

newsletter

LEGAL UPDATE | UKRAINE

2 APRIL 2014

This legal update provides a brief overview of recent important changes in the NBU regulation on foreign exchange transactions affecting business activities in Ukraine. We would also like to draw your attention to certain legal developments related to the crisis in Crimea, affecting Ukrainian and foreign companies operating there, as well as labour issues with regard to the military mobilization in Ukraine and developments in the tax regulation. Should you need any assistance evaluating the impact of the new rules on your operations please do not hesitate to contact us.

NBU CHANGES FX MARKET RULES

NBU Resolution No 172 "On Regulation of Foreign Exchange Transactions and Operations of Financial Institutions" (the "NBU Resolution") took effect on 28 March 2014 and replaced NBU Resolution No. 49 dated 6 February 2014 in its entirety. The NBU Resolution includes a set of measures, the most essential of which are as follows:

OVERSEAS PAYMENTS

Pursuant to NBU Resolution residents may no longer prepay (either involuntarily or voluntarily) principal, interest and other amounts payable under foreign currency loans from non-residents, including where the prepayment is made from own foreign currency of the borrower. This restriction also applies where the parties put the repayment dates ahead by way of amending the loan agreement. Previously, residents were allowed to make early payments under cross-border loan agreements from own foreign currency proceeds (not borrowed or purchased on the interbank market). On the positive side, the prohibition on Ukrainian residents to purchase foreign currency on the interbank market with the purpose of making outbound investments or covering a part of insurance reserves was completely removed. However, the outbound investments still require an individual license of the NBU.

PURCHASE OF CURRENCY

Previously, in order for legal entities and private entrepreneurs to purchase foreign currency on the interbank market they were required to keep the corresponding amount of local currency (UAH) on the bank's special analytical account for at least five banking days (a so-called "freezing period") prior to the intended conversion date. The NBU Resolution has significantly reduced the freezing period and permitted banks to purchase foreign currency for their clients on the second banking day after the client's funds were credited to the special analytic account.

Additionally, in the event that a pre-allocated sum in the local currency appears insufficient to buy the intended amount of foreign currency due to FX rate fluctuations the bank may debit the difference in the local currency from the client's account to complete the FX transaction. Alternatively, the bank may purchase a lesser amount of the foreign currency if the funds in the local currency on the client's current account are insufficient. The NBU Resolution requires banks to refrain from crediting accounts of their clients in foreign currency if there is a risk that the currency so attracted will be used by the clients to circumvent the freezing period. We note that the purchase of foreign currency for interest payments under loans is exempt from the above rule.

It also worth mentioning that a ban on tod, tom and spot FX transactions has been lifted but non-deliverable FX transactions remain prohibited.

DEPOSIT OPERATIONS

Pursuant to NBU Resolution banks must suspend the issuance of deposit (saving) certificates while the redemption of already issued certificates should be performed solely by transferring money to the current account of the certificate's owner.

At the same time, the NBU extended the permission for banks to redeem deposit certificates and repay foreign currency deposits in the local currency under commercial FX rate of the bank in case of early redemption or withdrawal thereof.

NEW LIMITATIONS ON INDIVIDUAL CURRENCY TRANSACTIONS

Individuals, whether residents or non-residents, can buy cashless currency for transfers abroad under non-trade transactions in the amount not exceeding the equivalent of:

- UAH 15,000 per one person during one month where the transfer is made without opening an account or without supporting documents. Non-residents are required to present supporting documents; and
- UAH 150,000 per one person during one month, provided that the transfer is made from the bank account and accompanied by supporting documents.

The above limitations will not apply to the following transfers:

- medical fees, including expenses for transportation of afflicted person;
- payments in connection with the death of a person, including transportation expenses;
- payments to be made under court judgments or decisions of enforcement authorities;
- transfers made by residents that emigrate from Ukraine to another country and thus, change their status to non-resident;
- transfers of currency received as salary from non-residents, retirement pension or alimony; and
- tuition fees.

In addition, individuals may not purchase foreign currency in cash or to withdraw foreign currency from bank or deposit accounts (either through ATMs or cash desks) in an amount exceeding the equivalent of UAH 15,000 per one day. This limitation also applies to overseas withdrawals from cash machines.

LABOUR ISSUES OF THE CRIMEAN CRISIS

MOBILIZATION OF EMPLOYEES

On 27 March 2014 the Parliament of Ukraine adopted the Law of Ukraine on Amendments to Certain Laws Relating to the Support of Mobilization No. 1169-VII. The Law was signed by the Acting President of Ukraine and published on 31 March 2014 and entered into force the next day, on 1 April 2014.

Among other things, the Law aims at introducing social guaranties for people who will be drafted to the military service. In particular, the Law provides for a special one year period, during which companies where the drafted persons are working should maintain the positions of the drafted employees and should pay them their average salary. It remains unclear whether such salary will be compensated from the State Budget as it is the case for military trainings. Also, the Law does not provide for clear rules which apply after the expiration of this one year period.

Please note that the Law was criticized by the Main Expert Department of the Parliament of Ukraine as contradicting the Law of Ukraine on Military Duty and Military Service and the Law of Ukraine on Draft Training and Mobilization. As argued in the Conclusion of the Main Expert Department, the Law on Military Duty and Military Service provides for a special cash allowance for the drafted citizens, whereby the Law suggests for payment of the average salary to their employees drafted to the military services.

Following this logic, the Main Expert Department states that such new obligation of the companies contradicts the Law on Draft Training and Mobilization which clearly states that companies may finance the draft training and mobilization only at their own initiative.

We expect that the State Employment Service will issue further clarifications in this regard.

PROSPECTIVE DEVELOPMENTS

On 1 April 2014, the Committee of the Parliament of Ukraine for Human Rights, National Minorities and International Relations prepared Draft Law of Ukraine No. 4473-1 on Protection of Rights of People in the Occupied Territories of Ukraine for the second hearing.

In particular, the Draft Law intends to considerably limit entry into, and exit from, Crimea. Such movements will require a special permit to be received by a traveller save for the Crimean residents who will be able to travel on the basis of their passports with registration. At the same time, all travellers (whether residents or not) will be subject to the customs and border control. Importantly, no exemption from the general limitation of movement is made for non-Crimean employees who are currently engaged in Crimean projects.

Besides, the Draft Law purports to prohibit any economic activities (whether commercial or non-commercial) which are subject to the state regulation (licensing, certification, standardization, etc.). The only narrow exception is planned to be made for activities which will be specifically carved out by the Cabinet of Ministers, but only for protection of the national interests of Ukraine and the rights and freedoms of the Ukrainian citizens, fulfilment of the international treaties, support of restoration of the constitutional order in the occupied territory. Importantly, the Draft Law does not provide for any transitional or grace period to enable Ukrainian businesses to withdraw from Crimean projects.

Notably, the Draft Law which was prepared for the second hearing is much milder than its initial version in terms of liability for non-compliance (most of the steep criminal sanctions were lifted). At the same time, adoption of the Draft Law by the Parliament in its existing version (with the outright prohibition of economic activities and severe limitations on movements) would outlaw pending Ukrainian business projects in Crimea and lead to the necessity to urgently relocate or lay off non-Crimean personnel.

The Draft Law may be voted by the Parliament of Ukraine on 8 April 2014 the earliest. Before that date, it may further be modified.

At the same time, while Ukraine has not recognized accession of Crimea into the Russian Federation and continues treating Crimea as a part of its territory, those employees of the Ukrainian companies in Crimea who are not Russian citizens are already *de facto* subject to the rules and regulations of the Russian Federation, including migration control and restrictions on employment of foreigners.

TAX

On 27 March 2014 the Parliament of Ukraine adopted the Law of Ukraine on Averting a Financial Catastrophe and Laying the Groundwork for Economic Growth in Ukraine No. 1166-VII. The Law was signed by the Acting President of Ukraine and published on 31 March 2014, which mainly enter into force on 1 April 2014.

Among other things, the Law introduces the following changes:

- Gradual rates of the personal income tax of 15%, 17%, 20% and 25% (depending on the amount) on passive income, such as dividends, royalty, interest;
- Introduction of the 0.5% charge for purchase of a foreign currency by companies and natural persons;
- Increase of excise taxes for transportation vehicles;
- Increase of excise taxes for alcohol and tobacco products;
- Increase of taxes for usage of mineral resources;
- Twofold increase of the charge for usage of radiofrequency recourses, including certain recourses of satellite radiocommunication and TV broadcasting; and
- Decrease to EUR 150 of the non-taxable allowance for goods sent to Ukraine in one package to one recipient.

In addition, the Law introduced a **7% VAT** for distribution and sale of medicines and medicinal products.

Despite the preliminary discussions and the fact that the initial draft introduced VAT only for the first sale of medicines and medicinal products, the Parliament voted for the 7% VAT for all distributions of medicines, which are allowed to be manufactured and used in Ukraine and which are registered in the State Register of Medicines, and all distributions of medicinal products according to the list approved by the Cabinet of Ministers of Ukraine.

Such a list has not yet been approved by the Cabinet of Ministers.

Following the logic of the Law, the 7% VAT is applicable at all stages of the medicines sale chain - from the importer or manufacturer up to the patient.

It is expected that prices for medicines and medicinal products will rise at once as the tax will be included into the products' price and will be borne by the buyer.

It should be noted that the Tax Code of Ukraine provides for a principle of stability of the tax system, according to which taxes and charges, their rates, tax reliefs cannot be changed during a budget year (sec. 4.1.9. art 4). However, since the legislator amended in particular the Tax Code it can be presumed that due to the urgency and importance of the tax changes the changes were introduced during the budget year by way of exception to the principle.

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