

1993

Foreign Investment in Ukraine: New Laws, Opportunities, and Issues

Daniel Gogek

Mary Hartnett

Recommended Citation

Daniel Gogek & Mary Hartnett, *Foreign Investment in Ukraine: New Laws, Opportunities, and Issues*, 27 INT'L L. 189 (1993)
<https://scholar.smu.edu/til/vol27/iss1/11>

This Current Developments is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in International Lawyer by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

Foreign Investment in Ukraine: New Laws, Opportunities, and Issues

The demise of the Soviet Union and the emergence of Ukraine as an independent state in late 1991 resulted in a dramatic transformation of Ukraine's foreign investment climate. Like most of the former USSR republics, Ukraine is now engaged in an ongoing transition from a centrally planned state to an open society and market economy. Faced with the task of establishing a comprehensive new legal, political, and economic system, Ukraine began this transition by making sweeping changes to its legislation: a new relatively liberal foreign investment law is now in force, a vast privatization program has been set in place, and a host of new commercial laws, in such areas as banking, trade, and tax, have been passed. Foreign investors may now invest, on the basis of these new laws, in numerous areas of the Ukrainian economy and may do so through a variety of forms including wholly owned subsidiaries, joint stock companies, and partnerships.

In the authors' experience, however, the rules on the books in Ukraine are not always applied in practice as might be expected. Ukraine's transition to a market economy has to date been marked by significant declines in production levels, rampant inflation, and mixed support from the Ukrainian people on the direction and pace of market reform. Moreover, such a transition necessarily involves

*Attorney, Coudert Frères, Paris. Mr. Gogek is active in the area of foreign investments in the former republics of the Soviet Union and has extensive experience in foreign investment projects in Ukraine.

**Attorney, Coudert Brothers, Washington. Ms. Hartnett was resident in Coudert Brothers' Moscow Office from January 1989 to July 1990 and continues to specialize in foreign investment projects in Ukraine, Russia, and the other newly independent states of the former Soviet Union.

The authors wish to thank Patricia Angus (Coudert Brothers, New York) and Piotr Tomaszewski (Coudert Frères, Paris) for their invaluable assistance in preparing this article; in addition, the authors would like to thank the members of the Coudert Brothers worldwide CIS Practice Group who provided helpful comments on earlier drafts of this article, as well as Alexey Volkov (Visil Kisil & Partners, Kiev), with whom Coudert Brothers regularly works in Ukraine.

retraining a large portion of Ukraine's labor force, particularly government officials instructed to apply the new market-oriented laws. It is against this backdrop of practical consideration that Ukraine's new commercial laws should be reviewed and analyzed. In structuring an investment or commercial transaction in Ukraine, one should thus not only take into account the current laws, but should also address the practical issues that inevitably surface and must be resolved to complete a successful transaction.

Accordingly, this article addresses not only the legal, but also the practical issues relevant to foreign investment and commercial transactions in Ukraine. We first discuss the current legal regime governing foreign investment in Ukraine (part I), and then outline the various legal forms which are now available for establishing a presence or investing in Ukraine (part II). We then address selected key legal and commercial issues which a foreign investor is likely to encounter in any Ukrainian project (part III), and present a brief overview of the essential steps in negotiating, documenting, and completing an investment project in the "new" Ukraine (part IV).

I. The Legal Regime

Since the beginning of 1991, and particularly since it became an independent state,¹ Ukraine has enacted a wide range of laws that either directly regulate or are relevant to foreign investment projects and commercial transactions. Although Ukraine continues to rely in certain limited cases on laws of the former USSR,² most relevant laws today are Ukrainian.

A. LAWS REGULATING FOREIGN INVESTMENTS

1. *The Ukrainian Foreign Investment Law*

The Ukrainian law "On Foreign Investments" (the Foreign Investment Law), promulgated on March 11, 1992,³ sets forth the general principles of the legal

1. Ukraine declared its independence on Aug. 24, 1991, and the Ukrainian electorate voted overwhelmingly for independence on Dec. 2, 1991. Ukraine officially became an independent state following the formal dissolution of the Soviet Union in Dec. 1991.

2. Two laws were adopted on Sept. 12, 1991, for the purpose of clarifying the status of preindependence laws. Under the Ukrainian Law on the Provisional Validity of Certain Acts of USSR Legislation in Ukrainian Territory, USSR laws that do not contradict the Ukrainian constitution or laws continue to apply in Ukraine on issues not yet regulated or superseded by Ukrainian legislation. The Law on Legal Succession of the Ukraine provides that Ukrainian international treaties concluded by the Ukrainian SSR as well as Ukrainian laws adopted prior to the date on which independence was declared (Aug. 24, 1991) continue to apply insofar as they do not contradict new Ukrainian legislation adopted after that date. The same applies to USSR international treaties, to which Ukraine is the legal successor unless such treaties contradict the Ukrainian constitution or are otherwise contrary to the interests of Ukraine.

3. Ukraine Law on Foreign Investments, adopted by the Ukrainian Supreme Soviet on Mar. 11, 1992, effective Mar. 12, 1992, available in LEXIS, WORLD Library, RCBLR File in RUSSIA AND COMMONWEALTH BUSINESS LAW REPORT, May 29, 1992 [hereinafter Foreign Investment Law]. For this article, the authors have used their own translations of the Ukrainian laws discussed herein.

regime applicable to foreign investments, provides a number of significant tax incentives, streamlines the registration process, and codifies a number of standard principles of international law.⁴ The Foreign Investment Law applies to (i) foreign investors and (ii) enterprises with foreign investment.⁵ Foreign investors are defined as foreign legal entities, nonresident physical persons, foreign states, and international organizations.⁶ An enterprise with foreign investment is defined as an enterprise where a foreign investor owns at least 20 percent of the authorized capital or a share averaging at least \$100,000 in U.S. dollars throughout a calendar year.⁷

a. Liberalization of Scope of Foreign Investments

Foreign investors may carry out a wide range of foreign investments: they may acquire all or part of the shares or interest in an existing Ukrainian enterprise; create new jointly owned or wholly foreign-owned enterprises; open a branch or representative office; acquire property; enter into production or cooperation arrangements; acquire limited rights in natural resources;⁸ and, more generally, make investments in any other forms of investment not prohibited by Ukrainian law.⁹

The Foreign Investment Law also establishes a number of special privileges, rules, and guarantees applicable to foreign investments, as discussed below. Foreign investors are also expressly permitted to provide for arbitration outside of Ukraine to resolve investment disputes with their Ukrainian counterparts.¹⁰ In addition, the Foreign Investment Law contemplates the creation of additional privileges in "priority branches of the national economy and social sphere pursu-

4. The relatively short Law on Protection of Foreign Investments in Ukraine was the first enactment on foreign investments following Ukraine's declaration of independence on Aug. 24, 1991. Law on the Protection of Foreign Investments in Ukraine, adopted Sept. 10, 1991, in *RUSSIA AND THE REPUBLICS-LEGAL MATERIAL* (Transnational Juris) (Apr. 1992) [hereinafter Law on Protection of Foreign Investments]. The importance of this law has diminished in light of the subsequent Foreign Investment Law; however, it serves to establish the basic principles on which the Ukrainian foreign investment regime is based. For example, it guarantees against unlawful expropriation or nationalization of investments (except for certain public order reasons), *id.* at art. 3, and it establishes the right to transfer profits abroad in foreign currency, *id.* at art. 4, and the right to reinvest the proceeds of investment activities in the territory of Ukraine. *Id.* at art. 5.

5. Foreign Investment Law, *supra* note 3, art. 2. Note that the Foreign Investment Law does not cover foreign investments carried out in Soviet roubles, contracts in roubles, securities in roubles that originated in countries other than Ukraine, and foreign investments in commodities from countries in which the Soviet rouble is still effective unless those commodities are highly liquid on the world market. *Id.* art. 2.

6. *Id.* art. 1.

7. *Id.* art. 1.

8. *Id.* art. 4.

9. *Id.* art. 3; see also art. 4. Please note, however, that licenses may be required for foreign investment in the banking, securities, or national security sectors. *Id.* arts. 8, 24.

10. *Id.* art. 49. Note, however, that disputes arising between foreign investors and the Ukrainian Government must be resolved in Ukrainian courts. *Id.* art. 49.

ant to state programs for encouragement of foreign investments."¹¹ Foreign investors considering projects in key sectors (such as agriculture, transportation, medicine, or defense conversion) should seek prior governmental approval of advantageous tax and other favorable terms for their projects.

b. Incentives for Creation of Enterprises
with Foreign Investment

The Foreign Investment Law contains the following incentives for enterprises with foreign investment:

i. Customs Rules

Among the incentives provided are the following: property imported into Ukraine as a contribution of a foreign investor to the authorized fund of an enterprise with foreign investment is exempt from customs duties and import taxes (if imported within the time limits prescribed under the Laws on Business Partnerships).¹² Enterprises with foreign investment are also entitled, license-free, to export their own production (goods and services), as well as to import products (goods and services) for their own needs.¹³

ii. Tax Benefits

The Foreign Investment Law grants significant tax benefits to new and existing enterprises with foreign investment. An important distinction is made between wholly foreign-owned subsidiaries and enterprises with Ukrainian capital. Enterprises with foreign investment with participation of Ukrainian capital enjoy the greatest advantages. These rules are summarized as follows.

(a) Enterprises with Foreign Investment and
Participation of Ukrainian Capital

- (1) If not in wholesale or retail trade, or intermediary activities, these enterprises are exempt from Ukrainian taxes for five years following the first receipt of profits and must pay only 50 percent of subsequent taxes.¹⁴
- (2) If in wholesale and retail trade, these enterprises are exempt from taxation for three years, while enterprises engaged in intermediary activity are exempt for two years.¹⁵ Enterprises in these categories must pay 70 percent of taxes imposed after their periods of exemption expire.¹⁶
- (3) Such enterprises that were created prior to March 12, 1992, also enjoy the above tax holidays.¹⁷

11. *Id.* art. 8.

12. *Id.* art. 28; see Ukraine Law "on Business Partnerships," *infra* note 73, for information on relevant time limitations.

13. Foreign Investment Law, *supra* note 3, art. 29.

14. *Id.* art. 32.

15. *Id.*

16. *Id.*

17. *Id.*

- (4) All such enterprises are exempt from the Value Added Tax (VAT) (currently 28 percent on most items) for a period of five years following their registration.¹⁸
- (5) Such enterprises operating in "top-priority branches of the national economy" or covered by legislation on "special (free) economic zones" may be granted additional tax privileges.¹⁹

(b) Enterprises with Foreign Investment
and No Ukrainian Capital

Such enterprises (wholly foreign-owned subsidiaries) do not enjoy the above tax holidays. They are, however, entitled to deduct from taxable income the total value of paid-in contributions to the enterprise's authorized capital, which are "converted to the currency effective" in Ukraine. A carryover into future years of this deduction is also permitted.²⁰ Wholly foreign-owned subsidiaries, however, do not enjoy an exemption from the VAT.²¹

(c) All Enterprises with Foreign Investment

Certain tax rules apply to all enterprises with foreign investment (with or without Ukrainian capital). For all such enterprises, a 15 percent withholding tax is deducted on profits repatriated abroad, unless reduced under a bilateral tax treaty.²² All such enterprises are also entitled to a tax deduction for reinvestment in a business in Ukraine.²³

c. Foreign Investment Guarantees

The Foreign Investment law also contains several "guarantees," intended to provide some degree of comfort to foreign investors. The law provides that: (a) rules in effect at the time of registration may be relied upon by the foreign investor for a period of ten years;²⁴ (b) foreign investments are exempt from nationalization, except in emergency cases²⁵ and only if there is "prompt, adequate, and effective" compensation,²⁶ and (c) foreign investors may repatriate profits, or reinvest them in Ukraine and earnings in foreign currency made by enterprises with foreign investment from the export of their products (goods and services) remain at the "complete disposal" of the enterprise.²⁷ It is important

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.* Ukraine has agreed to adhere to USSR tax treaties, pending execution of new bilateral tax treaties. See *supra* note 2. The status of such treaties should be checked on a case-by-case basis.

23. *Id.*

24. Foreign Investment Law, *supra* note 3, art. 9. Also, a foreign investor may be protected by the Law on Protection of Foreign Investments (*supra* note 4).

25. Foreign Investment Law, *supra* note 3, art. 10.

26. *Id.* art. 11.

27. *Id.* arts. 14, 29. (Foreign currency earnings are also governed by the general currency rules: see *infra* part I(D)(3).)

to remember, however, that such guarantees exist only in the context of the current legal regime, and foreign investors should structure their transactions to anticipate potential adverse changes in law, and ensure the option to terminate an agreement under such circumstances.

2. *Law on Foreign Economic Activity*

Adopted when Ukraine was still a socialist republic within the Soviet sphere, the Law on Foreign Economic Activity was Ukraine's initial endeavor to liberalize its foreign economic regulations.²⁸ The scope of the Law on Foreign Economic Activity is comprehensive, covering such topics as taxation, customs, insurance, export/import, product and technical standards, antitrust and unfair competition, conflicts-of-law principles, recordkeeping, free enterprise zones, business-government relationships, liability of enterprises, and dispute resolution. Although individual pieces of Ukrainian legislation, most notably the Foreign Investment Law, have superseded or supplemented various provisions of this law, many of its provisions remain generally applicable to commercial transactions and foreign investments in Ukraine.

B. GENERAL INVESTMENT RULES:

THE LAW ON INVESTMENT ACTIVITY

Ukraine's Law on Investment Activity (Investment Law), adopted on September 18, 1991, defines the general principles and procedures concerning all investment activity, including activity involving foreign investors in the territory of Ukraine.²⁹ The Investment Law gives foreign legal entities and physical persons, as well as foreign states, the right to possess, use, control, transfer, and pledge the objects and proceeds of their investments.³⁰ However, these rights are subject to certain limitations, particularly in the area of national resources.

C. PRIVATIZATION LAWS AND PRIVATIZATION PROGRAM

Ukraine has embarked on a sweeping privatization program designed to transfer the ownership of almost half of state enterprises and assets into private hands by 1995. Despite this initial ambitious undertaking, only a few very small-scale privatizations have been launched to date, and many questions remain regarding key aspects of the privatization laws and program.

Two fundamental privatization laws were adopted in March 1992: the Law on Privatization of State Enterprises,³¹ and the Law on Privatization of Small

28. Ukraine Law on Foreign Economic Activity, adopted Apr. 16, 1991 [hereinafter Foreign Economic Activity Law].

29. Ukraine Law on Investment Activity, adopted Sept. 18, 1991.

30. *Id.* art. 7.

31. Ukraine Law on the Privatization of State Enterprises, adopted on Mar. 6, 1992, effective Mar. 15, 1992 [hereinafter Privatization Law].

Enterprises.³² The privatization "Program," which sets forth the plan for implementing privatization goals, was adopted on July 7, 1992.³³

In sum, the Program divides all state property into three categories: (i) property prioritized for privatization during 1992 (including certain enterprises in the retail, construction, food, agricultural, and forestry industries, and certain enterprises operating at a loss);³⁴ (ii) property requiring approval from the Ukraine Cabinet of Ministers prior to privatization (including certain enterprises in the transportation, energy, mining, and other natural resource sectors);³⁵ and (iii) property which generally may *not* be privatized (such as the property of state governing and administrative bodies, the armed forces, water resources, nuclear power plants, television and radio broadcasting centers, alcohol production facilities, grain procurement and processing enterprises, and port construction enterprises).³⁶

The new privatization regime is important to foreign investors in two key ways. First, foreign investors are generally allowed to participate in privatizations and so should be familiar with what rules apply to their participation. The fundamental restriction placed on foreign investors is the requirement that they may only use foreign currency to participate in privatizations. If the privatization is carried out through competition or auction, the base exchange rate to be used is the market rate. However, the sale price is to be increased by a "special coefficient" set by the State Property Fund. In cases where the foreign investor does not purchase through competition or auction, a "special valuation of the property in hard currency" must take place. Further rules defining how such "special valuations" take place have not yet been implemented. Foreign investors should also be familiar with permissible privatization methods, and aware of the special rights available to employees of enterprises subject to privatization.³⁷

Secondly, even if foreign investors do not elect to directly participate in a privatization, the new privatization framework may indirectly have an impact

32. Ukraine Law on the Privatization of Small State Enterprises, adopted on Mar. 6, 1992. This law will apply to small-scale privatization, generally, enterprises whose "balance value" is under 1.5 million roubles. The framework for a system of "privatization certificates" is set forth in the Ukraine Law on Privatization Certificates, adopted on Mar. 6, 1992. The privatization of residential housing is regulated by the Ukraine Law on the Privatization of Housing Stock, adopted on June 19, 1992. On September 24, 1992, the European Bank for Reconstruction and Development gave an important boost to the privatization program by announcing it will provide Ukraine with assistance in organizing and implementing the new program.

33. Ukraine State Program for the Privatization of the Property of State Enterprises, adopted on July 7, 1992.

34. *Id.* art. 1.1.

35. *Id.* art. 1.2.

36. *Id.* art. 1.3.

37. A detailed discussion of privatization steps and methods is beyond the scope of this article. For a comprehensive discussion of Ukraine's privatization rules and methods, see Salbaing & Gogek, *Ukraine Proceeds with Ambitious Privatisation Programme*, 10 *Doing Business in Eastern Europe* (CCH) 1 (Oct. 21, 1992).

upon investment projects. Because privatization is defined broadly as the "acquisition" of state property (not only the privatization of enterprises), the new rules potentially apply to any disposition of state property into private ownership. Since many commercial transactions and foreign investment projects entail some form of sale or contribution of assets from Ukrainian state entities, foreign investors should confirm that such transactions do not contravene the privatization rules. Often, it is simplest to request such confirmation from the Ukraine State Property Fund, which retains authority and responsibility for implementing the privatization laws and program.

D. OVERVIEW OF OTHER RULES AFFECTING FOREIGN INVESTMENT

1. *Import/Export and Barter Rules*

Unless otherwise provided in the Foreign Investment Law or other applicable legislation, foreign investors must comply with general Ukrainian procedures and rules governing customs duties, export or import bans, quotas, and license requirements under Ukrainian legislation. Foreign investors should therefore check to determine whether any contemplated import or export activities are banned or require a license prior to finalizing such transactions.³⁸

Barter transactions were specifically authorized, and simultaneously regulated, by a resolution passed by the Ukrainian Supreme Soviet in May of 1992 (the Barter Resolution).³⁹ The Barter Resolution requires that a hard currency value be stated in all barter agreements, and imposes a state barter fee of 10 percent of the value of the products to be exported. (The barter fee may be reduced to 5 percent if the *imported* products include technology, equipment, components, spare parts, raw materials or semifinished goods.) This amount is to be paid by the Ukrainian barter participant, in hard currency, within sixty days from the export date. The barter fee is waived if the goods are imported for use by the Ukrainian party, and not for resale. All barter transactions must be registered with the Ukrainian Ministry of Foreign Economic Relations and Trade. In practice, this registration requirement will likely be used as an opportunity for the Ministry to review the barter agreement to ensure that the values set forth are not understated.

2. *Taxation*

Foreign investors are subject to general Ukrainian laws on taxation, as modified by any tax incentives established in the Foreign Investment Law.⁴⁰ The Ukrainian

38. For example, the Ukraine Supreme Court Decree, "On the List of Goods for Which Export Licensing and Quota Conditions are to be Established," enacted May 12, 1992, sets forth a list of goods subject to license and quotas for 1992. The list includes thirty-six categories of products, including many agricultural and natural resource items.

39. Ukraine Supreme Soviet Resolution, "On the Conduct of Barter Operations in 1992 in the Area of Foreign Economic Activities," enacted May 12, 1992.

40. See *supra* part I.A.1.b.

Law on the Taxation of Incomes of Enterprises and Organizations (Enterprise Tax Law) establishes the general rules of corporate taxation, as well as the rates to be in effect until the end of 1992.⁴¹ During 1992, the tax rate for most enterprises and organizations was 18 percent.

For Soviet joint ventures created prior to January 1, 1992, the implementing decree of the Enterprise Tax Law confirms the two-year tax exemption from the first receipt of profits for any joint venture in material production created before January 1, 1992, where the share of foreign investment exceeds 30 percent.⁴²

3. *Banking and Currency Matters*

The Foreign Investment Law establishes that operations in currency by foreign investors must comply with general Ukrainian currency legislation.⁴³ The following subsections briefly discuss several laws governing banks and currency matters with which a foreign investor must comply.⁴⁴

a. *Banking*

The Law on Banks and Banking Activity (Banking Law)⁴⁵ established the National Bank of Ukraine as the central bank of the Ukraine. In addition, this law recognizes commercial banks such as the Ukrainian Savings Bank and the Ukrainian Bank for Foreign Trade (Vneshekonombank of Ukraine).⁴⁶ The Banking Law also authorizes the creation of private commercial banks, subject to licensing from the National Bank of Ukraine,⁴⁷ and the selling of foreign currency originating from sources located on Ukrainian territory.⁴⁸ Other currency opera-

41. Ukraine Law on the Taxation of Incomes of Enterprises and Organizations, adopted by the Ukrainian Supreme Soviet on Feb. 21, 1992 [hereinafter Enterprise Tax Law], implemented by the Decree of Feb. 21, 1992, On the Order of the Implementation of the Ukrainian Law On the Taxation of Incomes of Enterprises and Organizations. See also the Ukrainian Law on the Taxation System (Law on the Taxation System), adopted on June 25, 1991. The Law on the Taxation System establishes the general system and framework of taxation of all enterprises in Ukraine. In addition, an Instruction on Taxation of Enterprises with the Participation of Foreign Investors, addressing tax treatment of certain foreign investments, was passed on Jan. 27, 1992.

42. Resolution of Supreme Soviet on Entry into Force of Law on Taxation of Incomes of Enterprises and Organizations ¶ 8. Also, the resolution mandates that 3 percent of an enterprise's salary funds must be paid to the state employment fund. *Id.* ¶ 14.

43. Foreign Investment Law, *supra* note 3, arts. 26, 30.

44. At the time of completion of this article, the Ukrainian Government announced that introduction of the Ukrainian national currency, the "grivna," will be delayed indefinitely because of severe economic problems. In July 1991, Ukraine issued transitional coupons called "U-roubles" which replaced a food "coupon" system terminated on July 1, 1991. These new coupons, convertible into Russian roubles, are to be used only during a transitional period until such time as the new Ukrainian currency is fully implemented. Ukraine also plans to introduce its own accounting unit, the "Karbvnets," in 1993.

45. Ukraine Law on Banks & Banking Activity, adopted Mar. 20, 1991, effective May 1, 1991 [hereinafter Banking Law].

46. *Id.* art. 22.

47. *Id.*

48. Foreign Investment Law, *supra* note 3, art. 3.

tions are neither expressly authorized nor forbidden. Under the law only the Vneshekonombank of Ukraine and the National Bank of Ukraine, or other licensed "authorized banks," have jurisdiction with respect to foreign currency.⁴⁹ Ukrainian entities are required to deposit all foreign currency earnings in accounts in authorized banks in Ukraine, unless the Ukrainian National Bank authorizes maintenance of funds offshore.⁵⁰ We are aware of only seven such authorizations granted to date.

b. Foreign Currency Revenue Tax

In February of 1992, Ukraine adopted a hard currency earnings tax that requires Ukrainian entities to pay to the state a varying percentage of all foreign currency earned from the sale of goods or services in the domestic market or abroad.⁵¹ The percentage rate ranges from a low of 15 percent for most agricultural and food products, to a high of 75 percent for vodka, natural gas, and precious metals. Entities with greater than 30 percent foreign ownership are exempt from this tax.

In our experience, the existence of this hard currency tax, coupled with the exemption for entities with greater than 30 percent foreign ownership, has resulted in Ukrainian entities attempting to structure otherwise simple commercial transactions through joint ventures with foreign participation in order to ultimately retain more foreign currency.

4. Securities and Brokerage Activity

Brokerage services and similar economic activities are specifically permitted under the Foreign Economic Activity Law subject to general licensing rules.⁵² On June 18, 1991, the Ukrainian Supreme Soviet passed the law on Securities and Stock Exchanges. The law contains requirements which will apply to all securities, including those issued by joint-stock companies with foreign investment. In addition, the Foreign Investment Law specifically authorizes foreign investment in Ukraine securities.⁵³

5. Antitrust Legislation

Pursuant to the Foreign Economic Activity Law, foreign investors may not hold a monopolistic position in an import/export market.⁵⁴ A monopolistic position for

49. Banking Law, *supra* note 45, art. 8.

50. Ukraine Supreme Soviet Resolution "On the Establishment of Hard Currency Funds in Ukraine," adopted Feb. 5, 1992 [hereinafter Hard Currency Resolution].

51. *Id.* This obligation apparently has replaced the previous forced conversion requirement. For a comprehensive discussion of both the Hard Currency Resolution, and the Barter Resolution (discussed in part I(D) of this article), see Vecchio, *Betting on Barter in Ukraine*, Vol. 3, No. 4, SURVEY OF EAST EUROPEAN LAW 1 (July 1992).

52. Foreign Economic Activity Law, *supra* note 28, art. 4.

53. Foreign Investment Law, *supra* note 3, art. 3.

54. Foreign Economic Activity Law, *supra* note 28, art. 20. The Foreign Economic Activity Law provides, however, that foreign investors may be granted exclusive rights to import or export in certain industries, such as military equipment, nuclear technologies and materials and precious metals.

this purpose is defined as 50 percent or more of the exports or imports of a particular product. The Foreign Economic Activity law also prohibits price-fixing and other anticompetitive activity,⁵⁵ as well as unfair competition, which is considered to include dumping, trademark infringement, false advertising, and misleading comparative advertising.⁵⁶

6. *Property and Ownership Rights*

In addition to the principles of ownership covered by the Foreign Investment Law,⁵⁷ the Ukraine Law on Property (Property Law) provides for ownership of "houses, apartments, personal items, dachas, . . . stock and securities" and other forms of property, including intellectual property.⁵⁸ The Property Law specifically extends all forms of property rights, including ownership, to foreign companies, citizens, and joint ventures.⁵⁹ The Property Law provides expressly that land, underground resources, air, and water are "objects of exclusive ownership by the people of the Ukraine."⁶⁰ The Ukraine Land Code, adopted March 13, 1992, provides for limited ownership of land by Ukrainian citizens in particular circumstances.⁶¹ Foreign investors may not own land, but may hold certain land use rights, subject to restricted transfer provisions.⁶²

7. *Employment Issues*

The Foreign Investment Law provides foreign investors with a fair amount of latitude on employment issues, provided that minimum labor standards established by Ukrainian legislation are met.⁶³ On March 1, 1991, Ukraine passed a law on Employment of the Population (Employment Law).⁶⁴ Under the Employment Law, Ukrainian citizens may work for "enterprises, institutions and organizations, regardless of the forms of ownership, in international and foreign organizations in [Ukraine] and abroad."⁶⁵ The Employment Law allows in-kind payments to employees, but is ambiguous as to foreign currency remuneration, providing that employment may bring "income in monetary or other form, such as wages, maintenance, additional allowances and payment in kind."⁶⁶ Finally, international treaties are granted supremacy.

55. *Id.* art. 20.

56. *Id.* art. 31.

57. Foreign Investment Law, *supra* note 3, arts. 3, 4.

58. Ukraine Law on Property, adopted Mar. 26, 1991, effective Apr. 15, 1991, art. 3.

59. *Id.* art. 13.

60. *Id.* art. 1.

61. Ukraine Land Code, adopted Mar. 13, 1992, art. 6.

62. *Id.* arts. 7-8.

63. Foreign Investment Law, *supra* note 3, art. 36.

64. Ukraine Law on Employment of the Population, adopted Mar. 1, 1991, effective July 1, 1991.

65. *Id.* art. 1.

66. *Id.*

8. *Environmental Issues*

Ukraine continues to experience severe environmental problems, not only as a result of Chernobyl, but also stemming from decades of increasing industrial output without adequate environmental safeguards. The Ukraine Ministry of Environmental Protection is currently drafting broad-based environmental legislation to introduce minimum environmental standards and to impose sanctions for violating these standards.⁶⁷

9. *International Agreements*

Certain Ukrainian laws, such as the Foreign Investment Law and the Law on Investment Activity, provide that international agreements shall prevail over contrary provisions in the law.⁶⁸ Ukraine has expressly reaffirmed its obligations under all "international treaties concluded . . . prior to the proclamation of Ukrainian independence."⁶⁹

Ukraine is in the process of negotiating and concluding new trade, investment and tax treaties with other countries worldwide. For example, Presidents Bush and Kravchuk signed a trade agreement on May 6, 1992, which entered into force on June 23, 1992.⁷⁰ The new trade agreement (almost identical to the former U.S.-U.S.S.R. trade agreement) provides for most-favored nation tariff treatments, incentives for establishing commercial representations, and increased protection for intellectual property rights.⁷¹ In addition, on May 6, 1992, the United States and Ukraine concluded a bilateral agreement that will allow U.S. investors to buy political risk insurance through the U.S. Overseas Protection Investment Corporation (OPIC).⁷² We understand that the United States and Ukraine are expected to finalize negotiations soon on a new bilateral tax treaty.

II. Available Business Forms for Foreign Investments

We discuss below the range of business forms currently available, either for direct foreign investment, or for establishing a representative office, in Ukraine. We also address current Ukrainian registration requirements which must be followed to establish such entities or representations.

67. See *New Ministry Developing Clean-Up Strategy for Environment*, UKRAINIAN BUSINESS DIGEST, Sept. 1992, at 7.

68. See, e.g., Foreign Investment Law, *supra* note 3, art. 6.

69. Law on Legal Succession of the Ukraine, *supra* note 2, art. 6.

70. *U.S., Ukraine Trade Agreement Takes Effect*, INT'L TRADE RPTR. CURRENT REPORTS 1182 (July 8, 1992).

71. *Id.*

72. White House Press Release, U.S.-Ukraine OPIC Agreement, May 6, 1992.

A. CREATION OF A NEW COMPANY, SUBSIDIARY OR PARTNERSHIP

1. *Jointly Owned Entities*

The Law on Business Partnerships⁷³ makes the following six jointly owned business forms available to all investors, including foreign investors. Each of these forms requires a minimum of two founders.

- (a) The open joint stock company is a limited liability enterprise whose shares may be traded freely on an exchange. The minimum capital is 100,000 roubles.⁷⁴
- (b) The closed joint stock company is a limited liability enterprise, the shares of which may not be freely traded on an exchange. However, shares may be traded freely in private transfers, or the company charter may place restrictions on transfers. The minimum capital is 100,000 roubles.⁷⁵
- (c) The limited liability company is a closely held company with limited liability. It does not issue shares. Instead the owners own "parts." Owners have statutory rights of first refusal on the transfer of parts. The minimum capital is 50,000 roubles.⁷⁶
- (d) The quasi-limited liability company is similar to a limited liability company. This corporate form permits the owners to provide in the statutory documents that they will be liable up to specified amounts beyond the authorized capital.⁷⁷
- (e) A general partnership is similar to a Western general partnership; the entity is created pursuant to an agreement between partners. Partners are jointly and severally liable.⁷⁸
- (f) A limited partnership is similar to a Western limited partnership; the general partners are jointly and severally liable. Limited partners are liable only to the extent of their capital contributions.⁷⁹

2. *Wholly Foreign-Owned Subsidiaries*

The foreign investor may create a wholly owned subsidiary in either of two ways: (a) one of the above corporate forms, such as a joint stock company, is created and held by two companies within the foreign investor's group of companies; or (b) the subsidiary is held by a single parent company.

73. Ukraine Law on Business Partnerships, adopted Sept. 19, 1991 [hereinafter Business Partnership Law]. The form of joint venture that previously existed under USSR Decree No. 49 of Jan. 13, 1987, is no longer used for the creation of new enterprises in Ukraine. In practice, however, such entities formed prior to Ukrainian independence are still valid, although certain joint ventures have been required to amend their charter documents to comply with current legal requirements.

74. *Id.* arts. 24-25.

75. *Id.*

76. *Id.* arts. 50, 52.

77. *Id.* art. 65.

78. *Id.* art. 66.

79. *Id.* art. 75.

a. Owned by Two or More Offshore Affiliates

The corporate forms outlined above and set forth under the Law on Business Partnerships require two founders. Thus, although the new company may be 100 percent owned by a foreign investor, Ukrainian law, as currently interpreted, requires at least two foreign founders.⁸⁰

b. "Single Parent" Subsidiaries

On the basis of a Business Enterprise Law, a wholly owned subsidiary may be created as a generic enterprise.⁸¹ In contrast to the jointly owned corporate forms described above, generic enterprises have only one founder. The Business Enterprise Law does not specify a minimum capital for such an enterprise. Such entities are probably considered to have limited liability, but this is not yet definite.⁸²

B. REPRESENTATIVE OFFICES

As an alternative to creating a new company in Ukraine, the foreign investor may choose to open a representative office, as provided under the Law on Foreign Economic Activity.⁸³ A representative office is defined as "an institution or person representing the interests of a foreign party" in regard to economic activity in Ukraine and "duly vested with full powers thereto."⁸⁴ A representative office is *not* a separate legal entity.

C. REGISTRATION OF FOREIGN INVESTMENTS

1. *Registration of New Entities*

All new entities created pursuant to the Law of Business Partnerships, such as companies, wholly owned subsidiaries, and partnerships, must be registered in order to acquire legal personality.⁸⁵ Registration is carried out in accordance with the procedures set forth in the Business Enterprise Law.⁸⁶ Under article 6 of the Business Enterprise Law, registration takes place at the local city council level.

80. Note that in practice an alternative is available: it is possible to arrange for a nominee to hold a minority share of the new company. We have been advised that the nominee's share may be designated as nonvoting.

81. Ukraine Business Enterprise Law, effective Apr. 1, 1991 [hereinafter Business Enterprise Law], art. 2.

82. *See id.* art. 36.3.

83. Foreign Economic Activity Law, *supra* note 28, art. 5.

84. *Id.*

85. Business Partnership Law, *supra* note 73, art. 6.

86. *Id.* art. 6. The Business Enterprise Law, *supra* note 81, art. 6 also enumerates the rules for registration and activity of all individuals and "juridical persons under all forms of ownership as established by the Law on Property." Under the Business Enterprise Law, businesses are registered at the local level, by submitting an application and other documents as required. Note that registration should not be confused with obtaining licenses, which are generally obtained following registration of the enterprise. Certain activities, such as mineral exploration, or the manufacture or sale of alcoholic beverages, require specific licenses from the Ukraine Council of Ministers.

In Kiev, this is the Kiev City Council Administration, formerly the Council of Peoples' Deputies. The documents to be submitted for registration vary as to the type of entity formed, but normally include: (i) an application; (ii) the charter of the enterprise and the decision of the founder (in joint-stock and limited liability companies a founding agreement and charter must be submitted); (iii) a letter of good standing from each foreign founder's bank; and (iv) other documents required under specific legislation (generally, a protocol or minutes of the founding meeting). A certificate of registration is to be issued within one month of the application, although in practice the registration process can take much longer.⁸⁷

2. *Registration of the Foreign Investment*

Foreign investors must also register their foreign investments with the Ministry of Finance, in accordance with procedures under the Foreign Investment Law. The registration is necessary in order to be eligible for the various tax advantages and other privileges (such as customs' exemptions) set forth in the Law on Foreign Investment.⁸⁸ The Ministry of Finance has prepared a standardized registration form that requires certain essential information about the scope, form, and term of the foreign investment. Additional information may be required for some foreign investments.⁸⁹

3. *Registration of a Representative Office*

A representative office must be registered with the Ukraine Ministry of External Economic Relations (MEER). In order to register a representative office, the following materials must be filed with MEER: (i) an application for registration; (ii) evidence of registration in the country in which the foreign entity has an officially registered office; (iii) a bank statement from the bank in which the applicant has an officially registered bank account; and (iv) a power of attorney authorizing representative office functions.⁹⁰ The documents must be notarized and consularized prior to filing. MEER is required to grant or deny the registration within sixty days of application, although in our experience this deadline is not always met.⁹¹

III. **Practical Issues Relating to Foreign Investment Projects in Ukraine**

Despite the long list of commercial laws that are now on the books in Ukraine, one of the major hurdles to doing business in Ukraine is the reality that the commercial and legal regime remains in an early phase of its development. Many

87. Business Enterprise Law, *supra* note 81, art. 6.

88. Foreign Investment Law, *supra* note 3, arts. 15-19.

89. *Id.* art. 15.

90. Foreign Economic Activity Law, *supra* note 28, art. 5.

91. *Id.* art. 5.

of the new laws often raise as many issues as they attempt to resolve. Institutions are still not in place to provide official interpretations of the laws. In addition, the laws are not always applied in practice as might be expected. For this reason the foreign investor should be aware of certain legal, practical, and commercial issues that invariably emerge in any Ukrainian foreign investment project.

A. CHECKLIST OF ISSUES

Although each foreign investment project will present its own set of legal, practical, and commercial issues, the following summary of issues should serve as a useful checklist against which to review the proposed project.

1. *Scope of the Project*

- What are the commercial goals of the investment project? Frequently a clear definition of the goals will help resolve many of the issues listed below.
- Can the goals be structured and presented in such a way as to qualify for special privileges or preferences available to foreign investments in certain sectors of the economy? For example, the Foreign Investment Law expressly allows the granting of additional privileges to foreign investments in "priority branches of the national economy and social sphere" under state programs set up for the encouragement of foreign investments.⁹²

2. *Ukrainian Partners*

- Is the investment project best carried out in cooperation with one or more Ukrainian partners? While the new Foreign Investment Law permits the creation of wholly owned foreign subsidiaries in the Ukraine, it may be commercially more feasible to carry out the project with local partners. In addition, various tax holidays (described above in part I) are not available to the wholly owned subsidiary.
- If the project is to be carried out with Ukrainian participation, is the proposed Ukrainian partner the most suitable for the tasks to be performed, and does the Ukrainian party have the authority and rights necessary for performance of its obligations? The success of the project may depend on the performance of certain tasks that may effectively be carried out only by particular Ukrainian entities.

3. *Form of the Investment*

- Are the goals of the project best achieved through the creation of a new company, such as a joint-stock company, or some alternative form?

92. Foreign Investment Law, *supra* note 3, art. 8.

- If a joint-stock company is chosen, will it be closely held (a closed joint-stock company) or will the shares be sold to the public (an open joint-stock company)?
- If a new company is to be created, what is the appropriate level of foreign participation in the capital of the company? Various thresholds of foreign participation (for example, 20 percent, 25 percent, and 30 percent) are established under different laws as a condition for the company to have certain rights, benefits, and privileges.
- Would a simple commercial transaction, or establishment of a representative office better meet the foreign company's immediate goals?

4. *Possible Impact of Privatization Rules*

- Does the proposed investment project fall within the scope of the Ukrainian privatization rules?
- If so, should the project be carried out within the framework of the privatization program?
- Alternatively, can special derogation from the competent Ukrainian authorities be obtained, confirming that the proposed investment may be completed notwithstanding otherwise applicable privatization rules?

5. *Local Sales vs. Exports*

- Will sales be limited to the Ukrainian market, or will exports be made?

6. *Hard Currency Issues*

- How will the investment project earn hard currency?
- What licenses, permits, or other authorizations, if any, will be necessary to conduct any proposed foreign economic transactions?

7. *Tax Aspects*

- Will the proposed investment project take advantage of tax benefits available?
- Is the proposed investment project being structured to take advantage of tax benefits available under international treaties? In principle, the Ukraine has agreed to adhere to international tax treaties concluded with the former USSR. Many of those treaties reduce local taxation on payment flows such as dividends, interest, and royalties to zero. Over time, Ukraine seems likely to conclude new bilateral tax treaties directly with other states. The status of such treaties should be checked on a case-by-case basis.
- Are any tax benefits available under agreements between the CIS member states? Will the proposed investment project involve trade transactions within the CIS that may qualify for such benefits?
- Will the proposed investment project subject the foreign investor to direct taxation in Ukraine?

8. *Financing the Project*

- How will the project be financed? The financing of investment projects in Ukraine continues to present one of the most difficult obstacles to doing business there.
- Will the proposed investment project require a bank account outside of Ukraine? Ukrainian law requires approval from The National Bank of Ukraine for such accounts, and such approvals are given sparingly.
- Will external financing be sought? Will security on property in Ukraine be required? At the time of writing, this generally presents a serious hurdle, as no specific Ukrainian law on mortgages or pledges exists.
- Are shareholder loans or other forms of financing from shareholders contemplated? Current Ukrainian tax laws are unclear as to whether interest payments on loans from shareholders are deductible. Under the tax rules of the former Soviet Union (the continued application of which remains unclear in Ukraine), such interest payments were not deductible.

9. *Antitrust*

- Will the proposed investment project give rise to a monopolistic position within the Ukrainian market? Does the proposed Ukrainian partner already occupy a monopolistic position? Under the Law on Foreign Economic Activity, a monopolistic position is defined (in the context of cross-border trade) as having more than 50 percent of the export/import market of a particular product.⁹³
- Does the proposed investment project include the grant of exclusive distribution rights?
- Will the foreign investor be adequately protected against unfair competition?

10. *Transfer of Technology*

- What forms of technology or intellectual property are being made available to the new enterprise or Ukrainian partner, if any? Have the transfers of technology been appropriately structured to protect the foreign investor's proprietary rights and provide for confidentiality safeguards?
- If the project involves transfer of Ukrainian technology or proprietary rights, has the Ukrainian partner satisfactorily documented ownership of the intellectual property and authority to transfer the rights as contemplated in the transaction?

11. *Applicable Law*

- What law will govern the particular project?
- Can non-Ukrainian law be designated, and if so, what law will Ukrainian partners accept?

93. Foreign Economic Activity Law, *supra* note 28, art. 20.

12. *Dispute Settlement*

- Can foreign arbitration be designated in all contracts with respect to the project?

13. *Environmental Issues*

- Has an environmental study been conducted for any land or buildings which may be the site of investment projects? Because of the changing nature of Ukraine's environmental laws and regulations, it is prudent not only to seek confirmation that all environmental standards are being met, but also to attempt to negotiate an indemnification from the Ukrainian party for environmental liabilities.

IV. Legal Documentation and Negotiation of the Investment Project

This section presents a general overview of the steps involved in negotiating, documenting, and closing the investment transaction.

A. PROTOCOL/LETTER OF INTENT

Although not required under Ukrainian law, an initial step that is often crucial to the success of the project is signing a brief but well-drafted protocol or letter of intent. While the protocol is often viewed from the Western point of view as a nonbinding statement of intentions, it is generally given more weight in Ukrainian business relations, as it is viewed as the important first step in mutual cooperation. Some of the essential elements of a proper protocol include:

- (1) A succinct, but complete summary of the fundamental goals of the proposed investment project and the general terms of the business agreement that have been decided.
- (2) A description of the obligations of the parties with respect to completing the proposed transaction prior to closing.
- (3) Inclusion of a schedule for completing the transaction, including allocation of responsibility for completing specific tasks.

B. FEASIBILITY STUDY

Ukrainian law does not require submission of a feasibility study (similar to a Western-style business plan) as part of the constitutive documents to be filed upon registration. Nonetheless, preparation of a feasibility study is advisable, in order to better focus key business issues and assumptions of the parties prior to expending large amounts of time and money. In addition, a feasibility study may be required for the purpose of obtaining outside financing, or to obtain official approvals from the Ukrainian authorities.

C. AGREEMENT AND CHARTER

For the creation of open or closed joint-stock companies, as well as limited liability companies, the founding documents will consist of an agreement and charter. Although no mandatory rules as to the form of such documents exist, both the agreement and charter will have to comply with specific requirements set forth in the Law on Business Partnerships.⁹⁴ These documents are normally drafted and negotiated in English (or other native language of the foreign investor) and in Russian or Ukrainian, although they must be submitted in Ukrainian for registration purposes. It is possible to specify that the English version will govern in the event of a dispute.

D. STATE APPROVALS OF THE INVESTMENT PROJECT

Various official approvals will be required depending on the nature of the project, the area of activity, and the identity of the Ukrainian partner. When such approvals are key to the project, we recommend making satisfactory receipt of such approvals a condition precedent either to registration, or to commencement of a foreign party's obligation.

E. REGISTRATION OF THE INVESTMENT AND/OR NEW COMPANY

As noted above in part II, two registrations are required in the creation of a new Ukrainian company. First, the newly created Ukrainian company must be registered in accordance with the Law on Business Enterprises.⁹⁵ In addition, the foreign investment itself must be registered with the Ukrainian Ministry of Finance, in order to be eligible for certain tax and other foreign investment incentives.⁹⁶

V. Conclusion

Ukraine offers immense potential to the foreign investor, as it is rich in resources, has a relatively well-educated labor force, and is a promising future market for foreign goods. It has established a relatively comprehensive set of foreign investment laws, and has attempted to provide substantial incentives to attract foreign capital. However, it is crucial to view these new laws and opportunities against the backdrop of current reality: a new legal structure and burgeoning institutions; severe economic problems, including soaring inflation and flagging production; and the resulting potential for political instability and civil unrest. In

94. Business Partnership Law, *supra* note 73.

95. Business Enterprise Law, *supra* note 81, art. 6.

96. Foreign Investment Law, *supra* note 3, arts. 15-19. Registration of representative offices of foreign companies, however, takes place with the Ministry of External Economic Relations, in accordance with the Law on Foreign Economic Activity.

this context, in the authors' experience, foreign investment projects in Ukraine enjoy the greatest chance for success when early and informed attention is given to defining the commercial issues, structuring the transaction, and documenting the agreement between the parties.⁹⁷

97. The publication deadline for this article was November 9, 1992; therefore, developments occurring after that date are not reflected herein.

