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# IMPORT-EXPORT IN UKRAINE





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# OVERVIEW OF IMPORT-EXPORT LEGISLATION

## I. Introduction

Since declaring its independence in August of 1991, the Ukrainian government has struggled to establish a legal system to accommodate its entrance into the global commercial economy. For instance, commercial structures are described in such legislative acts as the Civil and Economic Codes and the Law "On Economic Associations." In the case of joint stock companies, the Law "On Securities and the Stock Exchange" and relevant Ministry of Finance instructions will also apply.

Foreign investment is governed by the Laws "On the Protection of Foreign Investments in Ukraine," "On the Foreign Investment Regime," "On Foreign Economic Activities," "On Privatization of State-Owned Property," "On Privatization of Small State Enterprises (Small-scale Privatization)," "On Restoration

of the Solvency of a Debtor or Recognition of a Debtor as Bankrupt," and "On Secured Transactions," as well as the Land Code. In the case of privatization, additional State Property Fund (SPF) instructions must be analyzed. Other laws also impact foreign investment, such as taxation, currency and import-export regulations, and intellectual property laws.

The Parliament of Ukraine adopted all required legislative acts for the WTO accession. The new documents should be passed to the WTO Working Group, which will assess whether the laws meet the WTO standards. Afterwards, the laws should return to the Parliament for the final ratification as a whole and such ratification announce Ukraine's accession. The legislation will liberalize and facilitate the import-export transaction and will promote stable trade relationships with other WTO-members.



Therefore, it is incorrect to say that Ukraine's legislation is not functional. Admittedly, some provisions in Ukrainian legislation are ambiguous, and sometimes contradictory, while others are plainly unenforceable. Nevertheless, a jigsaw puzzle-like legislative system exists and, as dysfunctional as it may be, deserves the analysis contained herein. By way of introduction to the peculiarities of Ukrainian commercial law, we begin with an overview of the foreign economic activities and, specifically, import-export aspects of Ukrainian legislation.

### A. The Law "On Foreign Economic Activities"

All foreign entities (legal and physical) can engage in various forms of business activities in Ukraine and effectuate many types of investment. As a rule, any activity contemplating foreign participation is classified as "foreign economic activity," and is therefore subject to a specific legislative regime.

The Law "On Foreign Economic Activities," No. 959-XII, dated April 16, 1991, is clearly outdated. Nevertheless, it is still technically effective, and therefore deserves at least a superficial review. Drafted and enacted in the nostalgic pre-hyper-inflationary Soviet economic era, when the ruble zone provided Ukraine with necessary economic support, much of this antique law has been supplemented or amended, either legislatively or in practice. The unaffected remainder does not reflect the substantial changes in commercial legislation that have occurred since Ukraine's independence.

In its heyday, this law encompassed all types of "foreign economic activities," including export and import of goods, services and capital; servicing of foreign businesses; scientific activity and training of personnel; international financial operations and securities trading; credit and financial operations and the creation of corresponding institutions; joint entrepre-

neurial activity; entrepreneurial activity through the granting of licenses, patents, know-how, trademarks; conducting of shows, auctions, trade fairs, conferences, symposiums, seminars, etc.; wholesale, retail and consignment trading for foreign currency; leasing operations; currency trade and sale through currency auctions, currency exchanges and inter-bank currency markets; contracts between Ukrainian citizens and foreign legal entities; employment of foreigners in Ukraine, among others.

Regardless of the self-proclaimed breadth of its jurisdiction over all transactions involving foreign entities, in reality the law "On Foreign Economic Activities" primarily serves as a basis for effectuating import-export operations. Immediately below, we summarize the various facets of Ukrainian import-export legislation, as reflected by the supporting laws which accomplish what the law "On Foreign Economic Activities" never could: namely, provide a functional structure for standard import-export operations.

With this brief overview, we can begin our analysis of the relationships and rights between Ukrainian entities and foreign importers.

### B. Import-Export Contracts

According to the Law "On Foreign Economic Activities," the single most important rule is that a foreign economic (or cross-border) contract must be concluded in written form. Later, the Regulations "On the Form of Foreign Economic Agreements (Contracts)," approved by Order No. 75 of the Ministry of Foreign Economic Relations and Trade of Ukraine on October 5, 1995, provided a variety of standard clauses to be incorporated into foreign economic agreements executed in Ukraine.

Subsequently, Order No. 75 was rendered ineffective by Order No. 201 "On Approval of the Regulation on the Form of Foreign

Economic Agreements (Contracts)" issued by the Ministry of Economy and European Integration on September 6, 2001, which provides the guidelines regarding the material terms and conditions of foreign economic contracts, taking into consideration the relevant provisions of international agreements to which Ukraine is a party.

Until the end of October 1999, it was relatively well-settled that one of the key requirements for the execution of agreements with Ukrainian companies was the appearance of two signatures on behalf of the Ukrainian party. This requirement was repeatedly stated in the Law of Ukraine "On Foreign Economic Activities," as well as the above-mentioned Regulations. However, on October 21, 1999, the Parliament adopted the Law "On Amendments to Article 6 of the Law of Ukraine 'On Foreign Economic Activities,'" No. 1182-XIV, which excluded the dual signature requirement for foreign economic agreements.

No additional permissions or registrations of foreign contracts are usually required by the state administrative authorities, unless specifically provided otherwise by Ukrainian legislation or unless licensing is required in the specific import-export transaction. Several exceptions exist, however, including barter and counter-trade contracts with foreign parties, almost all contractual arrangements with Ukrainian state-owned enterprises (which are subject to review and approval by such enterprises' higher-standing organization, such as its Ministry), certain transactions in foreign currency (which require special permission from the National Bank) and, recently, joint investment agreements with foreign entities.

Today, any Ukrainian physical or legal entity may enter into foreign trade contracts without obtaining any special state permissions. That said, however, Ukrainian individuals engaging in any commercial activities (local or foreign) must now register as "subjects of

entrepreneurial activity" with the local state authorities and pay the much-dreaded income tax. The introduction of a simplified taxation procedure and a flat tax rate in 2004 (15% since January 1, 2007), however, have made the payment of income taxation almost commonplace.

Naturally, the parties to a foreign economic contract have the right to choose foreign arbitration for settlement of disputes. Alternatively, such issues can be resolved in Ukraine under foreign law by agreement of the parties. If the parties failed to agree as to choice of law under a contract, Ukrainian law will dictate the law to be applied to the contract. However, there are notable exceptions. For



example, contracts for the construction or acquisition of immovable property on the territory of Ukraine are governed exclusively by Ukrainian laws.

The form of foreign economic contracts is determined by the place of execution thereof, unless the parties provide otherwise. Accordingly, a contract entered into in a foreign country cannot be invalidated by Ukrainian laws for reasons of non-compliance with Ukrainian standard forms. However, such foreign economic contract must adhere to substantive Ukrainian laws.

On the other hand, a foreign economic contract must be complete in form as well as substance if such contract is executed in Ukraine. Under Ukrainian law, either a foreign agreement or some of its provisions may be declared invalid or void by a court if it does not comply with the requirements of Ukrainian law or international agreements of Ukraine. An agreement is void under Ukrainian law from the moment of its execution.

### C. New Licensing Requirements

The Law of Ukraine No. 1315-IV, dated November 20, 2003, introduced amendments to Article 16 of the Law "On Foreign Economic Activity" regarding the licensing of certain foreign economic operations. Such amendments deal with the licensing of the export/import of goods into Ukraine under either an "automatic" licensing procedure or a "non-automatic" licensing procedure in certain cases. Automatic licensing grants permission to subjects of foreign economic activity for the export or import of goods within a specified period provided that such goods are not subject to a quota. Conversely, non-automatic licensing grants permission to subjects of foreign economic activity within a specified period for the export or import of goods, which are subject to quotas (quantitative or otherwise limited).

Export is subject to licensing in Ukraine if there is a disbalance of certain vitally important goods on the internal market or to protect the population, animals, plants, the environment, public morale, national wealth, intellectual property or state security. Likewise, import of goods is subject to licensing in case of (i) certain fiscal problems; (ii) a decrease in gold-currency reserves; (iii) necessity to protect the population, animals, plants, the environment, public morale, national wealth, intellectual property or state security; (iv) importing precious metals (except bank metals); (v) protecting national production of goods and patents, trademarks and copyrights; and (vi) fulfilling international agreements of Ukraine.

The Cabinet of Ministers is empowered to apply quotas and establish a licensing regime on certain goods at the request of the central body of the executive branch responsible for issues of economic policy or other authorized body. According to the amendments to Article 16, only one type of license may be issued for each type of product. The licenses themselves are issued by the central body of the executive branch responsible for issues of economic policy or other authorized body on the basis of applications. In some cases, the granting authority may also request to review any documents and information necessary to confirm the data in an application, as well as the foreign economic agreement itself.

In the case of automatic licensing, the application for a license and the other necessary documents may be submitted on any working day before the customs clearance of goods. The term for issuing a license should not exceed ten (10) working days from the date of receipt of the application packet. However, in the case of non-automatic licensing, the following will apply:

- 1) the term for considering applications should not exceed 30 days from the date of receipt of applications if they are considered in the

order of their receipt, but not more than 60 days commencing from the date of the expiration of the announced term for acceptance of applications if they are considered simultaneously;

- 2) a license shall be issued on the basis of an application within the limits of a quota with an indication of the validity term of the license;
- 3) if established quotas are exhausted at the moment of submission of an application (in case of the application of procedures of consideration pursuant to the order of receipt), such application shall not be considered. A subject of foreign economic activity, which submitted a corresponding application, shall be informed in writing of the fact of the exhaustion of quotas within seven (7) working days from the date of its receipt;
- 4) a decision on the issuance of a license shall be taken, taking into account information on earlier received licenses provided that the applicant observes the requirements of the

legislation on the protection of economic competition.

Upon payment of the issuance fee and acceptance of the application, a license will be issued to the subject of foreign economic activity. The customs clearance of goods will only take place upon the presentation of an original license. A copy of the license will be attached to the cargo customs declaration and will serve as one of the grounds for the admission of the goods across the customs border of Ukraine.

Each month the regional customs authorities receive information on the issuance of licenses for the export or import of goods falling under a licensing regime. For its part, the regional customs authorities inform the central body responsible for issues of economic policy on the volume of the export or import of goods.

The licensing requirements also apply to barter operations with goods falling under a licensing regime and to the export or import of disks for laser reading systems, matrixes, equipment and raw materials for their production. However,



the licensing requirements do not apply to the export of goods received by an investor on the basis of production sharing agreements, unless otherwise provided by the production sharing agreement itself. They also do not apply to certain goods related to military production, atomic energy and state secrets of Ukraine on the basis of Article 20 of the Law "On Foreign Economic Activity."

Finally, the list of goods, the export or import of which fall under a regime of licensing, the validity term of licenses and any amendments to such information, as well as the procedure for the submission and consideration of license applications is published in the official publications of Ukraine with a notice to the corresponding committee of the World Trade Organization (WTO) within 60 days from the day of the publication and the presentation of copies of such publications.

If a quota is allocated amongst countries-suppliers, information on such allocation is published with a notice about the allocation to other countries interested in the supply of certain goods in Ukraine. The official publication must take place 21 days before the date of the introduction of a licensing regime, but no later than such date. At the request of an interested member of the WTO, the corresponding information must be provided regarding the following:

- 1) the procedure for the application of limitations;
- 2) the quantity of issued licenses for a specific period with an indication, if necessary, of the volume and/or value of goods;
- 3) the allocation of licenses amongst countries-suppliers;
- 4) the statistical information regarding the volume and/or value of goods.

## II. Miscellaneous Supporting Legislation

The simplicity of the Law "On Foreign Economic Activity" ultimately necessitated additional legislation to provide a common payment mechanism for effectuating various import-export transactions. A separate set of supporting instructions governs case-specific transactions, such as barter or consignment agreements. As should be expected, therefore, numerous supporting legislative acts govern import-export transactions, including:

- Resolution No. 1123 of the Cabinet of Ministers "On Lists of Products, the Exportation and Importation of Which are Subject to Licensing and Upon Which are Established Quotas in 2009," dated December 27, 2008;
- Resolution No. 136 of the National Bank of Ukraine "On Approval of the Instruction on the Procedure for Executing Control Over and Obtaining Licenses for Export-Import and Leasing Operations," dated March 24, 1999 (as lastly amended on August 22, 2008);
- Resolution No. 1104 of the Cabinet of Ministers "On Approval of the Procedure for the Issuance, Circulation and Repayment of Promissory Notes Which Are Drawn In The Amount of VAT When Importing (Carrying) Products Onto the Customs Territory of Ukraine," dated October 1, 1997 (as lastly amended on November 21, 2007); and
- Order No. 201 of the Ministry of Economy and European Integration "On Approval of the Regulation on the Form of Foreign Economic Agreements (Contracts)," dated September 6, 2001 and registered with the Ministry of Justice on September 21, 2001 under No. 833/6024.

In combination, these directives create a system whereby a Ukrainian resident can execute a contract to sell or purchase any

desired goods or services. In a typical import transaction, for instance, a Ukrainian resident can convert Hryvnia, the Ukrainian national currency, into virtually any foreign convertible currency. The contractually agreed-upon amount will then be wired to the seller as payment under a foreign economic agreement (e.g., sale-purchase of goods or services).

Note that Ukrainian legislation requires that proceeds received by Ukrainian residents in foreign currency must be transferred to their currency accounts in authorized banks within the term set forth in the relevant contracts, but no later than 90 calendar days from the date of the customs clearance of export goods. In case of the export of works, services or intellectual property rights, payment must be received by Ukrainian residents within 90 calendar days from the date of the signing of the document certifying the performance of works, services or the export of intellectual property rights. The above 90-day term may be extended upon receipt of a special conclusion or certificate from the central executive body responsible for economic policy issues.

In case a Ukrainian resident carries out import operations, which are subject to deferred delivery conditions exceeding 90 calendar days from the date of making an advance payment or providing a promissory note in favor of the supplier of import goods, works or services, a special conclusion or certificate from the central executive body responsible for economic policy issues will be required. If settlements for a Ukrainian resident's import operations are in the form of documentary letters of credit, the 90-day term will start running from the date the authorized bank makes payment in favor of the non-resident party. Importantly, the Cabinet of Ministers and the National Bank of Ukraine have established a special procedure, terms and conditions for the conclusion of import operations without the actual importation of goods onto the territory of Ukraine.



If a Ukrainian resident is in violation of the above 90-day terms, they will be subject to a fine for each day of delay in the amount of 0.3% of the amount of the outstanding proceeds or the value of undelivered goods in foreign currency. This amount will be calculated in Ukrainian currency at the exchange rate of the National Bank of Ukraine on the day the indebtedness arises. However, the total amount of the imposed fine may not exceed the amount of the outstanding payment or value of undelivered goods.

The supporting legislation, such as indicative price legislation, wisely protects against the more obvious abuses, such as inflating the contract price (for receiving kickbacks) or deflating them (for dumping on foreign markets).

On October 2, 1996, the National Bank of Ukraine's Directive No. 254 imposed a system calling for the "registration of foreign contracts" whereby all licensed banks were required to provide guarantees for their clients' performance of contractual obligations if such a foreign contract contained a pre-payment provision. Ukrainian banks suddenly found themselves liable for 100% of the contract amount if the goods were not delivered in a timely fashion and, as a result, no contracts were signed with "pre-payment" clauses. Fortunately, this Directive was canceled on January 10, 1997, by Directive No. 2, and pre-payment clauses are once again per-

missible without limitations. Nevertheless, such theatrics should serve as a reminder of the necessity to seek advice immediately prior to undertaking any transaction in Ukraine.

The last significant step in completing the cycle of an import transaction under the Law "On Foreign Economic Activities" involves clearing Ukrainian customs taking into account the Cabinet of Minister's Resolution No. 390 "On the Importation onto the Territory of Ukraine of Certain Types of Goods," dated March 29, 2002, which takes effect from January 1, 2004. Generally, the Ukrainian customs officials allow products to cross the Ukrainian border only upon presentation of a customs declaration, proof of payment of customs duties and value added tax (and, where applicable, excise tax), and, in certain cases, a cash deposit or a guarantee from the side of importer.



# THE BASICS OF UKRAINIAN CONTRACT LAW

## I. Introduction

An import-export contract is known in Ukrainian legalese as a "foreign economic sale-purchase agreement (contract)," and it must correspond in form and substance with the Law of Ukraine No. 959-12 "On Foreign Economic Activities" (hereinafter the "Law No. 959-12") and Order No. 201 of the Ministry of Economy and European Integration Issues "On Approving the Regulations on the Form of Foreign Economic Agreements (Contracts)," dated September 6, 2001 and registered with the Ministry of Justice on September 21, 2001 (registration No. 833/6024) (hereinafter the "Regulations").

When drafting a foreign economic agreement, the parties may use recognized international customs and recommendations of international

bodies and organizations, unless such use is directly and expressly prohibited by the provisions of Law No. 959-12 and other Laws of Ukraine. Notably, if Ukraine is a party to international treaties, which provide different terms and conditions than contained in Law No. 959-12, then the provisions of such international treaties will prevail.

There are exceptions, however, such as in the case with the UN Convention on contracts on the international sale-purchase of goods (1980 Vienna Convention). Ukraine has made a reservation to the provisions which permit the parties to an international sale-purchase agreement to conclude oral contracts or conclude written contracts by use of telegraph or teletype. Thus, Ukrainian law only recognizes international sale-purchase agreements which are concluded in written form and signed in original by the parties.



The general rule is that a business entity or its authorized representative must execute a foreign economic agreement in a written form. Importantly, actions taken on behalf of a foreign business entity by a properly authorized Ukrainian business entity are deemed to be actions taken by such foreign business entity itself.

Finally, if the parties to an agreement (contract) fail to draft such agreement in accordance with the requirements of the relevant Ukrainian laws or international treaties to which Ukraine is a party, then a court of law may recognize them as invalid.

## II. Form and Substance: Keeping within the Guidelines

In general, the rights and duties of the parties to a foreign economic agreement must be in compliance with the substantive and procedural law of its place of conclusion. Importantly, from September 1, 2005, the Law of Ukraine No. 2709-IV "On International Private Law," dated June 23, 2005, came into force, which cancelled the provisions of the Law "On Foreign Economic Activity" with respect to certain cases of the mandatory application of Ukrainian law to contracts. However, this new law still provides the parties with the choice of governing law.

Importantly, if the parties fail to insert a choice of law into a foreign economic contract, the Law of Ukraine "On International Private Law" provides that the law with the closest connection to the transaction will be applied. Unless otherwise provided, the transaction is most closely connected with the law of the country (place of residence or place of location) of the party, which must perform or will have the decisive significance for the contents of the transaction. In this case, the parties are as follows: (i) the Seller in case of a sale-purchase agreement; (ii) the Service

Provider under an agreement on the provision of services; (iii) the cargo carrier under a shipping agreement; (iv) the Agent under a commission agreement; (v) the legal owner under an agreement on commercial concession, etc.

Significantly, the agreement may be deemed as not concluded or it may be recognized as invalid if the parties fail to comply with the effective requirements of Ukrainian legislation regarding foreign economic agreements. For the record, the mandatory terms and conditions of a foreign economic agreement (including sale-purchase agreements for goods, services and works and barter agreements) are as follows:

1. The agreement's title, number, date and place of conclusion.
2. A properly drafted preamble. While this may seem insignificant, the Ukrainian authorities and, especially, judges look to the preamble to provide a quick and concise summary of the agreement. The preamble must include (i) the full names of the parties to the foreign economic transaction (as duly registered in their countries of origin); (ii) the names of countries; (iii) an abbreviated identification of the counterparts (e.g., "Seller," "Buyer," etc.); (iv) the name of the person on behalf of which the foreign economic agreement is being concluded; and (v) titles of the documents governing the counterparts during the conclusion of the agreement (e.g., constituent documents, etc.).
3. The subject matter of the agreement. This section must determine the goods (services or works) that one counterpart undertakes to provide to or perform for the other, including accurate titles, brands, grades, sorts or the final result of any services provided.



If the goods or services require description in greater detail or the nomenclature of the goods or services appears to be rather extensive, then such items must be described in an annex, which will become an integral part of the agreement. Importantly, an appropriate provision to this effect must be set out in the text of the agreement as well.

An annex to an agreement for the processing of a customer's goods must state the corresponding technological scheme of such processing. Significantly, this technological scheme must reflect the following:

- I) all of the principal processing stages for the materials and the process of transforming the materials into a finished product;
  - II) quantitative indicators of the materials at each stage of processing, which must include substantiated technological losses of materials; and
  - III) the losses of the processing performer at each stage of processing.
4. Quantity and quality of goods or scope of provided services. The parties must state, depending on the nomenclature, the measurement unit accepted for the type of goods in question (e.g., ton, kilogram, units, etc.), its total quantity and the qualitative characteristics. In case of an agreement for the provision of services, the parties must state in the text the specific scope of the services and the deadline for their performance.
  5. Basic delivery terms of goods or acceptance of provided services. The parties must state the type of transportation and the basic

terms of delivery which determine the counterparts' duties regarding delivery of the goods and which establish the moment when the relevant risks transfer from one party to the other. Of course, the agreement should clearly set forth the specific term of delivery of the goods (specific shipments thereof).

As foreign economic agreements often involve international trade, it is best to use generally understood and accepted trade terms in an agreement. The Decree of the President of Ukraine "On Application of International Rules of Interpretation of Commercial Terms," dated October 4, 1994, provides that Ukrainian entities must use the current edition of INCOTERMS (2000) upon concluding any foreign economic contract within Ukraine. Therefore, it is advisable for foreign investors to apply INCOTERMS in their agreements with Ukrainian counterparts to avoid any misunderstanding of trade terms.

In case of an agreement for the provision of services, the parties must state in the text the specific terms and conditions, as well as the deadlines, for the provision of the appropriate services.

6. Price and total value of the agreement. The parties must determine the price for the measurement units of the goods and the total value of the goods or provided services delivered (performed) under the agreement (except when the price of the goods is calculated according to a specific formula), as well as the monetary currency of the contract. If the parties deliver goods of various quality and assortment under an agreement, the price must be determined separately for the unit of goods of each sort. The total value of such agreement must be set out in a separate provision. In this case, the pricing indicators may be set out in

annexes with the relevant references thereto in the agreement.

If the price of the agreement is determined according to a formula, then the parties must state the estimated value of the agreement as of the date of its conclusion.

In case of an agreement (contract) for the processing of a customer's materials, the parties must state the collateral value of the materials, the price and total value of the finished products and the total cost of processing.

7. Payment terms. The parties must state the currency of payment, method of payment, order (procedure) and deadlines for financial settlements, as well as the parties' security for the performance of their mutual payment obligations. The parties must include the following into the agreement:

- I) the terms of the bank transfer prior to (advance payment) and/or following the dispatch (shipment) of goods or the terms and conditions of the documentary letter of credit or cash collection with a guarantee in the form determined by Resolution No. 444 of the Cabinet of Ministers of Ukraine and the National Bank of Ukraine, dated June 21, 1995; and

- II) the terms and conditions of the guarantee, if any, and if necessary the type of guarantee (demand guarantee, conditional guarantee, etc.), the effective term of the guarantee and the possibility to change the terms and conditions of the agreement without changing the provisions of the guarantee.

The terms and conditions of payment are vital in that they determine what will happen if a purchaser fails to make timely

payment or complete payment, including the amount of penalty for such violations. These terms and conditions also should indicate which party and in which volume taxes, customs fees and other mandatory payments will be paid.

8. Terms of accepting and turning over goods or services. The parties must state the dates and place for the actual turning over of the goods (or final performance of services) and the list of title documents to such goods. Goods are accepted according to the title documents as far as the quantity is concerned. As far as quality is concerned, goods or services are accepted according to the documents that certify their quality.

9. Packaging and marking. The parties must include the information regarding the

packaging of the goods (boxes, sacks, containers, etc.), proper markings placed thereon (name of both the seller and the buyer, number of the agreement, place of destination, dimensions, specific storage and transportation conditions, etc.) and, if necessary, the terms for returning the goods.

10. Force Majeure. As in most cross-border agreements, the parties must describe the force majeure events that would allow them to dispense with the terms and conditions of their agreement (e.g., acts of God, hostilities, embargo, intrusion by governmental authorities, etc.). Under such circumstances, the parties are typically relieved of their duty to comply with the terms and conditions of the agreement for the specific duration of the circumstances, or they may



decline to perform the agreement in part or in full without additional financial responsibility. In most agreements, the parties must receive confirmation of the existence and duration of Force Majeure circumstances from the chamber of commerce and industry of the country where such circumstances occur.

11. Sanctions and complaints. The parties must set out the procedure for applying penalties, recovering damages and lodging claims in connection with the failure to perform or the improper performance of their respective obligations.

Importantly, the parties must expressly set out the size of the penalties (in percentage of the value of non-delivered goods or services or non-paid amounts), the terms of penalty payments (i.e., when the penalty starts to apply and how long it remains applicable), or any limitations on penalty amounts. The parties must also set forth the terms during which claims may be lodged, the parties' rights and duties in such cases and the methods of settling claims.

12. Dispute resolution. The parties must set out the procedure for dispute resolution in courts, which disputes may arise out of the interpretation, failure to perform or improper performance of the agreement. This section must also expressly state the forum and/or the express criteria for determining the forum by any of the parties depending on the subject matter and nature of the dispute, as well as the parties' selection of the substantive and procedural law that will be applied by the forum and the rules of procedure.

In Ukraine, the principal legislation governing arbitration includes the Law of

Ukraine "On International Commercial Arbitration", the 1958 New York Convention on the recognition and enforcement of arbitration decisions, and the European Convention "On Foreign Trade Arbitration" of 1961. Arbitration is popular with foreign investors in Ukraine due to their mistrust of the unstable legal system and incompetent or corrupt judges. Arbitration is also quicker and less expensive than bringing disputes to national commercial courts.

13. Finally, any cross-border agreement must reflect the place of the parties' location (residence), mailing and their banking requisites (account number, name and location of the bank, etc.). This information is important for any notices that must be sent under the terms and conditions of the agreement and for other obvious reasons.

The above list of material terms and conditions for cross-border agreements in Ukraine is by no means exhaustive. The parties may agree to set out additional requirements regarding insurance, quality guarantees, agents, freight forwarders, as they see fit.

### III. Conclusion

Many foreign companies apply their worldwide agreements to Ukrainian transactions without foreseeing the risks involved. This often leads to problems in the intended transaction when Ukrainian legislation does not recognize provisions included in standard company agreements. Once a Ukrainian court recognizes a contract as null and void, the process of collecting debt becomes impossible. Therefore, companies without experience in Ukraine should seek professional advice before applying their standard agreements to the non-standard Ukrainian market.

# IMPORT-EXPORT TAXES

## I. Introduction

As in other European countries, Ukrainian import-export operations are subject to various taxes, including, but not limited to, customs duties and value added tax. Further, depending on the specific product, excise tax and other official costs associated with obtaining licenses or necessary product labels may be applicable. The Cabinet of Ministers has also implemented a licensing system for the import of certain goods, such as chemical substances, fertilizers, pharmaceuticals, cosmetics and veterinary items, among others.

The various taxes associated with standard import operations are summarized below.

## II. Value-Added Tax

Ever since December 26, 1992, when the Cabinet of Ministers executed its Decree

No. 14-92, "On Value Added Tax," the legislation governing value added tax ("VAT") has changed frequently, arousing the ire of many companies, foreign and local, large and small.

Staying true to its reputation for constantly amending key legislation, on April 3, 1997, the Parliament approved a new and improved VAT law, which became effective on October 1, 1997 (as lastly amended on July 24, 2009). Subsequently, the Cabinet of Ministers passed Resolution No. 540, dated June 9, 1997, implementing a new VAT payment procedure.

Generally, the law continues to apply a 20% tax for all businesses and other legal entities (such as funds) providing goods and services on the territory of Ukraine, but the calculation mechanism has been liberalized somewhat. The new law finally closed one of the last loopholes by canceling tax holidays for non-profit "Chernobyl-type" organizations, but kept the exemptions for products used by



underprivileged children and the disabled, (e.g., children's food products, magazines and newspapers, etc.). The law also implemented a new mechanism for effectuating the payment of value added tax: the importer simply posted a promissory note instead of effectuating a cash payment.

Ukrainian VAT legislation sets up a two-tier structure, designed to effectively protect domestic market from foreign imports. Below we describe each of the two VAT tiers separately.

#### A. Import VAT

The VAT rate under Ukrainian law is 20%, as levied against taxable turnover, which does not include VAT. Taxable turnover for import VAT is calculated as the customs value of the goods, including customs duties and any applicable excise taxes. This import VAT is due and payable at the same time customs duties are being assessed (with a potential thirty-day extension made at the discretion of the customs office).

#### B. VAT on Retail Sale in Ukraine

Of course, VAT is levied on all products and services manufactured and sold in Ukraine. Costs associated with obtaining/maintaining equipment that are reflected in the final price of the goods also are subject to VAT.

Any goods or services sold in Ukraine are subject to a 20% VAT, which is levied against the costs of the materials and is included in the sale/purchase price (i.e., sales turnover). Upon resale, sales VAT is levied on the total difference between customer-paid VAT and the VAT paid by the seller for all component materials.

In the event that an imported product is re-sold in Ukraine, VAT is paid on the difference between the sale price and the customs value (including customs duties and any excise taxes) plus import VAT.

### III. Excise Tax

The Ukrainian government has always levied excise tax on luxury items imported into Ukraine, such as alcoholic beverages and tobacco products, and the letter from the State Tax Inspection "On Excise Tax," No. 16-1221/10-7232, dated September 9, 1997, merely reaffirms this fact. Other legislation governing excise tax includes Decree No. 18-92 of the Cabinet of Ministers "On Excise Tax," dated December 26, 1992 and the Law of Ukraine No. 329/95-VR "On Excise Tax on Alcoholic Beverages and Tobacco Products," dated September 15, 1995.

In the past, there was no clear system of tracking the importation and distribution of cigarettes and liquor products. Naturally, the sale of unchecked contraband products resulted in a gold mine of tax-free opportunities for all types of traders, who supplied Ukraine with well-recognized vices with virtually no payment of taxes.

In an attempt to control the illegal importation and distribution of cigarettes and liquor, on July 12, 1995, the President executed Order No. 609/95, "On Excise Stamps on Alcoholic Beverages and Tobacco Products." Unlike the excise tax law, this order provided a new approach for collection of excise tax by requiring importers to purchase special customs stamps and place them on each bottle of alcohol and every individual cigarette pack. Without such stamps, no alcohol or tobacco products could henceforth enter or be sold in Ukraine and, if found in Ukraine, they are subject to confiscation.

Entirely too much legislative attention has been devoted to alcohol and tobacco, as evidenced by the Parliament's Resolution, dated September 15, 1995, "On the Procedure for Implementing the Law of Ukraine 'On Excise Tax on Alcohol Drinks and Tobacco

Products;" the Cabinet of Ministers' Resolution No. 1755 "On the Term of Validity of Licenses for Carrying Out Certain Types of Economic Activity and the Procedure for Calculating the Payment Amount for the Issuance Thereof," dated November 29, 2000; Decree No. 666 "On Measures for Implementing Excise Stamps on Domestic Alcohol Drinks," dated June 20, 1996; Decree No. 493 "On the Temporary Procedure for Issuing Licenses for Import, Export and the Wholesale Trade of Ethyl Alcohol, Cognac Alcohol Drinks and Tobacco Products," dated May 13, 1996, among others.

Other luxury items are also subject to the excise tax, and they are identified in the Cabinet of Ministers' Resolution No. 1078, dated September 29, 1997, as caviar, crab, shrimp, chocolate, automobile tires, audio and video cassettes, televisions, among others. Interestingly, the minimum rates for television and video equipment imported by Sony and Panasonic were higher than for Daewoo and LG Electronics, but no official explanation was given.

The excise tax rates and the listed products tend to change constantly, which keeps the importers on their toes. On June 2, 1997, for instance, the Cabinet of Ministers imposed minimum customs values for certain foodstuffs (e.g., coffee, black caviar, frozen chicken and turkey legs, among others.) and clothing (fur coats and leather jackets).

#### **IV. Customs Duties**

As a rule, all imports are subject to payment of customs duty (and, of course, the much-hated value added tax). The only exception applies to foreign investors who contribute qualified foreign investment into a Ukrainian resident company's authorized capital in exchange for the ownership rights in such company.



The Foreign Investment Law expressly provides that in-kind investment imported into Ukraine as a foreign partner's contribution to the authorized capital of any Ukrainian company, such as a joint venture or a 100% foreign-owned subsidiary, is exempt from customs duty, but is still subject to value added tax. If, however, the above foreign investor's property is alienated within three (3) years from the date it is credited to the Ukrainian company's balance, the Ukrainian company will need to pay customs duty thereon. Importantly, the registration of foreign investment is mandatory from June 23, 2009 until at least January 1, 2011.

The specific rates for various products may be found in various laws starting with the Customs Code of Ukraine, effective on January 1, 2004, and the Cabinet of Ministers' Decree No. 4-93, "On Unified Customs Tariff," dated January 11, 1993. Other legislation evidencing that import duty rates are subject to constant changes include the Cabinet's Resolution No. 1648 "On Introduction of Amendments to and Recognition of Certain Resolutions of the Cabinet of Ministers of Ukraine Which Were Rendered Ineffective," dated December 13; Law No. 313/96-VR, "On Rates of Excise Tax and Import Duties on Certain Products," dated July 11, 1996, as amended on May 22, 2003; the Law of Ukraine No. 2097-XII "On Uniform Customs Tariff," dated February 5, 1992, among others.

On December 21, 2000, the Parliament adopted amendments to the Law "On the Unified Customs Tariff," according to which the Cabinet of Ministers no longer has the authority to establish rates of customs duties. Reacting swiftly, on January 12, 2001, the Cabinet of Ministers adopted Resolution No. 16 "On Amending the Rates of Import Duties for Certain Types of Products and Certain Resolutions of the Cabinet of Ministers of Ukraine," which was thereafter rendered ineffective by the Cabinet of Minister's Resolution No. 1648 of December 13, 2001.

Currently, the Law "On the Unified Customs Tariff" bestows upon the Parliament the authority to have the final approval over the Cabinet's proposals regarding the unified customs tariff. Additionally, the Law of Ukraine No. 2371-III "On Customs Tariff" was passed on April 5, 2001, which replaced the old Commodity Nomenclature for Foreign Economic Activity with the Ukrainian Classification of Goods of Foreign Economic Activity.

## V. Miscellaneous Costs: Labels and Certification

Several categories of import products are subject to special licenses or "certifications" such as pharmaceutical, agro-chemical and food products (e.g., the Cabinet of Ministers' Resolution No. 1996 "On the List of Goods, the Importation and Exportation of Which is Subject to Licensing and On Which Quotas are Established").

Naturally, cigarettes and alcohol are subject to a mandatory "certification" process under Orders Nos. 378 and 379 of the State Committee on Standards, Metrology and Certification, entitled "The Rules of Obligatory Certification of Tobacco Products" and "The Rules of Obligatory Certification of Alcohol Products," both dated September 13, 1996.

Food products were the next in line for certification. As of January 1, 1997, all imported food products undergo a "certification" process, during which the required labels containing various information (in the Ukrainian language) must be affixed onto the product. The required information includes the product's name, volume, chemicals and additives, expiration date, and calorie content, among others.

On November 4, 1997, the Cabinet of Ministers' Resolution No. 1211 "On Approval of the Procedure of the Customs Clearance of Imported Goods (Products) Which Are

Subject to Mandatory Certification in Ukraine" approved the procedure for the customs clearance of imported products subject to obligatory certification in Ukraine. Four years later, on December 13, 2001, the above procedure was slightly amended by the Cabinet's Resolution No. 1671.

The practical implementation of the otherwise reasonable certification requirements continues to cause great anxiety amongst importers. Many foreign companies complain, and rightfully so, that clear and transparent compliance with this particular piece of legislation is often possible only after rewarding (in cash or in-kind) the state official(s) responsible for granting the necessary permissions. Regrettably, this viewpoint has merit.

While product certification is designed to ensure consumer safety and quality standards, it can also become a good tool to protect domestic producers from importers. A good example of this dichotomy is provided by Procter & Gamble's struggles with the Ukrainian authorities. On March 3, 1998, the State Committee for Standardization, Certification and Metrology ("DerzhStandart") revoked Procter & Gamble's laundry detergent certificates, which reportedly cost the company USD 135,000 to acquire. The DerzhStandart asserted that the formula used to produce Procter & Gamble's soap powder was of inferior quality and was aimed at the poor Ukrainian public.

Procter & Gamble disagreed wholeheartedly, and launched a counter-attack on March 20, 1998, by requesting that the Presidential Independent Chamber on Foreign Investments form an expert panel to resolve this conflict, and initiating a criminal investigation to trace its payment of USD135,000 for the certificates. In the meantime, the dispute had a negative side-effect on Procter & Gamble's activities.

## VI. Conclusion

As a rule, in any import-export transaction something can always go wrong at any moment. Even a miniscule degree of non-compliance with Ukrainian import rules may lead to significant delays, increased costs, additional efforts, and even lost profits (especially in case of perishable goods). As legislation in this area changes all too frequently, foreign business entities wishing to sell their products in Ukraine must inform themselves about the latest applicable import taxes and duties, certificates and licenses, contract formalities and related matters.



# CUSTOMS LICENSED WAREHOUSES

## I. Introduction

All countries do their best to monitor and control import-export flows that pass through their borders. While some European countries have significant experience in these activities, contemporary Ukraine is continually developing its customs control systems (and supporting legislation) due to its rather short history.

As elsewhere, the Customs Service of Ukraine ("Customs Service") plays the most important function in monitoring goods during their passage through the Ukrainian borders. The Ukrainian Customs Code (hereinafter the

"Customs Code," dated July 11, 2002 and effective January 1, 2004) serves as basis for the Customs Service to control the creation and operation of customs warehouses, among other things.

Originally, the Customs Code was supposed to come into force on January 1, 2003. However, most customs authorities were not prepared for its novelties, so the Code was postponed until January 1, 2004. In any case, it is still extremely important to seek expert advice when dealing with Ukrainian customs authorities.

Significantly, the Customs Code distinguishes between ordinary customs warehouses and so-called "*Customs Licensed Warehouses*."



## II. Discussion

### A. Ordinary Customs Warehouse

Ordinary customs warehouses are defined as specially-equipped buildings for the storage of goods and other items, which are owned and used by the Ukrainian Customs authorities.

The following goods are subject to mandatory transfer for storage in ordinary customs warehouses:

1. Goods which are prohibited from passage into Ukraine due to established bans or restrictions on their importation into Ukraine or transit through Ukrainian territory, provided that such goods will not be exported from Ukraine on the same day of import;
2. Goods which are subject to duties and customs fees during importation into Ukraine, provided that the said duties and customs fees have not been paid and the importer has no documents evidencing deferred or installment payments thereof;
3. Goods which before the expiration their term of temporary storage by an enterprise were not declared by the owner or its authorized person/body in accordance with a customs regime;
4. Goods which were declared in a regime of abandonment in favor of the state.

### B. Customs Licensed Warehouses

The Customs Code also allows any subject of entrepreneurial activity to own a so-called "customs licensed warehouse," if such entity receives a license to open and operate a customs licensed warehouse and complies with the Regulations on Opening and Operating Customs Licensed Warehouses.

On December 2, 1996, as a New Year's present to the Ukrainian business community, the Cabinet of Ministers ordered the Customs Service to approve a new text for the Regulations On Opening and Operating Customs Licensed Warehouses. On December 31, 1996, the Customs Service amended the Regulations once again via Regulation No. 592, aptly entitled "On Approval of the Regulation for Opening and Operating Customs Licensed Warehouses" (as lastly amended on July 21, 2005).

The said Regulations subject a customs licensed warehouse to a special regime pursuant to which goods imported into Ukraine are kept under customs control without payment of any duties and other taxes. Further, non-tariff regulations and other restrictions are not imposed during the storage of such goods. If the goods are to be exported from Ukraine, such goods are kept under customs control from the beginning of their customs clearance until their actual export from the territory of Ukraine.

Ukrainian legislation provides for the following two (2) types of customs licensed warehouses:

1. open customs licensed warehouses, which are used for the storage of goods by any person, and
2. closed customs licensed warehouses, which are used for the storage of goods that belong strictly to the owner of such warehouse.

The Cabinet of Ministers of Ukraine establishes the state fee for receiving a license to open and operate a customs licensed warehouse. Currently, those entities who wish to receive such a license must pay a fee equal to USD 2,500, payable in Ukrainian Hryvnias at the exchange rate of the National Bank of Ukraine as of the date of filing the relevant documents with the Customs Service of Ukraine.



### III. Technical Requirements of a Customs Licensed Warehouse

Any duly equipped buildings or other premises designated for storage of goods within the customs warehouse regime can serve as a customs licensed warehouse. Notably, the territory of a customs licensed warehouse must be fenced in, and the following facilities must be available:

- (a) security and fire-safety alarm devices are connected to the guard post of the organization hired as security for the customs licensed warehouse;
- (b) communication means in the places designated for the customs officials to exercise customs control in such warehouse; and
- (c) metal grating on the internal side of the warehouse's windows, if applicable.

Additionally, the owner of a warehouse must provide the relevant logistical equipment necessary for the warehouse's operation. At the same time, the Ukrainian customs authorities have the authority to set additional requirements for outfitting customs licensed warehouse facilities in order to ensure the safe storage of goods.

### IV. The Procedure for Opening a Customs Licensed Warehouse

An entity, which intends to open and operate a customs licensed warehouse, must file an application for the applicable license to open and operate such a warehouse. This application must be filed with the relevant customs office in the customs zone at the location of the warehouse.

The following documents must be attached to the application form:

- (a) copies of the foundation and registration documents (i.e., the charter, founding agreement, registration certificate, etc.) of the entity seeking to receive a license;
- (b) documents confirming the right to own and use the building(s) designated as the warehouse;
- (c) the economic grounds for the necessity to open a customs licensed warehouse;
- (d) the blueprints of the building designated as a customs licensed warehouse specifically marking the areas designated for use by customs employees;
- (e) the security and fire-safety alarm plans approved by the relevant authorities;
- (f) an agreement on the provision of security services for the premises with the authorities of the Ministry of Internal Affairs or with an entity possessing a license to provide security services, issued by the Ministry of Internal Affairs;
- (g) any relevant permits issued by the authorities for sanitary and ecological control (for warehouses which are designated for the storage of goods subject to control by such authorities);
- (h) a technological scheme, including the means of control and inventory (this pertains only to warehouses designated for the storage of liquid and granular (loose or poured) goods); and
- (i) a list of goods to be stored in the warehouse (this is related only to closed customs licensed warehouses).

The local customs office at the location of the customs licensed warehouse reviews the application within thirty (30) days from the

date of its receipt. If the local customs office grants preliminary permission to open a customs licensed warehouse, it will establish a so-called "Procedure of Organization of a Customs Regime - Customs Warehouse" (hereinafter the "Procedure").

Significantly, while each Procedure is established on a case-by-case basis, it includes providing a list of employees who will have access to the customs licensed warehouse, the head of the customs licensed warehouse, the number of customs officials who will participate in the clearance of goods, the working hours, etc. Additionally, the customs office may establish a simplified methodology for the customs clearance of goods for closed customs licensed warehouses.

Once the Procedure has been finalized, the local customs office delivers the package of documents to the main office of the Customs Service of Ukraine. The Customs Service then makes a final decision on issuing a license within thirty (30) days. If necessary, the management of the Customs Service may extend the term for consideration of the above matter for an additional thirty (30) days.

In the final stage, the Customs Service will issue a license signed by the Chairman or Deputy Chairman of the Customs Service. Licenses can remain in force for an indefinite period of time, provided that the customs licensed warehouse is re-registered annually. The state fee for such annual re-registration is equivalent to USD 1,500, which must be paid in Ukrainian Hryvnias as of the date of filing the relevant documents with the Customs Service. Significantly, the license to open and operate a customs licensed warehouse is not transferable to third persons.

The Customs Service may refuse to issue a license if: (i) the facilities/equipment of the building(s) designated for the customs licensed

warehouse do not comply with the Regulations; (ii) not all required documents were submitted for consideration, or (iii) the information contained in the filed documents contradicts applicable legislation. In case of refusal, the Customs Service will inform the applicant in writing, specifying its reason for such a refusal. Fortunately, the decision of the Customs Service is not final, and the applicant may appeal the refusal.

#### **V. Storage of Goods in Customs Licensed Warehouse**

All goods, regardless of their origin (Ukrainian or foreign), may be stored in a customs licensed warehouse, except goods associated with humanitarian assistance, the storage of which the Customs Code specifically forbids in customs licensed warehouses.

Various goods in transit through Ukrainian territory may be placed in customs licensed warehouses if they are to be reloaded from one

type of transport onto another. It is worth noting, however, that certain goods, which are not permitted to be imported into or exported from Ukraine, as well as goods which are specifically prohibited from being contained in customs licensed warehouses pursuant to the laws of Ukraine, will be denied storage in such warehouses.

Ultrahazardous goods require the prior consent of the Customs Service if their storage necessitates special conditions due to toxicity, inflammability, etc. Such goods may be stored only in specially equipped areas of a customs licensed warehouse. Naturally, all items stored in a customs licensed warehouse are under customs control and strict supervision by the customs authorities. Along with the said security measures, the seal of the owner of the customs licensed warehouse must be available at all times. Goods placed in a customs licensed warehouse may be released only in the presence of authorized customs officials. All operations in a customs licensed warehouse are



carried out with the permission of the customs authorities and at the expense of the warehouse owner.

As a general rule, goods imported into Ukraine can be stored in a customs licensed warehouse for a maximum of three (3) years. However, the customs authorities can reduce this period for certain goods. In contrast, goods to be exported from Ukraine can be stored in a customs warehouse for a maximum of three (3) months before actual export. In all cases, however, the specific term for storage of goods within the above periods is determined jointly by the owner of the warehouse and the person placing the goods for storage.

During the transportation of imported goods from one customs warehouse to another, the term for storage of these goods starts from the date of their initial placement into the customs warehouse regime. After expiration of the storage term, such goods must be transferred for storage to a customs office, or a new customs-warehousing period must be declared and approved. In the latter case, the customs clearance of goods will be effectuated pursuant to the terms of the newly-declared regime.

## VI. Functions of a Customs Licensed Warehouse

A customs licensed warehouse may only be used to store goods specifically declared for storage in certain customs warehouse. To store such goods in a customs licensed warehouse, the owner of the customs licensed warehouse, regardless of the value of the declared goods, must submit a customs cargo declaration to the relevant customs authority pursuant to the established procedure.

If the goods will be stored pursuant to a long-term agreement, the application must be submitted upon the storage of the first consignment of goods. In this case, the goods may be stored in the warehouse for the duration of the agreement or one calendar year.

In all cases, goods stored in a customs warehouse are subject to declaration, regardless of their value, by filling out a cargo customs declaration and submitting the following documents:

- 1) the agreement on the storage of goods in the customs licensed warehouse between the owner of the customs licensed warehouse and the entity, which stores such goods in the warehouse, and the foreign economic agreement (contract) pursuant to which the goods are imported or exported into/from Ukraine;
- 2) the transportation and other accompanying documents (way-bills, bills of lading, certifications, invoices, etc.);
- 3) permission of state bodies, which carry out control during the crossing of goods via the customs border of Ukraine.

If the goods are subject to certification after import into Ukraine, then the certificate of conformity does not have to be submitted with the above documents. In all cases, the storage of goods in a customs licensed warehouse must be carried out in the presence of a customs official.

A customs licensed warehouse may perform certain operations with goods stored therein in order to ensure storage, including the movement of goods within the warehouse for purposes of rational storage, cleaning, ventilation, creation of optimal temperature, painting, protection from corrosion, inventorying, etc. Additionally, to prepare for sale and transportation, a customs licensed warehouse may split up consignments of goods, prepare shipments, and sort, pack, re-pack, mark, load, unload, reload and test goods. Operations involving the equipping and/or repairing of warehouse premises may also be conducted by a customs licensed warehouse.



Regardless of the operation conducted, the description and nature of goods may not change in relation to their classification under the Ukrainian Classification of Goods of Foreign Economic Activity.

Goods may be released from a customs licensed warehouse:

- 1) into free circulation on the customs territory of Ukraine;
- 2) outside of the customs territory of Ukraine;
- 3) for temporary use on the territory of Ukraine under a regime of temporary import;
- 4) for processing on the territory of Ukraine;
- 5) for transfer to a customs warehouse for storage or, in case of their abandonment, in favor of the state;
- 6) for destruction under the control of a customs body;
- 7) for transfer to another customs body for the purpose of customs clearance under the selected customs regime;
- 8) temporarily with the subsequent return for:
  - (a) demonstration at an international exhibition carried out in Ukraine; or
  - (b) certification by the state standards authorities of Ukraine or examination by other state bodies (i.e., sanitary-epidemic, veterinary-sanitary, phytosanitary and ecological authorities).

In order to release imported goods from a customs licensed warehouse, the declaring party must submit to the relevant customs body a duly executed cargo customs declaration and all other documents required for carrying out

customs clearance of the goods and paying all taxes and duties established by law. The customs value of goods is determined during the release of goods from a customs licensed warehouse.

If goods are released for demonstration at an international exhibition or for certification or examination, however, the owner of the warehouse must submit to the relevant customs authority an application for permission to release the goods. The application must contain the following:

- 1) information on the good(s) (name, quantity, weight, value) with a mandatory indication of its code under the Ukrainian Classification of Goods of Foreign Economic Activity;
- 2) information on the purpose of the release of the good(s) temporarily with its (their) subsequent return;
- 3) information on the documents pursuant to which the goods were stored in the customs licensed warehouse;
- 4) the obligation to return the good(s) to the customs licensed warehouse with an indication of the term for return;
- 5) the obligation to pay the taxes and duties (mandatory payments) due in case of the failure to return the good(s) to the customs licensed warehouse within the established term;
- 6) information on the director of the customs licensed warehouse (surname, name and patronymic).

Additionally, the following documents must be submitted along with the application:

- 1) the agreement between the owner (or holder) of the goods and the entity carrying

out the examination, listing the quantity of samples of the good and the term for performing the work; or

- 2) the certificate of the corresponding controlling body, affirming the existence of a valid agreement, containing the number of such agreement, the date of its execution, quantity of samples of the good and the term for performing the work.

The term of releasing the goods from a customs licensed warehouse temporarily with subsequent return for demonstration at an international exhibition held in Ukraine may not exceed the term of such exhibition, taking into consideration the time necessary for the transportation of the exhibits and the construction and deconstruction of the exhibition. In contrast, the term for the temporary release of goods from a customs licensed warehouse with subsequent return for carrying out certification or examination may not exceed 45 calendar days. If it is impossible to carry out an examination within 45 calendar days, such term may be extended upon submission to the relevant customs body of a document confirming such impossibility, issued by the corresponding controlling body.

If, upon the carrying out of certification or examination, samples of goods are completely used up or destroyed, and are not returned to the customs licensed warehouse, they are taken into account in the consignment of goods during the customs clearance into free circulation on the customs territory of Ukraine. The quantity of samples, which are released from a customs licensed warehouse, may not exceed the norms established by the authorized state body for certain types of goods.

In cases of transfer of goods from one customs licensed warehouse to another within the zone of activity of one customs body, the goods may only be transferred during the term of their

storage. However, the procedure of customs control over the transfer of such goods must be approved by an order of the customs body. Transfer is permitted in the following cases:

- 1) the liquidation of the customs licensed warehouse in which the goods are stored;
- 2) force majeure circumstances, which may cause the loss or damage of the goods stored at the customs licensed warehouse;
- 3) the termination of the storage agreement concluded between the owner of the customs licensed warehouse and the entity, which stored the goods in the warehouse, and the signing of a new storage agreement with an owner of another customs licensed warehouse.

The transportation of goods to another customs body to carry out customs clearance per selected customs regime takes place when the declaring party submits to the customs body an internal transit document, pursuant to the procedure established by the State Customs Service of Ukraine.

If a customs licensed warehouse released goods without the permission of a customs body, or if the goods somehow mysteriously vanish (except in cases of force majeure or natural deterioration (wear and tear) or a decrease due to normal conditions of storage), the owner of the customs licensed warehouse bears liability pursuant to the Customs Code of Ukraine and must pay cash in the amount of import (export) taxes and fees, which should have been paid had the goods been cleared pursuant to the customs regime of import (export).

### **VII. Cancellation and Suspension of a License and Liquidation**

A license to operate a customs licensed warehouse can be suspended for a period of up to three (3) months, or even cancelled altogether, by the Customs Service in the following cases:

- (a) if the operations of a customs licensed warehouse are halted for over four (4) months;
- (b) if the owner of the warehouse or persons with access to the warehouse repeatedly



violate the Regulations and applicable customs legislation;

- (c) if the owner of the customs licensed warehouse violates foreign economic legislation after receiving notice to cease and desist certain activities;
- (d) non-fulfillment of the requirements set forth in the head of the local customs office's decision to suspend the validity of a license;
- (e) if a customs licensed warehouse continues the violations mentioned in paragraphs (a), (b) and (c) in this list of suspension cases, provided that temporary suspension of the validity of a license has been earlier applied;
- (f) if a criminal case is initiated against the customs licensed warehouse with respect to its foreign economic activity; and
- (g) if the Customs Service uncovers violations of applicable legislation during an inspection of the customs licensed warehouse.

The head of the Customs Service will cancel a license upon petition of a local customs office. Upon cancellation of a license, the owner of the warehouse must return the license to the local customs office no later than seven (7) days from the date of such cancellation.

### **VIII. Conclusion**

The provisions of the Customs Code concerning customs licensed warehouses are rather straightforward, although proponents of economic reforms constantly urge amendments to the legislation governing this topic (taking into account the new Customs Code). Instead, what is sorely needed is a concentrated effort to implement in a transparent manner this otherwise well-developed and comprehensive legislation.



# CERTIFICATION OF GOODS AND SERVICES

In Ukraine, all goods and services must undergo a mandatory certification process that involves two state entities: the Ministry of Health and the DerzhStandart (the State Committee for Standardization, Certification and Metrology). This certification process is expensive and lengthy, which adds to the price of the goods and services offered by the producers. For instance, a company must receive a so-called "hygienic conclusion" from the Ministry of Health with the corresponding certification of the goods and services from Derzhstandart.

Likewise, any Ukrainian company that wishes to utilize European technology in Ukraine must present the equipment/machinery to the laboratory of DerzhStandart in order to receive a certificate for its use. Although this certification means absolutely nothing in

Europe, it raises the price of the goods to be produced because literally every nook and cranny must be checked and certified. Not surprisingly, this cumbersome barrier to entry does not sit favorably with foreign companies.

Furthermore, DerzhStandart establishes the size of packages and the storage term for products. Therefore, if a company wishes to produce, for example, three and a half liter bottles of a soft drink and such bottle sizes are not provided for by DerzhStandart, then the company does not have the right to produce such bottles. Additionally, DerzhStandart can establish a storage term for the soft drink at 15-20 months while the corresponding certificate will be valid for only six (6) months.

If taken literally, this means that every six (6) months the company must re-certify the soft



drink, which will be done at the same cost as the first certification. Officially, the cost for certification can run between UAH 1,000 and 1,500 each time certification becomes necessary. Taking all of these costs into consideration, the price of goods and services can increase by as much as 10-15% of the actual cost. Ultimately, this cost increase negatively affects the buying power of the customer.

Importantly, the Presidential Decree No. 817/98 "On Certain Measures for the Deregulation of Entrepreneurial Activity," dated July 23, 1998, exempts products (except food products) whose quality is confirmed by certificate issued outside of Ukraine in accordance with the international standard ISO or other international standards, from having to repeat the certification for such goods in Ukraine.

This being said, however, Ukraine is still not a member of the European Co-operation for Accreditation ("EA"), therefore the accreditation of goods in a Ukrainian laboratory for their subsequent export is not accepted by most member states of the EA (i.e., the goods must be examined in a European laboratory). Likewise, goods imported into Ukraine must go through the accreditation process in a Ukrainian laboratory if Ukrainian accreditation is not accepted in the country of origin. Again, this affects the price for which goods will be sold on the market.

In a related matter, on December 1, 1999, the Parliament issued Resolution No. 1258-XIV "On the Draft Law 'On Liability of Suppliers for the Manufacture and Sale of Poor Quality and Dangerous Products.'" The draft law was prepared by DerzhStandart and it finally resulted in the Law of Ukraine No. 1393 "On Extraction From Circulation, Processing, Utilization, Destruction or Further Use of Poor Quality and Dangerous Products," dated January 14, which covers one of the

requirements for joining the European Union, namely the quality maintenance of sanitary and ecological norms in accordance with international standards. Among other clauses, it levies disciplinary, administrative, civil and/or criminal liability for supplying poor quality or dangerous products and failing to comply with the provisions of the law.

Although many of the old practices remain in custom, the Ukrainian government has taken significant steps in implementing more transparent certification procedures. This is evidenced by the passing of Order No. 9 of the Ministry of Health Protection "On Approval of the Procedure for Carrying Out Certification of Pharmaceuticals for International Trade," dated January 14, 2004, and registered with the Ministry of Justice on January 30, 2004 under No. 129/8728.

In the near future, hopefully, Ukraine will permit the construction of Western and/or European accreditation laboratories on the territory of Ukraine thereby making the accreditation procedure faster and decreasing the price of goods which still require both Western and Ukrainian accreditation.



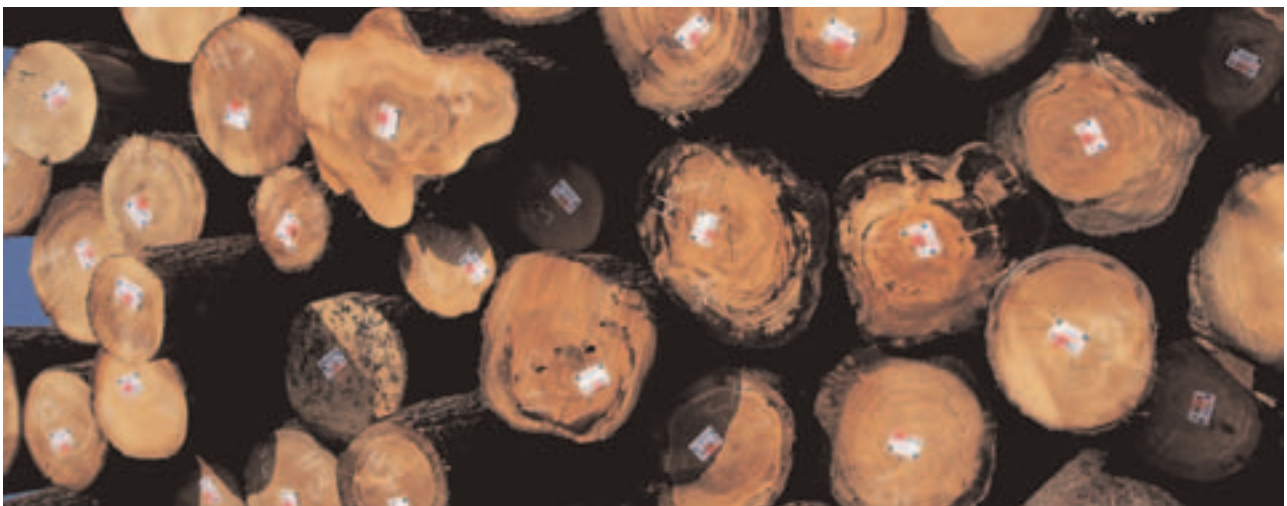
# TOLL MANUFACTURING/ PRODUCT OUTSOURCING

Ukrainian law provides for a so-called "tolling transaction," which is actually a specific type of outsourcing known traditionally as production outsourcing. Tolling transactions, whereby Ukrainian producers manufacture items by using raw materials imported by foreign customers, have become increasingly common in Ukraine. Many foreign companies currently apply a tolling strategy, which enables them to minimize expenses for the assembly of the intended finished products and to avoid the necessity to upgrade their own production facilities and hire additional workforce in the home country.

According to the general principles of a tolling transaction, a customer supplies a producer with raw materials for further processing and/or manufacturing of finished products.

The relationship between customer and producer is based upon a remuneration basis (either in cash or by a portion of finished products and/or raw materials) for payment by the customer to the producer. Practically, a foreign customer may either import the raw materials into Ukraine or purchase them on the territory of Ukraine.

After production, the finished products are exported (re-exported) to the customer according to the terms and conditions of the specific agreement between the customer and producer. The imported raw materials and the finished products made therefrom are exempt from import taxes (with the exception of customs fees) and VAT under a tolling transaction provided that such transaction meets the requirements of the applicable Ukrainian laws. On February 4, 2009, the Parliament decreased the amount of goods that may be processed under toll manufacturing transactions by amending the relevant legislation. As of March 17, 2009, goods under groups 1-24 of the Ukrainian Classifier of Goods in Foreign Economic Activity may not be subject to toll manufacturing schemes. These goods include, among others, livestock, meat products, fish and shell fish products, milk and milk products, chicken eggs, natural honey, certain trees, plants, flowers and vegetables, coffee, tea, grains, flour, cereals, starch, certain fats and oils, food products, sugar, etc. This list is quite extensive and should be checked before entering into any tolling transactions.



## **MINIMAL VALUE OF TOLLING RAW MATERIALS - THE 20% RULE**

Ukrainian law prescribes that raw materials used in tolling transactions must have a value of no less than 20% of the value of the finished products made therefrom and must be supplied to the producer before commencing the manufacture of the finished products. If the value of the raw materials is less than 20% of the value of the finished products, then the transaction will not be considered by law as a tolling transaction. When calculating the value of the raw materials into the value of the finished products, the value of all raw materials and the expenses incurred in connection with the transportation of the raw materials to the producer must both be taken into consideration.

## **TITLE TO THE TOLLING RAW MATERIALS**

According to Ukrainian law, the ownership rights to tolling raw materials at each stage of their processing and the ownership rights to the finished products manufactured from such raw materials belong to the customer throughout the entire transaction.

## **THE 90-DAY RULE**

Tolling raw materials, which are imported onto Ukrainian territory by a foreign customer, are subject to import duties according to the rates as set forth in the Unified Customs Tariff of Ukraine, whereas taxes and fees associated with import of raw materials are governed by general Ukrainian legislation. The payment of import duties, taxes and fees (with the exception of customs fees) is effectuated by the Ukrainian producer by way of a promissory note to the tax body at the producer's location with a repayment term equal to the period of time required for completion of the tolling transaction.

Importantly, the repayment term may not exceed ninety (90) calendar days from the date of execution of the import customs declaration. If finished products manufactured from tolling raw materials are exported from Ukrainian territory within the above 90-day term, the promissory note will be deemed as repaid and the import duties, taxes and fees (with the exception of customs fees) will not be collected. If, however, the finished products are not exported from Ukraine within 90 days, then, in addition to taxes owed, the Ukrainian producer will be subject to a fine in the amount of 0.3% of the total value of the undelivered finished products for each day of delay.

## **TECHNOLOGICAL SCHEME**

As an important rule, the implementation of a tolling transaction requires preparation of a so-called "technological scheme" for processing raw materials. Such scheme must be given to the Ukrainian customs authorities in order to determine the indices of the specific proportion of raw materials as a percentage of the value of the finished products.

## **FORM OF AN AGREEMENT (CONTRACT) FOR PROCESSING RAW MATERIALS ON A TOLL MANUFACTURING BASIS**

As one of the parties to an agreement (contract) for processing tolling raw materials must be a Ukrainian non-resident (a foreign business entity), such agreement (a contract) will be deemed a foreign economic agreement (a contract) and must meet the requirements for the form and contents of such agreements under Ukrainian law.

## THE FIRM'S CLIENTS INCLUDE:

- Advanced Logic Solutions, Inc.
- AMADEUS GLOBAL TRAVEL DISTRIBUTION, S.A.
- Baltic Beverages Holding;
- Bank Austria Creditanstalt
- British Energy
- Bruhn Internationale Transporte GmbH
- BT Global Services
- Chumak
- Commerzbank Aktiengesellschaft
- Credit Commercial de France
- CTB, Inc.
- Deloitte
- Direct EDI Inc
- DUROPACK
- Emilceramica SpA
- Fiat Auto
- FL Smidth & Co.
- Freshfields Bruckhaus Deringer
- Hewlett-Packard Company
- Imanto AG
- INDEVCO
- Jahn General Products Ukraine
- Jabil Circuit, Inc.
- Quality Schools International
- KLM Royal Dutch Airlines
- KPN Royal Dutch Telecom
- Linklaters
- Notaro & Michalos
- Philips Electronics
- Robert Fleming & Company, Ltd.
- SCL Corporate Finance SA
- Sealed Air Limited
- Skanska East Europe OY
- Stragen Chemical SA
- Sun Microsystems
- Theeuwes de Jong B.V.
- The Danish Investment Fund for Central and Eastern Europe
- Thornkild Kristensen Properties AS
- Tyco Electronics AMP GmbH
- Van Oostveen Medical B.V.
- Vetropack Holding Ltd.
- The Embassy of Austria
- The Embassy of Sweden
- The US Embassy
- Vimpel Communications, among others.



## REFERENCES

*"Since 1992 we have the pleasure of being the client of Frishberg & Partners, and recent results just confirm that this was and still is a very right choice for KLM Royal Dutch Airlines."*

***Sergey Fomenko, KLM Royal Dutch Airlines***

*"We are very satisfied with the services of your law firm and especially appreciate the quick, accurate and business-minded responses and analysis."*

***Dr. Brigitte Carbonare-Hartsleben, BT Global Services***

*"I really appreciate the capability and professionalism of your lawyers and the efforts your company successfully put in the defense of ours. We thank you for your assistance and cooperation."*

***Flavia Smiraglio, Fiat Auto S.p.A.***

*"We at Sun and I am personally as legal counsel for Sun operation in CIS region, are very pleased with a level of expertise and service which were and are provided to our company in Ukraine by Frishberg & Partners. I would like to particularly mention also a constant effort of F&P lawyers to keep its clients updated on the most recent developments of Ukrainian legal environment and their responsiveness to our needs in that country."*

***Dr. Andrei Zalivako, Sun Microsystems***

*"Frishberg & Partners' advice and services are of excellent quality, very timely, reliable and to the point, and with a good understanding of our business interests."*

***Christoph Zeyen, Tyco Electronics***

*"As always, thank you for your immediate attention to our needs. Your assistance will help*

*enable us to successfully complete a very large contract and to keep a very good customer."*

***Lori K. Rose, CTB, Inc.***

*"Emilceramica appreciates Frishberg & Partners' professional collaboration in supporting the project "Joint Venture Zeus Keramik" with Ukrainian participation. In this regard, Emilceramica hopes to have Frishberg & Partners' assistance in future."*

***Dr. Efrem Montepietra, Emilceramica SpA***

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***Elias N. Ashkar, INDEVCO Group***

*"You did an excellent job for Joss Chemicals BV, and you prepared an excellent report on our behalf. This was very positive for us, and it allowed us to set up our business in Ukraine. Now we are actively pursuing this business thanks to your excellent lawyers."*

***Jan Huijbregts, Joss Chemicals BV***

*"We hired Frishberg & Partners to analyze certain issues in the Ukrainian legislation in the process of acquiring a company in Ukraine and were very happy with the services we received. All your lawyers we worked with are extremely professional, competent and helpful. Thank you for a job well done."*

***Dmitriy Kasyanenko, Vimpel Communications***

## ABOUT THE FIRM



Over the last 15 years, **Frishberg & Partners** has served as corporate counsel to multinational companies and banks (see our list of clients). We have registered a multitude of joint ventures, subsidiaries and representative offices in Ukraine. By now, the registration process is well-established, as is liquidation.

Acquisition of controlling blocks of shares in Ukrainian companies, however, is an entirely different game, requiring knowledge and experience of local corporate legal specialists. Because each target company is unique, there is no standard approach. That is why our lawyers provide a comprehensive analysis of alternative corporate and tax-efficient acquisition structures in light of the client's specific goals.

Strategic investment is often structured around real property, and sometimes land plots. Together with our real estate specialists, we can set up turn-key operations on industrial greenfield sites, from land right allocations and construction permits to the finished enterprise, fully commissioned and ready for use. Just turn the key.

After the acquisition has taken place, we continue to work closely with our clients to resolve the day-to-day issues, including employment law, capital increases or decreases, tax and customs matters.

At the corporate law firm of **Frishberg & Partners**, our clients truly benefit from getting the most complete package of corporate legal services available on the Ukrainian legal market.