



Profit shifting in Ukraine's exports of agricultural commodities



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INTRODUCTION

Tax avoidance is high on the political agenda in the EU¹, but even higher in Ukraine², where the state budget is chronically underfunded due to the country's large 'black economy' (up to 50%³). By way of a comparison, Ukraine has a population of about 45 million, with the state collecting only €20 billion in taxes, whereas neighbouring Poland, with a population of less than 40 million, collects more than €80 billion in taxes⁴. The Ukrainian state has to compensate for this lost tax revenue by borrowing from the IMF and receiving macro-financial assistance from the EU. However, successive Ukrainian governments, including the newly formed administration, have shared a hard-line, pro-business, anti-state ideology. For example, the new minister for economic development has challenged the view that the country's huge black economy needs to be reduced to boost the state budget⁵.

As our previous study⁶ showed, either the transfer pricing rules themselves or their implementation by the fiscal authorities were probably insufficient to tackle tax avoidance associated with iron ore exports. In this paper, we continue examining the topic by focusing on transfer pricing in agricultural exports and touching on other ways in which agribusiness minimises its tax payments.

Tackling the non-payment of tax on exports is particularly important for Ukraine since its economy is heavily reliant on trade in commodities. Products derived from natural resources, such as iron ore and agriculture,

are expected to benefit the majority of the population. While the owners of these assets tend to be rich or super rich, wages in their industries are meagre, even when compared to those paid in developing countries' industries. The seven richest Ukrainians own key assets in the iron, steel and agricultural sectors⁷. This existing flagrant inequality is exacerbated by low taxation in Ukraine and the use of various methods of 'tax optimisation'.

The focus of this study is agribusiness, Ukraine's 'new iron and steel sector', and the growth, political influence and wealth it generates for its owners. Agricultural exports have been growing steadily and now account for more than 40% of Ukraine's exports. Contrary to the stereotype of "the breadbasket of Europe", during Soviet times and until recently agriculture was not Ukraine's main export. Only now that agricultural holdings have concentrated production and lobbied for tax breaks has the sector overtaken the previous leaders.

The sector is also mired in controversy linked to politics. Ukrainian mass media have published reports about offshore schemes used by the country's main agricultural exporters. Ukraine's agricultural oligarchs are active politically and internationally, serving as advisors to the president and MPs, financing political parties, receiving state decorations as 'heroes of Ukraine', and even funding international chambers of commerce⁸.

1 [http://www.europarl.europa.eu/RegData/etudes/BRIE/2019/633153/EPRS_BRI\(2019\)633153_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2019/633153/EPRS_BRI(2019)633153_EN.pdf)

2 <https://golos.ua/i/477711>

3 <https://biz.liga.net/ekonomika/all/novosti/tenevaya-ekonomika-v-2018-godu-dostigla-47-ot-vvp---opros-kmis>

4 <https://data.worldbank.org/indicator/GC.TAX.TOTL.CN>

5 <https://nv.ua/biz/economics/ministr-ekonomiki-milovanov-intervyu-novosti-ukrainy-50041337.html>

6 http://guengl-panamapapers.eu/wp-content/uploads/2018/09/180911_Study-Tax-Avoidance-UA.pdf

7 https://pep.org.ua/media/documents/focus.ua_richest_Ukrainians_27.04.2018.pdf

8 <https://112.ua/statji/semya-vadaturskih-gotovitsya-k-vyboram-starshiy-dogovarivaetsya-s-batkiivshhinoy-mladshiy-stroit-partiyu-dlya-groysmana-441992.html>

http://antikor.com.ua/articles/141771-zvezda_oligarha_ukrainy

<https://glavcom.ua/interviews/andriy-vadaturskiy-bpp-ce-partiya-vladi-yaka-vzhe-nikomu-ne-potribna-394265.html>

Given such close political links, it is hardly surprising that the state has been awarding subsidies and tax breaks to agribusiness⁹.

Agricultural oligarchs' lavish lifestyle has also attracted media attention with yachts worth €150 million, birthday parties in alpine resorts consuming countless bottles of premium champagne, and enormous mansions built on archaeological sites. The main holdings have also been subject to criminal investigations related to tax avoidance¹⁰.

Despite such controversies, agribusinesses have received state subsidies, were until recently exempt from paying VAT, enjoy a reduced tax rate on dividends and are eligible for a simplified income tax system¹¹.

As before, this collaborative work was carried out at the transaction level and using daily market data, rather than aggregated global figures on which other studies have been based. This sets it apart in terms of the reliability of its findings.

9 <https://commons.com.ua/uk/opadatkuvannya-silskogo-gospodarstva-vikliki-i-mozhlivosti/>

10 <https://www.unn.com.ua/ru/news/1703976-kernel-treyd-pidozryuyetsya-v-bagatomilyonnomu-ukhilyanni-vid-splati-podatkov>
<https://latifundist.com/novosti/38193-sledovateli-gfs-izuchayut-prichastnost-kernel-k-shemam-vyvoda-deneg>
<https://112.ua/obshchestvo/kernel-obvinili-v-mahinaciyah-s-nds-smi-433879.html>

11 <http://taxsummaries.pwc.com/ID/Ukraine-Corporate-Tax-credits-and-incentives>

AGRICULTURAL MARKETS

WHEAT AND CORN

Cereals are the most widely consumed agricultural products and global consumption is expected to expand significantly, predominantly driven by global demographic growth. Greater demand for animal feed will push up consumption, mainly within developed regions, but also in developing countries. In those regions, rising incomes, changes in dietary patterns (consuming more protein-rich calories, such as meat and dairy) will sustain rising growth for grain and meal as key components of animal feed. By contrast, the consumption of other cereals, such as wheat, which are predominantly for human consumption, is expected to remain relatively stable.

While global imports of grain have become spread over a larger number of countries, exports of agricultural commodities are concentrated, going to fewer countries. The Black Sea region is one of their leading exporters. Ukraine is ranked among the world's largest grain exporters, supplying around 10% of grain on the global market, a position that is expected to be further consolidated in future. Indeed, Ukraine has huge potential to increase its grain production, productivity and exports, having the most agricultural land in Europe (42 million ha, 70% of Ukraine's total surface area) and 25% of the world's highly fertile 'black soil'.

Average yields in Ukraine have increased significantly in recent years, but they are still 20-40% lower than those of producers in more developed countries or regions (like the USA, EU, Canada and Argentina) despite Ukraine's much higher soil quality. One of the main goals of cereal farmers there in coming years is to boost yields by modernising their

agricultural machinery (combine harvesters, etc.), sowing better seeds and making more effective use of fertilisers and crop protection.

Unlike other major producers, such as China, India and Brazil, where domestic production is mostly used to supply local markets, usually less than half of Ukraine's grain output is consumed domestically. Consequently, with domestic demand stagnating against the backdrop of a dwindling population, any additional production by Ukraine will be destined for export.

This conclusion underlines one of the main findings of the previous report, on profit shifting in iron ore exports, namely that Ukraine's economy is very 'open', i.e. it has a high exports-to-GDP ratio. In other words, the country's economy is based on exports to richer countries and low domestic wages. Correspondingly, the Ukrainian oligarchy is based on exports of commodities including agricultural produce.

Extensive exportable supplies and rising global consumption are already underpinning growth in grain exports, a trend that is expected to continue. By 2020, annual grain production in Ukraine is expected to reach 100 million tonnes (mt), up from 66 mt in 2017, and annual grain exports are expected to increase from the current 45 mt in 2017 to 70 mt in 2020.

Ukraine's main grain exporters are Kernel, accounting for 10% of the country's export total, followed by Nibulon, Cargill, State Food and Grain Corporation of Ukraine, Bunge Ukraine and ADM. Together, these companies account for over 70%, 75% and 55% of all Ukrainian exports of wheat, corn and barley respectively.

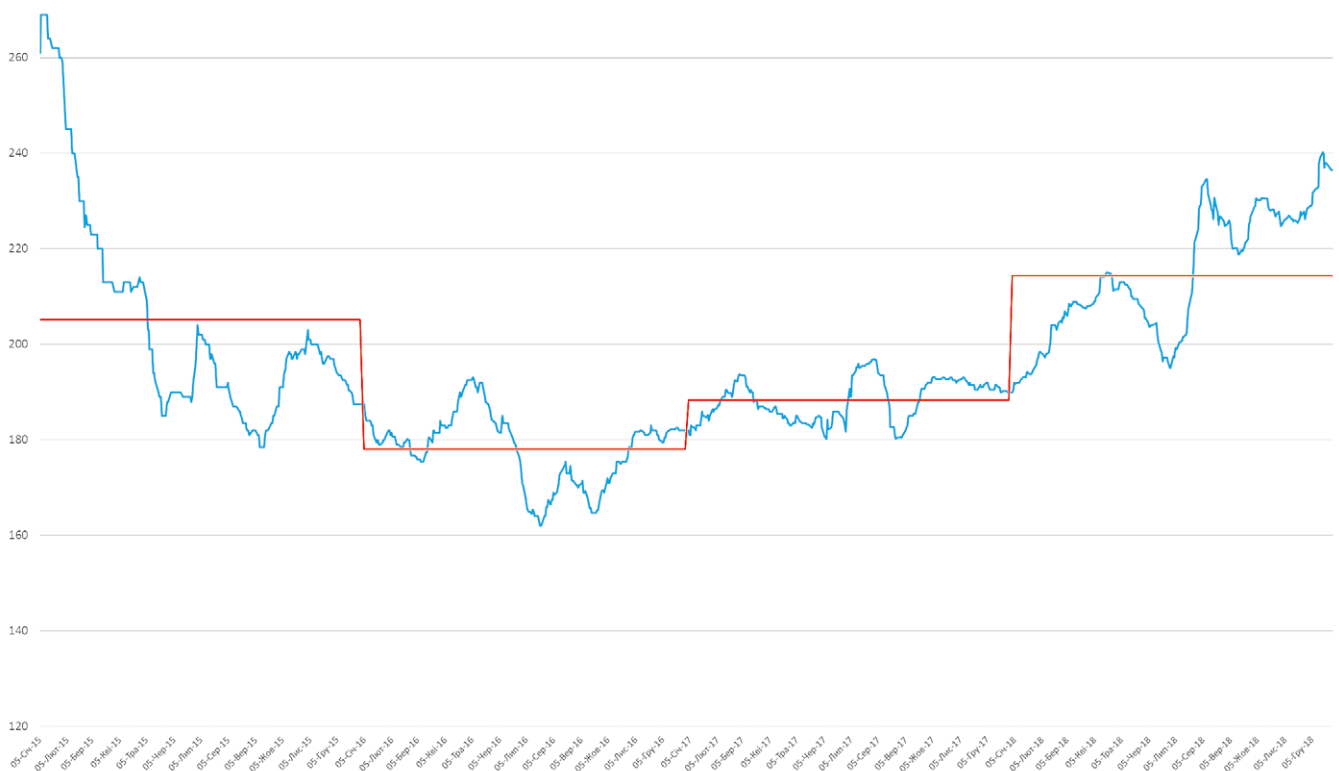
Only Russia has recently threatened Ukraine's steady rise as one of the top actors on the world grain market. Having exported just 1.3 mt of grain in 2000-2001, Russia had 44 mt earmarked for export in 2017-2018. But even more than Ukraine, Russia faces major infrastructure constraints. In 2017-2018, its logistical incapacity prevented it from shipping out 10 mt of grain.

Ukraine's competitiveness is underpinned by greater cost efficiencies in its grain supply chains. Those companies that are ready with efficient logistical and throughput facilities are expected to benefit the most from the

projected growth in grain exports and thereby further consolidate their market position. Ukraine's leading companies are shielded by high entry barriers that protect the profitability of their businesses in the medium term. This justifies their ongoing choice to invest in relatively capital-intensive private storage and transportation infrastructure.

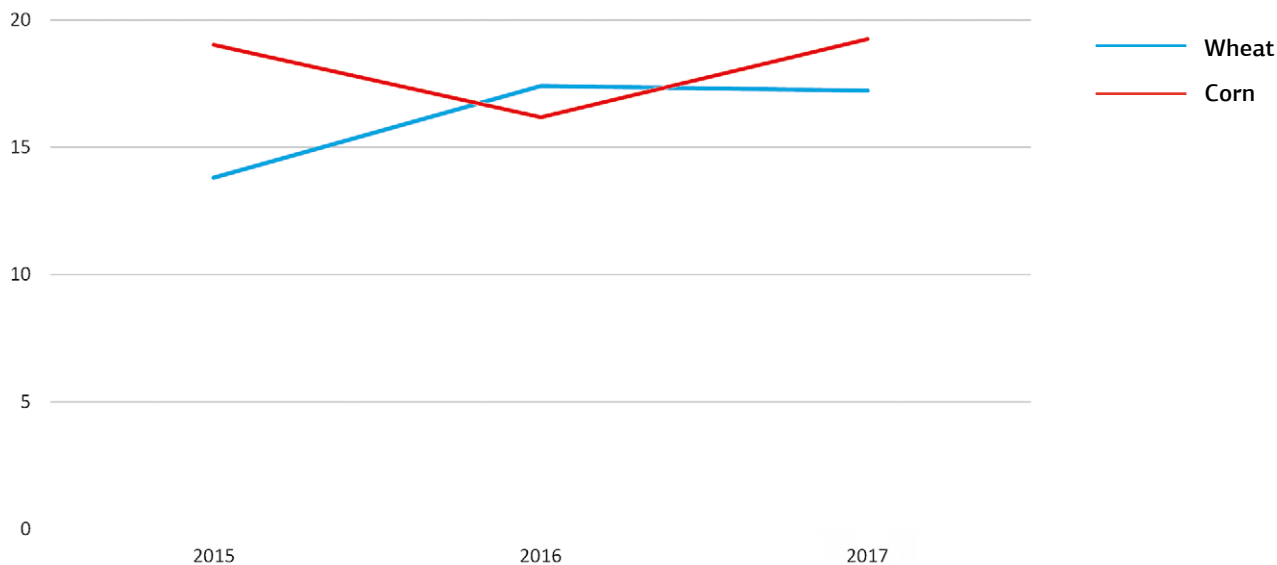
The graphs below show that wheat prices were relatively low in 2016 and 2017, while over the same period the volume of wheat exports from Ukraine went up, whereas corn exports remained relatively stable.

Figure 1. Daily prices of wheat (US\$/t) and their annual averages, Black Sea Wheat index



Source: Platts

Figure 2. Exports of wheat and corn by year, million tons



Source: Import Genius customs database

The widely dispersed destinations of physical deliveries also speak volumes for our analysis, and below it will be shown that this broad spread starkly contrasts the high

concentration of intermediaries handling these exports, which are predominantly from low-tax jurisdictions such as Switzerland, Cyprus and Great Britain.

Table 1. Destinations of agri-exports from Ukraine (top cumulative 76%), and where the intermediaries are located

Destination of delivery (wheat, corn, oil)	Share in the total exports 2015-2017
India	16%
Egypt	10%
China	9%
Spain	8%
Netherlands	6%
Italy	6%
Iran	3%
Indonesia	3%
Bangladesh	3%
Thailand	3%
South Korea	2%
Israel	2%
Tunisia	2%
Turkey	2%

AGRICULTURAL MARKETS

SUNFLOWER OIL

Ukraine is the world's largest supplier of sunflower oil, producing 5.8 mt in 2016/2017 (57% of all international exports). The Ukrainian company Kernel is the biggest exporter of this commodity, not just in Ukraine, but in the world, trading with more than 60 countries. As with wheat, the business is export-oriented, with 90% of the sunflower oil produced being exported in bulk to major importers such as India, the EU, China, Egypt and Turkey.

Global imports of crude sunflower oil are increasing. During the 2016/17 season, they rose by almost 10% compared to the previous season, reaching a volume of 9 mt¹². The largest importers are India, the EU and Turkey, together accounting for more than 45% of global imports. India and Turkey have been major contributors to global growth in imports in recent years by increasing their consumption without boosting domestic production.

Global consumption of refined sunflower oil for cooking is also rising. The negative perception of palm oil, the most widely produced vegetable oil in the world and a major competitor of sunflower oil, has helped to push up demand for sunflower oil in the Western EU, Australia and the USA. Meanwhile, in several countries, including India and China, sunflower oil is increasingly replacing palm oil in specific industrial applications.

India and China are key importers of Ukrainian sunflower oil, together accounting for around 46% of its foreign exports. India accounts for 29% (2017) of Ukraine's sales of sunflower oil. India has a 70% supply-demand gap for vegetable oil and is the world's largest importer of vegetable oil (mostly in the crude state, owing to the higher tax levied on imports of refined oil). India is importing growing volumes of vegetable oil, and this trend is expected to continue in the near future, driven by an expanding population, rising disposable incomes and increasing awareness of health, food safety and hygiene issues.

¹² USDA data

TRANSFER PRICING RULES IN UKRAINE

AN OVERVIEW OF TRANSFER PRICING RULES IN UKRAINE

The pricing of transactions (aka 'transfer pricing' or TP) between connected parties (e.g. sales or purchases of goods, services, funding and intellectual property licensing) can be manipulated for tax avoidance purposes to artificially shift profits to low- or no-tax jurisdictions.

TP rules, which are set by reference to guidelines produced by the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN), detail how transactions between connected parties

should be priced for tax purposes, and are based on the 'arm's length principle', whereby such transactions are treated by referring to the profit that would have been generated if the transactions had been carried out under comparable conditions by independent parties.

Ukraine has relatively little experience with TP rules, having only introduced them in 2013 and significantly revised them since, as outlined in the sections below.

UKRAINE'S INTRODUCTION OF TP RULES IN 2013

Ukraine issued new TP rules in January 2013¹³ and further amended them during that same year, when new legislation introduced the arm's length principle as well as five standard OECD transfer pricing methods. These TP rules initially applied to all related-party transactions (including domestically) and all cross-border transactions (including those effected with independent parties).

Previous Ukrainian tax law contained definitions of terms such as 'arm's-length price' and 'related parties', but the new legislation expanded their definitions. Defining 'related parties', the new legislation stipulated that interdependence between parties (whether individuals or organisations) is established via capital participation or contractual or other relationships that allow one party to influence decisions made by the other party, either directly or through other, dependent third parties.

Types of transactions that can be deemed to be 'controlled', subject to a materiality threshold, include business transacted between Ukrainian taxpayers and related parties registered in foreign countries with domestic related parties under certain conditions, and with entities registered in 'low-tax jurisdictions'.

Low-tax jurisdictions were defined as countries or territories that impose corporate income tax rates five or more percentage points lower than the corresponding

Ukrainian rate (though foreign legal entities with an effective tax rate five or more percentage points lower than the corresponding Ukrainian rate also qualified).

Unlike the previous rules, the new TP rules, which were initially valid for an initial period of 5 years, until January 1, 2018, did not allow for a 20% deviation from market prices, but rather required 'baseline' prices to be set for imports and exports of certain goods to or from entities registered in 'low-tax jurisdictions', using either prices realised at commodity exchanges or pricing intervals set by the Ukrainian government derived from prices quoted in published market overviews.

Minor deviations from market prices were permitted, with exporters able to set prices for such transactions at up to 5% below the minimum of the baseline pricing interval, and importers allowed to charge prices up to 5% above the maximum of the baseline pricing interval.

The goods subject to these special pricing rules included certain agricultural commodities (grain, oils, and fats of animal or vegetable origin), minerals (coal, crude oil and its derivatives, mineral ores), organic chemical compounds and products of inorganic chemistry, including compounds of precious and rare earth metals or radioactive elements, and ferrous metals or items derived from ferrous metals.

¹³ The new law was implemented in the Ukrainian Tax Code as a new section (Tax Code of Ukraine, Article 39) and subsequently amended in The Resolution of the Cabinet of Ministers of Ukraine (CMU) on 04.07.2013 No 408-VII "On Amendments to the Tax Code of Ukraine on transfer pricing" and on 02.10.2013 No.749 "On approval of the percentage price range for certain commodity items under Ukrainian classification of import-export goods for transfer pricing purposes"; The Order of CMU dated 23.10.2013 No.865-p "On the list of specialized commercial publications for transfer pricing purposes"; The Order of CMU dated 23.10.2013 No.866-p "On approval of the list of information sources about market prices for transfer pricing purposes"; The Order of the Ministry of Revenues and Duties dated 11.11.2013 No.669 "On approval of the form and the Order for the controlled operations statement"

2015 UPDATE TO TP RULES

New rules introduced in 2015¹⁴ set out the criteria for taxpayers to choose the method for ascertaining whether the price of a transaction complied with the arm's length principle. The general rule was that taxpayers could choose any TP method they deemed appropriate with due regard to the criteria (Article 39, section 39.3.2.1, Tax Code of Ukraine). However, the Comparable Uncontrolled Price ('CUP'¹⁵) method was set as the 'basic' approach (i.e. the prime way of substantiating the price). Where either the CUP method or some other approach could be used, taxpayers were meant to apply the former.

The rules designed to determine whether two parties are 'related' were also extended to cover any legal entities or individuals in specific relationships that could influence the conditions under which they transacted business or its outcomes.

The updated rules did not apply to transactions between Ukrainian related parties, since they only apply to cross-border activity. Controlled transactions with non-residents include the following scenarios:

SPECIAL TP RULES FOR COMMODITIES TRADING

The new rules included special rules for commodity trading with companies registered in 'low-tax' jurisdictions. These special rules¹⁶ applied both to transactions with non-residents registered in the list of 'low-tax' countries adopted by the Cabinet of Ministers of Ukraine and to transactions involving exports or imports of commodities with quoted prices.

The CUP method must be used to determine whether the conditions of such transactions comply with the arm's length

- transactions with non-resident related parties;
- transactions with foreign companies involving the sale of goods through non-resident commission agents;
- transactions with non-residents registered in low-tax jurisdictions according to the list adopted by the Cabinet of Ministers of Ukraine, whereby under the new rules, the list of these jurisdictions will serve as the definitive source of what are deemed to be low-tax jurisdictions;
- transactions between related parties involving independent persons (as intermediaries), provided that such persons do not perform any significant functions and do not use significant assets and/or do not bear significant risks in the transactions between related parties.

principle. **When applying the CUP method, taxpayers must calculate the arms' length price range based on the prices quoted on the respective commodity exchanges over the 10-day period before the controlled transaction.**

Taxpayers are permitted to use other TP methods, but in such cases must submit details to the fiscal authority on the profits realised by each related party involved in the supply chain for the respective commodity, up to the first non-affiliated entity.

14 On 28 December 2014, Ukraine's parliament adopted Law No. 72-VIII, which introduces major amendments to the TP rules introduced by the previous government in 2013. TP control rules were subsequently amended by Law No. 609-VIII on 13 August 2015.

15 The Comparable Uncontrolled Price (CUP) method compares the price charged for property or services transferred in a controlled transaction with the cost of property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

16 Article 39, section 39.2.1.3, Tax Code of Ukraine

LIST OF TRADED COMMODITIES

On 8 September 2016, the Cabinet of Ministers of Ukraine (CMU) adopted Resolution No. 616 approving the list of traded commodities for TP purposes and stipulating that compliance with the arm's length principle now has to be checked using the comparable uncontrolled price (CUP) method.

The commodities covered by CMU Resolution No. 616 include:

- agricultural produce (livestock, meat, grain, food, seeds, palm and soya oil, etc.);
- energy products (coal, crude oil, natural gas, petrol, etc.);
- industrial and precious metals, cotton and rubber;
- other commodities.

For each group of commodities, CMU Resolution No. 616 stipulates an approved commodity exchange as an information source for arm's length testing. Approved commodity exchanges include (non-exhaustive list)::

- **Agricultural produce:**
Chicago Mercantile Exchange (CME), Euronext, Intercontinental Exchange (ICE), New York Mercantile Exchange (NYMEX), National Commodity and Derivatives Exchange (NCDEX);
- **Energy products:**
Intercontinental Exchange (ICE), European Energy Exchange (EEX), Chicago Mercantile Exchange (CME), Tokyo Commodity Exchange (TOCOM), European gas hubs (NCG, CEGH, GASPOOL);
- **Industrial and precious metals:**
Intercontinental Exchange (ICE), London Metal Exchange (LME), Dubai Gold and Commodities Exchange (DGCX), Chicago Mercantile Exchange (CME);
- **Cotton and rubber:**
Chicago Mercantile Exchange (CME), Intercontinental Exchange (ICE), Multi Commodity Exchange of India Limited (MCX), Singapore Exchange (SGX), Shanghai Futures Exchange (SHFE).

2018 REVISION OF TP RULES

In 2018¹⁷, Ukraine's TP rules were further revised to expand their application to unrelated entities. Transactions between Ukrainian entities and entities located in low-tax jurisdictions or entities with special legal status may be subject to TP checks even if the parties are not related. The list of low-tax jurisdictions is approved by the

CMU and includes countries and territories (a) whose corporate tax rate is up to 5% lower than the rate in Ukraine; (b) that have not concluded double taxation treaties with Ukraine; and (c) that fail to provide tax information requested by Ukraine's fiscal authorities in a timely manner.

LATEST DEVELOPMENTS

In recent years, Ukraine has actively cooperated with the OECD, and in 2016 it joined its Inclusive Framework on Base Erosion and Profit Shifting (BEPS). This cooperation resulted in Ukraine's ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting in February 2019¹⁸.

In addition, Ukraine has been actively working on legislation to implement BEPS standards, the adoption of which should facilitate effective tax controls on international operations that meet all the OECD's requirements. Applying such standards will enable more efficient TP audits and proper monitoring of transactions between the related parties.

On 24 October 2018, the Ministry of Finance published the Draft Law on Amending the Tax Code of Ukraine Towards the Implementation of the Base Erosion and Profit Shifting Action Plan, which lays foundations for implementing the OECD/G20 Action Plan on Base Erosion and Profit Shifting.

For the purpose of our analysis, we assume that exports of agricultural products between related parties should be priced by referring to quoted market prices, in accordance with Ukraine's TP rules. Any significant deviation from market prices would indicate a high risk of profit shifting from Ukraine designed to avoid corporation tax.

¹⁷ Ukraine Law No. 2245-VIII "on the Introduction of Changes to the Tax Code of Ukraine and Some Legislative Acts of Ukraine on Ensuring the Balance of Budget Revenues in 2018", effective from 1 January 2018.

¹⁸ <http://sfs.gov.ua/en/mass-media/news/print-387691.html>

RESULTS

After 2014, the structure of Ukrainian exports changed when agricultural commodities became Ukraine's single largest exports, overtaking iron and steel products. In the previous study on iron ore exports we found substantial underpricing and thus shifted profits. Since both agribusiness and iron and steel assets owners operate in the same system, one characterised by strong links between the state and big business, we hypothesised that agricultural exports might be equally (i.e. roughly 20%) underpriced.

We analysed data on wheat and corn, two of Ukraine's three most important agricultural exports, accounting over the period of 2015-2017 for a share of around 41%. The other major commodity is sunflower oil, of which Ukraine is the world's leading exporter. However, being unable to acquire reliable market price data for sunflower oil, unlike in the case of wheat and corn, we desisted from a detailed analysis of underpricing of this product.

To analyse export transactions during the years 2015-2017, we used Ukrainian customs data supplied by Import Genius, a US provider of business intelligence. That database includes the following information: transaction dates, HS codes of traded commodities, detailed descriptions of traded products, weight and invoice value in both Ukrainian hryvnia and US dollars, incoterms, names and tax codes of shippers (i.e. the sellers in Ukraine), destinations (for physical delivery) and consignees (intermediaries, usually an 'offshore' entity). The data were prepared for analysis by unifying units for weight, recoding destination and consignee countries using ISO 3166 country codes and recalculating prices in USD using daily Ukrainian hryvnia-US dollar exchange rates provided by the National Bank of Ukraine.

Our cleaning of these data was partly reliant on the detailed description of transactions. To reduce the role of outliers and make transaction prices more comparable to market prices, we used HS codes to remove the prices for hard wheat and seeds and filtered out corresponding transactions using text patterns from the product description: organic products, specimens, etc. The overall values of the resulting dataset are very close to the annual statistics provided by the State Service of Statistics of Ukraine. Most of the differences between annual totals are less than 5% and never exceed 10%. These discrepancies can plausibly be attributed to the data cleaning procedure, which is a reassuring sign of the reliability of the transaction data we used.

For market price data we used indices of daily prices for Black Sea wheat and Black Sea corn, both under FOB terms, collated and sold by Platts. For weekend transactions, we used the market prices on the last day for which they were available. There is a delay between the sale date and customs registration, so we calculated Pearson correlations between weighted daily mean export prices and weighted daily mean time-lagged market prices, starting with a 1-day lag and ending with a 90-day one. The highest correlation is for market prices with a 45-day lag, so these were used in all the calculations in this study. Although these totals are close to the figures for market prices with a 30-day time lag and to non-lagged market prices, the results for individual transactions with no lag can be very different.

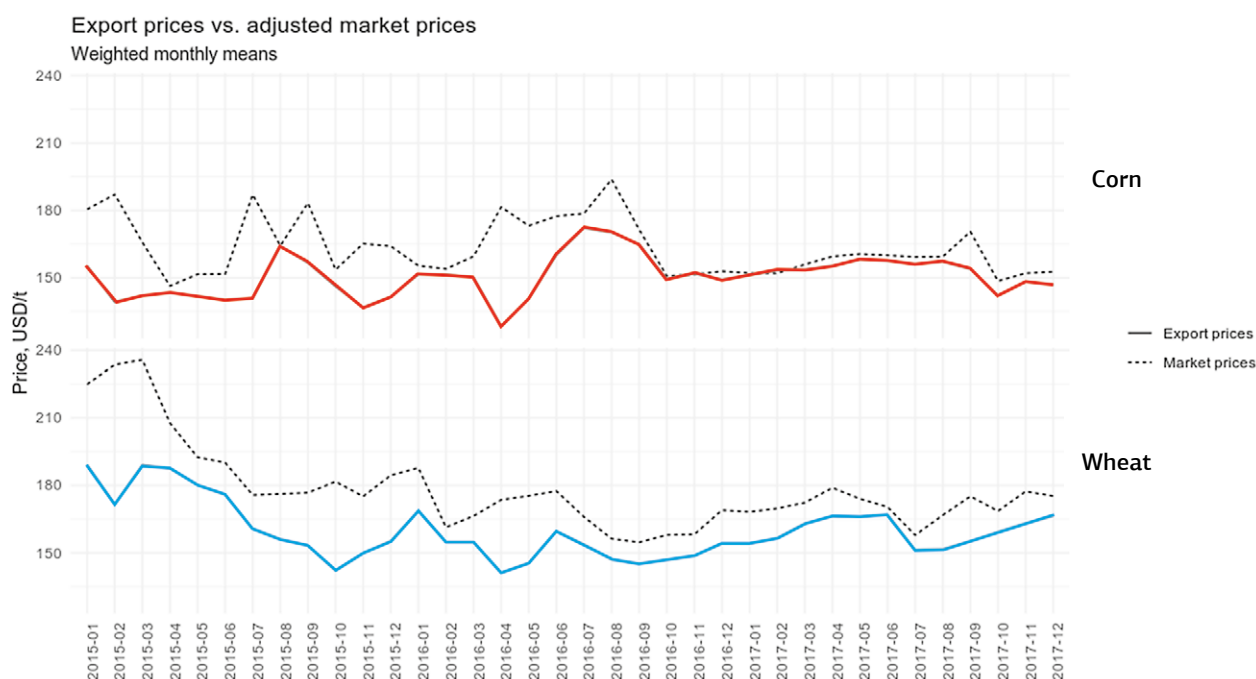
We also had to take account of the impact on exports of different incoterms and fluctuations in product quality. Weighted mean prices for second-class wheat differ from those for fifth-class wheat by \$22/t.

Using the product description, we classified classes 1-6 of wheat according to Ukrainian State Standard 3768 (DSTU) as well as classes A and B¹⁹. The properties of class A produce, such as its wet gluten content and protein content, correspond more closely to the characteristics used in Platts' methodology than the properties of class B²⁰. Since the mean prices for these two classes differ considerably (the difference being \$13 per ton, we used the ratios of monthly weighted mean prices for classes B and A as coefficients to correct market prices for class B produce²¹.

Market prices were estimated for free-on-board (FOB) transactions, which only account for 35.9% of all transactions involving wheat and corn. To make transactions under different terms more comparable, we

adjusted their market price for all other terms of delivery, provided that the total value of transactions effected under those terms for the commodity in question amounted to at least 0.5% of the value of all transactions involving that commodity. The underlying assumption here was that price differences between FOB transactions and other terms of delivery, whose market prices were adjusted, were not due to higher (or lower) underpricing under those terms than under FOB terms. We followed the same procedure as for wheat classes A and B, multiplying market prices with monthly or annual coefficients calculated as ratios of monthly weighted export prices applying to other terms of delivery and deliveries under FOB terms²².

Figure 3. Dynamics of monthly weighted mean prices for adjusted market prices and real export prices



Source: Import Genius and Platts, authors' calculations

19 We grouped the sixth class together with class B due to their very similar mean prices and product characteristics, though sixth class does not fall under class B according to the official standard. Besides, the automatic coding of classes could not be revised manually, given the available resources, so we manually checked just the 500 largest transactions and corrected coding errors for 45, accepting any remaining inaccuracies. The proportion of inaccuracies in coding classes A and B was even lower.

20 Only a small proportion of product descriptions contained information on protein content, so the coding of this parameter had to rely on approximate values defined per class of wheat. This was the path we started out taking, but since protein content did not seem to be the crucial parameter influencing the classification of wheat quality (which depends on multiple factors — see <http://www.proagro.com.ua/reference/standard/usstand/11021.html>), it was deemed unrealistic to try to take account of all these parameters (it would probably boil down to the coding of classes in the end).

21 If no information on class was available, we did not multiply the market price with the coefficient, since the difference between the mean price for transactions for which no class information was available and the mean price for class A transactions was just \$2 per ton, this figure being much closer than for class B.

22 The choice of monthly or annual coefficients depended on the number of available transactions.

The underpricing for each aggregated level of data is reported below as both a total value and a percentage.

Under-invoicing is calculated as product weight multiplied by the difference between the market price and the price reported to the customs authorities.

Using this approach, we estimate total underpricing over a three-year period for

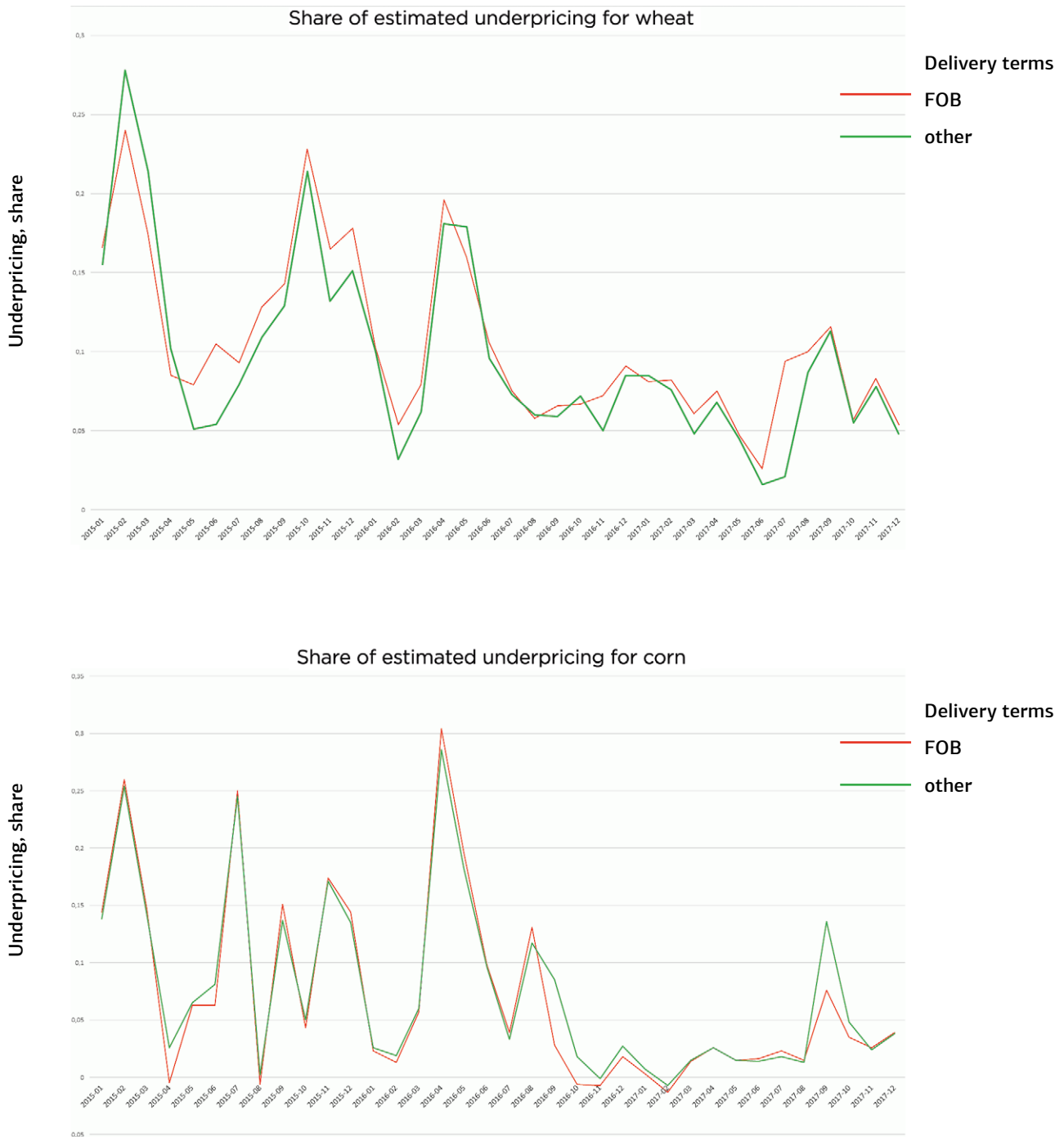
all incoterms at about \$875 million for wheat and roughly \$664 million for corn, whereby shifted profit accounts for some 10.4% of the total invoice value for wheat and approximately 7.6% for corn. Annual underpricing for each commodity and incoterms is presented in Table 2, its monthly dynamics in Figure 4.

Table 2. Annual underpricing for wheat and corn

<i>Commodity</i>	<i>Year</i>	<i>Under-invoicing, total value in \$ mil</i>	<i>Share of under-invoicing</i>
Wheat	2015	408	0.157
	2016	250	0.088
	2017	217	0.073
Corn	2015	413	0.132
	2016	198	0.076
	2017	53	0.018

Source: Authors' calculations

Figure 4. Monthly dynamics of underpricing for wheat and corn



Source: Import Genius, Platts and authors calculations

Although significant overall profit shifting took place over the three-year period under review, the overall trend is clearly declining. Whereas in 2015, overall under-invoicing totalled around 16% for wheat and 13% for corn, by 2017 these figures had fallen to 7% and 2% respectively. Calculations for FOB transactions with class A wheat and with corn confirm this trend and are not due to our adjustments of market prices, since we did not correct these categories of transactions.

There are many possible explanations for this improvement. In 2016, agricultural commodities were included in the list of products for TP purposes, for which the arm's length principle should be checked using the comparable uncontrolled price method. However, if these checks were the principal reason for the drop in under-invoicing, they should have prompted similar developments for other commodities covered by the new regulations, yet this was not the case for iron ore, as shown in the previous study²³. At least some under-invoicing could perhaps be attributed to the increase in traded volumes, which would keep the total shifted revenue high despite the percentage drop. Other possible reasons include changes in regulations and more stable currency exchange rates. Following the rapid devaluation of Ukrainian hryvnia in 2015, farmers tended to use offshore jurisdictions to avoid losses caused by mandatory sales of foreign currency revenue. In 2016, the devaluation trend significantly slowed and the rules on mandatory sales were also gradually relaxed²⁴. New regulations made it cheaper to turn revenue into cash,

so the trade-off between losses due to regulations and the risks associated with using offshore jurisdictions leaned somewhat more in Ukraine's favour. The data do not justify any unequivocal link between the decline in under-invoicing and any single factor. It can be assumed that a number of the factors listed above (and possibly some others, too) contributed to the improvement.

About 64% of under-invoiced value for wheat passed through companies registered in Switzerland and the UK as consignee countries, and their involvement remained relatively stable over the three years reviewed. Companies from the United Arab Emirates and Cyprus accounted for another 11%. The joint share of companies from Switzerland and UK was about 59% for corn (46% for Switzerland and 13% UK). At the same time, this declined between 2015 and 2017, whereas other jurisdictions, such as Hong Kong or Luxembourg, played a more prominent role. Indeed, in 2017 they even overtook Switzerland, which accounted for a mere 10% of under-invoicing for corn.

Among the 10 companies with the biggest shifted revenues in wheat exports, which are jointly responsible for about 36% of its total value, the share of under-invoicing varied significantly, ranging from 7% to 32%. For corn, this variation was even more pronounced, ranging from 7.5% to 42% for the 10 biggest exporters, together responsible for 44% of shifted value. However, at least some of this variation may be due to differences in product quality unaccounted for in our market price adjustments.

²³ Antonyuk et al. (2018). Profit shifting in Ukraine's iron exports.

²⁴ In the end, such mandatory selling was abolished in June 2019.

CONCLUSIONS

The objective of this study was to identify risks of profit shifting in Ukraine's agricultural exports (agro-exports), following up on a 2018 study on profit shifting in Ukrainian iron ore exports.

Our results show that most of Ukraine's agro-exports take place via conduits in low-tax jurisdictions (e.g. Switzerland, Great Britain and Cyprus), a practice mirroring the situation for iron ore exports.

For the period between 2015 and 2017, we identified a misalignment between reported prices and market prices of 10.4% for wheat and 7.6% for corn.

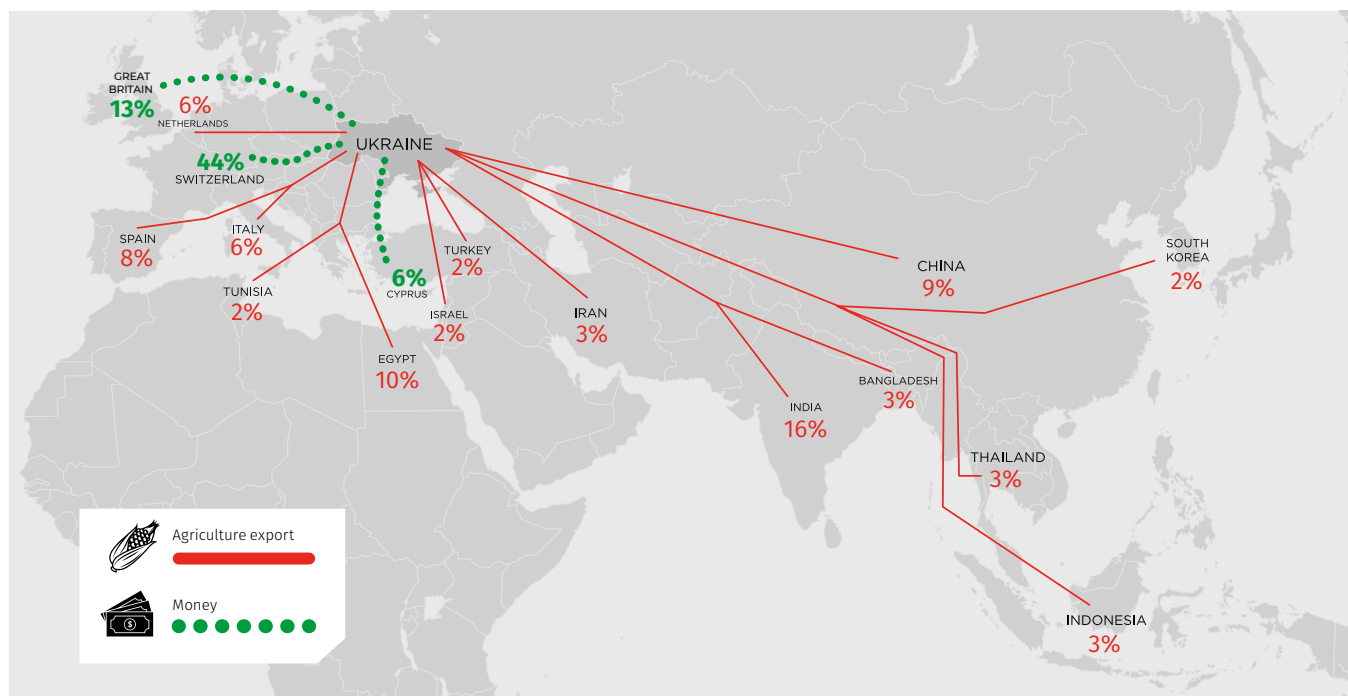
As from 2016, this difference dropped substantially, due to a combination of several factors, including the new TP rules introduced by the government requiring multinationals to price exports with reference to prices quoted on commodity exchanges.

Our estimate of potential profit shifting shows that for exports of wheat and corn, which constitute approximately 40% of Ukraine's agri-exports, some \$1.5 billion was potentially shifted between 2015 and 2017.

No tax returns by agro-exporting entities in Ukraine owned by multinationals are publicly available, so there is no way of accurately identifying whether profit shifting between Ukraine-based companies and related low-tax entities in offshore jurisdictions result in tax avoidance.

Multinationals operating in Ukraine in the agro-export and other key sectors should make country-specific data publicly available to show what share of their total profits are recorded and how much corporation tax is paid in Ukraine compared to offshore jurisdictions.

Figure 5. Geographical structure of Ukrainian exports of wheat, corn, and sunflower oil in 2015-2017



Import Genius, authors' calculations

Successive Ukrainian governments have deemed agriculture a strategic sector, and the owners of businesses in this sector have enjoyed substantial tax breaks, including VAT exemptions, a special simplified tax regime for agriculture (an alternative to normal corporation tax), and a lower rate of tax on dividends. In other words, Ukrainian society has supported these private businesses financially, but there is a risk that a high proportion of the resulting profits are shifted out of the country and taxed elsewhere.

This study also provides useful material on debates surrounding the proposed privatisation of agricultural land. According to the National Bank of Ukraine, 37% of foreign direct investment (FDI) comes from offshore jurisdictions. Given that some of the major agribusinesses are financially consolidated in low-tax jurisdictions and our finding that substantial profits have been or are being shifted to those jurisdictions, it is highly likely that funds used to privatise land will stem from profits shifted offshore. Would it be a fair and optimal practice to let these profits, shifted out of Ukraine and potentially undertaxed, be used for privatising the very land that generated them? How will our latest findings alter public opinion, with 75% of people currently rejecting privatisation?

Our results could also serve as a basis for discussions of economic policies for growth. Exports of basic commodities have

been declared to be of strategic importance by successive Ukrainian governments. The new government is continuing this tradition. Indeed, the minister for economic development recently listed five priorities of his ministry, including "land reform" (to boost agricultural exports), "exports", and "international trade".²⁵ In the light of our findings, would a further rise in agricultural exports, without any changes to TP control and taxation, lead to inclusive economic growth or merely end up benefiting a small minority?

There is a lot more work to be done on the profit shifting of commodities exported by Ukraine. Firstly, it would prove instructive to complete the full picture of profit shifting out of Ukraine by examining the country's other remaining major export: steel. Secondly, profit shifting by agribusinesses and the taxes levied on them merit further research. Several factors may have contributed to the drop in shifted profits in 2016 and 2017 and these need to be researched in greater detail. These factors are: 1) the lowering of market prices and profits; 2) the introduction of TP checks on agricultural exports; 3) the lowering of the tax rate on dividends; and 4) the stabilisation of US dollar exchange rate. Thirdly and finally, TP is just one method used to shift profits from Ukraine in a bid to avoid corporation tax. Interviewed industry experts maintain that other methods are actively being used and should therefore be investigated as well.

²⁵ <https://latifundist.com/novosti/46256-milovanov-oboznachil-prioritety-v-rabote-s-agrosektorom-ukrainy>

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