



Tax Alert

Overview of tax law changes that have the potential to affect your business

Dear friends,

In this alert we provide an overview of recent development regarding the tax authorities' rights and authority with respect to the recognition of transactions as invalid.

According to the Tax Code, the tax authorities are entitled to file lawsuits to have transactions recognised as invalid in court.¹

In September 2019, the Chairman of the State Revenue Committee of the Ministry of Finance approved Methodological Recommendations² on certain issues to recognise transactions as invalid, referring to tax

¹ Article 19.1 (10) of Code No. 120-IV *On Taxes and Other Obligatory Payments* to the State Budget dated 25 December 2017 (the "Tax Code")

² Methodological recommendations on Certain Issues to Recognise Transactions as Invalid, approved by the Chairman of the State Revenue Committee of the Ministry of Finance on 5 September 2019 ("Methodological Recommendations")

authority rights, and the criteria used as evidence for invalidating transactions.

Legal force

According to open information sources, the Methodological Recommendations were introduced as part of the Order of the Chairman of the State Revenue Committee of the Ministry of Finance from 5 September 2019 *On Certain Tax Administration Issues*.

However, we did not find confirmation of this.

Kazakhstan tax legislation is based on the Constitution of the Republic of Kazakhstan, and consists of the Tax Code and regulatory acts whose adoption is provided for by the Tax Code. Regulatory acts are official documents adopted by the authorised body, types of which are directly prescribed by law.

Thus, if the given Methodological Recommendations have not been approved by an order, they cannot be recognised as a regulatory act or tax legislation. As a result, they should be regarded as recommendations by the tax authorities, which subsequently should be taken into consideration by the courts.

The main objective of the Methodological Recommendations is to help prevent the shadow economy.

Under the Methodological Recommendations, the confirmation of the actual performance of the transaction between the parties for tax accounting purposes is required. For example:

- the existence of primary accounting and other documents does not indicate the actual conclusion of a transaction.
- the existence of a product (object, work or service) within the framework of a fictitious transaction likewise does not confirm the validity of tax accounting data, since such a product (object, work or service) can be purchased from another entity as part of a different transaction or illegally.

With this in mind, state revenue body employees may highlight dubious transactions both during tax audits and during other forms of tax control, such as in-house inspections (cameral control).

The goal of the Methodological Recommendations is to review dubious transactions and potentially recognise them as invalid.

At the same time, a *dubious transaction* is a financial and business transaction between a taxpayer and a counterparty where (i) goods are not delivered, or work or services are not provided or (2) *the transaction is performed with an entity not specified in primary accounting documentation (imaginary transaction)*.

If taxpayers are already aware of the first ground for recognising a transaction as dubious, the second ground is new.

Under the Kazakhstan Civil Code, a transaction is the *actions* of individual and legal entities aimed *at establishing, amending or terminating civil rights and obligations*. A fictitious transaction is one concluded solely for appearance, without intent to create *the associated legal consequences* (fraudulent transaction). Until 2017, a fraudulent transaction was defined as one with no intention to cause legal consequences.

Thus, the previous definition of a fraudulent transaction was one with no intention to cause to *any* consequences whereas, according to the current version of the Kazakhstan Civil Code, a transaction can be recognised as fraudulent if the rights and obligations created by it do not correspond to its essence. Please note that the current definition may be misleading due to its similarity to that of “sham transaction”.

Tax consequences

For sellers: (1) consideration of criminal or administrative liability in accordance with Kazakhstan law and (2) the prosecution of entities that issued fictitious invoices.

For buyers: the adjustment of tax obligations as a result of the tax authorities disallowing tax deductions for CIT purposes and corresponding input VAT.

Criteria

Upon detection of dubious transactions, the tax authorities should collect evidence and prepare the relevant claims to recognise such transactions as invalid.

The Methodological Recommendations further establish circumstances that may serve, together or separately, as evidence of a dubious transaction, such as:³

1. the taxpayer’s inability to conclude a transaction (operation) due to timeframes, the location of property or the volume of material or work resources, or insufficient production capacities

³ Appendix 2 of the Methodological Recommendations

- (storage facilities or vehicles) required to supply goods, perform works or services;
2. transactions (operations) with goods, works or services were not produced (provided) or could not be produced (provided) in full or in the amount indicated by the taxpayer (tax agent) in accounting documents;
 3. the transaction is not economically viable, including for the relevant counterparty;
 4. subcontractors have been hired without relevant indication in documentation stipulated by Kazakhstan legislation on state procurement;
 5. there is a lack of information on the counterparty (a lack of documentation confirming the results of a counterparty search, monitoring, selection process, information sources, the results of market research for relevant goods (work or services), the study and evaluation of potential counterparties);
 6. the origin of goods sold has not been confirmed (no confirmation of the import or origin of goods);
 7. the actual location of the counterparty, the location of its warehouse and/or production and/or retail facilities cannot be confirmed;
 8. it cannot be confirmed that the counterparty has the required permission to perform licensed activities;
 9. information on the founder / head of a legal entity as a non-resident located outside of Kazakhstan; or

- individual with prior convictions or previously a founder of an unreliable company;
10. the parties to a transaction are related (affiliation or control of a legal entity by another transaction party);

In addition, accounting documents, letters from commercial banks detailing cash flows, explanations from transaction parties can serve as evidence that a transaction has not been performed.⁴

Please note that the evidence and circumstances referred to in the Methodological Recommendations confirming that a transaction did not occur include a non-exhaustive list of documents, which provides the tax authorities with extensive opportunities to determine which circumstances and documents may serve as grounds to confirm the existence of a dubious transaction.

Please further bear in mind that, even though the Methodological Recommendations have no legal force, they reflect the tax authorities' position and strategy. It is important to note that they have been suspended until further revision due to discussions and comments from the business community.

⁴ Appendix 1 of the Methodological Recommendations

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How Deloitte can help:

If you would like to express your opinion on this issue or in any other way participate in discussions, please reach out to any of our experts whose contact information may be found below.

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