Deloitte.
Legal

LT in Focus

Court practices overview of various disputes: Issue № 4

February 2018

Content

© 2018 Deloitte TCF LLP

Transfer pricing 5
Tax issues 9
Environmental issues 17
Customs issues 28
Contact us 31

Introduction

The attention your business deserves

Dear friends,

We have great pleasure in presenting this latest litigation alert looking at tax (including transfer pricing), customs and ecological disputes, and other investment-related cases reviewed by Kazakhstan courts as investment or general disputes. We have focused on the most significant, in our opinion, court cases that have the potential to impact various aspects of your business. We would also like to turn your attention to a brief overview of the main legislative amendments dealing with tax audit dispute procedures and the professional regulation of investment disputes from 2017.

We will be pleased to discuss any court case reviewed in LT in Focus of interest to you in greater detail, and any of the recent court trends when considering tax, customs and ecological related investment disputes.

Best regards,
Litigation group

© 2018 Deloitte TCF LLP

Stay in Focus of changes

2017 was significant for a number of interesting legislative amendments around out-of-court appeal procedures for tax audit findings, and for considering investment disputes. We would like to mention what we think are the most significant legislative amendments and proposals:

- After analysing court practices around investment disputes, the Supreme Court issued clarifications and recommendations to remove discrepancies in the interpretation and application of legislation, bring them into line with international law and international treaties ratified by Kazakhstan.
- A concept and procedure for disputing preliminary tax audit acts has been introduced for certain categories of taxpayers.
- The authorised body has created a commission to consider appeals against tax audit notifications.
- Supreme Court Regulatory Resolution No. 4 dated 29 June 2017 *On Court Practices for the Application of Tax Legislation* entered into force on 27 July 2017, replacing previous Regulatory Resolution No. 1 dated 27 February 2013.
- Point 4 of article 27 of the Civil Procedural Code ("CPC") has been clarified to allow foreign legal entities (branches and representative offices) operating in Kazakhstan, including those with state interest (foreign interest should be at least 51%) and investors with an investment contract in place to file lawsuits with the Astana municipal court.
- The Supreme Court is looking at proposals from local courts to extend the court case preparation period in the Civil Procedural Code to one month and set the consideration period for cases involving a dispute of tax authority notifications to two months.

© 2018 Deloitte TCF LLP

Transfer pricing

Regarding applicability of pricing methods (1/3)

Ruling of the Judicial Board for Civil Cases of the North-Kazakhstan Oblast Court dated 8 December 2016 for Case № 5999-16-00-2a/1583

Transkhleb LLP

On the settlement of company demands

After a targeted tax audit of Transkhleb LLP ("Transkhleb") and its transfer pricing-related tax payments for the period between 1 January 2010 and 31 December 2014, inspectors from the North-Kazakhstan Oblast State Revenue Department (the "Department") accrued additional corporate income tax ("CIT") and late payment interest of KZT 13,023,047.

The Department cited Transkhleb's wheat sales at prices that differed from retail prices given in the official "Grain Union of Kazakhstan" information source, approved by Government Resolution №292 dated 12 March 2009.

Transkhleb went to court asking to have the audit recognised as invalid and the results of the review cancelled.

The North-Kazakhstan Oblast Specialised District Economic Court partially upheld Transkhleb's demands, cancelling the Department's Notification of Audit Results №334 dated 14 April 2016. However, the audit was not recognised as invalid.

Case history

Period	Instance	Review result
September 2016	Court of first instance	Demand partially upheld
December 2016	Court of appeal	Court of first instance ruling left unchanged

Judicial Appeal Board's position:

The Court established that during its audit the Department had violated the Transfer Pricing Law (the "Law"), specifically:

- **the method for determining the market price**
  Transkhleb used the "cost plus" method to determine the market price. In turn, to identify market price, the Department used the comparable uncontrolled price ("CUP") method by comparing the transaction price for goods (work or services) with the market price taking into account a range of prices for identical (or similar) goods under comparable economic conditions.

© 2018 Deloitte TCF LLP

Regarding applicability of pricing methods (2/3)

As it did not have prices for DAP Samur in Azerbaijan, the Department applied DAP Petropavlovsk prices in Kazakhstan.

In this respect, the transaction price, according to the Department, results in economic conditions that are comparable to the market price through a differential as follows:

a) actual expenses to deliver the wheat from the dispatch station to the destination station (Samur) were deducted from the transaction price, at the same time determining the wheat price at the dispatch station.

b) then, the cost of delivering the wheat from the dispatch station to Petropavlovsk was added.

According to the court of first instance, using a price in Kazakhstan violates article 13 of the Law, **as the economic conditions are not comparable**. The Department did not present evidence of specific wheat supply prices on the relevant market. DAP Petropavlovsk supply prices cannot be used, as they do not comply with contractual conditions.

As a result, according to the court of first instance, Transkhleb was correct in using the "cost-plus" method to best support all transportation expenses, and direct and indirect contractual costs.

- **Information sources.** The Department used a response from the Kazakhstan Grain Union as an officially recognised source of information to determine the market price. However, in a response to court questioning from 24 August 2016, the Kazakhstan Grain Union stated that it had not published the "Grain Market Overview," which is an officially recognised source, since 2012. Likewise, to calculate the market price, the Department used prices in Kazakhstan as a pricing source, which, according to the court of first instance, violates article 13 of the Law.

The Department did not research grain prices in Azerbaijan, **for which reason the court of first instance considered that it did not have the opportunity to clearly define the pricing range and calculate a differential**.

- **Differential.** The Department used a different source of information – CTM's carriage payment "Rail-Tariff" programme - to calculate the differential, which was incorrect because the site and the "CTM" company are Russian; the site does not make calculations for earlier periods and does not make calculations for each mode of transport; calculations are made for closed wagons, semi-wagons and platforms, while wheat was transported in our case loose in cement carriers.

© 2018 Deloitte TCF LLP

Regarding applicability of pricing methods (3/3)

Supply conditions were compared according to DAP Petropavlovsk as the Kazakhstan Grain Union did not provide pricing information for DAP Samur. Comparison by removing supply expenses to Azerbaijan from the transaction price and adding supply costs to a different Kazakhstan market directly contradicts the Law with respect to determining market price and the differential. The market price for wheat was calculated for wheat delivered to the Petropavlovsk railway station, while supplies were made to Samur station in Azerbaijan.

The Department did not provide a specific method for calculating and monitoring export prices and the differential with reference to the relevant rules and calculation formulas.

The Department disputed the court of first instance's ruling in the court of appeal.

Appeal Court position:

The Judicial Board for civil cases of the North-Kazakhstan Oblast Court Judicial Board established a significant violation by the Department and resolved that (i) the court of first instance ruling should remain unchanged; (ii) the appeal should remain unchanged.

Thus, the court of appeal took the company's position and left the ruling of the court of first instance **unchanged**.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Tax issues

Reversal of tax audit results due to procedural violations and the use of invalid circumstances (1/3)

Resolution of the Supreme Court Judicial Board for Civil Cases dated 11 January 2017 on Case №6001-16-00-3гп-1072

PSK Oskemen-Kurylys LLP

Resolution to leave a previous court ruling and resolution unchanged

PSK Oskemen-Kurylys LLP ("Oskemen-Kurylys") took legal action against the East-Kazakhstan Oblast State Revenue Department (the "Department") to have its actions during a tax audit recognised as unlawful, and to notification of tax audit results № 866 dated 23 December 2015 recognised as unlawful and cancelled.

Case history

Period	Instance	Review result
April 2016	Court of first instance	Taxpayer demands upheld
July 2016	Court of appeal	Court of first instance ruling left unchanged
January 2017	Supreme Court	Courts of lower instance ruling left unchanged

Hearings established that:

- based on an instruction from 1 September 2015, the Department initiated a targeted tax audit of Oskemen-Kurylys regarding the execution of CIT obligations for 2010.
- on 4 September 2015, a senior Department specialist, at the hospital where Oskemen-Kurylys chief executive was undergoing in-patient treatment, drafted an act in which the latter would confirm his refusal to sign the above instruction, and in which he did not explain his reasons for refusing to sign and accept the instruction.
- on 7 September 2015, the tax authorities sent Oskemen-Kurylys a request by registered mail to provide documents to be used in an audit. On 9 September 2015, they sent notification of the suspension of the audit. The letter was returned because the recipient was not available to receive the letter.
- on 4 December 2015, Oskemen-Kurylys received notification of the resumption of the audit. Due to Oskemen-Kurylys's failure to provide the requested documents, the audit was conducted using the indirect method.

© 2018 Deloitte TCF LLP

Reversal of tax audit results due to procedural violations and the use of invalid circumstances (2/3)

- an act of tax audit was drafted on 23 December 2015 and on the same day, notification of the accrual of corporate income tax ("CIT") was sent for KZT 28,168,761 and late payment interest of KZT 38,682,401. The two documents were sent by registered mail. However, on 8 January 2016, they were returned due to the recipient's absence at the receipt address.

On 15 January 2016, an act of investigation into Oskemen-Kurylys absence at its legal address was drafted, and only on 27 January 2016, did Oskemen-Kurylys chief executive receive the above documents at the Department.

The grounds for the accrual of CIT and late payment interest was the removal of expenses on operations with legal entities recognised as fictitious companies based on court rulings from 2010 CIT deductions.

In this respect, the courts of first instance and appeal based their rulings on the following conclusions:

The act recording the refusal to sign cannot be treated as the start of the tax audit as it was not drafted in the presence of witnesses. In addition, it did not show the reasons for the refusal to sign.

In addition, it was contradictory information in the tax audit act stating that the audit was conducted using the indirect method, with the knowledge of Oskemen-Kurylys chief executive and in the presence of the chief accountant is not true.

Supreme Court position:

Based on the above, the Supreme Court upheld the court of first instance and appeal's position, and established that the tax authorities failed to produce due evidence to back up its arguments on the Oskemen-Kurylys audit in accordance with Kazakhstan law.

Furthermore, case materials confirm that **the tax authorities did not duly serve an instruction to instigate an audit to Oskemen-Kurylys.**

According to point 1 of article 633 of the Tax Code, a tax audit starts from the date a taxpayer (tax agent) receives an instruction or the date a record of a taxpayer's (tax agent's) refusal to sign an instruction is served. Point 5 of article 633 of the Tax Code states that if a taxpayer (tax agent) refuses to sign an instruction from the tax authorities, the inspector who conducted the audit will draft a record of refusal to sign in front of at least two witnesses. Any such record of a refusal to sign should refer to the reasons for the refusal to sign an instruction.

© 2018 Deloitte TCF LLP

Reversal of tax audit results due to procedural violations and the use of invalid circumstances (3/3)

Furthermore, the court received no written evidence by the date in question of Oskemen-Kurylys's receipt of documents from the tax authorities confirming the instigation, suspension, renewal or conclusion of a tax audit.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Deducting expenses and reducing total annual income (1/3)

Ruling of the Supreme Court Judicial Board for Civil Cases ("Supreme Court") dated 18 January 2017 for case 3rn-1092-16

JSC SB Alpha Bank

Ruling to amend a previous court judgement

After a comprehensive tax audit of Alpha Bank for the period between 1 January 2008 and 30 September 2013, tax inspectors assessed additional corporate income tax ("CIT"), value added tax for services provided in Kazakhstan, land tax and CIT from non-resident legal entities withheld at the source, except for receipts from oil sector organisations.

According to the tax authorities, their actions were justified due to:

1. the deduction in 2010-2012 of expenses for provisions (reserves) created for loans issued during that period, and on which payment was not yet due, while security was registered late, meaning the Bank treated the expenses as doubtful and bad assets.
2. the Bank's deduction of the depreciation on fixed assets acquired from Koksai Group.
3. a reduction in AAI due to the write-off of late payment interest and fines for a loan issued by BIOHIM.
4. a reduction in AAI due to a recalculation of interest on a loan provided by Imstalkon.

Alpha Bank took legal action against the tax authorities with the request to cancel the results of the tax audit.

Case history

Period	Instance	Review result
July 2016	Court of first instance	Alpha Bank claims not upheld
October 2016	Court of appeal	Court of first instance ruling remained unchanged
January 2017	Supreme Court	Courts of lower instance rulings recognised as illegal and cancelled

Supreme Court position:

- **Deduction of provision expenses**
  As the Bank allowed a deferral in the period for creating security, the local courts agreed with the tax authorities that the loans in question could not be recognised as security-free loans, which is why there were no grounds to create provisions (reserves) against doubtful or bad assets. For that reason, the amounts in question were not deductible.

© 2018 Deloitte TCF LLP

Deducting expenses and reducing total annual income (2/3)

According to the Supreme Court, the tax authorities' conclusions that the Bank had been late in drafting pledge agreements cannot be correct as civil law does not require pledge agreements to be drawn up at the moment a loan is issued or during the period preceding it.

Furthermore, based on rules for classifying assets, contingent liabilities and creating provisions (reserves) against them, the Supreme Court established that the tax authorities had acted unlawfully to disallow the Bank's expenses to create provisions (reserves) according to article 106 of the Tax Code.

- **AAI reduction in connection with a write-off of loan late payment interest and fines**

The Bank adjusted AAI for 2009 due to an adjustment in late payment interest and fines assessed by BIOHIM.

The tax authorities and local courts treated the adjustment as not complying with article 132 of the Tax Code, as the write-off if late payment interest and fines is not grounds for adjusting income.

However, according to the Supreme Court, as the debt restructuring agreement between the Bank and BIOHIM is an amendment to transaction conditions, the Bank's income adjustment for 2009 meets the requirements of subpoint 2) of point 1 of article 132 of the Tax Code.

- **AAI reduction due to a recalculation of loan interest**

In 2007, the Bank and Imstalkon entered into an agreement to provide a credit line with interest at 16%.

In 2009, an additional agreement was concluded to increase the interest rate by 83%.

However, according to an Almaty Specialised Inter-Regional Court ruling, the interest rate change was recognised as invalid. In this respect, the court obliged the Bank to calculate interest at the former 16% rate.

The Bank made the relevant changes to its CIT return for 2009.

However, the tax authorities treated the amendment as a consequence of changes to transaction conditions in accordance with article 132 of the Tax Code and decided to increase the Bank's AAI.

The tax authorities' conclusions contradict point 8 of article 157 of the Civil Code, whereby an invalid transaction does not give rise to legal consequences.

© 2018 Deloitte TCF LLP

Deducting expenses and reducing total annual income (3/3)

The contents of this provision of the law confirm that the recognition of a transaction as invalid may not be recognised as a change in transaction conditions. Consequently, the Bank's change to its 2009 tax return is lawful, and the tax authorities' conclusions resulting in an additional assessment of CIT contradict the provision of subpoint 2) of point 1 of article 132 of the Tax Code.

The Supreme Court established a significant violation of material and procedural law by the local courts and issued a new ruling upholding the Bank's claims.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Contradicting court rulings on the identification of the start of production

Resolution of the Specialised Judicial Board of the Supreme Court dated 14 February 2017 on case №6001-17-12-6a/66

Samek International LLP

Company demands rejected

After a transfer-pricing audit of Samek International LLP ("Samek") for the period between 1 October 2009 and 31 December 2009, inspectors accrued additional CIT for 2009 as Samek had not recorded income from oil export sales received in the period after production was started after a commercial discovery in its 2009 CIT return.

Samek applied to a court to have the tax audit notification and act recognised as illegal and cancelled.

The case was considered as an investment dispute.

Case history

Period	Instance	Review result
December 2016	Court of first instance	Company appeal rejected
February2017	Court of appeal	Court of first instance ruling left unchanged

Supreme Court position:

The court established that production started after a commercial discovery from the date the State Reserves Committee issued a protocol in 2007 (with the P index) accepting an increase in initial oil and gas field reserves at additional productivity sites determined as a result of Samek geological work.

Samek also determined the start of mineral resource production after a commercial discovery from the date the State Reserves Committee issued a report in 2010 (with the Y index) confirming oil and gas reserves by field, motivating its conclusion on article 11 of the Tax Code.

Deloitte calls your attention:

The court dispute is a continuation of a series of Samek's disputes on defining the start of production after a commercial discovery.

In this respect, we note that during the previous tax dispute around the audit of Samek's activities between 1 January 2005 and 31 December 2008, until 2016, courts of all instances considered the issue date of the SRC Protocol in 2010 as the date production started with reference to article 111 of the Tax Code, according to which, in the court's opinion, the start of production is the moment an SRC protocol approves mineral reserves, i.e. from the date of the 2010 SRC protocol.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Environmental issues

Compensation for economic damage caused by air pollution from unauthorised emissions (1/2)

Resolution of Supreme Court Judicial Board for Civil Cases dated 1 February 2017 for Case 6001-17-00-3ГП/2

Catkaz LLP

Ruling to refer a case for reconsideration

The Mangistau Oblast Ecological Department (the "Department") conducted an unscheduled audit of Catkaz LLP ("Catkaz") for compliance with ecological law between 1 January 2012 and 14 October 2015. The audit established that between March 2013 and February 2015 Catkaz had used a Cooper LT0-750 drilling rig to drill 75 wells without an environmental emissions permit for stationary sources, which was documented in an act on 12 November 2015.

For this reason, Catkaz received a fine for not having an ecological permit, which it did not dispute and paid.

The Department assessed air pollution damage using the indirect method based on rules for estimating economic damage from environment pollution, approved by Government Resolution №2 535 dated 27 June 2007 (the "Rules"). It sent Catkaz an instruction to clear violations of ecological law, which prohibits companies from performing drilling work without an emissions permit.

However, Catkaz disputed the audit act and the amount of ecological damage in court. In response, the Department took legal action with a counter claim for damages, as a result of which the court of first instance concluded that actual emissions did not exceed 2013-2015 permit levels, meaning no damage to the environment had occurred.
In this respect, the court pointed out that the source of the emissions was a diesel generator, meaning **a permit to drill each well was not obligatory.**
Furthermore, other companies using natural resources (Tulpar Munai Services and IBK Sea Bu) had emissions permits in place to drill 13 wells.

© 2018 Deloitte TCF LLP

Compensation for economic damage caused by air pollution from unauthorised emissions (2/2)

Case history

Period	Instance	Review result
April 2016	Court of first instance	Catkaz claim upheld. Department's counterclaim rejected
June 2016	Court of appeal	Court of first instance ruling left unchanged
February 2017	Supreme Court	Court of first instance and court of appeal rulings cancelled and the case was sent for reconsideration. The General Prosecutor and Department petitions partially upheld

Supreme Court position:

The Supreme Court did not agree with the court of first instance and court of appeal positions. According to subpoint 71) of article 1 and point 1 of article 69 of the Ecological Code, Catkaz, as a company making use of natural resources, is obliged to receive an environmental emissions permit to make emissions. Catkaz emissions before it received an ecological permit are confirmed in an audit act and are not disputed. At the same time, according to point 3 of article 11 and subpoint 3) of point 2 of article 321 of the Ecological Code, companies making use of natural resources should not pollute the environment. Likewise, not only excess emissions give rise to damage compensation, but also unauthorised emissions.

For this reason the conclusions of the courts of prior instances that environmental pollution did not exceed annual standards have no legal basis as Catkaz made unauthorised emissions, and for that reason is obliged to pay for the damage caused by the drilling of wells before it received a permit, in full.

Based on the above, the Supreme Court rejected the rulings of the court of prior instances and sent the case for reconsideration.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Determining economic damage in the event of air pollution caused by malfunctioning technological equipment (1/3)

Resolution of the Supreme Court Specialised Judicial Board ("Specialised Board") dated 12 December 2016 for Case №6001-16-00-2a/21

Tengizchevroil LLP

Resolution to leave a previously issued court ruling unchanged

The Atyrau Oblast Ecology Department (the "Department") conducted an unscheduled audit of Tengizchevroil LLP for compliance with ecological law, and discovered that gas had been flared due to an equipment failure in 2014-2015. It calculated damage caused by air pollution of more than KZT 2 billion.

The Department used the indirect method to estimate pollution damage, which is based on rules for estimating economic damage from environment pollution, approved by Government Resolution №2 535 dated 27 June 2007 (the "Rules") and the Method for calculating Emission Parameters and Total Emissions from Hydrocarbon Flares, approved by Minister for Environment Order № 23-п dated 30 January 2007 (the "Methodology").

The case was considered as an investment dispute by the Astana City Court according to rules of the court of first instance in accordance with article 27 of the Civil Procedural Code.

The court of first instance, based on article 321 of the Ecological Code, concluded that the Department's claims were justified.

Tengizchevroil did not agree with the court of first instance ruling and, citing breaches of material and procedural law, requested that the court of appeal cancel the Astana City Court ruling.

Case history

Period	Instance	Review results
October 2016	Court of first instance	Department claim upheld
December 2016	Supreme Court	Court of first instance ruling left unchanged, while the Tengizchevroil appeal was not upheld

Position of the Specialised Board of the Supreme Court:

The Specialised Board agreed with the court of first instance's position, and did not take into account Tengizchevroil arguments that it had not exceeded emission permit limits for 2014-2015, which is why no damage or unauthorised pollution took place from gas flaring, because the permit did not stipulate permissible gas flaring emissions caused by equipment breakdowns or emergencies, due to a lack of any such standards.

© 2018 Deloitte TCF LLP

Determining economic damage in the event of air pollution caused by malfunctioning technological equipment (2/3)

The Department's air pollution damage assessment was recognised as complying with points 6 and 13 of the Rules and Methodology. Point 6 of the Rules states that the indirect method for assessing damage is used in cases of air and water resource pollution and the illegal use of the subsoil, and production and household waste disposal, including radioactive waste, excess standards, and the excess depletion of natural resources, in accordance with article 110 of the Ecological Code.

The Specialised Board also dismissed Tengizchevroil's argument that the damage assessment was incorrect because the Department had used maximum permissible concentration ("MPC") values and safe reference levels of impact ("SRLI") in its calculations.

In its appeal, Tengizchevroil pointed out that daily average MPC did not exist for certain pollutants, such as hydrogen sulphide, methane and mercaptans, referring to Sanitary and Epidemiological Requirements for Air in Urban and Rural Populated Areas, Soil and their Safety, the Maintenance of Urban and Rural Populated Areas, Working Conditions with Physical Factors impacting the Public, approved by Government Resolution № 168 dated 25 January 2012 (the "Sanitary Rules").

The Specialised Board did not agree with Tengizchevroil arguments because point 94 of the Sanitary Rules refers to maximum one-off and daily average MPC and SRLI for the above pollutants used by the Department in its economic damage assessment.

© 2018 Deloitte TCF LLP

Determining economic damage in the event of air pollution caused by malfunctioning technological equipment (3/3)

The Specialised Board also rejected Tengizchevroil's appeal against the incorrect application of the monthly calculation index ("MCI") in its damage assessment formula due to the reduction of the rate from 52 MCI to 2.2 MCI after amendments and additions to the Rules for the Economic Assessment of Environmental Damage, approved by Government Resolution №367 dated 21 July 2016, as the Department's assessment in the petition was made during the period when the defendant acknowledged air pollution. According to article 43 of the Legal Acts Law, the MCI rate reduction cannot have retroactive force for Tengizchevroil.

Based on the above, the Specialised Board left the court of first instance ruling unchanged, and did not uphold Tengizchevroil's appeal.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Contesting the actions of a state ecological inspector during an unscheduled targeted audit (1/3)

Resolution of the Supreme Court Specialised Judicial Board dated 19 January 2017 for Case №6001-16-00-2a/27

Tengizchevroil LLP

Resolution leaving a previously issued court verdict unchanged

Tengizchevroil took legal action in Astana to dispute the actions of Atyrau Oblast State Ecological Inspector E M Zhumashev ("Inspector") during an unscheduled targeted audit of compliance with ecological law, basing its claims on the fact that the Inspector concluded, without conducting a thorough inspection, that on 29-30 May 2016, Tengizchevroil had discharged pollutants without an ecological permit. In return, Tengizchevroil claimed to have an environmental emissions permit and that emissions generated as a result of a gas leak and response actions, including gas flared, were within the maximum permissible emissions plan for air pollutants in 2016-2018. Furthermore, according to Tengizchevroil, the Inspector committed procedural violations with respect to notifying Tengizchevroil of the suspension of the audit.

The lawsuit was filed as an investment dispute with the Astana City Court according to the rules of the court of first instance.

Case history

Period	Instance	Review results
November 2016	Court of first instance	Tengizchevroil appeal rejected
January 2017	Court of appeal	Court of first instance ruling left unchanged

In its appeal, Tengizchevroil questions the replacement of the ruling with a new ruling upholding the lawsuit, referring to the court's violation of material and procedural law.

Having heard the parties' explanations, the court of first instance concluded:

- Based on Zhylyoi District (Atyrau Oblast) Prosecutor letter №2-05-16-02209 dated 30 May 2016 and subpoint 5) of point 3 of article 144 of the Entrepreneurial Code, the Atyrau Oblast Ecology Department issued act №111 dated 8 June 2016 to instigate an unscheduled audit with respect to Tengizchevroil's compliance with ecological law between 1 and 20 July 2016, and ordered it to be conducted by state ecological inspectors A B Seilkhan and E M Zhumashev.

© 2018 Deloitte TCF LLP

Contesting the actions of a state ecological inspector during an unscheduled targeted audit (2/3)

- After the audit, state inspector Zhumashev drafted audit act №06-14/31 dated 27 September 2016 and issued an instruction to clear ecological law violations dated 27 September 2016.

In explanations to the court of appeal, a Tengizchevroil representative confirmed that the demand to dispute the audit act results dated 27 September 2016 were not made in a lawsuit, specifically the Inspector's actions to issue the above documents in violation of the Entrepreneurial Code, i.e. on procedural grounds.

- In this respect, the court of first instance, in its ruling, concluded that the Inspector was justified in issuing an audit act and instruction according to current law and in compliance with the Entrepreneurial Code procedure and deadlines for conducting audits.

Supreme Court position:

- The Specialised Board agreed with the court of first instance. According to article 156 of the Entrepreneurial Code, an audit is recognised as invalid if it was conducted in gross violation of organisational requirements established by the Entrepreneurial Code.
- According to article 148 of the Entrepreneurial Code, the audit period takes into account the scope of work to be done and objectives, and should not exceed 30 business days for small, medium-sized and large companies. If special research, testing or reviews are required, and if the audit scope is significant, the head 9deputy) of the authorities may extend the audit period for up to 30 business days. Furthermore, an audit may be suspended once for up to 1 month.

  In both cases, the audit target is notified 1 (one) day in advance of the suspension or renewal of the audit.

- The Specialised Board established that the audit period was from 8 June until 20 July 2016. Furthermore, the audit was suspended between 20 July and 18 August 2016 by act №111 dated 20 July 2016, i.e. for less than a month.

© 2018 Deloitte TCF LLP

Contesting the actions of a state ecological inspector during an unscheduled targeted audit (3/3)

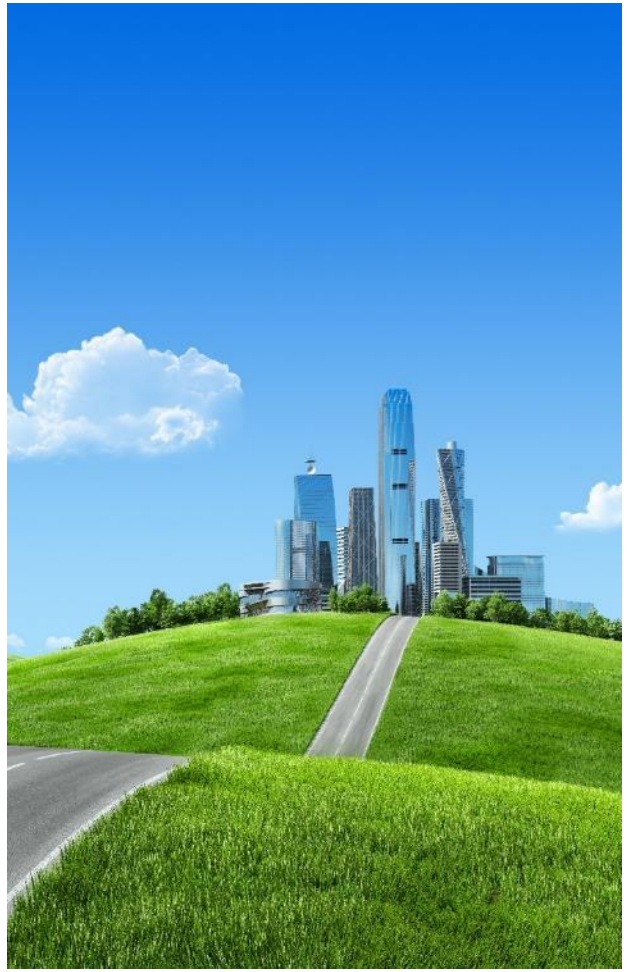
- The Atyrau Oblast Ecology Department faxed notification of the suspension of the audit to Tengizchevroil with a covering letter on 19 July 2016. The suspension came into force on the same day. The claimant's argument about receiving the notification by fax only on 20 July 2016 due to a technical breakdown in data transfer does not affect the general audit period, and cannot be blamed on the Inspector.
- Furthermore, the Specialised Board also established that the audit period and deadline for notifying Tengizchevroil of the audit extension were observed. The extension act did not provide a reason for the audit extension, but this is not itself grounds for recognising the audit as invalid.
- All the above acts were registered with the legal statistics and special reporting authorities.

Thus, the Special Board concluded that the audit period had not been violated and the arguments in Tengizchevroil's appeal were not upheld.

Thus, the Specialised Board left Tengizchevroil's appeal unchanged.

Source: *Judicial Office of the Supreme Court*

More details



© 2018 Deloitte TCF LLP

Contesting the environmental audit results and determining the jurisdiction of the dispute as related to the investment activity (1/2)

Astana City Court ruling dated 1 March 2017 on Case 2-19-17

KATCO LLP

Ruling to leave a lawsuit without consideration at the request of KATCO LLP

KATCO LLP ("KATCO") took legal action in the South-Kazakhstan Oblast Specialised Interregional Economic Court against the South-Kazakhstan Oblast Ecology Department (the "Department") to recognise an audit as invalid and cancel an act of sample audit for compliance with ecological law. KATCO filed a successful petition to have the civil case transferred to the Astana City Court as an investment dispute.

In turn, the Department filed a private appeal with the South-Kazakhstan Oblast Board of Appeal for Civil Cases, which left the South-Kazakhstan Oblast Interregional Economic Court ruling unchanged and rejected the Department's private appeal.

Case history

Period	Instance	Review result
December 2016	Court of first instance	Katco petition upheld
January 2017	Court of appeal	Court of first instance ruling left unchanged
March 2017	Astana city court	Petition left without consideration at Katco's request

The following was established during the hearing:

- KATCO operates under Contract №414 dated 3 March 2000 between the Kazakhstan Investment Agency and KATCO to explore and produce uranium at the Moiynkum field.
- The Department requested to have the court of first instance ruling overturned due to its illegality and invalidity, as the Contract from 3 March 2000 is not an investment contract, rather a contract to explore and produce uranium at the Moiynkum field. At the same time, KATCO disputed the audit act, which in no way may be deemed an investment dispute.
- According to article 274 of the Entrepreneurial Code, investments are all types of property (apart from goods used for personal consumption), including financial lease objects from the moment a lease agreement is concluded, and rights to them, invested by an investor in the charter capital of a legal entity or in increasing fixed assets used in entrepreneurial activities, and to realise a state-private partnership project, including.

© 2018 Deloitte TCF LLP

Contesting the environmental audit results and determining the jurisdiction of the dispute as related to the investment activity (2/2)

a concession project. The term "investor" means an individual or legal entity investing in Kazakhstan. In this respect, investment activities are defined as the participation of individuals and legal entities in the charter capital of commercial organisations or the creation or increase of fixed assets used in entrepreneurial activities, and to realise a state-private partnership project, including a concession project.

- Thus, since it began operations, KATCO has made a significant investment in fixed assets used in entrepreneurial activities, which confirms KATCO's claims that it is an investor.

In this respect, court of first instance based its ruling on the following conclusions:

- according to point 4 of article 27 of the Civil Procedural Code, the Astana City Court considers and rules on civil investment cases according to court of first instance rules, except for cases under Supreme Court jurisdiction, and in relation to other disputes between investors and the state authorities related to an investor's investment activities.

Astana City Court position:

The appeal board agreed with the court of first instance position based on the following:

- In execution of obligations accepted according to the given subsoil use contract, KATCO created fixed assets such as three uranium processing plants, permanent and temporary rotation villages, administrative buildings, canteens, electricity grids, water supplies, a pump station, a boiler room, a drainage system, vehicle roads, hydraulic networks, pipelines, acid storage tanks, warehouses, and repair shops for machinery and equipment.
- the Board believes the Department's argument that KATCO's subsoil use contract is not an investment agreement to be invalid for the above reasons.
- Thus, the Appeal Board took KATCO's position and rejected the tax authorities' partial appeal.

According to KATCO's petition, the Astana City Court issued a ruling to leave the lawsuit to recognise the audit invalid and cancel the act without consideration.

Source: *Judicial Office of the Supreme Court*

More details

© 2018 Deloitte TCF LLP

Customs issues

Incorrect declaration of the customs value of imports (1/2)

Resolution of the Astana City Judicial Board for Civil Cases dated 2 February 2017 for case 7199-17-00-2a/359

PETROLINE BAU LLP

Rejection of company demands

In 2014, PETROLINE BAU LLP (the "Company") imported ceramic tiles from Spain to Kazakhstan under a contract with Petroline GmbH.

The Company declared the goods using the transaction value with imported goods method (first method).

The customs authorities carried out an in-house customs review and issued notification of an understatement of the value of imports by failing to record the relationship between the parties in a customs declaration.

The Company went to court to cancel the notification claiming that it had evidence to prove that expenses to transport the goods after their arrival in the Customs Union were shown separately in the contract from the price paid, which complies with customs law requirements to exclude expenses for transportation after the goods' arrival in the Customs Union from the customs value.

Case history

Period	Instance	Result
October 2016	Court of first instance	Company petition not upheld
February 2016	Court of appeal	Court of first instance ruling left unchanged

In its appeal, the Company stated that the customs authorities had not observed control procedures or adjusted the customs value of goods after their release, and instead of that had issued notification of a requirement to pay overdue customs charges.

The Company does not agree with the customs authorities' conclusions that the transaction value with imported goods method does not apply, but believes that a relationship between the seller and buyer is not necessarily grounds for recognising the transaction value method as inapplicable for determining the customs value of goods.

Position of the Astana Judicial Board for Civil Cases:

- The Company's customs value of the goods included transportation costs to the place of arrival in the Customs Union under CIP Astana supply conditions.

© 2018 Deloitte TCF LLP

Incorrect declaration of the customs value of imports (2/2)

- Appendix №1 to the contract gives a price for the goods of Euros 351,021.76, and shows costs to deliver the goods CIS Astana broken down into before the Customs Union border of Euros 40,000 and in the Customs Union – Euros 80,000.
- However, two invoices with the same number provide different information. One invoice gives a value of Euros 471,021.76 CIS Astana, while the other – Euros 351,021.76 EXW Toledo.
- Company documents provide no chronology for the transportation and transfer of goods from one entity to another, specifically according to certificate of Origin №7056175, the company GREGO GRES INTERNASIONAL supplied goods to Petroline GmbH FOB Valencia, which meant that transportation expenses to Valencia port in Spain were GREGO GRES INTERNASIONAL's responsibility. At the same time, Petroline GmbH, to supply goods to the Company, entered into a separate freight forwarding agreement with a carrier that showed a different loading location of Toledo (Spain) and recording transportation costs to the Customs Union border and through the Customs Union.
- The buyer and seller for the above transaction are related parties, which the Company concealed during customs declaration.

Due to discrepancies in the documents provided that do not allow us to determine accurately transportation expenses incurred before and after the Customs Union border, which testify that the existence of a relationship between the seller and buyer affected the price, the Company did not prove that the relationship of the seller and buyer did not affect the price actually paid or due for payment, and also did not prove that the transaction value was close to one of the test amounts listed in point 4 of article 101 of the Kazakhstan Customs Code.

Thus, the Judicial Board concluded that the court of first instance ruling based on a case review was valid and justified.

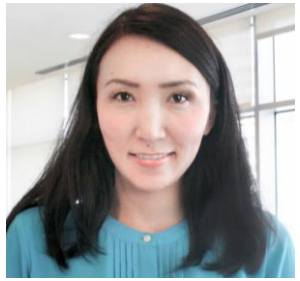
Source: *Judicial Office of the Supreme Court*

More details

"***Deloitte recommends":*** If goods are imported by related parties, then that relationship should be recorded during customs clearance. We also recommend having evidence in place to confirm that any such relationship did not affect pricing.

© 2018 Deloitte TCF LLP

Contact us:



Agaisha Ibrasheva

Tel: +7(727) 258 13 40
Fax: +7(727) 258 13 41
Email: aibrasheva@deloitte.kz

Yelena Ryzhkova

Tel: +7(727) 258 13 40
Fax: +7(727) 258 13 41
Email: yryzhkova@deloitte.kz

Nurzhan Dairbekov

Tel: +7(727) 258 13 40
Fax: +7(727) 258 13 41
Email: ndairbekov@deloitte.kz

© 2018 Deloitte TCF LLP

Deloitte.

deloitte.kz

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 264,000 professionals make an impact that matters, please connect with us on Facebook, LinkedIn, or Twitter.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2018 Deloitte TCF, LLP. All rights reserved.