

# **Doing Business in Ukraine**

**2010**



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# 1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 70 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Ukraine has been provided by the office of UHY representatives:

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Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and

take professional advice before making any decisions. This publication is current at February 2010.

We look forward to helping you do business in the Ukraine.

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## **2. Business environment**

Ukraine is an Eastern European country. It occupies a land area of 603,700 sq km, which makes it the second largest country in Europe. 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. On 1 December 1991, 90.3% of those who voted approved a referendum formalizing independence from the Soviet Union and Ukraine's independence was recognized officially by the international community.

The Head of Ukraine is the President, who is elected by voting for a five-year term.

Legislative power is exercised by the Verkhovna Rada, which comprises 450 deputies and is elected every four years.

The highest Executive body is the Cabinet of Ministers. The Cabinet of Ministers is nominated by the parliamentary majority and approved by the President.

Ukraine is comprised of 24 regions and the Autonomous Republic of Crimea.

The Constitution of Ukraine was adopted in June 1996. The powers of government are divided into three branches: legislative, executive and judicial.

### **Population**

Ukraine's population amounts nearly 45,870,700 people. The capital of Ukraine is Kyiv with 2.7 million people. More than two-thirds of the population live in urban areas. Females constitute 54% of the population.

### **Language**

The official language of Ukraine is Ukrainian. The majority of Ukrainian population speaks both Ukrainian and Russian. English is also used in business.

### **Unemployment**

In 2010 the official unemployment rate is about 8.7%.

### 3. Foreign investment

The successful transition to a market economy in Ukraine will depend to a great extent on the development of an adequate legal infrastructure to support an attractive and enabling investment environment. Traditionally, international financial institutions and other multilateral aid organizations have focused on the adoption of macro-economic structural reform measures consisting of the elimination of exchange controls, price liberalization, restrictive fiscal and credit policies and privatization to facilitate the transition from command economies to market systems in the post-communist societies of Central and Eastern Europe.

Ukrainian authorities regularly try to encourage foreign investment and the broader public is well disposed to foreign investment.

Investment permits are not required, but all enterprises must be established according to the form and procedure prescribed by Ukrainian law and registered with appropriate government agencies. Foreign investors are generally not required to seek special approval from authorities for foreign direct investments.

There are some restrictions for foreign investments in the publishing and broadcasting sectors, and foreigners are not allowed to participate in the manufacturing of weapons.

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.

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 exist in the publishing and broadcasting sectors, and foreigners are not allowed to participate in the manufacturing of weapons.

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.

## 4. Setting up a Business

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.

### **Limited liability companies**

A limited liability company (LLC) does not have shares in a traditional sense. Participants in a LLC own a percentage in the company's capital, as specified in its Charter.

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'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. LLC does not generally require a financial audit unless demanded by a participant holding greater than 10% of the capital.

### **Joint stock companies**

A joint stock company (JSC) is a legal entity whose share capital is divided into a 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 "public" or "private" JSC. Ukrainian joint-stock companies are similar in function to Russian JSC; however, in some aspects they are closer to more western joint-stock companies.

A public JSC is established via a public offering and subscription of shares; a private JSC's shares are distributed privately among the founding shareholders. At least two founding shareholders are necessary to create a JSC. They are free to determine among themselves the share distribution that each will have in the legal entity. Shares issued by both closed and public JSCs must be registered with the State Commission of Securities and Stock Market. There are two levels of taxation: the JSC is taxed on its profits and the shareholders are then taxed when dividends are distributed.

## **Representative offices**

It is possible for a foreign company to establish a representative office in Ukraine. A representative office can carry out marketing, promotional, and other auxiliary and preparatory functions on behalf of the company. The establishment of a wholly-owned company in Ukraine would be recommended if the company intends to carry out manufacturing or other significant local commercial activities. There is no prohibition for a foreign legal entity to have both a representative office and to establish a wholly-owned subsidiary at the same time.

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

There are two types of representative offices in Ukraine: “permanent” representative office and representative office.

Registration of representative offices of foreign companies is handled by the Ministry for Foreign Economic Relations and Trade (MFERT) of Ukraine, and is done within 60 days of submission of all required documents and upon payment of a \$2,500 fee. A representative office also has to be registered with 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.

Permanent representative offices are corporate income tax payers.

Non-commercial representative office is generally not subject to VAT.

## **5. Labour**

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

Employers can enter into individual labour contracts with employees, the 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.

### **Salaries and wages**

Minimum wage levels are prescribed in the annual budget law. 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.

### **Social security system**

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.

Obligatory 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.

### **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. 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.

## 6. Taxation

In Ukraine all taxes are classified either as national or local. As a basic legal principle, taxes, their rates, tax collection procedures and tax incentives may be established only through the laws of Ukraine. National taxes such as Corporate Income Tax (CIT), Value Added Tax (VAT), Personal Income Tax (PIT), Customs Duties, and Excise Taxes account for the largest portion of budget revenues. Local authorities may also collect revenue from a number of local taxes, such as advertisement tax, community development tax, hotel tax, parking tax, recreation tax, and other taxes.

### Taxation of the legal entities:

- Corporate Income Tax
- Unitary tax (6 per cent + VAT; 10 per cent without VAT)
- Land rate
- Own transportation facilities tax
- Value added tax (VAT)(20 per cent)
- Excise duty
- Duties and fees
- Social insurance Fund
- Other taxes:
- State Tax
- The local taxes (municipal tax, advertising tax, right on usage of local symbolics fee, etc.)
- Environment contamination fee
- Use of natural resources fee.

### Taxation of individuals

- Income tax (according to the scales) 15 or 30 per cent
- Entrepreneur tax
- Own transportation facilities tax (depends on a volume of engine)
- Duties
- State Tax
- Usage of natural resources fee
- Local taxes and fees.

Ukraine has a broad network of tax treaties with foreign countries. Under such treaties the rates may be reduced to as low as 0% for dividends, interest and royalties.

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.

New Tax Code of Ukraine was enacted in 2010 and it changed rules of deduct most of taxes starting 2011.

## 7. Accounting & reporting

On the 1<sup>st</sup> of January 2000 the Law on Accounting and Financial Reporting was passed, introducing National Accounting Standards. The law states that these local standards should not contradict International Financial Reporting Standards (IFRS).

Ukrainian entities, as well as representative offices of foreign companies, must maintain accounting records and financial statements in accordance with National Accounting Standards. 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 (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.

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UHY Prostir Ltd has been established since 2003 and specialises in audit, outsourcing of accounting, tax, legal and financial consulting. Among our clients there are Atlas Ward Holdings, Schuko Ukraine, Sandoz d. d., NGO "Democracy through culture", HIAS Incorporated representative, Reckitt Benckiser Household, Healthcare Ukraine, Wavin Ukraine and others.

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