

Ukraine

Sweeping Changes to Rules Regulating Foreign Investments and Repatriation of Investments in Ukraine

The National Bank of Ukraine (the "NBU") has recently issued two sweeping new resolutions (collectively, the "Resolutions") concerning the procedure for making foreign investments into Ukraine, as well as repatriating such investments and any related profits, dividends or other income. The new Resolutions introduce significant changes to the legislative framework for foreign investments in Ukraine, designed in large part to bring foreign investment transactions "on-shore." In general, the Resolutions require foreign investors to carry out investment activities in Ukraine through Ukrainian bank accounts and using Hryvnia, the Ukrainian currency. The Resolutions immediately affect settlements for transactions related to the purchase or sale of securities issued by Ukrainian entities ("Ukrainian Securities") (such as shares in Ukrainian stock companies) where one or both parties are non-residents.

The first enactment, Resolution No. 482, regarding foreign investment regulations and the repatriation of profits, income and other funds obtained from investment activities in Ukraine, took effect on November 12, 2004 ("Resolution No. 482"). Resolution No. 323, on amendments to the rules for conducting transactions on the Interbank currency market of Ukraine, took effect on September 18, 2004 ("Resolution No. 323"), and establishes, among other things, the procedure for Ukrainian residents to purchase foreign currency for the purpose of making payments abroad to non-residents.

Requirement for Non-Residents to Open Ukrainian Bank Accounts

Under Resolution No. 482, foreign investors may now conduct investment activity in Ukraine (either in Hryvnia or in foreign currency) only through bank accounts opened with a Ukrainian bank. This requirement is applicable to both foreign legal entities and foreign individuals. Individuals may also deposit foreign currency in cash into such bank accounts upon producing evidence of the legitimate source of such cash (e.g., a customs declaration).

Conversion Requirement

Resolution No. 482 also requires investments to be effectuated in Hryvnia. Conversion into Hryvnia is carried out by the foreign investor's Ukrainian bank, which sells the foreign currency on the Ukrainian in-

terbank currency market and deposits the proceeds into the foreign investor's Hryvnia bank account.

Only so-called "joint (investment) activity agreements," which are purely contractual joint ventures between foreign investors and Ukrainian companies in which a legal entity is not created, are exempt from the foregoing requirement.

Sale of a Foreign Investment/Other Divestment

Similarly, Resolution No. 482 introduces a stringent requirement that settlements related to a foreign investment may take place only in Hryvnia. When purchasing an investment from a non-resident, a buyer (whether a resident or a non-resident) must always transfer the purchase price from its Hryvnia bank account to the seller's Hryvnia bank account. Exemptions from this rule mainly relate to NBU-licensed transfers of foreign currency abroad.

Notably, the new procedures also apply to transactions conducted between non-residents involving Ukrainian Securities where settlement occurs in foreign currency outside of Ukraine, such that the settlements are brought onshore and are made in Hryvnia.

Repatriation of Profits

Under Resolution No. 482, profits received by a foreign investor from its investment activity in Ukraine may be transferred abroad if the foreign investor provides, among other documents, evidence (in the form of a certificate from the Ukrainian tax authorities) that it has paid all applicable withholding taxes and other applicable charges on those amounts. Alternatively, the foreign investor may provide a legal statement (e.g., a residency certificate) indicating the foreign investor's entitlement to relief under a double tax treaty between Ukraine and the investor's country of origin.

Pricing Ukrainian Securities and other Investment Objects

A foreign investor seeking to repatriate proceeds from the sale or other divestment of Ukrainian Securities or the cash value of an in-kind investment must provide a valuation act issued by a licensed Ukrainian appraiser, indicating the corresponding market value.

Further, Resolution No. 482 and Resolution No. 323 allow for the repatriation of the cash value of an in-kind investment (instead of the in-kind investment it-

self) only if such arrangement is contemplated by an applicable treaty entered into between Ukraine and the foreign investor's country of origin (such as a treaty on the mutual protection of investments).

Expanded Authority of the NBU

Resolution No. 323 allows the NBU to suspend a bank's purchase of foreign currency on behalf of its clients and/or to suspend or terminate a bank's license to purchase foreign currency if the NBU has justifiable cause to suspect that the transactions at issue are carried out without an "apparently lawful goal" or are subject to financial monitoring in accordance with legislation on money laundering. This assessment is made based on an analysis of certain statistical data which commercial banks must provide to the NBU.

Conclusion

Clearly, Resolution No. 482 and Resolution No. 323, if applied strictly as written, will significantly affect the foreign investment regime in Ukraine. Foreign investors investing in Ukraine will need to ensure that sellers provide them with the necessary documentation to repatriate their investment and/or associated profits. Foreign investors who already have investments in Ukraine should review these new requirements to determine whether they have sufficient documentation to comply with the new rules concerning repatriation. Finally, foreign investors in the process of structuring acquisitions in Ukraine, and in particular, acquisitions of shares in Ukrainian companies or any other Ukrainian Securities, may need to reconsider these structures if an off-shore settlement mechanism in foreign currency is currently contemplated.

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NBU Moves to Support Banks

The National Bank of Ukraine (the "NBU") has moved to counter potential negative reaction in the banking and financial system in the aftermath of the failed presidential elections on November 21, which was marked in some regions of Ukraine by a stronger than usual demand for hard currency and an accelerated rate of bank deposit withdrawals. Although the banking system has remained stable, a number of second and third-tier banks experienced temporary difficulties meeting demands for cash.

NBU Resolution No. 576 "On Temporary Measures Concerning the Operation of Banks" ("Resolution No. 576"), dated November 30, 2004, which took effect on the same date and is to re-

main in effect until at least the end of the year, provides for the following measures.

Boosting Bank Liquidity. Resolution No. 576 widens the access of banks, particularly smaller banks, to liquidity, by easing lending terms for banks unable to raise money on the market (e.g., by relaxing security deposit requirements).

Restricting Lending. Banks have been directed to keep the overall size of their loan portfolio at levels existing on November 30, 2004. Resolution No. 576 also bans the issuance of new certificates of deposit.

Limiting Access to Foreign Currency. Banks are currently allowed to sell clients foreign currency in an amount equivalent to no more than US\$ 1,000 in cash or US\$ 50,000 by bank transfer in a single transaction, with larger amounts requiring the approval of an authorized bank officer.

Restrictions on Cash and Deposit Withdrawals. The right of individuals and companies to make early withdrawals from time deposits, allowed in the past subject only to the loss of accrued interest, has now been suspended. Cash withdrawals by companies from current accounts have been limited to a maximum of 80,000 Hryvnia (approximately US\$ 15,000) per month, except for the payment of salaries and similar expenses. Banks have further been advised to set ATM withdrawal limits at 1,500 Hryvnia (approximately US\$ 300) a day. These restrictions concern only the withdrawal of cash from bank accounts and do not affect the ability of businesses or individuals to make payments in any amount by wire transfer.

Funds Transfers. Banks may now carry out funds transfers only within the limits of the available balances in the payer's account at the time the bank accepts the payment order, a step apparently designed to prevent account overdrafts and consequently expansion of credit. Furthermore, Resolution No. 576 requires that funds be transferred to the payee's account the day after the payment order is made, a departure from the usual practice of completing transfers on the same day.

Foreign Trade Contracts. The NBU has instructed banks to step up monitoring over clients' compliance with the statutory 90-day time limit for repatriating export proceeds. Banks have also been recommended to limit purchases of foreign currency to clients whose import contracts provide for deferred payment for imported goods or services or for payment by a letter of credit.

While the strict legality of all the measures adopted by the NBU in Resolution No. 576 may be ques-

tionable, they appear to have been universally welcomed by the Ukrainian banking community.

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Justice Ministry Obtains New Powers to Vet Regulations

The Cabinet of Ministers of Ukraine has amended the procedure by which the Ministry of Justice of Ukraine registers normative acts issued by governmental agencies. In accordance with the "Procedure on the State Registration of Normative Acts of Ministries and other Executive Power Agencies," adopted by Decree No. 731 of the Cabinet of Ministers of Ukraine on December 28, 1992 (the "Registration Procedure Decree"), regulations issued by governmental agencies are subject to review and registration by the Ministry of Justice. The Ministry of Justice has the right to deny registration of a regulation that, in its view, fails to comply with the laws or the Constitution of Ukraine.

The changes introduced by the Registration Procedure Decree are aimed at limiting the ability of governmental agencies to regulate matters reserved to parliament. In particular, under the changes, a regulation that fails to specify the date and number of its Ministry of Justice registration will have no legal effect. In addition, any recommendations made by the Ministry of Justice concerning a regulation whose registration has been denied will now be mandatory for the agency issuing the regulation, and registration will be denied again if the revised regulation does not reflect these recommendations. In general, the amendments are a welcome development in that they are aimed at strengthening the separation of powers between the legislative and executive branches of the government.

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Tax Authorities Clarify VAT Rules for Imports

The State Tax Administration of Ukraine (the "STA") has issued interpretative letter No. 8312/6/15-2415-8, dated September 21, 2004 (the "Letter"), clarifying the procedures for calculating value added tax ("VAT") with respect to imported goods. Under the Law of Ukraine "On Value Added Tax," dated 1997 (the "VAT Law"), for purposes of determining a taxpayer's overall VAT liability for a particular tax period, VAT paid by a taxpayer on imported goods (i.e., VAT paid to suppliers, or "input" VAT) may be deducted from the taxpayer's output VAT (VAT the taxpayer col-

lects from purchasers of its own output supplies), provided that the cost of the imported goods is deductible (or depreciable) for corporate profits tax purposes. The Letter sets out the STA's interpretation of the circumstances under which amounts paid as import VAT may be applied to reduce overall VAT liability. First, the Letter states that import VAT amounts paid may offset output VAT amounts owed by an importer in a tax period only to the extent that the cost of the imported goods is deductible (or depreciable) for corporate profits tax purposes in the same tax period. Secondly, the Letter indicates that if the value of imported goods is reduced subsequent to their import into Ukraine (e.g., due to discovered defects), the amount by which overall VAT liability may be reduced should be decreased correspondingly.

In general, the interpretation does not seem to be entirely consistent with the VAT Law, which does not condition the determination of VAT liability on compliance with any particular time periods or fluctuations in the value of goods. The Letter, therefore, has the potential to generate more tax disputes.

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Regulations Implementing Electronic Signatures Law Adopted

The Cabinet of Ministers of Ukraine has adopted two regulations implementing provisions of the 2003 Law of Ukraine "On Electronic Digital Signatures" (the "Electronic Signature Law"). The first regulation, "On the Central Certification Authority," adopted by the Cabinet of Ministers in Resolution No. 1451 of October 28, 2004, names the Ministry of Transport and Communication of Ukraine as the Central Certification Authority, which under the Electronic Signature Law is responsible for issuing enhanced key certificates to local certification centers and key certification centers. Key certification centers are entities authorized to issue key certificates, which provide a means of authenticating the user of the key and the key's validity. Enhanced key certificates employ stricter security features.

The second regulation, "On the Establishment of Procedures for the Use of Electronic Digital Signatures by Governmental Agencies, Local Self-Governance Bodies, State-Owned Enterprises, Institutions and Organizations," adopted by Resolution No. 1452 of the Cabinet of Ministers of

Ukraine, dated October 28, 2004, sets forth a legal framework for governmental agencies, state-owned companies and other state organizations to use digital signatures. According to this regulation, state organizations may use an electronic signature only when the state agency responsible for chirographical protection of information has reliable means for certifying the electronic signature. Further, state organizations may only use an electronic signature in transactions with individuals and legal entities who possess enhanced open key certificates. Finally, state organizations may not use electronic signature in transactions exceeding one million Hryvnias (about US\$ 185,000) or to execute documents that, under the Electronic Signature Law, may not have electronic documents as originals.

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New Rule for Payments Under Guarantees in Favor of Foreign Creditors

NBU Resolution No. 323, discussed above, also establishes a new rule with respect to foreign currency payments made by a Ukrainian guarantor (or surety) under a guarantee (or suretyship) provided in favor of a foreign creditor to secure the obligations of a Ukrainian debtor (e.g., in connection with a loan agreement in foreign currency from a non-resident lender). Under the new rule, payments by the guarantor must be effectuated from the same bank that acts as the Ukrainian borrower's servicing bank with respect to the foreign currency loan.

By way of background, a Ukrainian entity who borrows foreign currency from a non-resident lender is required to register the foreign currency loan

with the NBU (for which it receives a registration certificate) and to designate a Ukrainian servicing bank, which monitors the flow of payments under the loan. If the borrower changes its servicing bank at any time throughout the life of the loan, the loan registration certificate must also be amended to reflect such change.

Under the new rules, if a guarantor is called upon to pay under the terms of its guarantee, the guarantor must open a bank account with the borrower's servicing bank to effectuate any payments thereunder. Since opening a bank account can be a time-consuming process, it is recommended that creditors require the guarantor to open such an account as one of the conditions precedent to disbursement of the loan.

This new rule may be regarded as a positive change, as it brings some clarity to the process by which payments under a guarantee may be effectuated. From the perspective of currency control, the new rule is logical as the borrower's servicing bank is required to monitor all amounts received by the borrower from the foreign lender and all payments made by the borrower to the lender. Thus, when a guarantor makes a payment under a guarantee, the servicing bank would be able to verify whether the amount to be paid corresponds with the amounts received by the borrower. Also, previously it was unclear whether an NBU license would be required to effectuate payments under a guarantee. Resolution No. 323 seems to indicate that a license will not be required, provided that the guarantor maintains a bank account with the servicing bank and provides all documents required under the interbank currency rules for the purchase of foreign currency to effectuate a payment under a guarantee.

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