

# IV Investors' Voice

The American Chamber of Commerce in Kazakhstan

Kazakhstan's Leading International Business Association



February 2020  
WINTER ISSUE

## FINANCE, TAX, LAW UNDERPINNING THE INVESTMENT CLIMATE



- ▶ Green Finance: The Kazakhstan Approach
- ▶ Double Taxation and Tax Treaties
- ▶ Kazakhstan's Tightening Immigration Laws
- ▶ Insolvency Proceedings Simplified
- ▶ Transfer Pricing: Trends/ Reporting Rules
- ▶ The Leasing Option
- ▶ Directors' and Officers' Liability
- ▶ Recent Trends in Tax Administration
- ▶ Difficult Digits: Tax Challenges in the Digital Economy

# APPLICATION OF THE MULTILATERAL INSTRUMENT IN KAZAKHSTAN

by Kaisar Yegizbayev  
Senior Lawyer, Tax and Customs, GRATA International

On February 6, 2020, the Parliament of Kazakhstan ratified the *Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (MLI)*. Assuming the President of Kazakhstan signs the law on ratification in 2020, it is expected the MLI's provisions on withholding tax will become effective from January 1, 2021. MLI was developed by the OECD Tax Committee and is intended to modify existing International Double Tax Treaties in order to tackle international businesses' aggressive tax avoidance strategies.

The extreme globalization of the economy and the global financial crisis has placed aggressive tax avoidance on the main agenda of the business community. Loopholes in international tax rules resulted in a shift of nearly 660 billion USD in 2012, which is equivalent 0,9 of world GDP. Abuse of inconsistencies in international tax legislation led to final recommendations on fifteen *Base Erosion and Profit Shifting (BEPS)* released by OECD in October 2015. Even though Kazakhstan is not an OECD member, Kazakhstan aims to reach OECD taxation standards in order to be recognized as a country with a favorable investment climate.



Kazakhstan has already adopted OECD recommendations on BEPS Action 3 by including a new provision to the country's Tax Code on *Controlled Foreign Company Rules*. Recommendations on Action 13 about transfer pricing documentation and country-by-country reporting were also incorporated into Kazakhstan's law on transfer pricing.

By ratifying *MLI*, Kazakhstan is also going to adopt another two *BEPS* actions: Action 6: *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* and Action 7: *Preventing the Artificial Avoidance of Permanent Establishment Status*.

The above BEPS actions are reflected in the following MLI articles:

- I. *Article 7 – Prevention of Treaty Abuse*, which includes:
  - *Limitation of Benefits (LOB)*;
  - *Principle Purpose Test (PPT)*.
- II. *Article 8 – Dividend Transfer Transactions*
- III. *Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies*.

Meanwhile, according to *MLI*, the given amendments to the Double Tax Treaty must be applied only if both jurisdictions are agreed to implement these amendments to the existing Double Tax Treaties and only after notifying OECD as a depositary of such amendments.



Therefore, under each article of the law on ratification, Kazakhstan directly indicates the list of Double Tax Treaties and the *MLI* provisions that must be applied to these treaties.

The following is a brief review of the most essential *MLI* provisions that will be adopted by Kazakhstan with a possible impact on the country's taxation of international business.

## I. Prevention of Treaty Abuse

According to *MLI*, application of benefits under the Double Tax Treaty must be determined by analysis under either LOB or PPT, or by their combination. In order to apply LOB and PPT to the existing Double Tax Treaties, both jurisdictions must have an agreement to apply them.

### • *Simple Limitation of Benefits*

According to the current law on ratification, all the existing Double Tax Treaties must be applied considering the provisions of *Simple Limitation of Benefits (SLOB)*. However, application of *SLOB* by Kazakhstan does not mean that *SLOB* will automatically be applied to all the Double Tax Treaties concluded by Kazakhstan. This is determined by each jurisdiction that has agreed to apply *SLOB* to the Double Tax Treaty with Kazakhstan.

If both Kazakhstan and other corresponding jurisdictions agree to apply *SLOB* and have notified the OECD, taxation of the residents of these states will be governed by the *MLI* provisions on *SLOB*.

Under *SLOB*, Double Tax Treaty benefits are provided only for "qualified persons", who are defined as:

- *Individuals;*
- *State authorities;*
- *Companies whose shares are traded on a recognized stock exchange;*
- *Non-commercial organizations with status regulated on the international level;*
- *Pension funds.*

Meanwhile, even if the taxpayer is not a qualified person, it is still possible to apply Double Tax Treaty benefits if the taxpayer can prove a main involvement in “*active business activity*”. Active business activity is defined as activity not including activities of holding companies, administration of group of companies, group financing, or making and managing investments.

For instance, an LLP registered in Russia (**RuCo**) performs engineering services for a Kazakh LLP (**KzCo**). KzCo pays RuCo fees for services. RuCo does not have a permanent establishment in Kazakhstan. The services are performed in Russia.

According to Kazakhstan’s Tax Code, the income from the engineering services is recognized as income derived from Kazakh sources even if performed outside of Kazakhstan. However, under Article 7 of the Double Tax Treaty between Kazakhstan and Russia, RuCo’s income must be exempted from taxation in Kazakhstan. After enforcement of *MLI*, it will be necessary to analyze international taxation taking into account *MLI*, aside from the Double Tax Treaty and the Tax Code.

Both Russia and Kazakhstan have notified OECD that the Double Tax Treaty between Russia and Kazakhstan must be applied, taking into account the *SLOB* provisions of *MLI*. Taxation of RuCo’s income must therefore be determined on the basis of *SLOB*.

Under *SLOB*, however, RuCo is obviously not a qualified person since it is not an individual, state authority or non-commercial organization. But *SLOB* still allows RuCo to apply the Double Tax Treaty exemption, provided that RuCo can prove its main activity involves “active business activity”. This means RuCo must prove it is not involved in a holding company, managing a group of companies, group financing or investment activity.

It is not clear how the Kazakh tax authorities will determine foreign companies’ main activity. Therefore, the country’s tax authorities should improve their cooperation with foreign tax authorities to avoid incorrectly implementing *MLI*. The tax authorities should also study the *BEPS Final Report* on Action 6 to understand the purpose of adopting *SLOB* and to formulate a clear approach on applying *MLI* in Kazakhstan.

#### • **Principle Purpose Test (PPT)**

Under *PPT*, the Double Tax Treaty exemptions cannot be applied if it is reasonable to conclude that one of the principal purposes of the transaction is to obtain Double Tax Treaty benefits. In other words, if the parties entered into a transaction with the main intention being to exempt the income from taxation or to apply a reduced tax rate under the Treaty, the exemption will be disallowed.

The *Final BEPS Report* on Action 6 envisages that *PPT* is a subjective test that must be applied on a case-by-case basis by analyzing each transaction. Therefore, in deciding the tax treatment of a given transaction, the tax authorities must pay close attention to the substance of the transaction and its economic purpose. If the transaction’s purpose is not a bonafide exchange of goods and services, but to obtain Double Tax Treaty benefits, the benefits can be denied.

In the *Final BEPS Report* on Action 6, OECD provides 10 examples of applying *PPT*. However, the examples describe straightforward and simple transactions, in which it is easy to spot the *PPT* violations. Moreover, some of these examples are already governed by the Kazakh tax legislation.

One of the examples describes a case in which RCo, a tax resident of state R, wins a tender for construction of a powerplant in state S. Construction work is intended to take about 22 months, so RCo splits the project into two contracts for 11 months each. One contract is for RCo itself, and the other is for SUBCo, a new RCo subsidiary.

The OECD holds that the second contract is solely for the purpose of obtaining exemptions under Article 5 of the Double Tax Treaty, which envisages a term of 12 months for creation of a permanent establishment. The transaction does not pass the *PPT* test and the Double Tax Treaty benefit for a 12-month period required to create a permanent establishment cannot apply to RCo.

It is worth noting that Kazakhstan’s Tax Code already prevents splitting contracts between related parties to avoid permanent establishment. The tax authorities are therefore generally able to tackle permanent establishment strategies without *MLI* involvement.

## II. Dividend Transfer Transactions

Kazakhstan’s Double Tax Treaties allow foreign companies to reduce tax on dividends distributed by Kazakh companies from 15%, as provided by the Kazakh Tax Code, to 10% or 5%. Under *MLI*, dividend benefits apply only if the foreign company holds the Kazakh company shares for at least 365 days. Otherwise, the foreign company cannot benefit from the reduced tax rate on dividends and the Kazakh company will be obliged to withhold 15% income tax, as a tax agent.



As an example, a Company from the Netherlands (**DutchCo**) purchases shares of a Kazakh company (**KzCo**) on 31 December 2021. As the sole shareholder, *DutchCo* decides to distribute dividends from *KzCo*. The dividends are paid on 30 December 2022. As a result, only 365 days pass since the share purchase. Under Kazakhstan's Tax Code, the dividends are taxed at 15%.

However, the Double Tax Treaty between the Netherlands and Kazakhstan provides a reduced tax rate on dividends down to 5%. Considering that *DutchCo* holds the *KzCo* shares for less than 365 days, the Double Tax Treaty's reduced tax rate does not apply to the *DutchCo* dividends.

### III. Artificial Avoidance of Permanent Establishment Status Through Commissionaire Arrangements

Generally, Double Tax Treaties define the dependent agent as a person with the right to conclude a contract in the name of the foreign company. This activity by the dependent agent leads to the foreign legal entity's permanent establishment, as represented by the dependent agent.

The *BEPS Final Report* on Action 7 recommends broadening the definition of a dependent agent to include

not only concluding contracts in the company's name, but also actions in the agent's name and on behalf of the foreign company. As such, a person can be recognized as a dependent agent even without a power of attorney from the foreign company. It is therefore sufficient to establish that the person acts in his own name, but on behalf of the foreign company, to recognize permanent establishment for the foreign company.

### Conclusion

It is expected that the main *MLI* provisions will become effective from January 1, 2021. During 2020, companies with businesses involving international transactions in Kazakhstan should carefully consider taxation of their income derived from Kazakhstan sources. Due to the complexity of *MLI* rules and lack of clear understanding of how *MLI* provisions may be implemented in Kazakhstan, it is possible that international businesses may have an additional tax burden on profits derived in Kazakhstan.

The State Revenue Committee should therefore adopt a joint approach to interpretation of *MLI* provisions and communicate this single interpretation to the local tax authorities to ensure proper observance of taxpayer rights.

Fund/Benchmark*	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE BEGINNING
Treasury» open and unit investment trust	25,8%	18,8%	37,9%	35,1%	53,5%
Deposit	10,6%	13,6%	14,3%	17,1%	24,7%
«Centras-Global Markets» open-ended mutual fund	39,3%	18,6%	40,3%	26,2%	43,5%
MSCI World Index*	25,9%	13,4%	26,5%	30,5%	38,8%
«Eurobond» open-ended mutual fund	18,2%	14,8%	37,1%	37,8%	43,7%
JP Morgan EM Bonds	15,0%	12,3%	36,1%	38,9%	44,5%



#### «Treasury» investment trust

The first open mutual fund in Kazakhstan, was registered on 5 January 2005 y. by the National Bank

#### FUND BENEFITS:

- \* **Balanced strategy** between currencies and assets, as well as among dividend shares, bonds and shares of fast growing companies;
- \* high investment performance over 10 years;
- \* Reliable credit quality of portfolio components.



#### Global Markets

«Centras-Global Markets» open-ended mutual fund was registered on 5 January 2005 y. by the National Bank

#### FUND BENEFITS:

- \* **Brave strategy**, attention on developed markets – combination of stable and fast growing stocks;
- \* high currency component >90%.
- \* risks and potential above average;
- \* opportunity to buy or sell fund's units on KASE.



#### «Eurobond» fund

«Eurobond» open-ended mutual fund was registered on 31 march 2009 y. by the National Bank

#### FUND BENEFITS:

- \* **Balanced strategy**, with the main focus on eurobonds of Republic of Kazakhstan and states with high credit rating;
- \* very high currency component > 95%;
- \* opportunity to buy or sell fund's units on KASE.