

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Most Commonly Used Business Structures

I. Introduction

January 1, 2004 will always be remembered well by legal experts in Ukraine. This was the date when all legal logic was swept under the rug by the simultaneous coming into force of the Civil Code of Ukraine (No. 435-IV, dated January 16, 2003) and the Economic Code of Ukraine (No. 436-IV, dated January 16, 2003). While experts have counted as many as 55(!) conflicts between these two documents, the fact remains that corporate life in Ukraine must move on.

In spite of the contradictions, difficulties and controversies, the Law of Ukraine “On Economic Associations” and other regulations related to the registration of legal entities and representative offices remain in effect. This being said, as of April 27, 2007, the Law of Ukraine “On Economic Associations” was noticeably amended and added to by the Law of Ukraine “On Introduction of Amendments and Recognition of Certain Legislative Acts as Those Which Lost Force in Connection with the Passing of the Civil Code of Ukraine”. These amendments, additions and cancellations were required in order to adjust the current legislation with the Civil Code of Ukraine. In this light, below we describe the most commonly used business structures by foreign investors in Ukraine.

Notwithstanding the dazzling range of business structures offered under Ukrainian law, foreign companies’ options in Ukraine are typically limited to one of the following four alternative business structures:

1. representative office (which is not a legal entity, and can be either commercial or non-commercial);
2. wholly-owned foreign subsidiary or enterprise (usually with limited liability company provided in their founding documents);
3. “joint ventures” – companies with foreign participation (either in the form of a closed stock company or a limited liability company); or
4. agreements on joint cooperation and production, which do not require registration of

a separate legal entity.

One significant consideration in selecting the appropriate business structure involves Ukrainian foreign currency legislation, which categorizes the above structures as either non-residents or residents, depending on the type of activities carried out by the structure. Non-commercial representative offices are usually considered “non-residents” under currency regulations and tax legislation, while subsidiaries and joint ventures are classified as “residents” because they are legal entities, registered and residing in Ukraine for more than 183 days per year. While the distinction is not clearly expressed in other laws, it is significant in terms of tax consequences and the ability of foreign businessmen to effectuate transactions in foreign or local Ukrainian currency.

Both subsidiaries and joint ventures have the status of separate corporate entities and, thus, both limit an investor’s liability to its initial investment. As Ukrainian corporate entities, joint ventures and subsidiaries are considered to be “residents” under Ukrainian currency regulations and they are subject to a different financial regime than “non-residents” (such as representative offices). For instance, resident companies must transact business in Ukrainian currency only.

Sometimes, for reasons of corporate strategy, foreign investors register both structures (i.e., a non-resident representative office and a wholly-owned resident company) to give them greater flexibility in performing various transactions in Ukrainian and foreign currencies. For example, a foreign company may conclude contracts directly with Ukrainian companies via a representative office and service and receive payment under such contracts in foreign currency abroad. At the same time, such foreign company’s Ukrainian legal entity may conclude local contracts with Ukrainian entities or citizens and generate revenue on the territory of Ukraine for maintaining their strictly Ukrainian operations.

Immediately below we review each of the above alternatives in greater detail.

II. Non-Resident Representative Offices

By definition, a representative office of a foreign company is not a separate legal entity, but is viewed as an “arm” of a non-resident company. As such, a representative office is not incorporated under Ukrainian law. A representative office simply represents the interests of a foreign legal entity on Ukrainian territory and, consequently, there is a flow-through liability for the parent company.

Another consequence: representative offices that are accorded a “non-resident” status under the Ukrainian taxation system are subject to a special financial regime under tax laws and currency regulations. In the past, Ukrainian foreign currency regulations permitted representative offices to pay their Ukrainian employees’ salaries in foreign currency (and additional instructions further reduced taxes by 50% for all foreign currency salaries). This legislation has since been rescinded,

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