Doing business and investing in Ukraine

2007 Edition

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The information in this book is based on taxation law, legislative proposals and current practice, up to and including measures passed into law as of 1 May 2007. It is intended to provide a general guide only on the subject matter and is necessarily in a condensed form. It should not be regarded as a basis for ascertaining the tax or any other regulatory liability in specific circumstances. Professional advice should always be taken before acting on any information in the guide.

Contents

Partner letter

Ukraine may not yet be knocking on the door for membership in the European Union, but its vibrant economy, proximity to the EU, and strong relations with Russia makes Ukraine an exciting investment destination. It is also a challenging investment location.

Ukraine has extensive human capital, natural resources, and industrial potential. The country has undergone many positive reforms in recent years. Despite this, the legal framework has not yet fully caught up with the demands of international business. Complex laws and regulations, frequent law changes, and uncertain judicial enforcement of contracts still present barriers to foreign investment. A recent World Bank study ranked Ukraine as one of the more difficult and time consuming countries in which to pay taxes. Clearly much still needs to be done, but the country is witnessing significant change.

The problems are not stopping investors. Ukraine enjoyed more than USD 6 billion of foreign direct investment in 2006. There is extensive interest in the real estate market. The privatisation process is continuing, and some attractive state enterprises, including Ukrtelecom and the Odessa Port Plant, are yet to be sold. The 2012 European Football Championship has recently been awarded to Ukraine (and Poland) and this will further increase interest in the country.

PricewaterhouseCoopers has operated in Ukraine since 1993. We can draw on our significant experience in the local market, as well as the strength of our international network, to help you build value, manage risk, and improve the performance of your business in Ukraine.

A brief guide such as this cannot answer all your questions. However, it will provide you with valuable insight into the Ukrainian market, and make you better prepared to meet the challenges ahead.

We look forward to hearing from you and having the opportunity to work with you in the future.

Boris Krasnyansky
Managing Partner

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1 Country profile and investment climate

Investor considerations

- Ukraine's population is 46.8 million people.
- The annualised growth rate from 2000 to 2006 exceeded 7% (including 7.1% in 2006).
- Growth for 2007 is expected to be greater than 5%.
- Hints for business visitors may be found in Appendix A.

1.1 Introduction

Ukraine is located in the heart of Eastern Europe and occupies a land area of 603,700 sq km, which makes it the second largest country in Europe after Russia. It neighbours Poland, Slovakia, Hungary, Moldova and Romania to the west, Russia to the east, Belarus to the north and the Black Sea to the south.

Ukraine proclaimed independence on 24 August 1991, following the dissolution of the Soviet Union. On 1 December 1991, 90.3% of those who voted approved a referendum formalizing independence from the Soviet Union. The Union formally ceased to exist on 25 December 1991, at which time Ukraine's independence was recognized officially by the international community.

1.2 Government structure

The Head of State is the President. He is elected by popular vote for a five-year term. The current President is Viktor Yushchenko, who was sworn in on 23 January 2005.

Legislative power is exercised by a single-chamber Parliament, the Verkhovna Rada, which comprises 450 deputies and is elected every four years. The last parliamentary elections were held in March 2006 when, for the first time, all of the members were elected by party-list proportional representation.

The highest Executive body is the Cabinet of Ministers. It is headed by the Prime Minister (currently Viktor Yanukovych).The Cabinet of Ministers is nominated by the parliamentary majority and approved by the President.

As Ukraine is transitioning from a presidential into a parliamentary republic, the "balance of powers" between the President, Parliament and the Cabinet of Ministers may be changing.

Administratively, Ukraine is comprised of 24 regions and the Autonomous Republic of Crimea. The cities of Kyiv and Sevastopol also have a special legal status.

1.3 Legal system

Ukraine is a civil law country.

The Constitution, adopted in June 1996, sets out the structure of the national government, as well as its powers and functions. The powers of government are divided into three branches - legislative, executive and judicial.

Laws adopted by Parliament are forwarded to the President for signature. If the President signs the law, or fails to act within a 15-day period, the law is considered officially promulgated. The President has the right to veto legislation within the 15-day period, but such a veto can be overcome by Parliament with a two-thirds majority.

The Constitutional Court of Ukraine is the sole organ of constitutional jurisdiction of Ukraine. The 18 justices are appointed for a one-time, nine-year term. The President, Parliament, and a Congress of Ukrainian judges each appoint six justices. The justices select the Chief Justice from among themselves.

The court system in Ukraine has three branches:

- The commercial court system consists of local commercial courts (one in each region, plus Kyiv and Sevastopol), appeal courts, and the Supreme Commercial Court. The commercial courts generally resolve disputes between legal entities.
- The district court system decides civil disputes and criminal cases, including cases filed by individuals that are not private entrepreneurs. The structure consists of local district courts, regional appellate courts and the Supreme Court of Ukraine.

- Disputes involving state authorities will ultimately be dealt with through the Administrative court system. The Code of Administrative Procedure was adopted in 2005 to regulate court procedures in such disputes. However, the system is still being developed. In the meantime, disputes involving state authorities are generally decided in the commercial court or in the district court system, depending on whether the plaintiff is a legal entity or an individual.

The Supreme Court of Ukraine is the highest court, and has the power to review decisions of all three branches of the court system.

As an alternative to litigation, Ukraine allows for third party arbitration. Ukrainian law also allows foreign companies to include provisions in their contracts, including those with Ukrainian entities, that allow for arbitration by international arbitration institutions.

1.4 People

Population

Ukraine's population in January 2007 was estimated at 46.7 million people, which is 3.5% lower than the population in the last census in 2001. Five cities have a population close to or exceeding one million people, including Kyiv with 2.7 million people.

Ukraine follows the principle that a person may be a citizen of only one country. It is estimated that Ukrainian nationals make up 78% of the population, while Russian nationals account for 17%. More than two-thirds of the population live in urban areas. Females constitute 54% of the population.

Religion

A majority in the population are members of one of the branches of the Orthodox Church. National holidays are celebrated on Orthodox Christmas (January 7), Easter and Holy Trinity Day (see Appendix A for a list of holidays for 2007). Around 8% of the population are Roman Catholic, while 4% are Muslim, concentrated mainly in the Autonomous Republic of Crimea.

Language

The official language is Ukrainian, although a majority of the population is bilingual, speaking both Ukrainian and Russian fluently. English is also used in business, although not extensively. Many government websites have an English version (see Appendix B).

Living standards

Per capita income has been rising, but average wages remain comparatively low. For 2006, the average monthly salary for employees in Ukraine was UAH 1,041 (USD 206). Average salaries in Kyiv were more than 40% higher than any other region in the country.

Despite these statistics, Ukraine has developed an affluent middle class. Minimum rents in Kyiv exceed USD 300 per month and Ukraine has one of the fastest-growing passenger car markets in Europe (with more than 300,000 units sold in 2006). Restaurant prices in Kyiv are approaching, if not exceeding, those of major European cities.

Ukraine has a sizeable unofficial (hidden) economy. The Ministry of Economy in 2006 estimated the size to be at least 29% of GDP while other commentators suggest that the true level is significantly higher.

Unemployment

The official unemployment rate at 2006 year end was 2.7%, but this may not reflect the situation throughout the country. Estimates range between 7% and 9%.

1 Country profile and investment climate

1.5 Economy

Following eight years of declining GDP, the Ukrainian economy grew at an annualised rate exceeding 7% from 2000 to 2006. Some momentum has been lost, however, as needed economic reforms have not fully progressed. Growth for 2006 was 7.1%, while 2007 growth is expected to be greater than 5%.

A summary of key economic indicators for Ukraine is provided in Table 1.

Transport

Ukraine has a well-developed transport infrastructure, and is readily accessible by land or air. Ukraine has a railway network of 22,000 kilometres, and 169,400 kilometres of highways. Ukraine has 16 airports open to commercial air traffic. Most international flights go to Boryspil International Airport, about 40km southeast of Kyiv, although limited international airports also operate in Dnipropetrovsk, Donetsk, Ivano-Frankivsk, Kharkiv, Lviv (Sknilow airport), Odesa and Simferopol.

Table 1: Key economic indicators (drawn from official statistics)

	2003	2004	2005	2006
GDP (USD billion)	50.1	64.9	84.1	106.1
GDP growth	9.6%	12.1%	2.6%	7.1%
GDP per capita (USD)	1,049	1,367	1,759	2,206
Inflation (year-end)	8.2%	12.3%	10.3%	11.6%
Budget balance (% of GDP)	-0.2%	-3.2%	-1.8%	-2.1%
Officially registered unemployment (year-end)	3.5%	3.5%	3.1%	2.7%
ILO unemployment (year-end)	9.1%	8.6%	7.2%	6.8%
USD/UAH exchange rate (average)	5.33	5.32	5.13	5.05
New foreign direct investment (USD billion)	1.4	1.7	7.5	6.3
External debt (USD billion)	10.7	12.1	11.7	10.3
Exports FOB (USD billion)	23.7	33.4	35.0	45.9
Imports CIF (USD billion)	23.2	29.7	36.2	48.9
Credit Rating				
Standard & Poors	B	B+	BB-	BB-
Moody's	B1	B1	B1	Ba3
Fitch	B+	B+	BB-	BB-
Foreign Exchange Reserves (USD billion)	6.9	9.5	19.4	21.2

Communications

The mobile cellular telephone system has been expanding in recent years at a rapid rate. The three main mobile operators report that they have more than 50 million subscribers between them. There are estimated to be more than seven million internet users in Ukraine, and more than 90,000 internet hosts.

1.6 Foreign trade

Russia and the European Union account for more than half of Ukraine's trade. By contrast, although the national currency is effectively pegged to the US dollar, the US is a relatively small trade partner, accounting for only 3.2% of exports and 2.0% of imports for 2006. Steel accounts for more than 40% of Ukraine's exports.

Ukraine imports 90% of its oil and most of its natural gas. The country is heavily dependent on Russia for the supply of natural gas, and this has a significant impact on Ukraine's economic and foreign policy.

1.7 Further reading

Some general tips for business visitors on visas, currency and public holidays may be found in Appendix A.

2 Business environment

Investor considerations

- Ukraine remains a challenging place to do business.
- Many investment opportunities exist, but Ukraine is still developing the legal and institutional frameworks required to fully support international business.
- There is extensive interest in the real estate market.

2.1 Business climate

Since becoming independent in 1991, Ukraine has struggled to shift from a centrally planned economy to a market environment.

Since 2000, Ukraine has implemented significant positive economic and legal reforms. The economy grew at an annual rate exceeding 7% over the period to 2006, including 12% growth in 2004. The growth was fuelled by strong domestic demand, low inflation, and solid consumer and investor confidence.

Ukraine generally encourages foreign trade and investment, and laws allow foreigners to purchase businesses and property (but not agricultural land), repatriate revenue and profits, and receive compensation if property is nationalized. Much reform is still needed, as complex laws and regulations and weak enforcement of contracts by the courts still hinder foreign direct investment.

There has been a lot of interest recently in Mergers & Acquisitions (M&A). The 2006 PwC M&A Survey noted that the M&A market increased in size from USD 2.3 billion in 2005 to USD 3.4 billion in 2006, with an average deal value of USD 45 million. The deal volume rocketed from 85 in 2005 to 171 in 2006 - up 101%, making Ukraine the fastest growing M&A market in Central and Eastern Europe (CEE). The hot industries are manufacturing, financial services and food & beverages. The average deal size in 2005-06 was USD 114 million in financial services, USD 14 million in manufacturing, USD 11 million in retail & wholesale.

Superficially, taxes appear quite low - 25% for companies, 15% for individuals while value-added tax (VAT) is 20%. There are many underlying issues:

- Restrictions on deductions mean the effective corporate tax rate is close to 30%.
- Social security contributions can be significant. For 2007, employer contributions to various funds will exceed 36% for employees earning less than USD 1,560 per month (see Section 7.3 for further information).
- VAT refund constraints, as well as restricted rules for zero-rating sales of services to non-residents, mean that VAT can become a significant cost to business.

Although Ukraine has extensive human capital, natural resources, and industrial potential, it is clear that the country still faces significant challenges.

The 2006 World Bank Doing Business study ranked Ukraine as the second most difficult country in which to pay taxes out of 185 countries surveyed. This has more to do with the level of tax accounting required than intrinsic difficulties in following legislation. Nonetheless, there is clear room for improvement.

2.2 Economic development plans

Following the 2004 Presidential elections, the President's team has focused on improving transparency. Tax privileges for economic zones were removed entirely in early 2005. Privatisation sales have been made more transparent. Some headway has been made in bringing a large hidden economy into the open.

Unfortunately, the government has not developed a clear strategy for reform. The removal of incentives and attempts to unwind questionable privatisations sent disconcerting signals to investors about the stability and predictability of the investment framework.

The transition into a parliamentary system is also likely to present some challenges, so it may be some time before a clear economic blueprint is developed.

2.3 Free trade zones

There are currently no free trade zones in Ukraine, although there is some uncertainty about what will happen in the future. Parliament supported a draft resolution to the Cabinet of Ministers in August 2006, recommending that special tax regimes in free economic zones and tax incentives for technology parks be restored. There is no certainty that the draft resolution will be implemented.

2.4 European Union, NATO

In 2005, President Viktor Yushchenko stated that membership in the EU was a strategic goal of his foreign policy. In practice, Ukraine maintains especially close ties with Russia (including energy dependence) and balancing this relationship affects the speed with which Ukraine can move toward integration. The EU is expected to deepen economic and political ties with Ukraine, but is yet to formally indicate that Ukraine has prospects of future EU membership.

Ukraine has a close relationship with the North Atlantic Treaty Organisation (NATO), particularly with respect to emergency situations, technical cooperation, scientific studies and military and defence reforms.

2.5 International agreements

Ukraine has established diplomatic relations with approximately 170 countries.

Ukraine is a member of the United Nations, the International Monetary Fund (IMF), the World Bank, the European Bank for Reconstruction and Development (EBRD), the Council of Europe, as well as a number of other international organisations. Ukraine also cooperates with the Organisation for Economic Cooperation and Development (OECD), but is not a member.

Ukraine is currently in the final stages in its application for membership of the World Trade Organization (WTO), and is expected to become a member by 2007 year end.

In addition, Ukraine has concluded a number of bilateral agreements concerning trade, avoidance of double taxation, and mutual guarantees of investments. It also has a free trade agreement with Russia, as well as countries of the Commonwealth of Independent States (CIS).

2.6 Legal environment

The Ukrainian judicial system underwent significant reforms in 2002. Senior judges are now nominated by Parliament and appointed by presidential decree for five years, after which Ukraine's Supreme Council confirms them for life.

Although the system has improved significantly, there are still many problems. The Supreme Court is regarded as being an independent and impartial body, but the same cannot yet be said for the lower courts. Courts also remain under-funded, meaning they are often understaffed while judges may not have sufficient background to resolve adequately some modern issues in corporate law, taxation, bankruptcy, and intellectual property. Poor enforcement of court decisions is also a significant problem.

A legal framework exists and courts are always there as an option for resolving disputes, but issues may best be resolved outside of the judicial system. It is worth considering arbitration as an alternative dispute resolution mechanism when drafting contracts, although it needs to be recognised that the Ukrainian alternative disputes resolution mechanism is still developing and there is still a shortage of skilled arbiters in the country.

2.7 Property market

Foreign citizens and legal entities have the right to own apartments, houses, and other facilities. Ownership of non-agricultural land is also possible, although legal and regulatory restrictions and red tape can significantly complicate the process.

There is extensive interest in the real estate market, but a lack of investment grade buildings in Ukraine limits the opportunities for property investors. This creates a lot of opportunity for foreign developers, if they are prepared to navigate the legal and regulatory hurdles that currently exist.

Class A buildings are currently leasing at USD 40 to USD 55 per square metre, and providing yields of around 10% to 13%.

2.8 Foreign investor associations

There are a number of foreign business chambers in Ukraine, including the American Chamber (www.amcham.kiev.ua) and the European Business Association (www.eba.com.ua). Both chambers have active committees on various issues affecting business and investors in Ukraine. Contact details are provided in Appendix B.

As part of its ongoing efforts to present suggestions to the Ukrainian authorities for improving the investment climate, the European Business Association publishes a report entitled *Barriers to Investment in Ukraine*. The latest publication (2006) may be downloaded from their website.

3 Foreign investment and privatisation

Investor considerations

- There are very few restrictions on foreign investment.
- The Ukrainian legal system is still evolving.
- Ukraine has limited foreign exchange restrictions, but these should not create unmanageable problems.

3.1 Foreign investment

Investment climate

Ukrainian authorities regularly declare a keenness to encourage foreign investment and the broader public is well disposed to foreign investment.

There are few restrictions on foreign ownership. The major exceptions are publishing and broadcasting, and the manufacture of weapons. Otherwise, the regulatory framework for the establishment and operation of businesses in Ukraine by foreign investors is similar to domestic investors. As a general rule, investment permits are not required, but all enterprises must be established according to the form and procedure prescribed by law and registered with appropriate government agencies. Foreign investors are generally not required to seek special approval from authorities for foreign direct investments.

Both domestic and foreign investors still encounter difficulties at a practical level. These do not relate specifically to the issue of foreign ownership or investment, but rather to administrative hurdles that are arbitrarily enforced, or random delays.

Total foreign direct investment at 1 January 2007 stood at around USD 23.2 billion, according to data from the State Statistics Committee. Foreign direct investment in 2006 totalled USD 6.3 billion.

Regulatory legislation

Ukraine is still struggling to build a legal system that facilitates easy interaction with the international community. Many issues are not dealt with by a single law, so it may be necessary to piece several laws together to develop understanding of an issue. The various laws may also be ambiguous or contradictory, which complicates the issue further. There is no consolidated tax code, although there are plans to introduce one by 1 January 2008.

The following major pieces of legislation (in addition to taxation law) affect foreign investment into Ukraine:

- *On Procedure for Foreign Investments* sets out in broad terms Ukraine's policy on inward investment and the rights and obligations of foreign investors.
- The *Civil Code* regulates civil relationships, the establishment of legal entities and personal property rights.
- The *Commercial Code* was enacted on the same day as the Civil Code, and governs business relationships. The Commercial Code is intended to regulate issues that are not dealt with in the Civil Code, although in practice there is some overlap.
- *On Securities and Stock Market* governs the public issuance and trading of securities.
- *On Protection of Economic Competition* restricts business monopolies, and aims to ensure an efficient operation of the Ukraine economy through the development of competition. The majority of mergers and acquisitions in Ukraine are likely to require pre-approval from the Anti-monopoly Commission.
- *On Protection from Unfair Competition* aims to protect business entities and consumers against unfair competition.
- *On Environmental Protection* establishes a framework for pollution charges to be imposed on any legal entity that discharges contaminants into the environment.
- Intellectual property rights are governed by various laws, including *On Protection of Rights to Inventions and Useful Models*, *On Protection of Rights on Industrial Design*, *On Protection of Rights for Trademarks for Goods and Services*, and *On Copyright and Related Rights*.

Restrictions on foreign investment

As mentioned above, restrictions exist for foreign investments in the publishing and broadcasting sectors, and foreigners are not allowed to participate in the manufacturing of weapons.

Investment incentives

Ukraine eliminated all investment incentives in March 2005. In August 2006, Parliament supported a draft resolution recommending that special tax regimes in free economic zones and tax incentives for technology parks be restored.

The draft resolution has not been approved at the time of writing, and it remains unclear what government policy on incentives will be in the future.

Foreign exchange issues

Foreign currency is regulated by the 1993 Cabinet of Ministers Decree, *On The System Of Currency Regulation And Currency Control*, as well as a number of implementing rules issued by the National Bank of Ukraine (NBU). A number of foreign currency transactions may only be undertaken if an individual license is obtained from the NBU. However, there has been an ongoing trend toward less restrictive rules, the most recent development being the removal of the requirement that Ukrainian residents convert at least 50% of any foreign currency proceeds into local currency (hryvnia).

A 1% Pension Fund charge applies to the acquisition of foreign currency.

For further discussion on the foreign exchange rules, see Section 4.2.

Repatriation of capital and earnings

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.

Although not strictly required under the law, registration of the foreign investment may reduce complications in the future (withdrawal of capital, for example). This involves submitting a prescribed set of registration documents to the regional (oblast) state administration, the Kyiv or Sevastopol state administration, or the government of the Autonomous Republic of Crimea, as appropriate.

Guarantees and rights

Foreign investments are not to be subject to nationalisation, expropriation, requisition, or any other measure of similar effect, except when this is in the public interest. In such cases, compensation must be provided to the investor based on the market value of the property.

3.2 Privatisation

Background

Privatisation of medium and large-scale enterprises was developed in 1995 under the "Mass Privatisation Program" (MPP) project sponsored by USAID. In parallel, the State Property Fund (SPF), the government's privatisation authority, privatised many small-scale enterprises, primarily for cash. The MPP was initially planned for one year (1995-96), but ended up applying through to 1999.

On privatisation program for 2000-2002 was approved in mid-2000, and ended mass privatisation in favour of selling large, ideally controlling, stakes of strategic industrial enterprises to investors who would then develop the enterprise. Although only intended to define government policy for two years, the law continues to apply.

Kryvorizhstal sale (2004 and 2005)

Before 2005, many privatisation deals were considered questionable. Most prominent was the sale of the 93.02% stake in the Kryvorizhstal steel mill in June 2004 for USD 800 million to a local consortium.

When the new President, Viktor Yushchenko, took office in early 2005, he initiated court action against the Kryvorizhstal deal. In June

2005, the courts dismissed the deal and ordered that the company be resold. In October 2005, in a bidding process broadcast live on Ukrainian television, the stake was sold for USD 4.81 billion, well in excess of the USD 3 billion predicted by analysts.

The Kryvorizhstal sale demonstrated that transparent privatisation sales in Ukraine are possible. The previous government initially indicated that several other large pre-2005 sales would be reviewed for irregularities and a limited number are being pursued. However, there is no longer a clearly defined government policy of revisiting other sales.

Legacy of privatisation

The impact of Ukraine's privatisation can be assessed in terms of the following strategic changes in Ukraine's economy:

- The State has given up majority ownership in 90% of the industrial enterprises it owned in 1991. Millions of Ukrainian citizens have become shareholders and more than 60% of Ukraine's labour force work for private enterprises.
- Although many directors and managers of privatised enterprises are from the Soviet era, they are gradually being replaced by a new post-Soviet generation of directors and managers.
- 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.
- State budget support for unprofitable enterprises has been greatly reduced.

Privatisation calendar

It is difficult to talk of a privatisation calendar in Ukraine. Political considerations mean that the list of potential privatisations can be a moving target. For example, one of the more attractive entities still to be privatised is Ukrtelecom (a monopolist in the fixed-line communications market). Originally it was contemplated that a 92.9% interest would be sold, with analysts expecting proceeds in the region of USD 4.9 billion. Currently, the thinking appears to be toward the sale of a non-controlling interest.

Another example is Odessa Pryportovyi Plant. Analysts anticipate that a 94.5% interest will realise in the region of USD 1.4 billion. Because of its perceived strategic importance, however, the Plant has moved on and off the list several times in the past few years.

There is some volatility in the privatisation list, and it is necessary to monitor ongoing developments to identify opportunities that may arise. Currently, there are more than 500 entities on the privatisation list for 2007, but very little activity.

4 Banking, finance and insurance

Investor considerations

- There has been a significant level of international investment in the banking and insurance sectors.
- A number of banks have accessed global capital markets.
- Local currency (hryvnia) is pegged to the US dollar (5.05 since 2004).
- Consumer credit facilities are expanding rapidly.
- A full range of traditional banking services are available in Ukraine, although intermediation costs remain high.
- In November 2006, Parliament passed a law that will permit foreign banks to operate branch offices in Ukraine once Ukraine joins the WTO (expected in 2007).
- There are no requirements to convert foreign currency export proceeds into hryvnia.
- Leasing and factoring are possible, but these markets are in the early stages of development.

4.1 Banking system

Ukraine has a two-tier banking system. The National Bank of Ukraine (NBU) is Ukraine's central bank. Commercial banks, including the state-owned State Export-Import Bank of Ukraine (Ukreximbank) and the State Savings Bank of Ukraine (Oschadbank), operate under the authorisation and supervision of the NBU.

National Bank of Ukraine

According to the 1999 National Bank Law, the primary function of the NBU is to ensure the stability of the Hryvnia (UAH), the national currency of Ukraine. The NBU's objectives are also to maintain stability in the banking system, as well as price stability within the scope of its power.

The highest governing body of the NBU is the Council, consisting of 15 members. Seven members are appointed by Parliament, seven by the President, and the Governor (who acts ex officio as the fifteenth member) is nominated by the President and appointed by Parliament. The Council is responsible for developing the principles of Ukraine's monetary policy.

Banking sector

The Ukrainian banking sector was historically characterized by a number of significant weaknesses, including undercapitalisation, weak corporate governance and management, poor asset quality and excessive political intervention in some banks. The situation is improving and reforms are continuing. Banks are required to prepare accounts that are based on International Financial Reporting Standards (IFRS).

Most banking services are available, and consumer credit facilities are expanding rapidly. Intermediation costs remain fairly high, although the presence of Western banks, particularly in retail banking, should force the sector to become more efficient over time. In November 2006, Parliament passed a law that will permit foreign banks to operate branch offices in Ukraine once Ukraine joins the WTO.

As of 31 December 2006, 193 commercial banks were registered in Ukraine, out of which 170 banks have been granted licences by the NBU to perform banking transactions. There are around 40 representative offices of foreign banks.

The Ukrainian banking sector has a high level of concentration. According to data published by the NBU, over 50% of the banking sector's total assets were held by the ten largest Ukrainian banks. According to the NBU, as of 31 December 2006 the total loans granted by banks amounted to UAH 245 billion (USD 48.6 billion), and their total statutory capital amounted to UAH 26 billion (USD 5.1 billion). At least 35 banks in Ukraine had some foreign capital, of which 13 were fully owned by foreign owners, and 38% of the total statutory capital of all Ukrainian banks was represented by banks with foreign capital (these include four of the ten largest).

Commercial banks require a license from the NBU. The NBU has established requirements for capital adequacy, minimum statutory capital requirements and minimum regulatory capital requirements. For banks registering after 4 October 2006, the minimum statutory capital requirement is EUR 10 million.

4 Banking, finance and insurance

4.2 Foreign currency rules

Foreign currency operations are regulated by the 1993 Cabinet of Ministers Decree, *On The System Of Currency Regulation And Currency Control*, as well as a number of implementing rules issued by the NBU. A number of foreign currency transactions may only be undertaken if an individual license is obtained from the NBU. However, there has been an ongoing trend toward less restrictive rules, the most recent development being the removal in 2005 of the requirement that Ukrainian residents convert at least 50% of any foreign currency proceeds into local currency (hryvnia).

Some of the main points to note about Ukraine's current exchange control regulations are:

- Payments under foreign trade contracts between a resident and a non-resident entity should be in foreign currency only.
- Payments in foreign currencies between residents in the territory of Ukraine are generally prohibited (although there are some exceptions, such as bank loans).
- Salaries to Ukrainian staff must be paid in Ukrainian currency.
- Foreign loans must be registered with the NBU before funds are remitted to Ukraine. NBU rules also limit the maximum interest and other charges that may apply to foreign currency loans from non-residents.
- Proceeds from export must be credited to the exporter's Ukrainian bank account within 90 days from the date of customs clearance (for goods) or date of services delivery. Similarly, prepaid goods must be imported and cleared through customs within 90 days of payment. Failure to do so can result in a fine of 0.3% of the amount of due or paid for each day of delay.
- The purchase of foreign currency is subject to a 1% Pension Fund charge, which is withheld by the bank.
- Payments by Ukrainian business entities for services rendered by non-residents for amounts exceeding EUR 100,000 require confirmation from the Foreign Markets Monitoring Centre (FMMC) that the fee for the services does not exceed market prices. Provided relevant documentation is in place, this should not be more than an administrative issue. However, the process cannot be taken lightly. If the FMMC rejects an application, no payment will be permitted.

Ukrainian companies (and individuals) are required to obtain a license from the NBU for a number of transactions, including the following:

- Cash investments abroad for the acquisition of fixed assets, intangible assets, corporate rights, securities and derivatives.
- In-kind contributions and transfer of property to a foreign branch.
- Purchase of Ukrainian securities from non-residents.
- Opening bank accounts with foreign banks.

4.3 Specialised financial institutions

The Ukraine leasing market is still relatively small, but is growing rapidly. According to the Ukrainian Leasing Development Project run by the International Finance Corporation (www.leasing.org.ua), the number of active leasing companies in Ukraine more than doubled between 2004 and 2006. A number of foreign banks have established leasing companies, while other potential investors have already been to Ukraine to assess their development opportunities.

Aircraft, car and truck leasing account for around three-quarters of the leasing market.

4.4 Investment institutions

The law, *On Joint Investment Institutions (Unit Investment Trusts and Corporate Investment Funds)*, was enacted in 2001 and provides a framework for the establishment of mutual funds and investment funds. Some funds exist, but they are not yet a prominent feature in the Ukraine investment landscape.

4.5 Capital markets

The Ukrainian equity market has grown rapidly in the past few years. There are more than 250 traded companies, although the ten largest companies account for more than half of the market capitalisation. Despite its rapid growth, the equity market is highly fragmented, lacks price transparency, and is illiquid. It is estimated that around 90% of securities transactions occur outside the organized market.

There are several stock exchanges in Ukraine, but almost all trading is now effected through the PFTS Stock Trading System (www.pfts.com/eng), which went electronic in 2005 and was finally afforded stock exchange status in June 2006. Shares, domestic and external government bonds, municipal bonds, corporate bonds, Ukrainian treasury bills, savings certificates, investment certificates and other types of securities are traded through PFTS.

4.6 Insurance

The insurance market continues to develop in Ukraine, and is undergoing dynamic growth. There are more than 50 Ukrainian insurers with foreign capital, and a broad range of insurance services are available. The market is regulated by the State Financial Markets Commission, and initiatives to strengthen industry practices are ongoing.

There are significant restrictions on Ukrainian residents wishing to make insurance payments abroad.

5 Importing and exporting

Investor considerations

- Ukraine is expected to joint the World Trade Organization (WTO) by the end of 2007.
- Goods imported into Ukraine are subject to customs duties, excise tax (if applicable) and value-added tax (VAT).
- Ukrainian customs valuation rules comply with the Agreement on Implementation of Article VII of the GATT 1994.
- Ukraine has a free trade agreement with Russia and other CIS countries.
- The customs authorities scrutinise customs values and the classification of imported goods, and post-entry customs audits are expected to increase.

5.1 Trends in customs policy

In recent years, Ukrainian customs regulations have gradually evolved towards greater compliance with international practice. Effective from 1 January 2004, Ukraine implemented a new Customs Code. The Code incorporates the main provisions found in international customs conventions and WTO principles, and the customs classifications follow WTO guidelines.

Although the legal framework has developed, many administrative practices remain unchanged. Thus, although Ukrainian law allows customs authorities to conduct post-entry audits to verify compliance with customs and tax legislation, the authorities in practice are still exercising almost all customs control during the initial clearance of goods. Post-entry audits are expected to increase after Ukraine joins the WTO.

5.2 Import restrictions

Import licenses are required for the importation of a number of products, including plant protection chemicals, optical polycarbonate for manufacturing disks of laser reading systems, copper sulphate, ozone damaging substances, printer's ink, paper with water marks, many meat products, livestock and sugar.

There is a compulsory certification procedure to ensure 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. If this document is absent, goods cannot be imported into Ukraine.

5.3 Customs duties

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 (1997/98), 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.

Valuation rules

Ukrainian customs valuation rules comply with the Agreement on Implementation of Article VII of the GATT 1994. This means that the declared customs value is generally used as the basis for determining customs duties. The customs value should be determined in accordance with the six WTO valuation methods. The customs authority is entitled to assess duties on a higher value in certain circumstances.

Tariff rates

There are two rates of import duty under the Customs Tariff, reduced rates and full rates.

- Reduced rates of duty apply to most goods originating from countries that have granted Ukraine "Most Favoured Nation" trade status. These countries include most European countries plus China, Turkey and the US.
- Full rates of duty apply to goods originating from other countries, or where the country of origin cannot be determined.

Rates of duty may be ad valorem, specific (in monetary units per unit of goods), or a combination. There are seasonal, special, anti-dumping and countervailing duties. A selection of customs duty rates is provided in Appendix D.

Free trade agreements

In addition to the reduced rates mentioned above, Ukraine has concluded a free trade agreement with Russia and other CIS countries, as well as with Macedonia. These agreements allow goods to be imported into Ukraine duty-free, subject to compliance with rules of origin.

The 2000 CIS Rules for Determining Country of Origin are used to determine whether goods originate sufficiently from a particular country to qualify for duty exemptions under free trade agreements with CIS countries.

Excise tax

Excise tax is payable on cars, alcoholic beverages, tobacco products, beer, petrol and diesel fuel. Rates of excise duty are specific. A list of selected rates can be found in Appendix D.

Value-added tax

VAT is imposed on imported goods at a rate of 20%, unless expressly exempted under the VAT law (see Chapter 12). The taxable base is the higher of the contractual or customs value of the goods, plus the amount of any import duties and excise duties (if any).

Processing fee

Customs clearance of goods is subject to a customs processing fee, calculated as 0.2% of the goods customs value, up to a maximum fee of USD 1,000 per customs declaration.

Payment

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

5.4 Temporary import relief

Permission for temporary import/export with full conditional exemption from import taxes may be issued for the following items:

- Goods intended for display or use during exhibitions, fairs, conferences and similar events.
- Professional equipment used by mass media or required for making films.
- Containers, pallets, packaging or any other goods imported in connection with commercial transactions.
- Samples of goods and advertising films for non-commercial use, provided they remain in the ownership of an entity or person established outside Ukraine.
- Goods imported for educational, scientific or cultural purposes.
- Personal items of passengers and goods imported for sporting 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.

5.5 Customs duties incentives

Contributions to capital

Property (except for re-saleable goods) contributed by a foreign investor to the capital fund of a Ukrainian entity may be imported free of customs duty, but will still be subject to VAT. Customs duty must be repaid if the property is disposed of within three years of importation.

Toll manufacturing

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. The processing should meet the following criteria:

- Raw materials and finished goods must belong to the foreign customer.
- The tariff code must change as a result of processing.
- The cost of the raw materials must be at least 20% of the value of the finished goods.
- The imported raw materials must be the main component at each stage of production.

Finished goods (other than agricultural products) can be sold in Ukraine after tolling. However, such sales will oblige the non-resident owner of the finished goods to register a permanent establishment in Ukraine and pay applicable import taxes and duties.

Representative offices

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

5.6 Documentation and procedures

All goods crossing the border are subject to customs control, which includes specific procedures aimed at ensuring compliance with customs rules. The customs authorities may conduct post-entry audits to verify compliance with customs and tax legislation.

In addition to customs control, other types of border control including sanitary, veterinary, phytosanitary, radiological, ecological controls and control over cross-border movement of art, may be conducted.

Registration of importers

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

Documentation

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.

The importation of goods must be supported by complete documentation. The following import documents are required for all shipments to Ukraine:

- Import customs declaration.
- Cross-border contract.
- Invoice.
- Waybill.
- Compliance certificate (if any).
- Certificate of origin.
- Evidence of payment of customs duties and taxes.
- Any other documents as may be requested by Customs.

Missing or deficient documents may cause delays during customs clearance.

Declaration of customs value

The customs value is declared by filing a declaration of customs value, including reference to the valuation method used. The importer must also provide relevant documents to evidence the customs value. If these documents are not available or the customs office has grounded doubts about the data provided by the importer, the customs office may determine the customs value based on information available. This may include information available to the authorities on prices for identical or similar goods.

When the customs value requires review or the importer does not agree with the customs value determined by the customs office, the importer may request the customs office to release the goods for free circulation against payment of import taxes. The importer may then appeal the determination of the customs value by the customs authorities to a higher customs office or to the courts.

5.7 Warehousing and storage

To defer payment of import taxes and duties, goods may be stored in a warehouse of temporary storage (WTS) under customs control for up to three months before they are released under a specific customs regime. The 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 may be stored in a customs bonded warehouse (CBW) under customs control without payment of import duty and taxes, potentially for as long as three years depending on the nature of the goods. Not all goods, however, may be stored in a CBW. As for a WTS, a CBW may be either open or closed. A CBW operator must obtain the license of the State Customs Service of Ukraine.

5.8 Exports

Restrictions

A limited number of exports are subject to licensing and/or quotas. Examples include precious metals and stones, rolled metal products and textile products exported to the US, meat and certain metal products exported to the EU and Russia, and oil or gas of Ukrainian origin.

The Ministry of Economics has established mandatory indicative export prices for certain categories of goods, such as metal products, livestock and raw hides, and sunflower seeds. The Customs authority will not clear the export of goods if the sales price is below these indicative prices.

Registration of exporters

Any business entity that is engaged in export operations is required to register with the customs office that serves the area in which the company is located. Customs clearance of goods through another customs office requires specific permission from the customs office where the entity is registered.

Export duties

Ukraine has no export duties except on natural gas, scrap metal, livestock, raw hides and certain oil seeds.

Exported goods and ancillary services are zero rated for VAT purposes.

Customs processing fee

Customs clearance for exported goods is subject to a customs processing fee, calculated as 0.2% of the goods customs value, up to a maximum fee of USD 1,000 per customs declaration. The fee does not apply, however, to goods re-exported under a toll processing arrangement.

5.9 Protection of intellectual property rights

Owners of intellectual property rights may request Ukrainian customs authorities to register goods containing intellectual property, to prevent the illegal import or export of pirated or 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 has taken place. If the importer or exporter does not submit sufficient evidence, the customs office may seize the goods and impose penalties.

6 Business entities

Investor considerations

- For representation, information gathering and liaison activities, a non-commercial representative office is likely to be an acceptable vehicle.
- Establishing a legal entity is recommended for commercial activities, although a commercial representative office may be effective for a limited range of activities.
- For a 100% investment, a limited liability company (LLC) is usually recommended. It is cheaper and quicker to establish than a joint stock company (JSC), and is less regulated.
- Unincorporated joint ventures and partnerships exist as investment vehicles, but are not widely used.
- Branches of foreign entities are not explicitly recognised by law, and would prove difficult to establish.

6.1 Legal framework

Legal framework for business entities (effective from 1 January 2004)

The primary framework for establishing and operating legal entities in Ukraine is found in the Civil Code. Legal entities may be established in the form of joint stock companies, limited liability companies, additional liability companies, general partnerships or limited partnerships

The Civil Code and the 1991 law, *On Business Associations*, also deal with such issues as shareholder rights and obligations, corporate governance, and minimum capital requirements.

Commercial law

The Commercial Code (also effective from 1 January 2004) governs business relationships, and was intended to regulate issues that are not dealt with in the Civil Code. In reality, parts of the two Codes overlap, including a number of provisions dealing with the establishment and operation of legal entities. Furthermore, the two Codes do not always have consistent positions, and this creates uncertainty.

6.2 Forms of business organisation

Choice of business entity

Establishing a legal entity in Ukraine involves registering with the local state registrar, the tax authorities, the statistics office, and various pension and social funds, as well as opening a bank account and other formalities.

From a foreign investor's perspective, the choice will tend to be either a LLC, a JSC, or in limited circumstances a representative office engaged in either commercial or non-commercial activities.

For a 100% investment, using a LLC tends to be more convenient. It is easier and quicker to establish, has lower minimum capitalisation requirements (approximately USD 9,000), and is less regulated.

One potential issue with a LLC is that members may withdraw their contributions at any time by giving three month's notice. If another investor will be involved in an entity, establishing a JSC (or establishing a JV entity offshore) may be more prudent.

If an investor intends to carry out only preparatory or auxiliary activities in Ukraine, such as representation, information gathering and liaison activities, establishing a non-commercial representative office is a viable and convenient option, provided there is double tax treaty protection.

It is not possible for foreign entities to conduct full commercial activities (executing contracts, selling and accepting payments for goods, etc.) through a commercial representative office. Nonetheless, a number of law firms and other service providers have established their presence in Ukraine in this manner.

6.3 Net asset requirement

According to the law, if the value of a company's net assets at the end of the second and subsequent financial year is less than its share capital, the company must decrease its share capital and make relevant amendments to its Charter. There is no provision for a JSC to increase its capital to achieve this objective.

Furthermore, the law states that if the value of net assets falls below the statutory minimum capital, the company should be liquidated.

There is no further clarification in respect of these articles, no explanation as to who may enforce the provisions, and no major penalties for non-observance. The Securities Commission has recently indicated that JSCs (particularly banks and insurance companies) may need to follow the rules more strictly.

6.4 Limited liability companies

A limited liability company (LLC) does not have shares in a traditional sense. Instead, participants in a LLC own a percentage in the company's capital, as specified in its Charter. Because investors' interests in a LLC are not "securities," they are not subject to registration with the State Securities and Stock Market Commission. This means that a LLC can be established more quickly than a JSC, and is easier to maintain.

There are a number of key points that investors need to be aware of before establishing a LLC:

- Participants of a LLC may transfer their participation in the company's capital to third parties (non-participants) only with the consent of all other participants.
- A participant may withdraw from a LLC at any time by giving three month's notice. Upon withdrawal, a participant is entitled to his proportionate share of the assets of the LLC, although this will often involve cash settlement.
- A participant who systematically ignores or improperly fulfils his duties, or whose actions interfere with reaching the aims of the LLC, may be excluded from the LLC by a majority vote. The excluded participant is entitled to his proportionate share of the assets of the LLC at the time of exclusion.
- A participant's personal creditors may demand to withdraw the participant's share in LLC assets to settle obligations, if the participant's other property is insufficient to satisfy the creditors' claims.
- Because a participant may withdraw from the LLC, it is unclear whether contributions to such LLCs should be reported as equity or a liability from the LLC to the participant. This issue should not have any implications from a tax or legal perspective, but may impact on the LLC's ability to obtain finance from external sources, and could impact the IFRS accounting.
- A LLC does not generally require a financial audit unless demanded by a participant holding greater than 10% of the capital.

If a LLC will be 100% owned by a foreign investor, these issues are likely to have little practical implication. If one of more investors will be involved, however, the issues will need to be addressed when the LLC is formed. Some issues, such as the length of notice required for withdrawal from the LLC and the method of compensation, could be addressed by including appropriate timeframes and constraints in the LLC's Charter.

Formation procedures

A LLC may be established by a single shareholder, provided that shareholder is not itself owned by a single shareholder. The governing document of a LLC is its charter. The charter determines the company's objectives and scope of activities, the size of its statutory capital, the composition and competencies of the governing bodies and the rules for decision-making.

The distribution of shares of a LLC is set out in its charter. If shares are transferred, the Charter will need to be amended to record the change.

Generally, incorporation will take three to four weeks from the day documents are filed with the registration authority.

A LLC is deemed to exist as a legal entity from the date of its state registration.

LLCs may make "check the box" elections for US tax purposes.

Capital structure

The minimum capital requirement for a LLC is the equivalent of 100 Ukrainian monthly minimum wages at the time when the LLC is formed. The minimum salary increases on a regular basis. Based on the 2007 Budget Law, the following minimum capital requirements will apply for LLCs established in 2007.

Established on or after	Minimum wage	Minimum capital (UAH)	Est. minimum capital (USD)
1 January 2007	UAH 400	UAH 40,000	USD 7,900
1 April 2007	UAH 420	UAH 42,000	USD 8,300
1 July 2007	UAH 440	UAH 44,000	USD 8,700
1 October 2007	UAH 460	UAH 46,000	USD 9,100

At least 50% of the share capital of a LLC must be paid before the company may register. The remaining contributions must be paid within the first twelve months of the LLC's activity.

A LLC must create a reserve fund from net profits in the amount of at least 25% of its share capital. At least 5% of annual after-tax profits must be transferred to this reserve until the entire 25% fund is fully paid (this is not tax deductible).

It is possible for participants to contribute assets in kind to LLCs.

Relationship of participants, directors and officers

LLCs have two corporate bodies.

The Participants' Assembly consists of the participants of the LLC, each of whom has votes proportionally to its interest in the company capital. Quorum for a participants' assembly requires the presence of participants holding at least 60% of votes. Most resolutions are approved by a simple majority of the votes present at the Participants' Assembly, although resolutions amending the Charter and a limited number of other decisions must be approved by a majority of all participants' votes.

The Board of Directors (or Director) is the executive body of a LLC, and is responsible for managing the day-to-day activities of the LLC and representing the LLC against third persons. There is no formal requirement to appoint a company president, corporate secretary or any other office holder. The structure of the Board, its authority, and its working procedures are specified in the Charter of the LLC.

Liquidation, receivership

A LLC is liquidated if its participants agree to liquidate the LLC, its corporate term expires (if one is specified in the Charter), or it is ordered to be liquidated by the court. In a voluntary liquidation, preference in distribution is given, in order, to:

1. Indemnification of losses caused by disability, other health injuries or death, as well as creditors' demands secured by pledge or otherwise.
2. Employees' demands connected with labour relations.
3. Taxes and duties.
4. All other demands.

The preferences are slightly different for liquidation through compulsory liquidation (bankruptcy).

6.5 Joint stock companies

A joint stock company (JSC) is a legal entity whose share capital is divided into a specified number of shares of equal nominal value. The liability of shareholders in a JSC is limited to the value of their capital contribution.

A JSC may be established as an "open" or "closed" JSC. Shares in an open JSC may be offered to the public, freely transferred, and may ultimately be traded on a stock exchange. By contrast, shares in a closed JSC are distributed initially between its founding shareholders. Existing shareholders in a closed JSC also have pre-emptive purchase rights for shares offered for sale by the other shareholders.

The legal framework for JSCs is similar to that for LLCs. A brief comparative of the two vehicles is provided in Table 2.

Other points to note are:

Formation: The issued shares of JSCs (open and closed) must be registered with the State Securities and Stock Market Commission of Ukraine, which involves filing a set of documents prescribed by law. Processing of the application by the Commission may take up to two months.

Capital: The minimum capital requirement for a JSC is the equivalent of 1,250 Ukrainian monthly minimum wages at the time when the JSC is formed. Based on the 2007 Budget Law, the following minimum capital requirements apply for JSCs established in 2007.

Established on or after	Minimum wage	Minimum capital (UAH)	Est. minimum capital (USD)
1 January 2007	UAH 400	UAH 500,000	USD 99,000
1 April 2007	UAH 420	UAH 525,000	USD 104,000
1 July 2007	UAH 440	UAH 550,000	USD 108,900
1 October 2007	UAH 460	UAH 575,000	USD 113,900

Table 2: Quick comparison of joint stock companies and limited liability companies

	Joint stock company (JSC)	Limited liability company (LLC)
Registration	As for all entrepreneurs, legal and business entities, primary registration is made with the State Registration Department. A JSC must register shares that it issues with the State Securities and Stock Market Commission.	As for all entrepreneurs, legal and business entities, primary registration is made with the State Registration Department.
Minimum capital	1,250 Ukrainian monthly minimum wages (approximately USD 110,000).	100 Ukrainian monthly minimum wages (approximately USD 9,000).
Transfer of shares	There are generally no restrictions on the transfer of shares in an open JSC. For a closed JSC, other shareholders have a pre-emptive right to buy shares before they may be transferred to third parties.	Unless the Charter says otherwise, other contributors have a first right of refusal before shares may be sold to third parties.
Supervision	Regular reporting with the State Securities and Stock Market Commission.	No regular reporting, but annual accounts must be filed
Management requirements	• Shareholders' Meeting. • Supervisory Board (not required if there are fewer than 50 shareholders). • Management. • Audit Committee.	• Participants' Assembly. • Management. • Audit Committee
Statutory audits	There is an annual requirement to submit an audit report to the State Securities and Stock Market Commission.	Generally not conducted in practice.
Risks	• Liquidation if negative equity at end of the second or subsequent year of existence.	• Liquidation if negative equity at the end of second or subsequent year of existence. • Contributors may withdraw from LLC at any stage, given three moths notice.
IFRS	Shares are treated as equity investment	Because contributors may withdraw contributions at any time, financial reporting standards may require investment to be reported as loans.

Reporting requirements: JSCs are required to submit quarterly and annual reports to the State Commission on Securities and Stock Market. These reports include the annual audited financial reports, quarterly financial reports, reports on securities circulation, and details of any shareholders owning more than 10% of the shares. JSCs should also publish their annual report in the official media not later than 30 April of the following year.

6.6 Foreign directors

If a foreign national is appointed as a director of a Ukrainian company, local authorities will expect to see some form of contract relating to the individual. This will take the form of either an employment contract between the director and the company, or a management service contract between the company and a foreign entity.

Because of this, a foreign national that is to be appointed as a director of a Ukrainian company may need to obtain a Ukrainian Tax ID Code before the company is registered. To obtain a Ukrainian ID Code, the foreign national or his/her representative should file with the tax authority a set of documents established by the law. Obtaining an ID Code can take up to ten calendar days. The foreign national may also be required to obtain a Ukrainian work permit after the company's registration is completed.

6.7 Partnerships and joint ventures

The Civil Code allows for the establishment of general partnerships and limited partnerships as legal entities, but such vehicles are not widely used. Because partnerships are legal entities, there are no regulatory or legal advantages to conducting business through a partnership. Taxation is also imposed at two levels - at the partnership level and in the hands of the partners.

Joint ventures typically involve establishing a separate legal entity (JSC or LLC) in Ukraine. However, the Civil Code enacted in 2004 does recognise the concept of a joint venture (including simple partnerships) without the need to establish a separate legal entity. The relationship between the parties will generally be governed by the partnership agreement. Such agreements are commonly referred to as "joint activity agreements."

The use of joint activity agreements is still relatively unexplored. On the face of it such agreements may offer benefits over a LLC. There are no minimum capital requirements and capital impairment rules to contend with. A partner may still withdraw by giving three months notice, but the law contemplates that this could be treated as a breach of contract and damages paid. At the end of the day though, aggrieved partners would still be faced with having to resolve issues through the Ukrainian courts.

6.8 Branches

In Ukraine, it is not currently possible to register a branch of a foreign legal entity.

6.9 Representative offices

A representative office is not a separate legal entity and operates in Ukraine on behalf of the foreign company it represents.

From a tax perspective, local rules for representative offices are broadly in line with those found in other countries. The problem is that the broader legal framework has not been updated. This can create uncertainty when dealing with government agencies.

Nonetheless, if the foreign company intends to carry out only non-commercial activities, such as representation, information gathering and liaison activities, it should be sufficient to establish a representative office, provided there is a double tax treaty in place.

If activities are limited to services, then a commercial/taxable representative office may be a suitable option, and a number of professional services firms, for example, operate under this structure.

Lost in translation

Ukrainian law is written in Ukrainian, but professional firms typically provide advice to foreign investors in English or other languages.

There is no agreed standard for how the names of laws should be translated. For example, the Commercial Code is also referred to as the Economic Code. The law, On Company Income Tax, is also referred to as On Enterprise Tax or as On Business Tax.

Individual words within the law may also be rendered in different ways. For example, the Ukrainian word *товариство* in the Civil Code is equally well rendered as company, association, society or partnership.

As with investment into any other country, one cannot assume that labels used in Ukraine will mean the same as they do in the investor's home country.

A representative office should be registered with the Ministry of Economics of Ukraine (currently subject to a registration fee of USD 2,500), the Statistics Department, the tax authorities, and pension and social funds. A representative office should also obtain the right to use a seal from the Police department. Once the representative office is registered with the tax authorities and obtained a permit for a seal, it may open accounts in hryvnia and foreign currency in a Ukrainian bank.

Representative offices are subject to normal corporate income tax. However, an exemption may be available if the activities of the representative office are not sufficient to establish a permanent establishment under a relevant tax treaty.

A non-commercial representative office is generally not subject to VAT. A commercial representative office must register for VAT once its taxable sales for the previous 12 calendar months exceed UAH 300,000, although it may also register voluntarily.

7 Labour relations and social security

Investor considerations

- Ukrainian labour law still contains many socialist concepts, including a strong sense of the employee's right to work and restrictive conditions on employment.
- Employer contributions to various social security funds exceed 36% of an employee's gross income, up to a maximum income of approximately USD 1,600 per month.

7.1 Labour relations and the Labour Code

Employer / employee relations

Employment conditions in Ukraine are generally governed by the Labour Code, which was enacted when Ukraine was still part of the Soviet Union. The Code still contains many socialist concepts, including a strong sense of the employee's right to work, and many protections for employees.

Potential employers should familiarise themselves with the general provisions of the law. Consistent with many other countries, complying with local labour laws tends to be one of the bigger challenges facing investors.

Although employers can enter into individual labour contracts with employees, the terms of those agreements may not be worse than conditions guaranteed under the Labour Code. Contracting out of the provisions of the Labour Code is not possible.

Notwithstanding the above, the Code itself is not that strongly enforced. When issues do arise, they tend to be pursued directly with the courts, rather than through a relevant administrative agency. If employers are aware of and respect the statutory rights of employees, labour should not cause any significant issues for employers in Ukraine.

Unions

Unions have a visible place in the labour market. There is a specific law for Trade Unions. They are easy to establish and the law grants certain benefits to the unions. The largest trade union confederation in Ukraine, the Federation of Trade Unions of Ukraine (FPU), claims to unite more than ten million trade union members.

The Labour Code recognises collective agreements, and employers must accept collective agreements if demanded by employees.

If a collective agreement is established, it will be binding for all employees, even those who are not members of a trade union. The trade union will also monitor the employer's compliance with the agreement. In addition, approval of the trade union is required before overtime may be worked, and in some circumstances when an employee is being terminated.

7.2 Working conditions

Salaries and wages

Minimum wage levels are prescribed in the annual budget law. At the start of 2007, the minimum wage was set at UAH 400 (approximately USD 80) per month. According to the 2007 Budget Law, this increased to UAH 420 from 1 April 2007, and will increase to UAH 440 from 1 July 2007 and UAH 460 from 1 October 2007.

Wages and other payments to Ukrainian employees should be paid in local currency (hryvnia). Salaries should be credited at least twice each month. Wages and other payments to foreign employees may be paid in foreign currency credited on a monthly basis.

Working hours

In general, working time is restricted to 40 hours per week, with a five-day working week. An employer may introduce a six-day working week, but employers may then not work more than seven hours in a day.

Under the law, overtime is restricted. Employers "may only introduce overtime in the cases of emergency." The amount of overtime may not exceed four hours in any two-day period or 120 hours in a year. The law also requires overtime to be paid at double rates.

The Labour Code also contains provisions that entitle some employees to work shorter weeks. The working week is limited to 36 hours for employees performing work under harmful work conditions. Night shift is one hour shorter, as is the day before a national holiday. Employees must also, if requested, grant a short workday or workweek on proportional pay to a pregnant woman or to a woman having a child under 14, a disabled child, or who is caring for a sick family member based on a medical recommendation.

Paid holidays

There are ten official holidays in Ukraine (see Appendix A). In addition, an employee's minimum annual holiday entitlement is 24 calendar days. This increases to 31 calendar days for employees under the age of 18. When determining the length of a vacation for purposes of complying with the Labour Code, weekends during the vacation period are counted as vacation days but public holidays are excluded.

The law also requires additional leave to be granted to women who have two or more children under the age of 15 or a disabled or adopted child, and to single parents. Workers who are engaged in part-time studies may also be entitled to additional vacation leave.

Paid maternity leave is required for up to 70 calendar days before and up to 56 calendar days after childbirth. Payment is funded by the Social Security Fund, and is based on levels of income used for social security contribution purposes.

Equal opportunities

The Constitution of Ukraine and the Labour Code both preclude discrimination based on race, colour of skin, political, religious and other beliefs, sex, ethnic and social origin, property status, place of residence, linguistic or other characteristics.

In addition, Ukrainian law requires enterprises employing eight or more individuals to employ a minimum number of invalids - 4% of their total employees but no less than one working place. If an employer does not meet their quota, they are required to make a payment to the Fund for the Social Protection of Invalids equivalent to the enterprise's annual average salary (50% for enterprises with eight to 15 employees) for each working place that is not properly occupied by an invalid.

Termination of employment

Employment contracts may be indefinite or for fixed periods. Employees on indefinite contracts may terminate the employment relationship at any time by giving at least two weeks notice. For fixed term contracts, an employee may terminate employment only because of sickness or if disability prevents performance of work under the agreement, or the employer infringes provisions of the contract or the Labour Code.

The Labour Code permits employers to terminate employment relationships for such reasons as reorganisation, failure to perform duties, loss of trust in employees involved in financial matters, theft, etc. It is important, however, to ensure that all termination formalities are complied with. Among these, the statutory period for termination notice is two months.

In practice, employment is commonly terminated by mutual agreement.

Normal retirement age is 55 years for women and 60 years for men.

7.3 Social security system

Coverage

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.

Contributions

Mandatory contributions to Ukrainian social security and pension funds only apply if salary is paid through the payroll of a Ukrainian entity or the Ukraine representative office of a foreign entity. Voluntary contributions to the State Pension Fund, the Employment Insurance Fund and the Social Security Fund are also possible.

The taxable base for contributions (both employee and employer) is capped. For 2007, the cap is set at 15 times the living wage set for able-bodied persons (increased from ten times in 2006). Based on revised living wages, as amended by Parliament on 15 March 2007, the cap is/will be:

- UAH 7,875 (approx. USD 1,559) from 1 January 2007.
- UAH 8,415 (approx. USD 1,666) from 1 April 2007.
- UAH 8,520 (approx. USD 1,687) from 1 October 2007.

Contributions (both employee and employer) are not due on income that is not subject to personal income tax.

Employees' contributions

For employees of Ukrainian entities (including those employed by a representative office), social security contributions are withheld by the employer at source from salary payments, and remitted directly to the appropriate authorities.

From 1 January 2007, Ukrainian and foreign national employee's contributions based on gross remuneration are as follows:

- 0.5% to the State Pension Fund from that part of salary up to the subsistence minimum set for able-bodied individuals, and 2% from that part of gross salary exceeding this amount.
- 1% to the Social Security Fund. A lower 0.5% rate applies if the employee's gross monthly salary does not exceed the subsistence minimum set for able-bodied individuals.
- 0.5% to the Employment Insurance Fund. Non-Ukrainian national employees and working pensioners are not required to make contributions.

The subsistence minimum for able-bodied individuals is set at the following levels for 2007:

- UAH 525 from 1 January 2007.
- UAH 561 from 1 April 2007.
- UAH 568 from 1 October 2007.

Foreign nationals remaining on a foreign payroll are not liable to pay social contributions in Ukraine.

Employers' contributions

Ukrainian employers are liable to pay social security contributions in respect of their Ukrainian and foreign national employees. From 1 January 2007, the following rates apply based on gross remuneration:

- 33.2% to the State Pension Fund.
- 1.5% to the Social Security Fund.
- 1.3% to the Employment Insurance Fund.
- 0.66% - 13.6% to the Fund for Social Insurance regarding Accidents at Work.

The rate for the Fund for Social Insurance should be determined by the Fund's authorities specifically for each entity, and depends on the level of accident risk of the entity's industry sector. In most cases, the rates will be in the region of 1% to 2%. The extreme rates are only likely to apply to high-risk activities (e.g., mining, working with highly inflammable materials).

Penalties for non-compliance

There are potentially heavy penalties for non-compliance with social security obligations, particularly for contributions to the Pension Fund. For payments to the Pension Fund:

- If the Pension Fund identifies that salaries subject to contributions have been underreported, the penalty for the first offence is 100% of the taxable base for contributions (i.e., the employee's income, rather than the amount of contribution). For subsequent underreporting identified within one year of the first offence, the penalty is 300% of the underreported income.
- Late reporting attracts a 10% per month penalty for the first offence, and 20% per month for subsequent offences within one year of the first offence.
- Late payment is subject to a 10% penalty if payment is made up to 30 days late, 20% if payment is made between 31 and 90 days late, and 50% if more than 90 days late.

Interest on late payments is charged at the rate of 0.1% per day, based on the amount of underpaid contributions.

Penalties are separately imposed by the Social Security Fund, Employment Insurance Fund and the Fund for Social Insurance regarding Accidents at Work. As the penalties are based on contributions (rather than salary levels), the potential penalty exposures are much lower than for the Pension Fund. However, penalties of up to 300% of underpaid contributions are possible for repeated offences.

7.4 Foreign personnel

Fiscal registration number

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 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.

Residence permit

Foreign nationals arriving legally in Ukraine may temporarily stay in the country on the basis of their passport and relevant entry visa (if required).

If a foreign national stays in Ukraine for more than three months for foreign nationals from countries with visa-free entry, or six

months for other foreign nationals, the foreign national's passport must be registered with the local agency for internal affairs (police/OVIR). A written application of the foreign national and their local employer must be submitted not later than three working days before the three or six month period expires. The extended registration will be evidenced by a registration stamp affixed to the foreign national's passport.

Work permit

Ukrainian employers must obtain work permits for foreign nationals who are either directly employed by local companies or seconded to work in Ukraine by foreign companies.

Work permits are not required for the personnel of representative offices of foreign companies who are employed abroad, for foreign nationals registered as private entrepreneurs under Ukrainian legislation or for foreign nationals having permanent residence status 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 submission.

Non-compliance with the work permit requirements is subject to penalties, as well as potential deportation of the foreign national from Ukraine at the cost of the employer.

8 Accounting and audit requirements

Investor considerations

- In principle, local accounting standards should not contradict international accounting standards. In practice, there are gaps between the two and separate books may be required.
- JSCs are subject to an annual audit requirement and must publish their annual financial statements. This is generally not required for LLCs.
- Tax accounting is separate from financial accounting and may require duplication of recording. Tax accounting rules are prescriptive, and operate independently of accepted accounting principles.
- The short form Chart of Accounts may be found in Appendix E.

8.1 Accounting

International Financial Reporting Standards

The Law on Accounting and Financial Reporting, effective from 1 January 2000, introduced National Accounting Regulations (Standards) (NR(S)AU). The law states that these local standards should not contradict International Financial Reporting Standards (IFRS), but in practice there are gaps between the two. As at 31 December 2006, 31 NR(S)AU standards have been adopted.

Ukraine accounting regulations

Ukrainian entities, as well as representative offices of foreign entities, must maintain accounting records and financial statements in accordance with NR(S)AU. Financial statements are prepared for a calendar year and relevant interim periods, and must be prepared in Ukrainian UAH as the reporting currency. The financial statements include the balance sheet, income statement, cash flow statement, statement of changes in equity, and notes to financial statements.

Financial statements should be submitted to the founders or shareholders of a legal entity, labour collectives (if required), and the state statistics authorities and registrar.

Other government agencies (e.g., State Commission on Securities and Stock Exchange, NBU, State Commission on Regulation of Financial Services Markets in Ukraine) may prescribe additional requirements for entities under their jurisdiction.

The enterprise's owners or the managing director are responsible for organizing the accounting function and ensuring that all economic transactions are recorded in supporting documents, ledgers and financial statements.

JSCs, bonds issuers, banks, trusts, stock exchanges, investment funds and investment companies, credit unions, non-state pension funds, insurance companies and other financial institutions are required to publish their annual financial statements and consolidated financial statement in the periodical press or by distributing them in the form of individual printed editions.

Differences between NR(S)AU and IFRS

Although NR(S)AU are generally based on IFRS, they are not identical. There are still areas for which no local standards have been introduced (e.g., Accounting for Government Grants and Disclosure of Government Assistance, Interim Financial Reporting, Investment Property, Share-Based Payments). In addition, when local standards do exist, they often lack the detail and some of the disclosure requirements found in IFRS.

NR(S)AU have less interpretative guidance, explanations and illustrations than IFRS, which inevitably leads to some confusion in the application of local standards. This undermines the comparability and quality of financial statements in Ukraine.

Tax considerations also play a role in local standards. Over the past several years, Parliament has enacted numerous tax accounting rules that operate quite independently of accepted accounting principles. For example, new buildings acquired after 1 January 2004 may be depreciated for tax purposes at a rate of 2% per quarter on a reducing value basis, and NR(S)AU 7 "Property, plant and equipment" provides for several depreciation methods, including methods stipulated by Ukrainian tax law. This is not fully consistent with IAS 16, which requires the depreciation method to reflect the pattern in which the asset's economic benefits are consumed by the enterprise.

8.2 Chart of accounts

According to the Decree №291 of the Ministry of Finance all Ukrainian legal entities should use the specified chart of accounts.

The chart of accounts represents the whole system of accounts, within which each account has a title and numerical symbol, and is assigned to a specific class or group.

According to a decree from 2001, small businesses, non-profit non-government organizations and foreign business entities' representative offices are permitted to use a simplified set of accounting rules. In addition to the statutory accounts, Ukrainian taxpayers need to maintain a separate set of tax accounting records.

A short form Chart of Accounts may be found in Appendix E.

8.3 Audit requirements

Auditing is primarily regulated by the Law on Auditing, which outlines requirements for auditing firms and auditors in individual practice, regulates auditing methodology, and sets out the legal framework of operations for the Chamber of Auditors of Ukraine (UCA) and the Professional Public Union of Auditors of Ukraine.

The UCA is responsible for approving audit regulations and standards, carrying out the certification of auditors, approving programs of professional training for auditors, and maintaining the register of auditing firms and auditors in individual practice that are eligible to provide audit services in Ukraine.

The UCA adopted the International Standards on Auditing (ISA) as the Ukrainian standards with effect from 1 January 2004.

Several other laws (e.g., Law on Financial Services and State Regulation of Financial Services Markets, Law on Banks and Banking Activities, Law on Securities and Stock Market, Law on Insurance) establish additional requirements for audits and auditors for selected industries.

Audits required by law

Under Ukrainian law, audits are mandatory for a range of enterprises, in particular:

- banks;
- insurance companies;
- JSCs;
- bond issuers;
- investment funds, trusts and other financial enterprises;
- brokers and traders;
- other companies identified in the "Ukraine accounting regulations" section above that are required to publish their financial statements.

9 Tax system and administration

Investor considerations

- Ukraine has a volatile tax system, and legislative amendments are frequent.
- Residents are taxed on worldwide income. Non-residents are taxed only on income from Ukrainian sources.
- Corporate profits are subject to 25% tax. Dividends are separately taxed at the shareholder level in the hands of individuals and foreign shareholders.
- Ukraine has a relatively high VAT rate (20%), but a low flat rate of tax on individuals (15%).
- With the exception of agricultural enterprises, the fiscal year for taxpayers follows the calendar year.
- The penalty for failing to deduct and remit withholding tax when required is 200%, plus interest.
- A recent World Bank study concluded that Ukraine was one of the most difficult countries in which to pay taxes out of the 185 countries surveyed.

9.1 Tax system

The Ukrainian tax system is evolving rapidly. The direction of reform is generally positive, although it is sometimes unpredictable. Tax laws have been revised frequently, sometimes several times in one month, and there are still many issues that need to be addressed. Tax law is often poorly worded, which results in ambiguous interpretation and increases the risk of disagreements between taxpayers and tax authorities.

Ukraine is not an easy country in which to pay taxes. In the recent "Paying Taxes" study released by PricewaterhouseCoopers and the World Bank, Ukraine was identified as one of the most difficult countries in which to pay taxes out of the 185 countries surveyed. Many companies employ tax accountants in addition to financial accountants as tax accounts are separate from financial accounts. The study estimated that a modest-sized domestic business would need to make 98 tax payments each year, and would require 2,185 hours per year to comply with its tax compliance requirements.

For several years, there have been discussions about consolidating the various revenue laws into a single Tax Code, which should ease compliance and administration. A new initiative is underway to have this introduced into Parliament sometime in 2007, and to apply from January 2008.

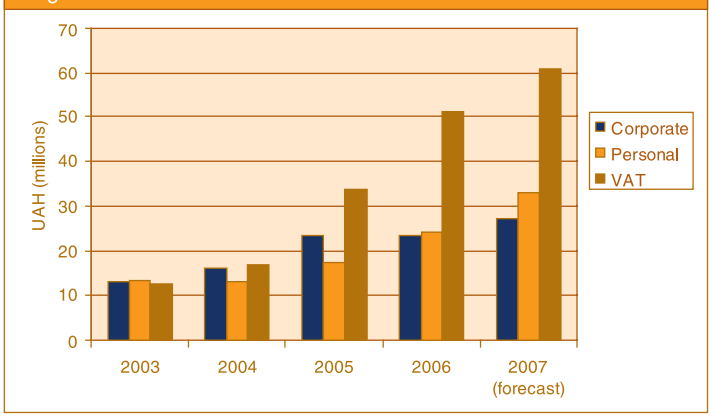
An interesting feature of the Ukrainian tax system is a simplified or unitary tax available for many small businesses. Qualifying sole proprietors opting to use the system pay a fixed amount of tax, while eligible entities pay a fixed rate of tax based on their revenues. In both cases, the businesses are exempted from income tax, a number of other small taxes, and potentially value-added tax (VAT). The corporate regime is discussed in Section 10.1, while the regime for individuals is discussed in Section 11.2.

9.2 Direct and indirect tax burden

Taxation accounts for around 73% of government revenues. More than three-quarters of this is collected through corporate income (profits) tax (CPT), personal income tax (PIT), and VAT.

Tax collections have increased rapidly over the past five years. The trend in income tax and VAT collections for the period 2002 to 2006 is illustrated in diagram 1.

Diagram 1. Tax collections



Source: Ministry of Finance

It can be seen that the reduction of the individual tax rate in 2004 significantly increased the collection of individual taxation.

A 15% increase in overall tax revenues is forecast for 2007.

9.3 Principal taxes

On Taxation System, the law that provides the general framework for taxation in Ukraine, provides for 28 national taxes that may be imposed. The principal taxes and compulsory payments are:

- Corporate income (profits) tax (CPT) (see Chapter 10).
- Personal income tax (PIT) (see Chapter 11).
- Value-added tax (VAT) (see Chapter 12).
- Pension Fund charge (see Section 10.6).
- Excise tax and import duties (see Chapter 5).
- Land tax (see Section 10.6).
- Stamp duty (see Section 10.6).

On Taxation System also provides for two taxes and 14 duties that may be levied at the discretion of local authorities. The main local taxes affecting business are the advertising tax, municipal tax, and the charge for using local symbols.

Employers and employees must also make mandatory contributions to the state pension and social security funds. The rates and maximum contributions are set in the annual budget law and may result in a significant cost burden for employers (see Section 7.3 for further information). There has been widespread discussion on reducing the burden as it is considered to have a negative impact on economic growth.

9.4 Legislative framework

Statute law

According to the Constitution, taxes and levies, as well as penalties for non-compliance, may only be established by laws enacted by Parliament. Parliament exercises this prerogative frequently, and it is quite common for more than twenty amendments to be made to the various Ukraine tax laws each year, sometimes with potentially retroactive effect. Although many amendments are very minor, the frequent changes, as well as the government's failure to proceed with declared intentions and schedules for tax reform, have earned Ukraine the reputation of having an unpredictable tax system.

Strictly speaking, the State Tax Authority (STA) does not have discretion to amend the law, but in practice, the STA often issues tax clarifications that are not always consistent with the law, although this can be a function of ambiguities in the law as much as anything else. Nevertheless, it is prudent to consider STA interpretations and the risk of conflict with the STA before taking a position based on the law.

9.5 Tax treaties

Ukraine has a broad network of tax treaties, with 60 treaties in force as at 1 January 2007. Rates are reduced to as low as 0% under some treaties for dividends, interest and royalties. A summary of withholding rates under the various treaties is provided in Appendix C.

Taxpayers do not require confirmation from the tax authorities before claiming relief under a treaty. However, the withholding agent must hold a certificate of residence from the treaty country for the person to whom income is paid. If the certificate 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 only valid for the calendar year of its issuance and must, therefore, be renewed annually.

Currently, one of the most favourable treaties is the Ukraine-Cyprus treaty, which provides for 0% withholding tax on dividends, interest and royalties. However, the treaty has recently been renegotiated (but not ratified), and increased rates will apply (10% on interest and royalties, 5/15% on dividends) after it has been ratified.

9.6 Administration of the tax system

National taxes are administered by the STA. Local taxes are administered by the various local governments.

The allocation of revenues between national and local governments is set out in the annual budget law. Revenues are

allocated based on source, rather than by amount. For example, revenues from personal income tax, although administered by the STA, are often allocated to local government. One consequence is that payments for some national taxes may need to be made to local government accounts.

9.7 Registration requirements

All taxpayers are required to register with the STA and to obtain a tax number. Registration is undertaken through the local tax office where the individual or business is located.

Without a tax number, it is not possible to open a bank account in Ukraine.

9.8 Tax returns and payments

Personal income tax returns are filed for each calendar year. Individual taxpayers whose entire income is subject to withholding tax at source (e.g., salaries) are not required to file income tax returns, although they may choose to do so if they are entitled to a tax credit. The personal income tax return must be filed by 31 March of the following year.

Corporate income tax returns are filed on a quarterly basis, and returns must be filed within 40 calendar days of the end of each quarter. Resident companies and non-resident entities with a permanent establishment in Ukraine must keep records that comply with Ukrainian tax rules.

Withholding taxes must be paid to the state not later than the date that the income is paid. Tax in respect of income that is accrued but not paid to individuals should be transferred to the state within 20 calendar days of the last day of the reporting month.

Value-added tax returns are generally filed on a monthly basis. The return must be filed within 20 calendar days of the last day of each month. As an exception, VAT-registered persons with annual sales of less than UAH 300,000 may opt for quarterly filing.

If the filing date for any return falls on a weekend or a public holiday, the return should be filed on the following working day.

Payment of tax must be made within ten calendar days from the day on which the return is required to be filed or the assessment is issued. Payments are normally made through designated bank accounts.

9.9 Assessments

Taxpayers make returns and payments on a self-assessment basis. However, if the tax authorities determine that the tax shown on the return is incorrect, they may assess taxes within 1,095 days (three years) from the deadline for filing a return or the date on which the return is actually filed, whichever comes later.

There is no limit on the period in which an assessment may be made if a taxpayer has deliberately evaded tax (if proven in court) or when a taxpayer fails to file a return. The tax authorities will also charge significant penalties for late filing or understatement of tax liabilities (see Section 9.13).

9.10 Appeals

Assessments may be appealed administratively or through the court system. The initial appeal is made to the local tax office that issued the assessment. If an appeal is rejected, a taxpayer may appeal in turn to the regional and national office.

An administrative appeal must be filed to the relevant level of the tax administration within ten calendar days of receiving an assessment or official advice that an administrative appeal has been rejected at a lower level.

The tax authorities must respond to the appeal within 20 calendar days. If they fail to do so, the appeal is deemed to be decided in favour of the taxpayer. The 20-day period may be extended by up to 60 days, but only if the authorities advise the taxpayer in writing within the initial 20-day period.

At any stage of the process, or if the national office rejects the appeal, a taxpayer is entitled to pursue an action through the courts instead.

Submitting an appeal suspends the requirement to pay the assessed tax, as well as the accrual of interest and penalties. Interest and late payment penalties will apply only if the taxpayer fails to pay the taxes by a revised due date after the appeal is finally resolved.

9.11 Withholding taxes

It is very important to ensure that withholding taxes are properly deducted and accounted for. Businesses generally have an obligation to withhold tax on payments to individuals (including sole proprietors) and payments to non-residents. Failure to withhold tax can attract a 200% penalty, as well as interest.

Withholding tax must be remitted to the authorities no later than the date when the payment is made to the income recipient.

Passive income (dividends, interest, royalties) from Ukrainian sources that is paid to non-resident entities is generally subject to 15% withholding tax. Other payments, including "engineering services," lease payments, agency and brokerage fees, are also subject to 15% withholding tax, but payments for most other services are not subject to withholding.

In addition, 15% withholding tax applies to gain on the sale of property, including real estate and securities, when paid by a resident to a non-resident entity.

All withholding tax rates may be reduced under a relevant tax treaty.

Payments to non-resident persons for advertising services performed in Ukraine are not subject to withholding. However, the resident payer is required to pay, from its own funds, a 20% tax based on the value of such services.

A resident payer is similarly required to pay, from its own funds, a 12% tax if a payment is made to a foreign insurer or reinsurer whose rating of financial reliability does not meet requirements set by the authorised state agency. A 0% rate applies otherwise.

As the taxes on advertising and insurance are levied on the resident party, they cannot be relieved using a tax treaty.

9.12 Tax audits

The tax authorities may carry out scheduled audits a maximum of once each year. Business entities must be notified of the audit in writing at least ten days before the scheduled audit. For normal business entities, the scheduled audit should be carried out within 20 business days, although the period may be extended by up to ten days.

In addition, the tax authorities may perform out-of-schedule audits in any of the following circumstances:

- A taxpayer does not respond within ten days to a request for information from the tax authorities when the tax authorities are cross-checking information, the cross-audit of another business entity has revealed a violation by the taxpayer, or the data in a tax return is inadequate.
- A business entity does not file tax returns on a timely basis;
- A taxpayer initiates an appeal process against an assessment;
- A business entity is reorganized or liquidated;
- A tax police investigation requires that a taxpayer's accounts be audited;
- A taxpayer claims a VAT refund for an amount exceeding UAH 100,000.

The duration of an out-of-schedule audit cannot exceed ten business days.

Before starting an audit, the tax inspector must present a written order to the taxpayer, outlining the scope and period of the tax audit.

9.13 Penalties

Penalties are often specified in terms of a multiple of the monthly "non-taxable allowances," which is currently UAH 17.

Multiple penalties may be imposed, and total penalties may potentially exceed 150% of the tax. Liability is assessed by the tax authorities.

Late filing

In addition to a nominal penalty, if the tax authorities assess tax when a taxpayer fails to file a return, penalties could reach up to 50% of the tax assessed, depending on the period of delay.

Late payment of tax

If a taxpayer does not pay the amount of tax shown in its tax return on time, or fails to pay an assessment within the time shown on the assessment notice (or if the taxpayer appeals the assessment, within ten days of the final resolution of the appeal), penalties are imposed as follows:

- 10% of the underpaid tax for delays of up to 30 calendar days;
- 20% of the underpaid tax for delays of 31 to 90 calendar days;
- 50% of the underpaid tax for delays exceeding 90 calendar days.

Understated tax liabilities

If during an audit the tax authorities determine that the tax liability shown in the taxpayer's return is understated, they will impose penalties of up to 50% of the tax assessed, depending on the timeframe involved.

Furthermore, a penalty of 50% of the tax assessed will be imposed if a taxpayer understates its tax liabilities by a "large" amount. The Criminal Code defines "large" to be any amount over UAH 600,000 for 2007. Consequently, a total penalty of 100% may apply.

Tax evasion

In addition to the above, if a taxpayer (or officials of the company) are convicted of tax evasion, a penalty of 50% of the tax due will be imposed.

The individual taxpayer (or officials) may also be subject to penalties under the Criminal Code. For a first offence, fines of up to UAH 340,000, prohibition from occupying certain positions or engaging into certain activities for up to three years, or imprisonment for up to five years may be imposed.

Failure to withhold and pay tax

If a taxpayer does not pay tax when it is a mandatory condition for the sale of goods, or a taxpayer fails to withhold tax when required, a penalty of 200% of the deficient tax is imposed.

Arithmetic or methodological errors in tax return

If the tax authorities determine during a "desk review" that arithmetic or methodological errors in a tax return resulted in an understatement of tax liabilities, a penalty will be imposed of 5% of the additional tax assessed.

Interest for late payments

When tax is not paid on time, interest for late payment is charged on a daily basis in addition to the above penalties. The rate is 120% of the NBU prime rate that is effective at the date the payment was due or the date that payment was made, whichever is higher.

For amounts calculated on the tax return, interest accrues from the date the tax was due. When the tax authorities assess tax, interest accrues from the due date for payment shown on the notice.

Interest is charged on the entire outstanding tax, including penalties.

Voluntary disclosures

If a taxpayer voluntarily discloses and pays the underpaid tax before the tax authorities commence an audit:

- A 5% penalty should be paid based on the amount of under-declared tax.
- Interest will not be charged.

To benefit from this rule, a taxpayer must have filed an amended tax return. Normal penalties and interest will also still accrue if a court rules that the taxpayer had evaded tax.

Penalties during appeal

Penalties and interest do not accrue during the appeal process (see Section 9.10).

9.14 Tax clarifications

Tax clarifications may be sought from the tax authorities, and the tax authorities are required to issue such clarifications.

Tax clarifications are not legally binding and do not provide solid protection against tax assessments and penalties. However, in practice tax clarifications are useful in resolving disputes with local tax authorities regarding uncertainty in the tax legislation.

10 Taxation of corporations

Investor considerations

- The standard corporate tax rate is 25%.
- For insurance companies, net insurance premiums are subject to a maximum tax of 3%.
- Qualifying small companies may opt to use a simplified tax system.
- There is no group consolidation.
- Depreciation is based on the reducing balance method. and relatively generous rates are available.
- Losses may be carried forward indefinitely (but are often restricted in practice).
- When companies pay dividends, they are generally required to pay advance corporate tax of 25%. They may also need to deduct up to 15% withholding tax.
- Taxable profit is based on the "first event rule."
- Returns and payments must be made on a quarterly basis. An eleven-month return is also required in 2007 (and in most years).

10.1 Corporate tax system

Companies

Ukrainian entities and foreign entities doing business in Ukraine through a permanent establishment are liable for corporate income tax. The standard rate is 25%.

Special rules apply to Ukraine insurance companies. Net insurance premiums (gross premiums less amounts paid to reinsurance companies) are taxed at 0% for long-term life insurance premiums and pension insurance premiums, and 3% otherwise. Profits earned by insurance companies from non-insurance activities are taxed at the standard rate.

Qualifying small legal entities may opt to use the simplified taxation, accounting and reporting system. VAT-registered entities pay 6% of their sales proceeds under the simplified tax system, while non-VAT-registered entities pay 10%.

Dividends

Companies paying dividends are generally required to pay advance corporate income tax at the standard rate. The advance payment is used to meet their subsequent corporate income tax liabilities (other than for insurance companies). If the advance tax is not able to be used in the year the dividend is paid, it is carried over to future income years, but it cannot be refunded.

The advance tax is not paid by companies deriving more than 90% of their income from dividends.

Companies must also deduct withholding tax from dividends paid to individuals and foreign entities. For dividends paid to resident or non-resident individuals, or to foreign entities (including those with a permanent establishment in Ukraine), the standard rate is 15%. A lower rate may apply under a relevant tax treaty.

Territoriality

Resident entities are legal and business entities whose personality or existence is established under Ukraine law. Non-resident entities are those whose existence is established under foreign law.

Resident entities are liable to Ukrainian tax on their worldwide income. Foreign taxes should be available for credit against Ukrainian tax liabilities, but may be difficult to obtain in practice.

Foreign entities are liable to Ukrainian tax only on income from sources in Ukraine. In broad terms, income will have a source in Ukraine if:

- The income arises from activities performed or property located in Ukraine; or
- In the case of dividends, interest, royalties and other passive income, the income is paid by a resident of Ukraine.

Professional services, except specific engineering services, are not treated as having a Ukraine source (so are not subject to withholding).

10 Taxation of corporations

Consolidation

There is no system of group taxation in Ukraine. Members of a group must file separate tax returns. There are no provisions to offset the losses of group members against the profits of another group member.

Permanent establishments

The domestic definition for a permanent representation essentially adopts the definition for permanent establishment found in the OECD Model Tax Convention, but with the addition of stronger agency tests.

When a foreign company conducts business in Ukraine through a permanent establishment, taxable income should be determined on the same basis as for domestic entities. If it is not possible to determine taxable profit based on the "direct" method (taxable income less deductible expenses), the allocation method or notional method may apply.

The allocation method requires the taxpayer to allocate a portion of its worldwide income and expenses to Ukraine and is difficult to apply in practice. The tax authorities have a preference for the notional method, which involves applying a notional margin of 30% to gross revenues earned in respect of activities in Ukraine.

Ukraine has no special tax rules for non-commercial representative offices established to engage in liaison type activities. Such offices are subject to the normal corporate income tax, but an exemption from income tax may be available under a relevant tax treaty if the activities of the representative office are not sufficient to constitute a permanent establishment for the foreign entity.

10.2 Incentives

Ukraine currently has very few incentives, although some are available (for the publishing and agricultural industries, for example). There have been discussions in Parliament about the possibility of restoring special tax regimes but there is no certainty of any such measure.

Ukraine does offer generous depreciation rates for fixed assets (see Section 10.4).

10.3 Gross income

Accounting period

The reporting year for companies generally follows the calendar year. The exception is for agricultural manufacturers, which report based on a 30 June year-end.

Returns and payments must be made on a quarterly basis, generally reflecting accumulated income and expenses for the year.

In addition, an eleven-month return to November and corresponding payment is required for 2007 (and in most years).

Business profits

Taxable profits are defined to be "adjusted gross income" less "allowable gross expenses" and depreciation charges.

Adjusted gross income encompasses all revenues received by a taxpayer from all economic activities, unless the revenues are expressly exempted under the law. Allowable gross expenses encompass all expenses incurred in relation to "business activities," unless a specific provision in the law restricts the deduction. "Business activities" are defined in the law as "any type of activity carried out by a person, aimed at making profits in the pecuniary form and creating tangible and intangible assets, provided such activity is regular, stable, and substantial."

There are significant differences between tax and financial accounting rules. Consequently, it is common for companies to prepare separate financial and tax accounts, which is very time consuming. The recent PricewaterhouseCoopers / World Bank "Paying Taxes" study estimated that a modest-sized domestic business would require 425 hours per year to comply with its corporate tax compliance requirements.

Accounting for income

Income should generally be recognised on the earlier of the date on which payment is received, or goods or services are supplied.

For goods, the date of supply is generally the date of shipment. For services, the practice in Ukraine is for the parties to a services contract to sign an "acceptance act" document once the services are delivered, and this is generally considered to be the date of supply.

Special rules are available to deal with the recognition of income from long-term construction contracts and R&D contracts.

Inventory valuation

Inventories may be valued for tax purposes using any of the following methods:

- Identified value of the appropriate inventory unit.
- Weighted average value of uniform inventories.
- First-in-first-out (FIFO) value of inventories.
- Target expenses.
- For inventories sold on a retail basis, the inventory sales price.

The selected method must be applied consistently for inventories having the same designated purpose and utilisation conditions. The method must also be applied consistently throughout each income year.

Securities

Income from securities is calculated separately from other income, and is based on a pooling method. Taxable income is determined by deducting the aggregate cost of acquiring each class of securities from the aggregate proceeds from selling such securities. If aggregate acquisition costs for the year exceed aggregate sales proceeds, the excess is carried forward and applied against sales of securities in subsequent years.

Exempt income

Dividends derived by a Ukrainian entity from another Ukrainian entity are exempt from tax.

10.4 Deductibility of expenses

Business expenses

Expenses incurred in the furtherance of a taxpayer's business activities should be deductible, unless a specific provision in the law says otherwise (refer below).

Special rules apply to payments for goods or services to foreign entities in listed jurisdictions operating offshore tax regimes (36 tax haven jurisdictions are listed). Only 85% of payments to an entity in one of these jurisdictions will be deductible, unless evidence is held that the entity is subject to the ordinary tax rules of that jurisdiction (i.e., it does not benefit from the offshore tax regime).

Non-deductible expenses

The following are the main items that are not deductible for corporate income tax purposes:

- Expenses that are not supported by relevant documents (e.g., contract, voucher, receipt, check, etc.).
- Expenses incurred for receptions, presentations, entertainment, and the provision of free samples and services for advertising purposes in excess of 2% of the taxpayer's taxable profits for the previous year, unless the taxpayer is in the business of providing such services.
- Insurance premiums (other than for medical, pension and mandatory insurance) in excess of 5% of the total deductible expense from the beginning of the year up to the end of the reporting period.
- Expenses for professional education and training, etc., in excess of 3% of employee compensation for the period.
- Business trip expenses for individuals that are not employees.
- Expenses relating to the financing of management bodies including holding companies.
- Payments in respect of goodwill, and amortization of goodwill.
- Expenses for car parking and the maintenance of cars. Further, only 50% of payments under an operating lease for cars or expenses relating to the purchase of fuel and lubricants for cars may be deducted. There is, however, no obligation for the taxpayer to prove that such expenses are related to its business.

- Expenses for provision of warranty services in excess of 10% of the value of goods sold.
- Expenses related to repairs to fixed assets subject to depreciation in excess of 10% of the aggregate book value of all groups of fixed assets as of the beginning of the reporting period (the excess is capitalised).

Accounting for expenses

The general rule is that expenses should be recognised on the earlier of the date on which goods or services were received or the date on which payment was made. Special rules apply for inventory. When payment is made to a non-resident, a tax-exempt entity or an entity paying tax at reduced rates (e.g., a small business that has opted to pay the unitary tax), expenses are recognised on the date on which goods or services were received.

Depreciation

Assets costing more than UAH 1,000 and with a useful life exceeding one year are required to be depreciated. Depreciation is determined on a quarterly basis, and is computed using the reducing-balance method. Taxpayers may adopt any depreciation rate up to the following maximum quarterly rate:

Description of assets	Acquisition date	
	Pre-1 Jan 04	Post-1 Jan 04
Group 1: Buildings, constructions, premises	1.25%	2 %
Group 2: Motor transport, spare parts, furniture, household electronic, optical and engineering devices and tools	6.25%	10 %
Group 3: All other assets, except intangible assets and Group 4 assets	3.75%	6 %
Group 4: Computers, telephones, etc.	N/A	15%

Land may not be depreciated. Intangible assets may be amortized using the straight-line method over the lesser of the asset's useful economic life or ten years.

If the inflation index exceeds 10% in a calendar year, taxpayers may adjust the book value of their assets for depreciation purposes by the amount of the excess.

Interest

As a general rule interest will be deductible if the related debt is used to fund business activities of the taxpayer.

There are restrictions on deductibility if a Ukrainian company is 50% or more owned or controlled by non-resident or tax-exempt persons, and interest is paid to those persons or their related parties. The deductible interest paid to those persons and their related parties cannot exceed the amount of interest income derived plus 50% of the company's taxable profit (excluding interest income and before the deduction of interest and depreciation). Any interest paid to affiliates in excess of this limit is carried forward to future income years.

Foreign exchange

Realised foreign exchange gains and losses are taxable/deductible.

In addition, foreign currency loans and similar, deposits and cash at bank are revalued quarterly and the difference is taxable/deductible. This revaluation does not apply for foreign currency credits and receivables.

Bad and doubtful debts

To claim a deduction for bad or doubtful debts, a taxpayer must initiate an action for collection. A deduction for bad or doubtful debts is allowed if:

- The creditor applies to the court with claim for debt collection or initiating bankruptcy.
- The debtor has not yet paid 90 days after the sale, the creditor attempts to collect the debt through the pre-court dispute settlement process, and either: (a) the debtor sends a notice accepting the claim; or (b) the debtor does not receive an acceptance notice within one month.
- The creditor has a note of execution for collection executed by a notary.

If the taxpayer subsequently recovers an amount that has been deducted as a bad or doubtful debt, the amount recovered is included in taxable income.

When a creditor pursues action to recover a debt, and the debtor fails to pay, the debtor is required to recognise income either 90 days after the deadline for payment under the contract or accepted claim, or 30 days after the court resolution or the execution of a note of execution by the notary. If the debt is subsequently repaid, the debtor may claim a deduction at the time of repayment.

Royalties and service fees

Royalties and service fees are deductible payments. When service fees are made to related parties, however, the payer is required to hold documentary evidence that the payments are for services actually rendered. The amount of the payment also may not exceed the usual (market) price.

Leasing

Lease payments on operating leases are deductible. The lessor would claim a deduction for depreciation of the leased assets.

Financial leasing is treated for tax purposes as if a sale had been made. The lessee would include the value of the property in the relevant group of fixed assets and claim depreciation charges. The lessee would also deduct the interest and commission elements of the lease payments in the period in which they are payable. Similarly, the lessor would recognize taxable income for the total principal amount of the lease at time when the asset is transferred, and would recognise the interest and commission element of the payments over the term of the lease.

A lease is treated as a financial lease if it meets any of the following conditions:

- The leased property is transferred for a period during which at least 75% of its acquisition cost would be depreciated under tax depreciation rules, and the lessee is obliged to acquire title to the property during or at the end of the lease period.
- The sum of the lease payments equals or exceeds the acquisition cost of the property.
- The leased property has already been more than 50% depreciated by the lessor, and the lease payments (excluding the financing component using the discount rate of the NBU) equal or exceed 90% of the normal price for the property.
- The property has been manufactured to the order of the lessee and cannot be used by other entities when the lease expires because of the property's process and quality features.

Even if a lease meets one (or all) of these conditions, the parties may still agree to treat the lease as an operating lease for income tax purposes. If they do so, however, they must continue to treat it as an operating lease throughout the term of the lease.

Employee remuneration

Employee remuneration is deductible. However, when an individual and members of his family own 20% or more of the shares in a company, compensation paid to those individuals cannot be deducted in excess of usual (market) compensation.

Expenses relating to providing employees with uniforms, safety clothes and shoes, as well as food, are non-deductible if the amount exceeds norms established by the Cabinet of Ministers of Ukraine.

Other deductions

Research and development expenses, other than those subject to amortization, are deductible when incurred.

Charitable donations and contributions to non-profit organisations are deductible within certain limits.

Ukrainian taxes, other than income tax, are generally deductible. For VAT-registered persons, revenues and expenses are determined net of VAT. For non-VAT-registered persons, the VAT component of any expenses will be included in deductible costs.

Losses

Special rules apply to losses arising from the sale of securities (see Section 10.3) and land. Expenses related to the acquisition of land are non-deductible. Losses incurred in the disposition of land are also non-deductible. However, gains from the sale of land remain taxable.

For operating losses, Ukraine does not have any rules permitting losses to be carried back. In principle, tax losses incurred from 1 January 2003 may be carried forward indefinitely, but in practice, Parliament has passed annual laws that have effectively restricted the carry forward to a single year. Currently it is understood that unutilised losses from 2003 to 2006 will be available for offset in 2008 unless Parliament suspends the law further.

10.5 Related party transactions

Special rules apply to transactions between related entities. Related entities are:

- A legal person that exercises control over a taxpayer, is controlled by a taxpayer, or is under common control with a taxpayer. Control is defined to include an interest of 20% or more in an entity.

- An individual (or family member of that individual) who exercises control over a taxpayer; or
- A company official (or family member of that official) who is authorized to execute binding legal agreements in the name of a taxpayer.

The tax authorities may adjust the price of transactions between related parties to the "usual price" for income tax purposes. The usual price is essentially the market price for equivalent transactions. There are some reasonably detailed rules in the law for determining the usual price and these are generally in line with principles followed internationally for determining market prices. Significantly, if it is not possible to determine the usual price because information on comparable transactions is absent or not publicly available, the law deems the contractual price to be the usual price.

If questioned by the tax authorities, taxpayers are required to justify the level of their prices. Nonetheless, the onus is on the tax authorities to demonstrate that the contractual price does not satisfy the usual price requirement.

10.6 Other taxes

Special Pension Fund charges

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

- 1% charge on the purchase of foreign currency in the foreign exchange market (withheld by the bank).
- 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. The tax base is the value of services charged by an operator of a mobile phone network. The charge is payable by individuals and companies that use mobile communications services, and is collected by the service providers through their billings.

There are a few other business activities that require contributions to be made to the Special Pension Fund, but they are unlikely to have an impact for most businesses.

Stamp duty

Stamp duty is imposed on certain actions, including notarisation of contracts and filing documents with courts. In most cases, the amounts involved are nominal, although there are exceptions. Operations carried out at commodity exchanges and sales of real property attract a stamp duty of 1%.

Excise tax

Excise tax is payable on cars, alcoholic beverages, tobacco products, beer, petrol and diesel fuel, whether imported or produced domestically. Rates of excise duty are specific. A list of selected rates can be found in Appendix D.

Land tax

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

Charge on environmental pollution

Environmental pollution charges are imposed on any legal entity that discharges contaminants into the environment (air or water) or disposes of wastes. The charge rate depends on the type and toxicity of each contaminant.

The law also establishes maximum concentrations for contaminants. If the maximum concentration is exceeded, the charge rate is multiplied by five.

Local taxes and duties

The principal local taxes and duties affecting business are:

- *Advertising tax*. This tax is payable by legal entities placing advertisement in mass media, on outdoor advertising or through other means. The 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 a maximum of 10% of the individual non-taxable allowance, multiplied by the number of employees. Currently, the monthly tax is UAH 1.7 per employee.
- *Charge for use of local symbols*. The charge is payable by legal entities that, for commercial purposes, use local symbols (e.g., city emblem, name or image of architectural or historical monuments). The maximum rate of the charge is limited to 0.1% of the value of the goods/services using the local symbols that are sold.

There are 13 other local duties that may be levied at the discretion of the local authorities. Few of them apply to business entities. It is unlikely that these duties will place a significant burden on companies.

10.7 Holding companies

There are no rules to permit the grouping or consolidation of income and losses among a commonly owned group. Dividend income received from another Ukrainian company is not subject to tax.

With effect from January 2007, companies deriving more than 90% of their income from domestic dividends are exempt from paying advance corporate tax.

11 Taxation of individuals

Investor considerations

- The tax year is the calendar year.
- Ukrainian tax residents are taxable on their worldwide income. Non-residents are subject to Ukrainian tax only on their Ukrainian source income.
- From 1 January 2007 the standard tax rate for tax residents increased from 13% to 15%. The standard rate is applicable to most types of income, including salary income, dividends, royalties and investment income.
- Income received by non-residents as interest, royalties, dividends and salary paid by a Ukrainian employer is taxed at 15%. Other income may be taxed at double this rate.
- Social security issues are discussed in Section 7.3. Employer contribution rates are high (exceeding 36%) but the contributions are capped at approximately USD 600 per employee per month.

11.1 Territoriality and residence

Individuals are classified into two categories for income tax purposes:

- Residents are liable for tax on their worldwide income. The standard rate is applicable to most types of income, including salary, dividends, royalties and investment income. Special tax rates apply in some cases specifically established by the law (e.g. inheritance, gifts, winnings and prizes, interest from deposits). Taxable income of foreign nationals who are tax resident in Ukraine is determined in the same manner as for Ukrainians.
- Non-residents are liable for tax only on their Ukrainian source income. A double tax rate (i.e., 30%) applies, except for interest, royalty, dividends and for salary received from a Ukrainian employer.

Tax residence

A person is tax resident in Ukraine if he or she has a place of abode in Ukraine. However, if the person also has a place of abode in another country, several tie-breaker rules apply to determine whether that person should be treated as a Ukraine tax resident. Thus:

1. The individual is deemed to be resident of Ukraine if he has a permanent place of abode (domicile) in Ukraine but not in another country.
2. If the individual has a permanent place of abode (domicile) in Ukraine and another country, the person is deemed to be resident in Ukraine if his centre of vital interests is in Ukraine. A sufficient but not exclusive ground for determining the country of an individual's centre of vital interest is the place of permanent abode of the individual's family members.
3. If an individual's centre of vital interests cannot be determined or the individual has no domicile in any country, the individual will be deemed to be a resident of Ukraine if he stays in Ukraine at least 183 days during the tax year (calendar year).
4. If residence status cannot be determined based on the previous rules, an individual will be deemed to be resident of Ukraine if he is a citizen of Ukraine.

An individual may also elect voluntarily that his or her main place of abode (and therefore tax residence) is in Ukraine. The law does not define the procedure for how this election should be made, but in practice a foreign national may apply in writing to the local tax office where he has a place of abode asking to be considered as tax resident for a given calendar year. Based on the application, the tax authorities should issue a written confirmation of the individual's tax residence status.

Non-residents are individuals who are not treated as tax residents of Ukraine under the previous rules.

Registration

All taxpayers, including foreign nationals, must register with the State Registry for Individual Taxpayers, and be assigned a personal tax ID number. This number is required for various transactions such as registering Ukrainian companies, renting apartments, opening bank accounts, and paying personal income tax. Receiving the ID number is also 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 who receive income from sources in Ukraine (except individuals who have diplomatic immunity).

In practice, non-resident individuals whose income from Ukraine is exempt under a relevant tax treaty will not need to obtain a tax ID number.

11.2 Private entrepreneurs

Individuals who are registered as private entrepreneurs (including foreign nationals) may elect to be covered by the "single (unified) tax" regime if they meet the qualification criteria.

The unified tax regime may be enjoyed for certain activities by private entrepreneurs employing up to ten employees and with annual proceeds from the sale of goods and/or rendering services of up to UAH 500,000 (approximately USD 99,000). The monthly single (unified) tax is fixed by local authorities, and ranges from UAH 20 to UAH 200 (approximately USD 4 to USD 40), depending on the type of activity. Payment of the 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), and land tax in respect of their income earned from the entrepreneurial activities.

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 within five calendar days after the end of each reporting quarter. A report to the Pension Fund is filed once a year before 1 April of the year following the reporting one.

11.3 Gross income

Resident taxpayers are liable to pay tax in respect of any income received or credited in Ukraine or abroad during the reporting period, except for items specifically exempted from tax under the law.

Employment income

All income received or credited from employment in monetary form or in kind during a calendar year is subject to personal income tax. This includes all basic pay, overtime pay, supplemental pay, awards and bonuses, compensation for unused vacation, honoraria, taxable pensions, tax reimbursements, allowances (e.g., living, education, transportation, entertainment, and the like), fees (including directors' fees), and other income of similar nature, whether monetary, in kind, or made by way of payment to third parties on behalf of the employee.

Additional benefits granted by employers also constitute taxable income, and include the following main items:

- Accommodation or other tangible or intangible assets provided for an employee's use free-of-charge.
- The value of goods and food provided to employees free of charge, other than special clothing, uniforms and food provided within norms established by the Cabinet of Ministers of Ukraine.
- The reimbursements of an employee's personal expenses or losses, except for items specifically exempted from tax (e.g., statutory daily allowances, cost of phone calls, dry cleaning included in the hotel invoice).
- The value of goods and services provided free of charge and the value of discounts when goods and services are sold to employees at less than the market price.

If a benefit is provided in non-monetary form, the tax base should be determined by grossing up the value of the benefit based on the formula:

Tax base = benefit value x 100% / (100% - employee's tax rate).

There are a number of important exceptions:

- The provision of accommodation or tangible assets for use free-of-charge is not taxable when it is a condition for performing labour functions by an employee or is provided under an employment contract or legislation within limits specified therein.

11 Taxation of individuals

- Benefits in the form of free use of vehicles do not constitute taxable income if granted by a resident employer that is subject to corporate income tax.
- Amounts paid by an employer in favour of an employee under any voluntary insurance constitute taxable income for the employee. However, an exemption is available for a portion of premiums under long-term life insurance or non-state pension insurance.
- Amounts paid by employers to educational institutions for training of employees is not taxable within limited amounts.

Income from independent activities

Income from independent activities is subject to the standard rate. However, individuals registered as private entrepreneurs may elect to be covered by the single (unified) tax regime instead (see Section 11.2).

Rental income

Rental income is subject to tax at the standard 15% tax rate. The income is determined based on contractual fee but cannot be lower than the minimum rental fee determined according to the methodology established by the Cabinet of Ministers of Ukraine.

If the lessee is a business entity, it is obliged to act as a tax agent, and to withhold 15% tax from rent payments to an individual, unless that individual is registered as a private entrepreneur.

Income from prizes and winnings

Income in the form of prizes (other than cash prizes from the state lottery) and winnings is taxed at double the standard rate (30%). If the prize or winnings are received in non-monetary form, the income is grossed up to determine the tax base. The tax is withheld by the person paying the prize or winnings.

Investment income

Income from the sale of investment assets is determined independently of other income. The gain or loss is determined for each investment asset sold (sales proceeds less acquisition cost), and then aggregated for the year. If the aggregate amount is positive, it is subject to tax at the standard 15% tax rate. If the aggregate amount is negative, it is carried forward and applied against investment income in subsequent years.

There are no requirements in the law for individuals to report sales income based on market values. However:

- The tax value in the hands of the person buying the financial asset will be the amount paid. In the case of a gift, the recipient is deemed to have acquired the asset for a zero value.
- If an investment asset is sold to a related person at a loss, the loss is disregarded. Losses when an asset is gifted are also disregarded.

The following transactions are also treated as the sale of an investment asset:

- The exchange of one investment asset for another investment asset. The sales proceeds are deemed to be the market value of the shares that the individual transfers.
- The redemption of a corporate right by the issuer.

Disposal of real estate

Revenues from the sale of real estate (including incomplete constructions) is subject to tax at either 0%, 1% or 5%, depending on the nature of the real estate and the number of real estate sales performed by the same taxpayer during the calendar year. The tax is based on the higher of the price indicated in the sale agreement and the property's value calculated by the authorised state authority.

The tax should be paid before the notarisation of the sale agreement.

Disposal of movable property

Gross revenue from the sale of movable property is subject to tax at the standard rate (15%).

As an exception, one sale per calendar year of a car, motorbike, yacht or boat with engine will be subject to a lower 1% rate, provided the seller pays the stamp duty before the sale agreement is notarised.

Inheritance and gifts

Income received as an inheritance or gift is subject to tax at the following rates:

- 0% - if received from a spouse, son or daughter, parent, parent-in-law, or a spouse's children;
- 5% - if received from resident testators other than those stated above;
- 15% - if received from a non-resident testator irrespective of the relations with such testator.

Proceeds from insurance

Payments from insurance companies under the following kind of insurance are exempt from tax:

- Proceeds from health insurance, provided the insurance event is confirmed by appropriate documents.
- Proceeds from property insurance, provided the amount of reimbursement does not exceed the market value of the insured property (increased by insurance payments) and is used for repair or replacement of the damaged or lost property. If the lost property is not replaced with similar property within the period 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), the amount of insurance reimbursement will be subject to tax at the standard rate (15%).

Proceeds from life insurance when an insured person dies are taxed on the same basis as an inheritance.

11.4 Tax-exempt income

Apart from the exceptions already noted in the discussion on employment income, the following are the main items of income that 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.
- Amounts received from employers in respect of certain types of medical treatment and services.
- Interest income from deposits placed with banks and non-banking financial institutions and from saving certificates (exemption is available until 31 December 2009).

11.5 Deductions

Business

Private entrepreneurs (other than those subject to the unified tax regime) are entitled to deductions from their gross income on the same basis as corporations (see Chapter 10).

If the actual expenses can not be documented, then a standard deduction may be applied. The rate of deduction ranges from 5% to 60%, depending on the type of activity.

Non-business

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

- Secondary professional or higher education of the taxpayer and his or her family members (spouse, parents, parents-in-law, children).
- Premiums for voluntary long-term life insurance or non-state pension insurance.
- Donations to Ukrainian charity and not-for-profit organizations in an amount exceeding 2% of the taxpayer's taxable income.

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

11 Taxation of individuals

Social security contributions

Taxable income is reduced by the amount of mandatory employee contributions to the State Pension Fund and to other social security funds.

The employer's mandatory pension and social security contributions are not included in the taxable income of the employee.

For details on Social Security contributions, see Section 7.3.

11.6 Foreign tax credits

Tax residents are allowed to credit foreign taxes paid on income received abroad against their Ukrainian tax liabilities 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. The taxpayer also requires an official confirmation of payment issued by the relevant foreign tax authority concerned.

11.7 Taxation of non-residents

Non-resident individuals are subject to Ukrainian tax only on income that has a source in Ukraine. The source rules for individuals are broader than those for corporations. For individuals, any income received from activities performed, capital employed or property used in Ukraine will have a Ukrainian source.

Income earned by non-residents from sources in Ukraine in the form of interest, dividends or royalties is taxed at the same rates as for residents, unless subject to a lower rate under a relevant tax treaty. Salary and director's fees paid by a Ukrainian resident employer (including a representative office) are also taxed at the standard rate.

Any other income earned from sources in Ukraine, including salary and director's fees paid by a non-resident employer, is taxed at double the rate applicable for residents. However, consideration should be given to the provisions in Ukraine tax treaties, which often exempt income earned by individuals from short-term visits to Ukraine from Ukrainian tax.

11.8 Tax compliance

Obligations of withholding agents

Employers and other business entities that pay income to individuals are defined as tax agents, and are responsible for withholding the tax and state pension and social insurance contributions and remitting it to the state and appropriate authorities.

Tax agents should remit the withheld tax to the state not later than 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, the tax agent should remit the tax to the state not later than the next banking day following the day of payment. Tax agents who fail to withhold tax from income paid to individuals are responsible for payment of the tax liability (plus fines and interest). The individual concerned is not obliged to settle the tax liability (i.e., the tax authorities may only recover the tax by pursuing the tax agent).

Tax agents must also file quarterly reports on income paid to individuals and the amount of tax withheld from that income.

Tax returns for individuals

A taxpayer is not required to file an income tax return if his or her only income during a reporting year is received from tax agents. However, if the individual wishes to claim a tax credit (deduction) for expenses incurred during the year or to claim a foreign tax credit, the individual may file a return.

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

A resident or non-resident individual who receives taxable income from entities or sources that are not tax agents is required to file a personal income tax return with the tax authorities. The return is filed with the local office where the individual resides, and must be filed by 31 March of the year following the reporting year. Tax due on the return must be paid by 10 April. Payment must be made in local currency (hryvnia).

Usually, no extensions are available. However, an individual who was not able to file the tax return by the deadline because of reasonable circumstances may apply for an extension of time to file. Adequate documentation must be provided to support the application. The return would then be due within 30 calendar days after the reasonable circumstances end, and any payment would be required within ten days of that new filing date.

If a tax resident departs from Ukraine, the individual must submit a "departure tax declaration" no less than 60 days before his departure, and settle the tax due based on the assessment issued by the tax authorities. No such requirement exists for non-resident individuals.

12 Value added tax

Investor considerations

- The standard rate of VAT is 20%. The export of goods and a very limited range of services are zero-rated.
- Many services to non-residents are effectively considered VAT-exempt, although the authorities tend to be restrictive in their interpretation of the law.
- Ukraine uses the input-output model. VAT-registered persons account for output tax after deducting VAT paid on their inputs.
- Buyers must ensure that invoices they obtain comply fully with the invoicing rules. The tax authorities look at invoices closely, and disallow input tax credits even if defects in the invoice are relatively minor.
- VAT returns and payments must generally be made monthly. Businesses with an annual turnover of less than UAH 300,000 may elect to account for VAT quarterly.
- Obtaining refunds is very difficult. In addition, the tax authorities' interpretation of the law is that VAT-registered persons may not claim a refund for their first twelve months following registration.

12.1 Introduction

Ukraine first introduced value-added tax (VAT), or *podatok na dodanu vartist* (PDV) as it is known in Ukrainian, in 1992. New VAT legislation, which was loosely based on the principles of the EU Sixth Directive, was put in place in 1997.

Ukraine operates the input-output model of VAT. VAT-registered persons deduct the VAT paid on their inputs from the VAT charged on their sales and account for the difference to the tax authorities.

The standard rate of VAT on domestic sales of goods and services and the importation of goods is 20%. Exported goods and related services are zero-rated.

12.2 Taxable activities

Other than businesses that elect to be covered by the unitary tax (see Sections 10.1 and 11.2), a person engaged in business is required to register for VAT if their sales for the past 12 months exceed UAH 300,000. Taxpayers engaged in business with sales below this threshold may also register voluntarily for VAT.

12.3 Scope of VAT

Unless there is an express exemption in the law, VAT applies to:

- Supply of goods and services where the place of supply is in Ukraine, including when supply is made without consideration; and
- Importation of goods into Ukraine.

Place of supply for goods

The place of supply for goods is determined under the following rules:

- If goods are to be transported, the supply takes place where the goods are located when they are dispatched.
- If the goods do not need to be transported, the supply takes place where the goods are located when they are sold.
- When goods are sold that require assembly or installation, the supply occurs where the goods are assembled or installed. However, when it is not possible for the goods to be shipped in assembled form, supply occurs where the goods are located when they are dispatched.
- The sale of real estate occurs in the place where the property is located.
- The supply of goods to sea, air or railroad vessels occurs at the place where the vessel will depart.
- For internet sales, goods are considered to be supplied in the place where the seller is located or is resident.

Place of supply for services

The general rule is that services are supplied from the place where the supplier is registered. However, when services are provided by a non-resident:

- The place of supply will be the location of its representative office or person exercising agency functions for the non-resident.

- If the non-resident has no representative office or agent, the place of supply is the location of the buyer. (The buyer is then required to account for VAT on the services under a reverse charge mechanism (see Section 12.8)).

Specific place of supply rules apply to the following services:

- The services of realtors and entities responsible for the preparation, co-ordination, supervision and performance of real-estate construction and finishing work (e.g., architects and designers) are supplied in the place where the relevant realty is, or will be, located.
- Personnel services for servicing maritime, air and space facilities occur in the place where the services are provided.

Special place of supply rules also apply to the supply of intellectual property rights, advertising, accounting, legal, consulting and data processing services, and the leasing of movable property to non-residents:

- If the non-resident recipient of such services has a permanent representative office, address or residence in Ukraine, the services are considered supplied at the location of that representative office, address or residence, so will be subject to VAT.
- if the non-resident does not have a permanent representative office, address or residence in Ukraine, the services will treated as performed outside Ukraine, so will be VAT-exempt.

The legislation is not clear and the tax authorities tend to claim that the above services provided to non-residents should be subject to 20% VAT.

VAT on importation

Unless expressly exempted under the law, imported goods are subject to 20% VAT during customs clearance. The taxable base is the higher of the contractual or customs value of the goods, plus the amount of any import duties and excise duties (if any). The imposition of VAT by Customs is not affected by whether the importer is VAT-registered.

12.4 Zero-rating

The export of goods and the supply of services that are ancillary to the export of goods are zero-rated. Zero-rating also applies to the supply of international transport services and toll manufacturing services.

12.5 Exempt supplies

Ukrainian law distinguishes VAT-exempt transactions from transactions that are outside the scope of VAT. From a practical perspective, however, the distinction is not important. In either case, a person making such sales will not be entitled to claim an input tax credit against those sales.

A number of transactions are "exempt" from VAT under Ukrainian law. Some of the more common exemptions are:

- Some financial services and the transfer of certain financial instruments. However, as exemptions are defined with respect to specific transactions, transactions must be reviewed individually to confirm whether an exemption applies.
- Depository, clearing and registrar activities in the securities market, as well as brokerage and dealer services for securities transactions.
- The issue, sale and exchange of securities and corporate rights and the payment of dividends and royalties in cash or securities.
- The interest or commission element of payments under a financial lease, up to a maximum of 200% of the NBU prime rate. However, the transfer of property under a financial lease is treated as a taxable sale.
- Insurance and reinsurance services supplied by licensed insurers, agents and brokers.
- The transit of cargoes and passengers through Ukraine.

12.6 Taxable amount

In most cases, the amount of VAT will be determined based on the transaction price for the supply of goods or services.

If the market price exceeds the transaction price by more than 20%, the seller must account for output VAT based on the market price.

For imported goods, VAT is based on the higher of the contract price or customs value stated in the bill of entry, increased by the

amount of costs bringing those goods to Ukraine, excise taxes and duties payable at the time of importation, and any payments for the use of intellectual property incorporated into the goods.

Where the place of supply is in Ukraine, VAT must be incorporated into the stated sale price.

12.7 Input tax credits

The general rules for VAT input tax credits are as follows:

- VAT paid on goods and services that will be used to make taxable sales may be claimed as an input tax credit.
- VAT incurred to purchase or import goods and services that will be used to make sales that are VAT-exempt or not subject to VAT may not be claimed as a credit.
- When goods and services will be used to make partly taxable and partly non-taxable sales, the input tax credit is apportioned between the taxable and non-taxable sales. Input tax credits are directly attributed to taxable and non-taxable sales. Any input tax credits that cannot be directly attributed would then be allocated based on the proportion of taxable sales to total sales for each month.
- No input tax is available for the purchase of a car, unless it will be used as a taxi cab.

A claim for input tax must be supported by a valid VAT invoice issued by a VAT-registered person or a duly executed import customs declaration.

In most cases, input tax credits will be based on the transaction price. However, if the transaction price exceeds the market price by more than 20%, the input tax credit should be based on the market price.

12.8 VAT compliance

Registration

A person qualifying as a taxable person is required to register with the tax authority at the place where its business is located and to obtain a VAT registration number.

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

Accounting requirements

VAT-registered persons are required to keep separate accounts for taxable and VAT-exempt sales and purchases.

Information on VAT invoice

If requested by the buyer, a VAT-registered person is required to issue a VAT invoice. The invoice must include the following information:

- The number of the tax invoice and the date the invoice is issued.
- The full name and registration number of both the buyer and the seller.
- The address of the seller.
- The type and quantity of the goods and services provided.
- The sales price (excluding VAT), the tax rate and amount of VAT, and the total amount payable.

Separate invoices are required for taxable and exempt transactions. Invoices for exempt transactions must include the words, "Без ПДВ" (*bez PDV* - without VAT).

Buyers need to pay particular attention to the information contained in VAT invoices, particularly when significant amounts are involved. The tax authorities pay close attention to the details on invoices when they conduct audits, and will disallow input tax credits even if there are relatively minor defects in the invoice.

VAT liability

The VAT liability is calculated using the input-output method. The VAT liability in any accounting period will be the total amount of output tax charged on sales, less the input VAT paid relating to taxable sales.

VAT is accounted for as follows:

- VAT on the sale of goods is generally accounted for at the earlier of the date that goods are delivered to the customer and the date that payment is received from the customer.
- VAT on the sale of services is generally accounted for at the earlier of the time a document is executed evidencing delivery of the service and the receipt of payment from the customer. It is usual commercial practice for both supplier and customer to sign a formal document evidencing the delivery of the service.
- The entitlement to an input tax credit for purchases arises on the earlier of the date of payment to the supplier or the date on which the VAT invoice is received.
- The entitlement to an input tax credit for imported goods or services arises on the date the tax is paid.

Reverse charge

Services acquired from non-residents are subject to the application of a VAT reverse charge. A person required to account for VAT on such transactions would report the VAT as output tax in a special line in the VAT return for the period in which the transaction is required to be recognised. The corresponding input tax would then be claimed as a credit in the following period (if the buyer is entitled to a VAT credit).

Returns and payments

Generally, VAT-registered persons are required to file VAT returns on a monthly basis. The return must be filed within 20 calendar days of the last day of the month (or the next working day if the 20th day falls on a weekend or a public holiday).

VAT-registered persons with annual sales of less than UAH 300,000 may opt for quarterly filing instead.

VAT payments must be made within ten calendar days of the date on which returns are required to be filed.

Refunds

A VAT-registered person may apply for a refund if they have been in a VAT credit position for two consecutive months. The refund is limited to the amount of input tax paid for the previous month.

According to the law, if an application for refund is filed, the tax authorities are required to check and confirm the entitlement within 35 days. In theory The State Treasury should then remit money to the applicant's bank account within five business days from receiving approval from the tax authorities. There is no liability for the government if it does not issue VAT refunds on a timely basis.

Historically, obtaining VAT refunds has been a major problem area for investors, and there is still uncertainty in this respect. Careful consideration is required.

VAT-registered persons are specifically not entitled to refunds if:

- They have been registered for VAT for less than 12 calendar months before the month for which a refund is sought.
- The amount of the refund claimed exceeds taxable sales for the last 12 calendar months.
- They have not carried on business activities during the last 12 calendar months.

It appears that the restriction under the first two tests should not apply to input tax arising from the construction or acquisition of fixed assets. In practice, however, the authorities are applying a blanket rule that refunds cannot be issued for the first 12 months following registration.

13 PricewaterhouseCoopers in Ukraine

PricewaterhouseCoopers (www.pwc.com), the world's largest professional services organisation, provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders.

Drawing on the talents of more than 140,000 people in 150 countries, PricewaterhouseCoopers provides a full range of business advisory services to leading global, national and local companies as well as to public institutions. These services include audit, accounting and tax advice; management, information technology and human resource consulting; financial advisory services including mergers and acquisitions, business recovery, project finance, and litigation support; business process outsourcing services; and legal services provided through a global network of affiliated law firms.

PricewaterhouseCoopers refers to the US firm of PricewaterhouseCoopers LLP and other members of the worldwide PricewaterhouseCoopers organization.

PricewaterhouseCoopers in Ukraine

Coopers & Lybrand and Price Waterhouse established their Ukrainian operations in 1993 and 1995 respectively, before merging in 1998. Having continued to expand its services and knowledge of Ukraine's business environment, today PricewaterhouseCoopers provides the highest level of professional services to international and Ukrainian enterprises. Overseen by nine partners and directors and employing more than 250 specialists and support staff, PricewaterhouseCoopers operates in Ukraine from its office in Kyiv. A second office will be opened in Donetsk in 2007.

The combination of local experience and a one-firm culture enables PricewaterhouseCoopers to provide advice that is consistent. In addition, its global standards are responsive to local conditions and requirements.

Engagements are generally staffed by a combination of Ukrainian specialists, with knowledge of local conditions and regulations, and international consultants, who have expertise in tackling issues faced by international enterprises and who are practised in dealing in the Ukrainian environment. The key element of PricewaterhouseCoopers' success in Ukraine is the quality of its staff, to whom partners are committed to providing the most up to date management training throughout their careers.

Our team is divided into three service lines: Assurance Services, Advisory Services, and Tax and Legal Services.

Assurance services

Assurance Services provides assurance on the financial performance and operations of our clients' business, through external and internal audits, financial and accounting reviews and investigations, regulatory consulting and training courses.

The Ukrainian practice is comprised of Ukrainian and international specialists possessing a deep knowledge of both national and international financial reporting standards. As part of our long-term development strategy, PricewaterhouseCoopers Ukraine encourages its local employees to obtain an internationally recognised professional qualification in accounting (UK ACCA). Our firm has the largest number of ACCA graduates of any professional service firm in Ukraine. In addition, we have a large number of certified Ukrainian auditors holding either banking audit or commercial audit qualifications

PricewaterhouseCoopers' knowledge and experience gained over fifteen years of reform in Ukraine, enables our specialists to advise not only on assurance matters, but also to put them in context and to advise on the likely impact that the pace and direction of economic and financial change will have on a commercial activity in Ukraine.

As a result of its long-term presence, PricewaterhouseCoopers Ukraine has developed strong relationships with key contacts, including government ministries and leading professional organisations. These relationships enable the firm to be well placed to assist in resolving queries on accounting, reporting and related regulatory issues.

Available Assurance services include:

- Audit - statutory and regulatory audit and treasury services.

  Our audit is aligned with business functions, not just financial processes. Businesses need auditors and advisors who understand their strategy and can reflect this in their audit approach. Using our approach and working alongside our clients, our lead partner provides strong control from the centre. We put great emphasis on understanding our clients' strategy and the need to address all risks. This approach represents, we believe, an important step forward in client service, audit quality and efficiency.

- Accounting and regulatory advice - corporate structures, technical accounting advice (supported by Global Corporate Reporting (GCR)), review of treasury operations, compliance with current and new regulations.

- Attest and attest-related services - independent assessment of financial and non-financial data.

- Public services audit and advisory - audit, internal audit and associated services for government, education and other non-profit organisations.
- Corporate training - business training and development services in the area of finance and accounting, IT systems, risk management, and management development.

Advisory services

The Advisory Services practice provides three main types of services:

Transactions: Transaction Services refers to assistance with and executing all types of financial transactions, providing advice on mergers and acquisitions, privatisations, financial and operational due diligence, value advisory and business valuation including real estate and asset valuation, feasibility studies and business plans, market analysis, project finance (including Public-Private Partnership schemes), finance raising and post-deal services.

PricewaterhouseCoopers provides a full range of services to guide clients through complex business transactions, and supports companies through every aspect of a transaction, from identifying the appropriate acquisition or divestiture candidates to assisting with deal structuring and capital sourcing. A wide range of privatisation services including lead advisory, target identification, company profiling, analysis of privatisation options, and transaction support are available, as well as assistance and support for companies seeking new capital, or companies involved in an acquisition, divestiture, restructuring or shareholder buyout. Services in relation to transactions, such as identification and evaluation of a transaction through due diligence, structuring services, market analysis and post-deal services, are provided.

PricewaterhouseCoopers Ukraine has the largest dedicated Transaction Services team in the country.

Performance Improvement: The Performance Improvement Department is dedicated to helping clients improve their financial and operational performance. Our Group works closely with other advisory practices in the firm to assist clients in meeting their most pressing challenges.

The assistance we provide is targeted at strengthening management control, increasing operational effectiveness and thereby increasing shareholder value. We know from experience that improving performance requires companies to focus on four distinct aspects: business model, financial drivers, management system and value creation system.

In our experience, projects are judged a success when the expected business benefits are clearly defined up front and when the project is managed to demonstrate achievement of those business benefits. By employing this principle in our methodologies, the Performance Improvement team strives to provide superior value to our clients.

Crisis Management: Crisis Management services involve corporate recovery and turnaround, optimised exits, insolvency/liquidation, as well as dispute analysis and investigations. It advises on and implements a complete range of solutions for business recovery situations, corporate bankruptcy and implementation of large-scale turnarounds for underperforming corporations.

Our dispute analysis and investigations practice involves corporate investigations, fraud risk management, background research of entities, computer forensics and cybercrime investigations, as well as investigations of insolvency and bankruptcy, together with intellectual property.

Tax and legal services

Effective tax planning is vital for the growth and development of any organisation. Very few major business decisions can be taken without considering their tax implications. In Ukraine, where the tax and legal system is complex and subject to constant revision, professional advice is even more of a necessity to achieve success.

Therefore, companies who seek the very best in tax advice in Ukraine turn to PricewaterhouseCoopers Tax and Legal Services Department for a complete solution to their complex business problems. Clients realise that by seeking our expert advice, considerable savings can be achieved.

Our team of local and expatriate professionals have the skills and experience in all areas of taxation - corporate and personal, direct and indirect - to help clients maximise their tax advantages and minimise their exposures. We advise both

13 PricewaterhouseCoopers in Ukraine

national and international companies based upon our knowledge of Ukrainian tax legislation and its interrelationship with international laws and treaties. This knowledge, together with our focus on specific markets and industries, helps us to add value to our clients' businesses and give them the edge they need in the marketplace.

Our Tax and Legal Services practice is divided into five main areas of expertise:

Corporate tax: Our team has extensive experience in advising clients based on Ukrainian laws and their interpretation by tax authorities, as well as their interrelation with international regulations and treaties. Our specialists are highly qualified to advise on all aspects of inward investments into Ukraine, and the structuring of those investments in terms of corporate income tax, withholding tax, dividend tax and local tax regulations. The team provides proactive advice on international tax planning and structuring, mergers and restructuring, and undertakes company health checks and due diligence projects, as well as assistance with tax authorities (during tax inspections and lodging of objections).

Within corporate tax, we have a large team dedicated to transactions services, mergers and acquisitions.

VAT and other indirect tax: Our indirect tax specialists have extensive experience in resolving complex issues related to indirect taxes, customs procedures and foreign trade. Services available include VAT consultancy and tax reviews, VAT planning and efficiency schemes for domestic and cross-border operations, assistance during tax inspections, and support and advice during appeals. Customs consulting includes tax planning for minimising import duties, assistance in complying with customs procedures, use of bonded warehouses, obtaining import/export licences, assistance during customs clearance and audits, and support during customs litigation or complaints.

Human Resources Services (HRS): HRS brings together all of the professionals working in the human resource consulting arena - specialists in individual tax, benefits, assessment, education, equity, reward, staffing, regulatory, legal, and process management - offering clients an unmatched breadth and depth of local and global expertise. Available services include individual advice, ranging from assistance with obtaining work and residence permits, to advice and assistance with all matters regarding Ukraine's personal income taxation legislation, salary surveys, outplacement, and human resources audit.

Compliance services: With the increasing focus on governance and regulation, tax compliance has never been so important. Compliance failure represents not only a financial risk but also a serious business risk, as it can damage the reputation of a business with the authorities and the public.

PricewaterhouseCoopers can help you manage your tax compliance issues, risks and opportunities, allowing you to have firm control. We can help you, both within Ukraine and cross-border, with preparing and reviewing tax returns and computations, negotiating with tax authorities, corporate income tax compliance, indirect tax compliance, accounting and payroll.

Legal services: Our lawyers have significant experience in implementing complicated projects that require high professionalism, an unconventional approach and detailed industry knowledge. Our lawyers are qualified to give advice in a multitude of areas that include advising multinational companies and local businesses on how to structure their investments and activities in Ukraine, banking, securities and financing, privatisation, mergers and acquisitions, legal due diligence, corporate structures, competition, trade practices, intellectual property and employment.

We closely cooperate with other lines of services, which enables us to offer unique integrated solutions including financial and tax consulting and general advice on doing business. When providing support for major international projects or structure deals based on international law, we interact with the PricewaterhouseCoopers international legal network, which gives us access to expertise from more than 2,000 lawyers in over 50 countries.

Appendices

Appendix A — Hints for business visitors

Visas

Citizens of the US, Canada, countries of the Commonwealth of Independent States (except Turkmenistan), European Union countries, Andorra, Iceland, Japan, Liechtenstein, Monaco, Mongolia, Montenegro, Norway, San Marino, Serbia and Switzerland do not need a visa to enter Ukraine if their stay will not exceed 90 days. However, they do need to hold a passport that is valid for at least six months from their entry into Ukraine.

For citizens of other countries, applications for business visas should be made to a Ukraine Embassy or Consulate outside Ukraine. The specific documents to be submitted are not consistent across all Embassies and Consulates. However, applicants who are not citizens of Slovakia or Turkey will need to obtain an official letter of invitation from a Ukrainian company before applying. Personal attendance at an Embassy or Consulate is not required to obtain a visa.

The list is subject to frequent change. Persons travelling to Ukraine should confirm the visa rules from a reliable source before they travel.

Currency

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

Currently, the NBU adopts a *de facto* peg against the US dollar. The official USD/UAH exchange rate was set at 5.05 in April 2005, and has remained at that level since, except for a seven-week period in June/July 2005 when the rate was 5.055.

It is common practice in Ukraine for some prices to be set in US dollars, and to a lesser extent Euros, particularly for high-value items. Property rentals, for example, will typically be expressed in dollars. However, settlement will still be made in Hryvnia.

Public holidays

In 2007, Ukraine will have the following public holidays:

- New Year's Day (January 1).
- Orthodox Christmas (January 7).
- International Women's Day (March 8).
- Easter (April 9).
- Labour Days (May 1 & 2).
- Victory Day (May 9).
- Holy Trinity Day (May 28)
- Constitution Day (June 28).
- Independence Day (August 24).

If a holiday falls on a Saturday or Sunday, the following Monday will be a non-working day. For 2007, the Cabinet of Ministers has also indicated plans to move the following working days:

- Friday 29 June to Saturday 16 June.
- Monday 31 December to Saturday 29 December.

Additionally, little business takes place between New Year's Day and Orthodox Christmas.

Appendices

Appendix B — Useful sources of information

Government websites

Many government websites have pages written in English. These can be useful to get a flavour of government policies and initiatives in various areas of the economy. Caution should be exercised, however, before relying on information in English. Although the Ukrainian web pages are generally well maintained and up to date, the same cannot be said for the English versions. To obtain current information, the only real solution is to have someone review the Ukrainian text and provide a translation.

At the time of writing, the following agencies have English pages on their website:

Cabinet of Ukraine	www.kmu.gov.ua/control/en
Main Department of Civil Service	www.guds.gov.ua/control/en/index
Ministry of Agricultural Policy	www.minagro.kiev.ua/?lng=E
Ministry of Economics	www.me.gov.ua/control/en/index
Ministry of Education and Science	education.gov.ua/pls/edu/educ.home.eng
Ministry of Finance	www.minfin.gov.ua/control/en/index
Ministry for Foreign Affairs	www.mfa.gov.ua/mfa/en/news/top.htm
Ministry of Labour and Social Policy	www.mlsp.gov.ua/control/en/index
National Academy of Sciences	beta.nas.gov.ua/En/main.html
National Bank of Ukraine	www.bank.gov.ua/Engl/default.htm
State Committee of Statistics	www.ukrstat.gov.ua
State Committee for Development of Enterprise	www.dkrp.gov.ua/control/en/index
State Property Fund	www.spfu.gov.ua/eng/index.php
State Tax Administration	www.sta.gov.ua/english/index.php3
Verkhovna Rada (Parliament)	portal.rada.gov.ua/control/en/index

Foreign investor associations

American Chamber of Commerce (AmCham)
42-44, Shovkovychna Vul.
LL1 Floor
Kyiv 01601
Tel. (380-44) 490-5800
Fax (380-44) 490-5801
www.amcham.kiev.ua

British-Ukrainian Chamber of Commerce
Suite 42
34A Grushevskogo Str.
Kiev 01021
Tel. (380-44) 410-5720
Fax. (380-44) 230-2151
www.bucc.com.ua

European Business Association (EBA)
1A Andrijivskyy Uzviz Str.
1st floor
Kyiv 04070
Tel. (380-44) 496 0601
Fax (380-44) 496 0602
www.eba.com.ua

Appendix C — Withholding taxes as at 1 January 2007

	Dividends		Interest (2)	Royalties (3)
	Non-portfolio (1)	Portfolio		
Domestic rates:				
Non-resident individuals	15	15	5 / 15 (4)	15
Non-resident corporations	15	15	15	15
Treaty rates:				
Algeria	5	15	10	10
Armenia	5	15	10	0
Austria	5	10	2 / 5 (5)	0 / 5
Azerbaijan	10	10	10	10
Belarus	15	15	10	15
Belgium	5	15	2 / 10 (5)	0 / 10
Brazil	10	15	15	15
Bulgaria	5	15	10	10
Canada	5	15	10	10
China (PRC)	5	10	10	10
Croatia	5	10	10	10
Cyprus (6)	0	0	0	0
Czech Republic	5	15	5	10
Denmark	5	15	0 / 10 (7)	0 / 10
Egypt	12	12	12	12
Estonia	5	15	10	10
Finland	0 / 5 (8)	15	5 / 10 (7)	0 / 5 / 10
France	0 / 5 (9)	0 / 15 (9)	2 / 10 (5)	0 / 10
Georgia	5	10	10	10
Germany	5	10	2 / 5 (5)	0 / 5
Greece	5	10	10	10
Hungary	5	15	10	5
India	10	15	10	10
Indonesia	10	15	10	10
Iran	10	10	10	10
Israel	5	15	5 / 10 (10)	10
Italy	5	15	10	7

Appendices

	Dividends		Interest (2)	Royalties (3)
	Non-portfolio (1)	Portfolio		
Japan (6)	15	15	10	0 / 10
Kazakhstan	5	15	10	10
Korea (ROK)	5	15	5	5
Kyrgyzstan	5	15	10	10
Latvia	5	15	10	10
Lebanon	5	15	10	10
Lithuania	5	15	10	10
Macedonia	5	15	10	10
Malaysia (6)	15	15	15	10 / 15
Moldova	5	15	10	10
Mongolia (6)	0	0	0	0
Netherlands	0 / 5 (11)	15	2 / 10 (5)	10
Norway	5	15	10	5 / 10
Poland	5	15	10	10
Portugal	10 / 15 (12)	15	10	10
Romania	10	15	10	10 / 15
Russian Federation	5 / 15 (13)	5 / 15 (13)	10	10
Serbia and Montenegro	5	10	10	10
Slovakia	10	10	10	10
South Africa	5	15	10	10
Spain (6)	15 (14)	15 (14)	0	5
Sweden	0 / 5 (15)	10	10	10
Switzerland	5	15	0 / 10 (5)	0 / 10
Syria	10	10	10	15 (14)
Tajikistan	10	10	10	10
Thailand	10	15	10 / 15 (10)	15
Turkey	10	15	10	10
Turkmenistan	10	10	10	10
United Arab Emirates	5	10	3	10
United Kingdom	5	10	0	0 (16)
U.S.A.	5	15	0	10
Uzbekistan	10	10	10	10
Vietnam	10	10	10	10

Appendices

(1) The ownership threshold for the non-portfolio rate is 10%, 20%, 25% or 50%, depending on the specific provisions in the treaty.

(2) Several treaties contain a 0% rate on interest paid to or guaranteed by a government or one of its agencies. The table does not analyse such provisions.

(3) Where more than one rate is shown, the rate will depend on the type of royalties that are paid.

(4) The lower rate applies to interest on current or deposit bank accounts, certificates of deposit, contributions to a credit union, and participatory and fixed-yield mortgage certificates.

(5) The lower rate applies to interest paid on certain credit sales, and on loans granted by a financial institution.

(6) The treaties with Cyprus, Japan, Malaysia, Mongolia and Spain were entered into by the USSR before it dissolved. Ukraine will continue to honour these treaties, unless they are superseded. The Cyprus treaty has recently been renegotiated and increased rates will apply once if has been ratified (10% on interest and royalties and 5/15% on dividends).

(7) The lower rate applies to interest paid in connection with the sale on credit of any industrial, commercial or scientific equipment, unless the indebtedness is between associated enterprises.

(8) Specific rules apply for the 0% rate.

(9) The 0% rate will apply if a French company or companies hold directly or indirectly at least 50% of the capital of the Ukrainian company, and their aggregate investments in the Ukrainian company is not lower than 5 million French francs.

(10) The lower rate applies to interest paid on any loan granted by a bank.

(11) The 0% rate applies if the investor holds directly at least 50% of the capital of the company paying the dividends, and the capital invested is at least USD 300,000.

(12) The 10% rate applies if the company receiving the dividend has, for an uninterrupted period of two years before the dividend is paid, owned at least 25% of the capital stock of the company paying the dividends.

(13) The 5% rate applies if the capital invested is at least USD 50,000.

(14) The treaty rate is 18%, so the lower 15% rate under domestic law would apply.

(15) The 0% rate applies if the Swedish company holds directly at least 25% of the voting power of the company paying the dividends, and at least 50% of the Swedish company is held by Swedish residents.

(16) The 0% rate applies only if the royalties are taxable in the United Kingdom.

Appendices

Appendix D — Selected customs duties and excise tax rates

Selected customs duties rates

Product or group of products		Rates of duty		
		Reduced rate, %	Full rate, %	Products originating in CIS, %
IT equipment		0 - 10	0 - 10	exempt
Cars		25	25	exempt
Office equipment	Items made of plastic materials	5	5	exempt
	Envelopes, paper	0 - 10	0 - 10	exempt
Coffee		0 - 5	0 - 5	exempt
Tea		0 - 10	0 - 10	exempt
Beer		EUR 0.5 per litre	EUR 0.5 per litre	exempt
Chocolate products		15	15	exempt /15[1]
Pharmaceuticals		0	0	exempt
Refrigerators		5 - 25	5 - 50	exempt
Washing machines		5 - 12	5 - 12	exempt
Manufacturing equipment (other than refrigerators)		0 - 15	0 - 15	exempt
Agricultural equipment		0 - 10	0 - 10	exempt

1. This product is excluded from free trade regime with Russia

Selected excise tax rates

Product	Excise duty rate/value
Beer	UAH 0.31 per 1 litre
Wine base of grapes	0
Wine, sparkling wine, vermouth	UAH 0.25 – UAH 2.6 per litre
Fermented fruit beverages with added alcohol	UAH 0.10 per 1% by volume of alcohol in litre
Fermented fruit beverages without added alcohol	UAH 1.2 per litre
Ethyl alcohol and other spirits, liqueurs and other spirituous beverages	UAH 17 per litre of 100% alcohol (UAH 18 temporarily to 1 July 2007)
Cognac, brandy	UAH 6 per litre of 100% alcohol (UAH 6.5 temporarily to 1 July 2007)
Cognac spirit	UAH 16 per litre of 100% alcohol
Tobacco raw materials	0
Cigars, cigarillos	UAH 20 per 100 sticks
Cigarettes	UAH 5 – UAH 11.5 per 1000 sticks and 8% of sale turnover
Tobacco for smoking, chewing tobacco or snuff	UAH 10 per kilogram and 8% of sale turnover
New cars	EUR 0.02 – EUR 0.1 per cubic centimetre
Used cars	EUR 1 – EUR 3.5 per cubic centimetre
Motorcycles, motor bikes	EUR 0.2 per cubic centimetre
Trailers for housing or camping	EUR 100
Car bodies used for production assembly of motor transport vehicles	UAH 200
Car bodies	UAH 4,000
Energy materials, petrol and diesel	EUR 12 – EUR 60 per 1000 kilograms

Appendices

Appendix E — Short form Chart of Accounts under Decree No. 291

Code	Synthetic Accounts (1st Tier Accounts) Name	Sub-accounts Code
	Class 1. Non-current Assets	
10	Fixed Assets	101-109
11	Other Non-current Tangible Assets	111-117
12	Intangible Assets	121-127
13	Depreciation of Non-current Assets	131-133
14	Long Term Financial Investments	141-143
15	Capital Investments	151-155
16	Long Term Account Receivables	161-163
17	Deferred Tax Assets	
18	Other Non-current Assets	
19	Negative Goodwill	
	Class 2. Stock (Inventories)	
20	Inventories	201-209
21	Livestock	211-218
22	Low Value Items	
23	Production (Manufacture)	
24	Production Wastage	
25	Semi-finished Goods	
26	Finished Goods	
27	Agricultural Produce	
28	Goods (Stock)	281-285
29		
	Class 3. Cash, Settlements and Other Assets	
30	Cash in Hand	301-302
31	Bank Accounts	311-314
32		
33	Other Funds	331-334
34	Short Term Notes Received	341-342
35	Current Financial Investments	351-352
36	Settlements with Buyers and Customers	361-362
37	Settlements with Various Debtors	371-377
38	Provision for Doubtful Debts	
39	Deferred Expenses	
	Class 4. Equity and Provision for Liabilities	
40	Statutory Capital	
41	Share Capital	
42	Additional Capital	421-425
43	Reserve Capital	
44	Retained Earnings (Losses)	441-443
45	Withdrawn Capital	451-453
46	Unpaid Capital	
47	Provision for Future Expenses and Payments	471-474
48	Targeted Finance	
49	Insurance Reserves	491-498
	Class 5. Long Term Liabilities	
50	Long Term Borrowings	501-506
51	Long Term Notes Issued	511-512
52	Long Term Liabilities in Respect of Bonds	521-523
53	Long Term Liabilities in Respect of Lease	531-532
54	Deferred Tax Liabilities	
55	Other Long Term Liabilities	
56-59		

Code	Synthetic Accounts (1st Tier Accounts) Name	Sub-accounts Code
	Class 6. Current Liabilities	
60	Short Term Loans	601-606
61	Current Debt on Long Term Liabilities	611-612
62	Short Term Notes Issued	621-622
63	Settlements with Suppliers and Contractors	631-632
64	Settlements in Respect of Taxes and Payments	641-644
65	Settlements in Respect of Insurance	651-655
66	Settlements in Respect of Labour Remuneration	661-662
67	Settlements with Members	671-672
68	Settlements in Respect of Other Transactions	681-685
69	Deferred Income	
	Class 7. Revenue and Results of Operations	
70	Sale Revenue	701-704
71	Other Operating Income	711-719
72	Income from Interest in Equity	721-723
73	Other Financial Income	731-733
74	Other Income	741-746
75	Extraordinary Income	751-752
76	Insurance Payments	
77		
78		
79	Financial Results	791-794
	Class 8. Expenses by components	
80	Material Expenses	801-809
81	Labour Costs	811-816
82	Social Payments	821-824
83	Depreciation	831-833
84	Other Operating Expenses	
85	Other Expenses	
86-89		
	Class 9. Operating expenses	
90	Cost of Sales	901-903
91	Production Costs	
92	Administration Costs	
93	Selling Costs	
94	Other Operating Expenses	941-949
95	Financial Expenses	951-952
96	Loss from Interest in Equity	961-963
97	Other Expenses	971-979
98	Profit Taxes	981-982
99	Extraordinary Expenses	991-993
	Class 0. Off balance sheet accounts	
01	Leased Non-current Assets	
02	Third Party Assets in Store	021-025
03	Contractual Liabilities	
04	Contingent Assets and Liabilities	041-042
05	Guarantees and Security Given	
06	Guarantees and Security Received	
07	Written-off Assets	071-072
08	Strict Accounting Forms	

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