

UKRAINIAN GOVERNMENT UNVEILS NEW APPROACH TO WORKING WITH MAJOR INVESTORS

Advantages and drawbacks of the law on supporting large investment projects

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Summary

On 16 December 2020, Ukraine unveiled a range of new incentives for major investors, as it looks to accelerate the economic recovery from the pandemic. The Verkhovna Rada passed a [law](#) on “Government Support for Major Investment in Ukraine” which applies to both Ukrainian and foreign companies that are 100% owners of an established, resident legal entity in Ukraine.

The Government views this law as a tool for accelerating investment into Ukraine by granting certain benefits and preferences to investment projects that meet specific criteria (investments of EURO 20m or more, creation of at least 80 new jobs, etc.). These benefits and preferences include:

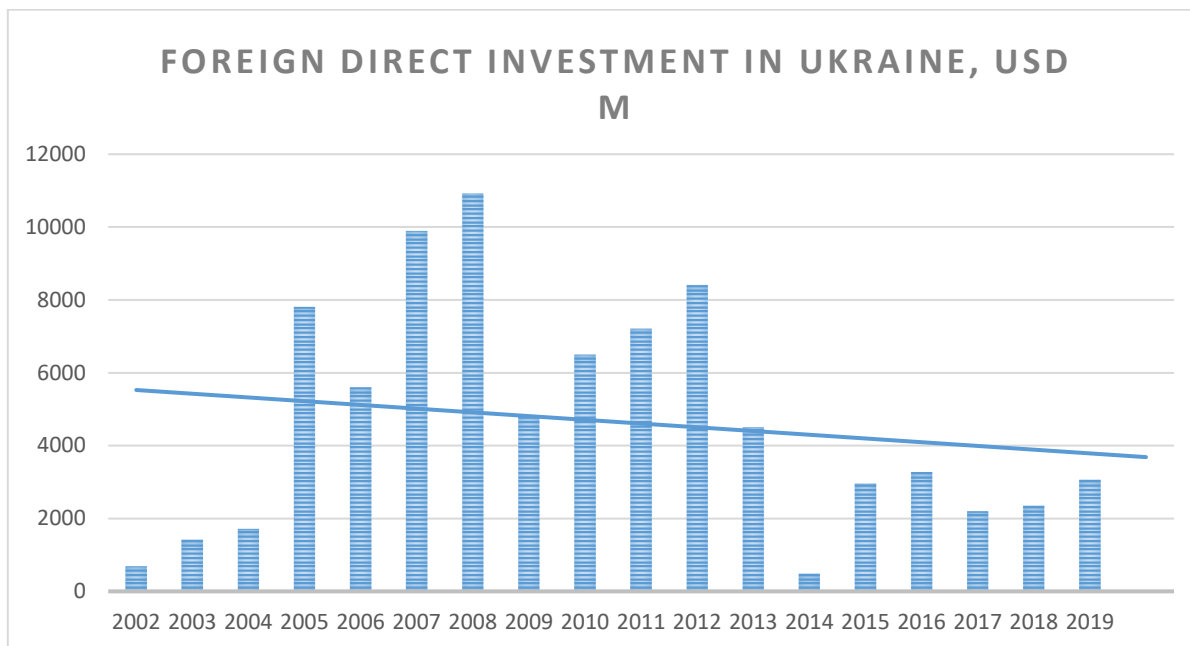
- › Five-years’ exemption from corporate income tax;
- › Exemption from VAT and import duties on equipment required for the project;
- › Preferences on buying and using land plots;
- › Ukraine Treasury financing of infrastructure construction required for the investment project.

The law also contains a non-regression clause applicable throughout the project implementation term.

These benefits and preferences should be stipulated in a special investment agreement between the investor and the Government and a local government body¹. A duly authorised organisation to be determined by the Cabinet of Ministers will provide assistance to qualifying investment projects. Should the Law be signed off by the President, the first special investment agreements may be concluded starting 1 January 2022.

¹ Provided regional benefits and preferences are granted.

The adoption of this Law should be viewed as an attempt to reverse the consistent trend of falling investment in Ukraine. Investments are sporadic and their volume has been reducing alarmingly over the last six years. At the same time, most investments are speculative (*investment in domestic government bonds*), since Ukraine is not a priority for strategic investors. The reasons behind this situation include poor guarantees of investor rights, confusing rules and bureaucracy, investors' lack of trust in the courts, a high level of corruption and high country risks stemming from the armed conflict in the east of the country.



Source: National Bank of Ukraine

The new Law is unlikely to resolve all of these problems, but it does offer certain solutions for individual investment projects. For instance, it permits disputes over the final terms for implementing an investment project to be referred to international commercial arbitration, which partly reduces the risks entailed by the perceived ineffectiveness of the Ukrainian justice system. However, since other basic problems remain unresolved, this measure alone will clearly not suffice to attract a broad range of additional investors.²

At the same time, big business in Ukraine could theoretically use the Law to cut the costs of current and future investment projects – in which case, application of the Law would defeat its original purpose. Instead of encouraging strategic, primarily foreign, investors to come to Ukraine, the policy change could instead actually negatively impact budget revenues while also granting excessive preferences to large Ukrainian businesses. Consequently, the practical application of the Law may draw criticism from the International Monetary Fund (IMF) and Ukraine's other institutional creditors, whose support largely determines the predictability of Ukraine's budgetary policy.

The Law on Government Support for Major Investment still looks rather vague and has several drawbacks:

- **It lacks the requisite regulatory basis** (*a methodology for calculating government support, investment project selection criteria, the powers and functions of the body authorised by the Government to provide investment project assistance, a system for monitoring investor compliance with their commitments, etc.*);
- The law is not “focused” enough: **its sectoral application range is fairly broad, yet its barrier to entry is quite high.** It could produce additional preferences for existing Ukrainian investors instead of attracting new, including foreign, investors;

² In the World Bank's Doing Business-2020 rating, Ukraine is ranked 64th out of 190 states (Kazakhstan is ranked 35th, Russia 28th, and Belarus 49th).

- › **Government support is capped at 30% of a planned project investment**, which could be insufficient to offset the risks of working in Ukraine and the existing corruption costs;
- › **A short timeframe for implementing investment projects – up to five years**, which could cut off big infrastructure projects with a longer recoupment time from the support instrument.
- › **The procedure for collaboration between central and local authorities is unclear**, particularly concerning the provision of land plots for investment projects. Given the weak governability and ongoing political crisis, it could provoke additional conflicts between the centre and the regions;
- › **The absence of a mechanism for ensuring government investment in the infrastructure required for implementing a project** (roads, communication lines, utilities, etc.). Such investment might require budget expenditure adjustment, which is rather difficult given the chronic budget deficit.

Despite these shortcomings, the Law deserves attention from potential large investors into Ukraine, given the range and scale of support on offer via tax exemptions and other preferential policy support mechanisms.

Prerequisites for adoption of the law and its parameters

Adoption of the law is based on the idea of establishing the “investment nanny” institution which President Volodymyr Zelensky spoke of in January 2020 at the Economic Forum in Davos. Throughout the year, while the regulation was under development, the requirements initially envisioned for investment projects have been adjusted, in particular:

- › The minimum investment threshold has been lowered from EURO 100 m to USD 20 m;
- › Instead of an “investment nanny” institution, i.e. personal assistants appointed by the State, a specially authorised organisation will provide assistance to such investment projects.³

Originally, the idea of adopting the law was tied to the Government’s plans for a new wave of state property privatisation. [The 2019–2021 privatisation plan](#) envisaged selling off a range of large industrial facilities⁴ but the coronavirus crisis has derailed this plan completely – the official text of the Law does not refer directly to privatisation.

The Law instead sets the overall framework of the new investment instruments. For it to be applied in practice, several other laws also need to be passed, including amendments to Ukraine’s Tax Code and Customs Code⁵, as well as several regulatory acts determining the procedures for signing special investment agreements.

WHAT IS A SPECIAL INVESTMENT AGREEMENT?

A special investment agreement will be concluded between an investor and the Government, with a local government body also potentially being a party to the agreement if there are regional investor benefits.

The signed agreement guarantees:

- › Stable conditions for economic operations throughout investment projects;
- › Government support to the amount provided for in the Law and in the special investment agreement.

³ In early 2020, plans envisioned an authorised organisation based at Ukraine Invest, the state agency for attracting investment, and the National Investment Council.

⁴ They include the Urkbud construction company, Turboatom turbine plant, Azovmash engineering company, Odessaoblenergo electric distribution company, etc.

⁵ These amendments are envisioned in relevant draft laws [No. 3761](#) and [No. 3762](#).

Both a Ukrainian and a foreign company may act as an investor; a foreign company must register a 100%-owned legal entity in Ukraine to focus solely on implementing the investment project. Additionally, the Law envisions the possibility of subsequently changing the ownership structure of the legal entity given government approval.

The concepts of special investment agreements and “investment nanny” are likely influenced by similar practices employed by other regional states, in particular Russia (*agreements on protecting and encouraging capital investment, special investment agreements*) and Poland (*the Polish Investment and Trade Agency*). The Ukrainian law contains a number of provisions which correlate with these and other countries’ investment incentivization programs.

INVESTMENT PROJECT CRITERIA

The Law introduces the concept of an “investment project with major investment” that could use government support for its implementation. Such a project should be implemented within Ukraine and meet several criteria:

- › Capital may be invested in:
 - › Processing industry (excluding production and turnover of tobacco, ethanol and alcoholic beverages);
 - › Extraction of mineral resources for subsequent processing (excluding coal, crude oil and natural gas);
 - › Waste processing;
 - › Transport, warehousing, mail and courier services, logistics;
 - › Education, science, scientific and technological activities;
 - › Health protection, arts, culture, sports, tourism, resorts and recreation.
- › Creation of a minimum of 80 jobs with an average wage 15% higher than the average wage in the relevant economic sector in the region where the project is implemented.
- › Investment throughout the timeframe of project implementation should exceed the equivalent of EURO 20 m.
- › The project’s implementation timeframe should be no longer than five years.

The Law specifically stipulates that government support may not be granted to investment projects in renewable energy, the extractive industry, horticulture and finance.

FORMS OF GOVERNMENT SUPPORT

Support for investment projects with major investment will be provided in the following forms:

- › A five-year exemption from corporate income tax;
- › Exemption from VAT and import duties on equipment required for the project;
- › The Law also contains a non-regression clause applicable throughout the project implementation term (the list of regulation provisions under non-regression clause should be marked in a special investment agreement);
- › Granting of priority right to use a government- or communally-owned land plot for the investment project, including preferential ground rent terms and a priority buyout right on expiry of the project implementation term;

- › Ukraine and local treasury financing of construction, reconstruction, restoration and overhaul of the infrastructure facility (roads, communication lines, utilities including heat, gas and power, etc.).

The total government support for the investment project, which will be set out in the special investment agreement, should not exceed 30% of the planned investment volume. It should be noted that, in the absence of a clear assessment methodology, the monitoring of support measures provided and funds actually invested could potentially be a point of significant controversy.

In conclusion

The Law on Government Support for Major investment projects in Ukraine gives mixed signals at a time when far more clarity is needed to arrest the significant, continuous slide in investment into Ukraine.

On the one hand, it signals the Government's intent to encourage strategic investors to invest in Ukraine's economy, thereby boosting the effect of the new wave of state property privatisation slated for the next few years. On the other, however, given Ukraine's low investment appeal, the Law looks like an attempt to wrap individual major investors in cotton wool, as it were; a strategy which could backfire and dilute any wider impact on the economy. It is certainly difficult to say at present that a significant number of investors will make use of the new Law.

Additionally, given the low governability and ongoing crisis, there are questions concerning the State's long-term ability to ensure enforcement of the Law, above all in the regions (land allocation and land plot acquisition issues), where lingering issues around compliance and corruption persist. Without steadfast assurance on enforcement and rooting out corruption, many investors will continue to be wary of entering Ukraine.

With this in mind, the prospects for applying this law largely depend on its subsequent development at the level of forthcoming regulatory acts and of the experiences of those investors executing the first wave of special investment agreements.

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