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KAZAKHSTAN'S APPROACH TO DIVIDENDS TAX EXEMPTION

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The article below covers the tax exemption of dividends distributed by a Kazakhstani company to its foreign shareholders (participants). In particular, the recent tendency of the Kazakh tax authorities in this respect is examined.

As a general rule, dividends received by a foreign shareholder (participant) from a Kazakhstani company are subject to withholding tax at rate of 15% in Kazakhstan. However, such dividends may be exempted from withholding tax upon compliance with the following conditions:

- the foreign shareholder (participant) is not registered in a tax haven;
- the foreign shareholder (participant) has owned its share (participant interest) for more than 3 years as of the date of the dividends' accrual;
- the Kazakhstani company distributing the dividends, is not a subsoil user;
- no more than half the assets of the Kazakhstani company distributing the dividends are comprised of the property of the subsoil users.

In addition to these four conditions, withholding tax exemption is not applicable to dividends distributed by Kazakhstani companies that enjoy corporate income tax exemptions (for instance, non-profit organizations, participants of special economic zones, investors implementing investment contracts, and others).

At first glance, the last limitation might seem reasonable – if the Kazakhstani company's income has already been exempted from taxation, why should it be subject to additional tax exemptions like the one in respect of the dividends? Moreover, the dividends are generally recognized as part of the net income distributed by the Kazakhstani company among its participants (shareholders).

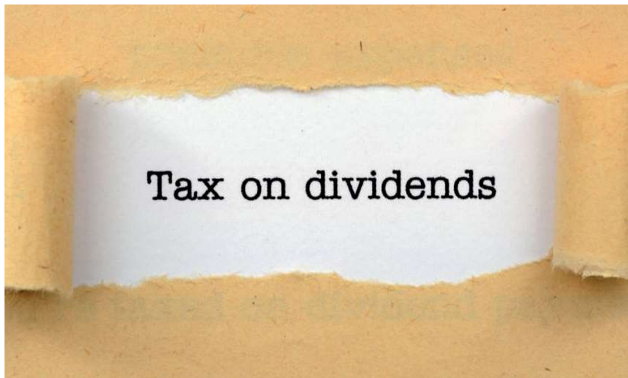
However, neither the tax legislation, nor any other legislative act provides for a clear definition of the net income. Thus it is generally implied that net income is income excluding expenses on its generation as well as taxes and other obligatory payments. Hence, disallowing dividends tax exemption by taxpayers enjoying corporate income tax exemptions appears to be justified.

But what if the Kazakhstani company applies a special accounting procedure such as the one applicable to the long-term contracts? Long-term contracts are contracts on manufacture, installation, and construction that cannot be completed within the calendar year in which they began. Kazakhstani companies implementing such contracts are allowed to determine their corporate income tax obligations on the basis of either the actual or completion method.

Under the actual method, taxable income is determined on the basis of income received in the reporting calendar year which at the same time shall not be less than the expenses incurred during that year. While under the completion method, taxable income is recognized as the total amount of income received under the contract multiplied by the percentage of the contract's completion. The percentage of the contract's completion is, in turn, determined on the basis of the expenses of the previous and current calendar years divided by the total expenses under the contract.

As can be seen from the above, the actual method does not limit the amount of income the company is allowed to recognize as the taxable one and, thus, pay to the budget, while the latter method allows the company to recognize only part of the received income as the taxable one. Respectively, if the Kazakhstani company implementing a long-term contract uses the completion method, there may be discrepancies between the amounts of actually received and declared income.

For instance, a company signed a construction contract for 3 years amounting to US$ 120,000 and intends to spend US$ 100,000 on its implementation. This year the company completed 30% of the construction work and spent US$ 30,000 on their performance. As a remuneration, it received USD $40 000 from the client. If the company used the general procedure, it would have declared taxable income in the amount of US $10 000 and paid corporate income tax in the amount of US $2000.



However, since the company uses the completion method of accounting, it declares the taxable income in the amount of USD 6 000 and pays corporate income tax in the amount of US $1,200 now, while recognizing US $800 (corporate income tax on the difference between the actually received income and the declared income) as the deferred tax payable in the following years.

In view of this, the question is – is it fair and reasonable to give such companies the same treatment as companies that do not pay corporate income tax at all, when the issue concerns dividends tax exemption?

Prior to this year one might give a negative answer to the last question as it seems that a deferred tax payment incentive cannot be equated to a full tax exemption, since in the first case the taxpayer is still obliged to pay the full tax to the budget, even if in installments, while in the latter case the taxpayer does not pay the tax at all.

But at the end of last year, Kazakhstan's Parliament adopted a package of tax legislation amendments, most of which came into effect this year. The amendment relevant to the case at hand is among these, namely, it envisages that the dividends tax exemption is applicable only in case when such dividends were distributed from the income earlier levied with the corporate income tax.

In accordance with the legislator's explanations, this amendment is purely editorial in nature and was adopted to clarify uncertainty about the definition of net income. If viewed from a different angle, however, this amendment may pose a threat to Kazakhstani companies implementing long-term contracts, in particular, the ones applying the completion method.

Thus Kazakhstani companies implementing long-term contracts under the completion method have recently already found themselves in disputes with Kazakhstan's tax authorities on the dividends tax exemption. The tax authorities have challenged the dividends tax exemption in this case on the grounds that the Kazakhstani companies distributed the dividends from income not recognized as net income. They justified their conclusion from the net income definition in the previous tax law that is now invalid.

According to the previous law, net income is defined as taxable income excluding accrued income tax. Respectively, in the opinion of Kazakhstan's tax authorities, if the dividends are distributed from income, in which respect the corporate income tax was not accrued, the dividends cannot be exempted from taxation as they were distributed from income not correspondingly to the definition of net income.

Prior to adoption of the above amendment, these claims by Kazakhstan's tax authorities were not sufficiently justified as application of an invalid legal acts is considered a violation of the general legislative rules. Hence, the taxpayers had a reliable defense in this regard. But it now seems the Kazakhstan tax authorities may have a "sturdier" argument for their claims against the dividends tax exemption, at least in this particular case.

Thus, using the above example, if the Kazakhstani company now distributes dividends from the income for which respect corporate income tax was partially paid and partially deferred, it will be difficult to prove that the full amount of these dividends is eligible for the dividends tax exemption. The Kazakhstan tax authorities may claim that this exemption can only be applied to the amount of the dividends distributed from the income levied with the corporate income tax, while the rest amount of dividends distributed from the income for which the corporate income tax was deferred, shall be taxed without a tax exemption.

Nevertheless, there is hope that the latter scenario may not happen as the Atameken National Chamber of Entrepreneurs has recently objected to this practice. The Atameken position was also supported by the Ministry of the National Economy, which is responsible for the taxation policy in Kazakhstan. Both Atameken and the Ministry are of opinion that for the purposes of the dividends tax exemption, the net income should be determined on the basis of the actually received income rather than the declared one.

Therefore, it is anticipated that the tax authorities will refuse to proceed with their unjustified claims on this matter. Nonetheless, for now Kazakhstani companies, fulfilling long-term contracts under the completion method, might want to exercise extra caution when distributing dividends among their foreign shareholders (participants).