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Corporate Forms of Doing Business in Ukraine for Foreign Companies

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Since gaining its independence in 1991 Ukraine has been steadily liberalizing its economy and reducing the State's regulation and control over the business process. Presently, foreign persons and entities can conduct business in Ukraine using a variety of different forms. These forms include acting through a Ukrainian company, either a joint stock, limited liability or other statutory company or an ad hoc 100 per cent owned subsidiary company, or a Ukrainian representative office of a foreign company. Alternatively, a foreign person or entity can conduct business in Ukraine by using contracts, such as a contractual joint venture (which operates as if it is a separate entity) or a direct business contract, with a Ukrainian company, a qualifying Ukrainian individual or the State. These various methods are treated differently under Ukrainian law.

The choice of the appropriate form depends on the particular needs and interests of the foreign entity, eg the projected volume of its operations in Ukraine and the extent and type of involvement in the relevant Ukrainian market. A foreign entity may want to change the method used for its Ukrainian business activity, or use several different methods simultaneously, depending on the stage of development of its operations in Ukraine. This chapter provides an overview of the relative advantages presented by each of these ways of doing business, and the procedure to register a foreign investment.

Ukrainian companies

Both a statutory company and a 100 per cent subsidiary company (described below), being Ukrainian legal entities, should benefit from the same rights and obligations in Ukraine even if owned by foreign persons and entities. Statutory companies, meaning those created according to the statutory requirements of the Law of Ukraine 'On Business Associations' of 19 September 1991, as amended, and related legislation (hereafter collectively referred to as the Law on Business Associations) for company formation, must have two or more shareholders (even if 100 per cent owned and controlled by a single corporate group as a 'subsidiary' – as that term is used in the West). There are five types of statutory companies, of which the most commonly used are joint stock companies and limited liability companies. Several of the other types of statutory companies are similar to the US limited partnership.

By contrast, Ukrainian law also permits 'ad hoc' companies (the most well-known of which is often referred to as the 'subsidiary company', that is wholly owned by one shareholder and which should not to be confused with the more general English term 'subsidiary'), the characteristics of which are based largely only on what the relevant charter provides. Unlike for the statutory types of companies, the ad hoc company's requirements are not heavily regulated under Ukrainian law, its status is somewhat undefined and therefore we usually recommend against using such companies. For example, there are no legislative provisions on the minimum amount of the charter fund for such entities. There have been a number of cases where issues on these matters have caused misunderstandings between the founders of a subsidiary company and the state bodies responsible for the registration of companies. By contrast, in the case of joint stock companies and limited liability companies, the minimum amount of the charter fund required by the Law on Business Associations is specifically denominated, currently being equal to UAH147,500 (approximately US\$27,315) for joint stock companies and UAH11,800 (approximately US\$2,185) for limited liability companies.

Presently, the registration of a company, including both the basic state registration (see Table 4.1.1) and registration with all the appropriate state bodies as required for operations (for example, with the tax administration, employment fund, etc) takes from two weeks to one month. After its registration the newly established company may, in principle, engage in any type of business activity authorized by its charter that is not directly forbidden by Ukrainian law and upon obtaining applicable permissions and licences for the activities subject to licensing under Ukrainian law.

Table 4.1.1 Documents required for the state registration of a company in Ukraine

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- foundation documents (consisting of a decision of the founder or a foundation agreement (if more than one founder) and a charter);
 - standard form registration card;
 - document confirming the payment of the registration fee;
 - document confirming the payment by the founder(s) of their contribution(s) to the charter fund;
 - document confirming the right of the founder to use the premises as the legal address of the new company;
 - document confirming the registration of those founders that are legal entities (must be notarized and legalized in the case of a foreign legal entity);
 - document confirming the authority of the person filing the documents; and
 - report on the results of the subscription for shares of stock, certified by the State Commission on Securities and Stock Market (for open joint stock companies).
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What is authorized by the charter is, presently, rather strictly construed. The current Civil Code of Ukraine, adopted in 1961, reflects the Soviet law concept of the 'special capacity' of a legal entity, based on which a legal entity has only such capacity as is granted by the founders and reflected in its charter. Such authorized capacity for action must be specifically described. Any contract and other action of the company outside of such expressly provided capacity may be declared invalid. The new Civil Code of Ukraine, partially adopted by the Ukrainian Parliament but not yet signed into law, provides that a company shall have a general capacity to act (at least unless otherwise limited in its charter), but until this becomes law charter provisions on the authorized aims and activities of a company must be carefully drafted. (There are other related problems as well, such as the refusal of the State Customs Service to permit a Ukrainian company to import goods if its charter fails expressly to authorize it to conduct 'foreign economic transactions'.)

Ukrainian legislation also establishes certain special requirements for the conduct of certain types of business activity. For example certain activities, such as construction, can be conducted only by Ukrainian companies licensed by an authorized state body or by specialized state-owned companies.

Foreign investment registration

To help secure the interests of a foreign legal entity operating in Ukraine through a statutory or subsidiary company, the foreign investor should obtain the state registration of its foreign investment. The authorized body for registering such investment is the local state administration of the *oblast* (region) or, in the case of Kyiv and Sevastopol, the city where the company in which the investment is made is registered.

This state registration gives the foreign investor the right to certain special guarantees and protection mechanisms. These include the protection of the foreign investment from nationalization and a guaranteed right for repatriation of the foreign investment and income derived from it, as well as a 10-year moratorium on the effect of any subsequent legislation changing any of these guarantees. A foreign investor also has a legal right to compensation for all losses, including lost profits and moral damage, incurred as a result of an act or omission of any Ukrainian state bodies. In practice, so far we know of no instance in which this latter remedy has been successfully applied for by a foreign company but, as the Ukrainian legal system develops, it is possible that successful redress along these lines will be obtained in the future.

Representative offices (branches)

A foreign legal entity may also operate in Ukraine through a representative office. This form of business activity is arguably the best option in order to have a minimal presence in the country. In Ukraine, a representative office of a foreign company does not, for most purposes, have the status of a separate Ukrainian legal entity and, therefore, is treated similarly to a branch of a resident Ukrainian company. The head of a representative office acts on the basis of a power of attorney issued by the parent foreign legal entity, and all contracts are concluded on behalf of the parent company. Unlike a resident Ukrainian legal entity, a representative office requires registration with the Ministry of Economy for its operations (although it is currently argued by some that registration with the state tax authorities should make the registration with the Ministry of Economy unnecessary, as a matter of practice both registrations should be made).

The activities of such representative offices of foreign companies may be exempt from income tax in Ukraine depending on the relevant tax treaty. Most tax treaties with Ukraine provide for an exempt status for a number of representative office functions, such as market research, storage of certain types of goods, marketing and other ancillary activities. Often foreign companies trading in Ukraine from abroad by contract establish local representative offices to assist with the proper performance

of their contracts. If, however, instead of merely assisting its foreign parent company the representative office itself trades, for example generally buying and selling goods commercially, then it will be subject to corporate income tax on its Ukrainian source income like any Ukrainian company.

When compared with merely concluding business contracts without any Ukrainian presence, operation through a representative office provides a foreign legal entity with a number of rights and obligations. By way of illustration, a foreign legal entity may purchase and resell goods within the territory of Ukraine only if it has a duly registered Ukrainian representative office. A representative office has the obligation of being responsible for withholding all taxes payable in Ukraine from the proceeds in transactions that it conducts which are payable to its parent foreign legal entity.

Contractual joint venture

Another alternative for a foreign legal entity to conduct business in Ukraine is the contractual joint venture – known in Ukraine as a ‘joint venture without the establishment of a legal entity’. Such a contractual joint venture in Ukraine must be created on the basis of a joint investment activity agreement between qualified subjects of business activity, being legal entities and individuals specially registered as entrepreneurs.

Often foreign legal entities use joint investment activity agreements as a first step in a business relationship with a resident company or where it is difficult for them to obtain a necessary licence, eg in the sphere of oil and gas exploration and production or for a certain construction activity where through a contractual joint venture a foreign company can effectively use a local company’s licence. Since such a joint activity agreement may be drafted so as to be relatively easily suspended or terminated, joint investment activity is often particularly suitable for the initial stages of a business project if the foreign party is then uncertain that it will want to proceed fully.

Such joint investment activity is treated for Ukrainian tax and many other purposes separately from the general activities of the various parties to it. Both the property contributed to the joint investment activity and the proceeds from it must be accounted for on a separate balance sheet, and special bank accounts must be opened for transactions of the joint investment activity. One party must be specially authorized to keep the records, represent the interests of the joint investment activity and file special reports to the relevant state bodies on the joint investment activity. The parties to a joint investment activity agreement share profits as they may agree among themselves or, if not

so agreed, based on the relative value of their contractually specified contributions to their joint venture.

Direct contracting

A foreign legal entity may also conduct business in Ukraine by concluding direct business contracts with Ukrainian legal entities or individuals, whether or not it has any local presence. Most of these business contracts fall within the legal criteria for special treatment under Ukrainian law as being 'foreign economic contracts'. In comparison to domestic business contracts, such foreign economic contracts may be governed by any law, Ukrainian or foreign, as chosen by the parties.

An important issue concerning foreign economic contracts is the relatively strict requirement as to the form for this type of contract. A failure to satisfy such form requirement may, as a matter of Ukrainian law, render such a foreign economic contract invalid, even if such matters of form are irrelevant under the foreign law that is stated to govern the contract.

Conclusion

Although the increasingly liberal legal regime in Ukraine facilitates foreign investment, Ukraine has become a legalistic society and close attention must be paid to detail when structuring and documenting any investment. Provided that the legal side is properly handled, a foreign company should be able to take advantage of the many investment opportunities arising as Ukraine's economy develops further along the lines of a market economy.

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