

Business Activity in Crimea Today

**AEB Legal Committee,
supported by Baker&McKenzie – CIS, Limited**

June 2014



UKRANIAN LAW PERSPECTIVE

CRIMEA AND SEVASTOPOL: LEGAL REGIME

- VR Declaration, 20 March 2014
- Law “On Ensuring Rights and Freedom of Citizens and Legal Regime in Temporarily Occupied Territory of Ukraine”, 15 April 2014
 - Territory of Ukraine – Ukrainian legislation applies
 - Special regime of entry/exit for individuals and goods (contemplated)
 - No restriction on business activities – subject to the special legal regime to be defined in a separate Law (not yet adopted)
 - Non-compliance with Ukrainian law requirements by Ukrainian or foreign legal entities and individuals may result in administrative, criminal and civil liability
 - Acts/decisions of Crimean authorities established in violation of Ukrainian law are invalid *ab initio* and do not have legal consequences

BANKING AND CURRENCY CONTROL

- On 21 April 2014, Bank of Russia prohibited operation in Crimea/Sevastopol of Privatbank, VAB, "Kyivska Rus" Bank and Imexbank
- NBU Resolution No. 260 of May 6, 2014 (came into force on the same day):
 - Two Crimean banks are declared closed and their licenses are canceled (i.e., "Chernomorskiy Bank of Development and Reconstruction" and Bank "Morskoy")
 - **All** Ukrainian banks are completely prohibited from providing **any** financial services and operating in Crimea (Crimean branches, if any, must be closed)
- Confirmed that general Ukrainian currency control rules apply
- UAH is the only valid currency in Crimea/Sevastopol, all settlements between Crimea and mainland of Ukraine shall be made in Hryvna

PROPERTY RIGHTS

Law of Ukraine “On Ensuring Rights and Freedom of Citizens and Legal Regime in Temporarily Occupied Territory of Ukraine”

- ✓ Acquisition and termination of ownership rights to real estate ***must comply*** with mandatory requirements of Ukrainian legislation
- ✓ Any transaction, which contradicts Ukrainian legislation, ***will be void*** and will entail no legal consequences

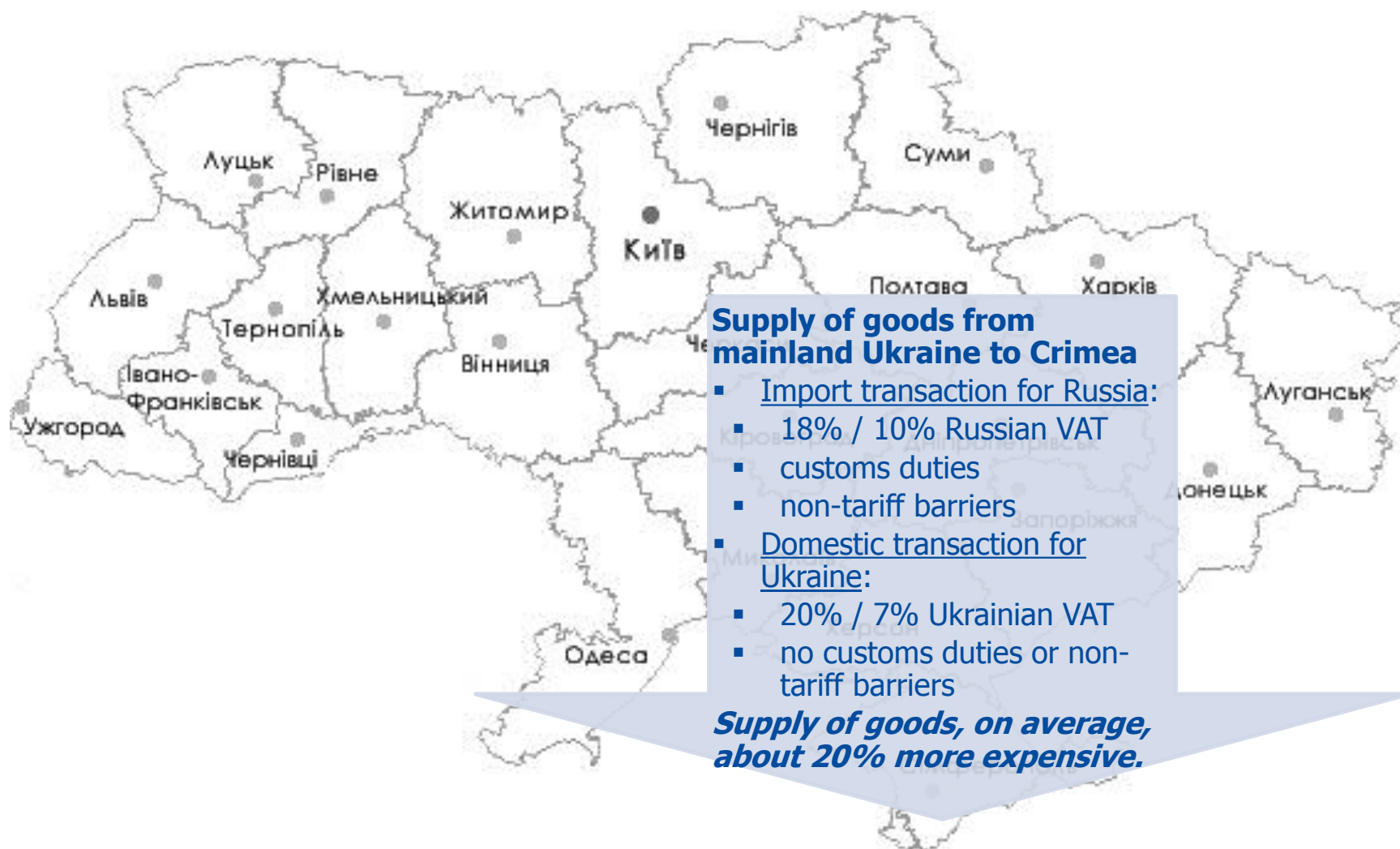


PROPERTY RIGHTS (continued)

- Property rights to real estate are *subject to registration* with the Ukrainian State Register of Property Rights to Real Estate
 - Who registers transfer of title to the property located in Crimea?
 - State registrar where one of the parties is located (if outside of Crimea)
 - State registrars in **Dnipropetrovs'k, Odessa, Khmelnytsky and Chernigiv regions** if the application is made to the Crimean state registrars, and/or
 - State registrars in **Kherson and Zaporizhzhya** region – upon application
- Order of the Ministry of Justice "*On Measures Ensuring Rendering of Services in State Registration of Property Rights to Real Estate*"
dated March 14, 2014



TAX/CUSTOMS: Supply from mainland Ukraine



Supply of goods from mainland Ukraine to Crimea

- Import transaction for Russia:
 - 18% / 10% Russian VAT
 - customs duties
 - non-tariff barriers
- Domestic transaction for Ukraine:
 - 20% / 7% Ukrainian VAT
 - no customs duties or non-tariff barriers

***Supply of goods, on average,
about 20% more expensive.***

TAX/CUSTOMS

Supply to mainland Ukraine

Tax/C



Supply of goods from Crimea to mainland Ukraine

▪ Export transaction for Russia:

- 0% Russian VAT
- customs duties
- non-tariff barriers

▪ Domestic transaction for Ukraine:

- Crimean supplier unlikely to charge 20% Ukrainian VAT
- VAT invoice unlikely to be registered
- no customs duties or non-tariff barriers

Supply of goods likely without VAT and, thus, cheaper.

TAX & CUSTOMS LANDSCAPE

UKRAINE

General rules remain applicable:

- reporting and filing
- payment of taxes and collections
- customs control of goods imported from Russia into Crimea

Occupation period rules:

- tax breaks designed for Crimean taxpayers registered in Crimea and city of Sevastopol for the duration of occupation (being drafted by the Ministry of Revenue and Duties of Ukraine)
- Crimean legal entities and individual entrepreneurs may re-register in mainland Ukraine and pay taxes at its new address (in force)
- customs control of individuals at the border with Crimea (as per Draft Law No. 4473-1 *On Provision of Rights and Freedoms of Citizens of Ukraine on the Occupied Territories* of 19 March 2014)

Sanctions for non-compliance with general rules

Tax Code:

- article 117 – violation of rules on registration
- article 120 – failure to file tax reporting documents
- article 126 – violation of rules on payment of taxes

Administrative Offenses Code:

- article 163-1 – violation of tax accounting rules
- article 163-2 – failure to file orders for payment of taxes and collections
- article 163-4 – violation of rules on payment and reporting in relation to personal income tax
- article 164 – business activity without registration

Criminal Code:

- article 201 – smuggling
- article 205 – sham business
- article 209 – money laundering
- article 212 – tax evasion
- article 212-1 – social security contributions evasion
- article 358 – forgery

TAX & CUSTOMS LANDSCAPE

RUSSIA

Transition period rules:

- taxes, customs and other duties, any other collections to be paid in RUB (despite UAH remaining in circulation until 1 January 2016 or an earlier date, if adopted by Russian Government)
- until 1 January 2015, tax and other revenues to be paid to budget of Crimea, city of Sevastopol and other local budgets
- since 1 March 2014, input VAT from Ukrainian taxpayers not to be offset against output VAT but treated as expenses for CIT purposes
- VAT debts for tax periods before 1 March 2014 written off
- VAT invoices issued since 18 March 2014 not to be registered
- starting from 26 March 2014, 18% / 10% VAT applies to goods supplied to Crimea from mainland Ukraine
- right to recover input VAT incurred on goods supplied from mainland Ukraine

Issues:

- applicability of Ukraine-Russia double tax treaty / domestic rules on taxation of non-residents' income:
 - risk of double taxation, permanent establishment risk
 - loss of foreign tax credit and other treaty benefits
- applicability of the CIS Free Trade Agreement / WTO instruments
- replacement of tax identification codes issued in Ukraine
- registration of branches of Russian / Ukrainian legal entities in Crimea and city of Sevastopol

JURISDICTION OF UKRANIAN COURTS

Law of Ukraine “*On Ensuring Rights and Freedom of Citizens and Legal Regime on Temporarily Occupied Territory of Ukraine*” of 15 April 2014:

disputes pending at Ukrainian courts in Crimea and all future claims (to be considered by such courts) shall be considered by the following courts:

Administrative and Commercial Cases

Administrative/Commercial
Courts of the Autonomous
Republic of Crimea



Administrative/Commercial
Courts of the Kyiv Region

Administrative/Commercial
Courts of the Sevastopol City



Administrative/Commercial
Courts of Kyiv City

Civil and Criminal Cases

Local courts of the Autonomous
Republic of Crimea/Sevastopol City



Local courts of Kyiv City
(shall be determined by the
Appellate Court of Kyiv City)

Appellate courts of the Autonomous
Republic of Crimea/Sevastopol City



Appellate Court
of Kyiv City





RUSSIAN LAW PERSPECTIVE

RUSSIAN LEGISLATION ON CRIMEA

- Russo-Crimean Treaty on Accession of Crimea to the Russian Federation, March 18, 2014
- Federal Constitutional Law No. 6-FKZ On Acceptance of Crimea to the Russian Federation and Formation of Two New Subjects of the Federation – Republic of Crimea and City of Sevastopol, March 21, 2014
- Federal Law No. 37-FZ On Functioning of the Financial System of the Republic of Crimea and the City of Sevastopol During the Transition Period, April 2, 2014
- Federal Law No. 39-FZ On Protection of Interests of Individuals Having Deposits with Banks Registered and/or Operating in the Republic of Crimea and the City of Sevastopol, April 2, 2014
- Normative acts of the Russian President, Russian Government, Central Bank of Russia, Federal Tax Service, Federal Customs Service, competent authorities of the Republic of Crimea and the City of Sevastopol

CRIMEA - RUSSIAN LEGAL REGIME (1)

- **Citizenship** – Automatic Russian citizenship for all residents, unless formally refused by April 18, 2014. Russian passports to be issued by June 18, 2014
- **Transition period** – until January 1, 2015
- **Local governance** – new governing bodies to be created in Crimea and Sevastopol by way of elections scheduled for September 13, 2015. Until then, present bodies govern, and can adopt local legislation, subject to compliance with the Russian Constitution
- **Local entities** – may continue operating in their current legal form until January 1, 2015, but they must re-register as Russian legal entities or branches / rep. offices of foreign companies, otherwise, they would be unable to perform any business activities after that date
 - Local subdivisions of the Russian Federal Tax Service already started registering legal entities, entrepreneurs willing to legalize under Russian rules. Until January 1, 2015 such registration is exempt from state duty.
- **State permits and activity licenses** – documents issued by the time of the Crimea accession to Russia remain valid without limitation, unless otherwise flows from the said documents or the corresponding legal relations
 - Exception: banks, financial organizations, customs brokers

CRIMEA - RUSSIAN LEGAL REGIME (2)

- **Banks** – may continue operating based on NBU license, subject to filing with the Russian Central Bank:
 - formal notification by April 17, 2014 on intention to continue activity
 - by May 2, 2014 - copies of basic constituent documents and licenses of the bank, its board and management, its more than 10% shareholders, and controlling persons
 - register of obligations before depositors and creditors

Note: Banks must already be able to process payments in Rubles

- **Currency** – the legal tender is Russian Ruble. Ukrainian Hryvna was allowed for payments until June 1, 2014.

CRIMEA - RUSSIAN LEGAL REGIME (3)

- **Administrative, family and other state documents** – all such documents duly issued by competent Ukrainian authorities by the time of the Crimea accession to Russia remain valid without limitation, unless otherwise flows from the said documents or the corresponding legal relations. However, as of the time of the accession and until the end of the Transition Period any such documents should be obtained in line with the Crimea/Sevastopol local legislation. Potentially, this period may last until September 2015. Thereafter, general norms of Russian law would apply

- **Immovable property** – the Russian Rosregister is now creating divisions in Crimea and Sevastopol which will re-register all the residential and commercial real estate under Russian rules within the transition period of 2-3 years. The re-registration is planned to be on a voluntary basis, however, after the expiration of the transition period in absence of a Russian property document no deal with any real estate without Russian documents will be possible

- Russian State Duma already issued draft law (No. 497399-6) on the 1-year transition period and simplified rules for re-registration of immovable property in Crimea, however, the draft is still under consideration
- Note! Russian law does not allow foreign citizens and entities owning land in sea ports, agricultural land and land in “border territories” (list defined by the President’s Decrees)

CRIMEA - RUSSIAN LEGAL REGIME (4)

- **Tax** – Russian tax laws govern, but during Transition Period taxes are payable to the Crimea/Sevastopol budget, and their establishment, incentives and enforcement are governed by local normative acts
- Russian **tax laws already apply** in Crimea (except for land tax and state duty) with respect to local Russian legal entities and their branches/rep. offices that were registered with the Unified State Registrar of Legal Entities (EGRUL), as well as separate subdivisions of foreign companies established in Crimea after March 18, 2014
- **Customs** – Russian/Customs Union rules to apply over the Transition Period. However, during that time no passport of transaction is required. Customs Houses of Simferopol and Sevastopol are formed, 3 customs posts on the border with mainland Ukraine are established, customs control on the ferry line between Kertch (Crimea) and Port Caucasus (Russia) is suspended. Cargo transportation between Crimea and mainland Ukraine is presently allowed based on shipment documents, without customs clearance
- **Labor** – Russian citizens may freely work in Crimea and Sevastopol. Other citizens, including Ukrainian, have to obtain Russian work permit/visa (currently, the Crimean migration authorities have not yet started issuing work permits/visas, Ukrainian nationals work under migration cards, which is formally illegal)

CRIMEA - RUSSIAN LEGAL REGIME (5)

- **Judicial system** – local courts to be formed in Crimea/Sevastopol under Russian law by the end of Transition Period. Until then, existing courts continue performing their activity
- Civil law and administrative cases fully considered (including cassation) by the time of the Crimea accession to Russia are not subject to review.
- Civil law and administrative cases not fully considered (appeal and/or cassation still being pending) can be so considered under Russian material and procedural law
- Criminal investigations and cases in progress are finalized under Russian material and procedural law, subject to review and confirmation of the charges by the competent prosecutor in Crimea/Sevastopol
- Criminal investigations, cases and sentence for the crimes non-existent under Russian law shall be suspended

DOING BUSINESS IN CRIMEA— Practical issues from the Russian side

- No coordination with Ukrainian rules
- High risk of challenge by Ukraine for violation of its established procedure
- Financial system – Ukrainian banks quit, Russian banks come in slowly
- Tax – transition to Russian tax rates and payment procedure yet to be developed, chances to credit/refund the taxes overpaid before accession unclear. For Crimean business – clear risk of double taxation (unless Ukrainian legislation on special tax regime for Crimea is adopted)
- Customs – so far, no clearance in trade with mainland Ukraine, but attempt to enforce general Russian customs rules might complicate that trade
- Citizenship – unclear status of those who miss the tight deadlines for refusal from Russian passport, unclear labor and migration rules for Ukrainian residents in Crimea
- Contracts – does failure to duly perform constitute *force majeure*? Problems with execution and enforcement for persons inside and outside Crimea
- Real estate – will limitations for foreign ownership of land apply in Crimea?
- And many, many more



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