

Doing business and investing in Ukraine

October 2005



*connectedthinking

This guide provides a brief introduction to foreign investment in Ukraine. Because of the rapid pace of change in the country, potential investors are advised to contact PricewaterhouseCoopers Ukraine for specific advice before taking any action.

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Ukraine Profile

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General Description

Ukraine is located in the heart of Eastern Europe, neighbouring Poland, Slovakia, Hungary, Moldova and Romania to the west, Russia to the east, Belarus to the north and the Black Sea to the south. The country is comprised of 24 regions and the Autonomous Republic of Crimea. It has a population of approximately 47 million people and occupies a land area of 603,700 sq km (which is comparable to the size of France). Approximately one-third of the population lives in large urban centers. The capital city, Kiev, has approximately 3.5 million inhabitants. The official language is Ukrainian, although a majority of the population is bi-lingual, speaking both Ukrainian and Russian fluently.

Ukraine was the center of the first Slavic state, Kievskia Rus, which during the 10th and 11th centuries was the largest and most powerful state in Europe. Weakened by internecine quarrels and Mongol invasions, Kievskia Rus was incorporated into the Grand Duchy of Lithuania and eventually into the Polish-Lithuanian Commonwealth. The cultural and religious legacy of Kievskia Rus laid the foundation for Ukrainian nationalism through subsequent centuries. A new Ukrainian state, the Cossack Hetmanate, was established during the mid-17th century after an uprising against the Poles. Despite continuous Russian pressure, the Hetmanate managed to remain autonomous for well over a century. However, during the latter part of the 18th century, most Ukrainian ethnographic territory was absorbed by the Russian Empire. Following the collapse of czarist Russia in 1917, Ukraine was able to bring about a short-lived period of independence (1917-1920), but was re-conquered and forced to endure a brutal Soviet rule that engineered two artificial famines (1921-22 and 1932-33) in which over 8 million died. Second World War accounted for some 7 to 8 million more deaths. Ukraine proclaimed independence in August 1991. The vote in favour of independence was an overwhelming 90%.

Since independence from the Soviet Union, Ukraine has struggled to shift from a centrally planned economy to a market environment. Ukraine suffered a protracted economic decline during 1991-1999, posting eight consecutive years of negative GDP. In addition, high inflation and unemployment, stifling debt payments, and state interference in the private sector, have contributed to a poor investment climate, further hindering Ukraine's economic development. There were significant political uncertainties that led to policy drift and low investment. However, during the last three years, Ukraine has implemented significant and dramatic economic and legal reforms leading to positive economic indicators across the board. Foreign investors are starting to take notice as foreign direct investment levels are rising sharply. The arrival of new President Viktor Yushchenko's reform-minded administration has been a positive message for investors.

Key Statistics

Total area:

- 603,700 sq. km

Principal cities:

- Kyiv, Donetsk, Lviv, Zaporizhzhya, Dnipropetrovsk, Kharkiv, Odesa

Neighbouring states:

- Russia, Moldova, Belarus, Poland, Romania, Slovakia, Hungary

Climate

- continental climate with hot summers and long cold winters.

Natural resources:

- iron ore, coal, manganese, natural gas, oil, salt, sulfur, graphite, titanium, magnesium, kaolin, nickel, mercury, timber, arable land

Land use:

- arable land: 57.1%
- permanent crops: 1.73%
- other: 41.17%

Population:

- 47.3 millions

Population growth rate:

- -0.66% (2004 est.)

Age Structure:

- 0-14 years: 15.9% (male 3,883,485; female 3,715,668)
- 15-64 years: 68.7% (male 15,692,388; female 17,096,611)
- 65 years and over: 15.4% (male 2,472,023; female 4,871,904) (2004 est.)

Birth Rate: 9% / per 1,000

Death Rate: 16% / per 1,000

Infant Mortality Rate: 20.61 deaths/1,000 live births (2004 est)

Life Expectancy:

- total population: 66.68 years
- male: 61.35 years
- female: 72.27 years (2004 est.)

Nationality:

- Ukrainian 77.8%, Russian 17.3%, Belarusian 0.6%, Moldovan 0.5%, Crimean Tatar 0.5%, Bulgarian 0.4%, Hungarian 0.3%, Romanian 0.3%, Polish 0.3%, Jewish 0.2%, other 1.8%.

Religions:

- Ukrainian Orthodox - Moscow Patriarchate, Ukrainian Orthodox - Kiev Patriarchate, Ukrainian Autocephalous Orthodox, Ukrainian Catholic (Uniate), Protestant, Jewish

Official language:

- Ukrainian (although Russian is a commonly used business language)

Political System

Ukraine is a Parliamentary democracy, with separate legislative, executive and judicial powers. It has a single-chamber Parliament.

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President: Viktor Yushchenko

Prime Minister: Yuriy Yekhanurov

Parliament's Speaker: Vladimir Litvin

Governor of the Central Bank: Vladimir Stelmakh

President of Ukraine

President is elected by popular vote for a five-year term. President Viktor Yushchenko was supported by a series of peaceful protests (called the Orange Revolution) that overturned a fraudulent election for the Presidency in the winter 2004-2005. The President nominates the Prime Minister, as well as the Governor of the National Bank of Ukraine (the central bank) and the Chairman of the State Property Fund with the approval of the Parliament.

Prime Minister and the Cabinet of Ministers

The Prime Minister is appointed by the President, based on Parliamentary approval. Ministers are nominated by the Prime Minister and approved by the President without Parliamentary consent. Key Cabinet appointments must be ratified by the Parliament. The Cabinet, headed by the Prime Minister Yuriy Yekhanurov, was appointed in October 2005. The Cabinet of Ministers exercises executive power.

Parliament

Legislative power is exercised by a single-chamber Parliament, the Verkhovna Rada, which comprises 450 deputies and is elected every four years. As a part of its legislative power, the Parliament also acts in an oversight capacity of the government's activities. The state budget and annual privatisation Program presented by the government and State Property Fund respectively must also be approved by the Parliament.

Constitution

Ukraine's Constitution was adopted in June 1996. The Constitution defines Ukraine as a sovereign and independent, democratic, social, legal and Unitarian state. It guarantees, among other things, the principles of political, economic and ideological diversity; human and civil rights and freedoms; freedom of the press; the inviolability of private property and the right to conduct entrepreneurial activity. The state ensures the protection of competition and business activity. It established a balance of power between the executive and legislature which has recently been amended in settlement of the disputed presidential election.

Judicial System

Ukraine is a civil law country and its court system is a multi-layered structure. The highest judicial body is the Constitutional Court, which also acts as an arbiter on constitutional issues. There are 18 justices on the Constitutional Court. The justices are appointed for a one-time nine year term by the President of Ukraine, the Parliament and a Congress of Ukrainian judges. Each of the aforementioned authorities appoints six justices. The justices based on a rotation system select the Chief Justice, or Head of the Constitutional Court.

Civil disputes that involve physical persons are decided through a three tier structure consisting of local district courts, regional appellate courts and a national Supreme Court. In addition, there is a Supreme Court of Special Jurisdiction that acts a cassation court against decisions by local district and appellate courts. Disputes between legal persons are under the jurisdiction of a three-tier commercial court structure consisting of district, appellate and a Supreme Commercial Court.

Political Parties and Parliamentary Elections

The last elections for Parliament were held on 31 March 2002. New democratic initiatives that took place during the Orange Revolution have shifted the composition of the Parliament. The next Parliamentary elections (which for the first time will be held on an entirely proportional basis) are scheduled for March 2006.

Foreign Relations

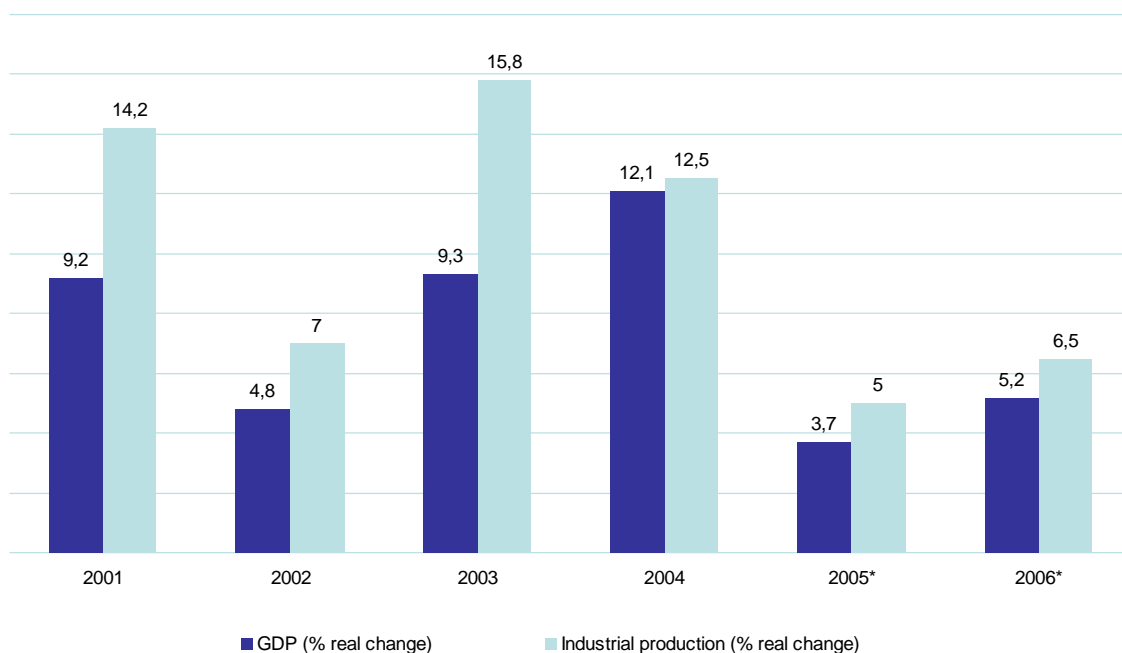
Reflecting its importance and size, Ukraine is a member of the United Nations, the IMF, the World Bank, the EBRD, the Council of Europe, as well as a number of other international organisations, and cooperates with the Organisation for Economic Cooperation and Development ("OECD"). Ukraine applied to join the World Trade Organisation in 1993 and has been aspiring to meet the necessary requirements. The negotiations on WTO membership are reportedly progressing well, with majority of bilateral protocols signed by now, and Ukraine hopes to join the WTO in the near future.

Accession to the European Union is a long-term strategic goal of the new Government. The first and most important step toward European integration was the signing of the Partnership and Cooperation Agreement with the European Union in March 1998. The new Government eagerly continues to work towards European Union membership, including maintaining consistent, structured dialogue with the European Union. Ukraine has also followed a policy of forming a close relationship with NATO, in particular with respect to emergency situations, technical cooperation, scientific studies and military and defence reforms.

Ukraine has established diplomatic relations with approximately 170 countries.

Economic Overview

Major Economic Indicators



Source: Economist Intelligence Unit (EIU), October 2005

Currency

The currency of Ukraine, the Hryvnia (UAH), was introduced in 1996.

During the global financial crises of late 1997 and 1998, the NBU had introduced a number of anti-crisis measures focused on exchange rate stabilisation. In 2000 the Cabinet of Ministers and the National Bank of Ukraine officially announced that the country would switch to a floating Hryvnia exchange rate policy. The strong currency policy and successful management of the external debt-service obligations implemented by the Cabinet of Ministers have facilitated the stability of the Hryvnia as the country smoothly moved to an openly floating exchange rate.

As the euro zone plays the most important role in Ukraine's foreign trade structure, the UAH/EURO rate is being watched carefully. At the end of October 2005, the exchange rate of Hryvnia against the US dollar was UAH 5.05 and against the EURO it was UAH 6.07. Generally, over the last two years, the Hryvnia has been stable against the dollar but has declined against the EURO.

Gross Domestic Product and other Economic Indicators

The gross domestic product of Ukraine has showed down after the Orange Revolution, despite several years of consecutive growth and optimistic expectation of inflow of investment. Over 2004 the GDP reached 12% or UAH 346 billion (USD 65 billion). However, the economic growth for 2005 is forecasted to be only 4% because of shrinking investment and declining global prices for Ukrainian export commodities.

GDP per head at PPP in 2004 was estimated at around USD 5,900, or around half that in neighboring Poland and still well below Russia. Ukraine's low level of GDP per head is partly mitigated by the existence of an unofficial economy that could be up to 50% of total GDP, according to research that compares official GDP figures with changes in consumption of electricity (usually a good indicator of levels of economic activity).

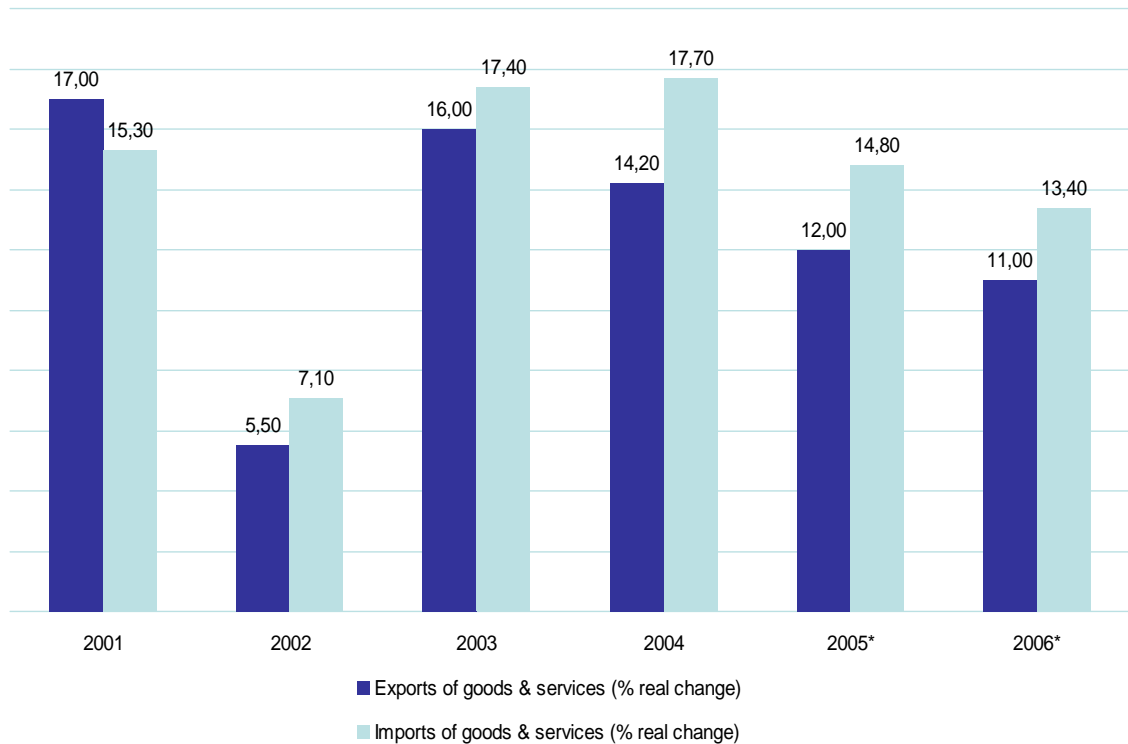
Selected Economic Indicators

The 2004 consumer price inflation reached 9% on average and 12.3% on the year-end basis. The ICPS forecast is for consumer price inflation to reach 13.5% in 2005.

The average monthly wage in Ukraine economy is UAH 589.6 in 2004 (USD 111 when expressed in market exchange rate).

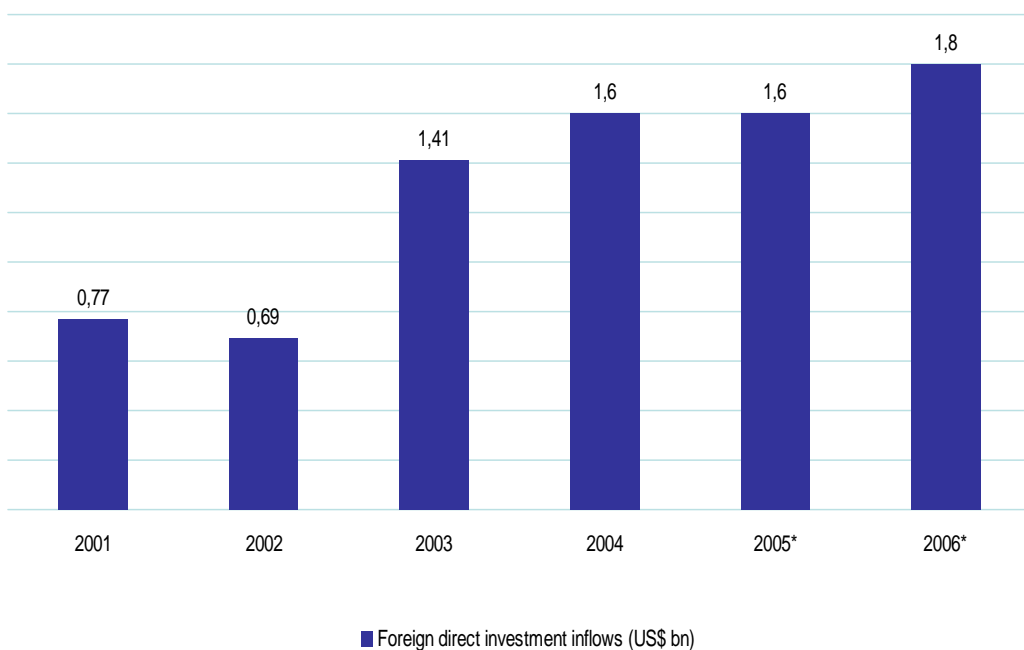
The official unemployment rate was 3.6% in 2004, however the actual unemployment figures in Ukraine are believed to be almost two and a half times larger (8.5%), since many Ukrainians do not formally register as jobless.

Around half of Ukraine's trade is with the CIS countries. Oil and gas imports from Russia represent 80% of total imports and Russia remains the largest overall trading partner. Other significant trading partners are Germany, Italy and China.



Source: Economist Intelligence Unit (EIU), October 2005

According to a Cabinet of Ministers report, net foreign direct investment (FDI) expanded by 23% reaching USD 1.559 billion in 2004. The FDI stock since the country's independence in 1991, has reached USD 8.354 billion, which is much below the other transition countries of the region. The dynamics of the new Government is positive, urging foreign investment communities to help increase the flow of foreign investments to Ukraine. The forecasted growth of foreign investments in 2005 did not take place as expected. Greater predictability in state policies after the Verkhovna Rada elections should spur investment in 2006-2007.



Source: Economist Intelligence Unit (EIU), October 2005



Privatisation

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Background

Privatisation in Ukraine started in 1992, however political circumstances and organisational constraints hindered this process and resulted in the Ukrainian Parliament's legislative moratorium on privatisation. Privatisation of medium and large-scale enterprises was renewed in 1995 in the form of the "Mass Privatisation Program" (MPP) project sponsored by USAID.

The Government privatisation authority, State Property Fund (SPF), developed appropriate legislation, strong internal procedures, and a marketing strategy necessary for the speedy privatisation of the State's assets in exchange for paper certificates (so-called Privatisation Property Certificates, PPCs). Circulation of PPCs and accordingly the duration of the MPP were initially planned for one year (1995-96). In parallel, the SPF conducted privatisation of small-scale enterprises, primarily for cash.

The main methods of privatisation were: buy-out of small-scale enterprises by buyers' associations; buy-out of State property leased with the right of subsequent buy-out, auctions, and the sale of shares in open joint stock companies.

Unfortunately, the results of MPP were not as fruitful as originally anticipated, largely because of a lack of political will, including the differing ideas that the SPF, the regional ministries, and the Cabinet of Ministers have had on the pace and priorities of privatisation. The MPP was prolonged several times up to the end of 1999.

In response to the Government's desire to generate additional budget revenues and a shift from mass privatisation to individual (case-by-case) privatisation for cash, the SPF developed a Law "On privatisation program for 2000-2002". Approved in mid-2000, this Law ended mass privatisation by use of PPCs and defined Government objectives and property privatisation principles for the next 2 years. The key objective was set as the sale of the large and, if possible, controlling stakes of strategic industrial enterprises to investors who would invest into the development of the enterprise.

Latest developments

The shares of thousands of privatised enterprises have served as the basis for the development of Ukraine's capital market, including the establishment of stock exchanges and an over-the-counter trading system.

Ukraine's privatisation in 2005 has reached its peak in terms of both the attractiveness of privatisation sales for investors and the revenues gathered from privatisation to the state budget with "Kryvorizhstal" privatisation. As the State Property Fund of Ukraine ("SPFU") reported, revenues from 93.02% shares in "Kryvorizhstal" steel mill amounted to UAH 24.2 billion (approximately USD 4.8 billion). The mill was sold via an open tender by the auction principle – the bidder that proposed the highest price and took the responsibility to meet all the requirements was announced the winner.

The privatisation gathered by the SPFU by October 3, 2005 amounted to UAH 707.511 million, which made only 10.24% of the budgeted plan. The sale of "Kryvorizhstal" has overwhelmingly covered all the expectations of the budget revenues.

Ukraine's privatisation gathered by the SPFU for 2004 amounted to UAH 9.599 billion (approximately USD 1.811 billion), which exceeded the revenue goals established by the State Budget Law for 2004 by 183.98%. In 2003 the SPF generated UAH 2.175 billion in privatisation revenues into the state budget.

The distinguishing feature of 2005 privatisation is that in spite of the Parliament's failure to adopt a new Privatisation Programme for 2004-2006, the SPFU, using the available current legislative framework, administered the privatisation process in a manner that allowed for the best privatisation revenue results ever. This is mostly due to the fact that that in 2004-2005 the SPFU put up for sale a number of controlling stakes in large and nationally strategic enterprises.

In 2004-2005, privatisation of state-owned companies has been conducted in accordance with the State Privatisation Programme for 2000-2002, which is still effective and will continue to be effective until the moment Ukraine's Parliament approves a new Privatisation programme. In 2004-2005 the Parliament several times rejected the new Privatisation programme, sending it back to the Government for modifications. After

presidential elections in December 2004 and recently changes in the SPF's management, it is expected that a new Privatisation Programme for 2005-2007 is to be approved by the Parliament till the end of 2005.

Some owners of Ukrainian companies privatised in the last two years that appear to have been subject to certain privatisation irregularities are concerned about possible re-privatisation. However, the Government has stressed that there are no grounds for mass re-privatisation or nationalisation, except in relation to companies privatised with obvious violations of law. Re-privatisation of such companies can be made only through the court.

Legacy of privatisation

The impact of Ukraine's privatisation can be assessed in terms of the following strategic changes to Ukraine's economy over the last ten years:

- The State has given up majority ownership in 90% of the industrial enterprises it owned in 1991. While authorities continue to exert informal influence over roughly 10,000 medium and large enterprises privatised since 1992, millions of privatised shares will never return to the hands of the State. Millions of Ukrainian citizens have become shareholders and more than 60% of Ukraine's labour force work for privatised enterprises.
- While in most cases the directors and managers of privatised enterprises are those from the Soviet era, they are gradually being replaced by a new generation of directors and managers from the post-Soviet generation.
- In many cases, the new generation of investment fund managers, who have become major shareholders via the privatisation program, are putting in place new enterprise directors and managers and introducing new management techniques, which ought to allow many ex-State enterprises to survive and compete in the post-Soviet economy.

State budget support for unprofitable enterprises has been greatly reduced since the beginning of the privatisation program.



Business Entities

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Types of Entities

Ukrainian legislation provides for several different types of business entities. The forms of business entities most commonly used by foreign investors in Ukraine are joint stock companies, limited liability companies and wholly-owned subsidiaries.

Joint-stock companies are normally used for foreign investment into a former state enterprise, business with Ukrainian partners, banks, insurance companies and other financial institutions. Limited liability companies and wholly-owned subsidiaries are mainly used for wholly controlled trade and manufacturing businesses.

Establishing and operating a joint stock company involves more registration requirements and formalities than a limited liability company or wholly-owned subsidiary. However, a joint stock company provides a relatively more stable and secure vehicle for business activity in Ukraine.

Legal Framework

Starting from 1 January 2004 the new Civil Code and Commercial Code of Ukraine, which both regulate the matters of incorporation, operation and termination of business entities, become effective. In some cases both Codes regulate the same issues, but in some instances they provide for conflicting norms/. Although the declared purpose of the Commercial Code is to regulate issues, which are not regulated by the Civil Code, they do overlap each other.

Civil Code

The new Civil Code of Ukraine, which replaced the Soviet Civil Code of 1963 on 1 January 2004, sets forth the general forms a legal entity may have. Most legal entities take the form of an association. An association can be formed for commercial and non-commercial purposes. However, the vast majority of associations are formed for commercial reasons and use at least one of the following structures:

- Limited Liability Companies;
- Full and Limited Partnerships;
- Joint Stock Companies; and
- Additional Liability Companies.

In addition, the Civil Code regulates certain issues relating to the establishment and operation of legal entities. Among the key issues regulated are the following:

- Establishment of privately and publicly owned companies;
- Shareholder rights and obligations; and
- Corporate governance issues.

Commercial Code

The Commercial Code covers (at least superficially) almost all issues of business activities in Ukraine including the types of business entities depending on their ownership structure, incorporation procedures, rights and obligations of persons [individuals] carrying out business activities, essences of commercial contracts and commitments, principles for domestic and foreign commercial activity. The Commercial Code classifies all enterprises depending on their ownership structure into private enterprises established by one owner; collective enterprises (cooperatives and cooperative enterprises); communal enterprises; state enterprises; enterprises established on the basis of mixed forms of ownership.

Law “On Business Associations”

Until 2004 the Law “On Business Associations” was the only legal framework that regulated all aspects of Ukrainian business associations. As of 1 January 2004, many issues that were previously governed by the Law “On Business Associations” are now governed by the new codes. However, the “Law on Business Associations” still sets for the basic framework by which the most common forms of business entities (as listed below) are formed and operate.

Joint Stock Company

JSC is a legal entity, which has a share capital divided into a specified number of shares of equal and nominal value. Liability of shareholders for the obligations of a JSC are limited by their capital contributions. Since 2004 a JSC may have one shareholder.

There are two forms of an JSC: “open” and “closed”. Shares in an open JSC may be offered to the public and traded on a stock exchange, whereas shares in a closed JSC shall be distributed between its founding shareholders. However, upon foundation of a JSC all its shares shall be distributed among its founders. Shares can be offered publicly only after complete payment of a company’s share capital. Shares of both open and closed JSC must be registered with the Ukrainian State Commission on Securities and the Stock Market. In addition, an open JSC must satisfy reporting requirements with the Securities Commission.

The minimum capital requirement for a JSC is the equivalent of 1,250 Ukrainian monthly minimum wages (currently equal to UAH415,000). At the end of the second and each subsequent financial year the value of net assets of a JSC shall not be less than its share capital, otherwise the company is obliged to decrease its share capital and make the relevant amendments to the Charter. If the value of net assets of a JSC is less than the statutory established minimum, then the company shall be liquidated.

Before establishment of a JSC, at least 50% of the share capital shall be paid-in. No distinction is made between authorized and issued share capital. No minimum value of a share is prescribed, but shares shall be nominated in Ukrainian currency. Shares can be in the form of either registered or bearer shares, ordinary (common) shares or preferred shares (total nominal value of which shall not exceed 10% of the company share capital). Shares can be issued either in documentary or non-documentary forms that has an impact on procedures of registration of ownerships rights to such shares.

JSC must create a reserve fund from net profits in the amount of at least 25% of the share capital. At least 5% of annual after-tax profits must be transferred to a reserve fund until the fund is fully paid in.

JSC may have three corporate bodies: the Shareholders’ Meeting, the Supervisory Board and the Management. It is allowed not to have the Supervisory Board if there are less than 50 shareholders in a JSC.

The Shareholders’ Meeting is the supreme governing body of a JSC and is responsible for the essential decisions of a JSC. To be duly constituted the Shareholders’ Meeting requires a quorum of at least 60% of the voting shares to be present. Shareholders’ voting rights shall be based on the principle of one share equals one vote. However, a JSC may issue a limited number of preferred non-voting shares. Most resolutions of Shareholders’ Meeting shall be approved by a simple majority of the voting shares present at a duly convened shareholders meeting. Amendments to the Charter of the JSC and liquidation of the company shall be approved by at least 75% of the voting shares presented at the meeting.

The Supervisory Board is a governing body that represents the interests of the shareholders between sittings of the Shareholders’ Meetings and provides control over the Management activities. The composition and authority of the Supervisory Board shall be specified in the Charter of a JSC.

The Management is an executive body of a JSC that is responsible for the management of day-to-day activities of the company and represent the company against third persons. Management of a JSC may be collective or individual (Director). The structure of the Management and working procedures shall be specified in the Charter of the company.

Limited Liability Company

LLC is similar to a joint stock company, but a LLC does not have shares in a traditional sense. Similar to a JSC investors in a LLC (named as “participants”) are only liable for a company’s obligation within their capital contributions. However, investors’ interests in a LLC are not “securities” and, therefore, are not subject to registration with the Ukrainian Commission for Securities and Stock Exchange. Participants in a LLC own a percentage in the company’s capital that should be specified in LLC’s Charter.

Starting from 2004 the law allows establishing an LLC with one participant. Participants of an LLC have almost the same rights as shareholders of a JSC. However, there are certain significant differences between LLC participants and shareholders of a JSC: participants of an LLC may transfer shares in the company’s capital only based on the consent of all other participants; a participant may exit from a LLC and withdraw part of company’s assets proportionally to its share in the company’s capital; a participant may be excluded from the company with compensation of its share in company’s assets; a successor of a participant may be not accepted to the company with compensation of its share in company’s assets; participant’s creditor may demand to withdraw participant’s share in company’s assets for settlement of its obligations.

The minimum capital requirement for a LLC is the equivalent of 100 Ukrainian minimum monthly wages (currently equals UAH 29,000). LLC shall create a reserve fund from net profits in the amount of at least 25% of the share capital. At least 5% of annual after-tax profits must be transferred to a reserve fund until the fund is fully paid

A LLC has two corporate bodies: the Participants' Assembly and the Management.

The Participants' Assembly consists of the participants of the LLC, each of them has votes proportionally to its interest in the company capital. A quorum for the participants' assembly is presence of participants, which hold at least 60% of votes. Most resolutions shall be approved by a simple majority of the votes present at the Participants' Assembly. Resolutions on amendments of the Charter, determination of the principal activities of the company and the exclusion of a participant shall be approved by 50% of all participants' votes.

The Management governs day-to-day activities of the LLC and represent the company before third persons. Management of a LLC may be collective (Directorate) or individual (Director). The structure, authority of the Management and working procedures shall be specified in the Charter of the company.

Wholly Owned Subsidiaries

A wholly owned subsidiary (also known as a daughter enterprise or enterprise with 100% foreign investment) is considered as a specific form of a legal entity established exclusively by another foreign legal entity that was its sole owner.

A wholly owned subsidiary (WOS) does not issue shares and has no capital distributed for any shares or portions. There is no minimal capital requirement for a wholly owned subsidiary. A WOS is not specifically regulated, as other forms of business entities such as an LLC or a JSC. The advantage of a WOS is that it offers more flexibility upon formation. Consequently, the disadvantage is that it gives the state authorities more flexibility in interpreting the regulations they wish to apply to a WOS.

Within the last years the legality of a wholly owned subsidiary as separate form of a legal entity has been an open question. Although the Commercial Code allows the formation of a wholly owned subsidiary at the moment in most cases, state authorities are reluctant to register a WOS.

Joint ventures

Before 1998 joint ventures were considered as a distinct form of business entities, but since that time joint ventures are no longer treated as a separate form of business vehicle. However, in certain cases the term "joint ventures" is used to refer to any company with foreign investment, which, actually, can be a joint stock company or a limited liability company.

Ukrainian legislation permits a foreign investor to conduct business in Ukraine without creating a legal entity by entering into a Joint Activity Agreement with a Ukrainian legal entity.

Partnership

Ukrainian legislation does not provide for the formation of partnership as "pass-through" entities for tax purposes. Although legislation permits the creation of a company with full liability, it is subject to two levels of taxation: at the company level and at the participants' level.

Representative offices

A foreign company can establish a representative office in Ukraine, which is similar to an un-incorporated branch. The representative office does not constitute a legal entity and operates in Ukraine on behalf of the foreign company it represents. A non-resident company operating a representative office is deemed to be conducting business activity in Ukraine through a permanent establishment and may be subject to corporate profits tax unless protected by a relevant double taxation treaty.



TAXATION ISSUES

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Overview of tax system and tax administration

Ukraine's tax system at present contains 22 types of national taxes. The principal taxes and compulsory payments include:

- Corporate profits tax;
- Value added tax (VAT);
- Personal income tax;
- Pension Fund charge;
- Excise tax;
- Land tax;
- Tax on owners of motor vehicles;
- Import duty;
- Stamp duty;
- Charge on environmental pollution;
- Royalties for extraction of oil, natural gas and gas condensate;
- Charge for the use of radio frequency;
- Charge to Fund for guaranteeing bank deposits of individuals.

There are 14 different local taxes that may be levied at the discretion of the local authorities. Few of them apply to business entities. The principal local taxes include advertisement tax, municipal tax and charge for use of local symbols.

Employers and employees should make mandatory contributions to the state pension and social security funds.

Tax administration issues

Tax audits

The tax authorities may carry on scheduled and out-of-schedule audits of business entities. Scheduled audits should be carried on maximum once a year. Business entities must be notified of the audit in writing at least 10 days prior to the scheduled audit. Scheduled audit should be carried out within 20 business days.

Out-of-schedule audits may be carried on in the following cases:

- cross-audit of other business entities reveals violation of legislation by the taxpayer and it does not respond to the tax authorities information request within 10 business days;
- business entity did not file tax returns timely;
- inadequate data is found in tax returns and the taxpayer does not respond to the tax authorities information request within 10 business days;
- taxpayer initiates appeal process regarding tax assessment;
- if the tax authorities cross-check information and the business entity does not respond to the tax authorities information request within 10 business days;
- business entity is being reorganized or liquidated;
- tax police investigation that requires auditing taxpayer's accounts;
- taxpayers has claimed VAT refund in the amount over UAH 100,000.

Duration of out-of-scheduled audit cannot exceed 10 business days.

In order to carry on audit the tax inspector must present a written order outlining scope and period of the tax audit.

Fines

Late payment interest

Daily late payment interest is imposed at the rate of 120% of the National Bank of Ukraine's (NBU) prime rate that was effective at the date of either tax debt arising or its settlement, whichever is higher.

Fine for failure to file tax return

Failure to file a tax return on time attracts a fine in the amount of 10 non-taxable allowances (currently UAH 170) for each case of non-filing or late filing of a tax return.

Where the tax authorities assess tax liabilities of the taxpayer due to failure to file a tax return, the fine is 10% based on the amount of tax liability per each month of delay in filing the tax return but cannot exceed 50% of the additional tax liability.

Fine for understatement of tax liabilities

If the tax authorities reveal, during an audit, an understatement of tax liabilities shown in taxpayer's tax returns, a fine in the amount of 10% of the underpaid taxes due per each reporting period of the arrears is levied up to 50% of the total tax liabilities additionally assessed.

Fine for arithmetical or methodological errors in tax return

If the tax authorities reveal, during a "desk review" of a tax return, arithmetical or methodological errors that caused understatement of tax liabilities, the taxpayer has to pay a fine of 5% of the tax additionally assessed.

Fine for tax evasion or understatement of tax liabilities of a "large" amount

In case the taxpayer (company's officials) is found guilty of tax evasion or where the taxpayer understated its tax liabilities of "large" amounts, in addition to other fines, the taxpayer should pay a fine of 50% of the tax due. The Criminal Code currently defines "large" amount as an amount over UAH 393,000 (for 2005 calendar year). The fine cannot be lower than 100 non-taxable allowances (currently UAH 1,700).

Fine for late payment of tax

Failure to pay the agreed tax liability on time attracts fines at the following rates:

- 10% of tax debt for delay in tax payment of up to 30 calendar days;
- 20% of tax debt for delay in tax payment from 31 to 90 calendar days;
- 50% of tax debt for delay in tax payment over 90 calendar days.

Agreed tax liability means the amount of tax liability shown in the tax return or tax liability assessed by the tax authorities and shown in the "tax notification" (unless the taxpayer appeals the tax liability assessed by the tax authorities).

This fine is levied in addition to the fines previously mentioned.

Fine for failure to withhold and pay tax

Where the taxpayer sells goods or pays money without prior computation and payment of tax, if according to legislation the requirement for prior payment of tax is a mandatory condition for sale of goods or payment of money, the fine is 200% of the tax liability.

It follows from the law that several fines can be applied, for instance, in case of tax evasion. Thus, a fine can reach 100% of the tax additionally assessed.

Relief from fines

Although it is not explicitly stated in the law, legislative intent was to relieve a taxpayer of fines if prior to a tax audit it reports on understated tax liabilities, settles additional tax liability and pays a fine of 5% of the tax debt. This relief does not apply if the taxpayer failed to file the return for the period when the tax was underpaid or where the court proved the tax evasion. In case of voluntary settlement of the understated tax liability, relief is also extended to late payment interest and administrative fines.

Appeals

A taxpayer may appeal against a decision of the local tax authorities within 10 calendar days following receipt of tax assessment notice. If the tax authority does not respond within 20 calendar days, the appeal is considered resolved to the benefit of the taxpayer. In case of a negative response the taxpayer may appeal to the higher level tax authorities or to the commercial court. The amount stated in the tax assessment notice is not due until the appeal process is closed.

Statute of limitations

The tax authorities may assess tax liabilities up to 1,095 days (i.e. 3 years) following the last day of filing a tax return. Limitation period does not apply in respect of tax periods where the tax return was not filed or deliberate tax evasion was committed as proved before a court.

Corporate Profits Tax

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Tax rate

A uniform tax at the rate of 25% applies to taxable profits earned by resident entities and permanent establishments of foreign companies.

A special tax regime applies to Ukrainian insurance companies. Net insurance premiums (gross premium less amounts paid to reinsurance company) are taxed at a 3% rate except for long-term life insurance premiums and pension insurance premiums, which are taxed at a 0% rate. Profits earned by insurance company from activities other than insurance are taxed at a standard rate.

Taxable profits

Taxable profits are defined as adjusted gross income (term used to depict taxable income) less allowable gross expenses (term used to depict deductible expenses) and depreciation charges. Gross income includes any sales or non-sales income received or accrued within a reporting period (i.e. quarter). Gross income is deemed to be received either on the date the goods/services are shipped/rendered, or the date the payment is received from the customer, whichever happens first.

Gross expenses include any expense actually incurred or accrued in respect of the taxpayer's business excluding non-allowable expenses specified by law. Generally, gross expenses are recognised either at the date of payment to a supplier (contractor) or at the date when the goods, works or services were received, whichever occurs first. However, expenses incurred on purchases from non-residents or resident tax exempt entities and entities that pay tax at reduced rates are recognised upon actual receipt of goods/services.

Deductible and non-deductible expenses

Deductible expenses include any expenses in cash or in kind incurred during acquisition of goods and services for further use in the taxpayer's business.

The following main items are not deductible for corporate profits tax purposes:

- expenses that are not supported by relevant documents (e.g., contract, voucher, receipt, check, etc.);
- expenses in relation to the financing of management bodies including holding companies;
- service fees paid to related entities unless there is documentary evidence that fees are paid in relation to services actually performed;
- payments in respect of goodwill;
- expenses in respect of parking for cars, 50% of expenses in respect of purchase of fuel and lubricants for cars and operating lease of cars;
- expenses relating to the provision of employees with uniforms, safety clothes and shoes as well as food if the amount exceeds the norms established by the Cabinet of Ministers of Ukraine;
- expenses in respect of personnel education in a non-resident educational institution and expenses in respect of education of individuals who are related to the business (e.g., shareholders who control at least 20% of business' capital or business' directors);
- expenses relating to receptions, presentations, entertainment, sampling and provisions of goods and services free of charge for advertising purposes in the amount that exceeds 2% of the taxpayer's taxable profits for the previous year;
- expenses in respect of business trips of the taxpayer's employees and members of its management bodies where the purpose of such a trip does not correspond to the taxpayer's business;
- expenses in respect of warranty services if the amount exceeds 10% of the total value of the goods supplied, which have valid warranty terms; and

- insurance expenses (except for medical, pension and mandatory insurance) in the amount exceeding 5% of total amount of deductible expenses incurred in the reporting period.

Deduction for interest expense

Interest paid is generally deductible for corporate profits tax purposes if incurred for business needs. However, limitation for deductibility of interest expense applies if the borrower's capital for at least 50% belongs to non-residents and the interest is payable to non-residents (and related entities) who have holding in the borrower's capital. The same rule applies if the borrower is owned by tax-exempt entities and pays interest to them.

The restriction is calculated as the interest received by the taxpayer in the reporting period, plus 50% of the taxable profits (excluding depreciation charge and interest received and paid). Any interest paid, which is non-deductible as a result of the restriction may be carried forward indefinitely for deduction in future reporting periods.

Deduction for bad debts

Deduction for bad debt is allowed if one of the following conditions is satisfied:

- creditor applies to the court with claim for debt collection or initiating bankruptcy;
- delay of payment exceeds 90 days and the creditor receives from the debtor acceptance of the claim or does not receive such acceptance within the term established by legislation;
- notary executes order on debt collection.

Taxpayer that failed to settle debt in the amount agreed with creditor should recognise taxable income for the amount of unsettled debt in the period of the following events:

- 90th day of term established in agreement or accepted claim; or
- 30th day of court resolution or the notary order on collection of debt.

In case of subsequent settlement of debt the debtor can claim deduction for the amount of settled debt.

Depreciation

Quarterly depreciation charges are computed on the basis of the reducing-balance method at the following quarterly rates:

Description of assets	Assets purchased prior to 1 January 2004	New assets purchased after 1 January 2004
Group 1 (buildings, constructions, premises)	1.25 %	2 %
Group 2 (transport vehicles, furniture, office equipment, household equipment, optical, electronic and electric appliances)	6.25 %	10 %
Group 3 (all other assets)	3.75 %	6 %

Group 4 assets (computers, devices for automatic processing of information, software, devices for scanning and printing, other information systems, telephone sets (including mobile), microphones and portable radio transmitters purchased after 1 January 2003) are subject to quarterly depreciation at 15% rate. Those assets purchased prior to 1 January 2003 belong to Group 2 assets and are depreciated at 6.25% rate.

Value of land cannot be depreciated.

Intangible assets may be amortized by using the straight-line method over the asset's useful economic life, up to a maximum of 10 years.

Transfer pricing

For tax purposes, the tax authorities can adjust either taxable income or deductible expenses of the taxpayer if they can prove that respective price does not represent "usual" (i.e. market price). If a service fee is paid to a related entity, it is tax deductible only if there is documentary evidence that the fee was paid in respect of services actually rendered.

Transfer pricing rules apply to transactions between related entities and the taxpayer's transaction with entities that do not pay corporate profits tax or pay this tax at the rate below the standard rate (i.e. 25%).

Related entities include:

- a legal person that exercises control over a taxpayer, is controlled by a taxpayer, or is under common control with a taxpayer;

- an individual or a family member of that individual who exercises control over a taxpayer; and
- a company official who is authorized to execute, in the name of the company, binding legal agreements or a family member of that official.

The exercise of control over a taxpayer means holding, directly or indirectly through a number of related entities, the largest participating interest (shares) in the charter fund of the taxpayer; control over the majority of votes in the governing body of such a taxpayer; or possessing participatory interests amounting to at least 20% of the charter fund of the taxpayer.

“Usual price” is defined as contractual price of goods or services, subject to the provisions of the law. Usual price is deemed to be fair market price, unless proven otherwise. Fair market price is the price at which the goods (services) are transferred to another person, provided that the seller is willing to transfer such goods (services), and the customer is willing to obtain them without any constraints, both parties are independent legally and de facto, possess sufficient information about such goods (services), as well as market prices for identical (or homogeneous) goods (services).

The usual price is determined based on comparable data for sales of identical or homogeneous goods (services) or public data on conditions of sale.

Where price for goods (services) is regulated by the state the usual price is the price established by the state (except for the case when state establishes minimum sale prices).

If the usual price cannot be determined based on the respective provisions of the Corporate Profits Tax Law, it is allowed to consider for justification of prices level the rules established by the National Accounting Standards and National Valuation Standards.

Where there are no transactions with identical (or homogeneous) goods (services), or where it is impossible to determine the price because the comparable information is absent or is not publicly available, the contractual price shall be deemed to be the usual price.

The burden of proof that the contractual price does not satisfy the usual price requirement is placed on the tax authorities.

Losses carry forward

Tax losses recorded prior to 1 January 2003 can be carried forward up to three years. Tax losses recorded after 1 January 2003 can be carried forward indefinitely. Losses cannot be carried back.

Taxation of dividends

Upon remittance of dividends the payer has to pay to the state from its own funds advance tax at standard rate (i.e., 25%), which can be offset against its future corporate profits tax liability. Tax liability on net insurance premiums cannot be used for such offset.

The above tax does not apply where dividends are paid by way of new shares, provided that allocation of holding between shareholders remains unchanged and where dividends are paid to domestic investment funds.

Dividends received from Ukrainian companies are not taxed at the level of domestic shareholders – legal entities. For individuals, taxation of dividends should be governed by personal income tax legislation.

Dividends payable to individuals (resident or non-resident) who own privileged shares are taxed as payment of salary. Amount of such dividends can be deducted for corporate profits tax purposes.

Payment of dividends to a non-resident business entity attracts a 15% withholding tax unless a double tax treaty provides otherwise.

Withholding tax

The following type of income earned by non-residents from Ukrainian sources attract withholding tax at 15% rate: interest; dividends; royalties; payments for engineering services; rental (leasing) income from property; income from the disposal of real estate located in Ukraine; gains from securities trading or sale of other corporate rights; income earned by an un-incorporated joint venture in Ukraine; income from long-term contracts; fees from cultural, educational, religious, sporting and entertainment activities; broker's or agent's fees in respect of services performed in Ukraine; income from lotteries and gambling business other than the state lottery; charitable donations payable to non-residents; other income from business activity in Ukraine except for sums payable to non-residents for goods or services supplied to Ukrainian residents.

Gains earned by non-residents from transactions with discounted bonds and treasury bills are subject to withholding tax at the rate of 25%.

Income from freight services is subject to withholding tax at 6% rate.

Resident entities that pay non-residents for advertising services performed in Ukraine have to pay to the state, from their own funds, a 20% tax based on value of such services. Effectively such tax is levied on a resident rather than on non-resident, which means that a double tax treaty cannot be used to avoid such tax.

Ukrainian residents must pay 3% tax based on value of insurance or re-insurance payments to foreign insurers or re-insurers if rating of financial reliability of such insurers or re-insurers does not meet requirements set by the Cabinet of Ministers of Ukraine.

Income from government bonds sold by authorized agents abroad and interest on loans granted to the government by non-resident creditors are exempt from withholding tax.

Ukrainian withholding tax can be reduced or avoided under a relevant double taxation treaty. The procedure for the application of double tax treaties allows advance reduction of the withholding tax rates, provided the Ukrainian payer of income obtains from the income recipient its residence certificate issued by the authorities of the treaty country. Where the certificate of residence is issued in a form prescribed by legislation of the treaty country it must be properly legalized (apostilled) and translated into Ukrainian language. The certificate is valid for the calendar year of its issuance.

For payment of interest between Ukrainian and foreign banks, the residence in the treaty country is evidenced by the excerpt from the "International Bank Identifier Code" (S. W. I. F. T., Belgium & International Organisation for Standardisation, Switzerland).

A non-resident that suffered excessive tax in Ukraine should apply to the tax authorities where the payer of income is located with the standard application and the residence certificate issued by the authorities of the treaty country. If the application is accepted, the state treasury of Ukraine will remit the relevant amount (in Hryvnia) to the Ukrainian entity that collected tax, which in turn must remit it (in the relevant currency) to the non-resident that applied for the refund.

Tax treatment of certain transactions

Transactions with entities based in tax haven jurisdictions

Expenses in respect of direct or indirect purchases of goods or services by Ukrainian entities from suppliers registered in tax haven jurisdictions are deductible for taxation purposes in an amount equal to 85% of the expenses actually incurred. An 85% limitation should not apply if the seller provides documents evidencing that it is subject to ordinary tax regime in its home country (i.e. entity does not enjoy "offshore" tax regime). At present the list of tax haven jurisdictions include: Andorra, Anguilla, Antigua and Barbuda, Aruba, Alderney, Bahrain, Bahamas, Barbados, Bermuda, Belize, Cayman Islands, Commonwealth of Dominica, Cook Islands, Cyprus, Gibraltar, Guernsey, Grenada, Isle of Man, Jersey, Liberia, Marshall Islands, Monaco, Montserrat, Netherlands Antilles, Nauru, Niue, Republic of Maldives, Puerto Rico, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and Grenadines, Samoa, Seashell Islands, Turks and Caicos, British and US Virgin Islands, Vanuatu.

Financial leasing

For tax purposes financial lease is treated as a sale (i.e. a lessor should recognise taxable income for the value of property or gain from disposal of its own fixed asset). Interest and commission elements of lease payments should be included in taxable income of a lessor in the period when a lease payment is due. A lessee includes value of the property to the relevant group of fixed assets and claims depreciation charges. The lessee can deduct interest and commission elements of finance lease payments in the period when lease payment is due.

Return of property leased under financial lease agreement is treated as a sale back. The tax base should be determined based on the "usual" price effective at the date of property return but it cannot be less than original value of property reduced by depreciation charges computed according to the Corporate Profits Tax Law.

Foreign exchange gains/losses

Foreign exchange gains or losses either realised or not realised (i.e. gains/losses computed based on quarterly revaluation) should be reflected in tax accounts as income or deduction if such gains/losses relate to indebtedness in respect to the following items denominated in foreign currency:

- Main body of financial loans and deposits;
- Interest accrued on financial loans and deposits that are overdue at the date of reporting period closure;
- Unpaid value of property under financial lease;
- Payments under financial lease agreement overdue at the date of reporting period closure;
- Value of debt securities.

The above rules apply to indebtedness that arose after 1 January 2003. Foreign exchange gains/losses in respect of debts that arose prior to this date should be governed by rules effective prior to 1 January 2003

(according to the tax authorities, interpretation foreign exchange losses in respect of the above items cannot be deducted).

Gains or losses should be also computed for tax purposes in respect of foreign currency that is held at the taxpayer's bank account or cash box at the date of reporting period closure.

Permanent establishments

The Ukrainian definition of a permanent establishment is in line with the provisions of OECD Tax Convention Model of 1992 and includes:

- a fixed place of business through which the business activity of a non-resident entity is wholly or partly carried on in Ukraine. A permanent establishment includes: a place of management, a branch, an office, a plant, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and
- a Ukrainian resident business entity which has the authority to act in the name of a non-resident entity generating civil rights and obligations for the non-resident entity (e.g. conclude contracts in the name of a non-resident; maintain a stock of goods belonging to the non-resident for supply on behalf of the non-resident).

Taxable profits of a Ukrainian permanent establishment can be determined by applying:

- the direct method – this is determined as the difference between the gross taxable income (i.e. income attributable to the permanent establishment received onshore or offshore) and allowable expenses incurred by the permanent establishment (i.e. expenses incurred onshore);
- the allocation method – this is based on data provided by the parent company about the permanent establishment's share of worldwide expenses, number of employees, fixed assets and working capital; and
- the notional method – this involves applying a notional margin of 30% to gross revenues earned in respect to activities in Ukraine.

Registration

Newly established legal entities must register with the tax authorities as payer of corporate profits tax within 20 days after receipt of the state registration certificate. Permanent establishments of non-residents must register with the tax authorities at the place of their location, prior to commencement of business activities in Ukraine.

Tax reporting and payment

Resident companies and non-resident entities that have a permanent establishment in Ukraine are obliged to keep accounts in accordance with Ukrainian accounting standards.

Tax returns must be filed both by resident and non-resident taxpayers on a quarterly basis within 40 calendar days following the last day of the reporting quarter (i.e. by 10 May, 9 August, 9 November and 9 February).

Tax should be paid quarterly within 10 calendar days following the date when the tax return has to be filed.

Value Added Tax

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General

Ukraine introduced VAT in 1992. New VAT legislation was introduced in 1997, which is loosely based on the principles of the EU Sixth Directive, although there are some significant differences.

Scope

The following transactions are subject to VAT:

- the supply of goods and services where the place of supply is in Ukraine; and
- the importation of goods and ancillary services (i.e. services cost of which is included to goods customs value) into Ukraine.

Supplies of goods and services by entities that qualify as VAT payers are subject to VAT irrespective of whether they are made for a consideration or free of charge.

The following transactions are outside the scope of Ukrainian VAT:

- the issue, sale and exchange of securities and corporate rights;
- depository, clearing and registrar activities in respect of securities;
- the provision of property by a lessor to a lessee under operating lease and return of property upon expiry of the operating lease;
- interest/commission element of lease payments under financial lease agreements in the amount of up to double prime rate of the National Bank of Ukraine;
- provision of financial loans and bank guarantees;
- exchange of foreign currency;
- insurance and reinsurance services supplied by licensed insurers and services of insurance/reinsurance agents and brokers;
- payment of dividends and royalties in cash or securities;
- funds under loan, deposit, insurance or proxy agreements;
- brokerage and dealer services in respect of securities transaction;
- transfer of a taxpayer's assets to another taxpayer in the course of business transformation;
- transit of cargoes and passengers through territory of Ukraine.

The place of supply of goods is deemed to be:

- in the case of goods dispatched or transported either by the supplier or by buyer or by a third person: the place where the goods are at the time when dispatch or transported begins; where the goods are installed or assembled, with or without a trial run, by or on behalf of the supplier: the place where the goods are installed or assembled; where due to technical or other similar reasons the goods cannot be supplied to the recipient other than disassembled: the place where the goods are at the time when dispatch or transported to the person to whom they are supplied begins;
- in the case of goods not dispatched or transported: the place where the goods are when the supply takes place;
- in the case of goods supplied on board ships, aircraft or trains during the part of a transport of passengers or cargoes effected in Ukraine: at the point of the departure of such transport;
- in the case the goods are being sold via Internet regardless of the place of registration of domain name: location of the seller or his domicile.

The place of supply of services is determined as follows:

- the place where the service is supplied is deemed to be the place where the supplier is registered as a VAT payer, and if the service is rendered by a non-resident: location of its permanent establishment or, in the absence of such place - the place of location of a resident acting as an agent of such non-resident or, in the absence of such place – the actual location of a buyer (recipient) which in this case acts as a tax agent of a non-resident;
- during supply of a tourist service the place of supply is the location of the tourist operator and during supply of such service by a non-resident – location of buyer;
- during supply of services of estate agents, intermediaries and other entities responsible for preparing and coordinating and supervising construction of immovable property, including the services of architects and designers, other similar services related to sale and construction of immovable property the place of supply would be the place where such property is or would be located;
- the place where the following services are actually carried out: (i) cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organizers of such activities, and related activities; (ii) ancillary transport activities such as loading, unloading, handling, warehousing and similar activities including insurance; (iii) valuations of immovable property;
- the place of registration of customer or his permanent establishment, or in the absence of such place of registration – place of permanent address or permanent domicile in case when the buyer to whom the service is supplied lives outside Ukraine, during the supply of the following services: (i) transfer or assignment of copyright, patents, licenses, related rights including trade marks; (ii) advertising services and other services for promotion of goods or services in the market; (iii) services of consultants, engineers, lawyers, accountants, auditors and other similar services, as well as data processing and the supplying of information; (iv) obligation to refrain from pursuing, in whole or in part from certain activities; (v) the supply of staff; (vi) the services of agents who act in the name and for the account of another person, when they procure for their principal the services referred to in this point; (vii) the hiring out of movable property including bank safes;
- during supply of staff to sea, air and space vessels, the place of supply of services is the place where the service is actually supplied.

VAT payers, whether residents or non-residents, include:

- entities whose volume of VATable transactions exceeded UAH 300,000 in any period during the previous 12 months;
- entities that are registered as VAT payer voluntarily;
- importers of goods.

Tax rates

VAT is levied at two rates:

- 20% on domestic supplies of goods and services and imports of goods, and
- 0% on export of goods, supply of processing and repair service to non-residents, international transport services.

Registration

Tax registration is compulsory if the value of a person's taxable transactions exceeds the compulsory registration threshold. The current registration threshold is UAH 300,000 during the previous 12 months.

A person qualifying as a taxable person is required to register with the tax authority at the place of its location and to obtain a VAT registration number. A voluntary VAT registration is available to any person whose turnover does not exceed the compulsory registration threshold. Voluntary registration is effective from the date of the issue of the registration certificate.

The local tax authority should issue a VAT registration certificate to the applicant within 10 business days. The registration takes effect from the date specified on the registration certificate.

VAT liability

VAT due to the state (or subject to refund) is calculated using the input output method. A taxable person's VAT liability in any VAT accounting period is the total amount of output tax due on its supplies less the input VAT they have incurred on related expenditure that the person has incurred during the same period.

On the supply of goods a person's liability to account for VAT arises on the date the goods are shipped to the customer or the date the payment is received from the customer, whichever occurs earlier. Goods that are not shipped or moved (such as land, buildings or machinery) are taken to be supplied at the time when they are actually transferred (i.e. when legal ownership passes).

On the import of goods the liability to account for VAT arises on the date of filing the import customs declaration.

On the supply of services a person's liability to account for VAT arises either at the time of the execution of the document evidencing delivery of the service or on receipt of payment from the customer, whichever occurs earlier. It is usual commercial practice for there to be a formal document (the format of which is not prescribed) signed by both the supplier and customer, evidencing the actual delivery of the service.

Generally, the amount of VAT to be paid is based on the contractually agreed price of the goods and/or services, which should correspond to market price. In the case of imported goods, the value is based on the contractual price, which cannot be less than the customs value of the goods inclusive of any customs and/or excise duty.

Domestic supplies must include the VAT in the stated sale price.

VAT recovery

Generally, VAT incurred by a registered person on the purchase and/or importation of goods and services used for the purpose of its own business (except for VAT incurred in relation to exempt supplies) can be recovered either by way of a credit against output VAT or as a repayment.

The right to credit for input VAT arises on either the date of payment to the supplier or the date the VAT invoice is received, whichever occurs earlier.

Input VAT in relation to purchase of cars intended for business use (except for taxi) cannot be recovered.

A valid VAT invoice issued by a registered taxable person or duly executed import customs declaration must support any claim for recovery of input VAT.

Refunds

Application for VAT refund can be submitted if during two consecutive months the VAT payer is in VAT credit position. Then the tax authorities should check within 30 calendar days entitlement for VAT refund and the State Treasury should remit money to the applicant bank account during 5 business days from the date of receiving approval from the tax authorities.

The persons that are not eligible to VAT refund include:

- a person registered as a VAT payer less than 12 calendar months prior to month of claiming the VAT refund and/or where volume of VATable transactions for the last 12 calendar months were lower than claimed VAT refund (except for VAT credit computed in respect of purchase or construction of fixed assets);
- a person that did not carry on activities during the last 12 calendar months.

Returns and payments

VAT returns must be made and liabilities paid on a monthly basis. However, a person whose volume of taxable transactions for 12 calendar months does not exceed UAH 300,000 may opt for quarterly reporting period.

The VAT return must be filed within the following period:

- within 20 calendar days following the last day of the reporting period for a person that files monthly VAT returns; and
- within 40 calendar days following the last day of the reporting period, for a person that files quarterly VAT returns.

VAT should be paid within 10 calendar days following the date when the tax return has to be filed.

Personal income tax

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General Principles

- For personal income tax purposes, the tax year is the calendar year.
- Taxation of income depends on the individual's tax residency.
- Ukrainian tax residents are taxable on their worldwide income, subject to restriction by the applicable double tax treaty.
- Individuals who qualify as non-residents for Ukrainian personal income tax purposes are subject to Ukrainian tax only in respect of their Ukrainian source income (this includes income received by the individual from his/her employer, either resident or non-resident, in relation to employment exercised in Ukraine).
- For 2004 – 2006 the standard tax rate for tax residents is 13% and from 1 January 2007 the tax rate will be 15%. The standard rate is applicable to most types of incomes, including salary income, dividends, royalties, investment income, gifts (with certain exemptions). Special tax rates apply in some cases such as inheritance of some kinds of income, winnings and prizes, interests from deposits, etc.
- Income received by non-residents is subject to tax at the double standard tax rate (i.e. 26%), except for interest, royalty, dividends and salary incomes paid by Ukrainian employer.
- Tax law sets out types of exempt income and deductions for personal income tax purposes. These are in general quite limited.
- Foreign nationals employed directly by a Ukrainian company under Ukrainian labour law are subject to mandatory pension and social security contributions. Employment of foreign nationals under another national law removes this obligation.

Tax Residency

The determination of tax residency is central to an individual's income tax position.

Residents are individuals who have place of abode in Ukraine.

Where an individual has place of abode in other country as well, such individual is deemed to be resident of Ukraine if he/she has a permanent place of abode (domicile) in Ukraine.

If an individual has domicile in other country as well, he/she is deemed to be a resident of Ukraine if he/she has a centre of vital interests in Ukraine.

A sufficient but not exclusive ground for determining country of individual's centre of vital interest is place of permanent abode of individual's family members.

In the event an individual's centre of vital interests cannot be determined or the individual has no domicile in any country, he/she is deemed to be a resident of Ukraine if he/she stays in Ukraine at least 183 days during the tax year (calendar year).

If residency status cannot be determined based on the above rules, an individual shall be deemed to be resident of Ukraine if he/she is a citizen of Ukraine.

Non-residents are individuals who do not qualify as residents of Ukraine.

The Law also provides that "a sufficient ground for determining that an individual is resident in Ukraine is the individual's independent election that his/her main place of abode is the territory of Ukraine according to the procedure established by this law". The Law does not define the procedure for election by an individual's of his/her tax residency status. Nevertheless, based on the Orders of the State Tax Administration of Ukraine No. 50 of 29 January 2004 and No. 581 of 5 October 2004, a foreign national individual may apply in writing to the local tax office in area where he/she has place of abode asking to consider him/her tax resident of Ukraine in a given calendar year. Based on the application the tax authorities should issue written confirmation of individual's tax residency for his/her employer.

Taxable income

Resident taxpayers are liable to pay tax in respect of any income received or accrued to an individual in Ukraine and/or abroad during the reporting period, except for items specifically exempt from tax under the law. Taxable income may be decreased by the amount of tax credit (deduction) allowed in the reporting year.

Taxable income shall be reduced by amount of mandatory employee's contributions to the State Pension Fund and the social security funds. Employer's mandatory pension and social security contributions are not included in the taxable income of the employee.

Ukrainian source income

Individuals who qualify as non-residents for Ukrainian personal income tax purposes are subject to Ukrainian tax only in respect of their income from source in Ukraine. Income from sources in Ukraine is defined as any income received from any activity performed in the territory of Ukraine. The main items specified in the non-exclusive list of incomes from sources in Ukraine include income received by a taxpayer from employer (either resident or non-resident) in respect of employment exercised in Ukraine; interest, dividends and royalties paid by residents; investment profits from transactions with securities and corporate rights; income from renting out or disposal of movable and immovable property; prizes (except for prizes from the state lotteries); gifts; charity donations; assets received as inheritance if such assets or source of payment are located in Ukraine; income received by the members of the Board of Directors or Supervisory Board of Ukrainian companies; income from entrepreneurial or independent professional activity in Ukraine.

Benefits in kind

Additional benefits granted by employers to employees constitute taxable income. Additional benefits include the following main items:

- Accommodation or other tangible or intangible assets provided for employee's use free-of-charge. Exemption is available where such free-of-charge provision is a condition for performing of labour functions by employee or is provided by an employment contract or legislation within limits specified therein. Benefit in form of use of vehicles does not constitute taxable income if a resident employer who qualifies as corporate profits tax payer grants this benefit.
- Value of goods and food provided to employees free of charge except for value of special clothing, uniforms and food provided to employees within the norms established by the Cabinet of Ministers of Ukraine.
- Amounts of reimbursements of employee's expenses or losses, except for items specifically exempt from tax.
- Financial assistance granted to employee including debts cancelled by a creditor.
- Value of goods, services provided free of charge and value of discounts in respect of goods, services sold to employees at a price lower than market price.

Exemptions

The following main items of income are exempt from taxation:

- Income from investments in securities issued by the Ministry of Finance and prizes from state lotteries.
- Alimony received from residents.
- Shares received from capitalization of undistributed profits provided that allocation of shares between shareholders remains unchanged.
- Premiums paid by employer in respect of long-term life insurance or non-state pension insurance of its employees within the limit equal to 15% of employee's monthly salary but maximum 1.4 times the subsistence minimum (in 2005 - UAH 570) per month.
- Amounts received from employers in respect of certain types of medical treatment and services. Income from sale of car, motorbike, yacht or boat with engine provided the seller pays the state (stamp) duty upon sale.
- Amounts paid by employers to educational institutions for training/re-training of employees within limits of 1.4 times the subsistence minimum (i.e. at present UAH 570) per month of education. If the employee terminates employment during education or prior to the end of the second calendar year following the year when education was completed the cost of education should be taxed as additional benefit.
- Interest income from deposits placed with banks and non-banking financial institutions and from saving certificates (exemption is available until 31 December 2009).

Deductions and allowances

There are no major deductions available to individuals in Ukraine. A registered taxpayer may claim a limited deduction (so-called "tax credit") from annual taxable income for the amount of documented expenses incurred in the reporting year in respect of:

- Secondary professional or higher education of taxpayer or his/her family members (spouse, parents, parents-in-law, children). Deduction is limited to the amount of up to 1.4 times the subsistence minimum (in 2005 - UAH 570) per month of education;
- Certain types of medical treatment of taxpayer or his/her family members. This deduction will be available in the year following the year when the law on mandatory medical insurance is introduced;
- Premiums on voluntary long-term life insurance or non-state pension insurance. Deduction is limited to the amount of up to 1.4 times the subsistence minimum (in 2005 - UAH 570) per month of insured period in case of self-insurance and half of this amount in case of insurance of taxpayer's family members. Deduction for expenses on non-state pension insurance are available starting from 1 January 2005;
- Donations to charity and non-for-profit organizations in the amount from 2% to 5% of individual's taxable income.

Total amount of deductions cannot exceed amount of taxable income received in the form of salary. Amounts not deducted from income of the reporting year cannot be carried forward.

Low-income individuals (with monthly income of less than 1.4 times the amount of subsistence minimum for able-bodied individuals – in 2005 - UAH 570) can claim a Social Tax Allowance (STA). Amount of STA equals the statutory minimum wage for ordinary taxpayers and 150% - 200% of minimum wage for some privileged categories. For 2005 the amount of STA is UAH 131 (that constitutes 50% of the minimum wage of UAH 262 effective on 1 January 2005).

Tax Rates

Residents

For 2004 – 2006 the standard tax rate for tax residents is 13% and from 1 January 2007 the tax rate will be 15%. The standard rate is applicable to most types of incomes, including salary income, dividends, royalties, investment income, gifts (with certain exemptions). Special tax rates apply in some cases such as inheritance of some kinds of income, winnings and prizes, interests from deposits, etc.

Income in form of prizes (except for prizes from the state lottery in cash) is taxed at double standard rates (i.e. 26% for 2004-2006).

Non-Residents

Income earned by non-residents from sources in Ukraine in form of interest, dividends and royalty is taxed at the same rates as for residents (see above).

The PIT Law provides that any other income earned by non-residents from sources in Ukraine is taxed at double standard rates (i.e. 26%). However, the PIT Law is unclear whether standard or double rates apply to salary income earned by non-residents in Ukraine. In accordance with the tax clarification issued by the State Tax Administration of Ukraine, salary income paid to a non-resident individuals by a Ukrainian resident employer shall be taxed at standard rate (i.e. 13%).

Foreign Tax Credit

Tax residents are allowed to credit foreign taxes paid on income received abroad against their Ukrainian tax liabilities (an official confirmation issued by the relevant foreign tax authority is required) provided there is a double tax treaty between Ukraine and the relevant foreign state. The amount of foreign tax credit is limited to the amount of Ukrainian tax that would arise from the equivalent income in Ukraine.

Tax Registration

All taxpayers, including foreign nationals, must register with the State Registry for Individuals. Every individual is assigned a personal tax ID number, which is necessary for various transactions such as registering Ukrainian companies, renting apartments, opening bank accounts, and paying personal income tax. Receiving the ID number is one of the conditions for obtaining the right to claim a tax credit (deduction) in respect of certain expenses incurred by a taxpayer during the reporting year.

For personal income tax purposes, taxpayers include:

- residents who receive income from sources in Ukraine and abroad; and,

- non-residents (except for individuals who have diplomatic immunity) who receive income from sources in Ukraine.

Tax Payment and reporting compliance

Tax agents

Employers and other business entities that pay income to individuals are defined as tax agents who are responsible for withholding the tax and state pension and social insurance contributions from income payable and remitting it to the state and appropriate authorities. Tax agents should pay tax to the state at the date of payment of income to individuals. Tax in respect of income that is accrued but not paid to the individuals should be transferred to the state within 20 calendar days following the end of reporting month.

If income is paid in-kind, tax agent should remit the tax to the state on the next banking day following the day of payment. Tax agents who failed to withhold tax from income paid to individuals are responsible for payment of tax liability (plus fines and interest) whereas the individual concerned should be free from obligation to settle the tax liability.

Tax agents should file quarterly reports on income paid to individuals and amount of tax withheld from such income.

Tax returns

In case an individual received during a reporting year income only from tax agents, which are obliged to file reports on personal income tax quarterly, such individual is not obliged to file personal income tax return. However, if tax resident individuals wish to claim tax credit (deduction) in respect of certain expenses incurred during the year and/or claim foreign tax credit in Ukraine they have the right to file a tax return.

If an individual, either resident or non-resident, received any taxable income from entities/sources other than tax agents such individual will be required to file personal income tax return with the local tax authorities (where the individual resides in Ukraine). The tax return must be filed before 1 April of the year following the reporting one and the tax due must be paid before 11 April.

Personal income tax should be paid in Ukrainian local currency, Hryvnia.

If individual is not able to file the tax return by the stipulated deadline due to reasonable circumstances, he/she is allowed to apply for an extension of the tax return filing term within 30 calendar days after termination of these circumstances. Adequate documentation will be required.

In case of departure from Ukraine, a tax resident individual must submit a "departure tax declaration" no less than 60 days prior to his/her departure and settle the tax due based on the assessment issued by the tax authorities.

Overpaid personal income tax should be returned to the taxpayer within 60 calendar days from the date of filing the tax return. In case of tax repayment delay the state treasury has to pay to the taxpayer a fine in the amount from 10% to 100% of the amount due, depending on the period of delay.

Special Rules for Taxation of Certain Incomes

Income from rent of real estate

If lessee is a business entity, it is obliged to withhold from rent payments to a lessor-individual, who is not registered as private entrepreneur tax at standard rates.

The law requires that rental agreements with a lessee-individual who is not registered as private entrepreneur be notarised. Notaries are obliged to report about such rental agreements to the tax authorities.

Income from renting out real estate is determined based on contractual fee but not lower than minimum rental fee determined according to the methodology established by the Cabinet of Ministers of Ukraine.

Income from disposal of real estate

In year 2005 income from sale of real estate is exempt from personal income tax.

With effect from 1 January 2006 income from disposal of real estate is taxed as follows.

Sale of one apartment or house (including attached land) per year that was acquired prior to 1 January 2004 is taxed at the rate of 1% for first 100 sq. m of premises and 5% for the portion of income attributable to premises exceeding 100 sq. m based on the property value.

Sale during a reporting year of more than one apartment, house, unfinished construction or other real estate acquired before 1 January 2004 is subject to tax at 5% rate based on the property value.

Sale of real estate acquired after 1 January 2004 is taxed at a standard rate based on gain realized from the sale. In case of sale of one apartment/house per year, taxable gain can be reduced by 10% for each calendar year of the property ownership, except for year of the property acquisition.

Income from disposal of movable property

Gross income from sale of movable property is subject to tax at standard rates. Exemption from personal income tax is available in case of sale of car, motorbike, yacht or boat with engine, once per calendar year, if the seller pays the state (stamp) duty (1% if sale to spouse, parents or children, 5% in other cases) upon notarisation of sale agreement.

Insurance

Amounts paid by employer in favour of employee under any voluntary insurance constitute employee's taxable income. Exemption is available for premiums under long-term life insurance or non-state pension insurance within the limit equal to 15% of employee's monthly salary but maximum 1.4 times the subsistence minimum (currently UAH 570) per month.

Payments from insurance companies under other kind of insurance are exempt from tax provided:

- In case of life/health insurance the fact of insurance event is duly confirmed by appropriate documents. In the event of death of an insured, individual payment to beneficiary is taxed similarly to inheritance.
- In case of property insurance, the amount of reimbursement does not exceed market value of the insured property (increased by insurance payments) and is used for repair or replacement of the damaged or lost property. If lost property is not replaced with similar property within terms established by the law (calendar year following the year of insurance event for movable property and two calendar years following the year of insurance event for immovable property) amount of insurance reimbursement will be subject to tax at standard rate.

Prizes

The law provides for taxation of prizes or other winnings at double rate.

Private Entrepreneurs

Current legislation establishes several options ("tax regimes") for taxing personal income of individuals (including foreign nationals) registered as private entrepreneurs. The most common are the ordinary taxation regime and the "single (unified) tax" regime.

In general, under the ordinary tax regime the taxable income is computed by deducting from gross income the expenses incurred in the course of business activity. The deductibility of expenses is determined based on the rules established by the Corporate Profits Tax Law. If the actual expenses cannot be documented then a standard deduction may be applied (rates ranging from 5% to 60%, depending on the type of activity). Private entrepreneurs are also subject to social security taxes, VAT (with some exceptions) and other taxes and dues.

The "single (unified) tax" regime may be enjoyed for certain activities by private entrepreneurs employing up to 10 employees and with the annual proceeds from the sale of goods and/or rendering services up to UAH 500,000 (approximately USD 94,000). Monthly "single (unified) tax" is fixed by local authorities and may range from UAH 20 to UAH 200 (approximately USD 4 – USD 38), depending on the type of activity. Payment of "single (unified) tax" relieves a private entrepreneur from other taxes such as personal income tax, VAT, social security taxes except contributions to the Pension Fund, land tax, but with respect to income earned from the entrepreneurial activities only.

A private entrepreneur is obliged to file with the local tax authorities reports on the amount of income received and tax paid during the reporting period on a quarterly basis within 5 calendar days after the end of the reporting quarter. Report to the Pension Fund is filed once a year before 1 April of the year following the reporting one.

Pension and social security contributions

Introduction

The social security system in Ukraine covers pensioners, workers and their dependants for work-related accidents, illness, retirement, death and disability benefits, sickness and maternity benefits, medical care, severance benefit, and for child and family allowances.

Mandatory contributions to Ukrainian social security and pension funds are only applicable if the salary is paid through the payroll of a Ukrainian entity (which in this context also includes representative offices of foreign legal entities in Ukraine). Voluntary contributions to the State Pension Fund, the Employment Insurance Fund and the Social Security Fund are possible.

Employer's contributions

Ukrainian employers are liable to pay social security contributions in respect of their Ukrainian and foreign national employees at the following rates based on gross remuneration:

- 32.3% to the Pension Fund;
- 2.9% to the Social Security Fund;
- 1.6% to the Employment Insurance Fund;
- 0.2 – 13.8% to the Fund for Social Insurance regarding Accidents at Work. The tax rate depends on the level of risk of accident for enterprises belonging to certain sectors of the economy.

The taxable base for the employer's contributions is currently capped at UAH 4,100 (approximately USD 800) per employee per month. This cap is subject to periodic review.

Employee's contributions

For employees of Ukrainian entities, social security contributions are withheld at the source from salary payments by the employer, and remitted directly to the appropriate authorities.

Ukrainian and foreign national employee's contributions based on gross remuneration are as follows:

- 2% to the State Pension Fund;
- 1% to the Social Security Fund. Reduced rate of 0.5% applies to monthly salaries below the amount of the subsistence wage (currently UAH 453 per month); and
- 0.5% to the Employment Insurance Fund (for Ukrainian national employees only).

The taxable base for the employee's contributions is currently capped at UAH 4,100 per employee per month.

Other taxes

Excise tax

Excise tax is applied to certain goods imported into, or produced in, Ukraine. The list of excisable goods includes alcoholic beverages, beer, tobacco and tobacco products, cars, petrol and diesel fuel.

Land tax

Land tax is paid monthly by the owners or users of land. The rate depends on the nature and location of the land.

Tax on owners of motor vehicles

This tax is paid by legal entities and individuals that own motor vehicles registered in Ukraine. The tax rate currently varies from 3 to 40 UAH per 100 cc of the engine displacement. Legal entities should pay the tax quarterly.

Stamp duty

Stamp duty is payable during notarisation of documents or performance of certain legal acts. Rates of stamp duty depend on the nature of the transaction.

Charge on environmental pollution

The charge is payable by legal entities that discharge contaminants into environment (air and water) or dispose of wastes. Charge rate depend on type and danger rating of each specific contaminant. Where the entity exceeds the limit for discharge of contaminants and disposal of wastes the rate of charge is multiplied by 5.

Royalties for extraction of oil, natural gas and gas condensate

Royalties for extraction of oil, natural gas and condensate are payable by the Ukrainian business entities involved in the extraction of these resources in Ukraine. Royalties' amount depends on volume of extraction, geological conditions of deposit and sale price for resources.

Charge for the use of radio frequency

Users of radio frequencies pay one-off license fee as determined by the Cabinet of Ministers of Ukraine and monthly charge (varies from UAH 0.21 to UAH 8,000 for 1 MHz of radio frequency).

Charge to Fund for guaranteeing bank deposits of individuals

The tax is payable by banks as follows. In 30 calendar days after obtaining a banking license the bank should pay to the Fund for guaranteeing bank deposits of individuals an initial charge in the amount of 1% of the bank's registered capital. Further banks should pay quarterly a regular charge computed as 0.25% of total amount of deposits belonging to individuals.

Special Pension Fund charges

The following special charges are payable to the State Pension Fund:

- 1.5% charge based on the value of a foreign exchange transaction. The charge is payable by legal entities and individuals purchasing foreign currency at inter-bank foreign exchange market. Purchase of foreign currency at exchange points is exempt from this tax;
- 5% charge based on the value of jewellery sales (except for wedding rings). The charge is payable by businesses involved in trade with jewellery; and
- 3% charge based on the transfer value of a car (except for cars designed for disabled people and cars that were inherited). The charge is payable by legal entities and individuals that acquire cars.
- 1% charge on the acquisition of real estate payable by individuals and legal entities that purchase real estate. The tax base is the contractual value of the real estate;
- 7,5% charge on mobile communication services payable by individuals and corporations that use mobile communications services. The tax base is the value of services charged by an operator of a mobile phone network.

Local taxes

There are 14 different local taxes that may be levied at the discretion of the local authorities. Few of them apply to business entities. The principal local taxes include:

- *Advertisement tax.* This tax is payable by legal entities placing advertisement in mass media, on big boards or through other means. Maximum rate of advertisement tax is limited to 0.5% of the advertisement services cost. Advertising agencies or other entities that place advertisements should collect the tax.

- *Municipal tax.* This tax is payable by legal entities monthly and is calculated as maximum 10% of individual's non-taxable allowance multiplied by the number of employees. Currently, the monthly tax is UAH 1.7 per employee per month.
- *Charge for use of local symbols.* The charge is payable by legal entities, for commercial purpose, use local symbols (city emblem, name or image of architectural or historical monuments). Maximum rate of the charge is limited to 0.1% of the value of goods/services sold with the use of local symbols.



Export/Import

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Introduction

In recent years, Ukrainian customs regulations have gradually evolved towards greater compliance with international practice. Thus, Ukrainian customs legislation absorbs main provisions of international customs conventions and WTO principles.

Ukraine is not a member of the WTO yet, but declared a strong commitment to join the WTO in the near future. Ukraine participates in the World Customs Organisation. Ukraine signed trade agreements with a number of countries and free trade agreements with ex-USSR countries.

Effective from 1 January 2004 Ukraine implemented a new Customs Code, which introduced progressive changes into customs practice.

Import requirements

Import licenses are required for plant protection chemicals; optical polycarbonate for manufacturing disks of laser reading systems; postage and similar stamps, officially stamped paper; copper sulphate; ozone damaging substances, products that are likely to contain ozone damaging substances, printer's ink, paper with water marks.

A compulsory certification procedure was introduced in 1993 with the purpose of ensuring that imported goods comply with national standards. The certification is provided by the Ukrainian certification authorities (UkrSEPRO) in respect to a wide range of imported goods by issuing a Ukrainian Compliance Certificate.

Export requirements

Export contracts for certain categories of products, such as those falling under anti-dumping regulations, are subject to registration by the Ministry of Economics. The main items that can be exported from Ukraine subject to licensing (and/or quotas where applicable): precious metals and stones; rolled metal products exported to USA and optical polycarbonate for manufacturing disks for laser systems of reading; textile products exported to USA; ozone damaging substances; and products that can contain ozone damaging substances; certain commodities exported to Macedonia, Lithuania, Latvia and Poland; meat, certain metal products exported to EU; certain goods exported to Russia; certain products from color metals and alloys; printer's ink, paper with water marks, coal-tar resin.

The Ministry of Economics is empowered to establish mandatory indicative export prices for certain categories of goods (e.g. metal products, ferrous silicon manganese, livestock and raw hides, sunflower seeds, etc.).

Customs clearance procedures

Any business entity that is engaged in export/import operations is required to register with the customs office, which serves the area in which the company is located. Customs clearance of goods in other customs office requires obtaining permission from the customs office where the entity is registered.

Goods crossing Ukraine's border should be declared to the customs authorities, either by the importer or a licensed customs broker on behalf of the importer.

Import of goods must be supported by proper documents. Absence of any document or its non-compliance with legislation may cause delays during customs clearance.

Customs classification of goods

The Ukrainian Classification of Foreign Economic Activities (UC FEA), which is based on the Harmonised Commodity Description and Coding System (1996) and EC Combined Nomenclature (2000), is the effective customs classification document in use. UC FEA serves as the basis for Ukraine's Customs Tariff. Ukraine is a member of the International Convention on Harmonised Commodity Description and Coding System.

Rules for determining goods country of origin

Country of origin of goods is considered to be the country where the goods were fully manufactured or underwent sufficient processing. Country of origin may be understood as a group of countries, customs unions, region or part of the country.

Goods fully manufactured in a given country include:

- Natural resources extracted within the territory or territorial waters, or continental shelf or interior waters of a country provided a country has exclusive right for development of its interior waters;
- Vegetable products grown and collected in the territory of the country;
- Live animals born and grown in the territory of the country;
- Natural products that are captured (e.g. through hunting and fishing);
- Sea products caught or manufactured in international waters by vessels belonging to or rented by the country;
- Secondary raw materials and waste materials resulting from manufacturing and other operations carried on in the country;
- High technology products obtained in outer space on space vessels belonging to or rented by the country
- Goods manufactured in the country exclusively from products listed above.

Sufficient processing criterion applies where two or more countries participate in goods' manufacturing. Sufficient processing may be determined by the following rules:

- Rule requiring change of commodity code of the first four digits under Harmonised Commodity Description and Coding System as a result of processing; or
- Ad valorem rule, where value of goods change as a result of processing such that added value or portion of used materials from other countries or of unknown origin constitutes at least 50% of value of goods received as a result of processing; or
- List of manufacturing and technological operations that although do not change commodity code or value during processing, still qualify sufficient under certain conditions.

Preferential origin is determined in accordance with certain free trade agreements and CIS Rules for Determining Country of Origin dated 30 November 2000.

Customs valuation

Ukrainian customs valuation complies with Agreement on Implementation of Article VII of the GATT 1994.

Generally, customs value is the goods value declared by the declarant or determined by the customs office and computed at the moment when the goods cross the customs border of Ukraine. Customs value of goods imported into Ukraine must be defined in accordance with 6 methods, which apply in hierarchical order (i.e. where method 1 cannot be used, Method 2 should apply etc., except for Methods 4 and 5 which apply at the discretion of the importer), namely:

Method 1: Transaction value

This is the basic method for determining customs value. Transaction value is the price actually paid or payable for the goods imported into Ukraine at the moment when the goods cross the customs border of Ukraine, but not lower than minimum customs value as may be established by the Cabinet of Ministers of Ukraine. Customs value under this method includes the following expenses if they were not included to transaction value:

- (i) Costs of delivery of goods to airport, port or other point of entry to customs territory of Ukraine including transportation, loading, unloading, transshipment, insurance.
- (ii) Costs incurred by the buyer such as commissions and brokerage (except buying commissions); the cost of containers which according to commodity nomenclature are treated as being one for customs purposes with the goods valued; the cost of packing.
- (iii) The value, apportioned as appropriate, of the following goods and services supplied directly or indirectly to the buyer free of charge or at reduced cost for use in connection with the production and sale for export of goods:
 - raw materials, components, parts, semi-finished products, etc incorporated in the imported goods;
 - tools, moulds and similar items used in the production of the imported goods;
 - materials consumed in the production of the imported goods (oils, fuel, etc.);
 - engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in Ukraine and necessary for the production of imported goods.
- (iv) License and other fees for the use of intellectual property that the buyer must pay, either directly or indirectly, as a condition for sale of the goods;
- (v) Profits of any subsequent resale, transfer or use of the imported goods in Ukraine that remitted directly or indirectly to the seller.

Transaction value method applies where:

- (i) There are no restrictions as to the rights of the buyer to use the goods except for restrictions that are imposed or required by law, limit the geographical area in which the goods may be resold; do not substantially affect the value of the goods.
- (ii) The sale and price are not subject to certain conditions for which a value cannot be determined;
- (iii) The importer provides documentary evidences for data used;
- (iv) No part of profits of any subsequent resale, disposal or use of the goods by the buyer will be remitted directly or indirectly to the seller;

Transaction value method does not apply where the exporter and the importer are related entities unless the customs authorities consider transaction value acceptable. Parties to the agreement deemed to be related if:

- One party to the agreement who is an individual or official of one party to the agreement, is the official of another party to the agreement;
- They are co-owners of a business;
- They are an employer or employee;
- One party to the agreement owns 5% or more of voting shares in the capital of another party to the agreement;
- Both of them are directly or indirectly controlled by a third person;
- Together they directly or indirectly control a third person;
- One of them directly or indirectly controls the other;
- Parties to the agreement - individuals or company's officials are relatives.

Persons who are associated in business with one another in that one is the exclusive agent, distributor or sole concessionaire are deemed to be related only if they fall under the above criteria.

If a customs office does not accept transaction value between related entities it must provide to the importer grounds for the rejection. Transaction value between related entities must be accepted if the importer demonstrates that such value closely approximates to one of the customs value of identical or similar goods as determined under methods 2, 3, 4 or 5.

Method 2: Transaction value of identical goods

Under this method, customs value is based on transaction value of identical goods. Identical goods are determined as:

- The same in all respects including physical characteristics, quality and reputation in the market;
- Produced in the same country as the goods being valued;
- Manufactured by the same producer as the goods being valued.

Minor differences in appearances cannot be the ground for disqualifying the goods as identical.

Transaction value of identical goods can be used if such goods were:

- Sold for import into Ukraine;
- Imported at or about the same time but maximum 90 days before import of goods being valued;
- Imported approximately in the same quantity and on the same commercial conditions. If this requirements is not satisfied, the importer can adjust the value with due regard to these factors and support adjustments by documents.

If there are several values of identical goods, the lower value should be taken.

The customs value determined under this method must be adjusted with respect to expenses listed under method 1.

Method 3: Transaction value of similar goods

Transaction value of similar goods is calculated in the same manner as for identical goods. Similar goods are the goods that closely resemble the goods being valued in terms of component materials and characteristics and capable of performing the same functions and are commercially interchangeable with the goods being valued. Same as for identical goods, in determining whether the goods are similar the following should be counted:

- Quality, brand and reputation in the market;
- Production in the same country as the goods being valued;
- Manufactured by the same producer as the goods being valued.

Goods cannot be treated as identical or similar if:

- They were produced in a country other than the country where the valued goods were produced;
- Manufactured by a producer other than the producer of goods being valued. Goods manufactured the other producer can be counted if there are neither identical or similar goods manufactured by the same producer as the goods being valued;
- The goods incorporate developing, design, artwork etc. made in Ukraine.

Method 4: Deductive method

Deductive method applies where the valued, identical or similar goods will be sold unchanged to an unrelated buyer in the greatest aggregate quantity in Ukraine. The sale should take place at or about the time of importation of the goods being valued but no later than 90 days after such importation.

Allowable deductions from the price of the goods include:

- Commissions, additions usually made for profit and general expenses added in connection with sales in Ukraine of imported goods of the same class and kind;
- Import duty and other taxes payable in Ukraine during import or sale of goods;
- Usual costs incurred in Ukraine in relation to loading, unloading, transportation and insurance.

Method 5: Computed method

Customs value of goods is based on a computed value that includes the following elements:

- Cost of materials and expenses incurred by the producer during manufacture of goods being valued;
- General expenses usually incurred during sale of goods of this type to Ukraine including costs of loading, unloading, transportation, insurance incurred up to the moment of crossing the Ukrainian border and other expenses;
- Usual profit of the producer during supply of such goods to Ukraine;
- Expenses listed under method 1.

Method 6: Fall-back method

When the customs value cannot be determined under any of the previous methods, or customs authorities proves that these methods cannot be applied customs value must be determined based on best global practices. Under the fall-back method, customs value is determined based on Ukraine's laws and must comply with the provisions of Article VII of the GATT and Agreement on Implementation of Article VII of the

GATT 1994. This implies flexible use of principles of all 5 previous methods with due regard to restrictions imposed by the fall-back method rules.

Under the fall-back method, the customs value should not be based on:

- The selling price of goods in the market of exporting country;
- The selling price of goods delivered from the exporting country to third countries;
- The selling price of goods of Ukrainian origin in Ukraine;
- Arbitrary price of goods;
- Production costs other than computed values which have been determined for identical or similar goods;
- Minimum customs value;
- Higher from two alternative values.

Declaration of customs value

Customs value is declared by filing a declaration of customs value with reference to valuation method used. The importer has to provide relevant documents to evidence customs value. If such documents are not available or customs office has grounded doubts as to the data provided by the importer, the customs office can determine customs value itself based on available information including information on prices for identical or similar goods adjusted based on valuation methods.

Where customs value should be checked or the importer does not agree with customs value determined by the customs office, the importer may request customs office to release the goods for free circulation against a bank guarantee or payment of import taxes. Bank guarantee can be replaced by the promissory note secured by the bank or bank deposit for the amount of import taxes.

Customs payments

The following import taxes and duties are payable by the importer when goods are imported into Ukraine:

- import duty in accordance with the Customs Tariff. Currently there are two rates of duty: relieved rates and full rates. Relieved rates of duty apply to goods originating from countries which have granted Ukraine "Most Favoured Nation" trade status. Full rates of duty apply to goods originating from other countries. Rates of duty can be ad valorem (in percentage to customs value), specific (in monetary units per unit of goods) and combined. There are seasonal, special, anti-dumping and countervailing duties;
- excise duty on certain goods (cars, alcoholic beverages, tobacco products, beer, petrol and diesel fuel). Rates of excise duty are specific;
- VAT at current 20% rate. Taxable basis is the goods contractual value which should not be lower than customs value, including the amount of import duty.

Import duty and taxes are payable by the importer in local currency before or upon customs clearance. In certain cases customs payments must be deposited to customs prior the goods cross the Ukrainian border.

There are no export duties except on natural gas, livestock, raw hides and certain oil seeds. Exported goods and ancillary services are zero rated for VAT purposes.

Customs clearance of goods attracts customs processing fee, calculated as 0.2% of the goods customs value, but maximum of USD 1,000 per customs declaration.

Import tax relief

Property (except for resalable goods) contributed by a foreign investor to the statutory fund of a Ukrainian entity or unincorporated joint venture can be imported free of import duty

Trade agreements

Ukraine has concluded free trade agreements, which allow duty-free import of goods, from the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Macedonia, Moldova, Russia, Turkmenistan and Uzbekistan.

Other countries that have favourable trade regimes with Ukraine include: Austria, Algeria, Argentina, Belgium, Bosnia and Herzegovina, Bulgaria, Brazil, Canada, China, Croatia, Czech Republic, Cuba, Cyprus,

Denmark, Egypt, Estonia, Finland, France, Germany, Great Britain, Guinea, Greece, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Jordan, Korean People's Democratic Republic, Latvia, Lebanon, Libya, Liechtenstein, Lithuania, Luxembourg, Malaysia, Malta, Mongolia, The Netherlands, Norway, Poland, Portugal, Romania, Serbia and Montenegro, Slovakia, Slovenia, South African Republic, South Korea, Spain, Switzerland, Sweden, Tunisia, Turkey, United Arab Emirates, USA, Vietnam.

Customs regimes

The new Customs Code outlined 14 customs regimes applied to goods crossing the Ukrainian border at the discretion of the declarant as follows: import; re-import; export; re-export; transit; temporary import; temporary export; customs warehouse; special customs zone; duty free shop; processing in customs territory of Ukraine; processing outside customs territory of Ukraine; destruction; disposal in favour of the state.

Temporary admission

Permission for temporary import (export) with full conditional exemption from import taxes may be issued in respect of the following items:

- Goods intended for display or use during exhibitions, fairs, conferences and the like events;
- Professional equipment used by mass media or required for making films;
- Containers, pallets, packaging or any other goods imported in connection with a commercial transaction;
- Samples of goods and advertising films for non-commercial use provided they remain the ownership of a person established outside Ukraine;
- Goods imported for educational, scientific or cultural purposes;
- Personal items of passengers and goods imported for sport purposes;
- Materials for tourism and advertising;
- Transport vehicles used for moving passengers and goods across Ukrainian border;
- Sea vessels and aircraft imported for repair;
- Equipment and materials designated by non-residents for construction and repair of sea vessels and aircraft.

Ukraine has joined the Istanbul Convention on temporary admission. However, rules for implementation of this Convention has yet to be approved.

Toll manufacturing

Currently, raw materials imported into Ukraine for processing under toll manufacturing arrangements enjoy exemption from import taxes and duties provided finished products are re-exported from Ukraine during a 90-day period. Finished goods can be sold in Ukraine after tolling. However, such sale will attract for a non-resident owner of finished goods obligation to register a permanent establishment in Ukraine and pay applicable import taxes and duties.

Warehousing

Prior to release under specific customs regime the goods may be stored in the warehouse of temporary storage (WTS) under customs control up to 3 months. WTS operator must obtain permission of the customs authorities. There are two types of WTS:

- Open WTS which is available to any users on a contractual basis with the WTS owner;
- Closed WTS which can be used only by its owner.

Alternatively, imported goods can be stored in the customs bonded warehouse (CBW) under customs control without payment of import duty and taxes during storage for three years and exported goods can be stored there under customs control after customs clearance for three months until actual exportation outside Ukraine. Certain goods can be stored in the CBW during limited period of time or prohibited for placing into the CBW. Similarly to WTS, CBW can be either an open type or a closed type. A CBW operator must obtain the license of the State Customs Service of Ukraine.

Customs control

All goods crossing the border are subject to customs control that includes specific procedures aimed at ensuring compliance with customs rules. Normally, the customs authorities exercise customs control during customs clearance of goods. However, the customs authorities are entitled to carry on post entry audits to verify compliance with customs and tax legislation.

Other types of border control include: sanitary, veterinary, phytosanitary, radiological, ecological controls and control over cross-border movement of pieces of art.

Import of assets by representative offices

Representative offices of foreign companies may import goods for official use, not intended for re-sale, temporarily for up to three years from the date of accreditation of such a representative office. Temporary import can be extended by local customs office.

Protection of intellectual property rights

Owners of intellectual property rights may request Ukrainian customs authorities to register goods containing intellectual property to prevent illegal import/export of pirated/counterfeited goods. In this case, customs authorities may hold customs clearance of such goods until it can be proven that no breach of intellectual property rights took place. If sufficient evidence is not submitted the customs office can cease pirated/counterfeited goods and impose penalties.



Investment regime

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Law “On Foreign Investment Regime”

According to Ukraine’s Law “On Foreign Investment Regime” (25 April 1996), foreign investors are subject to the national regime of investment and business activity. In most instances, the law provides for the equal treatment of foreign and Ukrainian-owned businesses, although certain restrictions exist for foreign investments in the publishing and broadcasting sectors. Foreigners are also not allowed to participate in the manufacturing of weapons or alcoholic spirits.

A company with foreign investments is defined as a company where at least 10% of the capital infusion belongs to a foreign entity. Incentives and guarantees provided by the law apply if the foreign investment is properly registered with the state authorities. The allowable forms of foreign investment include:

- acquiring property not expressly excluded by law from foreign ownership;
- participating in a company jointly with a Ukrainian partner, or setting up an un-incorporated joint venture; and
- acquiring an existing company, shares in a company, or the right to use land or develop natural resources.

The following assets can be contributed to a Ukrainian company: hard currency, local currency in the case of re-invested profits, movable and immovable property, property rights (including intellectual property), securities, valid debts denominated in hard currency, and contractual or statutory rights to carry out specific activities, such as rights to develop natural resources.

The law provides the following guarantees to foreign investors:

- protection for a period of 10 years against adverse changes to the investment guarantees contained in the law;
- investments cannot be expropriated, except in case of national emergency and with proper compensation;
- compensation for losses due to negligence of state bodies; and
- the right to repatriate the original investment in the event of termination of the investment.

Investment protection and promotion treaties

Ukraine has concluded investment protection and promotion treaties with more than 50 countries. If domestic legislation is less favourable, international treaties for investment protection may be invoked by investors to secure their rights.

Profit repatriation

Foreign investors are entitled to repatriate profit, income or other funds relating to investments without any restrictions, after the payment of applicable taxes. Foreign investors are guaranteed the right to the prompt and unimpeded repatriation of profits and other funds in foreign currency derived from their investments in Ukraine. Conversion of funds for repatriation is effected through the Ukrainian Inter-bank Currency Exchange.

Foreign Exchange control

The key provisions of Ukraine's current exchange control regulations are as follows:

- payments under foreign trade contracts between a resident and a non-resident entity should be in foreign currency only;
- foreign loans must be registered with the National Bank of Ukraine prior to their receipt;

- payments in foreign currencies between residents in the territory of Ukraine are prohibited (although there are some exceptions to this rule);
- salaries in the territory of Ukraine must be paid in Ukrainian currency only;
- Ukrainian companies must receive payment for exported goods (services), and obtain goods (services) pre-paid to a foreign supplier, within a 90-day period.

A Ukrainian company is required to obtain a license from the National Bank of Ukraine in respect of the following transactions:

- in-cash investments abroad in respect of acquisition of fixed assets, intangible assets, corporate rights, securities and derivatives;
- in-kind contributions and transfer of property to a foreign branch;
- the purchase of foreign securities and Ukrainian securities from non-residents;
- opening bank accounts with foreign banks;

Payments by Ukrainian business entities for services rendered by non-residents for value exceeding EURO 50,000 require obtaining confirmation from an authorized state organisation that the service fee (price) corresponds to market prices.



Employment Issues

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The Labour Code

Conditions of employment in Ukraine are governed by the Labour Code. The main requirements under Ukraine's employment legislation are as follows:

- Ukrainian labour legislation requires employers to follow statutory requirements as to the working time, overtime and time-off from work. In Ukraine, working time is limited to 40 hours a week. An employer may introduce a six-day working week, in which case the working day may not exceed seven hours. Shorter working time is ensured for some categories of employees;
- The amount of monthly wage shall meet the minimum threshold established by the legislation in force (as of 1 July 2005 it is UAH 310). Wages and all other payments due to employees shall be in UAH only;
- Employees may at any time terminate the employment relationship. The notice period is at least two weeks. In contrast, employers may terminate the employment relationship only in cases that are expressly envisaged by the Ukrainian Labour Code and provided that all applicable formalities are met. The statutory termination notice is two months;
- Employee's minimum annual holiday entitlement is 24 calendar days. However, it may be longer depending on the number of years worked, working conditions and the employee's position;
- Normal retirement age is 55 years for women and 60 years for men.

All enterprises must ensure employment of handicapped persons according to quotas specified in the law. The quota for enterprise employing 8 or more individuals equals to 4% of the total number of employees but no less than 1 working place. Failure to employ handicapped workers within the quota can attract a fine amounting to the enterprise's annual average salary per each working place for handicapped not occupied by a handicapped person.

Expatriate Personnel

Work permits

- Ukrainian employers must obtain work permits for foreign nationals, who are either directly employed or seconded to work in Ukraine by foreign companies.
- The personnel of representative offices of foreign companies in Ukraine who are employed abroad as well as foreign nationals registered as private entrepreneurs under Ukrainian legislation are not required to obtain work permits for their work in Ukraine.
- A work permit may be issued for up to one year with subsequent renewal. The overall time of employment in Ukraine is not limited.
- The labour authorities must consider an application for a work permit within 30 days after its registration. The foreigner is not allowed start working in Ukraine until the work permit is issued.
- Non-compliance with the work permit requirements is subject to penalties, as well as potential summary deportation of the foreign national from Ukraine at the cost of the employer.

Visas and registration requirements

- Entry of foreign nationals to Ukraine requires a visa (except citizens of most of the CIS countries and some Eastern European countries).
- Any foreign national coming to Ukraine on a business trip must obtain a business visa from a Ukraine's Embassy or Consulate abroad based on an official letter of invitation from the inviting company. The duration of a business visa cannot exceed one year.
- Citizens of EU countries, Swiss Confederation, Turkey, Canada, USA and Japan may apply for business visa without an invitation letter.

- No personal attendance at an Embassy is required for obtaining a Ukrainian visa.
- A foreign national's visa (multi-entry or single entry) must be registered with the state authorities at the time of crossing the state border of Ukraine.

In case of the foreign national's uninterrupted stay in Ukraine for more than 6 months (3 months – if no visa is required), the individual's visa (passport) must be registered with the local agency for internal affairs (police/OVIR).



PricewaterhouseCoopers Ukraine

In 1993 PricewaterhouseCoopers was one of the first international professional services firms to establish its practice in Ukraine. As a company that has worked in Ukraine for over 10 years, we understand the issues that confront businesses here and the importance of finding practical solutions. PwC Ukraine now employs a large number of professionals providing high quality services to a number of world famous multinational corporations and influential Ukrainian enterprises. We see our main goals in providing effective solutions, and in sharing our global experience with our clients and thus reinforcing the competitiveness of the Ukrainian economy as a whole.

Whether you are a leading local enterprise, multinational company, government authority, or financial institution, we are able to offer you a full range of professional business advisory services that are designed to anticipate business trends, evaluate your organisation and deliver value through far-reaching strategies and solutions.

The following are major attributes of PwC Ukraine:

- A highly respected international name and reputation
- Our partners and managers have more years experience in Ukraine and internationally than any other professional services firm in Ukraine
- A highly professional and experienced team of full-time staff
- The highest skills and industry knowledge of our staff in the sectors most important to Ukraine, such as energy, oil & gas, telecommunications and information technologies, financial services, consumer and industrial products, manufacturing, services and agriculture
- Long term client relationships
- A diverse and well founded network of clients and contacts
- An active participant in Ukrainian business community via European Business Association and American/ British Chambers of Commerce
- Our firm is truly committed to Ukraine and its integration into the world community

In Ukraine, our client base includes the largest Ukrainian and multinational companies, as well as government institutions. Our close interaction with economic and state bodies allows us to keep up with the fast changing environment in which businesses have to work in Ukraine. We have over 170 professionals in Ukraine who are focused on providing you with constructive and efficient advice for your specific business. Our services include:

Assurance

Our Assurance Services comprise audits of financial statements prepared in accordance with IFRS other recognised frameworks, including advice on accounting requirements and internal control matters.

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Tax and Legal Services

Our tax advisers provide comprehensive tax advisory services on all aspects of Ukrainian, EU and international taxation. Our assignments include tax reviews, tax planning services, representation at tax disputes, tax due diligence and all aspects of tax compliance work.

Our legal advisors are highly skilled in many aspects of law and are well qualified to offer an extensive scope of legal services to Ukrainian and foreign commercial entities, specially in-bound investment and mergers & acquisitions. Moreover, our lawyers have access to the knowledge and experience of over 1,400 other legal professionals through our firm's legal network, Landwell.

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Advisory

Transaction Services are designed to help investors or business vendors maximise their deal value. Our specialists conduct financial and operational due diligence whose findings help our clients make decisions regarding the transaction and prepare for deal negotiations. We advise on the most efficient deal structure and provide overall support to deal makers.

Performance Improvement is aimed at helping clients improve their financial and operational performance. Relying on our expertise in finance, performance, IT systems and regulation the assistance we provide is targeted at providing confidence that your key business processes operate to predetermined standards; and, where appropriate strengthening management control, increasing operational effectiveness and thereby increasing shareholder value.

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