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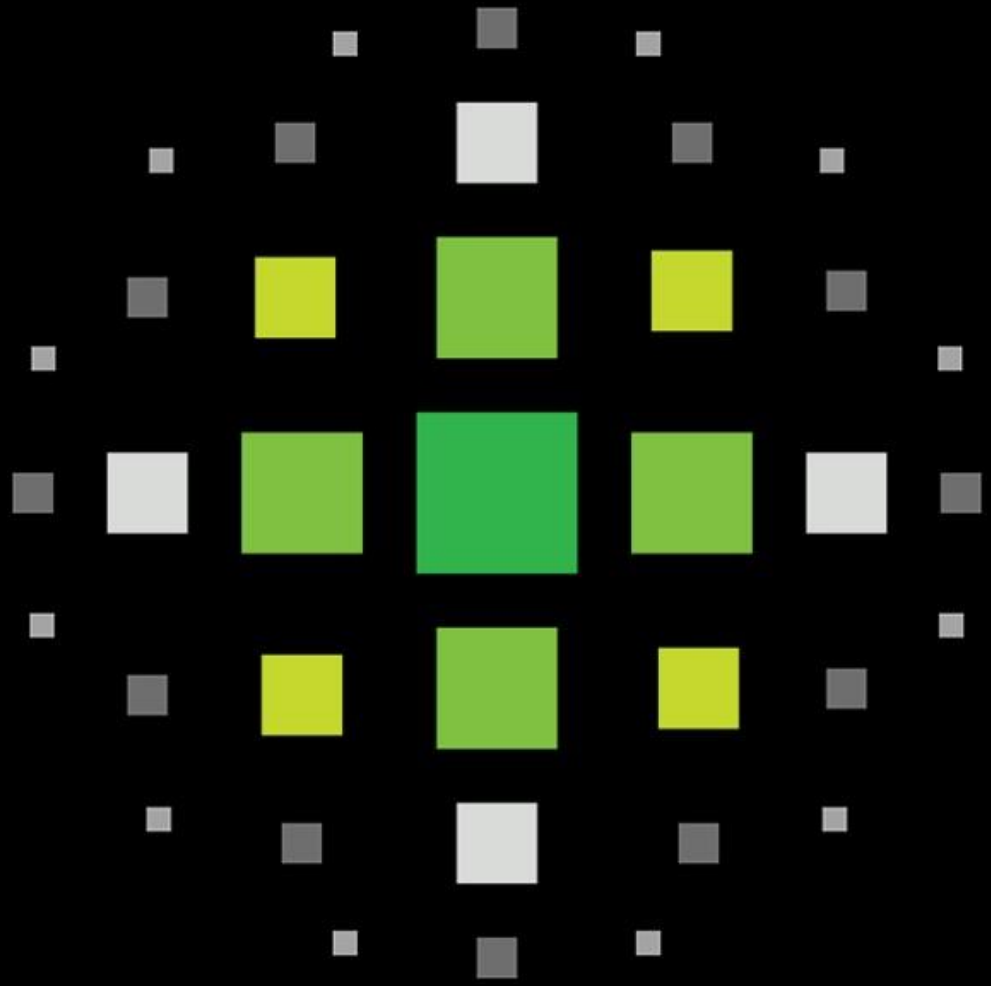


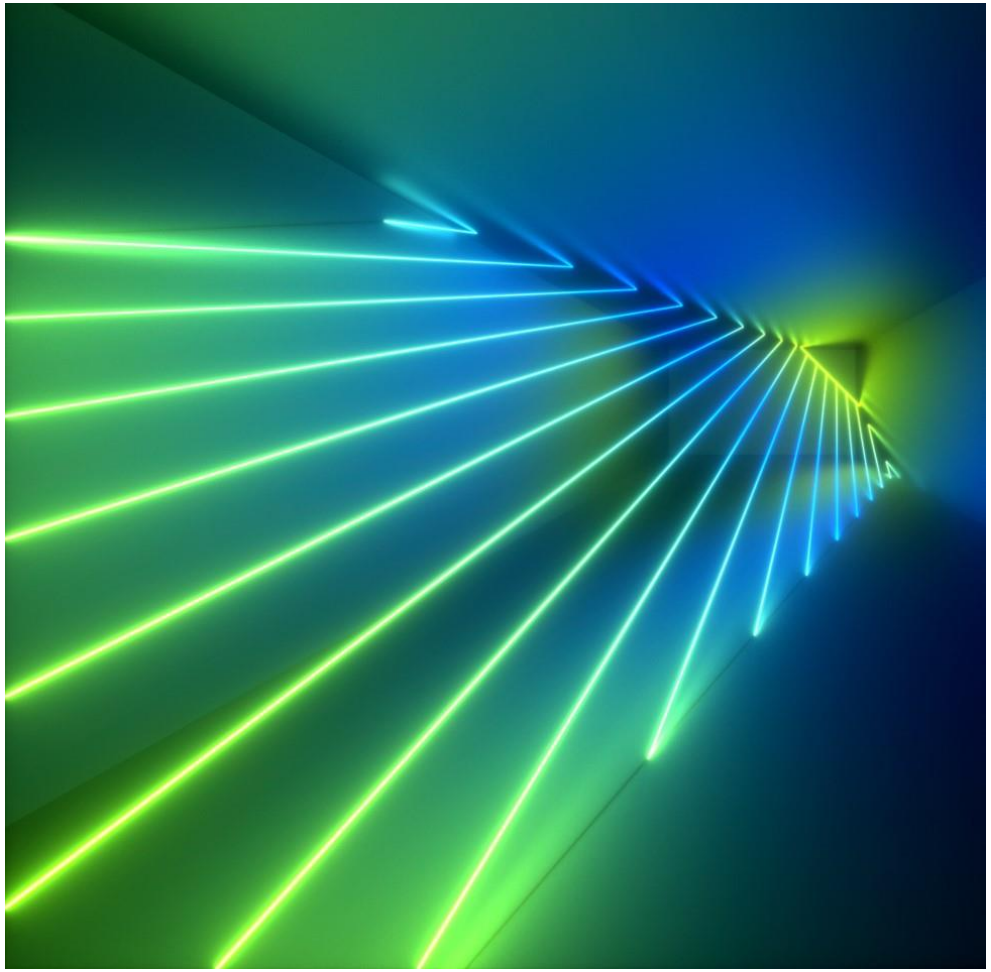
# LT in Focus

## Tax Disputes and Litigation Review: Issue №6

September 2018

# Contents





# Introduction

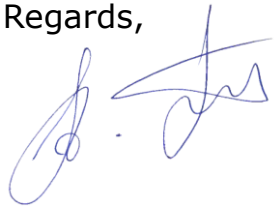
## We keep our finger on the pulse of your business

**Dear friends**

We are happy to offer this latest overview of court practices around Kazakhstan court tax disputes. In it we have considered the most interesting and significant cases that may have the potential to impact any aspect of your business.

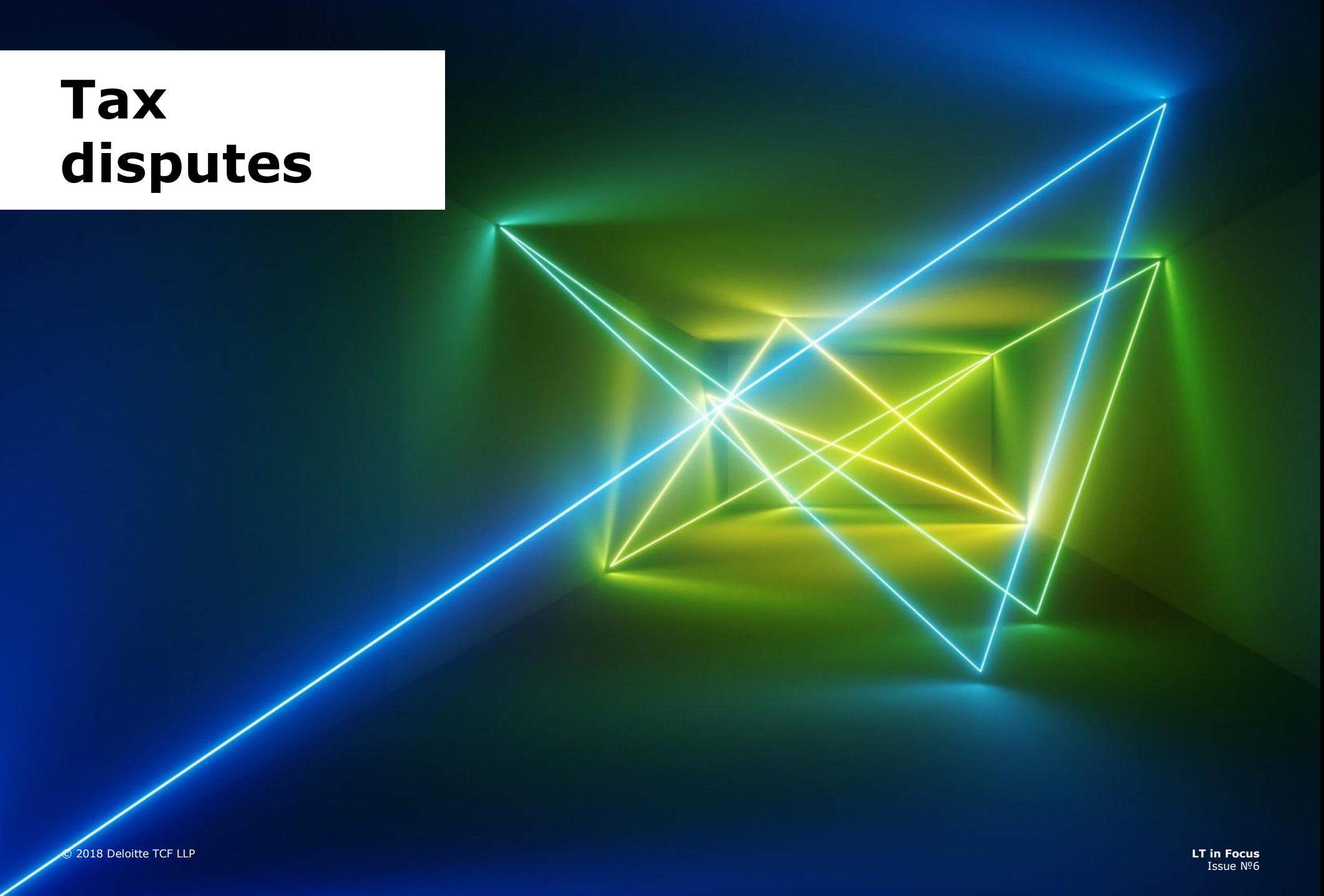
Should you be interested, we would be happy to have a more detailed discussion on any of the cases considered in this **LT in Focus**, or any question you may have on the latest tax court practices, including investment disputes.

Regards,



**Dispute Resolution Group**

# Tax disputes



# Tax audit appeals (1/3)

**Ruling of the Karaganda Oblast Court Civil cases Panel dated 19 July 2017**

**Etalon Export LLP**

**Recognition of a notification issued upon results of the tax audit as illegal and its cancellation**

Etalon Export LLP (“Taxpayer”) filed a claim to court against Karaganda Oblast State Revenue Department (“Department”) to have the section of Notification of Tax Audit Results №2251 dated 14 February 2017 covering the failure to confirm a value added tax ("VAT") refund of KZT 7,525,502 and interest of KZT 1,839,882 recognised as incorrect and cancelled.

The Taxpayer believes the audit results to be incorrect because the period had already been audited and the result of the audit reflected in Act of Tax Audit №239 dated 5 May 2015.

Moreover, analysis of two Acts of audit shows that the unconfirmed VAT had been calculated by applying Risk Management System Rules approved by Government Resolution dated 27 March 2013 ("RMS Rules") in different ways, while the calculation of the unconfirmed VAT at the last audit does not meet tax law principles.

The Department believes the appealed notification is correct, as it had carried out its audit based on a State Revenue Committee letter, while the smallest VAT amount offset on suppliers of goods, work or services and not eligible for compensation for the tax period, and for which a VAT return referring to the requirement to return excess VAT has been filed, has been identified correctly in total for the audit period (by summing up the two quarters) according to pyramid analytical report by supplier as required by the RMS Rules.

The Karaganda Oblast Specialised Interdistrict Economic Court ruled in favour of the Taxpayer on 5 May 2017.

In an appeal, the Department and prosecutor, asked the court to cancel its ruling and issue a new ruling meeting their demands.

**Case Review History**

| Period | Instance | Decision |
|---|---|---|
| **May 2017** | Court of First Instance | In favour of the Taxpayer |
| **July 2017** | Court of Appeal | Court of first instance ruling upheld |

**Position of the Court of First Instance**

The court established that during the audit, the Department had violated the RMS Rules and Tax Code from 10 December 2008, specifically:

- The inspectors did not apply paragraph 12 of the RMS Rules correctly to identify the smallest VAT amount offset by adding two quarters contrary to Tax Code requirements, according to which the VAT period is the calendar quarter.
- The procedure for applying the RMS Rules specifies the creation of “supplier pyramids" and determines the smallest VAT amount, separately by quarter of total VAT, i.e. by combining amounts for each quarter, but not combining quarters as in the disputed case, which is what the Department specialist did. For this reason, the Notification is incorrect.
- **Position of the Court of Appeal:**

The Court Board ruled that the previous decision should be upheld and the appeal and appeal protest be rejected.

**Thus, the court of appeal supported the Taxpayer, upholding the decision of the court of first instance.**

More details

# Tax audit appeals (2/3)

**Ruling of the Supreme Court Board for Civil Cases dated 22 January 2018**

**Vostoksvetmet LLP**

**Recognition of a notification issued upon results of tax audit as illegal and its cancellation**

Vostoksvetmet LLP ("Taxpayer") requested that the State Revenue Committee cancel East-Kazakhstan Oblast State Revenue Department ("Department") notification №878 dated 25 November 2015 accruing additional VAT of KZT 404,956,499 for management, agency and audit services.

The State Revenue Committee ruled that a previous ruling dated 2 June 2016 be upheld and rejected the appeal.

After that, the taxpayer appealed the notification in court for the following reasons:

The Taxpayer and its counterpart entered into a contract to provide verbal and written management and agency services, with deliverables taking the form of documents, payment documents, production plans, contracts concluded, orders and others. The Department received the documents during the audit, allowing the provision of the services to be duly confirmed.

The incorrect completion of a certificate of acceptance for the services (column No. 2) should not be the basis for disallowing VAT for offset and recharging it.

According to the Tax Code, the Taxpayer is not obliged to confirm the provision of services to offset VAT. A duly issued invoice is sufficient.

For audit services provided to the Taxpayer by a different contractor, the Taxpayer believes that the audit is directly related its business activities and, moreover, is obligatory according to the Audit Law (audit of subsoil users). For this reason, the decision to charge VAT on audit expenses was correct.

On the other hand, the Department believes that the acceptance certificate form contains eight columns, one of which is column No. 2 "Name of work (services) (by subtype in accordance with technical specifications, task or work (service) schedule, if available)."

As such, column No. 2 should be completed to indicate the subtype of work (services) with the required information. Since the Taxpayer failed to meet this requirement, the tax authorities were correct to disallow VAT for offset and, accordingly, accrue VAT on management and agency services.

The Department also supposes that VAT on overhead costs incurred by the taxpayer's counterparty in the provision of audit services should not be considered as services received for taxable turnover, because according to the contract any such expenses are used directly to pay counterparty costs.

Therefore, the exclusion of VAT from offset and its subsequent charging are also lawful.

Tax disputes

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# Tax audit appeals (2/3)

The East-Kazakhstan Oblast Specialised Interdistrict Economic Court partially upheld the Taxpayer's appeal on 26 January 2017. Notification of an accrual of VAT of KZT 1,832,906 (for audit services) was cancelled. All other Taxpayer applications were dismissed.

On 12 June 2017, the East-Kazakhstan Oblast Civil Cases Panel upheld the ruling of the Court of First Instance.

Disagreeing with the court rulings, the Department requested that the Supreme Court revise judicial acts in the case.

**Case Review History**

| Time Period | Instance | Decision |
|---|---|---|
| **January 2017** | Court of First Instance | In favour of the Taxpayer |
| **June 2017** | Court of Appeal | Ruling of the court of first instance is left unchanged |
| **January 2018** | Court of Cassation | Review of court decisions rejected |

**Court of First Instance position:**

- VAT should be offset if a supplier issues an invoice for taxable turnover on the basis of a certificate of acceptance.
- Research of management and agency service contracts and agreements between the Taxpayer and its counterpart shows that the services performed are broken down into subtypes.
- Meanwhile, case materials clearly show that columns No. 2 of certificates of completion include only the name "managerial services" or "agency services" with no further details.
- In this situation, the Department's arguments are reasoned because the primary documents submitted have not been drafted correctly, i.e. do not allow the user to determine the cost or scope of services, and costs, and ultimately any related taxes.
- For this reason, the authorities acted correctly in disallowing the offset and charging additional VAT.
- At the same time, the court does not uphold the exclusion and charging of additional VAT of KZT 1,832,906 on settlements with the counterparty under the audit agreement since, according to point 3.1 of the contract, the cost of audit services is fixed and include the auditor's overhead expenses directly related to the audit.
- Overheads, if they arise and are duly confirmed, should be included in the transaction cost, and as such the Taxpayer legally accepted the VAT offset from this part of the transaction value.

**Courts of appeal and cassation positions:**

- The Court of Appeal found no grounds to reverse or change the decision of the court of first instance.
- The Supreme Court judge did not establish grounds to review the judicial acts.

**Thus, the courts of appeal and cassation supported the Taxpayer's arguments, leaving the decision of the court of first instance unchanged.**

More details

Tax disputes
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# Tax audit appeals (3/3)

**Ruling of the North-Kazakhstan Oblast Court Civil Cases Panel dated 26 April 2018 on an appeal case**

**BioOperations LLP**

**Cancellation of notification of tax audit results**

BioOperations LLP (the "Taxpayer") filed a claim to court against North-Kazakhstan Oblast State Revenue Department (the "Department") to cancel notification of the results of tax audit No. 188 dated 3 November 2017, which had accrued additional corporate property tax of KZT 60,034,475. The Taxpayer considers that the Department acted unreasonably because its immovable property had been correctly reflected in the balance sheet as goods and not as a fixed asset. The Taxpayer's position is justified because it contributed the given property to its charter capital and is to be sold, and as such property tax is not due.

Due to the legality of the additional accrual, the Department believes that there is no reason to cancel the notification. As such, the basis for the additional taxation was the registered title to industrial and production real estate. It should have been recorded as a fixed asset and, therefore, subject to all relevant taxes.

The North-Kazakhstan Oblast Specialised Interdistrict Economic Court upheld the Taxpayer's appeal on 15 February 2018.

In an appeal, the Department and the prosecutor asked the court to cancel its decision, issue a new decision, and reject the Taxpayer's demands in full.

**Case Review History**

| Time Period | Instance | Results |
|---|---|---|
| **February 2018** | Court of First Instance | In the Taxpayer's favour |
| **April 2018** | Court of Appeal | Review of court decisions rejected |

**Court of First Instance position:**

During court sessions, the Court found that:

- The immovable property was the founder's contribution to Taxpayer authorised capital and was not used by the Taxpayer, as it was intended solely for sale.
- According to point 8 of IAS 2, inventories include goods purchased and held for sale, including land and other property held for sale.
- During the tax audit, the Department did not review the Taxpayer's charter or accounting policy, from which it could have established the designation of real estate as goods to be disposed of.
- Therefore, the Department's conclusion that real estate should be considered as a fixed asset (rather than as goods) and pay the corresponding tax is incorrect.

**Court of Appeal position:**

- The board left the decision of the court of first instance unchanged, did not uphold the Department's appeal and the prosecutor's protest.

**Thus, the appeal instance upheld the Taxpayer's arguments, leaving the ruling of the court of first instance unchanged.**

**More details**

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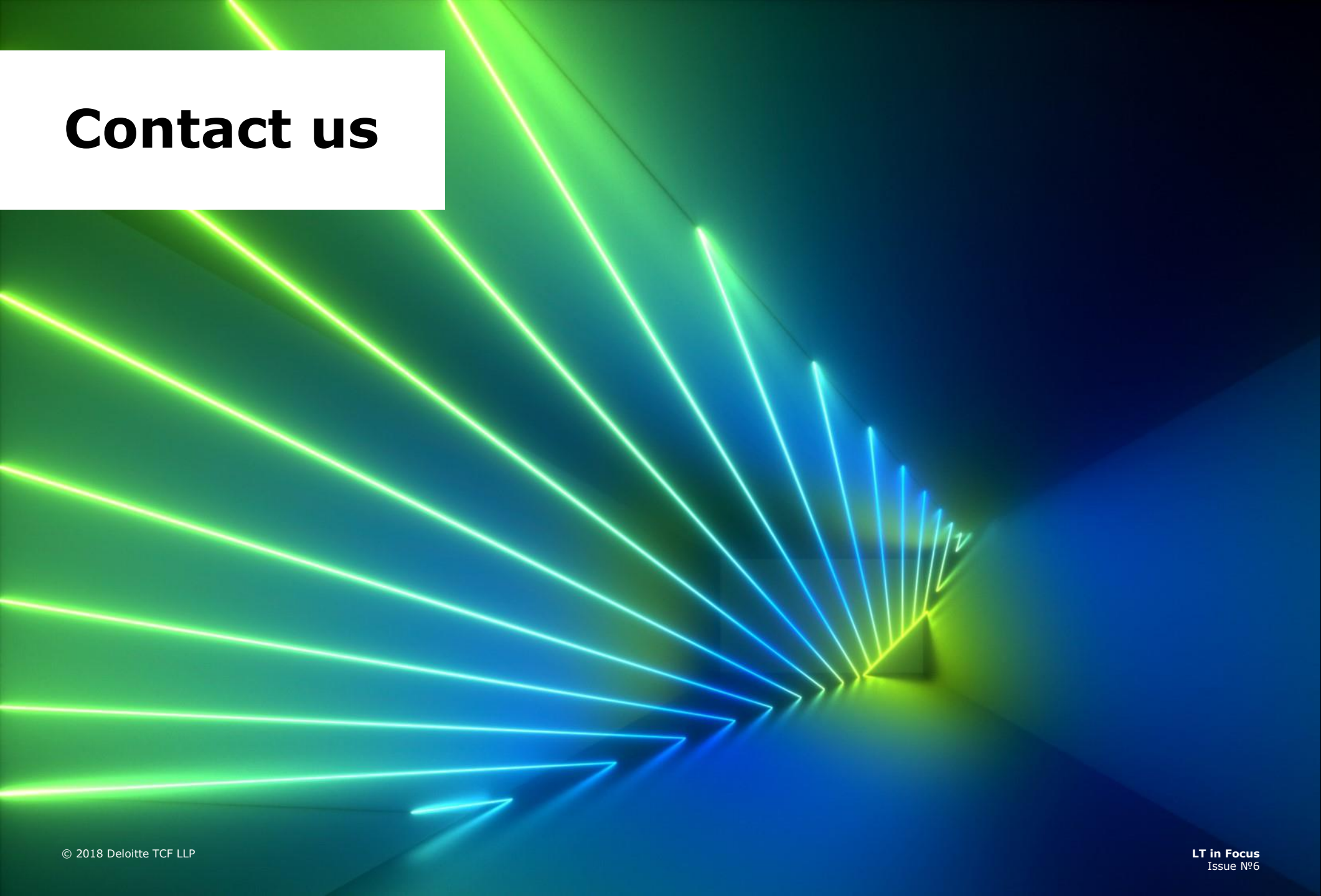

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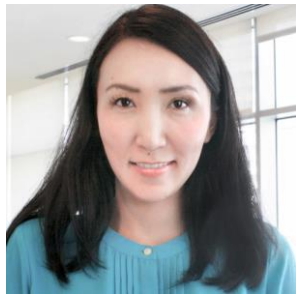

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