

## **Establishing production in Ukraine: toll processing**

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### **1. What is tolling raw materials and processing regime**

Ukraine is located on the border with the European Union and has good logistical connections with Western countries. That is why Ukraine is an ideal location for foreign companies that produce goods on a tolling basis and supply them to their Western customers. For many years, the customs regime for toll processing has been used mainly by suppliers of automotive parts, textile companies, and furniture manufacturers, which mainly produce products by hand.

According to Ukrainian law, tolling raw materials are raw materials (materials, semi-finished products, components, energy) owned by one entity (a customer) and transferred to another entity (a manufacturer) for the production of finished goods, with the subsequent transfer or return of such goods.

In this case, tolling transactions include transactions in which the customer's raw materials at a particular stage of processing account for at least 20% of the total value of the finished product.

Ukrainian legislation allows for the temporary importation of foreign goods into the customs territory of Ukraine under the customs regime of processing for a period of up to one year. The period is set individually depending on the processing required. In each case, the period starts from the date of importation of the goods to be processed into the customs territory of Ukraine. The goods are placed under the customs regime of processing with full exemption from customs duties, provided that the processed products are to be subsequently re-exported. Such goods are not subject to certification.

### **2. Restrictions on raw materials tolling**

Some raw materials, in particular, meat and edible offal cannot be imported as part of tolling projects. Such restrictions also apply to second-hand clothing and other goods. In addition, goods processing of which results in the production of

ferrous or non-ferrous scrap, as well as semi-finished products, cannot be imported under this customs regime.

Furthermore, it is not permitted to use Ukrainian goods (except for fuel and energy), which are subject to export duties, in the processing of foreign goods.

The Government of Ukraine may impose additional restrictions, conditions, or exemptions for certain goods. At the same time, processing of goods (raw materials) already placed in the processing regime at the time of the introduction of the new rules is completed under the conditions that were in force at the time of placing such goods in the processing regime.

The Association Agreement between Ukraine and the European Union, which entered into force in 2016, also facilitates foreign investment in the processing industry.

### **3. Conditions for applying processing regime**

An application for a permit to process goods on a tolling basis is submitted by the owner of the goods to the customs authorities of Ukraine; the permit is issued free of charge within 5 working days. However, before the permit is issued, i.e., usually in the application itself, the processing company must prove that it has sufficient infrastructure, as well as technological equipment, production and storage facilities. The applicant also has the opportunity to determine whether it meets the requirements of the special customs regime for processing in Ukraine; for this purpose, a preliminary decision of the customs authorities can be obtained.

Note: the timeframe for issuing permits is currently subject to change depending on the operation of the energy infrastructure and the current situation at the location of the customs office, which affects its work.

When applying for a permit for toll processing, it is necessary to submit, among other things, a foreign economic contract containing technological plans for processing, a specific scope and timeframe for the performance of work, as well as a processing schedule (this does not apply to repair of goods) with information on all processing stages.

There is no limit to the number of processing operations. Processing operations may include the actual processing of goods (in particular, their mechanical processing), assembly or disassembly operations, the use of certain goods that support or facilitate the production of compensatory goods, as well as repair of goods (including modernisation, calibration, restoration, and adjustment).

Goods imported into the customs territory of Ukraine and products manufactured in the processing mode are subject to customs control. In particular, the volume of processed products output is checked to ensure that it complies with the quantity specified in the foreign economic contract. In case of complex processing operations, experts may also be involved.

### **4. Liability for violating the processing regime**

A Ukrainian company that has been granted a permit for tolling manufacturing is liable for violations of the processing procedure. In case of violation of the relevant

Ukrainian legislation, fines may be imposed on such a company.

If a company holding such a permit fails to comply with the customs legislation of Ukraine, the permit may be revoked. In this case, the commenced processing operations must be completed within 20 days from the date of cancellation of the permit, and the goods imported into Ukraine under the customs regime of processing must be exported from the customs territory or transferred to another customs regime within 30 days from the date of the permit cancellation.

If the initiated processing operations cannot be completed within 20 days without irreparable damage to the goods or technological equipment, they must be completed in accordance with the processing schedule, and the processed products must be exported or placed under another customs regime within the following 10 days.

## **5. Conditions for re-export of finished products**

Ukrainian goods or components used in the processing process are subject to customs clearance when exporting finished goods. Export of finished goods may be carried out through another customs office, not necessarily the one through which the raw materials were imported into Ukraine.

It is also possible to process goods for free circulation in Ukraine. To do so, the processed product must be placed in the import regime. However, such an operation is only possible if the customs authority can verify that the processed products were obtained from the goods in question and that the processed products cannot be restored to their original condition in an economically viable manner.

## **6. Equivalent goods**

Sometimes processing of goods is delayed due to delays in the delivery of certain components for processing. However, this can be solved by using equivalent goods, i.e., Ukrainian and foreign goods that are identical in descriptive, quantitative and technical characteristics to the foreign goods they replace.

At the same time, the products obtained as a result of processing of equivalent goods are considered to be the products of processing of foreign goods. It is also allowed to re-export processed products obtained using equivalent goods before the goods are imported for processing in the customs territory of Ukraine or before the completion of processing operations.

## **7. Waste and residues**

During the processing, wastes and/or residues may be generated. They can be divided into two categories:

- with economic value (can be used to generate profit);
- with no practical value.

Residues or wastes that have economic value and/or can be recycled are subject to placement in this state under the appropriate customs regime until the expiry of the processing time of the goods. At the declarant's request, such residues or

wastes may be declared under one classification code, provided that this code corresponds to the highest rate of duty. If non-tariff regulation measures are applied to certain goods included in the specified batch of residues, such a method of declaration does not exempt from compliance with such measures.

If the waste has no economic value, it shall be disposed of with the permission of the customs authority in accordance with the legislation of Ukraine before the expiry of the processing period.

## **8. Recommendations on the terms of recycling agreements**

Pursuant to Ukrainian law, the ownership of recycled goods (unless otherwise stipulated by specific provisions of law or contract) belongs to the owner of the raw materials. However, if the cost of processing and the newly created item significantly exceeds the cost of the material, the ownership of the new item is acquired at the request of the person who performed such processing (in the absence of appropriate regulation established by the contract). Therefore, it is recommended that the processing agreement specify the rights of each party at each stage of processing.

Under Ukrainian law, the customer's ownership rights arise from the moment of transfer of the finished product, unless otherwise provided by the contract. The goods shall be deemed transferred after their delivery to the customer or to a designated carrier, transport company, etc. for shipment (depending on the delivery terms agreed by the parties in the contract).

Accordingly, when drafting processing agreements, it is necessary to provide for the terms of delivery, the moment of ownership transfer, as well as the legal regime of raw materials and finished products at every stage.

In addition, it is necessary to provide for backup mechanisms for the transfer of ownership of the processing result (finished products, raw materials, waste) in case the Ukrainian contractor is unable or refuses to sign the necessary documentation. It is also useful to specify the procedure to be followed in case of discrepancies in quality/quantity.

In addition, ownership and responsibility for the appropriate processing and/or disposal of processing waste (residues) should be determined.

It should also be borne in mind that due to the martial law in Ukraine, certain cross-border settlements may be complicated, which may result in payment delays. This is especially true for foreign currency payments from Ukraine. Therefore, it is recommended to take this temporary circumstance into account when making calculations, establishing deadlines and drafting contracts.

However, the law stipulates that the customer may pay for processing services with part of the raw materials, residues, and other goods of economic value. This may help to resolve currency regulation issues. However, it is important to note that the transfer of ownership of a part of the raw materials results in an obligation to change the customs status of such raw materials and pay the relevant customs duties and taxes in Ukraine.