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Tax Alert - Introduction of the New Tax Code

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INTRODUCTION

Dear Colleagues,

Law On Taxes and Other Obligatory State Budget Payments (the "New Tax Code") was developed within the framework of the government's response to the President's "Kazakhstan in the New Global Reality: Growth, Reforms and Development" message and the "100 Concrete Steps" Plan of the Nation to realise five institutional reforms. On 25 December 2017 the President of the Republic of Kazakhstan has signed and enacted the New Tax Code.

This Tax Alert highlights what we think are the most significant changes or amendments due to become law with the introduction of the New Tax Code.

For instance, a fundamental change will be that all ambiguities and issues not covered by tax law should be ruled in favour of the taxpayer. I think it would be safe to say that there is uncertainty as to how this will work in practice, but it is still a very important milestone in tax legislation, and one that could go a long way towards protecting the interests of responsible taxpayers.

The New Tax Code also stimulates the tax treatment of subsoil users and other taxpayers, increases the time given to review legislative changes throughout the year and simplifies tax administration procedures.

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Yours faithfully,

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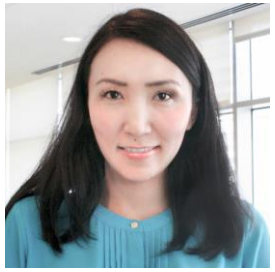

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Tax administration

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Statute of limitations

Starting from 1 January 2020, the statute of limitation period for tax liabilities will be:

- 5 years for:
  - taxpayers subject to tax monitoring (monitoring of major taxpayers and horizontal monitoring)
  - subsoil users
- 3 years for other business entities

Compulsory termination of activities

The tax authorities will be authorised to forcibly terminate a taxpayer's operations if it has simultaneously not:

- filed tax reports
- performed export-import operations
- made payments and (or) transferred money to bank accounts
- registered as a VAT-payer
- registered title to objects that are subject to property, vehicle or land tax
- paid its debt on social payments
- paid its debt on taxes or other payments to the state budget

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Classification of risks

With respect to violations identified by the tax authorities as a result of in-house control, the New Tax Code introduces the following risk classification of violations, which provide various methods for elimination:

- for high risk violations - notification of the elimination of violations;
- for medium risk violations - notification of violations.

Risk Management System

The tax authorities have decided that based on OECD country best practices specific risk management system criteria should not be disclosed to taxpayers. Thus, the criteria for assessing risk levels are confidential, except for criteria stipulated by the authorised body jointly with authorised body on entrepreneurship.

VAT control account

From 1 January 2019, the New Tax Code introduces VAT control account as an account opened by a VAT-payer in a commercial bank to keep accounts on the movement of VAT payments, including:

- VAT payments to the budget (including VAT on imports and non-residents), suppliers / customers
- Obtaining proceeds from another bank account of the VAT-payer

Only payers of VAT using e-invoicing software may use VAT control accounts.

We believe that VAT control accounts will be used to receive VAT on sales from customers and make VAT payments to suppliers to purchase goods, work and services.

Under the New Tax Code, amounts remaining on a VAT control account (once all VAT liabilities have been executed) is subject to be refund from the state budget.

For taxpayers using VAT control accounts, the New Tax Code provides for a shorter period for the VAT refund after confirmation of VAT amount by the tax audit - within 15 business days.

The following taxpayers using VAT control accounts are entitled to VAT refunds:

- manufacturers that use the purchased goods (lease objects) to produce other goods
- exporters
- sellers of petroleum products to foreign airlines performing international flights and for refueling aircraft
- sellers of processed gold produced from raw materials (extracted by the taxpayer independently or acquired for processing purposes) to the National Bank
- sellers of goods to special economic zones if the goods are used as part of the activities performed in the special economic zones

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Horizontal monitoring

From 1 January 2019, the New Tax Code is adding a concept of "horizontal monitoring" whereby the authorities and taxpayer will exchange information and documents (including access to book and tax accounting systems, and accounting documentation at the taxpayer's location)

Taxpayers may enter three-year horizontal monitoring agreement starting from January 1 of the year following the year of signing the agreement, with option to extend the agreement. The categories of taxpayers, the procedure for concluding and terminating the agreement shall be established by the authorized body.

Taxpayers involved in the horizontal monitoring scheme will be entitled to:

- preliminary explanations and comments regarding planned transactions
- VAT refunds according to the simplified procedure of up to 90% of input VAT-excess
- a moratorium on tax audits during the horizontal monitoring period, except for:
  - counter tax audits or tax audits performed at the taxpayer's (tax agent's) request
  - those performed for the reasons stipulated by criminal procedural law and the General Prosecutor's Law
  - those performed in connection with a taxpayer's (tax agent's) appeal against audit findings

Also, the proceedings on the case on administrative violations of the tax legislation can not be initiated and, if initiated, are subject to termination if violation is identified during:

- horizontal monitoring, while simultaneously meeting the following conditions:
  - the taxpayer's agreement with notification on the results of horizontal monitoring;
  - absence of court appeal on the notification on the results of horizontal monitoring.
- tax audit for the taxpayer's horizontal monitoring period

Tax audit appeals

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Tax audit appeals

Tax audit

The New Tax Code adds to the already substantially amended tax audit appeal process which entered into force on 1 July 2017, aiming to improve and clarify organisational and procedural issues.

Notification

The tax authorities are now obliged to notify taxpayers of a tax audit in relation to:

- the split-off or liquidation of a resident legal entity
- the termination of a non-resident legal entity's activities in Kazakhstan through a permanent establishment
- the termination of the activities of an individual entrepreneur, private notary, private law enforcement officer, advocate, and a professional mediator and
- deregistration for VAT based on a taxpayer application

Change in the period of notice for a suspension or resumption

Under the New Tax Code, the period of notice for suspending or resuming a tax audit has been changed from one business day to three business days from the suspension or resumption date, with notification sent to the legal statistics authorities regarding the same.

Likewise, entities that have registered as electronic taxpayers may receive the above notifications from the tax authorities by email.

Tax audit notification

Due to the introduction of digital signatures, the tax authorities are no longer required to physically stamp tax audit notifications and register them in a special log.

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Tax audit appeals

Tax audit act

The New Tax Code introduces a rather confusing amendment to the legislative acts applicable to tax audit acts. According to the Current Tax Code, the tax authorities refer to "tax law" to evaluate violations. However, the New Tax Code removes the word "tax" before legislation, meaning the tax authorities will be entitled to refer to any legislative act it sees fit, which makes the amendment rather ambiguous.

Standard audit file

Taxpayers will now be entitled to load standard audit files into the tax authority information system during a tax audit. The "standard audit file" is an accounting document used to identify taxable objects, objects related to taxation and tax liabilities. Standard audit files are submitted voluntarily, at the taxpayer's discretion, and are signed using the taxpayer's digital signature.

The authorised body still needs to approved the format of the standard audit file.

Any rulings in relation in relation to legislative ambiguities will be made in favour of the taxpayer

According to the New Tax Code, any rulings with respect to ambiguities and unclear issues in tax law will now be made in favour of the taxpayer (tax agent).

The tax authorities' individual written explanation

During the proceedings of a complaint on tax audit notification, tax liability shall be corrected, no fines or penalties shall apply if the taxpayer had fulfilled its tax obligations in accordance with the tax authorities' individual written explanation that was later withdrawn, found to be erroneous or a new clarifications were issued.

Corporate income tax

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Corporate income tax

Taxable income

The list of taxpayers' taxable income has been updated to include total profit of controlled foreign companies or the permanent establishments of controlled foreign companies, in the amount determined by tax law.

Date of recognition of sales income

The concept of the recognition of sales income for CIT purposes has been updated as follows:

- the date of recognition of sales income is determined in accordance with IFRS and the Law on Accounting
- sales income may be adjusted in accordance with transfer pricing law

Income on doubtful obligations

The New Tax Code allows taxpayers to avoid double taxation on interest by clarifying that a taxpayer will not have to recognise income on doubtful obligations if it had not deducted interest accrued on loans obtained from banks and other organisations providing banking services.

Income on property received free of charge

The value of property (including work and services) received free of charge, which is deemed taxable income, is determined in accordance with its accounting value (IFRS and the Accounting Law) which should be no lower than the value specified in an act of transfer (if any), inclusive of VAT as specified in transferring party documents.

Under current tax law, the transfer of property (including work and services) is treated as taxable turnover for VAT purposes for the transferring party. However, it does not mention the tax treatment of the recipient's input VAT. This has been rectified by the New tax Code.

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Objects of social sphere

The tax authorities no longer treat assets used to facilitate the following activities as objects of social sphere:

- medical activities
- primary, secondary, technical, professional and higher education activities
- activities in the field of science, physical exercise and sports, culture, the preservation of historical and cultural heritage, and archive valuable
- activities to organise the leisure time of employees, their families, related parties, and to maintain housing facilities

The New Tax Code has changed the above concept of social assets so that social assets are now assets belonging to the taxpayer and:

- used in one or more of the following activities:
  - recreation and entertainment
  - science, culture, physical culture and sports, the preservation of historical and cultural heritage, and archive valuables
- which are a residential property

Interest deductions

The New Tax Code clarifies the formula for calculating interest deductions, removing liabilities accrued in accordance with IFRS and the Accounting Law from average annual liabilities.

In other words, a general approach is established on liabilities accrued in accordance with IFRS and the Law on Accounting for tax accounting purposes.

Business trip compensation

Under the New Tax Code, "business trip destination" is the destination specified in an employer order or written instruction to send an employee on a business trip for work, education, training or professional development purposes.

The New Tax Code also provides an additional deduction for the following business trip expenses incurred by board of directors' members:

- travel expenses to and from a place of work, including reservation costs, except for transportation within one town or populated area
- business trip accommodation costs, including reservation fees
- daily allowances
- visa support (visa, consular or medical insurance fees)

The above additional deductions are provided on the basis of documentary evidence.

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Corporate income tax

Deduction of doubtful claims

The New Tax Code clarifies the procedure for identifying the period when doubtful claims occur, for example:

- for loan agreements – starting from the day following the maturity date of interest payments as specified in the loan agreement
- for lease contracts – starting from the day following the maturity date of the lease payment as specified in the lease agreement
- in other cases – starting from the day:
  - following the end date for a claim on goods sold (work, services), if that date can be determined
  - when goods (work or services) have been transferred, if the end date cannot be determined

In introducing the above, the New Tax Code has removed any ambiguity with respect to the date doubtful claims arise.

Non-deductible expenses

The list of non-deductible expenses has been expanded with:

- the book value of fixed assets transferred to temporary possession and use under proprietary lease contracts, except for lease contracts

Depreciation charges

Under the New Tax Code:

- the transfer of fixed assets to temporary possession and use under proprietary rental contracts, except for lease contracts, are not regarded as a disposal for tax accounting purposes and
- the receipt of fixed assets transferred to temporary possession and use under proprietary rental contracts, except for lease contracts is not treated as an addition of fixed assets for tax accounting purposes

Thus, despite the changes to IFRS with respect to the accounting treatment of fixed assets transferred to temporary possession under proprietary rental contracts, asset owners will still continue the tax accounting for the given fixed assets.

Other deductions for fixed assets

A subsoil user extracting solid minerals is entitled to a deduction of the ending balance of fixed asset subgroup (group) value for tax purposes.

Deductions can be claimed in the tax period in which field damage control and recovery work is completed.

If a taxpayer does not generate taxable income or has a current tax loss position under a subsoil use contract, it can claim the deduction under another of its subsoil use contracts. The deduction amount should not exceed 150,000 times the month calculation index.

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Capital gains income

Reduction in taxable income

Under current tax law, a taxpayer is entitled to reduce its taxable by the value of a capital gain on the sale of shares (participation interest) in Kazakh legal entity, if on the date of sale the shareholder has owned them for more than three years.

The New Tax Code introduces a provision whereby the holding period is determined collectively, taking into account share or participatory interest ownership periods of former owners, if the taxpayer received the shares or participation interests following the reorganisation of previous owners.

Capital gain on the sale of shares/participation interest

Under current tax law, a taxpayer cannot reduce taxable income by the value of a capital gain on the sale of shares (participation interest) in subsoil users.

The New Tax Code clarifies that subsoil users (during the 12-month period preceding the date of sale) carrying out further processing (after initial processing) on at least

- 35% of extracted raw materials (including coal) (from 1 January 2018)
- 40% of extracted raw materials (including coal) (from 1 January 2019)
- 50% of extracted raw materials (including coal) (from 1 January 2020)
- 40% of extracted raw materials (including coal) (from 1 January 2022)

at their own production facilities in Kazakhstan or at those owned by related parties will not be treated as subsoil users for the purposes of this provision.

To determine the volume of extracted minerals (including coal) sent for further processing, taxpayer should use raw materials sent for production after primary processing and those used to generate products of primary processing for further use in subsequent processing.

Value Added Tax

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Value Added Tax

Place of sale of goods, work and services

The New Tax Code adds technical maintenance, software updates and internet resource access to the list of work and services whose place of sale is determined by the buyer's place of registration.

Thus, when Kazakhstan legal entities procure the above services from a non-resident, Kazakhstan will be recognised as the place of sale and such purchase will be subject to VAT in Kazakhstan.

At the same time, when Kazakhstan legal entities provide the same services to non-residents, Kazakhstan will not be recognised as the place of sale and such services will be exempt from VAT.

Exempt sales turnover

Services provided by state authorities for a fee are no longer exempt from VAT.

The following are now exempt from VAT:

- gambling and betting services
- housing cooperative services to manage common assets, performed in accordance with local housing law
- goods, work and services sold in the Khorgos International Centre for Border Cooperation special economic zone

This change has provided additional tax incentives that stimulate certain types of activities.

Date of turnover

For the following services, under the New Tax Code, the date of turnover will be:

- a printed periodical publication - the transfer date
- media products – the forwarding date to an e-mail or electronic subscriber mailbox
- mass media products on an internet resource in public telecommunication networks - the posting date

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Value Added Tax

Taxable turnover

The New Tax Code also clarifies the procedure for determining taxable turnover for:

- the sale of reusable packaging that was not returned within a specified period – the book value of the reusable packaging at the date of its return
- an employer's transfer of goods (work or services) to an employee as a salary payment
- the purchase of work or services from a non-resident - the cost of purchasing the work or services, including income tax withheld at the source of payment

With these changes, the tax authorities are clarifying the procedures for calculating VAT obligations whereby no additional tax burden will be imposed on the employer.

Invoicing date

Under the New Tax Code, invoices (electronic and hard copy) should be issued:

- for exports – within 20 calendar days of the turnover date
- for financial lease interest accrued for the calendar quarter – not later than the 20th day of the month following the quarter
- in other cases – not earlier than the date of turnover and not later than 15 calendar days of that date

Input VAT

The New Tax Code clarifies the procedures for determining the amount of input VAT allowed for credit for the construction of a residential building (part of a residential building):

- For the sale of a residential construction-in-process (CIP), the input VAT amount is determined (at the date of sale):
  - CIP of a residential building or land - VAT amount on purchases of goods, works and services used for construction at a rate effective at their acquisition date;
  - CIP, which is part of both non-residential and residential building or land – as input VAT on purchased goods, works and services used for construction multiplied by the ratio of area of CIP facility for sale (per design estimate documentation) over the total area of CIP facility.
- For the sale or lease of a part of a residential building that consists exclusively of non-residential premises, input VAT is determined as:
  - The difference between input VAT on purchases used for the construction of a residential building (part of a residential building) and input VAT offset on CIP, which is part of both non-residential and residential buildings or land; multiplied by
  - The ratio of the area of non-residential premises in a residential building (part of a residential building) over the total area of the residential building (part of the residential building).

Thus, companies selling or leasing a part of a residential building should keep separate records of the purchase of goods, work and services used in the construction of both non-residential and residential buildings or land.

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Value Added Tax

Exclusion from input VAT

The New Tax Code also excludes input VAT that was previously claimed for an offset with respect to the following transactions, that are simultaneously:

- performed without actual provision of goods, works, services
- performed with a taxpayer de-registered as a VAT-payer on the basis of the tax authorities' decision (due to recognition of registration or re-registration of a legal entity as invalid on the basis of an effective court decision)
- General Director, founder (participant) was not involved in registration (re-registration) of its legal entity and (or) in performance of financial and economic activities.

Such a provision does not apply to transactions for which the court confirmed the actual receipt of goods, works, services from such a taxpayer.

International taxation

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International taxation

Non-resident permanent establishments in Kazakhstan

Clarification of the definition of "dependent agent"

Under the Current Tax Code, a dependent agent is recognised as a person who simultaneously complies with a set of certain conditions.

Under one of these conditions, an entity is recognised as a dependent agent if it is contractually authorised to represent the interests of a non-resident in Kazakhstan, act and (or) perform specific legal actions on behalf of and at the expense of a non-resident.

According to the New Tax Code, the above legal actions involve concluding a service contract or performing a major role to conclude such contract on behalf of a principal or agent, or transfer title (user rights) to property belonging to a non-resident.

Clarification of the procedure for determining a non-resident's income from secondment services

A non-resident providing secondees does not create a permanent establishment in Kazakhstan, provided it meets three specific conditions simultaneously, one of which being that its income should not exceed 10% of costs incurred to provide the secondees.

With the New Tax Code, a non-resident's income is the positive difference between the fee received for providing secondees and its costs incurred in providing the secondees.

Start date of a non-resident's activities in Kazakhstan

According to the Current Tax Code, a non-resident is deemed to have begun activities in Kazakhstan on the earliest of the dates:

- it enters into contracts (agreements) to:
  - work or provide services in Kazakhstan
  - authorise others to act on its behalf in Kazakhstan
  - purchase goods in Kazakhstan for sales purposes
  - work or provide services in Kazakhstan within the framework of a joint activity agreement
  - purchase work or services to perform work or services in Kazakhstan
- it enters into a first employment contract or other civil law agreement with an individual in Kazakhstan
- an employee arrives in Kazakhstan to work in Kazakhstan
- a document authorising a non-resident to operate in Kazakhstan enters into force

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Start date of a non-resident's activities in Kazakhstan (continued)

The New Tax Code, however, states that non-resident is deemed to have begun activities in Kazakhstan on the earliest of the above dates, but not the earlier than:

- the date an initial employment contract for activities in Kazakhstan is concluded or
- the date a non-resident individual, employee or other hired individual arrives in Kazakhstan to execute a contract

Non-resident income from Kazakhstan sources

The list of non-resident Kazakhstan-source income has been expanded to include:

- income from providing engineering and marketing services outside of Kazakhstan
- the income of an entity registered in an "offshore" country in the form of an obligation to return an advance payment if:
  - the non-resident has not made repayments over a two-year period from the advance payment date
  - the non-resident has not made repayments by the date the entity that made the advance payment files a liquidation tax return until two years from the advance payment date

The New Tax Code also establishes a procedure for determining liabilities when the liquidation of the entity that made the advance payment requires a tax audit or in-house control.

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International taxation

Taxation of non-residents operating without a PE in Kazakhstan

WHT exemption for the dividends of legal entities reducing CIT by 100%

According to the current Tax Code, the dividend WHT exemption does not apply if the legal entity paying them reduces CIT by 100%.

The New Tax Code states that if CIT reduced by 100% is less than 50% of total CIT assessed for the resident legal entity paying the dividends, the exemption applies to the entire dividend amount.

WHT exemption on dividends paid by subsoil users

The New Tax Code has amended how dividends paid by subsoil users are exempt from WHT.

To be entitled to exempt dividends from WHT, resident subsoil users paying dividends should carry out subsequent mineral processing (post-primary processing) work during the 12-month period preceding the first day of the month in which dividends were accrued.

The New Tax Code also envisages an increase in the percentage of processed minerals to trigger dividend WHT exemptions to:

- 40% of extracted minerals (effective from 1 January 2019 until 1 January 2020)
- 50% of extracted minerals (effective from 1 January 2020 until 1 January 2022)
- 70% of extracted minerals (effective from 1 January 2022)

Minerals (including coal) should also be processed at the subsoil user's processing facilities and (or) at the processing facilities of a related-party resident legal entity in Kazakhstan.

Additions to the definition of "subsoil user" for the purpose of exempting dividends from WHT

The New Tax Code has expanded the list of entities not recognised as subsoil users for the purpose of exempting dividends from WHT, to include those with the right to extract underground water and (or) basic building materials for its own needs.

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Clarifications to provisions dealing with dividend WHT exemptions and capital gains from the sale of shares/a participatory interest arising from subsoil users and non-subsoil users in Kazakhstan

The New Tax Code specifies how a three-year ownership period for holding shares or a participatory interest is calculated (one of the conditions for applying the WHT exemption to dividends and capital gains from the sale of shares and participatory interest).

According to the clarification, a three-year ownership period is determined cumulatively, taking into account the ownership period of former owners, if such shares or the participation interest are held by the taxpayer as a result of a reorganization of the previous owners.

Changes to the definition of a "subsoil user" for the purpose of applying the WHT exemption to capital gains from the sale of shares or a participatory interest

The New Tax Code has expanded on the list of persons who are *not* recognized as subsoil users for the purpose of applying the WHT exemption to capital gains from the sale of shares or a participatory interest.

In accordance with the new provision, a user will not be a subsoil user for these purposes just because they possess the right to extract groundwater and/or basic building materials for their own needs. Further, a user will not fall within the definition of a subsoil user if the user is engaged in processing the relevant percentage (or more) of extracted minerals in the twelve-month period preceding the first day of the month in which the shares or a participatory interest is sold. The relevant percentages of processed minerals are as follows:

- 40% of extracted minerals (effective from January 1 2019 to January 1 2020);
- 50% of extracted minerals (effective from January 1 2020 to January 1 2022);
- 70% of extracted minerals (effective from January 1 2022 onwards).

For the purposes of calculating the relevant volumes, the minerals (including coal) processed at processing facilities the volume of processed minerals (including coal) should include:

1) raw materials sent for production after primary processing; and
2) those used to generate products of primary processing for further use in subsequent processing.

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Taxation of income of non-residents carrying out their activity through a PE in the Republic of Kazakhstan

Exceptions to the total annual income of a permanent establishment of a non-resident

If the positive exchange rate difference is greater than the negative exchange rate difference (arising from the obligations of a PE of a non-resident legal entity in Kazakhstan which are owed to the head office or other structural units of the non-resident legal entity) the excess should be excluded from the aggregate annual income of the PE in Kazakhstan.

Similarly, if the negative exchange rate difference is greater than the positive exchange rate difference (arising from the obligations of a PE of a non-resident legal entity in Kazakhstan which are owed to the head office or other structural units of the non-resident legal entity) the excess should not be deducted from the income of the PE in Kazakhstan.

Changes in the procedure for determining the taxable income of PE in Kazakhstan

A non-resident legal entity that carries out activities in the Republic of Kazakhstan through a PE should calculate CIT retrospectively from the date of commencement of the business activities that led to the formation of the PE.

Application of any international tax treaty

Expansion in the application of the beneficial owner concept

According to the New Tax Code, the concept of the beneficial owner of income applies not only to passive income but also to other types of income for the purposes of applying a tax exemption under the international tax treaty.

Under the New Tax Code provisions, the tax agent has the right to apply the tax exemption for non-resident income if the non-resident, among other things, is the beneficial owner of the income.

For the purposes of this provision, the beneficial owner of income is a person who has the right to own, use and dispose of income and is not an intermediary with respect to such income, including an agent or a nominal holder.

The relevant changes in this respect are included in a number of related articles in the New Tax Code.

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Simplification of the terms with respect to provision of tax residency certificate

To apply the tax exemption for non-resident income, the residency certificate shall be provided:

- not later than 31 March of the year following the tax period in which the income was paid to the non-resident or the assessed unpaid income was deducted for CIT purposes; or
- not later than five working days before the completion of the tax audit on WHT liability for the tax period during which the income was paid to a non-resident.

Expansion in the list of documents that a non-resident is required to provide for the purposes of applying the provisions of an international tax treaty

If a non-resident has no constitution documents or an extract from the trade register in accordance with the requirements of the foreign state's legislation, the non-resident can provide any other document indicating the organizational structure of the consolidated group of which the non-resident is a participant, all its participants and their geographical location (names of states/territories where the members of the consolidated group are established (registered) as well as state and tax registration reference numbers of all participants in the consolidated group.

Additional provisions for the tax exemption of non-resident income from the provision of international transportation services and net income of PE under an international tax treaty

The relevant provisions are supplemented with a clause which states that in the absence of a document confirming residency as of the date of submission of the CIT declaration, the non-resident is not entitled to apply the provisions of the international treaty.

At the same time, a non-resident has the right to apply the provisions of an international treaty within the limitation period by submitting an additional CIT return and a document confirming residence to the tax authorities.

Exclusion of provisions regarding the procedure for the return of income tax from a conditional bank deposit

The New Tax Code excludes provisions regulating conditional bank deposits.

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New rules on "controlled foreign companies"

The mechanism for taxing profits of a controlled foreign company (CFC)

The profit of the CFC is included in the income of a resident legal entity or resident individual.

Criteria for CFC

CFC is a non-resident legal entity or any other form of foreign business organization, where:

- More than 25% of the shares or participatory interest in the CFC directly or indirectly or de facto belong to a legal entity or an individual resident of the Republic of Kazakhstan or legal entity or individual resident of the Republic of Kazakhstan has direct or indirect or de facto control over CFC; and
- the CFC or the PE of the CFC is registered offshore or the effective tax rate of the CFC or PE of the CFC is less than 10%.

Elimination of double taxation of CFC profit

Double taxation of CFC profits is eliminated by way of a tax credit, tax exemption or reduction of the CFC profit. A tax credit is applied where the effective profit tax rate of the CFC or PE of the CFC in the foreign state is less than 20% for CIT or less than 10% for PIT.

If the effective profit tax rate of the CFC or PE of the CFC in the foreign state is 20% or more for CIT or 10% or more for PIT, the tax exemption applies.

Tax exemption

The profit of the CFC or PE of the CFC is tax exempt in the RoK in the following cases:

- if there is indirect participation in the CFC or indirect control over the CFC through another resident of the Republic of Kazakhstan;
- If there is indirect participation in the CFC or indirect control over the CFC through a person who is not a controlled person;
- if the financial profit of the CFC PE was taxed in the state in which the CFC that established the PE is registered, at an effective rate of 20 percent or more;
- if the profit of the CFC or the CFC PE was taxed in the state in which the controlled person is registered, through which the resident indirectly holds participation or has indirect control over CFC, at an effective rate of 20 percent or more;
- if the financial profit of the CFC or the financial profit of the PE of the CFC that is registered in a state with preferential taxation treatment is taxed at an effective rate of 20 percent or more.

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Documents required for the CFC tax exemption to apply

For tax exemption of the CFC's or the CFC PE's profits, the following documents must be maintained:

- copies of documents confirming the indirect participation or indirect control of a resident in a CFC;
- a copy of the document indicating the organizational structure of the consolidated group;
- a copy/copies of the legislative act/acts of the state of registration of the controlled person, through which the resident indirectly owns a participation interest (voting shares) in the CFC;
- a copy of the financial statements of a CFC that has established a PE;
- a copy of the legislative act/acts of the state of registration of a CFC that established a PE.

Reducing the profit of the CFC

The resident has the right to reduce the profit of the CFC before taxation by the following amounts if there are supporting documents:

- amount of profit/loss of subsidiaries (associated, joint companies) of the CFC if there is an obligation to prepare consolidated financial statements without compiling separate unconsolidated financial statements;
- income from sources in the RoK, taxed at a rate of 20%;
- dividends from sources in the RoK; and
- dividends paid between two CFCs controlled by the same resident of Kazakhstan.

Transfer pricing legislation

Tax Alert - Introduction of the New Tax Code

Transfer pricing legislation

Changes to transfer pricing rules

On 6 January 2017, the OECD published an announcement that Kazakhstan had joined the Inclusive Framework developed by members of the OECD and G20 countries for implementing the Base Erosion and Profit Shifting ("BEPS") Project.

Membership of the Inclusive Framework allows member countries to work alongside OECD and G20 members to develop BEPS related standards and monitor and review implementation of the BEPS Project. Countries and jurisdictions joining the Framework are committed to ensure consistent implementation of BEPS measures and "minimum standards" aimed at enhancing international tax rules preventing tax avoidance.

As part of this initiative, in line with BEPS Action Plan 13, Kazakhstan introduced the concept of three-tiered transfer pricing documentation, including preparation of a Master File, Local File and Country-by-Country Reporting ("CbCR") by multinational enterprises ("MNEs").

Though no precise form of the Master File, Local File and CbCR is specified yet, in accordance with OECD guidelines, the following information should be included:

- Master File – general information about a MNE's business and overview of basic transfer pricing approaches.
- Local File – more detailed information on specific intragroup transactions in specific jurisdiction.
- CbCR – summary information about an MNE's economic activities in relevant jurisdictions.

Who is affected?

The amendments affect the following MNE group entities included in MNE group consolidated financial statements, or which would be if equity interests in that MNE group business unit were traded on a public securities exchange:

- The MNE's ultimate parent company, which is a resident of the RoK;
- Residents, which are members of a MNE group and are not a parent entity or constituent entity (subject to certain conditions);
- Kazakhstan residents that are constituent entities;
- Non-residents of Kazakhstan that are members of MNE group and that operate in Kazakhstan through a PE.

Tax Alert - Introduction of the New Tax Code

Transfer pricing legislation

Filing requirements

The CbCR filing requirement has retrospective effect from 1 January 2016. As such, MNE groups with an consolidated revenues (for the financial year prior to the reporting year) of no less than 750 mln EUR would be required to file CbCR.

The Master and Local File requirements enter into force from 1 January 2019, for those MNEs with an aggregate annual income of the MNE group entity (for the financial year prior to the reporting year) which is no less than c. 29 mln EUR.

The Master and Local File requirements would enter into force starting from 1 January 2019, if:

- For Local File - the revenues of MNE group entity (for the financial year prior to the reporting year) is no less than c. 29 mln EUR.
- For Master File – the consolidated revenues of MNE group (for the financial year prior to the reporting year) is no less than 750 mln EUR.

Notification requirements

Effective from 1 January 2018, all local member of the MNE group must notify the tax authorities of their participation in a MNE no later than 1 September of the year following the reporting year.

The first notification should be submitted no later than 1 September 2018.

Penalties

Failure to submit the transfer pricing documentation or submission of inaccurate information to the authorities will be subject to a penalty of c. 1,400 EUR for medium-sized entities and c. 2,900 EUR for large entities (comes into force in 1 January 2019 according to Law № 122-VI dated 25 December 2017).

Repeated violations of these requirements in the 12 months following the imposition of an administrative penalty, will entail a penalty of c. 2,900 EUR for medium-sized entities and c. 5,800 EUR for large entities (comes into force in 1 January 2019 according to Law № 122-VI dated 25 December 2017).

Taxation of individuals

Tax Alert - Introduction of the New Tax Code
Taxation of individuals

Changes into structure of new tax code with respect to PIT

The New Tax Code has been restructured. PIT changes in Section 8 (PIT) and 9 (PIT on income of individual entrepreneurs and those from private practice) of the New Tax Code will apply as follows:

- Prior to **1 January 2020** – the provisions from the *Law On Enforcement of the Tax Code* apply;
- from **1 January 2020** – amended rules apply to accommodate *Universal Reporting for individuals* including:
  - new obligations for individuals under Universal Reporting rules (scope of persons subject to reporting, types of tax returns, procedure and deadlines);
  - Introduction of additional tax deductions (for families with multiple children, on education, on mortgage interest);
  - Additional obligation for tax agents when issuing income tax certificates for individuals;
  - New procedure for recovery of overpaid PIT;
  - New rules for determining income of individuals subject to reporting by the indirect method.

Object of taxation for social tax

The New Tax Code changes the list of income items that are not subject to social tax taxation with the following:

- Additions:
  - OSMI deductions
- Exclusions:
  - compensatory payments made for terminating employment agreements because the employer (an individual) discontinues activity or because the employer (a legal entity) goes into liquidation, or there is a reduction in the number of employees or staff size, to the amounts established by the legislation of the RoK
  - compensatory payments made by employers to employees for unused payable annual leave

Social tax rate

Temporary changes in the effective rate for social tax have been introduced as follows:

- from **1 January 2018** – **9.5% of the taxable base** (*previously 11% of social tax base*)
- from **1 January 2025** – **11% of the taxable base**

Tax Alert - Introduction of the New Tax Code
Taxation of individuals

Tax residency

There is a new updated definition of Center of Vital Interests for determining the tax residency of individuals as follows:

- The Center of Vital Interests of an individual shall be recognized as being in the RoK where the following conditions are simultaneously met:
  - The individual is a citizen or a residence permit holder of the Republic of Kazakhstan;
  - The **Spouse** and/or close relatives of the individual reside in the RoK (*previously "family and/or close relatives"*); and
  - The individual and/or **his/her spouse and/or close relatives** have real estate in the RoK in accordance with ownership rights or otherwise, which is available at any time for his/her residence and/or the residence of **his/her spouse and/or close relatives** (*previously it was "his/her family"*)

The New Tax Code requires an annual PIT return to be submitted by the following:

Scope of persons

- **Citizens, oralmans and resident permit holders in the RoK** who have money in bank accounts in foreign banks situated outside of the RoK **on 31 December of the reporting year which exceeds in total 12 times the minimum monthly salary** (*previously it was "Tax resident individuals"*) – *for 2018 the threshold amounts to KZT 339,408*; and
- **Citizens, oralmans and resident permit holders in the RoK** who own the following property **on 31 December of the reporting period** (*previously it was "Tax resident individuals"*):
  - Real estate and/or ownership rights in real estate which is/are subject to state or other registration as per local legislation of a foreign jurisdiction
  - Shares whose issuers are registered outside of the RoK;
  - Shares/participatory interest in entities registered outside of the RoK

Tax Alert - Introduction of the New Tax Code
Taxation of individuals

Taxation of employees of a non-resident legal entity without a PE in Kazakhstan

Scope of persons/income to be taxed in Kazakhstan

Income received by foreign citizens and stateless individuals from activities in the territory of the RoK:

- Including:
  - Employees' income (pursuant to a labour agreement) from a non-resident legal entity without a PE in the RoK; and/or
  - **Personnel's income (pursuant to a civil agreement) from a non-resident legal entity without a PE in the RoK; and/or**
  - **Income in the form of material gain from a non-resident legal entity without a PE in the RoK; and/or**
  - **Income in the form of housing allowances from a non-resident legal entity without a PE in the RoK**
- For individuals spending in the territory of the RoK not less than 183 days within any 12 month consecutive period ending in the reporting period.

  Please note that the following provision has been eliminated:

  "In the event the foreign citizen or stateless individual is not recognized for the tax period in question as a tax resident in the RoK, then income of such an individual shall not be subject to tax."

Documentary basis and injunctive remedies for PIT calculations

The entity receiving services in the RoK will act as the tax agent responsible for settling the PIT for income of individuals of a non-resident and shall provide the following documents provided by the non-resident:

- employment agreement between the individual and non-resident legal entity; or
- **civil agreement** and/or other document containing details of income of individual from the non-resident legal entity

If the non-resident fails to provide supporting documentation for the PIT calculation the entity receiving services in the RoK will be responsible for withholding PIT ie 10% of 80% of the total amount of income due to the non-resident legal entity for services being rendered in the RoK.

Tax Alert - Introduction of the New Tax Code

Taxation of individuals

Changes in the Law "On Obligatory Social Medical Insurance" (OSMI) for 2018-2022

Employee deductions under labor agreements

Employers, in addition to making OSMI contributions in favor of employees, are also obliged to make employee deductions and remit these to the authorities. However, the introduction of employee OSMI deductions has been postponed as follows:

- from **1 January 2020** – 1% of the taxable base (*previously effective as of 1 January 2019*)
- from **1 January 2021** – 2% of the assessment object (*previously effective as of 1 January 2020*)

Individual deductions under civil agreements

Tax agents are obliged to make deductions for individuals generating income from civil contracts and remit these to the authorities. Starting 1 January 2018 obligations for OSMI deductions under civil agreements have been rearranged as follows:

- from **1 January 2020** – **1% of the taxable base** (*previously 5% of the taxable base effective as of 1 July 2017*)
- from **1 January 2021** – **2% of the taxable base**

Contributions of individuals residing abroad

Kazakhstan nationals residing abroad are obliged to make individual contributions to their benefit for the relevant financial year. However introduction of such individual OSMI contributions has been postponed as follows:

- from **1 January 2020** – 5% of the minimum monthly salary (*previously effective as of 1 January 2018*)

Changes into the Law "On Social Insurance" for 2018-2022

Obligatory social contributions

Employers are responsible for making social contributions in favor of employees. Temporary changes in the applicable rate for social contributions have been introduced as follows:

- from **1 January 2018** – **3.5% of the taxable base** (*previously 5% of the taxable effective as of 1 January 2010*)
- from **1 January 2025** – **5% of the taxable base**

Changes into the Law on Pension System for 2018-2020

Obligatory employer pension fund contributions

Employers, in addition to making professional pension fund contributions in favor of its employees and being obliged to withhold and remit employee obligatory pension fund contributions, will be responsible for making obligatory employer pension fund contributions.

However, the introduction of this new obligation for employers has been postponed as follows:

- from **1 January 2020** – 5% of the taxable base (*previously effective as of 1 January 2018*)

Other taxes and budget payments

Tax Alert - Introduction of the New Tax Code

Other taxes and budget payments

Property tax calculation for trust management agreements

Under the New Tax Code a mechanism for the property tax calculation on the transfer of property by state institutions to trust management will be introduced.

If the tax obligations must be executed by the trustee, the tax is calculated by the average annual book value:

- by the trustee on his own if such property is transferred to his accounting balance.
- by the state institution if the property is on its accounting balance. At the same time, information about the tax base of such property should be annually transferred to the trustee no later than 1 February of the reporting year.

In the absence of data on the average annual book value of the property, the tax base for such property is its book value reflected in the act of acceptance of delivery.

Cancelation of certain levies and payments

The following levies and payments have been cancelled as they contradict the principles of levies and payments:

- the payment for the use of navigable waterways;
- the auction levy.

Gambling business tax

The New Tax Code provides an increase in tax rates on gambling business. Starting from 1 January 2018, the following rates will be applied to the unit of the taxation object per month:

- gambling table – 1,660 MCI (previously 830 MCI);
- slot machine – 60 MCI (previously 30 MCI);
- totalizator counter – 300 MCI (previously 150 MCI);
- electronic totalizator counter – 4,000 MCI (previously 2,000 MCI);
- bookmaking office counter – 300 MCI (previously 150 MCI);
- electronic bookmaking office counter – 3,000 MCI (previously 2,000 MCI).

Monitoring emissions volumes

From 1 January 2018 the authorized body of the Ecology Committee (rather than the tax authorities) will be responsible for monitoring the actual volume of emissions. The functions of accepting declarations, accounting accrued and paid amounts and collecting debts to the budget remain with the tax authorities.

Taxation of subsoil users

Tax Alert on New Tax Code

Taxation of Subsoil Users: General Provisions

Corporate Income Tax (CIT)

Article 258 of the New Tax Code clarifies allocation of the cost pool of expenditures (for geological study, exploration, preparatory works for production and other costs) incurred by a subsoil user under an existing exploration contract when a production contract is concluded for a part of the contractual territory already granted to the subsoil user under the existing exploration contract.

In this case, a portion of the cost pool shall be allocated to the new production contract pro rata to the amount of "direct expenses" incurred for the part of the contractual territory for which the production contract is concluded.

The New Tax Code further clarifies rules for formation of cost pools such that subsoil users' assets shall be excluded from the cost pool:

- If the assets are transferred as an in-kind contribution to the charter capital of another legal entity – for the amount specified in the foundation documents of the person receiving such assets;
- If the assets transferred free of charge – for the amount specified in the act of transfer-acceptance of the assets, but not less than the book value of such assets.

The rules for separate tax accounting (ring-fencing) have been favorably amended to allow deduction of certain expenses incurred one subsoil user contact against taxable income from activity under other subsoil use contracts.

According to **Article 259** of the New Tax Code, subsoil users with two or more subsoil use contracts will now have the right to form a separate cost pool (of expenditures for geological study, exploration, preparatory works for production and other costs) incurred after 1 January 2018 under exploration contracts, or exploration-stage contracts for combined exploration and production, so that this cost pool can be deducted (amortized) against taxable income generated under other subsoil use contracts, i.e. production contracts and production-stage contracts for combined exploration and production.

The separate cost pool can be created in the tax period in which a new production contract is concluded and/or production stage starts under other combined exploration and production contract(s).

The separate cost pool shall be amortized for taxation purposes and allocated to production contracts and such other production-stage contracts for combined exploration and production, pro rata to their share in the subsoil user's "direct income".

Once a production contract is concluded based on a commercial discovery and field appraisal under an existing exploration contract and/or the production stage starts under an existing contract for combined exploration and production, any unamortized balance of the separate cost pool shall be further amortized pursuant to the provisions of Article 258 only against taxable income from the (underlying) new production contract and/or the existing contract for combined exploration and production.

Tax Alert on New Tax Code
Taxation of Subsoil Users: General Provisions

Corporate Income Tax (CIT)

Recognition of income and deductions

The New Tax Code gives several notable clarifications with respect to the recognition of income for taxation purposes:

- *The difference* between the actual revenue from the sale of commodities and the income included in the aggregate annual income (AAI) from subsoil user's "contractual" activity (at 120% of the cost of extraction and "initial treatment" of underlying minerals) shall be included in the AAI from subsoil user's "non-contractual" activity. Previously, only *a positive difference* was to be included in the AAI from "non-contractual" activity;
- The term "*production cost of extraction and initial processing (refining)*" has been replaced with "*production cost of extraction and initial processing of mineral raw materials, treatment of hydrocarbons*";
- A mine, pit, quarry, rock-crushing plant (unit) is excluded from the definition "*technological subdivision of a legal entity*".

There is a further clarification in the New Tax Code that methods applied by subsoil users for allocating "common" and "indirect" income and expenses between "contractual" and "non-contractual" activity cannot be changed once the respective tax period is over.

Expenses for education

The New Tax Code also re-classifies subsoil users' deductible expenses for the education of Kazakhstan personnel as follows:

- A subsoil user's actual expenses (within limits established by subsoil use contracts) for the education of Kazakhstanis who *are not employees* of the subsoil user, shall be deducted *as subsoil user's expenses for the education of Kazakhstan personnel*;
- However, the subsoil user's expenses for education, enhancement of qualifications or re-qualification of the subsoil user's *employees* in professions associated with the subsoil user's industrial activity shall be deducted as part of *payroll costs*.

Liquidation fund

The New Tax Code also clarifies that a "liquidation fund" (i.e. restricted cash accumulated in a special bank account for future site restoration works) received/inherited by the subsoil user following the acquisition of a subsoil use contract, shall not be regarded as income or deductions for the recipient.

Tax Alert on New Tax Code

Taxation of Subsoil Users: General Provisions

Tax Accounting Policy (TAP)

There are several notable clarifications with respect to TAP that need to be maintained by subsoil users:

- If the TAP does not contain a procedure for separate tax accounting and/or such a procedure does not satisfy principles of taxation set out in the New Tax Code, during a tax control audit (e.g. an on-site or paper-based audit) the tax authorities may re-allocate "common" and "indirect" expenses between the subsoil user's "contractual" and "non-contractual" activities pro-rata to the share of "direct income" attributable to these respective activities;
- With regard to subsoil users' expenses pursuant to certain minor subsoil use contracts (e.g. for exploration/extraction of common minerals, underground waters etc.) which fall within the scope of contracts for exploration and/or production of hydrocarbons or solid minerals, subsoil users must specify in their TAP the procedure for allocating such expenses between contracts for exploration and/or production of hydrocarbons or solid minerals and "non-contractual activity";
- Subsoil users must specify in the TAP their approach to the application of Article 259 of the New Tax Code (i.e. whether and how they will create is a separate cost pool of expenditures incurred for geological study, exploration and development of field infrastructure);
- There is no longer a requirement for subsoil users to submit amendments to their TAP or a new version of their TAP to local tax authorities within 10 business days following approval/ adoption of such amendments by the subsoil users;
- Taxpayers are not permitted to amend retroactively their TAP for tax periods covered by a tax audit;
- Methods applied by subsoil users for allocating "common" and "indirect" income and expenses between "contractual" and "non-contractual" activity cannot be changed once a respective tax period is over.

New Terminology

The New Tax Code introduces definitions for the terms "subsoil use operations", "petroleum operations", "production", "operator", "mineral resources", "mineral raw materials", "treatment of hydrocarbons".

New terminology will be used in the New Tax Code – "hydrocarbons", "raw gas", " solid mineral resources", as defined in the new Code on Subsoil and Subsoil Use.

Tax Alert on New Tax Code

Taxation of Subsoil Users: General Provisions

Signature Bonus due upon Grant of Subsoil Use Rights under Auctions or Direct Negotiations

There are several notable clarifications with respect to calculation of the Signature Bonus:

- Clarification of procedure for determining starting level of the Signature Bonus for exploration contracts for territories with approved reserves of minerals;
- If production contracts and contracts for combined exploration and production of hydrocarbons are granted for a territory which is divided into blocks, the starting level of the Signature Bonus will be increased by 10 MCI for each block in excess of 300 blocks;
- Abolition of the requirement that the starting level of the Signature Bonus for production contracts must not be lower than the amount of commercial discovery bonus;
- The coefficient for calculating the Signature Bonus if the contractual territory (subsoil site) is extended shall be calculated using four digits after the decimal point;
- The Signature Bonus shall be paid in one installment not later than 20 business days from the date of announcement of the taxpayer as the winner of the auction or the date of signing the protocol of direct negotiations for granting subsoil user rights, whichever is applicable (under the previous Tax Code the bonus was paid in two equal installments);
- Introduction of tax period for Signature Bonus - calendar quarter in which the bonus became payable.

Minerals Extraction Tax (MET) on Underground Waters

Under the New Tax Code, the following volumes of underground waters extracted by subsoil users:

- as by-product (from a mine, pit, quarry) upon exploration and/or production of solid minerals and sold or used by the subsoil user for technical water supply and other industrial needs;
- and sold to a sanatorium-and-spa institution (sanatorium, health and recreation resorts) for providing sanatorium-and-spa treatment services under domestic legislation on public health;
- and used by the subsoil user for accommodation for tourists in accordance with domestic legislation on tourist activity;

need to be accounted separately for MET purposes to enjoy a reduced MET rate of 0.003 MCI for 1 cubic meter of extracted underground water (previously 1 MCI).

Under the New Tax Code, MET shall not be paid upon dumping of underground waters extracted as by-product (from a mine, pit, quarry) upon exploration and/or production of solid minerals.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Oil and Gas Companies

Alternative Tax on Subsoil Use

The Alternative Tax on Subsoil Use is introduced starting from 1 January 2018 as an alternative to "subsoil users' taxes" for entities which have concluded the following types of subsoil use contracts:

- For exploration and/or the combined exploration and production of hydrocarbons on Kazakhstan's continental shelf; and
- For production and/or exploration and extraction of hydrocarbons at fields with the highest (not above 4,500 meters) and lowest (not below 5,000 meters) levels of hydrocarbon reservoirs as specified in the mining allotment or the subsoil use contract (if there is no mining allotment).

In order to apply this Alternative Tax, a qualifying subsoil user has to submit a formal notification to the local tax authority about its intention to apply the tax, not later than 30 calendar days after the date of conclusion of the production contract or the start date of the production stage under a contract for combined exploration and production.

For subsoil use contracts concluded before 1 January 2018, the above notification has to be submitted not later than 1 March 2018.

The Alternative Tax has to be applied throughout the duration of the production contract or the duration of the production stage under a contract for combined exploration and production and subsoil users and once the subsoil user has chosen to pay the Alternative Tax they cannot then revert back to paying subsoil users' taxes.

It should be noted that the Alternative Tax cannot be deducted for CIT purposes (similarly to EPT).

The Alternative Tax shall be paid by subsoil users in lieu of:

- Excess Profits Tax (EPT);
- Minerals Extraction Tax (MET) on Extraction of Hydrocarbons;
- Payments Reimbursing the State's Historical Costs;
- Rent Tax on Exports of Hydrocarbons.

Taxable income shall be calculated similarly to calculating taxable income for CIT purposes, except that the following shall be disregarded for calculating the Alternative Tax:

- Adjustments to aggregate annual income;
- Adjustments of taxable income;
- Positive and negative foreign exchange differences;
- Any interest expenses;
- Accrued (assessed) CIT.

In the absence of specific provisions, any "excess of deductions over income" (i.e. tax loss) most likely cannot be carried forward.

Tax rates vary between 0% and 30% depending on the "world" (market) price of crude oil, increasing by 6% for each increase of world price by US$ 10 per barrel. For example, the tax rate will be 0% when the "world" price of oil is below US$ 50 per barrel, 6% - when the price is between US$50 and US$60, etc.

Deadlines for filing the tax declaration and payment of the tax are similar to deadlines for CIT: 31 March and 10 April respectively.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Oil and Gas Companies

Corporate Income Tax (CIT)

Under the New Tax Code, income from selling oil produced by the subsoil user shall be determined based on the value of sold oil, taking into account transfer pricing adjustments (if any), but regardless of the cost of production of the oil.

Accordingly, for taxation purposes income from sales of oil on the domestic market will continue being recognized at the higher of the sales prices and production cost.

If a subsoil user sells raw gas to the national gas operator (KazTransGas JSC) income from the sale shall be determined based on the value of sold raw gas, considering transfer pricing adjustments (if any), but regardless of the cost or the price approved by respective government agencies for acquisition by the national gas operator.

Accordingly, for taxation purposes income from sales of raw gas on the domestic market to any person other than KazTransGas JSC will continue being recognized at the higher of the sales price (considering transfer pricing adjustments, if any) and production cost. It is relevant that there have been a number of tax disputes around determining the production cost of associated gas.

Commercial Discovery Bonus

From 1 January 2019, the Commercial Discovery Bonus shall be abolished for all subsoil users in Kazakhstan.

Signature Bonus

The minimum starting level of the Signature Bonus for contracts for production and contracts for combined exploration and production of hydrocarbons with approved reserves was increased to 10,000 MCI from 3,000 MCI.

Rent Tax on Exports of Hydrocarbons

Rent Tax shall not apply to persons exporting crude oil and gas condensate produced by subsoil users who are payers of the newly introduced Alternative Tax on Subsoil Use.

According to another clarification, Rent Tax shall also not apply to persons exporting crude oil and gas condensate produced by subsoil users under Production Sharing Agreements and the Subsoil Use Contract approved by the President of Kazakhstan.

It has also bee clarified that the barrel to tonne conversion ratio will be calculated using four digits after the decimal point.

Note: 1 MCI (monthly calculation index) for 2018 is KZT 2,405, which is approx. US$ 7.2.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Oil and Gas Companies

Excess Profits Tax (EPT)

From 1 January 2018, EPT shall not apply to subsoil users who are payers of the newly introduced Alternative Tax for Subsoil Use.

The following notable clarifications have been made with respect to calculation of EPT:

- Capital expenditures will be deducted for EPT purposes in the tax period in which they were incurred (previously deduction was made in the tax period chosen at the taxpayer's discretion);
- Accordingly, depreciation charges (as part of CIT deductions) will not be deductible any more;
- Further to above, rules for recognising income from realization, transfer and retirement of assets previously fully deducted for EPT purposes, have been clarified;
- Costs of acquiring so-called "common" and "indirect" fixed assets will be deducted from/allocated to subsoil use contracts pro rata to "direct" expenses attributable to a particular subsoil use contract and non-contractual activity;
- Tax losses will not be deductible in principle;
- Instead, an existing grey area regarding the carry-forward of tax losses has been resolved: "excess of deductions over income" (i.e. tax losses) arising upon calculation of EPT will be eligible to be carried forward for offset against taxable income in future periods.

As a transitional provision, accumulated costs which were eligible for deduction but were not deducted by a subsoil user for EPT purposes between 2009 and 2017, shall be deducted in calculating EPT liability for 2018.

In our view, varying interpretations may occur in practice about whether "accumulated costs" include (i) residual (i.e. tax written-down) value of fixed assets commissioned prior to 1 January 2009, and (ii) accumulated tax losses as at 31 December 2017.

Deadlines for filing the EPT declaration and payment of EPT have been synchronized with similar deadlines for CIT: 31 March and 10 April, respectively (currently: 10 and 15 April, respectively).

Payments Reimbursing State's Historical Costs

Historical Costs shall not apply to subsoil users who are payers of the newly introduced Alternative Tax on Subsoil Use.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Oil and Gas Companies

Minerals Extraction Tax (MET) on Extraction of Hydrocarbons

From 1 January 2018, MET shall not apply to subsoil users who are payers of the newly introduced Alternative Tax for Subsoil Use.

The following notable clarifications have been made with respect to calculation of MET on hydrocarbons:

- Introduction of a formula for calculating weighted average barrelization coefficient (resembling the formula for calculating rent tax on export);
- Clarification that barrelization coefficient will be calculated using four digits after the decimal point;
- Clarification that MET rate will be calculated based on cumulative annual production under a subsoil use contract and thus shall remain unchanged if subsoil use rights are transferred during a calendar year;
- Clarification that the Ministry of Energy will provide local tax authorities with information about volumes of planned production of hydrocarbons across all oil and gas companies. Currently, such information is submitted by taxpayers.

Minerals Extraction Tax (MET) on Extraction of Hydrocarbons at Low-Profit Fields

Unfortunately, there will be no transition to self-assessment of MET at reduced rates.

As previously, in order to apply reduced rates, subsoil users will have to submit an application to the Government for inclusion of their fields into the list of low-profit, high-viscosity, water-flooded, low-yield and depleted fields.

Such applications are periodically reviewed by the Government and the list of qualifying fields is periodically approved/ updated by a formal Government resolution.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Mining Companies

Excess Profits Tax (EPT)

From 1 January 2018, EPT will be abolished for subsoil users carrying out activity under contracts for exploration and/or production of solid minerals, provided that these contacts do not envisage production of other groups of mineral recourses.

According to the new Code on Subsoil and Subsoil Use, mineral recourses are divided into following groups:

- Underground waters;
- Hydrocarbons;
- Solid mineral recourses.

Commercial Discovery Bonus

From 1 January 2019, the Commercial Discovery Bonus shall be abolished for all subsoil users in Kazakhstan.

Rent Tax on Export of Coal

The rate of Rent Tax on Export of Coal was increased to 4.7% from 2.1% to compensate the Government's losses from abolishing EPT for producers of coal.

Payments Reimbursing State's Historical Costs

From 1 January 2018, Historical Costs shall not apply to subsoil users carrying out activity under licenses for exploration or production of solid minerals, provided that both of the following conditions are met simultaneously:

- The license for exploration or production of solid minerals was granted under the New Code on Subsoil and Subsoil Use after 31 December 2017; and
- The territory for which the license for exploration or production of solid minerals is granted was not previously granted prior to 1 January 2018 under a subsoil use contract.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Mining Companies

Signature Bonus due upon Grant of Subsoil Use Right under Licensing Regime

Under the new licensing regime for subsoil use introduced by the proposed New Code on Subsoil and Subsoil Use, the Signature Bonus will apply to persons who were granted with licenses:

- For exploration of solid minerals;
- For production of solid minerals;
- For use of underground space;
- For geological study;
- For gold digging.

The minimum starting level of the Signature Bonus for licenses for use of underground space shall be 400 MCI.

The rates of the Signature Bonus will vary depending on the type of license granted:

- For exploration of solid minerals – 100 MCI;
- For production of solid minerals – 50 MCI;
- For geological study – 2,000 MCI;
- For gold digging, based on the area of licensed territory as follows:
  - Up to 0.3 sq. km – 9 MCI;
  - Between 0.3 and 0.5 sq. km – 12 MCI;
  - Between 0.5 and 0.7 sq. km – 15 MCI.

The Signature Bonus shall be payable to the State not later than 10 business days after the license has been granted. Paid bonuses for exploration or production licenses cannot be refunded or offset.

Note: 1 MCI (monthly calculation index) for 2018 is KZT 2,405, which is approx. US$ 7.2.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Mining Companies

Fee (Rent Payments) for Use of Land Plots

Under the new licensing regime of subsoil use introduced by the proposed New Code on Subsoil and Subsoil Use, the Fee for Use of Land Plots will apply to subsoil sites granted by the State under licenses for the exploration or production of solid minerals. In the New Code on Subsoil and Subsoil Use, this Fee is defined as "Rent Payments for Using Land Plots".

On a quarterly basis, government agencies authorized to grant subsoil use rights shall provide local tax authorities with information about payers of this Fee, taxable items, duration of licenses for exploration or production of solid minerals, identifying coordinates of blocks and their individual codes.

For exploration licenses, the rates of the Fee will vary and increase with progress and duration of the license:

- Between 1st and 36th months – 15 MCI;
- Between 37th and 60th months – 23 MCI;
- Between 61st and 84th months – 32 MCI;
- From 85th month onwards – 60 MCI;

For production licenses, the rate of the Fee will be flat during the whole duration of the license – 450 MCI.

The tax period will be a calendar year between 1 January and 31 December.

Levy for Granting (Extension) of License for Gold Digging

The rates of the levy for granting and extending the license for gold digging under the proposed New Code on Subsoil and Subsoil Use will be based on the area of licensed territory as follows:

- Up to 0.3 sq. km – 3 MCI;
- Between 0.3 and 0.5 sq. km – 4 MCI;
- Between 0.5 and 0.7 sq. km – 5 MCI.

Tax Alert on New Tax Code

Taxation of Subsoil Users: Mining Companies

Minerals Extraction Tax (MET) on Extraction of Solid Minerals

MET shall not apply to subsoil users carrying out activity exclusively under a license for gold digging.

Rate of MET on extraction of tin was reduced to 3% from 6%.

There are several notable clarifications with respect to calculation of MET on solid minerals:

- Clarification that units of measurement used/specified in the balance report of reserves of commercial minerals and "consolidated balance" will be used for calculating MET;
- Abolition of the requirement to calculate MET based on the content of useful minerals in the taxable volume of recovered reserves specified in the local project (which was developed based on the production schedule in the approved technical project of field development);
- MET rates for rare and rare earth metals will be specified in the New Tax Code (previously these were stipulated in a separate Government resolution).
- Non-taxable volumes of minerals transferred for technological sampling and study will be limited *only to* the minimum weight of technological samples specified in national standards for respective types of minerals, underground waters and therapeutic mud. Under the previous Tax Code, such non-taxable volumes included also volumes envisaged by the working program to a subsoil use contract.

Minerals Extraction Tax (MET) on Extraction of Common (Wide-spread) Minerals and Therapeutic Muds

The New Tax Code contains amendments that simplify calculation of MET on common (wide-spread) minerals and therapeutic muds. In particular, MET will be calculated based on the statutory "monthly calculation index" ("MCI") and volume of extracted common (wide-spread) minerals and therapeutic muds.

The MET rate varies from 0.02 to 0.04 MCI for a unit of measurement of volume of extracted common minerals and therapeutic muds.

The New Tax Code further clarifies that units of measurement used/specified in the balance report of reserves of commercial minerals and "consolidated balance" will be used for calculating MET.

In addition, the list of common (wide-spread) minerals was updated in the New Tax Code according to comprehensive list of common (wide-spread) minerals specified in the new Code on Subsoil and Subsoil Use.

Customs Code

Tax Alert - Introduction of the New Tax Code

Customs Code

The new Customs Codes of the Eurasian Economic Union (EEU) and RoK entered into force simultaneously on **1 January 2018**.

Customs Code of EEU

The Treaty on the EEU Customs Code was signed on 11 April 2017 and the Treaty was ratified in EEU member countries. The Treaty on the EEU Customs Code was enforced from beginning of 2018.

The new EEU Customs Code entered into force after the Eurasian Economic Commission (EEC) was in receipt of all ratification notices from EEU member countries (Russia, Kazakhstan, Belarus, Armenia and Kyrgyzstan).

The Code of the Republic of Kazakhstan "On customs regulations in the Republic of Kazakhstan" (the "New Customs Code")

The New Customs Code of the Republic of Kazakhstan entered into force on 1 January 2018 and includes the norms of the new EEU Customs Code, and establishes legal relations within the competence of domestic legislation. The main difference between the two Codes and the previous legislation is a fundamentally new approach to customs regulation.

The terms of entry of the Customs Code of the Republic of Kazakhstan and the Customs Code of the EEU are synchronized as of January 1, 2018.

Tax Alert - Introduction of the New Tax Code

Customs Code

Below we present a brief overview of the basic provisions of the New Customs Code

Introduction of an electronic customs declaration

The main principle behind the new regulations is automatization of business processes within customs authorities.

The New Customs Code provides for an electronic customs declaration of goods. It will no longer be necessary to attach the supporting documents to the customs declaration. All the required information regarding goods and vehicles as well as the foreign trade transaction will be reflected in the customs declaration. We assume that a paper declaration will still be permissible in certain cases when, for example, technical errors occur.

The new electronic declaration will permit the automatic release of goods without any involvement of the customs authorities.

Even though such supporting documents will not need to be attached, such documents are still required and must be kept in case the customs authorities request them as part of their risk management system.

It is possible that goods will not be released automatically if the risk management system highlights that the supporting documents should be provided and/or a different customs control regime should applied.

If the documents are not provided within the due date set for the release of goods (which is no later than one business day from the registration date of the customs declaration), the release could be denied by the customs authorities.

Customs authorities' officials may complete the customs declaration

An entity may opt for transit, passenger or vehicle customs declarations to be completed by a customs authority official.

The authorized body must approve the customs declaration (completed by the customs authority official) as well as the details of the customs transactions.

Even though a customs official may complete the form, only the declarant or another party liable for customs declaration shall be liable for the accuracy of the declared information.

Release before submission of customs declaration

The New Customs Code extends the list of goods allowed to be released prior to the submission of the customs declaration to the customs authorities.

In particular, the list covers the following goods:

- Goods which are subject to priority customs regulations (for instance, goods necessary for the relief of natural disasters, perishable goods, animals, radioactive materials, explosives etc.);
- Goods imported to realise investment projects;
- Goods imported by authorized economic operators;

Tax Alert - Introduction of the New Tax Code
Customs Code

Release before submission of customs declaration (continued)

- Goods declared under the customs procedures for 1) processing on the customs territory 2) the free customs zone 3) free warehouse 4) the temporary import without payment of customs duties and taxes;
- Goods determined by the Commission.

Please note that the release of goods prior to the submission of the customs declaration is permissible provided that the declarant:

- files the prescribed application form with the customs authorities;
- ensures that it pays customs duties, taxes, special anti-dumping, countervailing duties (except in certain cases);
- provides documents confirming compliance with certain restrictions and limitations.

Customs audit and appeals

Any uncertainties in the law to be considered in favor of the party appealing the notification

The New Customs Code stipulates that all uncertainties and unresolved issues in customs legislation should be considered in favor of the party who appealed the notification regarding the customs audit results as well as the notification on elimination of the violation. This protects the legitimate interests of the declarant.

Preliminary customs audit act

The New Customs Code includes new provisions requiring inspectors to provide a preliminary customs audit act during the review of certain categories of entities (1) large taxpayers; and (2) declarants who have signed investment contracts.

A similar procedure has been already introduced and is being applied during tax inspections.

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