

TO: Clients and Friends of the Firm

FR: Frishberg & Partners

RE: Free Economic Zones

I. Introduction

Every government makes ungrounded or unwise decisions. In 2005, during Ms. Timoshenko's reign as Prime Minister, several tax-related amendments were made to Ukrainian legislation via changes to the 2005 State Budget. The special privileges, including tax benefits, provided by Free Economic Zones did not escape Ms. Timoshenko's attention. Citing mass tax avoidance, money laundering and unfair business practices in the zones (not necessarily by foreign-owned companies), Ms. Timoshenko approved amendments to the 2005 budget which wiped out the special privileges for all companies in such zones.

Understandably, foreign investors were quite frustrated with this unilateral removal of their privileges without forewarning. While their commitments to the local authorities remained valid, foreign companies lured to the free economic zones were faced with the prospect of continuing their business without the privileges promised by the local government for specific types of projects. Many foreign investors cried that the State of Ukraine breached its contract with the investors after they met the requirements for receiving the privileges. Moreover, Ms. Timoshenko's move arguably violated the law "On the Foreign Investment Regime" and the Ukrainian Constitution.

Recognizing such erroneous move by the Ukrainian government, President Yushchenko reinstated the privileges in the free economic zones for foreign investors with existing, on-going projects with the local governments. President Yushchenko all but admitted that this was no way to improve the investment climate and attract foreign investors. However, President Yushchenko did not hand back the privileges without requiring measures to eliminate shadow and questionable activities of companies located in the free economic zones.

Thus, by its Resolution No. 1119 of November 30, 2005, the Cabinet of Ministers charged the State Customs Service, the Ministry of Finance, the State Border Service and the State Tax Administration to shape up the rules for exporting goods outside of the borders of free economic zones. The direct result was Joint Order No. 163/242/159/100 "On Approval of the Requirements for the Technical Equipping and Outfitting of Territories of Special (Free) Economic Zones and for the Control Over the Crossing of Goods Via the Borders of Such Zones," dated March 2, 2006. In

addition, a list of subjects of entrepreneurial activity conducting investment projects in free economic zones is maintained by the customs authorities.

While it is clear that free economic zones have not been liquidated and the original privileges envisioned by legislation have been reinstated for existing investment projects in such zones, it is currently unclear whether new investment projects with the participation of foreign investors will be permissible in the free economic zones in the future. Moreover, it is unclear whether the privileges granted by the legislation on free economic zones will be extended to any newly created investment projects in the zones in the future. Obviously, a complete overhaul of the legislation in this sphere needs to be conducted before these issues can be clearly resolved.

With this recent background in mind, the article below describes the general legislation regarding free economic zones in Ukraine and some of the specific benefits certain zones provided upon their initial creation.

II. Discussion

With the cancellation of the formerly granted 5-year tax holidays, the Law “On Foreign Investment Regime” ceased to be a useful (or reliable) vehicle for effectuating investing in Ukraine. As a result, the ever-resourceful Ukrainian legislative minds came up with a new and improved plan for attracting elusive foreign capital. While passing restrictive legislation on the one hand, the Ukrainian Parliament passed several laws designed to inject foreign capital into Ukraine’s so-called “special regions.”

This is not a new idea. The first attempt to create free economic zones was made on October 13, 1992, when the Ukrainian Parliament passed Law No. 2673-XII “On General Principles on the Creation and Functioning of Special (Free Economic) Zones,” as lastly amended on January 19, 2006 (the “FEZ Law”), which established a general framework for the creation of free economic zones (“FEZ”), and that was about it. This experiment had lasted less than one year and was eventually forgotten. Perhaps for that reason the Parliament, together with the President, once again attempted to return to the policy of the free economic zones.

This time around the Parliament started to pass such case-specific gems as the Law of Ukraine No. 65/96-VR “On Certain Questions Related to Currency Regulation and Taxation of Subjects of the Experimental Economic Zone Syvash,” dated February 23, 1996; the Law “On Special Regime of Investment Activity in the Zakarpatskaya Region,” dated December 24, 1998; Law No. 356-XIV “On Special Economic Zones and the Special Regime of Investment Activity in Donetskaya Region,” dated December 24, 1998; Law No. 970-XIV “On the Special Regime of Investment Activity on the Priority Development Territories in Luganskaya Region,” dated July 15, 1999; Law No. 402-XIV “On the Special Economic Zone ‘Yavoriv,’” dated January 15, 1999; the Law of

.....
: If you wish to receive the entire article, please
: contact us at: office@frishberg.com.ua.
:
: Thank you.
:.....