchased by a foreign customer for foreign currency in Ukraine), or exported from the customs territory of Ukraine by a Ukrainian customer, for use thereof in the manufacturing of finished product. The foreign customer may not purchase the give-and-take raw materials at the customs territory of Ukraine for the national currency of Ukraine or obtain them in the result of other operations, including barter operations. The customer shall enjoy the rights of ownership to give-and-take raw materials at each stage of their processing, as well as to the products manufactured thereof<sup>1</sup>.

In Article 16 of the Tax Code of Ukraine adopted on 02.12.2010, № 2755-VI (hereinafter TCU) there was found a slightly different definition of give-and-take raw materials: raw materials, materials, semi-finished products, component parts, energy carriers owned by one entity (customer) and transferred to another entity (manufacturer) in order to produce the finished product, with subsequent transfer or return of such product or its part to their owner or on his behalf – to other entity<sup>2</sup>. Apparently, TCU is not limited in foreign economic aspect of give-and-take raw materials.

Lets consider in more detail, what is meant by the tolling operations. According to Article 1 of the Law № 327, the tolling operation is an operation on preliminary supply of raw materials for their further processing (treatment, enrichment or use) into the finished products for the corresponding remuneration regardless of the number of performers, as well as stages of processing of these raw materials under condition that the value of give-and-take raw materials at each stage of processing is not less than 20 percent from the total value of the finished products. Transactions, which do not provide for preliminary supply of raw materials for receiving finished products, or if the value of raw materials is lower than the specified 20 per cent, shall not be considered as operations with give-and-take raw materials<sup>3</sup>.

It should be noted that according to recent amendments to the Law № 327 adopted on 09.12.2011, the possibility of assigning the Ukrainian Government at the submission of the Ministry of Economic Development and Trade of Ukraine of certain types of transactions in which there is no change in code according to Ukrainian Goods Classification of Foreign Economic Activity (taking into account the technological features of processing) to tolling operations in foreign economic relations, is expected.

<sup>1</sup> On Tolling Operations in Foreign Economic Relations: Law of Ukraine adopted on 15.09.1995, № 327/95.

<sup>2</sup> Tax Code of Ukraine adopted on 02.12.2010, № 2755-VI.

<sup>3</sup> On Tolling Operations in Foreign Economic Relations: Law of Ukraine adopted on 15.09.1995, № 327/95.

According to Article 16 of TCU tolling operation is a processing operation (processing, enrichment or performance) of give-and-take raw materials (regardless of customers number and performers and stages (operations)) in order to obtain finished goods for corresponding fee. Tolling operations are operations in which give-and-take raw materials value on a particular stage of processing is not less than 20 percent from the total value of the finished products<sup>4</sup>.

Thus, the Law № 327 and TCU contain similar definition of tolling operations, which clearly indicates that the share of give-and-take raw materials in the total value of finished products should be not less than 20 percent.

Characteristically, the tolling operations may be performed also by residents of Ukraine, but so far there is no special legislative act that would regulate these relationships.

### **Ordinary bills in tolling operations**

Article 14 of TCU determines that tolling operations in foreign economic relations should be performed in the manner prescribed by the Law 327<sup>5</sup>. Article 2 of this Law states that Ukrainian performer shall carry out payment of import duties, taxes and fees (except for customs fees) through issuance of an ordinary bill to the body of state tax administration at performer's location. The term of payment shall be equivalent to the period of performance of operation with give-and-take raw materials, but not longer than 90 calendar days from the day of legalization of the import cargo customs declaration. The amount specified in the bill shall be paid in the currency defined in the contract on performance of operation with the give-and-take raw materials<sup>6</sup>.

In case of exporting the whole volume of finished products determined by the contract from the customs territory of Ukraine the bill shall be cancelled, and import duties, taxes and fees (except for customs fees) shall not be paid. Products made on tolling conditions are not subjected to licensing and fixing quotas, except for goods for special purposes determined by Ukrainian government. If exported excisable goods are made from raw materials, they are exempt from excise tax.

The bill shall be cancelled as well in case of partial export of finished products, determined by the contract, from the customs territory of Ukraine, provided the Ukrainian performer documentary confirms the payment of import duties, taxes and fees which had to be paid when importing into Ukraine the part of raw materials, used for manufacturing the finished products not exported from Ukraine. In order to determine the amount of import duties, taxes and fees, the value of give-and-take

---

<sup>4</sup> Tax Code of Ukraine adopted on 02.12.2010, № 2755-VI.

<sup>5</sup> *Ibidem*.

<sup>6</sup> On Tolling Operations in Foreign Economic Relations: Law of Ukraine adopted on 15.09.1995, № 327/95.

raw materials shall be converted into the national currency of Ukraine at the rate of the National Bank of Ukraine as of the day of payment of the bill<sup>7</sup>.

Customs legalization of the finished products, manufactured of the give-and-take raw materials imported from the customs territory of Ukraine and exported from the territory of Ukraine, can be performed on the grounds of the copy of the bill (written commitment) submitted by Ukrainian performer to the customs body, as well as copy of the import cargo customs declaration and, in case of need, conclusion of the Chamber of Commerce and Industry of Ukraine or that of regional chambers of commerce and industry, certifying that the relevant finished products have been manufactured through processing of the give-and-take raw materials, value of which is not less than 20% from the total value of the finished products.

Transactions between residents and nonresidents of Ukraine within their trade turnover should be paid in foreign currency only through authorized banks. The Law of Ukraine "On the Order of Payment in Foreign Currency" adopted on 23.10.1994, № 185 provides that the residents' proceeds in foreign currency should be placed to their foreign currency accounts in authorized banks in terms of debt payment specified in the contract, but not later than 180 calendar days from the date of exports customs clearance.

Violation of this term provides for the Ukrainian performer penalty of 0.3% of non-received proceeds (customs cost of short delivery products) in foreign currency for each day of delay, transferred in Ukrainian national currency at the official exchange rate of the National Bank of Ukraine, which is in force on the day of debt incurring<sup>8</sup>.

Realization of waste products or scrap remaining after spoiling of give-and-take raw materials or finished products or after processing of the give-and-take raw materials at the customs territory of Ukraine shall be levied by import duty and other taxes and fees, charged for imports of similar wastes and scrap in accordance with the legislation<sup>9</sup>.

### **Possible tax evasions via tolling schemes in Ukraine**

Imperfect tax control mechanism for the tolling operations implementation in foreign economic relations laid in the Law № 327 creates favorable environment for shadow schemes realization, and as a consequence – to tax evasion. Foreign customer and domestic agent are beyond the state tax control after importing give-and-take raw materials into the customs territory of Ukraine and until the export of manufactured finished goods.

---

<sup>7</sup> Р.Л. Хом'як, В.І. Лемішовський, В.І. Воськало та ін., *Бухгалтерський облік та оподаткування: навч. посібник*, за ред. Р.Л. Хом'яка, В.І. Лемішовського. 3-є вид., доп. і перероб. Львів: Бухгалтерський центр "Ажур" 2010, 1220 с.

<sup>8</sup> On the Order of Payment in Foreign Currency: Law of Ukraine adopted on 23.10.1994, № 185/94.

<sup>9</sup> On Tolling Operations in Foreign Economic Relations: Law of Ukraine adopted on 15.09.1995, № 327/95.

After importing batch of give-and-take raw materials there are all odds for selling manufactured finished products in the customs territory of Ukraine in order to receive income (without paying duty and the necessary taxes imposed on similar goods importation). Later one can buy a new batch (batches) of the same materials inside the state in order to manufacture finished products over again and freely take it from Ukraine. Also there is an opportunity to export Ukrainian production of higher quality under the guise of finished products manufactured from give-and-take raw materials.

A typical example of such fraud is scheme of sugar production. Raw cane sugar is imported as give-and-take raw materials and processed in Ukrainian plants. Then finished products are realized on the domestic market. In order to fulfil the external economic contract sugar made from this year sugar beet harvest is exported as finished products. As a result, low-quality products stay in Ukraine and high-quality sugar is exported abroad. Such schemes harm the State Budget of Ukraine, the national producer and each consumer separately<sup>10</sup>.

Within a single foreign economic activity entity amount of damage inflicted to the State budget of Ukraine seems inconsiderable. The amount of underpayment to the budget is quite significant if take into account that tolling operations are about 5% of all foreign economic operation carried out in Ukraine. More and more give-and-take raw materials are imported in customs territory of Ukraine every year (for example, in 2010 the amount of imported give-and-take raw materials exceeded 3 billion dollars).

### **Implementation of tax control over tolling companies**

Lets consider the implementation of tax control over tolling operations in foreign economic relations from the perspective of domestic performer. The procedure of bill is extremely inconvenient and unprofitable for the performers, costly both financially and in terms of time. Commercial bank takes commission for bill avalization service. Commission ranges between 1–2 per cent of the bill. Provision of bank guarantees (aval) is based on the transfer of property in pawn, which is registered by appropriate mortgage agreement or movable property security agreement and is accompanied by additional notary services costs for performers. In addition, the performer may periodically take bank credits. As a result much of his property at the time of raw materials clearance and bill avalization may already be in bank pawn. Finally, the performer physically can not have an inexhaustible list of assets that can be pledged. Banks, in turn, require the transfer of liquid assets, on which a penalty can be inflicted in case of principal obligation failure.

The procedure of bill avalization is very costly in terms of time. In order to pawn, for example, estate property one needs to make a list of documents in the bureau of

---

<sup>10</sup> О.П. Борисенко, *Державне регулювання та фінансовий контроль операцій з давальницькою сировиною*. Держава та регіони. "Науково-виробничий журнал" 2009, № 4, с. 15–20.

technical inventory, and coordinate all matters with notary public who will witness a transaction.

Taking into consideration all foregoing bureaucratic procedures, the performer loses 2–3 days for give-and-take raw materials clearance. As a result delays in deliveries of finished products take place and foreign counterparties may implement financial sanctions.

Lets examine international experience of the income tax characteristics of tolling companies. Participants establish tolling companies to build, own and operate production facilities at which the raw materials owned by the participants in the joint venture will be processed into finished product for use or disposal by the participants individually. C. Birch concluded, that whilst tolling companies facilitate fiscal benefits for participants by transferring the incidence of income tax in respect of a business activity to them, those fiscal benefits come at the cost of compliance costs. Compliance costs will erode the fiscal benefits derived. Tolling companies will stop being a favourable tax vehicle when the fiscal benefits associated with their fiscal transparency are less than or equal to the compliance costs from adopting the structure.

A tolling company arrangement allows participants to fund expensive capital works necessary for the refinement, transportation or conversion of raw materials extracted by the joint venture into a finished product for sale<sup>11</sup>.

A tolling agreement is a contract between one company that owns raw materials and a company that is engaged to process those materials, according to the specifications of the owner. In some cases, the owner of the raw materials may retain control of the products that are created as a result of the processing. In other instances, the owner sells the materials to the processor, also known as a toller, using pricing that is defined in the terms and conditions of the agreement. With both situations, the working relationship is usually designed to enhance the financial position of everyone concerned<sup>12</sup>.

The tolling company structure can be illustrated by a simplified example. Assume that a tolling company, which operates a gold refining plant, is owned 50% by Participant A, 25% by Participant B and 25% by Participant C. Participant A provides the tolling company with raw materials, Participant B provides technology and Participant C provides financial and general management services. Figure 2 usefully illustrates the interrelation of the participants to the tolling company and to the financiers.

---

<sup>11</sup> C. Birch, *Tolling companies and their income taxation features*, "Journal of Australian Taxation" 2002, № 5 (2), pp. 213–262.

<sup>12</sup> *What is a Tolling Agreement?* Access mode to p.: <http://www.wisegeek.com/what-is-a-tolling-agreement.htm>.



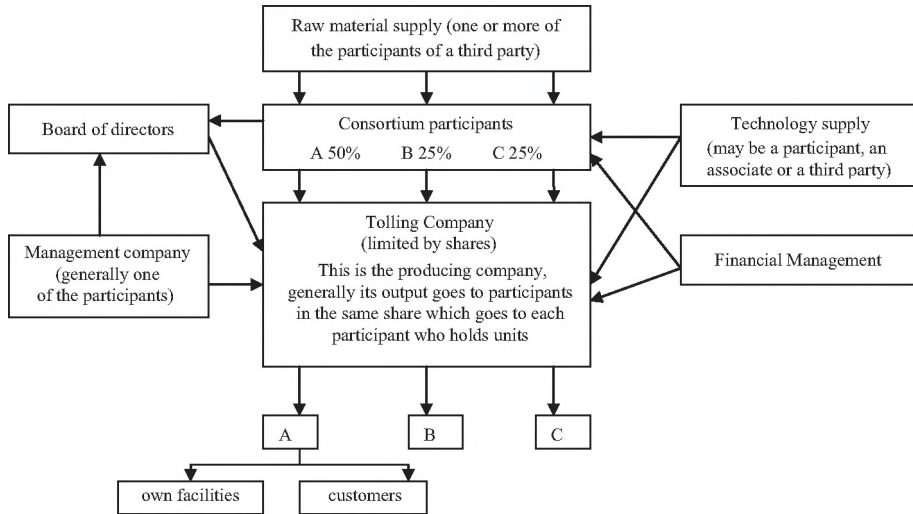


Fig. 2. Organization structure of a tolling company

Source: C. Birch, *Tolling companies and their income taxation features*, "Journal of Australian Taxation" 2002, № 5 (2), pp. 213–262.

The tolling company makes capital expenditure to provide a service for the joint venture through funds borrowed from a financier. The shareholders in the tolling company are the participants who, through the use of that company, ensure that financing is, where possible, non-recourse. Security is provided by the assets of the tolling company including the contracts with the participants. It is considered that because the assets of the tolling company are generally highly specific and specialised (and thereby have limited value to other parties), debt securitised over the assets is not disclosed in the participants' balance sheets<sup>13</sup>.

## Conclusions

According to the results of the research we can conclude that the control tax system over tolling operations in foreign economic relations is characterized by an essential drawback: there is a significant number of control measures on the stages of import of give-and-take raw materials into the customs territory of Ukraine and finished products export abroad, while manufacturing process of give-and-take raw materials remains completely ignored by the regulatory agencies.

Regulatory framework of tolling implementation is unfavourable for business entities and at the same time it does not exclude give-and-take raw materials processing

<sup>13</sup> C. Birch, *op. cit.*

shadow schemes realization possibility. This circumstance puts to doubt current tax control system effectiveness.

Apparently, economic security and prosperity of the state is impossible without well-established and coordinated continuous control of give-and-take raw materials throughout their stay on customs territory of Ukraine. Besides such control should not only serve fiscal purposes but also should be based on the interest combination of all parties of the tax relationship. Improvement directions of tax control mechanisms in the field of foreign economic relations, including the tolling operations, require further researches.

In order to improve the organizational side of public authorities control measures it is necessary to create a separate structural subunit in the structure of the State Customs Service of Ukraine. Such subunit will be entrusted with the functions of the organization and methodical support of tolling operations financial customs control.

Besides, relevant units should be established in the structures of regional customs offices. Such units will be assigned a function of performing of scheduled and unscheduled inspections of tolling operations in foreign economic activity in the region through which it will be possible to control each subject of a separate tolling operation with give-and-take raw materials at any stage of their implementation.

### Bibliography

1. Birch C. *Tolling companies and their income taxation features*, "Journal of Australian Taxation" 2002, № 5 (2).
2. Борисенко О.П., *Державне регулювання та фінансовий контроль операцій з давальницькою сировиною*, Держава та регіони. "Науково-виробничий журнал" 2009, № 4.
3. Р.Л. Хом'як, В.І. Лемішовський, В.І. Воськало та ін., *Бухгалтерський облік та оподаткування: навч. Посібник*, за ред. Р.Л. Хом'яка, В.І. Лемішовського. 3-е вид., доп. і перероб. Львів: Бухгалтерський центр "Ажур", 20 Foreign Trade of Lviv Region: statistical collection. Lviv 2010.
4. On the Order of Payment in Foreign Currency: Law of Ukraine adopted on 23.10.1994, № 185/94.
5. On Tolling Operations in Foreign Economic Relations: Law of Ukraine adopted on 15.09.1995, № 327/95.
6. Tax Code of Ukraine adopted on 02.12.2010, № 2755-VI.
7. *What is a Tolling Agreement?* Access mode to p.: <http://www.wisegeek.com/what-is-a-tolling-agreement.htm>

### Taxation features of tolling in foreign economic relations

This article examines the definition of "give-and-take raw materials" and "tolling operation" in various Ukrainian legislative and regulatory acts. The mechanism of tolling taxation in foreign economic relations is described. The shortcomings of the existing tax control system for tolling operations and opportunities for shadow tolling schemes implementation are highlighted. Effect of tax compliance on the activity of domestic enterprises which process give-and-take raw materials was found out. This

article also examines international experience of income tax characteristics of tolling companies. Possible ways of remedial action of tolling operations state control are offered.

### **Cechy opodatkowania opłat tollingowych w ekonomicznych stosunkach międzynarodowych**

W artykule zbadano definicję surowców oddanych do przetworzenia (*give-and-take*) w różnych ukraińskich aktach prawnych i regulujących. Opisano mechanizm opodatkowania opłat tollingowych w ekonomicznych stosunkach międzynarodowych. Zwrócono uwagę na wady istniejącego systemu kontroli podatkowej operacji tollingowych oraz na możliwości wprowadzenia niejasnych schematów opłat. Określono wpływ zgodności podatków na działalność przedsiębiorstw krajowych, które przetwarzają surowce *give-and-take*. W artykule zbadano również międzynarodowe doświadczenia dotyczące cech charakterystycznych podatku dochodowego firm tollingowych. Zaproponowano możliwe sposoby zastosowania środków naprawczych w operacjach tollingowych.