

## Service contracts with Ukrainian contractors: 5 legal and tax risks for foreign companies

### Introduction

1. Risk of requalification as employment
2. Risk of creating a permanent establishment in Ukraine
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B A foreign company may engage Ukrainian contractors without establishing a subsidiary or branch in Ukraine, but this model requires proper contractual and tax structuring. The main risks are requalification of the relationship as employment, the emergence of a non-resident's permanent establishment, currency restrictions, additional tax assessments and difficulties in protecting rights in a cross-border dispute.

Engaging local contractors under service contracts or contracts for work remains one of the most flexible ways for foreign companies to operate in Ukraine. This model may be effective for IT, consulting, commercial representation, engineering, marketing, technical support and other service areas.

At the same time, Ukrainian law and tax practice assess not only the name of the contract, but also the actual conduct of the parties. If a contractor works like an employee, represents the non-resident before clients or effectively shapes the commercial terms of contracts, the foreign company may face a significantly higher risk than it expected when entering into the contract.

This article examines five key risks: requalification of a contractor relationship as employment; the emergence of a non-resident's permanent establishment in Ukraine; currency and cross-border restrictions; tax consequences; governing law, jurisdiction and dispute resolution.

**Summary table of risks**

Risk	When it arises	How to reduce the risk
Employment requalification	The contractor works like an employee	Describe the result, not the work process
Permanent establishment	The contractor in fact represents the non-resident	Limit authority in the contract
Currency restrictions	The bank reviews a payment or return of funds	Prepare bank documents in advance
Additional tax assessments	The actual model does not correspond to the contract	Align the contract, payments and actual conduct of the parties
Disputes	There is no governing law, court or arbitration clause, or evidence mechanism	Include a full dispute resolution section

**1. Risk of requalification as employment**

Ukrainian tax authorities increasingly analyse not only the formal title of a contract, but also the actual organisation of cooperation between the parties. Foreign companies should therefore carefully assess whether Ukrainian contractors operate independently or effectively function as employees.

In Ukrainian practice, the decisive factor is not the title of the contract, but the actual nature of the interaction between the parties. Employment relationships are usually associated with the performance of work within an employment function, remuneration for work, organisational subordination and the provision of working conditions by the employer. Therefore, the tax authorities and courts may assess whether a civil law contract conceals the actual use of hired labour.

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In practice, the risk arises when the contractor is integrated into the company's internal structure and works under conditions similar to those of an employee. For example, if the contract requires the contractor to comply with internal labour rules, work during fixed hours, report to a specific manager as a subordinate or perform functions corresponding to a particular position, this may be used as evidence of hidden employment relations.

Particular attention should be paid to the payment model. If remuneration is regular and fixed and is not linked to a specific result, stage of work or acceptance certificate, it may look like salary. For example, a monthly fixed payment to a Ukrainian developer under a service contract may create a risk if the contract and the actual cooperation do not show an independent result of works or services.

Requalification may result in additional assessments of personal income tax, military levy and unified social contribution, penalties, as well as claims relating to employment guarantees. For a foreign company, an additional risk is that the actual cooperation model may also affect the tax assessment of the non-resident's presence in Ukraine.

To reduce the risk, the contract should focus on the result, scope of works, deadlines, acceptance criteria, liability for defects and acceptance certificates. The contractor should not be described as part of the team, nor should the contract establish a work schedule, corporate position or an obligation to carry out ongoing instructions from a manager as an employee.

Practical conclusion: a safer service contract describes not "who is being hired", but "what result must be delivered to the customer".

## **2. Risk of creating a permanent establishment in Ukraine**

International businesses should carefully assess whether Ukrainian contractors effectively perform representative, negotiation or operational functions that may create a taxable presence of the foreign company in Ukraine.

A separate material risk for foreign companies is the inadvertent creation of a permanent establishment in Ukraine through the activities of local contractors or consultants. From a tax perspective, this means that a non-resident may acquire a taxable presence in Ukraine even without a representative office or subsidiary.

The risk increases when the contractor goes beyond technical or auxiliary performance of work and in fact acts as a representative of the foreign company in Ukraine. Negotiations with clients, agreement on prices, delivery volumes, payment terms, discounts, warranties or other material commercial parameters are particularly sensitive.

For example, a foreign trading company engages a commercial consultant in Ukraine to develop its client base. If the consultant in fact

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negotiates material terms of future contracts, agrees prices, delivery volumes and payment deadlines, and the foreign company then signs such arrangements almost without changes, the tax authorities may regard the consultant not as an independent contractor, but as a dependent agent of the non-resident.

The key issue is not the contractor's formal status, but their actual role in creating the non-resident's business in Ukraine. If the activity is regular and effectively replaces the function of a local representative office, there is a risk that a dependent agent permanent establishment may be recognised.

To reduce this risk, the contract should expressly provide that the contractor has no right to enter into contracts on behalf of the non-resident, agree material terms, make binding commercial offers or create the impression for third parties that the contractor acts as a representative of the foreign company. In practice, this provision must be complied with not only in the contract text, but also in correspondence, commercial presentations, email signatures and negotiations.

### 3. Currency and cross-border risks

Cross-border payments involving Ukrainian contractors may be subject to enhanced bank review, financial monitoring and currency regulation, particularly under martial law conditions in Ukraine.

When working with Ukrainian contractors, foreign companies face currency, banking and cross-border restrictions. These may affect not only the timeliness of payment, but also the possibility of returning an advance payment, recovering a penalty or transferring compensation abroad.

Cross-border payments may be subject to bank control and financial monitoring. In practice, a contract and an invoice alone may be insufficient: the bank may request technical specifications, acceptance certificates, detailed reports, confirmation of the actual performance of works or additional documents concerning the parties to the payment. This creates operational costs and may delay payments.

Banks may also carry out enhanced checks of the foreign customer, its group of companies, ultimate beneficial owners, sources of funds and the economic substance of the transaction. If the non-resident's corporate structure is complex or insufficiently transparent, the first payment may be delayed until an additional package of documents is provided.

Under martial law, currency restrictions remain an important factor. Even if the contract provides for the return of an advance payment, payment of a penalty or compensation to the foreign customer, the actual transfer of funds abroad may require a separate bank review and depend on the currency rules in force on the payment date.

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For example, if a foreign company has paid an advance to a Ukrainian contractor and later needs to recover it due to termination of the contract or non-performance of obligations, the contractual basis alone may be insufficient for a quick actual return of funds. The currency scenario, banking documents and alternative mechanisms for protecting the foreign customer should be assessed in advance.

In practical terms, it is advisable to use staged payments, link payments to acceptance certificates, retain part of the remuneration until completion of the works, prepare a clear list of documents for the bank and include separate provisions on the consequences of the impossibility or delay of a currency transfer.

#### **4. Tax risks in service contract structures**

Ukrainian tax authorities increasingly assess the economic substance of service contract structures and analyse whether contractors effectively generate the non-resident's business in Ukraine.

The key tax risk for foreign companies is that cooperation with a Ukrainian contractor may be viewed not as independent performance of works, but as a hidden commercial presence of the non-resident in Ukraine or the actual use of hired labour.

The tax authorities assess the economic substance of the transaction, the contractor's actual powers, the payment model, documents evidencing performance of works and the genuine business purpose of the structure. The most typical risk situations are regular fixed payments not linked to a result, management or representative functions of the contractor, and situations where the contractor in fact generates the non-resident's income on the Ukrainian market.

In addition, the subject matter of the contract should be assessed against the business purpose principle. If the contract describes "operational administration", "coordination of local partners", "sales development" or "representation of interests", but does not set clear limits on the contractor's authority, this may increase the tax risk.

For example, a foreign company enters into a contract with a Ukrainian contractor for "operational administration services and coordination of interaction with local partners". If the contractor in fact independently agrees commercial terms, conducts negotiations, manages the non-resident's local processes and regularly influences the conclusion of contracts, such a model may be risky.

This may create a risk that the Ukrainian contractor will be classified as a dependent agent permanent establishment of the foreign company. In the event of such requalification, the non-resident may be required to register as a taxpayer in Ukraine, additional corporate income tax may be assessed, and penalties and late-payment interest may be applied.

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Practical conclusion: a more tax-secure contract must correspond to the actual conduct of the parties. If the contract text limits the contractor's powers, but emails, presentations or negotiations show otherwise, the actual actions may become the key evidence for the tax assessment.

## 5. Jurisdiction and dispute resolution

Cross-border contracts with Ukrainian contractors should clearly regulate governing law, jurisdiction, arbitration, electronic evidence and legally valid communication mechanisms.

If there is no clear choice of law, the applicable law will be determined under the conflict-of-law rules of the court or arbitral tribunal hearing the dispute. In many cases this may lead to the application of Ukrainian law, or at least to the need to analyse mandatory Ukrainian rules if the contractor, place of performance or material elements of the cooperation are connected with Ukraine.

For cross-border contracts with Ukrainian contractors, it is advisable to separately determine whether disputes will be heard by state courts or by international commercial arbitration, and to provide for the language of the proceedings, the seat of arbitration or court, the procedure for service of notices and the availability of interim measures.

For example, if a contractor breaches confidentiality obligations, uses the customer's materials or transfers commercial information to third parties, an unclear jurisdiction or arbitration clause may complicate a quick response. Therefore, the contract should provide not only for a court or arbitration, but also for interim protective measures, the procedure for recording a breach, electronic evidence, the language of correspondence and permitted methods of sending notices.

Template contracts that do not take into account the cross-border nature of the relationship are a separate risk. The contract should determine whether email is permitted as legally significant notice, which addresses are official, when a notice is deemed received, the language of correspondence and which electronic documents may confirm performance or breach of obligations.

Clear contractual regulation of governing law, jurisdiction, notices, evidence, confidentiality, intellectual property and liability determines how effectively a foreign company will be able to protect its rights in the event of a conflict with a Ukrainian contractor.

## 6. Practical recommendations for foreign companies

Particular attention should be paid to situations where Ukrainian contractors regularly communicate with the foreign company's customers, negotiate commercial terms or coordinate operational processes in Ukraine. Such functions may be regarded by the Ukrainian tax authorities

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as an indication of the non-resident's actual business presence in Ukraine and may increase the risk of creating a permanent establishment.

Additional legal and tax risks frequently arise in long-term IT, engineering, marketing, technical support or distribution projects, especially where Ukrainian contractors are permanently integrated into the foreign company's business processes. In such cases, international businesses are advised to conduct regular legal and tax reviews of both the actual cooperation model and the contractual documentation.

Furthermore, foreign companies should assess in advance which documents banks or regulatory authorities may require in connection with cross-border payments, advance payments or refunds involving Ukrainian contractors. Insufficient documentation or a non-transparent contractual structure may lead to payment delays, additional compliance checks or operational restrictions.

#### **DLF attorneys-at-law**

DLF attorneys-at-law advises foreign companies on structuring service contracts with Ukrainian contractors, assessing permanent establishment risks, tax consequences, currency regulation and cross-border disputes. Our legal services include contract structuring, tax risk assessment, compliance advice and legal support for international business operations involving Ukrainian contractors.