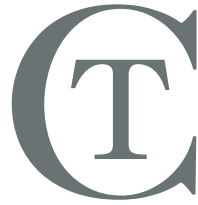


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EXECUTIVE SEARCH

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NEWSLETTER INTERNATIONAL

UKRAINE

INTERVIEW | ANALYSIS | ANNOUNCEMENT

## "THE OPPORTUNITIES IN UKRAINE ARE MANIFOLD"

### **What effects did the political crisis concerning the annexation of Crimea and the conflicts in the southeast of Ukraine have on the dealings of German firms active in Ukraine?**

In eastern Ukraine, to outline it more exactly, in parts of the provinces of Donetsk and Lugansk there are more and more military-related conflict situations. This is far from the entire area of these two regions being under the control of the pro-Russian forces.

North of Donetsk, near the little city of Artyomovsk, for example, Knauf has one of its factories and it was recently reported to me that work there can resume. Most German firms which had their operations in regions controlled by pro-Russian forces or in Crimea had to stop their activities in the meantime. That is annoying for every affected firm, but in light of the entire situation in Ukraine, those are however individual cases.

Because of that the term "southeast" is possibly somewhat misleading. In the entire south of Ukraine, including Crimea, no military quarrels at all are happening right now. Even the Russian Girkin aka "Strelkov", elevated to fame above all in the Russian media by the occupation of Slovyansk, admitted in a television interview in Russia, that Project "New Russia" is said to have failed.

### **Which factors now speak to a positive development in the Ukrainian economy in 2015?**

Most representatives of German firms in Ukraine have said to me that they still do not expect a clear improvement in 2015. It would be most important that the situation, particularly in eastern Ukraine, not worsen.

Fundamentally I am an optimist, however the situation in Ukraine must first stabilize before we can hope for improvement. A lot would depend on the new government and the question of how monetary policy will be aligned in the next year.

Most experts agree that the current policy, a mix of administrative measures and then again liberal policies, is unlikely to lead to success. Also the German Advisory Group (Deutsche Beratergruppe) recommends abandoning the idea that the exchange rate can be held against the market at a politically desired level. No one has managed that yet. Even Russia with its much larger currency reserves understands that very well now.

### **What are the greatest obstacles or risks for the Ukrainian economy currently?**

The subject of monetary policy I have just named. Then I see the greatest risk is in simply carrying on, but the real great reforms are not yet begun. To date it could quite clearly be said that there is, in the area of economics, still no great impact. Ukraine has, for example, a law on deregulation from 2003/2004. This law was perhaps formally applied but not in the sense intended by the authors. To issue new laws is, after all, not so difficult. In Ukraine the greatest problem is always in the implementation of laws. ►



**Alexander Markus**

is Delegate of the German Economy in Ukraine. Being a slavist and economist by education, Mr. Markus worked at the German-Russian Chamber of Industry and Trade in Moscow before taking his current position in Kiev.

The lightening of bureaucracy is a very important subject. With a radical simplification of the business process there will also be far fewer places for corruption to start, as where there are no barriers, there is no reason for unofficial payments. A second very important subject is legal security.

**For which European firms, for which branches, does Ukraine offer special opportunities in the near future, and for what reasons?**

The opportunities are manifold. Above all I see possibilities in the areas of automotive supplies and light industry, like textile and leather work, also in shoe production, for example. There are already very successful business models in this field today.

A further field is IT outsourcing. Costs here in the Ukraine are clearly lower than in many other countries and the workers are well motivated and educated. Firms in the field report that they value above all the unconventional solutions of the Ukrainian IT workers.

On this subject we organize a trip, in the first quarter of the year, for delegates to Lviv, which has crystallized itself in the meantime into an IT hub in Ukraine.

**For what reasons could Ukraine be interesting as a production centre for international firms, also considering the delivery to European markets or the countries of the Eurasian Economic Union?**

In the future, delivery to third countries as well as the EU will increasingly play a roll. Russia, as the largest market of the Eurasian Union, increasingly introduces non-tariff trade barriers and thereby cordons itself off. To what extent Belarus and Kazakhstan will go along with that is still difficult to assess.

The fields are the same as those which I named above: Automotive supplies, light industry, and IT.

A further field will be the export of food. The food processing level is constantly increasing within Ukraine.

A few years ago, for example, Ukraine was one of the biggest exporters of sunflower seeds, which were processed into cooking oil. This has changed radically: Today the cooking oil is processed in Ukraine and Ukraine is one of the biggest exporters of sunflower cooking oil. There are definitely opportunities in Ukraine.

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## “WE HOPE FOR A QUICK SOLUTION TO THE POLITICAL CRISIS”

### How is Quarzwerke active in the Ukraine?

We are present at three locations in Ukraine in total. About 200 km west of Kiev we have been operating a kaolin production facility since 2006, exploiting the biggest and qualitatively most valuable deposit in Europe. We employ 300 workers there. In the past three years we invested consistently in processing plants and deliver high-quality kaolin in the ceramic industry, to paper and fibreglass as well as in many other areas of use. Simply on account of our high standards of quality we have a high export ratio. Besides the Ukrainian market, we have customers in Russian, Western Europe, Southeast Asia, India, the Middle East and North Africa.

From northern Ukraine, just like from one of the deposits in the south of the county, we serve the glass industry, among others, with qualitatively high-value quartz sands.

### What effect did the regime change in spring have on your business in Ukraine?

From the beginning we set our hopes on the change of government, because an atmosphere of awakening accompanied that, both towards more market and more deregulation. The new government addressed these subjects with vigour, until the priorities of politics temporarily slipped under the pressure of the political tensions between Russia and Ukraine, for understandable reasons.

### What expectations do you have for the further development of your Ukrainian business? What opportunities and risks do you see?

The media have been frequently speaking of commercial blockades of Russia over Ukraine, which we luckily were not affected by.

We expect to see our Ukrainian engagements keep the same course; we expect a further increase in sales volume from Ukraine. Our export ratio is at 80%, so that in comparison to other foreign investors in Ukraine, we are less dependent on the domestic market, which will surely need a few years of economic recovery after the current political crisis will have been settled.

Our kaolin site has a 100-year history, so that there are very well-qualified personnel on site. It is desirable that the energy market, which the current crisis between Russia and Ukraine has detrimentally affected, will stabilize again, because energy for our production process is an important production and cost factor. We hope for a quick solution to the political crisis, then the hryvnia exchange rate will also stabilize, which has been devalued in 2014 by about 40% and rose the inflation in the country to double digits.

### What could or should the Ukrainian government do to positively affect your local business?

At present the Ukrainian government, understandably, is occupied above all resolving the tensions with the neighbour. ►



### Dr. Otto Hieber

is managing director of the Quarzwerke GmbH in Frechen, Germany, a medium-sized family enterprise with more than 30 sites in Central and Eastern Europe and 130 years of experience in the extraction, processing and refinement of industrial minerals. The Augsburg native holds a degree in business administration and earned a doctorate in business economics.

Following that they should above all set the liberalization of the market again on the agenda and continue courageously combating corruption, as they had begun before. But also in spite of the politically difficult prevailing conditions we feel, in comparison to previously, the winds of change in politics, a clear professionalization of the cooperation with the authorities, also a clear improvement in VAT refunds as a customary problem of earlier years.

Approval processes have been running more professionally since the change of government.

The authorities have obviously been instructed to provide companies, including foreign investors, a predictable framework. At the end of the day it is they who make a major contribution to the country's economic stability.

## ANALYSIS

### CUSTOMS VALUATION RULES IMPACTING IMPORTATION OF FOREIGN-MADE GOODS INTO UKRAINE: NUANCES AND PITFALLS

With its over 40-million population and developing economy, Ukraine is an interesting and fast-developing market for a large range of products manufactured outside Ukraine: from consumer goods, medicines and food products to high-tech goods, automobiles and industrial machinery. It is not a secret that in the past the Ukrainian importers, a good deal of which are subsidiaries of foreign companies, had experienced various problems in the course of importing into Ukraine due to Ukraine's flawed and outdated customs legislation inherited from the USSR, with the problems relating to customs value of goods imported into Ukraine and customs valuation being among focal.

Following Ukraine's accession to the World Trade Organization in May 2008, Ukrainian customs valuation rules have been systematically revised and updated in order to generally comply with the WTO standards (i.e., the Agreement on Implementation of Article VII of the GATT 1994). For instance, article 49 of the Customs Code of Ukraine, dated 13 March 2012 No.4495-VI (the "Customs Code"), defines customs value of imported goods as the value, which is based on the price actually paid or payable with respect to goods being imported. Such definition is in line with the definition of customs value contained in the Agreement on Implementation of Article VII of the GATT 1994. The revised Ukrainian customs rules have to a large extent streamlined the import practices and procedures in Ukraine and have made them more effective.

Nonetheless, to date Ukraine has not been able to fully combat bureaucracy at customs and put in place transparent "rules of the game" at the Ukrainian customs border, including, inter alia, with respect to customs value of goods imported into Ukraine. ►



**Ihor V. Mehedyuk,**  
Partner, Dentons Kiev



**Viktoriia Fomenko**  
Associate, Dentons Kiev

Over the recent years, the process of determination of customs value of imported goods has been an area of dispute between importers and the Ukrainian customs authorities as the manipulation of customs value is one of the most popular mechanisms to minimize the tax burden for imports into Ukraine. While Ukrainian customs valuation rules are based on clear and long-standing WTO principles, the Ukrainian customs authorities use administrative levers to challenge the declared customs value of goods, usually without explanation, with a goal of increasing the collection of revenue. To achieve this goal, at the time of clearance of goods through Ukrainian customs, the customs authorities try to increase the customs value of imported goods as it serves as a basis for levying the customs duty and VAT upon goods imported into Ukraine. Especially it is true for imports of goods between related entities: e.g., a Ukrainian subsidiary buying goods for importation into Ukraine from its parent foreign company or its related entities, if the Ukrainian customs authorities have grounds to believe that relations between such related parties have influenced the declared customs value of the goods imported into Ukraine.

A possible remedy for the importer to use if the customs value of imported goods is challenged is to present additional documents to support the declared customs value of goods. Sometimes, such additional documents are difficult to obtain and may not be readily at the disposal of the Ukrainian importer (e.g., a foreign export customs declaration, price calculations, etc.), which may cause additional difficulties for the importer. Obviously, effective planning of import operations by the Ukrainian importer as well as cooperation with its foreign resident suppliers of goods with respect to collection of various import-related documents is a nuance that may help to minimize possible negative implications relating to customs value at the time of clearance of goods through customs in Ukraine.

Once the goods have been cleared through Ukrainian customs and problems have been resolved with Ukrainian customs authorities, the Ukrainian importer, which oftentimes would be a subsidiary of the foreign manufacturer or principal supplier of goods to be imported into Ukraine, may encounter tax problems relating to the contract price of the imported goods. In brief, the Ukrainian tax authorities try to apply transfer pricing adjustments in an effort to decrease the purchase price (value) of imported goods with an aim of increasing the taxable base for purposes of the Ukrainian corporate profit tax.

Hence, a company importing goods into Ukraine should be prepared to counteract the above-referenced asymmetric efforts of the Ukrainian customs and tax authorities with respect to imports of goods in order to reach a commercial success in Ukraine.

Unfortunately, the customs problems relating importation of goods into Ukraine do not end upon customs clearance of the goods. Another problem that may be faced by a Ukrainian importer long after goods have been cleared through Ukrainian customs and even sold to third-party buyers relates to the so-called "post-audit control" of customs value: by law, the Ukrainian customs authorities have a right by to perform post-audit control of customs value and correctness of payment of the customs duty and VAT upon importation of goods into Ukraine within 3 years after the release of goods into free circulation in Ukraine. ►

Upon revealing the underpayment of the customs duty and VAT during the post-audit control, the Ukrainian customs authorities have a right to prescribe the payment of additional customs duty and VAT as well as applicable fines and penalties. While the imported subject to additional customs duty, VAT and applicable fines and penalties may seek further administrative and judicial remedies, it will always be an extra cost of doing business in Ukraine, which should be borne in mind.

It is fair to say, though, that it is not always the arbitrary approach of the Ukrainian customs authorities to dealing with importers that is a cause of disputes with importers in Ukraine. Many Ukrainian importers and their counterparties engage in dubious techniques and practices, including transfer pricing techniques, to maximize profits and to minimize tax exposure in Ukraine at the time of customs clearance of imported goods in Ukraine. Such techniques and practices may be dangerous pitfalls for Ukrainian importers and should be of interest to foreign suppliers of the goods for their internal and general compliance purposes as well as for precluding business and reputational risks.

For instance, in a fairly standard sale and purchase arrangement between a Ukrainian resident buyer (i.e., an importer) and a foreign resident supplier, which provides that a Ukrainian purchaser of foreign-made goods (i.e., an importer) takes delivery of the goods Ex Works from the foreign manufacturer/supplier of the goods under their contract, the following oftentimes happens:

(i) the Ukrainian importer arranges that some foreign[non-Ukrainian]company (the "Intermediary Company"), which is, as a rule, controlled by the Ukrainian importer, takes delivery of the goods from the foreign manufacturer/supplier of the goods and pays (pre-pays) the invoice issued by the manufacturer/supplier of the goods.

(ii) Thereafter, the Intermediary Company resells the goods to the Ukrainian importer, issuing its own invoice and other supporting documentation for the goods. Except for pharmaceuticals, the price of the goods indicated in the invoice issued by the Intermediary Company would be usually much lower than the price, at which the same goods were in fact purchased by the Intermediary Company from the manufacturer/supplier. As a result of this, the Ukrainian importer pays the Ukrainian VAT, customs duties etc. based on the lowered contractual price, saving on the VAT and customs duties. To the contrary, pharmaceutical companies usually use the Intermediary Company to increase the contractual price of the pharmaceutical products given that the customs duty for most of the drugs is 0% in Ukraine and the VAT rate is lower (7% instead of the regular rate of 20%) in order to reduce taxation and channel profits from Ukraine (the taxable margin from the sale of pharmaceutical products may be very low in Ukraine due to the fact that (1) a lot of prices for pharmaceutical products are governed regulated, and (2) using such technique as a result of which the principal sale margin for the pharmaceutical products is retained by the Intermediary Company). ►

(iii) Extra profits thus obtained may be channeled by the Ukrainian importer abroad to the Intermediary Company in the form of payment for the products supplied, as well as in the form of repayment of the loan principal and payments of interest under loan agreements and/or cashed out locally, in the form of payments for services etc., to Ukrainian companies/individuals enjoying beneficial tax status.

To minimize the risk of a Ukrainian importer's use of intermediary companies for transfer pricing purposes, a foreign resident supplier may consider the delivery of goods to the customs territory of Ukraine using, for example, DAP, DAT, CPT or CIP (Incoterms 2010) terms of delivery. In this case, the foreign resident supplier would be able to control that documents (invoices, other supporting documentation) issued by the said supplier serve the basis for customs clearance of the supplied goods in Ukraine.

Another common scheme used by Ukrainian importers to minimize tax obligations due upon importation of goods into Ukraine is known as "grey import". The "grey import" scheme may be realized in two ways:

(i) a Ukrainian resident purchaser (importer) arranges for a fake package of documents that contains different information about the goods (quantity, value, description of goods, etc.). Such fake package of documents replaces the original package of documents before the Ukrainian border prior to customs control at the Ukrainian border. Thus, the Ukrainian importer is able to clear goods through customs using the fake documentation, or

(ii) a Ukrainian resident purchaser (importer) uses the original package of documents, but requests the foreign resident supplier not to indicate certain information about the description of goods in the relevant invoices or other supporting documentation. In such case, the Ukrainian resident purchaser (importer) may declare the goods in question under a different customs code with a lower customs duty rate.

To minimize the risk of a Ukrainian importer's use of "grey import" schemes, the foreign resident supplier may consider obliging the Ukrainian resident purchaser (importer) under a supply contract to provide with a copy/translated copy of the Ukrainian cargo customs declaration after the customs clearance of the goods is completed in Ukraine.

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## HANNES SHARIPUTRA CHOPRA JOINS CT AS SENIOR ADVISOR

Hannes Shariputra Chopra is heading „Sberbank Insurance“, the insurance arm of Russia’s largest bank, which focuses on non-Life products.

Hannes has been continuously working in the insurance industry since 1996, thereof more than 10 years in top management positions.

Hannes worked with Allianz AG from 1996 onwards until 2011. He started his career in the business development & controlling department, supervising Africa, Middle East and South Asia.

Hannes later served as Chairman of the Board of Directors of Allianz Russia, Allianz ROSNO Life, Allianz ROSNO Asset Management, Progress-Garant, Allianz Ukraine, Allianz Kazakhstan and was a Member of the Board of Directors of ROSNO Group, Allianz Poland, Allianz Tiriac (Romania), Allianz Bulgaria and Allianz Insurance Ltd. (South Africa).

He actively participated in the expansion of Allianz SE in Emerging Markets and was instrumental in Allianz SE joining the shareholding structure of OJSC IC ROSNO. Between 2007 and 2011 Hannes acted as Chairman of the Board for ROSNO and between 2006 and 2011 as President of Allianz Eurasia.

In 2004 Hannes moved to Russia and joined the management board of ROSNO still under the majority ownership of AFK Sistema. Subsequently he was appointed CEO of OJSC IC ROSNO, CEO and President of Allianz Eurasia.

He then moved into the position of Chairman of the Board of Directors of OJSC IC ROSNO and left end of 2012.

In August 2012 Hannes joined the Advisory Board of Da Vinci Capital. He was a member of the World Economic Forum Advisory Council on Russia between 2012 and 2014. Currently, Hannes serves as Chapter Chair of the Young Presidents’ Organization Russia and acts as Managing Director of CKW-Consult.

Hannes is an economist by education and a native speaker in German and Punjabi, fluent in English and Hindi and advanced in Russian.



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