



# Real Estate Investment in Ukraine

THE LEGAL PERSPECTIVE

# Introduction

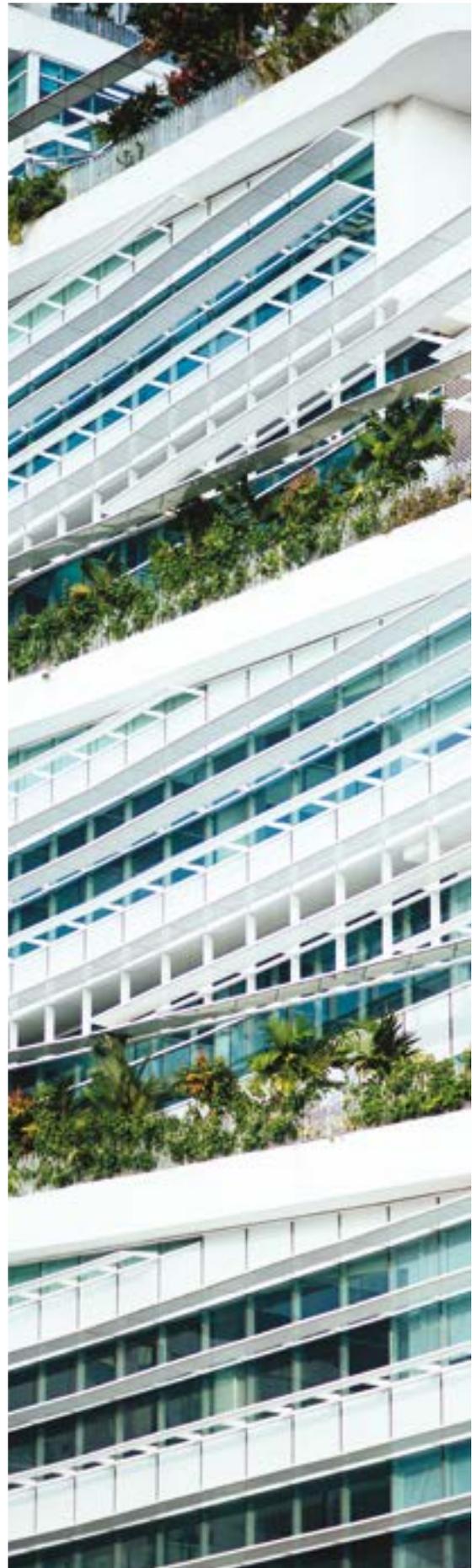
Despite the challenging sociopolitical and economic situation in Ukraine successful real estate investment is still achievable.

The country's government has been making some progress towards easing the regulatory burden on businesses. Recently, some remarkable de-regulation measures have been introduced, including simplification of the regulatory procedures: timeframes have been shortened, electronic submissions introduced requirements for a number of permits and approvals have been abolished, obsolete regulatory norms and rules abolished or modified, powers of state authorities have been limited and a number of anti-corruption measures have been introduced. As a result of these recent initiatives, Ukraine has moved up 32 places in the World Bank's "Doing Business" rankings since 2014.

In addition, Ukraine possesses a third of the world's rich black-earth soil and is the number one exporter of sunflower oil globally. The country has the number one software engineering force in Central and Eastern Europe. Combined with a population over 40 million and a 99% literacy rate, Ukraine has plenty of opportunities for real estate investors. Given high vacancy rates and low occupier demand

on the one hand, and an excellent geographic location in the very heart of Eastern Europe, bordering the Black Sea, between Poland, Romania, and Moldova to the west and Russia to the north east, Ukraine can offer a great mix of opportunities for investors seeking to enter the market at the very heart of Europe.

DLA Piper boasts one of the largest real estate practices in the world. We believe that legal services relating to investment in real estate should consist of more than merely helping to acquire title. In our opinion, sound investment in real estate requires knowledge of all available investment structures and their respective tax implications. This document is intended to serve as a comprehensive guide to the most relevant civil and tax law aspects of investing in Ukrainian real estate. We aim to use our practical experience as a valuable source of information for our readers. The guide does not claim to be exhaustive so if you have any further questions relating to the material, our experienced Ukrainian real estate team will be happy to assist you.



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# 1. Ownership of Real Estate

## 1.1 Ownership

In contrast to the former system of state and collective ownership of property of the Soviet era, the Civil Code of Ukraine, dated 16 January 2003, specifically recognized and honoured private ownership of property in Ukraine.

Ukrainian law expressly states that there are three types of ownership in Ukraine: private, municipal, and state.

According to Ukrainian law, the status of ownership is the right to a thing to be enjoyed by a person at their own discretion, regardless of the wishes of third parties and in compliance with the law. Ownership includes a right (capacity) to possess, to use and to dispose of a property.

According to Article 318 of the Civil Code of Ukraine, the State, as well as foreign states, municipalities, legal entities and individuals may own property in Ukraine.

Under Article 26 of the Constitution of Ukraine, foreign citizens enjoy the same rights and freedoms and bear the same responsibilities as Ukrainian citizens, including property rights. According to the Civil Code of Ukraine, foreign citizens and legal entities are entitled to own property in Ukraine, unless otherwise provided for in the international treaties of Ukraine or other Ukrainian laws.

Subject to few exceptions, the scope, quantity and value of the rights encompassed in ownership by a legal entity or individual is not limited.

Ukrainian law establishes specific regimes, limitations and procedures for acquisition, ownership and use of land, subsoil, water resources, air and the natural resources of the continental shelf.

Ukrainian courts ensure the protection of property rights in accordance with the applicable Ukrainian laws.

Ownership as well as other proprietary rights to real estate (lease, servitudes, etc.) is subject to state registration according to the procedure established by the Law of Ukraine on State Registration of Property Rights to Real Estate and their Encumbrances, dated 1 July 2004.

According to Ukrainian law, ownership arises on the date of its state registration.

Recently, information on registered property rights to real estate has become publicly available.

## 1.2 Restrictions on ownership by foreignerst

Ukrainian law allows foreigners to own real estate in Ukraine subject to certain restrictions. The Land Code of Ukraine prohibits foreigners, foreign companies and foreign countries from owning agricultural land in Ukraine. It also prohibits foreign companies from purchasing plots of land other than:

- plots of land located within the boundaries of populated areas in the case of acquisition of real estate facilities located thereon or for the purpose of constructing facilities related to their commercial activities in Ukraine; and
- plots of land beyond the boundaries of populated areas where the plot of land is the site of a building or structure owned by the buyer.

These restrictions also apply to joint ventures, i.e. companies established under Ukrainian law with the participation of foreign investors and Ukrainian citizens or legal entities.

The Land Code also establishes a number of other limitations, especially with respect to agricultural land.

The procedure for the purchase of land by foreigners is rather complicated and time-consuming.

The purchase of non-agricultural municipal land by foreign investors and joint ventures requires approval from the Ukrainian government, and the purchase of non-agricultural state land requires approval from the Ukrainian parliament.

In addition, a sale of state or municipal land to a foreign company requires the registration of a permanent establishment in Ukraine with the right to carry on a business activity.

Moreover, there is no definitive position as to whether Ukrainian companies that are 100% foreign owned may acquire land in Ukraine. On the one hand, there are court decisions stating that the acquisition of plots of land by Ukrainian companies that are 100% foreign owned are not provided for by Ukrainian law. On the other hand, the State Agency for Land Resources has issued a clarification stating that a 100% foreign owned Ukrainian company will be treated as a foreign company and thus should be allowed to acquire non-agricultural land in Ukraine.

## 2. Acquisition of Ownership

### 2.1 Formal requirements

All transactions dealing with the transfer of title to real estate must be notarized.

Under the recently amended Title Registration Act, as of 1 January 2016, registration powers in respect of title to land and other real estate have been granted to local authorities, accredited public and municipal enterprises and notaries. All titles to land and real estate are registered in the unified register – the State Register of Proprietary Rights over Immovable Property.

As from 1 January 2016, ownership rights over real estate (including land) are valid once the right of ownership is registered with the local state registrar or with the notary once the appropriate document (such as a notarized sale and purchase agreement) is formalized.

### 2.2 Registration

Under Ukrainian law, the title to real estate arises from the date of state registration of such title in the State Register of Proprietary Rights to Immovable Property.

Under the Title Registration Act, as of 1 January 2016 registration of title to land and other real estate is effected by the state registrars (including notaries).

On 26 November 2014 legislation came into effect providing for information on the State Register of Rights Over Immovable Property to become publicly available. In particular, any person has the right to obtain information about the owners of real estate (including buildings, structures, plots of land etc.) if those rights are registered

in that State Register. Since 1 January 2015 the information in the State Register of the Rights over Immovable Property became publicly available on-line via the website of the Ministry of Justice.

All transactions affecting real estate (both plots of land and other property) executed prior to 1 January 2013 were also registered with the State Registry of Deeds (a record of transactions) administered by the Ministry of Justice and operated by the notaries. Almost every real estate transaction must be registered with this registry. As from 1 January 2013, registration of real estate transactions is abolished (the State Register of Deeds is discontinued) and has been replaced with registration of titles under the Title Registration Act.

### 2.3 Asset deals

Property can be acquired directly (asset purchase) by a purchaser from the owner. All formal requirements referred to above must be observed, meaning that these asset deals also need to be notarized to be effective.

Generally, the transaction will include the following stages:

- conclusion of a confidentiality agreement/preliminary agreement/letter of intent;
- legal due diligence, as well as environmental and technical due diligence where appropriate;
- negotiation of the contract;
- obtaining approval from the Anti-Monopoly Committee of Ukraine (if required under Ukrainian legislation);
- signing and notarizing the contract;

- fulfilment of any conditions precedent to completion;
- completion of the contract; and
- registration of the buyer's title to the real estate/land.

Memoranda of understanding, letters of intent, and heads of terms or the like will not have a binding effect under Ukrainian law unless they are executed in a notarial deed in the form of a "preliminary agreement".

In order for the property transfer agreement to be valid, it should contain all material terms required by law for the relevant type of agreement. Otherwise, the content of the agreement is negotiable.

Sale and purchase agreements for real estate (other than land) usually include the following:

- details of the property;
- the rights and obligations of the parties;
- the purchase price;
- the liability of the parties;
- details of the underlying plot of land (its cadastral number and aggregate area), except in relation to a sale of premises in an apartment building; and
- other relevant terms.

Sale and purchase contracts involving plots of land should include the mandatory conditions necessary for the effective fulfilment of the agreement (location and size of the plot of land, its cadastral number, purchase price, encumbrances, terms of transfer, timing of the transfer, etc.).

Therefore, in most cases the parties are assisted by specialist lawyers when drafting the relevant documents, negotiating the agreement, financing the transaction and completing the transfer.

It is highly advisable for the buyer to carry out due diligence on all aspects of the property prior to the notarization of a property transfer agreement. Usually investors carry out financial, technical, legal and environmental due diligence on title, building permits, leases and contracts, and other aspects relevant to the property. As a rule this is carried out before purchase, either after signing the preliminary agreement, letter of intent or term sheet etc (which provides the buyer with an exclusivity period), or after signing a principal agreement, which will make the conduct of due diligence a condition precedent for completion.

Due to a recent amendment to Ukrainian law, the title transfer and registration of title to the real estate is made by the notary simultaneously with the notarization of the property transfer deed.

In the case of asset sales, VAT is payable at the rate of 20%. The amount subject to VAT in respect of such transactions cannot be less than the book value of the property asset as of the beginning of the tax

period during which it is disposed of (or the arm's length value – if the property asset is not recorded in the books). The sale of plots of land (without buildings and/or other structures) is not subject to VAT.

State duty (calculated according to the value of the transaction), pension fund duty, state registration fees, legal fees, technical and financial consultants' fees etc may apply.

Pension fund duty is paid by a purchaser of real estate at 1% of the value of the real estate (excluding VAT) indicated in the sale and purchase agreement but cannot be lower than the book value.

State duty, also applies, at 1% of the contractual value of the real estate being transferred. However, the value of the real estate for the purposes of levying state duty cannot be less than its book value if purchased from a legal entity or its appraised value if purchased from an individual.

The notary's fees are divided between the parties as agreed. The state registration fee varies depending on terms for completion of registration (from 2 hours to 5 business days). The state registration fee for the registration of title (i.e. the ownership) is 0.1 to 5 living wage, established for employable individuals. The registration of an encumbrance (e.g. a mortgage) is 0.05 living wage, established for employable individuals.

Real estate agencies' charges are around 2.5% to 5% of the contractual price.

## 2.4 Share deals

Another way to acquire real estate is to purchase the legal entity which owns the property (asset holding company). In Ukraine, such a legal entity is often organized as a limited liability company (LLC). The name of the LLC emphasizes the fact that the owners (also known as participants) of the LLC are only liable for the company's obligations up to the value of their contribution to the charter capital of the LLC.

Ukrainian law provides for the following corporate vehicles:

- a limited liability company;
- an additional liability company;
- a joint-stock company (private or public);
- a partnership; and
- a commandite partnership.

A limited liability company is the best vehicle for real estate investment in Ukraine for the following reasons:

- the incorporation procedure is simpler and less time-consuming;
- there is no need to issue shares and register them with the State Commission for Securities and the Stock Market;
- there are no reporting and publishing requirements;
- the corporate governance structure is relatively simple and flexible; and
- there are no requirements as to the minimum amount of charter capital.

Generally a share purchase in Ukraine of an LLC as an asset holding company will include the following stages:

- conclusion of a confidentiality agreement/preliminary agreement;
- legal due diligence, as well as financial, environmental and technical due diligence where appropriate;
- negotiation of the agreement for the sale and purchase of the participatory interests (shares) in the asset holding company;
- the convening of a general participants' meeting of the asset holding company;
- obtaining written refusals from the participants (owners) of the asset holding company in respect of their pre-emptive right to buy-out the participatory interests of the other participants (if the asset holding company is owned by several participants);
- approval of the general participants' meeting of the asset holding company of the sale of participatory interests to the buyer;
- signing of the SPA(s);
- obtaining approval from the Anti-Monopoly Committee of Ukraine (if required under Ukrainian legislation);
- fulfilment of any conditions precedent to completion; and
- state registration of the restated version of the asset company's charter, whereby the buyer is shown as the new (sole or otherwise, as the case may be) participant (owner) of the asset holding company.

The SPA should be executed and signed in a simple written form. Notarization of the SPA is optional and depends on the decision of the parties.

The timing for completion of the share deal depends greatly on the parties' timeframes for the performance of the legal and financial due diligence. However, the parties should keep in mind statutory terms for:

- the convocation of a general participants' meeting of the asset holding company and obtaining refusals in respect of pre-emptive rights (items (d) and (f) above) – 30 days; and
- state registration of the restated charter of the asset holding company (item (j) above) – 5 days.

The transfer of participatory interests (shares) of the LLC is considered completed upon completion of the state registration of the restated charter of the asset holding company.



## 3. Other Rights to Property

### 3.1 Other rights to property

Ukrainian law provides for the following real estate rights apart from full ownership:

- lease (the right to use immovable property for a certain period subject to a rent payment);
- possession of someone else's immovable property (actual possession of property that belongs to another person);
- use of someone else's immovable property ('servitude' – the right to use someone else's land in order to meet one's own needs, if these cannot be met in any other way);
- use of someone else's land for agricultural purposes (emphyteusis);
- use of someone else's land for construction (superficies);
- permanent use of a plot of land (for an unlimited term and only in relation to plots that are state or municipal property) – a right granted only to state or municipal enterprises, organisations and institutions, religious organisations or to civil organisations whose members are disabled;
- a right of economic management (applicable to real estate other than plots of land) – a right granted to state or municipal commercial enterprises; and
- a right of operational management (applicable to real estate other than plots of land) – a right granted to state or municipal non-commercial enterprises.

### 3.2 Mortgages and charges

Ukrainian law recognizes the mortgage of immovable property as one of the instruments for securing monetary contractual obligations such as repayment of debt, payment of the purchase price, etc.

Ukrainian law provides that land, buildings/structures on land, unfinished construction works (subject to appropriate registration) as well as rights to use buildings/structures or land are considered to be real estate which may be mortgaged to secure the repayment of money or other obligations.

Ukrainian law contains restrictions with regard to the ownership of land by foreigners and individuals. Particularly, agricultural land can only be mortgaged to Ukrainian banks. Ukrainian law stipulates that real estate and land (except for agricultural land) can be mortgaged to foreign lenders and the relevant mortgages can be enforced.

### 3.3 Easements

Properties under Ukrainian law can be encumbered in favour of the owner of a neighbouring property by establishing rights of way, certain rights of use or prevention of use, prevention of construction, permission for construction etc.

Ukrainian law recognizes the following easements:

- Servitude – a right to use a third party's property, including land, in order to meet one's own needs, if these cannot be met in any other way. The servitude may be permanent (established for a limited term) or perpetual.

Ukrainian law recognizes the following types of servitudes:

- rights of way;
- rights to place permanent structures;
- rights to build a water pipeline to the plot of land from a third party's water reservoir or through a third party's land;
- rights of passage through a third party's plot of land to a water reservoir; and
- rights to install temporary construction structures, machines and construction materials for the purposes of repair or construction of a building or structure etc.

A servitude may be established on the basis of an agreement, by law or court decision.

- Emphyteusis – is a right to use someone else's land for agricultural purposes and may be established by agreement.
- Superficies – is a right to use someone else's land for construction purposes and may be established by agreement or by testament.

Under Ukrainian law, the above easements are subject to state registration in the State Register of Proprietary Rights to Real Estate and become effective from the date of such registration.

### 3.4 Pre-emption rights

Tenants who duly fulfill their obligations under their lease agreement enjoy a pre-emptive right to purchase the property they occupy subject to payment of the sale price. If the real estate is then sold by auction the tenant's offer, if it equals or beats the best offer made by the bidders at the auction, prevails.

A tenant who has duly fulfilled the lease agreement has a pre-emptive right to an extension of the lease term or renewal of the lease agreement for the new term offered to other potential tenants.

Co-owners of property have a right of pre-emption if one of the owners sells his share. A co-owner who intends to buy property in this

way must pay the purchase price set by the seller, who must inform the other co-owners of the sale. This right of pre-emption must be exercised by one of the co-owners within one month of the date the seller announces an intention to sell the property.



## 4. Zoning and Planning Law Permits

Under Ukrainian law the development/use of a building must conform to the zoning of the plot of land on which the building is placed.

If the building has special status, i.e., is an asset of cultural or historic value or is listed as hazardous, additional legal restrictions are usually applicable to its use and disposal.

Almost any construction, reconstruction or capital repair (irrespective of the ownership of the underlying plot of land) must be carried out in accordance with the permissive procedure stipulated in the legislation.

Depending on the complexity of the construction it may be necessary to develop and approve planning documentation, obtain a construction permit and commission the building (for technically complex projects) or notify on the commencement and declare completion of construction (for technically simple projects). State control by the local departments of the State Architectural and Construction Inspectorate over construction, reconstruction or capital repair is applicable from the commencement until the completion of the relevant works.

Permission for development is granted by means of the authorization of plots of land for construction purposes by the local councils or state administrations (depending on the location of the plot of land) and the issuance of initial data for planning by the authorized local architectural and construction authorities to the owners and users of those plots of land ready for development subject

to consideration of applications to be made by those owners and users.

Provided that any construction accords with existing town planning documentation and the zoning of the plot of land, the owner/user of the plot of land should obtain town planning conditions and restrictions for the development of the plot of land, which represent an authorization to commence planning works.

Pursuant to Ukrainian legislation, if planned construction complies with the existing town planning documentation the local authorities must issue initial data for planning (meaning town planning conditions and restrictions on the development of the plot of land) within 10 business days from the submission of the relevant application. If the planned construction does not comply with the existing town-planning documentation there are no definite timeframes for issuing the initial data for planning. In practice this could take around two to five months since the relevant amendments must first be introduced into the existing town-planning documentation.

The complexity of the construction procedure depends on the complexity of the building. Technically simple buildings may be constructed without the development and approval of planning documentation and based on notification on commencement and declaration on completion of construction works.

The planning documentation for a complex building should be approved by the independent expert organizations which are licensed for such works. These organizations are entitled to involve the state land resource, environmental, sanitary and other competent authorities in the conduct of an expert review of the documentation. After approval of the planning documentation a Permit for the Carrying out of Construction Works (the document allowing commencement of construction works) should be obtained from the State Architectural and Construction Inspectorate of Ukraine (from 1 September 2015 – also from the local municipal authorities). Before approval of the planning documentation only preparatory works (e.g. excavation works, etc.) may be undertaken subject to obtaining a Permit for the Carrying Out of Preparatory Works.

It should be noted that currently in Ukraine not all levels of town planning documentation are in place. Starting from 1 January 2015 the allocation of state or municipal land to the ownership or use of individuals or legal entities, as well as any change in land zoning for town planning (construction) purposes is prohibited if the zoning plans or the detailed plans are not developed for the territory where relevant land is located. In addition, in cases where the abovementioned plans are not available, local authorities are not entitled to issue the data for planning. It is possible that such restrictions will be suspended by the Parliament of Ukraine, though several draft laws on this issue have already failed to pass in Parliament.

## 5. Environmental Liability

Ukrainian law obliges owners of real property (comprising buildings, structures and plots of land) to comply with environmental protection requirements. As a result persons whose activities have a harmful effect on the environment must equip themselves with any installations and facilities necessary for purifying or sterilising emissions, as well as minimising the effect of harmful agents.

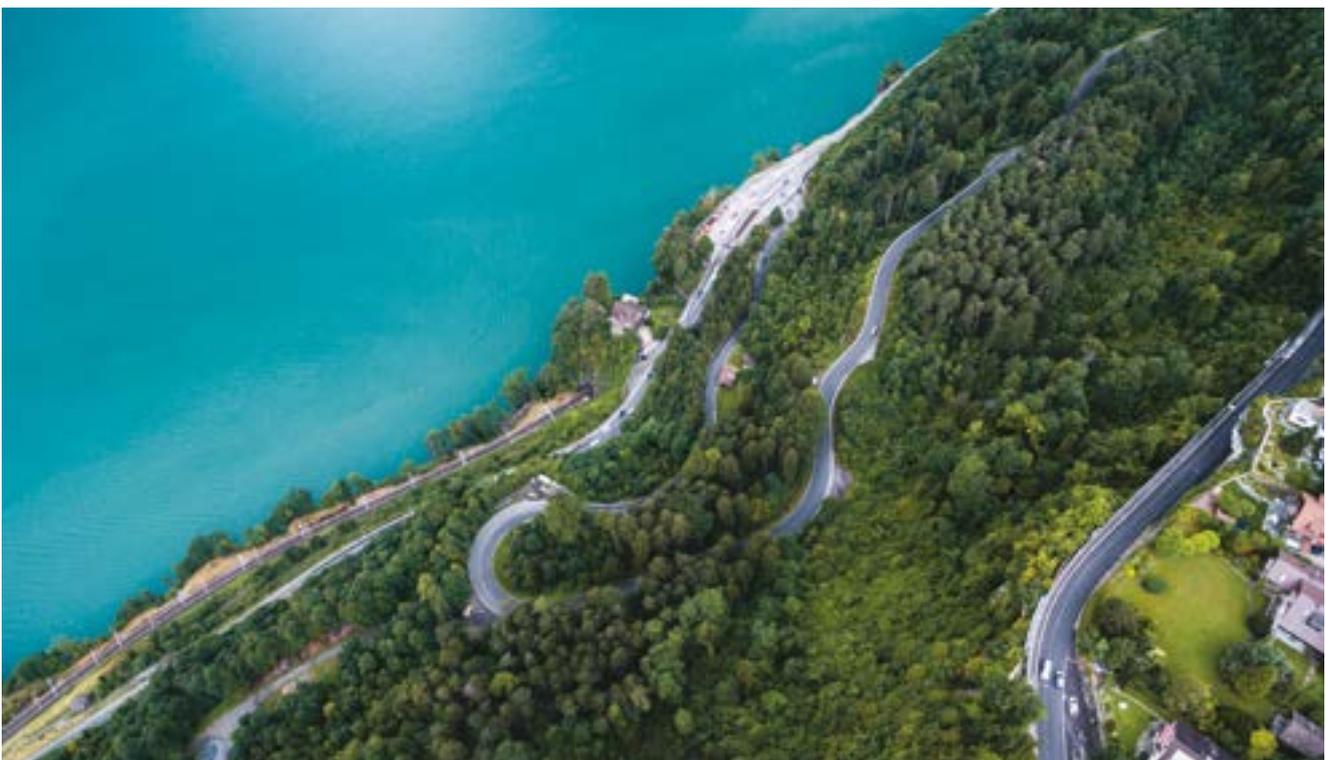
Such persons must protect the environment and people from contamination by biological, acoustic, electromagnetic, ionizing and other physical factors and radiation. Similarly, land owners and users (including tenants) must comply with the requirements of environmental and land protection law and must use the land in the way that does not damage the land and its fertility, will ameliorate the land's fertility, and comply with standards and norms of land

protection. Carrying out any harmful activity requires a special permit, for example, contamination of the environment (e.g. contamination of the air, discharge of sewage or removal of the fertile layer of the soil etc.). There are also requirements to comply with environmental protection law in relation to the construction of buildings. Thus construction projects involving technically complicated buildings are subject to mandatory state expert oversight.

Non-compliance with environmental protection requirements may result in administrative, disciplinary, civil and even criminal liability, as well as termination of land use rights. Ukrainian law establishes administrative liability for numerous violations of land and environmental legislation: eg contamination of agricultural and other land, use of land not in accordance with its designated purpose, removal of

fertile layers of soil without a special permit, contamination of the air without a special permit or not in accordance with rules set out in such permit, non-compliance with the requirements of air protection and the commissioning and exploitation of companies, structures and other buildings. If the violation of environmental protection rules leads to loss of life, contamination of a wide area or other serious effects, criminal liability may be imposed.

Regardless of the imposition of administrative or criminal liability, violators will be liable for damages for non-compliance with environmental protection law in accordance with procedures established by law. The amount of recovery is calculated by state authorities authorized to monitor compliance with environment protection legislation.



## 6. Leases

### 6.1 Leases generally

A real estate lease is a contractual right to possession and use of property for a limited period of time, which is granted in return for the payment of rent. Under Ukrainian law only the owner of a property may grant a lease.

Ukrainian law provides for two main types of real estate lease, depending on the type of property:

- land leases; and
- real estate leases (which deal with premises, buildings etc.).

The lease is formed on the basis of a lease agreement concluded between the lessee and the lessor. Lease agreements regarding real property (except for a land lease agreement) for a term of three or more years are subject to notarization.

Ukrainian law establishes specific procedures for the grant of leases of state and municipal property.

According to the Decree of the Cabinet of Ministers of Ukraine on State Duty, parties to a lease agreement must pay a state duty for the notarization of a lease agreement of 0.01% of the contract price of a lease agreement for a building or other capital structure (instead of the 1% that applied formerly) which is capped at 50 times the “non-taxable minimum income” (currently UAH 850), and 0.01% of the land appraisal for a land lease agreement.

The right to lease real property for a period of three or more years is subject to mandatory state registration in the State Register of Proprietary Rights to Immovable Property.

The existence of the lease arises on the date of its state registration.

In order to be valid, the real estate lease agreement should contain the following material terms and conditions:

- a description of the leased property (location, content, value and indexation);
- the lease term;
- rent payments and terms of any indexation;
- depreciation charges and their use; and
- renovation of the leased property and conditions of its return and/or buy-out.

Leases in Ukraine are governed by the Land Code of Ukraine and the Law of Ukraine “On Land Leasing”.

All Ukrainian and foreign individuals and legal entities, foreign states, and international organizations may lease land in Ukraine. The Land Code provides for two types of land lease: short-term (up to five years) and long-term (up to 50 years). The Land Code establishes the right of a lessee to sublease a plot of land, subject to the lessor’s consent. The term “lessors of plots of land” is defined to include only land owners or their authorised representatives.

More specifically land lease relations are governed by the Law of Ukraine on Land Leasing (the Land Lease Law), dated 6 October 1998, which governs the issues of land lease agreements and land rent payments in more detail.

According to the Land Lease Law, a land lease agreement must be executed in writing and must contain a set of essential terms. The essential terms of any land lease agreement are the following: the leased property (its location, cadastral number and size); the term of the agreement; the amount of rent, any indexation, rent revision, terms and means of payment, liability for failure or delay in paying the rent.

The procedure for the lease of state and municipal land is set out in the Land Code and the Land Lease Law. Currently, state or municipal land can be leased out pursuant to a decision of the relevant local state administration or local council and exclusively on a competitive basis (auction).

The Land Code allows for waiver of the auction requirement in some cases, such as:

- when the plot of land is occupied by a building owned by an individual or a legal entity;
- for the use of natural resources and special water use according to a special permit (license);
- the plot of land is to be used by a religious organization legally recognized in Ukraine for the location of a religious building;
- construction of an asset which is fully financed by the state or local budget;
- allocation of land to cultural and artistic enterprises, establishments, and public organizations for workshops;
- land leased for the purposes of reconstruction of old residential blocks, social residential construction based on the results of the relevant investment tenders;

- the allocation of land for the purposes of the private partner in public and private partnership projects;
- the allocation of plots of land withdrawn for public needs or public necessity;
- use for the location of diplomatic and similar representative offices of foreign states and international organizations in accordance with the international treaties of Ukraine;
- use for the construction and maintenance of engineering, transportation or energy infrastructure and roads;
- the allocation of land to individuals for farming purposes, individual agricultural household, gardening, individual residential construction;
- use of land for concession projects;
- leasing or concession of buildings and structures located on state-owned or municipal land;
- renewal of land lease agreements;
- leasing the site of industrial parks to companies operating such industrial parks, etc.

Currently, the Land Code establishes the requirements and the procedure for holding land auctions. According to this procedure a land auction must be held by a licensed organization.

## 6.2 Duration

A land lease agreement can be entered into for a term of not more than 50 years. The lease term for agricultural irrigated land for commercial agriculture, farm enterprises or private agricultural households cannot be less than

10 years. There is no limit on the term of other real estate lease agreements (with the exception of leases of apartments with the right to buy-out, the length of which should not exceed 30 years).

The Civil Code of Ukraine provides that if a lessee under a lease agreement remains in occupation of real estate following the expiry of the lease term, this continued occupation will be considered to be an extension of the original lease term provided that the landlord does not serve an objection within one month of the lease expiry date. The Commercial Code of Ukraine provides that, if neither the landlord nor the lessee serve a notice relating to the termination or change in the conditions of the lease within one month following the expiry of the original lease term, then the lease agreement is considered to be extended for a term equal to the original term on the same conditions.

## 6.3 Rent

Ukrainian law recognises the rent as a material term required for the validity of the lease agreement. The law does not establish the minimum and maximum amount of the rent except for certain types of land and state property. Therefore, the parties are free to determine the amount and mechanism for calculating the rent for the property, other than land.

Ukrainian law provides for a specific methodology for the calculation of rent for state and municipal property, which has been adopted by the Cabinet of Ministers of Ukraine.

The rent for state owned land is calculated on the basis of the normative evaluation of the plot of land, which is performed by a certified appraiser.

The tax code of Ukraine establishes the minimum and maximum annual rent rates for state owned and municipal plots of land ie not less than 3% and not more than 12% of the normative evaluation of the plot of land. The rent may exceed the 12% threshold only if the rent is determined in the course of a public auction.

The exact amount of the rent for state owned or municipal land is determined by the relevant lessor (local state administration, municipality, etc.) based on the zoning and expected use of the plot of land.

## 6.4 Rent review

The method for determining rent should be agreed and provided for by the parties in the lease agreement. Where the state/municipal property/land is leased, Ukrainian law contains a mechanism for adjusting the rent which is to be adhered to by the parties to the lease agreement (although the parties are entitled to amend it to a certain extent).

The rent is subject to indexation. This means that the rent varies in relation to the index measuring inflation or according to other circumstances stipulated in the lease agreement.

A lessor and lessee may also agree and stipulate in the lease agreement other grounds for changing the rent during the lease term and the relevant procedure for doing so.

### 6.5 Operating expenses

According to market practice, the lessee is obliged to pay for utilities (water, electricity, etc.), to reimburse the lessor for operational expenses (garbage disposal, cleaning, etc.) and land tax (if a stand-alone building is leased).

These payments may be included in the rent or may be payable separately. All these issues should be agreed and addressed by the parties in the lease agreement.

### 6.6 Maintenance, repair and renovation at end of lease

Under Ukrainian law, unless parties to a lease agreement agree otherwise, day to day repair of the leased premises should be carried out at the expense of the lessee, while capital repair is the responsibility of the lessor.

### 6.7 Assignments/transfers

Under Ukrainian law a lessee is entitled to transfer his rights under the lease agreement to a third party subject to the lessor's approval, unless the parties agree otherwise in the lease agreement. Leases of

state and municipal plots of land may not be assigned, or granted as a contribution to the charter capital of a company, or subjected to a pledge.

### 6.8 Subleases

Under Ukrainian law, the lessee may sub-lease the property subject to the prior approval of the lessor. Sub-leasing the premises without the approval of the lessor is a statutory ground for early termination of the lease agreement by the lessor.

The law directly prohibits the subleasing of integral property complexes.

According to the law, the lessor may unilaterally terminate the lease agreement in the following events:

- the lessee fails to pay the rent for three consecutive months of the lease term;
- the lessee uses the property in violation of its designated use defined in the lease agreement;
- the lessee transfers the property to a third party without the approval of the lessor;

- the lessee, by its irresponsible behaviour, creates a danger of damaging the property;
- the lessee fails to start capital repairs of the property if such an obligation is imposed on the lessee by the lease agreement.

The lessee may unilaterally terminate the lease agreement in the following events:

- the quality of the property provided under the lease by the lessor does not comply with the requirements of the lease agreement;
- the lessor fails to perform capital repairs to the property, if such an obligation is imposed on the lessor by the lease agreement.

As a matter of practice, the parties to the lease agreement often establish additional grounds for early termination of the lease agreement.



# 7. Tax

## 7.1 Transfer taxes

Below is a general comparison of standard transfer options.

A foreign investor can invest in Ukrainian real estate either by directly purchasing the real estate (i.e. an asset deal) or by purchasing a company holding the asset (i.e. a share deal).

The advantages of asset deals include:

- anti-monopoly Committee approval is generally not required;
- there is no need to acquire any assets other than the real estate asset/relevant plot of land.

The disadvantages of asset deals include:

- VAT at 20% applies in most cases;
- 1% state duty is payable;
- 1% pension fund duty is payable (except on the acquisition of plots of land);
- the tax authorities' express approach that the direct ownership of Ukrainian real estate by a non-resident as such leads to the creation of a permanent establishment (although this position is disputable); and
- it takes time to re-register the relevant title/rights to the plot of land.

The advantages of share deals include:

- no VAT is applicable;
- no state duty is applicable;
- no pension fund duty is applicable;
- there is no need to re-register the title/rights (for plots of land);
- there is no need to re-issue the approvals and permits (if applicable).

The disadvantages of share deals include:

- anti-monopoly Committee approval may be required;
- in addition to the relevant assets, the buyer acquires the other assets and liabilities of the company.

## 7.2 Value added tax

The buyer pays no taxes in the case of an indirect purchase of real estate or shares through a local company (i.e. a share deal). VAT does not apply to share purchases where the consideration is cash or share-for-share.

Asset deals involving real estate assets are normally subject to VAT. A sale of real estate is normally subject to VAT at the standard rate of 20%. The amount subject to VAT in respect of such transactions cannot be less than the book value of the property asset as at the beginning of the tax period during

which it is disposed of (or the arm's length value – if the property asset is not recorded in the books). Sales of undeveloped plots of land and residential real estate (except for the first sale) are exempt from VAT.

The buyer can recover input VAT provided it is registered for VAT and the input VAT is attributable to its VATable supplies in the course of its VATable commercial activities. Importantly, a non-resident may not be registered for VAT in Ukraine other than through its representative office registered in the country. Therefore, where a non-resident directly – in its own name – acquires real estate in Ukraine, VAT charged by a resident seller would become the non-resident's cost with no possibility of recovery.

A VAT refund can be claimed provided relevant conditions are met. Currently, the VAT system operates electronically and VAT refund became significantly simpler.

### 7.3 Land tax

Legal entities and individuals pay property tax in respect of real estate assets. Property tax applicable to real estate consists of:

- immovable property tax (which applies to residential and non-residential immovable property except for land) and
- land payment (which applies to land in ownership and lease).

Land payment consists of:

- land tax (which applies to land owners); or
- land rent (which applies to lessees of land from state or municipal authorities).

The amount subject to land tax is:

- the normative valuation of the land (if a normative valuation has been carried out in the region where the plot is located. The tax in this case is determined as a percentage multiplied by the normative valuation; or
- the area of the plot (if a normative valuation has not been carried out in the region where the plot is located). The amount of tax payable is determined as the area of the plot multiplied by a fixed rate established per square meter of land for a particular region. Increasing coefficients may apply depending on the location, zoning and other characteristics of a plot of land.

The amount of land tax in the regions with an established normative valuation cannot exceed the following thresholds (irrespective of where the plot of land is located):

- 3% of the normative valuation of the plots of land (the general rule);
- 1% of the normative valuation for agricultural plots of land;
- 12% of the normative valuation of plots of land which are in so called special permanent use.

The amount of land tax on plots on land which are located outside localities and which have not undergone normative valuation cannot exceed 5% of the normative valuation relevant to croplands established for the relevant region ("oblast").

The amount of land rent is stipulated in the lease contract between the lessee and the state/municipal state authority. The land lease contract is subject to registration.

The law stipulates that land rent cannot be less than 3% or more than 12% of the normative valuation.

Land tax is assessed annually for the following year and is paid monthly by the owners or users of land. Land rent is also paid monthly.

### 7.4 Other real estate taxes

Legal entities and individuals pay property tax in respect of real estate assets. Property tax applicable to real estate consists of:

- immovable property tax (which applies to residential and non-residential immovable property except for land); and
- land payment (which applies to land in ownership and lease) (as described above).

The rates of immovable property tax are established by municipalities and may not exceed (per sq. m of the area of the property) 1.5% of the minimum salary, effective on 1 January of the tax year.

Municipalities are free to decide whether to establish the immovable property tax for a particular vicinity and which rate to apply within the maximum allowed cap (i.e. 1.5%).

The amount subject to immovable property tax is the total area of residential/non-residential property.

Immovable property on individuals is assessed by the tax authorities. Legal entities self-assess the tax and file the relevant tax return annually.

## 7.5 Taxation of rental income from real estate

Typically, the income from ownership of real estate consists of rental income.

Income from real estate is included in taxable income and taxed at the standard corporate profit tax (CPT) rate which is currently 18%.

The taxable profit of the company is equal to accounting profits calculated on the basis of either local or IFRS standards being subject to several adjustments established by the Tax Code.

Income may be reduced by deducting allowable expenses (costs) including depreciation charges.

The rate of depreciation applicable to real estate depends on the depreciation method chosen by the taxpayer as well as on the period of useful life of the real estate defined in accordance with the applicable legislation, except in the case of plots of land which cannot be depreciated.

The rental income of a non-resident derived from Ukrainian real estate is subject to withholding tax at the rate of 15% and, in most cases, may not be avoided under double tax treaties.

## 7.6 Taxation of dividends from a company owning real estate

To receive a share of a company's profits (dividends), including those from leasing or selling real estate, profits are distributed by way of a dividend repayment.

Income generated can be distributed to shareholders/participants in the company. A Ukrainian company paying dividends is generally required to pay advance CPT at the applicable rate (except in specific cases where advance tax should not be paid). Such advance tax can further be credited against CPT due in future periods.

The CPT rate is 18%.

A distribution of dividends from a Ukrainian company to a non-resident shareholder is subject to 15% withholding tax, unless a relevant double tax treaty provides for a lower rate or an exemption.

## 7.7 Taxation of capital gains on real estate

Income from the disposal of real estate exceeding its book value (i.e. capital gain) is treated as taxable income and is subject to CPT at the applicable rate (18%). Such taxable income may be offset against any allowable deductible expenses of the seller. Therefore, no specific opportunities are available to offset or reduce the tax on a disposal of real estate.

## 7.8 Taxation of dividends from a company owning real estate

Income from the disposal of shares in companies (whether or not that company owns any real estate) exceeding their book value (i.e. capital gain) according to accounting profits is treated as taxable income and is subject to CPT at the applicable rate (18%). Such taxable income may be offset against any allowable deductible expenses of the seller. Therefore, no specific opportunities are available to offset or reduce the tax on a disposal of real estate.

## 7.9 Taxation of gain on disposal of partnership interest in a partnership owning real estate

The disposal of a partnership interest is treated in the same manner as the disposal of shares in a company owning real estate.

## 8. Real Estate Finance

### 8.1 Assets held as security

Ukrainian law provides for the following security instruments: mortgage, pledge, guarantee, surety and security deposit. In practice, the security instruments that are the most common in the financing of real estate are mortgages and pledges of shares in a corporate entity.

According to Ukrainian law, plots of land, buildings/structures inseparably connected to land, unfinished construction (subject to appropriate registration) as well as rights to use buildings/structures or land may be used as collateral under mortgage agreements. Ukrainian law contains restrictions with regard to the owning of land by foreigners and individuals.

In particular, agricultural land can only be mortgaged to Ukrainian banks. Ukrainian law stipulates that real estate and land (except for agricultural land) can be mortgaged to foreign lenders and the relevant mortgages can be enforced. Mortgages are subject to notarization and state registration in the State Register of Proprietary Rights to Real Estate. The mortgage arises at the moment when it is entered on the State Register.

According to Ukrainian law and market practice, the following may be used as collateral under pledge agreements: a pledge of movable property, a pledge of property rights, a pledge of funds on bank accounts, a pledge of a right to claim, a pledge of shares in a corporate entity. The right against collateral arises when an agreement is concluded or when notarized if an agreement is subject to notary certification. Unlike a mortgage, for which state registration is mandatory, a pledge may be registered in the State Register of Encumbrances of Movable Property. State registration of a pledge does not affect the time when it becomes effective.

### 8.2 Further collateral agreements

Ukrainian law stipulates that collateral may be transferred under further agreements.

The collateral under a mortgage agreement may be further mortgaged subject to the consent of previous mortgagees unless otherwise stipulated by a previous mortgage agreement. An earlier mortgage has priority against any further mortgage.

Ukrainian law also establishes that a mortgage bond may be issued on the basis of a mortgage agreement. The mortgage bond is a mortgage security transferring to its owner the absolute rights under principal and mortgage agreements. Owners of a mortgage bond may alienate it to any third party. The transfer of the mortgage bond should be effected by way of endorsement and state registration is required.

The collateral under pledge agreements may be further pledged as well, unless otherwise stipulated by previous agreement.

When a further pledge is created the previous pledge remains effective. The further pledgee can enforce its rights against the collateral after full enforcement of the rights of the previous pledgee. The registered pledge has priority against non-registered pledges and any further registered pledges.

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## About DLA Piper

With more than 600 lawyers globally, DLA Piper boasts the world's largest real estate practice and is consistently top-ranked around the world. As real estate develops into a truly global industry, the ability to provide legal services quickly and efficiently in structuring crossborder investments and transactions is paramount. DLA Piper clients value the team's global resources, regional strength and local delivery,

and include private and public companies, institutional investors and government entities.

In Ukraine DLA Piper has a large team of lawyers in its Kyiv office with years of experience in the local real estate industry. They advise on issues affecting all stages of the real estate investment and development cycle and work with a large number of Ukrainian and international clients.

Our lawyers are also active members of and contributors to the business communities and industry associations that have a key role in shaping the future of the Ukrainian real estate industry.

In short, we are one team with no borders, providing a real advantage to clients in Ukraine and beyond.

This guide was written predominantly by Oleg Milchenko of our Real Estate practice group.

This guide was prepared in July 2018. Subsequent changes in law are therefore not taken into account. This guide cannot be considered as a substitute for obtaining specific legal advice in individual cases. DLA Piper does not assume any liability in connection with this guide.

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