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1. INTRODUCTION

In regard of its large geographical and population extension as well as the possibilities of its economical development, the Ukrainian market offers to foreign investors great opportunities to extend their business activities in this region.

The Legal Alliance Law Company prepared a brief review of basic legal aspects that should be taken into account by foreign investors that consider entering the Ukrainian market not only by exporting their products or services to it, but also by establishing their constant presence on this market through creation or acquisition of a local branch.

As shown below, investors may, in general, opt for a number of different forms of legal entities in Ukraine, the structure and operation of which are much similar to the European ones. Generally, the most common forms to opt for when entering the Ukrainian market are represented by limited liability companies (“LLC”) and joint stock companies (“JSC”). The Ukrainian legal system also allows for creation of a representative office (“RO”) which is a special form designed for representation of foreign entities in Ukraine.

The Legal guide outlines the following main aspects:

- Legal forms of business units in Ukraine;
- Short overview of the Ukrainian taxation system;
- Representative Office vs. Legal Entity: advantages and disadvantages;
- Representative Office vs. Legal Entity: taxation issues;
- How it works in practice.

It should be taken into account that Ukrainian legislation is still developing and frequently changing. Present legal guide cannot be relied upon as a comprehensive legal advice. Actual legislation and law enforcement should be analyzed in every specific case with a law office based in Ukraine.

2. LEGAL FORMS OF BUSINESS UNITS IN UKRAINE

There is a variety of different forms of legal entities under Ukrainian law that can be established by foreign investors in regard of the characteristics of business they want to run:

- Limited liability companies (LLC) and additional liability companies;
- Joint-stock companies (JSC);
- General and limited partnerships; or
- Representative office.

It may be chosen to establish or acquire such companies solely or with other, foreign or Ukrainian partners.

Anyway, it shall be kept in mind that for example an LLC or JSC, both Ukrainian and foreign one, founded or owned by a sole member cannot be a sole member of a Ukrainian LLC or JSC.

Besides that, Ukrainian legislation defines very low thresholds and vague scope of businesses in relation to which the acquisition of a Ukrainian entity or its establishment with other partner(s) shall be considered as concentration, which requires a preceding approval of the Ukrainian Antimonopoly Committee.¹

2.1. Limited Liability Company

The most common and widespread form of a company in Ukraine is an LLC. This form is also used the most frequently for establishing branches of foreign companies.

An LLC may be founded by one or more persons or entities (but not more than 10²) by taking decision on creation and drawing up its statutes.

The registered capital of an LLC must currently amount to no less than approximately EUR 75³ and it may be created by monetary and/or non-monetary contributions.

Regarding the non-monetary contributions, their value is determined by the founders or members in the LLC statutes. The founders are free to determine the rules of the evaluation of such contributions, so no expert opinion is needed in principle.

Prior to registering an LLC, each founder must have paid up no less than 50% of its contribution as provided by the statutes, which shall be certified by the founders' bank.

¹ The approval is needed when the total annual turn-over or value of assets of the merged companies is EUR12.000.000 or more and at the same time the total annual turnover or value of the assets of each of at least 2 of the merging companies is EUR1.000.000 or more and at the same time the annual turnover or the value of assets of at least one of the companies in Ukraine is EUR1.000.000 or more.

² Otherwise, it shall be transformed into a JSA.

³ Minimal amount of registered capital is variable. It is established for not less than 1 multiple of official minimal salary which is regularly increased. From 01.01.10 – 31.03.09 minimal salary is established at 869 UAH.

Then, the entirety of the contributions must be paid up within a year of the registration of an LLC.

Each LLC shall be governed and controlled by a General Meeting of its members, an executive director or a board of directors and a Supervisory board (called “revision commission”).

A General Meeting is the highest body of the company which decides on the fundamental matters of the LLC’s operation (change of statutes, adoption of the financial sheets, liquidation of the LLC, etc.).

A director (or board of several directors) represents an executive body of LLC; he/she represents the LLC outwards and provides its current management. Directors are appointed and dismissed by General Meeting from among the members of the LLC or other persons, either Ukrainians or foreigners. In this respect, it is important to say that a Foreign person cannot validly become a director of LLC unless he/she obtains a labour permit in Ukraine. However, such labour permit, being connected to the position of director of the specific LLC, can only be issued after the registration of the LLC at the State registrar. Thus, it means that at least for the time period extending between the registration of the LLC and delivery of the labour permit, a Ukrainian citizen (for instance, a local lawyer) shall be appointed temporarily to the position of director.

The revision commission is a controlling body of LLC that exercises a control over the company’s activities; it shall consist of at least 3 persons – shareholders of LLC⁴.

The members of an LLC are generally not liable for the obligations of the LLC; they are only liable up to the amount of the unpaid parts of their contribution.

2.2. Joint Stock Company

Besides LLC, Foreign entities may also opt for a branch in form of JSC. This form is normally chosen to serve for bigger companies or for operators in some specific sectors, such as banking, insurance, etc.

In comparison with an LLC, a JSC has more complicated structure, procedure of establishment and operation of a business activity.

As to its characteristics, a JSC is a company with the registered capital divided into a fixed number of shares, each having an equal nominal value.

Ukrainian law defines two types of JSC: a *private* and *public* JSC.

⁴ However, being not possible in the LLCs with less than 3 members, the revision commission is often composed of less than three members.

A private JSC is a company with shares divided among its founders; the shares are not subject to subscription and cannot be acquired on stock markets.

The public JSC is a company with the shares distributed via public subscription or sale, passing through a licensed securities trader.

However, either public JSC or private JSC may be established only on the basis of the closed emission of shares.

The shares shall be registered at the authorized official body – the State Commission for Securities and Stock Market.

The registered capital of a JSC must currently amount to not less than approximately EUR 94 500.5

Concerning the types of shares, these must be registered in the shareholder's name, i.e. anonymous (bearer) shares are not permitted. Priority shares are also permitted (up to 25% of the registered capital).

Likely to the LLC, the obligatory bodies should also be established in JSC, namely General Meeting of the Shareholders, a (general) director or board of directors (executive body), and Audit commission and Supervisory board (controlling body).

2.3. Additional Liability Company

Besides a regular LLC, Ukrainian legislation knows also an additional liability company (“ALC”), structured and governed basically in the same manner as an LLC.

The only difference consists in the fact that members of an ALC are liable up to the total amount of their contributions into the registered capital, and in the case of the insufficiency of their participation to cover all debts, they are additionally liable with their own property in the amount equal to a set multiple (divisible) of the contribution of each member up to the limit stipulated in the statutes of the ALC.

2.4. General Partnership

It is a company in which two or more partners jointly exercise a commercial activity and are jointly liable for the company’s obligations with the entirety of their property.

Partners (members) in a general partnership are to be registered as entrepreneurs by the State registrar at their place of residence or registered office.

⁵ Minimal amount of registered capital is variable. It is established for not less than 1250 multiple of official minimal salary which is regularly increased. From 01.01.10 – 31.03.10 minimal salary is established as 869 UAH.

However, a person may be a partner in only one general partnership and may not be at the same time a full partner of a limited partnership.

2.5. Limited Partnership

On the other hand, a limited partnership is a company in which, besides one or several partners who perform commercial activity on behalf of the limited partnership and have joint liability for company's obligations with their entire property (full partners), one or more partners are liable only to the amount of their contributions (depositors) and do not perform commercial activity on behalf of the company.

A person may only be a full partner in one limited partnership. A full partner of the limited partnership cannot be a partner (member) of the general partnership.

Moreover, the total amount of depositors' contributions may not exceed 50% of the nominal capital of the company.

2.6. Representative office

There is a special institute under UA law that foresees an alternative form to the legal entity and that is specifically designed for representation of foreign companies in Ukraine – Representative office. As the RO does not have a separate legal personality, it acts in the name and on the account of its mother company.

There are two types of the RO in Ukraine: the RO of foreign states (e.g. embassies, consulates) and the RO of non-residential legal entities.

The RO is supposed to operate without exercising commercial activities or generating income. Under current Ukrainian legislation a RO may also exercise commercial activities (permanent commercial RO) – it may conduct trade and other commercial activities, including conclusion of trade contracts.

Current Ukrainian legislation distinguishes two types of the RO of foreign legal entities:

- The permanent (commercial) RO with the right of execution of business activity in Ukraine;
- The non-commercial RO with the functions of representation the parent company in Ukraine only. In this respect, its functions are limited to the representation and protection in Ukraine of the interests of a foreign parent company, and are especially limited to the promotion of its activities and related marketing affairs; in this regard, the RO is not supposed to operate commercial activities or generate income.

Incidentally, in case when some activity requires a license, neither the RO, nor its foreign mother company will be able to obtain it.

3. SHORT OVERVIEW OF THE UKRAINIAN TAXATION SYSTEM

The current UA tax structure consists of national and local taxes. It is rather similar to the tax system of the developed European countries, however the main differences relate mainly to the tax treatment of foreign entities (legal or natural persons) and to cross-border transactions.

Thus, these are often modified by numerous double taxation treaties concluded between Ukraine and other states.

There are two taxation schemes provided by the Ukrainian law: a general one and a simplified one.

- **General taxation system** – is the common taxation scheme that includes: profit tax (25%), VAT (20%), and some other compulsory payments (~3%) and to which all business units are subject to.
- **Simplified taxation system** – the taxation scheme that implies payment of single tax (6%+VAT or 10%) for legal entities, provided that they fulfil the established requirements of law.

3.1. General taxation system

General system of taxation includes payment of the entire assortment of taxes and charges provided by law, namely, the Income Tax, the Value Added Tax, the Excise Tax (where applicable), local taxes and charges, royalties for resources, and contributions towards social funds.

3.1.1. Obligatory national taxes

According to the current Ukrainian legislation the obligatory national taxes must be paid by all taxpayers depending on the respective peculiarities.

Income tax

This tax is payable in accordance with the Law of Ukraine *On Companies' Income Taxation* dated 22 May 1997, no. 283/97-BP (the "Income tax law").

Income tax is levied on income received by residents, non-residents and permanent representatives of non-residents from business activity carried out within the Ukrainian territory.

The tax base is an income originating in Ukraine calculated as difference between adjusted gross income and the aggregate of gross expenses and depreciation.

Payers of this tax are defined as:

- Ukrainian residents, business entities, government-funded, public-sector and other enterprises, institutions and organisations carrying out profit-making activity both in and outside Ukraine⁶;
- Ukrainian non-residents, private individuals and legal entities in any constitution form who receive income originating in Ukraine⁷;
- Permanent RO of non-residents who receive income from sources in Ukraine or act as agents/representatives for such non-residents or their principals⁸.

Tax law distinguishes between several types of such RO having different status in terms of profit taxation.

Types of Representatives and Their Status for the Purposes of the Income tax law

Type of a Representative	Status under Income tax law
Residents acting as independent agents	Residents
Representatives of non-residents not involved in business activity	Non-residents
Representatives of non-residents involved in business activity	Permanent representatives
Residents acting as dependent agents	

Income originating in Ukraine means and includes any income received by a resident or a non-resident from any kind of activity in Ukraine including interest, dividends, royalty and any other types of passive income paid by Ukrainian residents; income obtained from rental/lease of residents' or non-residents' property located in Ukraine; income obtained from sale of real estate in Ukraine; income received as premiums and fees for insurance and reinsurance of risks in

⁶ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 2, clause 2.1.1.

⁷ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 2, clause 2.1.2.

⁸ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 2, clause 2.1.4.

Ukraine, as well as any other business income originating within the Ukrainian customs territory or in the territories under control of the Ukrainian Customs Service⁹.

Consequently, both a non-resident's permanent representative and a Ukrainian resident legal entity that maintain business operations in Ukraine are treated as payers of income tax on common grounds.

Income tax does not apply to income of non-residents received directly from activity carried out outside customs border of Ukraine, within the territories of other states.

The following tax rates are applied:

- General tax rate – 25%;
- To non-residents for the income obtained through their permanent RO - 25%¹⁰;
- To non-residents for certain kinds of income - 15%¹¹.

Withholding tax

Income paid to a non-resident company directly is generally subject to withholding tax deducted by the withholding agent (a resident company or a permanent establishment of a non-resident company) at the moment of payment. No withholding tax is due or lower withholding rate applies if the income is exempt from tax (e.g. certain types of interest) or if so provided in a tax treaty. For purposes of treaty relief, the non-resident must file a certificate of residence issued by the foreign tax authorities to the withholding agent.

The established tax rate constitutes 15%. A resident remitting income to a permanent RO of a non-resident is not subject to the 15% tax; this tax is withheld only when the recipient of income is a **non-resident**.

- **Dividends**

Dividends paid to non-resident companies directly are subject to a 15% final withholding tax, unless a tax treaty provides otherwise.

- **Interest**

Interest paid to non-resident companies directly is subject to a 15% final withholding tax, unless a tax treaty provides otherwise. However, interest on government securities issued abroad through authorized non-resident agents and interest on loans granted to the government or the National Bank is exempt from Ukrainian tax.

⁹ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 1, clause 1.21.

¹⁰ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 13, clause 13.8.

¹¹ Law of Ukraine *On Companies' Profit Taxation* of 22 May 1997 no. 283/97-BP, article 13, clause 13.2.

- **Royalties**

Royalties paid to non-resident companies directly are subject to a 15% final withholding tax. The definition of the term "royalties" broadly follows that used in the UN Model Convention. However, it does not include income from the use of, or the right to use, industrial, commercial or scientific equipment.

- **Other**

Fees for international freight paid to a non-resident without a permanent establishment in Ukraine are subject to a 6% final withholding tax.

Other income paid by residents or permanent establishments of non-residents to non-resident companies without a permanent establishment in Ukraine is subject to a 15% final withholding tax.

Taxes are withheld from such incomes and paid immediately upon remittance of income to a non-resident or use of this income (or its part) for purposes set by the non-resident.

Value Added Tax

Value Added Tax (VAT) is paid in accordance with the Law of Ukraine *On Value Added Tax* dated on 4 March 1997 no. 168/97-BP (the "VAT law").

Payers of this tax include subjects of commercial activity with a legal entity status, including those with foreign investments, irrespectively of the residency status in Ukraine; and the RO of non-residents without a legal entity status whose transactions involving supply of goods, works or services in the past twelve months exceeded 300,000 Hryvnias¹².

Registration as VAT payers is obligatory for legal entities and permanent RO of non-residents who are involved in import of goods across the customs border of Ukraine or who receive works or services from a non-resident for use within the customs territory of Ukraine.

Depending on a transaction type, VAT may be charged at the rates of 0% or 20%¹³.

According to the Ukrainian laws, there is no difference between a non-resident's permanent RO and a legal entity operating for the benefit of a non-resident in regard to the VAT payment procedure.

¹² Law of Ukraine *On Value Added Tax* dd. 4 March 1997 no. 168/97-BP, article 2.

¹³ Law of Ukraine *On Value Added Tax* dd. 4 March 1997 no. 168/97-BP, article 6.

Land Charges

In accordance with the current Ukrainian legislation, a tax declaration shall be submitted and the land tax and land rental shall be paid in respect of any relevant government or communal land at the location of a land plot¹⁴.

Therefore, in case if there is a relevant tax base at the location of a non-resident's RO the non-resident shall pay the tax and duly submit a calculation for this tax to the respective tax authority. The RO may be either registered as a payer of land tax or pay land rental.

Land tax is paid for the use of land irrespectively whether its user is a permanent RO of a non-resident or a legal entity.

3.1.2. Local Taxes and Charges

Pursuant to the current Ukrainian legislation, only legal entities are qualified as payers of local taxes and charges¹⁵. A non-resident's representative without a legal entity status is therefore not deemed to be a payer of local taxes.

Transport tax

This tax is paid by legal entities that own vehicles, which are duly registered in Ukraine¹⁶. Tax from the owners of land based vehicles is paid at the location of relevant legal entities¹⁷.

The law also provides that legal entities may submit tax calculations to the respective tax authority either at their own location or at the place of permanent stationing of vehicles¹⁸.

The transport tax rates differ depending on the technical characteristics of the vehicles. There is no difference in the tax rates depending from the owners of vehicles and its order of payment between permanent RO of non-residents and legal entities operating for the benefit of non-residents.

Environment Pollution Charge

The RO or legal entities that own motor vehicles are subject to the environment pollution charge payable in accordance with the *Instruction on Accrual and Payment of Natural Environment Pollution Charge* approved by the joint order of the Ukrainian Ministry for Environment Protection and Nuclear Safety and the State Tax Administration of Ukraine dated 19 July 1999 no. 162/379.

¹⁴ Law of Ukraine *On Land Charges* dd. 7 March 1992 no. 2535, articles 14, 17.

¹⁵ Decree of the Cabinet of Ministers of Ukraine *On Local Taxes and Charges* dd. 20 May 1993 no. 56-93.

¹⁶ Law of Ukraine *On Tax from Owners of Transport Facilities*, article 1.

¹⁷ Law of Ukraine *On Tax from Owners of Transport Facilities*, article 2.

¹⁸ Law of Ukraine *On Tax from Owners of Transport Facilities*, article 6.

Procedure of withholding and payment of this charge does not depend on a payer's legal status.

3.1.3. Individual Profit Tax

Responsibility for accrual, withholding and payment (remittance) to the state budget of the individual Profit tax from salaries of employees is borne by an employer (or a self-employed person) who pays such profit for the benefit of the payers of this tax (or such self-employed person).

Employer is construed as a legal entity (or its affiliate, division, any other detached unit, or the RO) or an individual entrepreneur (including a self-employed individual), who enters into employment contracts with the hired personnel and is responsible for payment of their salaries and accrual, withholding and payment of individual profit tax to the state budget, remittance of appropriate payroll surcharges, and has other relevant responsibilities provided by law¹⁹.

Tax agent is a legal entity (or its affiliate, division or any other detached unit), an individual, a non-resident or its representative which must accrue, withhold and pay to the state budget the aforesaid tax on behalf and at the expense of its employees, keep relevant tax records, and submit appropriate reports, irrespective of its own legal status and applicable scheme of payment of other taxes.

Taking into account the abovementioned, under the common taxation scheme there is no material difference in the tax statuses of a legal entity and the RO.

3.1.4. Avoidance of double taxation

The Decree No. 470 dated 6 May 2001 of the Ukrainian Cabinet of Ministers endorsed the *Procedure for Release From Tax/Reduction of Taxable Income Originating in Ukraine under International Treaties of Ukraine on Avoidance of Double Taxation*.

In case if there is concluded international bilateral treaty on avoidance of double taxation it allows for non-residence to be subject for taxation both in Ukraine and in the country of its origin.

The treaty contains the withholding tax rates that are applicable to dividend, interest and royalty payments by Ukrainian companies to non-residents under the tax treaties currently in force. Where, in a particular case, a treaty rate is higher than the domestic rate, the latter is applicable.

The reduced treaty rates may be applied immediately where the non-resident has provided the withholding agent with a certificate of residence issued by the foreign tax authorities.

¹⁹ Law of Ukraine *On Individual Income Tax* dd. 22 May 2003 no. 889-IV, article 1.

A non-resident should submit a Statement of Taxes Paid to the respective tax authority at the place of its registration. Such statement is issued by a competent authority and is effective for one calendar year²⁰.

A Statement of Taxes Paid allows a non-resident to claim for the reimbursement of a difference between the tax paid and the tax payable under the international conventions.

3.2. Simplified Taxation System

Ukrainian legislation provides for a simplified taxation and tax accounting procedure, also known as a single tax scheme, for legal entities and individual entrepreneurs. This scheme is not applicable to the RO.

Persons who pay a single tax are not subject to other taxes and charges²¹.

A legal entity, which provides commercial activity, may opt for a simplified taxation scheme, tax accounting and reporting under one of the following alternative single tax rates:

- **6 per cent** of revenue from sale of products (goods/works/services), exclusive of the excise tax, in case of payment of the Value Added Tax in accordance with the Law of Ukraine *On Value Added Tax*;
- **10 per cent** of revenue from sale of products (goods/works/services), exclusive of excise tax, with Value Added Tax being included in the single tax.

A simplified taxation system may be applied to the legal entities of any legal status and organisation form, which carry out business activity, and fulfil the following requirements:

- The staff does not exceed 50 persons;
- The annual revenue from sale of products (goods/works/services) does not exceed the amount of 1 million Hryvnias (approximately EUR 87 000)²².

Revenue from sale of products (goods/works/services) is determined as the amount of actually received by a business entity into its bank account and/or cashier's office for transactions involving sale of products (goods/works/services)²³.

As seen from the above, legal entities using a simplified scheme of taxation enjoy significant advantages over the RO to which this scheme is not applicable. However, they are limited by the cap of rather low annual revenue from sale of products (goods/works/services).

²⁰ Decree of the Cabinet of Ministers of Ukraine dd. 6 May 2001 no. 470

²¹ Decree of President of Ukraine *On Simplified Scheme of Taxation, Tax Accounts and Reports for Subjects of Small Enterprise*, clause 6.

²² Decree of President of Ukraine *On Simplified Scheme of Taxation, Tax Accounts and Reports for Subjects of Small Enterprise*, clause 1, paragraph 3.

²³ Decree of President of Ukraine *On Simplified Scheme of Taxation, Tax Accounts and Reports for Subjects of Small Enterprise*, clause 1, paragraph 5.

4. REPRESENTATIVE OFFICE VS. LEGAL ENTITY: ADVANTAGES AND DISADVANTAGES

4.1. Operation via a Representative Office

The RO of a legal entity (either Ukrainian or foreign one) under Ukrainian legislation is its separate division, situated beyond its location and entitled to carry out marketing and promotional activities in Ukraine on behalf of a mother legal entity.

Therefore, the RO of a foreign business entity constitutes itself neither a legal entity nor a business unit²⁴.

In this status the RO does not have any legal capacity, i. e. is not entitled to acquire rights or bear obligations on behalf of its own, while a mother company is fully responsible for its activity. Moreover, the RO may conclude transactions only on behalf of its mother company.

Capacity of the RO is determined in the Regulations of the RO and a power of attorney (the “PoA”), issued by the mother company to the Head of the RO. Consequently, the RO may perform only activities, expressly provided in the said Regulations and the PoA.

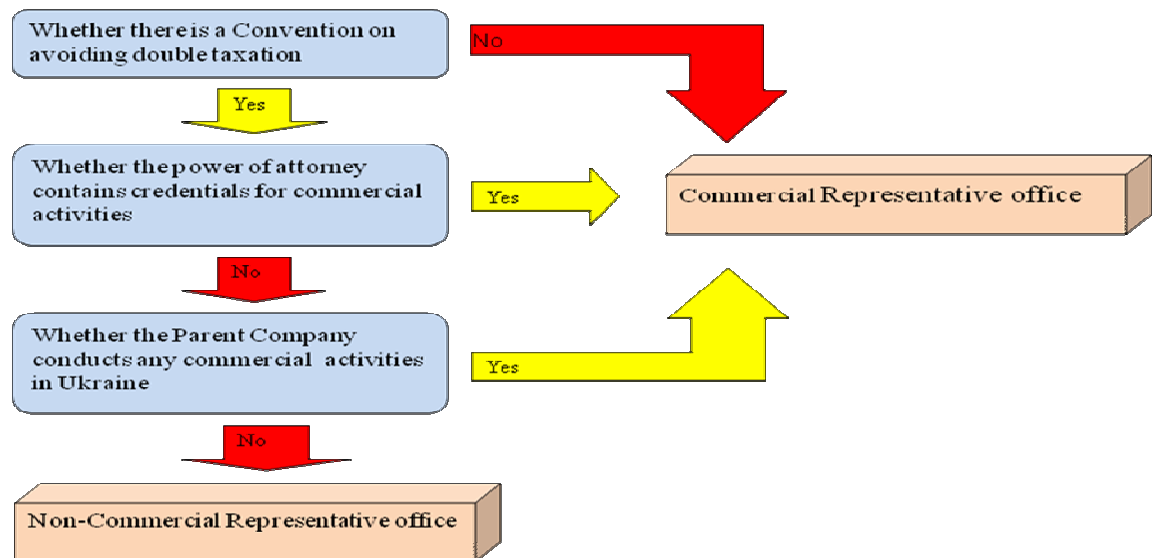
Note that the PoA issued by a non-resident legal entity would require legalisation in Ukraine²⁵. Depending on jurisdiction, legalisation process may involve extra constraints in the activity of a non-resident legal entity within the territory of Ukraine. Thus, any change in the scope of authority of a person named as attorney in a PoA will require a new legalisation procedure to be run from scratch.

Taking into account that the RO does not have a status of a legal entity, it is restricted for the RO to obtain licenses and other approvals. In case if there is a need to provide the commercial activity which is subject to licensing, the RO would have to contract Ukrainian intermediary with the respective license.

²⁴ Law of Ukraine *On Amendment of Certain Regulatory Acts* dd. 04 February 2005, no. 2424-IV, section I, article 1, clause 1, sub clause “a.”

²⁵ Law of Ukraine *On Foreign Economic Activity*, article 5, part 18.

Rep Office: Commercial / Non-Commercial



Unlike the commercial RO, the status of which is more similar to the legal entity, providing activity in Ukraine through the non-commercial RO offers a number of benefits to the foreign investors. This form of activity allows more efficient control over the RO and its business by the mother company.

By the means of the PoA and the Regulations of the RO the parent company may effectively limit the scope of authority of its RO in Ukraine.

Another advantage of the RO is that it enjoys a less cumbersome procedure in employment of foreigners. Registration of such foreigners in the Ministry of Economy of Ukraine and obtaining of the respective service card would be enough legal grounds for employment of the employees of the RO²⁶.

Finally, a RO may be funded by the mother company and such funds will be treated as non-profit making, i.e. not taxable, although there is still a debate pending in Ukraine concerning this matter, since the supreme tax authority of Ukraine is disposed to view these revenues as profit²⁷.

However, the downside of this type of operation is that the RO is not an independent business unit and may not apply the simplified taxation scheme.

²⁶ Procedure for Issuance of Employment Cards for Employees of Representative Offices of Non-resident Business Subjects Registered by the Ministry of Economy of Ukraine, as approved by the Order of the Ukrainian Ministry of Economy dd. 15 July 2007 no. 179.

²⁷ Letter of State Tax Service of Ukraine dd. 27 June 2003 no. 10205/7/15-1317, clause 3.

4.2. Operation via a Special Purpose Legal Entity

A legal entity is a duly registered and incorporated organisation with civil legal capacity and capability, which may independently enter into relationships with other business subjects and act as a plaintiff or defendant in court.²⁸

Any legal entity has a status of an independent subject of business relationships.²⁹

Moreover, as the legal entity is responsible for its own activity the parent company will not bear responsibility for the activity of its affiliated legal entity, and would be liable only in the amount of its contribution to the registered capital.³⁰

The legal entities enjoy capability and legal capacity enough to fully represent the parent company in the Ukrainian market, including carrying out distribution activity.

Furthermore, the legal entity has an independent status and its assets are separated from those of the mother company. Accordingly, chief executive (director) of the legal entity has the right to carry out its operations, including close transactions, at his sole discretion.

Besides, according to the Ukrainian legislation, in certain circumstances a legal entity may enjoy a simplified taxation treatment³¹.

However, the funding of a subsidiary legal entity by the mother company may only be performed on a contractual basis, hence, the direct financing is impossible.

At the same time, other downsides related to operation in Ukraine via a legal entity, mostly dealing with the coordination of arrangements between the mother company and the subsidiary legal entity.

Thus, control by the mother company over the activity of the legal entity becomes more complicated and is subject to applicable laws and the charter (articles of association) of the legal entity.

²⁸ Civil Code of Ukraine, article 80.

²⁹ Economic Code of Ukraine, article 55, part 2, clause 1.

³⁰ Civil Code of Ukraine, article 96, clause 3.

³¹ Decree of President of Ukraine *On Simplified Scheme of Taxation, Tax Accounts and Reports for Subjects of Small Enterprise*.

	REPRESENTATIVE OFFICE	LEGAL ENTITY
ADVANTAGES	<ul style="list-style-type: none"> - effective control by the mother company over the on-going activities; - competence of is limited by the PoA and the Regulations of the RO; - less complicated procedure of employment of foreign nationals; - directly financing by the mother company. 	<ul style="list-style-type: none"> - wide scope of authorities; - ability to enjoy a more attractive taxation scheme; - ability to act directly as a plaintiff or defendant in court; - legal capacity and capability sufficient to carry out business in Ukraine; - liability is limited to assets of the legal entity.
DISADVANTAGES	<ul style="list-style-type: none"> - questionable tax status; - simplified taxation scheme does not apply; - the RO is not an independent subject of law; - the RO has a limited capability; - complicated procedure of change of scope of authority; 	<ul style="list-style-type: none"> - lack of direct control by the mother company; - complicated procedure of employment of foreign nationals; - funding by the mother company is provided on contractual basis; - necessary registered capital and management bodies.

In other words, a legal entity has a substantially broader scope of authority compared to the RO: it possesses legal capacity and its capability is as set by applicable laws and the shareholders (in this case, the Company) in its bylaws, but in the same time, the management procedure is rather complicated.

5. REPRESENTATIVE OFFICE VS. LEGAL ENTITY: TAXATION ISSUES

It should be noted that both the RO³² and legal entities³³ are subject to compulsory registration with appropriate tax authorities at their location.

There exist certain discrepancies between tax laws and business laws as to the extent of capability of the RO, namely, the tax laws treat the RO as being involved in business activity³⁴, while the business laws do not. It has to be pointed out that the non-resident's RO is considered as a business entity by tax laws for taxation purposes only; this does not affect its legal status under business laws.

³² *Instruction On Registration of Representatives of Foreign Business Subjects in Ukraine*, as approved by the Order of the Ukrainian Ministry of Foreign Economic Relationships and Trade dd. 18 January 1996 (paragraph 13).

³³ *Procedure for Registration of Payers of Taxes and Fees (Mandatory Charges)*, as approved by the Order of the State Tax Administration of Ukraine dd. 19 February 1998 no. 80.

³⁴ *Law of Ukraine On Companies' Profit Taxation*, article 1, clause 1.17.

Non-commercial RO is not subject to taxation in Ukraine.

A non-resident company that carries on a business through a commercial RO in Ukraine is subject to corporate income tax on the worldwide profit derived through such commercial RO. The taxable income of the commercial RO is generally determined in the same manner as that of a resident company (i.e. the direct method). However, the commercial RO has an option to choose one of the following two alternative methods for calculating its income tax: (1) the separate balance sheet method, or (2) the indirect method.

The direct method is used when the non-resident company can easily determine the amount of profit attributable to the activities or assets of its commercial RO. Allowable expenses are deducted from its gross profit, and the difference is reported as the taxable profit.

Under the separate balance sheet method, the taxable profit of a PE is determined on the basis of the non-resident's worldwide income. Under the Income Tax Law, a non-resident company operating in and outside of Ukraine, without separately declaring its profits received through the commercial RO in Ukraine, may be imposed with the income tax based on a separate balance sheet composed by such non-resident company in co-ordination (i.e. by negotiation) with the local tax authority at the commercial RO's location. This method is used for non-resident companies with activities in multiple countries that do not have readily available gross income figures which could be used to allocate a portion of their incomes to their commercial RO in Ukraine.

Under the indirect method, the taxable income is calculated by applying a coefficient of 0.7 to the gross income attributable to the commercial RO.

Taking into account the information presented in the previous paragraphs the main comparative aspects in the taxation are presented in the table below:

	Legal entity	Representative Office (commercial)
Status of the tax payer	Obligatory tax payers General taxation system (simplified system is possible cases foreseen by law)	Questionable tax status

Corporate income tax	25 % Tax basis is the net income, i.e. the difference between gross revenues and the sum of gross expenses and amortization expenses. Financial contributions from a related foreign legal entity, such as under a loan agreement, may have to be included in the taxable income under certain conditions.	25 % * Tax basis is the net income obtained on the territory of Ukraine, i.e. the difference between gross revenues obtained on the territory of Ukraine and the sum of gross expenses and amortization expenses incurred in Ukraine. Financial contributions from the mother legal entity have to be included in the taxable income under certain conditions.
Corporate profits withholding tax (repatriation tax)	15 % if otherwise is not stipulated by international agreement on avoiding of double taxation.	15 % * if otherwise is not stipulated by international agreement on avoiding of double taxation.
VAT	20 % **	not paying ***
Dividends	25%	not paying
Import duty	Depends on type of equipment****	Depends on type of equipment****

* Please note that if the RO does not conduct commercial activities in Ukraine but merely non-taxable promotional and marketing activities, it will in general not be taxed in Ukraine. The exclusion from taxation is however subject to examination of the activities of the RO.

** Please note that major uncertainty remains regarding recuperation and refunding of VAT.

*** The RO becomes a VAT payer if it gets income during the tax period in excess of UAH 300 000 (e.g. as a result of the property sale).

**** Could be released if the imported equipment is considered as a contribution to the chartered capital.

6. HOW IT WORKS IN PRACTICE

Foreign investors may opt for a number of different forms of legal entities in Ukraine; however, the most widespread are the Limited liability companies and the RO. Please, see figure on the next page.

Rep. Office + LE Scheme

- **Representative office** may perform tax-free activities under Convention (marketing, promotion etc.).
- **Legal Entity** may perform other commercial activities (production, delivery etc.).

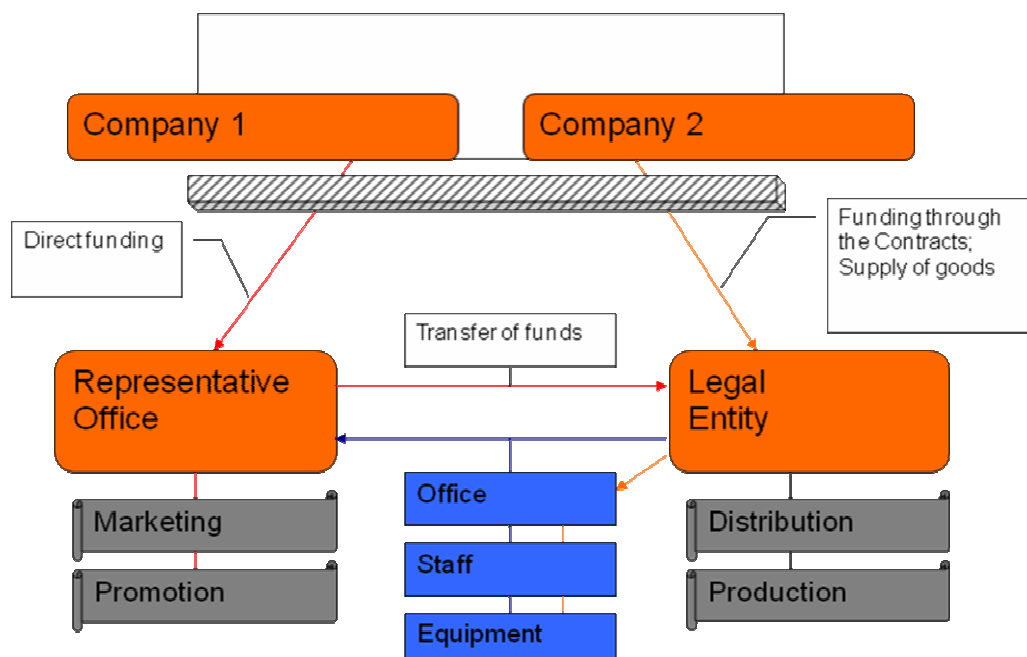
Warnings

- Legal Entity and Representative Office should be incorporated by different Parent Companies
- Representative Office may not render services to Legal Entity
- Legal Entity may not use office and equipment of Representative Office

Opportunities

- Legal Entity may render services to Representative Office
- Representative Office can use office and equipment of Legal Entity according to Contracts;
- The same personnel can be engaged (partial engagement) with exception of the Head Manager.

The main (and in practice most significant) difference between the commercial RO on the one hand and legal on the other hand relates to their legal personality.



Operation of a non-resident company in Ukraine via the RO allows the mother company to establish presence in the Ukrainian market. The activities of the RO are exercised on behalf and for the account of the foreign mother company, and is fully bound by the acts undertaken and obligations incurred by the RO.

At the same time the foreign company seeking to carry out business in Ukraine directly (without intermediaries) will find the capabilities of the RO as not sufficient. Such an activity would suggest creation of a legal entity that would have full legal capacity and capability to maintain business activity for the benefit of the mother company (including entering into contracts on its behalf, obtaining necessary licenses and other permits and approvals, etc.). Registered legal entities act in their own name, may freely conclude contracts and enjoy all other rights prescribed by the laws for legal entity and bear their own obligations and liabilities in the amount of statutory capital.

Apart from the benefits in the general logistics, the operation through a legal entity will allow to achieve a more favourable tax treatment, including a simplified taxation scheme.

At the same time, correct choice of ownership form of such legal entity will mitigate the downsides related to control and management on the part of the mother company.

In regard to the taxation issues for the non-residents acting in the territory of Ukraine via the RO and in case of existence of the convention on avoidance of double taxation, there is the following practice.

A non-resident company begins performing a business activity in Ukraine via a permanent representative office. In case if the representative office provides a commercial activity (e.g. buy or sell goods/services), the income obtained from such activity is entitled for taxation. Usually, for the beginning it carries out only promotional activities and represents the mother company in negotiations, thus having non-commercial status.

No profit shall be attributed to a permanent RO by virtue of a mere purchase by this office of goods or products for a non-resident.

A non-resident may claim tax credit in the country of its origin for the amount of income tax paid in Ukraine in case if types of income from which the tax has been paid in Ukraine are not exempt from tax in country of origin of the non-resident.

Taking into account the abovementioned short overview we may conclude that Ukraine proposes to foreign investors a vast and favourable field to start up a business here.