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Biofuel Producers Enjoy Tax Benefits

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Bio-Fuels

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Report Highlights:

The President of Ukraine signed into law provisions giving significant tax benefits for a biofuel industry in Ukraine. The law is aimed at stimulating biofuel production and consumption in Ukraine, intending to increase the share of energy produced from alternative (renewable) sources up to 20% by 2020.

Executive Summary: Ukraine has taken steps to give incentives to biofuel producers. The question remains: will this law be implemented and how will authorities check to see that those who apply for exemptions are actually the intended biofuel producers? Historically Ukraine has exported rapeseed for EU biofuel production, but has not been a serious biofuel producer for its own domestic purposes.

General Information:

The Law of Ukraine “On Amendments to Some Laws of Ukraine on Stimulating Production and Consumption of Biological Fuels” (#1391-VI dated May 21, 2009) was passed by the Parliament of Ukraine in May, 2009 and signed by the President of Ukraine on June 17, 2009. The law if implemented may create favorable conditions for the development of biofuel industry in Ukraine and help to increase domestic biofuel production and consumption in Ukraine, which remain marginal despite large domestic production and exports of products that may be used as a source of bio-energy

(e.g. rapeseed).

Lack of tax benefits and unclear state (including technical) regulation of biofuel market were considered the major problems for biofuel industry growth in Ukraine in recent years, and the new legislation was elaborated to address these issues.

The law introduces the following tax benefits for biofuel industry in Ukraine:

- In the period from January 1, 2010 to January, 2019, importers of machinery and equipment that is used for reconstructing and building new enterprises producing biofuel, as well as machinery and equipment used for production and modernization of transport vehicles for biofuel consumption (if these machinery and equipment or their equivalents are not produced in Ukraine) will enjoy zero import duty. It is set by the law that this provision may apply only to the products with the following HS codes: 8402, 8403, 8404, 8405, 8406, 8416, 8417, 8419, 8422 40 00, 8423 20 00 00, 8423 30 00 00, 8423 81, 8423 82, 8423 89 00 00, 8423 90 00 00, and 8514. The list of the commodities may be changed by the Government of Ukraine if approved by the Parliament's Energy Committee. The procedure of the importation of the equipment is to be adopted by the Government of Ukraine. If imported equipment is not used for the targeted purpose, importers will be fined.
- Machinery and transport vehicles, including agricultural machines, will be imported with zero import duty if they are fueled with biofuel and if these transport vehicles are not produced in Ukraine. It is set by the law that this provision may apply only to the products with the following HS codes: 8701, 8702, 8704, 8705, and 8709. The list of the commodities may be changed by the Government of Ukraine if approved by the Parliament's Energy Committee. The procedure of the importation of these transport vehicles, including agricultural machines, is to be adopted by the Government of Ukraine. If imported vehicles are not used for the targeted purpose, importers will be fined.
- Until January 1, 2019, apart from zero import duty, above-mentioned (1, 2) equipment and vehicles will be exempted from value added tax (VAT, set at 20% in Ukraine). This VAT exemption will also apply to the similar domestically produced products. The procedure of the importation of the equipment and vehicles is to be adopted by the Government of Ukraine. If equipment or transport vehicles are not used for the targeted purpose, importers or supplier will be fined.
- For 10 years, starting from January 1, 2010, income of biofuel producers obtained from selling biofuel will be exempted from income tax. For 10 years, starting from January 1, 2010, income of enterprises obtained from business activities related to the production of electrical and thermal energy with the use of biofuel will be completely from income tax.
- For 10 years, starting from January 1, 2010, exemption from income tax will also be enjoyed by producers of machinery and equipment that are used for the production or reconstruction of machinery or transport vehicles, including agricultural machines and energy station, which consume biofuel (the exemption deals only with the income from selling abovementioned machinery and equipment that were produced domestically. Additional resources obtained due to the tax exemption should be targeted at lowering selling price of the abovementioned machinery and equipment.
- Until January 1, 2019, the assets of enterprises consuming biofuel or used for the production of alternative fuel (including biofuel) are allowed to be accounted with "bonus" depreciation, implying more favorable conditions of depreciation compared to other enterprise assets. The purpose of this decision is to stimulate investments into biofuel producing or consuming equipment.
- Until January 1, 2014, biofuel is exempted from excise duty that the other motor fuels face. For motor fuels that contain biofuel as a component, excise duty for biofuel component is charged at zero rates, i.e. it is also exempted from excise duty. Producers of motor fuels that contain biofuel will also enjoy some tax benefits while purchasing biofuel for processing.
- Until January 1, 2014, raw ethanol is exempted from excise duty if it used for bioethanol production, and

bioethanol is exempted from excise duty if it used for biofuel production.

- Individuals who modernize their motor vehicles to be fueled with bioethanol, biodiesel and other types of biofuel will enjoy an exemption from income tax for individuals in the amount spent for this purpose.

According to the new legislation, biofuel has to be certified if it is produced for selling. Biofuel producers may consume it without certifying. All entities (companies, individuals) that are involved in production, storage and selling liquid biofuel and biogas have to be included into the state registry of biofuel producers. The procedure for creation and maintenance of the registry is to be developed by the Government of Ukraine. All biofuel producers are bound to introduce accounting of produced biofuel and bio-components based on the procedure to be set in the legislation. Moreover, all companies that produce, store and sale liquid biofuel (bioethanol, biodiesel) or biogas have to get a license to do it.

Based on recently adopted legislation, the Government of Ukraine is to adopt national standards for bioethanol and other types of biofuel in 6 months.

It should be noted that previously only state companies were allowed to produce both ethanol and bioethanol in Ukraine. Currently, bioethanol production will be allowed to private companies that received a license.

It is prohibited in the law to produce ethanol by enterprises that specialize in bioethanol production. It is also prohibited to store and transport bioethanol without its denaturation with 1-10% of gasoline. If bioethanol is produced for exportation, denaturation has to be done based on export contracts.

According to the Ministry of Agrarian Policy, 6 state plants are planed for reconstruction to produce bioethanol in 2009, and 4 state plants have already been reconstructed and are able to produce bioethanol with total capacity estimated at 36,000 tons annually. Moreover, 10 state ethanol-producing plants are to be equipped for biogas production in 2009-2010. As of now, only one of such state plants has biogas producing equipment, which helped to decrease natural gas consumption by this plant by 32%.

Ukraine is a large producer and net exporter of grains and oilseeds, including rapeseed, which is a main source of biodiesel production in the EU. However, most of rapeseed produced in Ukraine is exported to EU states for further processing and consumption as biofuel. Please, refer to GAIN Oilseeds and Products Annual Report for details (<http://www.fas.usda.gov/gainfiles/200903/146347656.pdf>).

In 2006, the Government of Ukraine adopted state program on the development of biodiesel industry. According to this program, biofuel production should increase to 520,000 tons in 2010, but some assumptions of the program seem to be not very well based. For example, according to the program, Ukraine should increase rapeseed production to 6.6 million tons in 2009 and to 7.5 million tons in 2010, compared to a record high of 2.9 million tons of rapeseed produced in 2008. The program envisaged very general and vague mechanisms to attain stated goals and did not provide any tangible benefits (e.g. subsidies, tax exemption) for biodiesel producers. Thus, its adoption and implementation had only a little if any impact on biofuel industry. The new law is different compared to the state program, as it is concentrated on the issues that may and should have impact on business environment in Ukraine's biofuel industry.

It is still not clear how the new law will be implemented and if private businesses are able to be fully competitive with tax benefits provided, but the legislation changes may potentially have some impact on trade in both biofuel and agricultural commodities in the region.