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Kazakh Approach to the VAT/GST for Electronically Supplied Goods and Services

Kazakh Approach to the Taxation of Foreign Companies Engaged in E-Commerce and E-Services



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In January 2022, Kazakhstan introduces the obligation on the VAT payment by foreign companies that are engaged in e-commerce with goods or provide e-services to individuals. The Law [1], dated 10 December 2020, No. 382-VI supplemented the Code of the Republic of Kazakhstan 'On Taxes and Other Obligatory Payments to the Budget' (hereinafter - the 'Tax Code') with a new 'Section 25. Features of Taxation of Foreign Companies When Engaging in E-Commerce with Goods, Providing E-Services to Individuals'.

Before discussing the new Section 25 of the Tax Code, we consider the recommendations of the Organisation for Economic Cooperation and Development (OECD), which are given by it in the *Addressing The Tax Challenges of The Digital Economy, Action 1 - 2015 Final Report* [2] (hereinafter - the *Report*). In addition to the challenges related to a uniform approach and application of international tax legislation to VAT and income tax of digital companies that do business in several countries, the OECD Report highlights the following:

- 1) Digital foreign companies earn income from their activities in countries, where they do not have a physical (actual) presence. The Report notes that a non-resident "leverages digital technology to participate in the economic life of a country" and to derive income in a regular and sustained manner, whereupon the OECD introduced the concept of "significant economic presence" [3];
- 2) Many countries faced a decrease in budget revenues from income tax and VAT resulted from the transformation of the goods and services supply into a digital format;

3) There is a negative impact on the domestic economies of countries importing goods and services in digital format, in particular, there is an imbalance in sales of similar goods and services by local suppliers towards sales by foreign companies, which goods and services are cheaper due to no VAT. Such imbalance is forcing local suppliers to move their business from the local market to offshore, which also causes an increase in unemployment in the domestic market.

According to general taxation rules, VAT payment is based on a destination/consumption principle. Given that cross-border supplies become very popular among the population of countries importing goods and services, many jurisdictions, however, considered it inappropriate to introduce obligations for the individuals to pay VAT on cross-border supplies of goods and services. In addition to the fact that the costs of administering VAT collection from the citizens may be higher than budget receipts from such supplies, the question also arises on the lawfulness of access to personal data of individuals and their protection.

In 2017, the OECD issued the International VAT/GST Guidelines [4] (hereinafter - the *VAT Guidelines*), defining internationally agreed guidelines for VAT collection (or goods and services tax - GST) on cross-border transactions with services and intangibles. Certain provisions of the VAT Guidelines cover transactions between a commercial entity (enterprise) and a consumer (B2C), as well as the taxation of non-resident providers of services and intangible goods.

[1] The Law of the Republic of Kazakhstan, dated 10 December 2020, No. 382-VI On the Introduction of Amendments to the Code of the Republic of Kazakhstan 'On Taxes and Other Obligatory Payments to the Budget' (Tax Code) and the Law of the Republic of Kazakhstan 'On the Enactment of the Code of the Republic of Kazakhstan 'On Taxes and Other Obligatory Payments to the Budget' (Tax code)

[2] OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <<https://doi.org/10.1787/9789264241046-en>>. (hereinafter - the *Report*), Clauses 309-312, 317-320.

[3] *Ibid*, paragraph 276.

[4] OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, <<http://dx.doi.org/10.1787/9789264271401-en>>, hereinafter - the *VAT Guidelines*

The OECD and the G20 recommended in the VAT Guidelines for *B2C Cross-Border Transactions* that suppliers should register for taxes and pay VAT in the country of consumption (or use), and jurisdictions should establish a simplified regime for such registration and for compliance with legal requirements in order to facilitate VAT collection from non-resident suppliers. In many countries, this approach has proven to be more effective [5], and non-resident suppliers follow these recommendations, because it is primarily a matter of business reputation for them. The jurisdictions, however, shall *limit* compliance obligations to *'what is strictly necessary'* [6]. Simplified registration and minimum compliance requirements are especially important for companies that face tax liabilities in multiple jurisdictions. At the same time, the states are important to keep in mind that the simplified registration for VAT is an individual issue separate from the traditional registration regime and compliance with VAT obligations[7].

Many of these OECD recommendations are incorporated in the new Section 25 of the Tax Code. Before discussing the new Section 25 of the Tax Code, we would like to note that it provides for the following definitions of e-commerce with goods and e-services [8]:

- *e-commerce* is business activity for the sale of goods to individuals performed using an internet platform (information system placed on the Internet to provide e-commerce with goods);
- *e-services* is services provided to individuals through the telecommunications network and the Internet.

To facilitate the further perception, we will use concepts such as *e-commerce* and *e-services*.

By the way, in summer of 2019, the draft law on the introduction of amendments to the Tax Code provided for Article 426-1 *'Features of the VAT Obligation Performance by a Non-Resident Providing E-Services to Individuals'*. This article contained a list of 15 types of services subject to VAT, including:

- providing access to search engines on the Internet;
- providing services for the search and(or) presentation of information on potential buyers to the client;
- providing advertising services on the Internet, including with the use of software and databases functioning on the Internet, as well as providing advertising platforms on the Internet;
- providing services for the placement of proposals to purchase (sell) goods (works, services), property rights on the Internet.

The current version of Article 777 of the Tax Code does not detail what e-services include.

Tax Liabilities Triggers

Please note that for tax purposes, the parties to a commercial agreement are a foreign company and an individual. In this case, the concept of a *foreign company* is defined as a non-resident legal entity or another foreign *form of organisation of business activity* without setting up a legal entity (Article 777.1.3 of the Tax Code). The wording *form of organisation of business activity without setting up a legal entity* can be interpreted quite broadly. It can mean any governmental registration of an activity (for instance, corporate, individual and/or tax) as business (or commercial) activity, regardless of who is engaged in this activity and whether a company is established in that situation. The trigger for the emergence of tax liabilities in this case is the income generation (either by corporate or individually).

For the purposes of taxation of e-commerce and e-services in Kazakhstan, the following two elements are key and basic for the term *'foreign company'*:

- 1) the existence of an economic actor in any form that require recognition as *organised* commercial activity under the legislation of a foreign state;
- 2) the purpose of the activity of such an actor is business activity, i.e. profit making.

Accordingly, one can conclude that the legislator tried to include all possible options for organising and performing business activities in foreign countries: companies in any form (limited liability, joint stock companies, cooperatives, etc.), and, *inter alia*, just individuals engaged in business activity (to generate income), who organised and perform it in the form stipulated by the legislation of their country.

Further, we draw attention to the *causal factor* of VAT obligations for a foreign company associated with e-commerce and the provision of e-services. Pursuant to Articles 779.1 and 779.2 of the Tax Code, e-commerce and the provision of e-services by a foreign company cause VAT obligations *if*:

- 1) e-commerce and e-services are provided through the Internet platform of this foreign company, and
- 2) a user of e-services and(or) buyer of e-goods is an individual.

[5] VAT Guidelines, paragraph 3.1.131

[6] *Ibid*, paragraph 3.1.132

[7] *Ibid*, paragraph 3.1.133

[8] Article 777 of Tax Code

These two main features further raise questions.

First, the Tax Code specifies that a foreign company may own an Internet platform used for e-commerce with goods (under the right of ownership, lease or other). If a person has created and owns an Internet platform where both individuals and companies can register and sell their goods or e-services to individuals, who bear VAT obligation? Whether the account of such a seller and his/her sale of goods or e-services to individuals on the Internet platform of another company creates VAT obligations for this seller in Kazakhstan? It appears that regardless of the accounts on the Internet platform, the fact that someone implements e-commerce and provides e-services through such a platform to individuals is an emergence trigger for tax liabilities for a foreign company that owns the Internet platform.

Second, under the Tax Code a buyer is an individual, who can be a foreign citizen, a tourist and any person, who is in some way related to Kazakhstan. At the same time, such a relation to Kazakhstan is confirmed by the presence of *any* of the following conditions:

- his/her place of residence is Kazakhstan;
- his/her network address used when purchasing e-services is registered in Kazakhstan;
- he/she pays for an e-purchase or e-service from his/her account with a Kazakhstan bank or through an e-money operator located in Kazakhstan;
- an international country phone (including mobile one) code used to purchase or pay for the services is assigned to Kazakhstan.

There are a lot of situations when the presence of any of the above features can make a foreign company in the area of e-commerce and e-services liable for taxes. Even a Kazakh citizen, who is on a long trip abroad (work or study) can use a Kazakh bank card or his/her mobile phone number of a Kazakh telecom operator to buy goods through the Internet. Is there a risk of extraterritorial application of the Tax Code of Kazakhstan in this case? Therefore, in other words, is there a risk for a foreign company of tax liabilities under Kazakh tax legislation? Thereat, it is unclear whether the risk of double taxation of a foreign company, in particular, VAT collection from the purchase of goods or e-services via the Internet in Kazakhstan and in the country of the actual place of residence of an individual related to Kazakhstan, is possible to eliminate.

Conventional Registration of a Foreign Company

Article 778 of the Tax Code generally incorporate a part of the OECD recommendations for simplified registration. The above Article in 5 subparagraphs lists the information that a foreign company should indicate in a paper confirmation letter for conventional registration with the tax authorities of Kazakhstan. The OECD recommendation to indicate information about a contact person and his/her details is not, however, included in the list of information that a non-resident should provide when registering in Kazakhstan. Besides, the tax authorities do not require specifying the URL of the company used to do business in Kazakhstan [9]. In addition, the OECD highlights that jurisdiction shall provide the e-option for registration, which is also not provided for by Article 778 of the Tax Code.

Although the legislator tried to reflect the OECD recommendations for simplified registration of foreign companies for VAT purposes in Kazakhstan, it is nevertheless not entirely clear how obligatory such conventional registration of a foreign taxpayer is. The wording of Article 778 of the Tax Code “the foreign company *shall send* a letter of confirmation” is more towards the existence of an obligation rather than the right to register for tax purposes. Even if a foreign company is obliged to undergo conventional registration, can it be made liable for violation of such an obligation?

The Administrative Code of the Republic of Kazakhstan provides for a fine for violating the deadlines for filing an application for registration [10]. Article 778 of the Tax Code, however, does not contain any deadlines for conventional registration, nor the requirement for a tax application (instead, a confirmation letter is indicated).



[9] VAT Guidelines, paragraph 3.1.138

[10] Article 269.3 of the Code of the Republic of Kazakhstan on Administrative Violations dated 5 July 2014, №235-V.

Given that the wording of Article 778 of the Tax Code does not contain a strict and direct indication of the obligation of conventional registration for a foreign company, as well as the absence of administrative liability, it can be concluded that Kazakhstan followed the OECD recommendations and the existing experience of other states, encouraging foreign companies to voluntary registration and fair payment of VAT.

Besides, following the OECD recommendations [11], Article 778 of the Tax Code explicitly provides that, for VAT purposes, foreign companies engaged in e-commerce and e-services are not subject to the provisions on voluntary and compulsory registration for VAT as specified in Chapter 9 of the Tax Code. In other words, the Tax Code has separated the conventional registration of foreign companies into an independent regime other than the traditional VAT registration regime.

VAT Payment and Tax Reporting

Article 780 of the Tax Code provides that a foreign company independently calculates and pays VAT at a rate of 12% to the cost of sold e-goods and(or) e-services. Kazakhstan has thus taken into account the OECD recommendations by setting the VAT rate for foreign companies being the same as for Kazakhstani e-commerce participants and e-service providers. As an exception, when VAT is not subject to calculation and payment in case of e-commerce and e-services, Article 779.4 of the Tax Code provides for two cases related to customs clearance of goods or services.

Section 25 of the Tax Code does not provide for obligations of foreign companies on tax reporting, drafting and storage of accounting documents, which excludes the administrative liability of a foreign company under Article 276 of the Code of the Republic of Kazakhstan on Administrative Violations. The absence of reporting requirements in the Kazakh Tax Code is in line with the VAT Guidelines [12]. This approach encourages foreign companies to register voluntarily and perform tax obligations in good faith.

Another issue of the practical application of Article 780 of the Tax Code is the tax payment itself. The article provides for the deadline for VAT payment, but is silent on what currency the payment shall be made. A foreign company, apparently, must pay the tax in tenge, since Article 36.8 of

the Tax Code does not classify the new Section 25 as an exception when tax can be paid in foreign currency. The OECD recommends paying taxes online and in the currency of major trading partners [13], while the Tax Code does not provide for such an option. Further, Article 780 of the Tax Code does not clearly indicate the method of paying VAT, while the OECD recommends providing the option to pay VAT electronically and in the currency of the countries of the main suppliers (USD, Euro, rouble, etc.). However, Article 779.3 of the Tax Code followed the OECD recommendation [14] and does not require non-residents to issue invoices, which provide for a separate VAT line and are required to be issued by local suppliers.

Among the OECD recommendations not reflected in the Tax Code, in addition to the above, we may highlight recommendations on the availability of information for foreign companies on VAT tax liabilities on official web resources and in the language of the countries of the major trading partners [15]. At the moment, the web resources of the State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan [16] do not allow foreign companies to receive complete, reliable and up-to-date information about their VAT obligations, legal requirements and observance thereof. Given that Section 25 of the Tax Code comes into force on 1 January 2022, until that date the state can develop and create the necessary conditions, as well as take the necessary measures. New amendment, perhaps, will be made to the tax legislation.

Generally, we may conclude that Section 25 of the Tax Code takes reflects the OECD recommendations, considering them the most necessary for Kazakhstan. Time will show what questions may arise when implementing the new provisions of the Tax Code, including in view of the application of taxation norms provided for by international treaties, which the Republic of Kazakhstan is a party to.

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[11] VAT Guidelines, paragraph 3.133
[12] Ibid, paragraph 3.141
[13] Ibid, paragraph 3.143
[14] Ibid, paragraph 3.145
[15] Ibid, paragraph 3.147
[16] <https://kgd.gov.kz/> and <https://www.gov.kz/memleket/entities/kgd>