



# RUSSIA / EURASIA

## *Executive Guide*

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#### Regular Features

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#### Russian Government Suggestions on Overcoming Crisis

In early April, the Federal Subsoil Use Agency (Rosnedra) offered 26 suggestions intended to stimulate exploration work and minimize the impact of the global financial crisis. Rosnedra's parent body, the Ministry of Natural Resources and Ecology, has also offered new measures, including compensating company exploration expenses for the mineral extraction tax (NDPI) paid. Page 2

#### Proposed Amendments to Russia's Tax Code Concerning Derivatives

In Russia, a long-awaited draft law that would introduce amendments to the Tax Code relevant to the taxation of derivatives ("the Draft") has been submitted by the government to the State Duma. This Draft covers both profits tax and VAT implications of derivatives transactions. Page 3

#### Legalization of Foreign Employees in Russia

The Russian system for employment of expatriates has changed significantly in recent years. Some of the changes include several amended laws and some new regulations to improve the procedures and make them more straight-forward. Page 4

#### Royalty Traps in Russia's Treaties

Language in Russia's double tax treaties may mean that equipment leases might be treated as royalties, resulting in higher levels of taxation in the absence of a permanent establishment. Page 7

#### Joint Implementation Projects in Russia under Kyoto Protocol

REEG examines the process for assessing joint implementation projects in Russia, a procedure known as the "Track 1" procedure under the Kyoto Protocol. Page 9

#### Stabilization Fund Update in Ukraine

Ukraine's anti-crisis legislation has been amended to address the issue of unfinished construction and to support the mortgage market of Ukraine. In particular, money from the stabilization fund can now be used to buy out unrealized housing from construction companies and/or financial institutions and to buy out the high-risk mortgage loans of individuals from creditors. Page 18

# Starting Agricultural Production in Ukraine

By Andrey Rozhnov (Frishberg & Partners)

With food prices rising across the globe, adventurous foreign investors can find excellent business opportunities in Ukrainian agricultural sector despite (or perhaps due to?) the global economic crisis. Known as “the breadbasket of Europe,” Ukraine still boasts enormous land reserves that can grow various grains, seeds, fruits and vegetables, plus livestock. And due to the crisis, at last everything and everyone is available for sale or rent at rock-bottom prices.

Below we discuss the key issues involved in starting agricultural production in Ukraine, including: (a) obtaining land rights; (b) importing equipment; (c) obtaining financing assistance during these difficult economic times; and (d) miscellaneous issues.

### Land Rights

The main question for foreign investors is whether there is any profit in buying Ukrainian *farmland* to start a

farm business. Thus, at first glance land rights may appear to be a sore topic for investors since the current legislation temporarily prohibits the sale of agricultural land.

To circumvent this legislation, many investors have been successfully leasing farmland either on a short-term (2-5 years), medium-term, (5-25 years) or long-term (up to 49 years) basis. In the process, they have saved millions of dollars in cash, which would otherwise be necessary to purchase the land, making their business more profitable. This is an excellent reason why investors prefer leasing Ukrainian farmland instead of owning it outright.

Note, however, that the sale of non-agricultural land (industrial property) does not fall under the same restrictions that apply to agricultural land (i.e., moratorium on sale). Thus, a foreign investor can build and operate a 100% foreign-owned processing facility on its own industrial land while leasing fields from agricultural landowners until the moratorium on the sale of agricultural land is lifted. In the past, the validity of lease agreements was often questioned and this risk

(of potential disruption or even termination of business activity due to a legal technicality) was too great for many investors. In today's harsh economic climate, however, very few landowners would breach their lease agreements and refuse to lease their fields to a paying client. In order to lease agricultural land, it is only necessary to enter into a land lease agreement with the landowner and simply comply with the terms of the agreement. Of course, the land lease agreement should be properly drafted, registered with the authorities, and notarized.

Obtaining land rights to start agricultural production is relatively simple in Ukraine. The legal framework is quite straightforward and the numerous examples of successful foreign-owned operations exist, including Cargill and Chumak (formerly known as "South Foods"). While owning farmland is temporarily out of the question, a foreign investor may lease the fields anytime. Of course, certain inherent business risks remain, like with any other type of investment throughout the world, but this should not serve as a deterrent to taking advantage of Ukraine's black, fertile soil.

### **Importing Equipment**

Importing foreign equipment is often a pre-requisite to starting agricultural operations due to the lack of quality machinery and/or outrageous prices in Ukraine. There are several ways in which foreign equipment can be imported, including:

(a) by contributing such equipment to a 100% foreign-owned company's share capital. This involves drafting and signing a founders' resolution, amending the company's charter, and registering amendments to the charter with the state authorities. In this case, no customs duties apply; however, 20% VAT will apply.

(b) via a leasing arrangement whereby the ownership of the equipment is retained by a non-resident, who receives regular payments for the use of the equipment. This arrangement is based on a financial leasing agreement, which complies with the requirements of the Law on Leasing and pursuant to which the ownership rights to the equipment will pass to the lessee upon full payment of the leasing agreement. Importantly, under a financial leasing agreement both the customs duty and a 20% VAT will apply to the imported equipment;

(c) by purchasing the equipment via a sale-purchase agreement. Such agreement must, at a minimum, provide for fundamental material conditions including the subject matter, price, payment schedule, title transfer, etc. Again, both the customs duty and a 20% VAT will apply to the imported equipment;

### **Obtaining Financing**

The current land-related legislation prohibits using agricultural land as collateral, precluding the possibility of obtaining much-needed financing. However, rights to

future harvests can serve as liquid collateral, giving rise to the possibility of financing according to the Civil Code of Ukraine and the Law on Pledges.

Thus, in order to obtain a commercial loan from a creditor, an agricultural producer can enter into a loan agreement and secure the repayment of the loan by a pledge (collateral) agreement using the rights to a future harvest(s) as collateral. Normally, such pledge agreements are notarized and registered with the relevant state registry of pledges.

### **Other Considerations**

Of course, as in any other jurisdiction, the Ukrainian government has a statutory right to regulate the market of agricultural products. It does so in the form of price regulation (e.g., setting minimum and/or maximum purchase price, when necessary), commodity and/or financial interventions, as well as the establishment of export and import quotas with respect to the agricultural products that are subject to regulation.

The list of agricultural products, subject to regulation, is established by law and includes certain grains and animal products. The measures that can be taken in respect of certain agricultural products are also established by law and can be used to avoid dumping, for example. It can also be abused: several years ago, Ukrainian authorities introduced a ban on the sale of grain, which caused alarm and anger among the grain traders.

Last, but not least, Ukrainian resident agricultural producers can enjoy a special VAT payment regime, provided they comply with the statutory requirements. According to this special regime, the producer retains the amount of VAT that it charges to the value of the supplied goods (services) instead of paying the tax to the budget. The producer uses the retained amount to compensate the tax paid or charged to a supplier in relation to the value of production factors. In cases when such amount of tax is in excess, the producer can use it for other production purposes. The relevant changes have been introduced to the legislation in order to support agricultural producers during hard times.

In conclusion, due to its enormous reserves of top-quality soil, Ukraine is undoubtedly one of the best places in the world for agricultural producers. And one day Ukraine will surely regain the long-standing status of being "the breadbasket of Europe." The brave investors who decide to set up production during these turbulent times will undoubtedly be rewarded in the future, as they corner the market before their competition even enters Ukraine.

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