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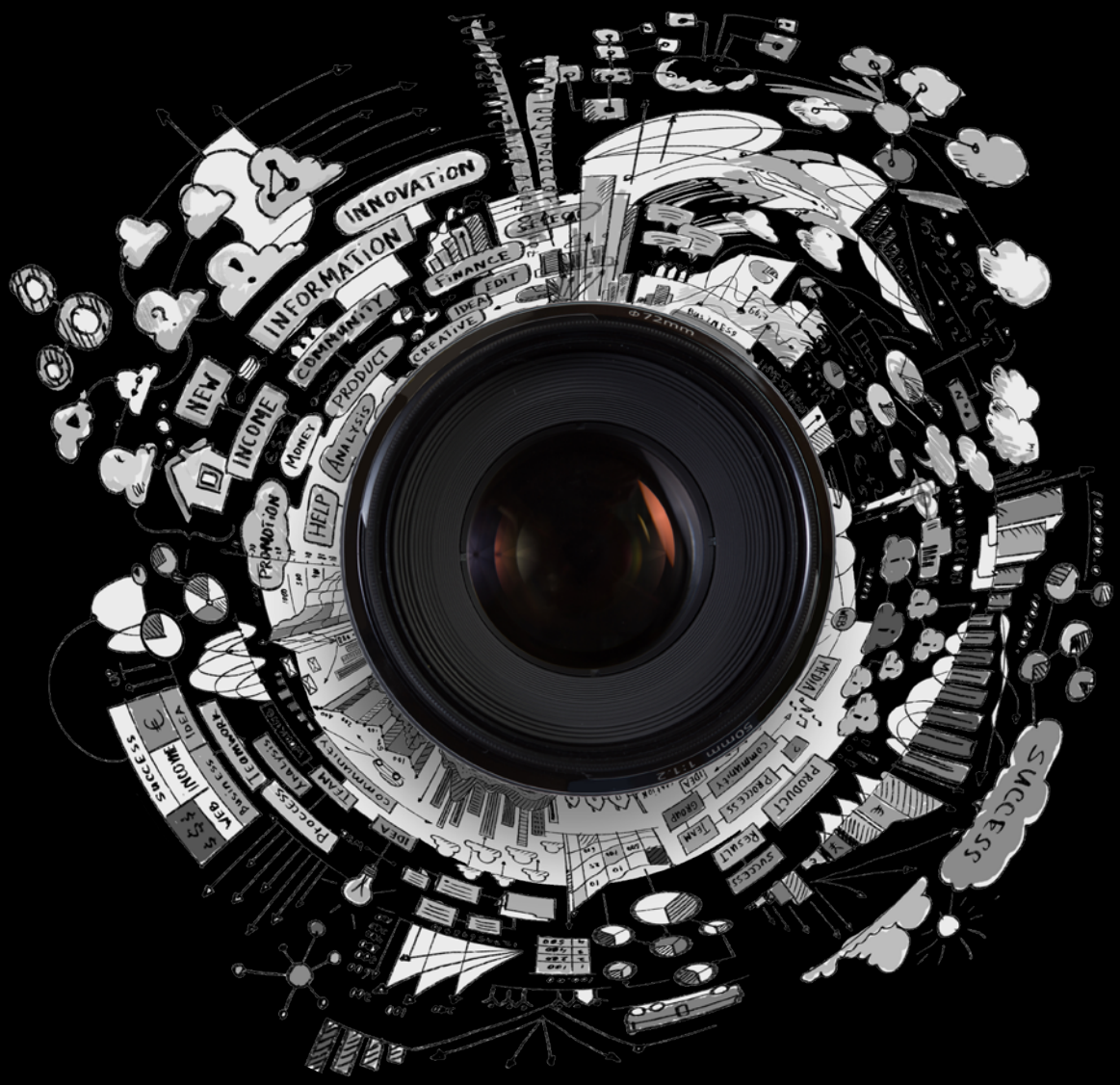
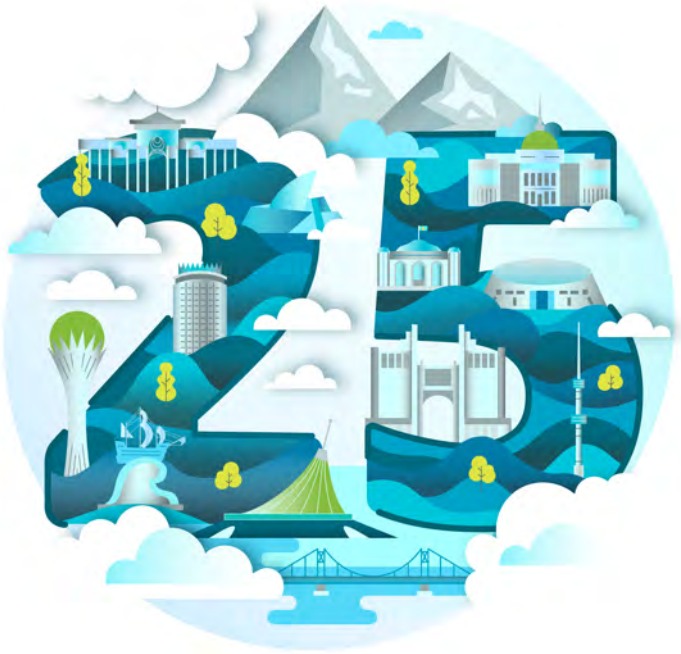


Selection of Deloitte articles
for the period from 2018
to February 2019



25 years of Deloitte in Kazakhstan

An ancient Chinese proverb says, “the journey of a thousand miles begins with one step”, and on 14 July 1994, Deloitte took its first step in Kazakhstan by opening an office in Almaty. And now, 25 years later, we are still moving forward, continuing to develop and expand our horizons!

Finding complex solutions, understanding client businesses, presenting innovative approaches to their goals, and extensive professional and sector knowledge all help us perform effectively and serve our clients to the highest level. We are ready to continue as your professional services partner, one that is ready to help your business reach the top!

Thank you for your trust in us and choosing us to be your professional services provider!

Introduction

In this brochure you can find a collection of some of the most interesting articles by our experts in 2018 and the start of 2019, discussing topics such as tax changes, financial reforms, investments, new technology, organisational changes and many other issues currently of interest for the Kazakhstan business community.

Our professional turn the complex into the simple, providing high-quality analysis in easy to understand formats. We are always ready to answer your question and provide any advice you may need on an individual basis.

Long arm of the law: the cross-territorial application of overseas legislation

(Forbes, 26 January 2018)

Western governments are increasingly extending the territorial reach of their legislation, particularly in the anti-corruption sphere. Their aim is to fight corruption wherever it may be and create a level playing field for the businesses responsible for preventing it. A similar trend is also seen beyond the white-collar crime space, for example in tax and data protection legislation.

***Caroline Armitage**, English law Counsel and Senior Legal Adviser*

Global reach

As part of their overall risk management, companies in Kazakhstan should look beyond national borders and rules to ensure they comply with the full suite of regulations applicable to them, so reducing their risk of exposure to international sanctions and a negative impact on their reputation. Legislation emanating from the United States, UK and Europe in particular could apply.

In summer 2017, the U.K. Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into effect. These Regulations implement the European Union's 4th Anti-Money Laundering Directive into UK law. These rules do not represent a major overhaul to the previous regime but they do introduce more detailed requirements regarding their global reach. They apply to a relevant person carrying on business in the UK and its subsidiaries, including those subsidiaries located outside the UK and any branches carrying out an activity which falls under the new regime. Different rules apply as to whether the overseas office is within Europe or in a third country.

Self-policing mechanisms

Governments are increasingly introducing self-policing mechanisms by imposing corporate criminal law obligations, which are direct obligations on companies themselves to introduce preventative measures. Those companies could be faced with a criminal conviction and unlimited fines for failure to do so.

In the wake of the Panama Papers saga, the U.K. announced that it would legislate to hold companies criminally liable, for failing to stop their employees facilitating tax evasion. The legislation has now been enacted in the Criminal Finances Act 2017which came into force on 30th September 2017.

The offence is the failure to prevent the facilitation of tax evasion, and businesses can be held criminally liable if their "associated persons" facilitate tax evasion by a taxpayer in the UK or overseas. An associated person includes employees but also extends to agents and subcontractors

among others. The offences are "strict liability" which means that the management of the business do not need to know about, or even suspect that, the associated person is facilitating tax evasion; they will have committed the corporate offence unless they can show that they have put in place "reasonable preventative procedures" (essentially a robust compliance programme).

Importantly, and as made clear in HMRC's guidance on the legislation, where there is a UK tax evasion facilitation offence, it does not matter whether the relevant body is UK based or established under the law of another country, or whether the associated person who performs the criminal act of facilitation is in the UK or overseas. In such cases, the new offence will have been committed and can be tried by the UK courts. The offence is typically relevant to organisations advising tax payers e.g. banks and other financial institutions, private wealth management firms, lawyers and consultancy firms. Beyond professional advisers, however, imagine a scenario in which, a foreign car parts manufacturer operating in the UK and overseas, enters into a sub-contracting agreement with a UK distributor. If the senior managers of the distributer create a false invoicing scheme with the assistance of a purchaser to allow the purchaser to evade UK taxes due on its purchase of the car parts in the UK, the foreign manufacturer may be at risk of committing the corporate offence if it does not have a clear compliance programme in place.

The legislation also introduces a foreign tax evasion facilitation offence which relates to evading payment of foreign (rather than UK) taxes. However, a pre-requisite for that offence is that the overseas jurisdiction must have firstly an equivalent tax evasion offence at the taxpayer level and secondly an equivalent offence covering the associated person's criminal act of facilitation.

The offences set out above are modelled closely on the UK Bribery Act 2010 which came into force on 1 July 2011 and created new offences of significant scope and extra-territorial reach.

The Bribery Act offences apply not only to behaviour in the UK, but also potentially to behaviour by individuals and corporate bodies overseas. Some of the offences, for example active and passive bribery, apply to acts committed anywhere in the world by a person with a close connection with the UK (among others, a body incorporated in the UK or a British citizen or resident). Further, there is an additional corporate offence for commercial organisations which fail to prevent persons associated with them from committing bribery on their behalf. For this offence, the requirement for the person to have a close connection with the UK does not apply; so the offence may apply to a company incorporated overseas if that organisation carries on a business or part of a business in the UK, no matter where or by whom the acts are committed.

Ensuring compliance: the astounding reach of FATCA

Governments aren't just looking to impose fines on those in breach of Western laws (sanctions which may ultimately not be enforceable in overseas countries) but they are also looking to more imaginative ways of achieving their aims. The U.S. Foreign Account Tax Compliance Act (FATCA) generally requires that foreign financial Institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on withholdable payments. Unless otherwise exempt, FFIs that do not both register and agree to report, face a significant withholding tax on certain U.S. source payments made to them.

Beyond anti-corruption

Stepping outside the white collar crime space, the European Union General Data Protection Regulation(commonly known as the GDPR) will take effect on 25 May 2018. The GDPR marks a significant expansion of the territorial scope of the EU data protection regime, bringing a large number of overseas businesses within its reach.

Data controllers or processors established outside the EU who are processing personal data in relation to the offering of goods or services to individuals in the EU or monitoring their behavior (in the EU) will be caught by the data protection requirements of the GDPR. So, for example, if a Kazakhstan internet company is offering products or services on its website, in an EU currency and in an EU language, or explicitly targeting EU customers, then they will be caught and if non-EU companies are "cookie-profiling" i.e. using persistent cookies to track a user's overall online activity on the website, this will be considered processing personal data to monitor behaviour.

Importance of a robust risk-assessment and compliance programme

In certain cases, the link to the country of origin may be almost imperceptible so it is important to carry out a thorough risk analysis to assess the full extent of legislation which may apply (this article only touches on some) and the extent to which stringent compliance procedures should be put in place. The approach to compliance may ultimately be very similar for the varying pieces of relevant legislation so a holistic approach to compliance is advisable.

Kazakhstan's long-awaited fiscal reform

(Investors' Voice, April 2018)

Following the introduction of Kazakhstan's previous tax code (which set out the current unstablized taxation regime[1]) in 2009 oil prices increased from around the $60 mark to their 2014 peak of over $100 per barrel. During this period of rising prices, upstream companies in Kazakhstan were faced by continuous pressure as the authorities sought to augment tax revenues using a fiscal regime designed for an environment of lower oil prices. The cumulative effect was that, by 2014, the level of government take for oil and gas projects in Kazakhstan was seen to be increasingly uncompetitive.

***Anthony Mahon**, Partner, Caspian Energy and Resources Leader*

***Maken Iskakova**, Senior Tax Manager*

Even before the slump in global oil prices, the outcome of this re-balancing of economic interests in favor of the state was a reduction in new investments in projects in Kazakhstan's oil and gas sector. With the exception of recently commenced "Future Growth Project" at the supergiant Tengiz field there has been a near total absence of significant new investment into the sector in Kazakhstan over the last 5 years.

Whilst there has been continuing interest in potential oil and gas projects in Kazakhstan over this period, the overwhelming sentiment from investors has been that fresh investment would not flow under the existing fiscal terms. As oil prices bottomed out at the end of 2015 a degree of emergency relief was handed to a market in distress as the rates of export customs duty (applicable to exports of crude oil) were reduced so as to lessen the tax burden on producers as prices remained depressed. Throughout the last couple of years, however, representations from the extractive industries (both hard minerals and oil & gas) led to a break in the legislative log-jam and the state authorities opened up to industry dialogue in relation to extractive industry taxation regimes (in addition to general tax reform). These discussions led to the new Kazakh Tax Code which is effective from 1st January 2018 but features certain provisions to be phased in from 2018 to 2020. This new code has been greeted with cautious but wide-spread approval from the industry and observers. Whilst there are clear areas where there is scope for continued improvement (most notably the absence of incentives for producers to make investments into brownfield acreage and/or employ more sophisticated enhanced recovery technologies and processes), there is clear potential for this newly issued legislation to be a trigger for new investment to flow into this sector in Kazakhstan.

[1]This applies to all upstream projects with the exception of 9 grandfathered contracts which are stablized.

New concepts applicable to all taxpayers

The new law is intended to provide more clarity on the taxation of companies in the extractive industries (normally referred to as 'subsoil users' in the relevant legislation) and related tax administration with the objective of fostering a more attractive investment climate. Amongst the conceptual changes introduced is the principle of taxpayer good faith, which shifts the burden of proof regarding "taxpayer fault" to the tax authorities.

Along with the Tax Code, a new concept of 'horizontal monitoring' is introduced, which is based on information exchange between the state revenue authorities and the taxpayer, and relies on the principles of trust, transparency giving the tax authorities enhanced access to taxpayers' records and information. New rules on horizontal monitoring will take effect from 2019 and allow taxpayers meeting certain criteria (as yet to be specified by the State Authorities), to sign an agreement for exchange of information with the state revenue authorities, which will also grant the authorities access to business and tax accounting systems of the taxpayers. Taxpayers opting into this horizontal monitoring regime will secure certain advantages, amongst which are (1) an automatic VAT refund (without a tax audit) and (2) an exemption from tax audits and (3) exemption from administrative fines in case of a tax violation discovered by the tax authorities in the course of horizontal monitoring.

Oil and gas related changes

The following are the most significant reforms to the bases and mechanisms of taxation for the oil and gas industry. This will affect current and future projects apart from those which are stabilized[2].

Discovery Bonus

As of 1 January 2019, the obligation to pay Commercial Discovery Bonuses shall be abolished for all subsoil users in Kazakhstan. This reform that has long been called for by the industry. The previous Commercial Discovery Bonus regime was contentious as payment was due often significantly in advance of a subsoil user actually being certain that such a discovery would indeed be commercially exploited. Consequently, the amount of bonuses payable to the state budget could lead to significant adverse impacts upon project returns, especially if the level of bonus due was substantial. The abolition of this regime is, therefore, seen as a positive step for the industry.

Alternative Tax

A new and elective tax regime is introduced starting from 1 January 2018 as an alternative to subsoil user taxes for entities, which have concluded mineral extraction contracts for exploration and production from deep (4,500 meters and lower) and continental shelf deposits. If a taxpayer elects to apply the Alternative Tax, this charge shall be due in place of the taxpayer's obligations in respect of Mineral Extraction Tax, historical cost payments[3], Rental Tax on Export and Excess Profits Tax.

In general, a taxpayer may opt to apply the Alternative Tax on a voluntary basis, but once this method is chosen, it shall not be able reverse the election until the expiration of the relevant contract.

Tax rates vary from 0% to 30%, depending on the world market price of crude oil[4], increasing by 6% for each US$ 10 step change in oil prices.

For example, the tax rate is 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 (please see below).

World market price	Rate, %
Below 50 USD per barrel	0
Below 60 USD per barrel	6
Below 70 USD per barrel	12
Below 80 USD per barrel	18
Below 90 USD per barrel	24
Above 90 USD per barrel	30

Early Depreciation of Exploration Expenses

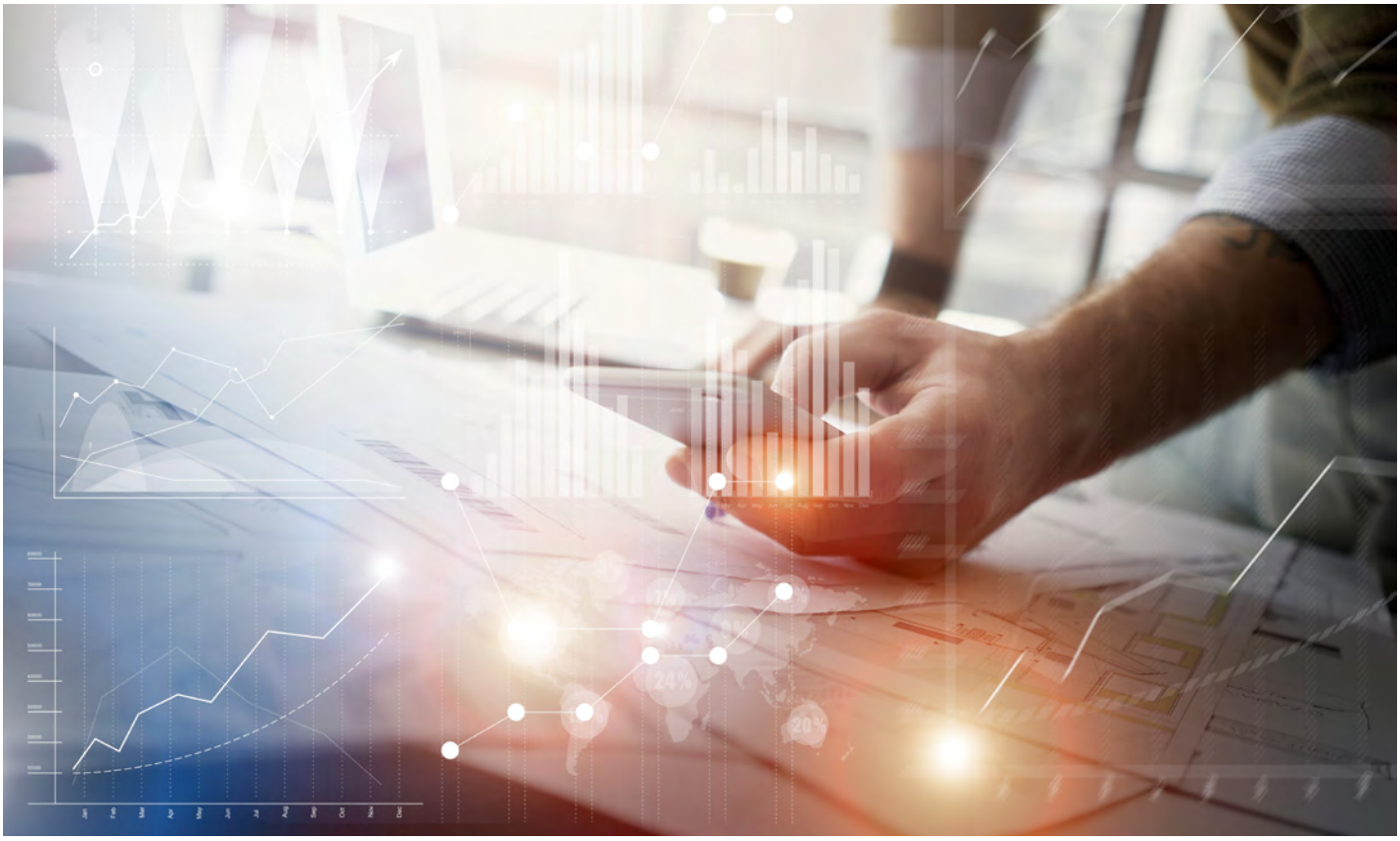
Subsoil users are entitled to deduct tax depreciation in respect of exploration expenses incurred from 1 January 2018 under a subsoil use contract where production has not commenced against taxable income arising under another contract where production has started. However, these expenditures shall not be available for tax offset in the event that the costs relate to abortive exploration.

Prior to this change there was a requirement to maintain ring-fenced accounting of income and expenditures for each subsoil use contract. Failure to comply with such requirements was considered to violate tax legislation and constitute a breach of the subsoil user's contract obligations (which could in principle lead to the contract being forfeit).

VAT control account

The changes also introduce a new VAT control account (regionally known as the "Azerbaijani method" of VAT accounting) as a tool to optimize the VAT refund process and reduce fraudulent VAT schemes. A VAT control account should be opened by an eligible VAT-payer in a Kazakh commercial bank. This is effectively an escrow account into which a purchaser of VAT-able goods and services will transfer VAT charged to it, instead of paying this to the supplier.

[2] Refer previous footnote.
[3] Meaning reimbursement of costs incurred by state entities/agencies in relation to the contract area.
[4] Defined as the average value of daily price quotations of each separate standard grade of crude oil "Urals Mediterranean" (Urals Med) or "Dated Brent" (Brent Dtd) in the tax period on the basis of information published in Platts Crude Oil Marketwire.



Only VAT payers using the e-invoicing system may elect to use VAT control accounts. Once VAT liabilities are settled, all amounts remaining in the VAT control account will be subject to refund within 15 working days.

Other changes

The New Tax Code adds software technical maintenance, software updates and internet resource access to the list of services whose place of sale is determined by the buyer's place of registration for VAT purposes. Thus, when Kazakhstani taxpayers procure such services from a non-resident, Kazakhstan will be recognised as the place of supply and charges will be subject to reverse charge VAT in Kazakhstan.

In addition, the categories of non-residents' Kazakh source income subject to withholding tax has been expanded to include:

- income from the provision of engineering and marketing services outside Kazakhstan to a Kazakhstan-based customer; and
- income of a tax-heaven registered non-resident entity in the form of an advance payment for goods or services not provided within a two-year period from the advance payment date.

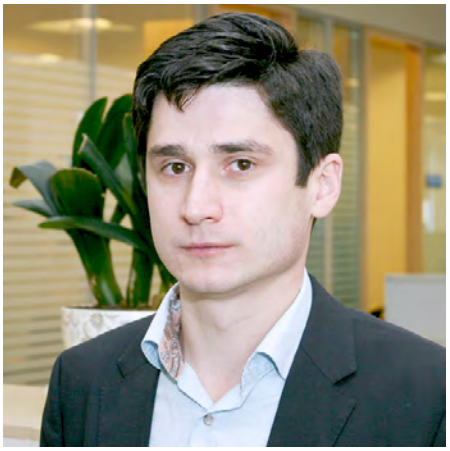
It is worth noting another fundamental change in the tax legislation: the new Tax Code states that any ambiguities and gaps not covered by the tax law should be interpreted in favor of the taxpayer. Whilst there is uncertainty as to how this will work in practice, it is a very important milestone in Kazakh tax legislation, and one that could potentially go a long way towards protecting the interests of taxpayers acting in good faith.

Conclusion

It is still too early to assess the impact of the government's attempt to tailor the new tax legislation to create a more adaptable "investor-oriented" environment. However, both the new code itself and (most importantly) the fact that industry consultation was one of the primary factors driving its development could be viewed with real optimism regarding the positive impact this may have upon the oil and gas industry in Kazakhstan.

Business oriented security department

(World Monitor, April 2018)



Rustam Mukhametshin, *Financial Advisory Director*

In the last two decades, we have seen huge technological breakthroughs that have radically transformed how we live our daily lives, created new business sectors or just changed the way we do business. Everything that affects the pace and performance of business processes has changed, whether it be in specific companies or in entire sectors, and with that the pace of life seems to speed up almost every day.

Technological progress goes hand in hand with new ways of perpetrating fraud and economic crime. Gone are the days when somebody just walks out of a company with something under their arm. Threats are now both external and internal, and any large company will have come up against dozens of incidents of fraud.

It goes without saying that all companies have their own security departments, which, as the name suggests, are responsible for protecting them against these threats. However, despite the immense advances and changes in corporate life, one thing has remained unchanged in most companies, and that is the security department. Generally speaking, security departments are staffed by former law enforcement officers, working their "pension years," and whose main job is to manage security guards, control building access and "unofficially" check new employees in police records. They are also asked to investigate crimes by questioning witnesses, analysing documents and financial data, if relevant, and also take on other functions, such as internal audit. By combining these functions, companies are able to carry out investigations, which more often than not are limited due to a lack of specialised technology, software and experience to build up a full picture of the events.

Corporate fraud prevention systems tend to be spread among a number of divisions. For example, the security department is responsible for the physical security of company assets and highlighting the criminal past of employee candidates. The internal audit department is responsible for checking payments and complying with internal requirements, but its functions are very broad and go way beyond revealing fraud, including corruption prevention and developing division compliance, but rarely following them. As a result, it turns out that the majority of large companies have no division responsible for preventing, highlighting and investigating corporate economic crime that would also be aware of company finances and fully understand business specifics.

The essence of a business-oriented security department lies in how it contributes to business development, understands business processes and protects against negative issues.

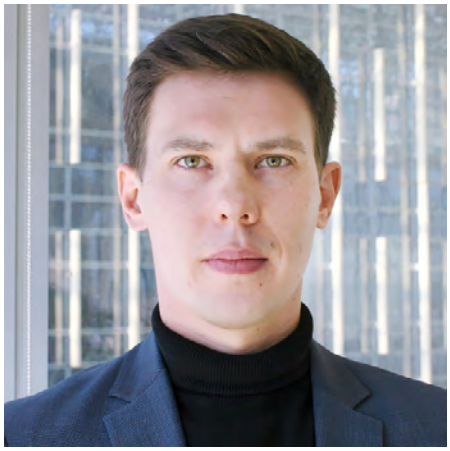
The classic security department mechanism is very outdated and in contrast to business practices in the CIS, has not developed in the last 20 years, even 50 years. In modern Western-styled companies, economic security department members have a financial education, understand internal controls, IT and, simultaneously, have experience of internal investigations and highlighting fraud. How many security departments nowadays actually take part in a warehouse stock-take and investigate the reasons for disappearing inventories? Guarding facilities, installing video surveillance equipment and studying playbacks are only a part of what needs to be done.

Practice has shown that centralising efforts to fight fraud in a single department does have its benefits, but the existence of a business-focused security department, is an indication of the maturity and development of any organisation.

Bankruptcy or how managers themselves become debtors

(Forbes, 1 August 2018)

The negative effects of this latest global financial crisis have been truly global, especially in those countries dependant on oil and gas. Unfortunately, Kazakhstan has been no exception, with events resulting in a wide range of economic and financial repercussions, such as general economic downturn, consumer difficulties and even recession.



***Maxim Bazhenov**, Legal Consultant, Tax and Legal Department*

Even though we seem to be through the worst of it and the market is starting to pick up, many companies in Kazakhstan still have no access to financing, with some of them facing insolvency. What's worse is that insolvency may only be the tip of the iceberg for anyone managing a company facing bankruptcy, because by law they may be made personally liable for all debts.

When do managers become liable?

The Rehabilitation and Bankruptcy law clearly states when company officials incur "subsidiary liability" for corporate debts, which means that if corporate funds are not sufficient to pay off all debts, then company officials cover the shortfall by their personal finances and property.

Practice has shown that by virtue of their responsibility for corporate finances, company officials can be taken to court usually for:

1) not declaring a company as a bankrupt within six months of when it became aware of insolvency;
2) not providing a court and administrator with details of corporate financial activity within three working days of the administrator's appointment;
3) or not providing a temporary manager with access to corporate accounting documents from the date a temporary manager is appointed.

The first violation is by far the most common reason why company officials fall foul of the law and then bear subsidiary liability. For that reason, it is imperative that company officials keep track of corporate finances and look out for the very first signs of insolvency, and more importantly, take all appropriate measures to fix the situation, and if needs be, refer to a court.

With respect to "insolvency", it occurs when a company cannot pay off tax arrears of no less than approximately USD 1,000 over a period of over four months or if amounts due to other creditors reach no less than approximately USD 7,000 during a period of over three months.

Having said that, we have seen cases where courts have taken an insistent position and considered companies as insolvent the minute they are unable to pay off all debts. Sometimes courts may define a company insolvent as soon as evidence of tax arrears appears on the company's digital tax account. With this in mind, we do not rule out that courts may begin to calculate the six-month bankruptcy declaration period without taking into consideration the so-called four- and three-month periods.

The second and third reasons for instigating the subsidiary liability are also common, and can be avoided by maintaining dialogue with appointed administrators and providing them with the information they require. It worth noting that they may be appointed without notification from a court side and, due to this, may require some documents with providing extremely short timeframe for delivery.

Company officials, who bear the subsidiary liability are managers (the members of executive body or director) of a company, because their commitments include the execution of the day-to-day administration and management of the company, which cover commitments related to the fulfillment of the said obligations.

What needs to be determined for the imposition of liability on managers?

Rather worryingly, courts need to determine no facts other than a violation of the obligations discussed above, making the statutory recognition of guilt, damage and unlawful actions redundant.

This position contradicts the general principles of civil liability and relevant provisions of the Civil Code of Kazakhstan, according to which, officials bear liability for the debts of a company only if bankruptcy is invoked by inadequate management of the company's affairs, or if bankruptcy is fraudulent/premeditated and invoked by activities (omission) of company officials.

Maybe because of this, initially, when the concept of the subsidiary liability was first introduced in 2014, courts avoided imposing subsidiary liability on officials without the determination of the existence of certain facts, such as guilt, damage and unlawful actions. We have witnessed many cases where courts have required that plaintiffs prove that company officials' actions led to corporate insolvency; and as our experience has shown, most courts eventually ruled in favour of company officials.

However, the situation altered in 2016, when courts began to impose subsidiary liability on officials for corporate debt far more frequently, often stating that, *"the defendant failed to notify the court about its insolvency and provide the administrator with all necessary information within the statuary period, which is enough to satisfy the statement of claim and impose subsidiary liability on the defendant,"* and potentially, most importantly, without consideration of the amounts involved, which sometimes reached billions of tenge.

To correct non-uniform juridical approach, the Supreme Court in 2017 added a relevant regulatory resolution by clarifications that the subsidiary liability for the violations of the above indicated obligations is an independent kind of liability, and arises regardless of whether bankruptcy was caused by the actions of founders (participants) and company officials or not, meaning that courts are not obliged to determine any other facts to impose it.

Purely, for this reason, it is currently very difficult to convince a court that company officials are not subject to the subsidiary liability for failing to notify a court of insolvency or provide administrators with requested information. The feeling is that the punishment does not fit the crime, but nevertheless, despite the controversy around potential crippling liability for what are essentially formal violations, we still need to make sure we observe the rules.

Is liability really inevitable?

Having said that, we have seen situations where company officials have not always been handed a "sentence" of the inevitable subsidiary liability. They may be released from such liability in certain situations, for example, if they can prove there were valid reasons for a misdemeanour or if they were appointed to their position after the company had incurred its debts. Irrespective of whether there is an opportunity to prevent liability, the most important policy is to be aware of the possible pitfalls; work out how to avoid them and have a defence strategy in place should you be unlucky enough to be involved in a lawsuit.

All of the above goes to show just how quickly legislation and subsequent court practices change, and the value in keeping up to speed with and complying those changes, because, as this article has tried to point out, the consequences of failing to do so, even if the requirements seem trivial, can be severe and put personal finances and assets of managers at risk.

Certificate of taxes paid in Kazakhstan by foreign nationals

(Forbes, 24 September 2018)

As the number of overseas nationals working in Kazakhstan continues to grow, the issue of confirming taxes paid in Kazakhstan is becoming more and more topical.

Madina Abisheva, *Tax and Legal Department*

Article 676 of the Tax Code "Certificate of Income received from Kazakhstan Sources and Taxes withheld (paid)" states that:

"1. A non-resident may apply for a certificate from the tax authorities confirming income received from Kazakhstan sources and taxes withheld (paid) (the "Certificate") in a format approved by the authorised body, if the given tax is due in Kazakhstan, including based on an international treaty, and if it is not refundable in accordance with articles 672, 673 and 674 of the Tax Code.

Tax agents may also apply for Certificates for income accrued and/or paid to non-residents and taxes withheld (paid) on that income.

In this case, a power of attorney in accordance with article 16 of the Tax Code is not required."

From the above it seems that this service is only available to non-residents. Article 217 of the Tax Code identifies that residents are those individuals permanently residing in Kazakhstan (for at least 183 calendar days in any consecutive 12-month period ending in the current tax period). If individuals do not meet this criterion, they may be treated as non-residents in the current tax period.

Under the above procedure, Certificates are generally received within 10 calendar days of an application or the required tax reporting being filed. Applications are available from the relevant state revenue department (SRD) and electronically.

So, what about foreign nationals who are residents and not eligible for the service? It seems unlikely that the tax authorities would have overlooked them.

If someone is recognised as a tax resident in Kazakhstan, then any personal tax should be paid in Kazakhstan. For this purpose Kazakhstan certificates of tax residence are available, and, consistent with global taxation standards, even if an individual is simultaneously recognised as a tax resident of a Kazakhstan double tax treaty country, a residence certificate means he/she can be recognised as a resident of one of the two countries.

"What if an individual is recognised as a tax resident of a different country, probably his/her country of citizenship, and thereby under the treaty, is automatically recognised as a tax non-resident in Kazakhstan?" That could happen, but it would mean different personal taxation conditions. It is worth remembering that tax residency certificates in some countries are not always that easy to get. Quite often, countries, such as France, stop recognising their nationals as tax residents if they leave to work abroad. On top of that, Kazakhstan only has double tax treaties with 53 countries.

"What about the remaining foreign nationals who are tax residents in Kazakhstan?"

Before the SRD transitioned to using electronic keys, local tax authorities would issue signed and stamped acts of reconciliation, which were recognised as confirmation of tax paid in Kazakhstan.

This service was abolished in 2017 and has been replaced by personal account statements of budget settlements and social payments, which are issued and stamped by local tax authorities, if applied for. As the service is not that common, a number of SRD refuse to issue statements in hard copy and prefer to download them using electronic keys. If this is the case, they will not be certified by the tax authorities.

We often come up against tax residency disputes in tax reporting, specifically in form 240 (individual income tax return). When tax authority employees hand out returns manually, all foreign nationals are treated automatically as non-residents. In a specific case, a deputy from a regional SRD explained that in this context, they do not focus on tax residency, rather the general concept of residency as a whole, while in another regional SRD they require the certificates as described above. From this, we can ascertain that the issue is not yet fully regulated within the tax authorities and approaches tend to differ depending on the office. In turn, when identifying residency and completing the relevant tax return columns, we tend to focus on the definitions of residency provided by the Tax Code and generally established rules for the completion of tax reporting.

It is time to take control — "The Oil & Gas Tax Function"

(Investors' Voice, October 2018)

Uncertainty within tax legislation, an inconsistent judicial system and a volatile business climate continue to combine to place a high-risk premium on investment capital in Kazakhstan. Foreign and domestic investors in the oil and gas and services industries often face difficulties when dealing with tax administration in particular.

***Anthony Mahon**, Partner, Tax and Legal*

***Aliya Tokpayeva,** Senior Manager, Tax and Legal*

Many of the difficulties with the tax authorities are the consequence of insufficiently thought out tax policy initiatives and a lack of certainty regarding future policy changes. It would be rare indeed to not hear complaints about the complexity and/or ambiguity of the tax law, and the lack of an integrated fiscal strategy when assessing the overall tax burden placed on the business community.

As Kazakhstan continues to combat corruption, improve its institutional framework, and entrench the rule of law; business routinely struggles with the frequent and intrusive tax inspections.

In addition, a lack of limit on the total amounts of penalties that can be assessed in addition to tax – actual amount of tax due may be substantially less than the penalties assessed – does not positively engender an environment of trust between business and the Kazakh fiscal authorities.

This issue of a lack of mutual trust is exacerbated by the local tax administrations creating problems for the business community in imposing burdensome reporting, record and source documentation keeping requirements, conducting excessive inspections and audits, but also failing to provide transparency in tax administration operations.

The vicious cycle of legislative uncertainty is something that business community in Kazakhstan has little / limited or no control of, as only meaningful reforms to the tax system can break the cycle resulting in an improved business climate.

This uncertainty, indeed, has become a fact of life in Kazakhstan, yet it doesn't need to be a barrier to the effective management of tax in the oil and gas industry.

Today, tax departments are facing a broader range of challenges and expectations, ranging from increased scrutiny from tax authorities across the globe to pressure from boards and audit committees.

The global focus on multinationals paying their 'fair share' of tax has put tax functions under further scrutiny. As a result, an organization's tax function shall not be viewed in isolation, but seen as part of a bigger picture of how the tax function fits into the wider organization.

Particularly, when organization undergoes through organizational change such as:

- changing the production line
- enlarges the market or goes international
- re-structures its holding structure, or merges with / to another organization
- tax function or other integrated processes are outsourced to a third party or are centralized within the group structure

- or when organisation brings in a new / updated version of the existing ERP or other technology

the organisation shall know its tax function from in-and-out to face the change promptly, effectively to properly re-engineer the processes, if required. Re-engineering, herewith, is not necessarily adding or killing one of the tax business processes, but also may include, but not limited to:

- reallocating / changing the responsibilities making sure there are no overlaps / gaps or duplication of functionalities within the tax department
- re-checking that integrated processes as of commercial, trading, accounting, treasure etc. are still running smoothly with the tax function (quality of information, timeline, formats etc.)
- tax technology or ERP provides sufficient and adequate level of quality / details of information for the tax accounting / modeling / forecasting / reporting purposes
- capabilities of tax personnel are addressing the new challenges, and
- methodological documents and supporting registers / forms / reports are still relevant and are considered as supporting tools but not seen as a burden for tax department personnel.

Re-engineering of the tax business process may be driven by not only organizational change, but also come from tax legislation requirements. For instance, starting 2018 the State Revenue Authorities (SRC) of Kazakhstan has introduced an Alternative tax, which is applicable by specific subsoil users operating in Kazakhstan replacing mineral extraction tax, rent tax, excess profit tax and obligatory payment for historical costs to the government. Apparently, before even applying a so-called an Alternative tax regime the organization would have to build a tax model to test either new regime worth of switching, but once such is finalized, the tax business processes are urged to be re-engineered. Herewith, the methodological documents and supporting registers shall be updated, the tax business processes related to overwritten taxes shall be updated / killed, the processes shall be re-visited from the perspectives of who, what, when, and how shall be done with the newly introduced tax.

Changes and uncertainty in tax law, evolving corporate structures and increasing regulatory oversight all combine to drive the tax departments to perform more effectively and efficiently.

So how often do the organizations operating in Kazakhstan review their tax business processes from an effectiveness and efficiency perspective? Is this something that happens by default and on a regular basis? Or is it something that has never been specifically addressed? Even if an organization did want to increase effectiveness, how should the relative "success" of such a function be measured?

The frustrations facing tax functions operating in Kazakhstan were summed up by a member of a tax function of a major taxpayer in Kazakhstan "the in-house tax team all struggle coping with the constantly changing tasks allocation among the team members, duplication of responsibilities, functions and efforts. There is an overall lack of adequate and standardized timelines, format of our work and quality control processes."

One of the most likely causes of such dysfunction would be if the organization had not undertaken any recent inventory of tax business processes and/or had poorly implemented the mapped out tax business process.

Today, validating your business processes ensures your business is running efficiently and effectively, and ready to face the challenges of external commercial and regulatory uncertainty.

Carefully crafted tax processes should be utilized to manage tax risk in close collaboration with the business of the enterprise. The ultimate goal should be the contemporaneous and effective management of tax risk in such a way that business operates "as usual" with tax neither acting as a commercial road block nor being an afterthought giving rise to increased risk exposure.

Unlike many other automated and systematized business processes, tax processes have traditionally been manual in nature.

The tax department has ordinarily not been charged with looking inside itself at the efficiency and effectiveness of its internal operations and therefore process improvement has never been high on the tax function's agenda.

However, a focused and concerted effort in improving processes within the tax department can result in cost reductions as a result of reducing time and efforts required to performing the requisite tax functions while simultaneously improving quality and reducing risk.

In doing so, the tax function is able to identify and address the tax ramifications of transactions early on, highlighting any potentially exceptional tax issues that could result in significant and unforeseen financial impacts for the business.

This type of contemporaneous risk identification and review activity should serve as the hallmark of a strategically integrated tax department that could facilitate increased efficiency and effectiveness in broadening tax's role across the entire organization. Tax risks and challenges are managed and controlled as an integrated component of the corporate operating model rather than as an afterthought.

Thoroughly understanding tax processes and optimizing these from an operations viewpoint, investing in technology for tax, strengthening the leadership of tax, understanding how the tax function should relate to and interact with operations, finance and technology within the enterprise — would all be steps towards the creation of the tax department of the future – one that operates significantly more effectively and efficiently.

It is time to take control.

Creating organizational maturity

(World Monitor, October 2018)

There are many websites, books, training courses or other sources of information available providing us with ways we can improve. We all want to improve our appearance, our job performance, our relationships and so on.

***Marina Kostanian**, Construction Consulting Partner*

Project managers probably want to be more efficient, and companies, too, want to increase their return on investment by doing things more professionally and smarter. In other words, we are all striving for the best, and to succeed we need to have a plan to continuously improve our ability to gather the right measurements, to build realistic plans and to overcome challenges. With this in mind, in this article, I discuss what I see as the basic attributes of organizational maturity.

The degree to which a business practices project management is referred to as organization project management maturity. There are several management tools and programs available offering guidance on organizational maturity. They are designed to take processes from an unpredictable, somewhat chaotic state to a disciplined process of continuous improvement. With this in mind, it goes without saying that companies with more mature practices find it easier to deliver projects on time and under budget.

Most of the models offer the following basic steps to improvement, which are repeated in cycles:

- an early learning phase
- the integration of lessons learned with processes
- the reengineering of business processes
- transition to a new phase of maturity
- repeat at the next level

Some model examples are:

- the Organizational Project Management Maturity Model (OPM3) – a Project Management Institute standard detailing knowledge, assessment and improvement elements, and which is generally recognized as the most comprehensive example of project management
- the Crawford Project Management Maturity Model, which discusses five levels of maturity and provides a framework for the continuous improvement of project management skills and results.
- ISO 9001:2008 Quality Management Systems by the International Organization for Standardization is a family of standards that although quite detailed, but are generic enough to be applied across almost all business sectors and industries

Most organizations in Kazakhstan are at the lowest level of progression according to the above models. This can be explained by a typical five-level progression:

At Level 1 companies will have a project management process but no structured process or standards.

To achieve Level 2, business will have to achieve Level 1 and have standard project metrics in place.

At Level 3, organizations should have standards and institutionalized processes incorporating project metrics and evaluate performance among portfolio projects. At this Level an organization should be adopting either an earned value management system (EVMS) or comparable metrics. EVMS are valuable in reporting general progress and forecasting schedule and cost performance behavior to people outside the project team such as project owners, sponsors, etc. They do not solve project management issues and in some cases even create them, at the same time raising questions on project performance.

Only after achieving Level 3 can an organization attempt Levels 4 and 5, which deal with continuous improvement. The last two levels offer tremendous benefits – especially if the organizations achieve them before their competitors.

Capital projects are complex undertakings with significant risks, often impacted by rising costs and schedule delays. Deloitte provides a wide variety of services designed to help clients deliver successful projects despite the risks. We enhance our clients'

ability to achieve their project goals by providing objective and independent advice, along with process improvement opportunities built from experience and our knowledge of leading industry practices.

Our Infrastructure and Capital Project offering covers the entire project life cycle and helps companies maximize their potential to deliver within project constraints.

Below are some of our competences:

Strategy and planning

Future market conditions will impact current business models and force companies to explore new investment alternatives to generate larger free cash flows. Successful business models are driven by a complex set of portfolio decisions at the business unit, program, project or individual asset levels.

These portfolio decisions focus on tradeoffs among competing priorities — from cost savings to growth and innovation to compliance with health, safety and environmental regulations. The hurdle many organizations must overcome is how to synthesize vast amounts of information into data-driven insights to assess the exposures, benefits and tradeoffs of different investment alternatives in order to make optimal business decisions and lead to optimal key performance metrics.

The Deloitte Portfolio Optimization approach is customized to meet exact business requirements by modeling the Client's definition of value, and incorporating business constraints and risk exposures. It is capable of presenting an array of optimal portfolios, which maximize defined value, considering a range of business constraints and risks. The array of portfolios can be filtered and disaggregated to review recommended investments with the highest returns and suggested start dates.

Financing & procurement

Deloitte services include raising project finance; establishing and managing the procurement process to acquire services, material or equipment to deliver a project, and prioritizing capital allocation between projects.

Project execution and construction

We are developing and managing a program to deliver major capital projects. To ensure delivery confidence, we offer the development of project controls / project management processes, project organizational structure, PM technology supporting and analytics. Our team applies EVMS methodologies to give the Client an objective and in-depth report of project performance.

Operation and maintenance

While assessing ongoing lifecycle costs and providing insights around optimizing, we forecast the performance and value of assets in operation.

Kazakhstan's taxation environment and alignment with international practice

(Investors' Voice, February 2019)

Kazakhstan continues to make progress towards cooperation and alignment with international tax community; yet, the divergence from fundamental international tax principles continues to exist. International tax practice is becoming more harmonized globally and more advanced in reaching consensus-based tax solutions. Value stands to be lost from the Kazakhstan economy insofar as the country does not similarly implement consistent rules and global practices that are clear, unambiguous, and applied in a straightforward and transparent manner.

***Anthony Mahon**, Partner, Tax and Legal*

Key drivers of the tax uncertainty created by local taxation system relates to:

(i) Tax Code provisions that are inconsistent with international standards or insufficiently clear;

(ii) Approach of the state authorities in interpreting tax legislation that is significantly out of line with the guidance set out by the Organization of Economic Co-operation and Development (OECD); and

(iii) Burdensome tax administration practice.

A combination of these issues correlates to increased cost and unpredictable risks for taxpayers, thus undermining the country's investment potential. The outflow of economic benefits occurs either when non-residents inflate the costs of their services to incorporate additional tax costs applied in Kazakhstan or by withdrawing from the market.

With this in mind, special attention should be given to improvement of domestic taxation rules that currently expose businesses to an unnecessarily uncertain tax environment.

Tax Code provisions contrary to international taxation principles

A key principle used in international tax law as regards the avoidance of double taxation is that of "beneficial ownership". This concept is a key measure in combatting certain forms of tax evasion employing intermediary recipients of income and is included in the Model Double Taxation Conventions of the OECD, the United Nations and the United States that serve as a basis for the majority of international double taxation treaties.

The term "beneficial owner" was introduced into the provisions of the OECD Model Tax Convention regulating the taxation of passive income, i.e. dividends, interest and royalties (Articles 10, 11 and 12) to address difficulties arising from the use of the words "paid to ...a resident". In the context of respective treaty provisions, the reduced tax rates on passive income are only available to income recipients if they are beneficial owners of such income.

In line with prevailing international tax practice, Kazakhstan's Tax Code provisions governing international treaty application concerning interest, dividends and royalties stipulate beneficial ownership of income as one of the obligatory conditions to access double tax treaty benefits.

However, in addition to the long-standing provisions related to passive income, the new Tax Code effective from 1 January 2018 introduced beneficial ownership requirements with respect to all types of income of non-residents from sources in Kazakhstan. The challenging area in automatic application of the treaty for a tax agent in Kazakhstan is now to ensure that non-resident recipients of all types of Kazakh-source income, including the active income, are beneficial owners.

Firstly, the new provision is inconsistent with the international approach of business profits taxation that provides taxing rights to the active income recipient's country of residence. Moreover, it does not explicitly require recognition of the latter as beneficial owner.

Secondly, local tax legislation is unclear in terms of burden of proof placed upon taxpayers. There is no guidance on documentation required to maintain or procedures to perform in order to sufficiently demonstrate beneficial ownership. Hence, the absence of concrete guidelines provides scope for the tax authorities to deny treaty exemptions, resulting in unfair and unnecessary time and financial costs imposed upon tax agents.

Finally, the beneficial ownership concept is still widely debatable at the international level and a lot of targeted work is taking place to make the concept globally coherent. The diverse application of the concept would ultimately intensify the gap between domestic and international interpretations. This, in turn, would result in global developments toward harmonization becoming irrelevant and not applicable to Kazakhstan legislation.

Improper use and interpretation of legislation

Another common issue is the state authorities' interpretation and application of taxation principles that contradict both international and local legislative provisions. This dysfunction is currently widely illustrated in relation to the issue of "permanent establishment" – one of the most important, yet subjective, principles of international taxation and determination of inter-jurisdictional taxing rights.

The local Tax Code and international treaties set the criteria defining when the activities of a non-resident trigger creation of permanent establishment subject to registration and taxation. The domestic legislation and many treaties provide that permanent establishment exists if a non-resident renders services through its personnel present in Kazakhstan for more than a certain time threshold. The tax authorities use different and inconsistent approaches in performing tests under this provision.

Thus, there are several cases where the authorities considered the length of the contract rather than the

physical presence of personnel as a key factor determining creation of a permanent establishment. In other cases, the state authorities apply the proper approach assessing the time spent by a non-resident's personnel in Kazakhstan.

The controversial position was also expressed relevant to the treaty provision on a building site or construction or installation project, or supervisory services connected therewith that create a permanent establishment only if such site or project lasts or services continue for more than certain period of time. The authorities' interpretation of the this provision implies that rendering of supervisory services connected with building site or construction located in Kazakhstan will lead to creation of a permanent establishment even if such services are rendered outside of Kazakhstan.

Although the OECD Commentaries on this provision does not set out prescriptive guidelines with respect

to supervisory services, the presence of non-resident entities on the site is regarded as a crucial condition in

evaluating the constitution of a permanent establishment. For example, the existence of a permanent establishment of subcontractors is assessed based on their activities' duration on the site. Additionally, the period of the site existence starts from the date on which the non-resident begins his work in the country.

The recognition of services performed offshore as activities triggering permanent establishment in other country may contradict OECD guidelines, including the principles of contract aggregations that require commercial and geographical coherence of projects. The main reason for different interpretations of permanent establishment provisions is that the concept requires the application of significant and specialised judgement resulting in different case-by-case outcomes.

It is important to also consider the detail of OECD Commentaries that provide an analytical guide and

comprehensive framework for tax treaty interpretation and its harmonized application.

Burdensome and unfair tax administration

The bureaucracy level in current taxation systems represents one of the main concerns exposing taxpayers to increased administrative and tax costs. The application of the treaty benefit requires compliance

with complicated formalities such as annual provision by a non-resident of the apostilled tax residence certificate of a due form within tightly prescribed timeframes. Treaty benefits may be denied on the grounds of non-compliance with one of the administrative requirements, for example, the late provision of the timely issued certificate due to the lengthy legalization process. All-too-often local tax administrations seem to be seeking ways to deny treaty benefits to taxpayers rather than simply making sure that non-residents are eligible for treaty benefits.

The authorities' form-over-substance approach forces the taxpayers to withhold taxes at their own expense. In practice, the only present solution for companies is to go through the long-lasting procedure for tax refund / credit.

In order to eliminate the highlighted challenges, Kazakhstan's government needs to consider effectively addressing the above matters by (i) amending the contradicting provisions, (ii) incorporating perspectives and examples of international best practice and (iii) developing new ways to simplify burdensome administration.

The OECD Report on Tax Certainty issued in 2017 indicates enhanced cooperation between tax administrations and taxpayers as the practical approach in responding to the tax uncertainty.

The overarching objective of collaborative work (using effective and inclusive communication platforms) should be to develop solutions to problematic matters in a manner that both protects the economic interests of Kazakhstan and improves the attractiveness of Kazakhstan's investment climate - ultimately contributing towards effective realization of the nation's strategic reforms.

Reclaiming lost assets from debtors in bankruptcy court

(Investors' Voice, February 2019)

***Alibi Akylas**, Legal Consultant, Tax and Legal Department*

Creditors may face a situation in which the creditor's organization is owed money, yet the debtor has filed for bankruptcy. If the court upholds the petition, the debtor faces bankruptcy procedures and the court will free him or her from unpaid debts. It is important to the creditor to consider what steps should be taken to avoid losing the original investment.

In any bankruptcy case, it is imperative that both parties act quickly. The debtor's main aim is to free himself of debts by removing remaining assets from his company as quickly as possible, whereas the creditor's goal is to regain as much of his investment as possible.

Filing a Proof of Claim

To ensure recovery of lost assets, the creditor must file a proof of claim with a temporary administrator within the allotted time. Unfortunately, the creditor has only one month to file, otherwise he will be treated as a non-voting creditor, which essentially gives him no influence over the bankruptcy proceedings.

Furthermore, creditors who miss the deadline will only get a chance to recover their lost investment after creditors who register their claims on time. Therefore, missing this deadline may force the creditor to wait until the very end of bankruptcy proceedings to make his case. In a recent court case, a major creditor with a claim in excess of 500 million Tenge missed the filing deadline. Taking advantage of this, the debtor arranged to exclude his assets from the proceedings to protect them from liquidation. After disputing the temporary bankruptcy administrator's actions, the decision was overruled.

In another case, a major creditor had a claim to a debtor for one billion Tenge. However, this creditor also missed the temporary administrator's deadline and was forced to abstain from the proceedings. This played into the hands of the debtor, who was waiting for the statute of limitation to end on his most valued asset: a subsoil use contract. While the creditor's party wanted to liquidate the asset, they had no legal authority to do so.

The Bankrupt Entity's Financial Condition

In these situations, creditors should study a debtor's financial condition. By law, bankruptcy petitions should

include a debtor's financial statements for the past three years and list all of their assets and debts. Creditors should take advantage of this by reviewing all the debtor's financial documents.

The creditor does not have to limit himself to studying published documents but may also try to find additional information from open sources and review the petition itself, which should list the reasons for the company's insolvency.

In one court case, Deloitte managed to locate and compare a debtor's financial statements with the published audit report, from which it soon became clear that there were discrepancies in the figures amounting to hundreds of millions of Tenge. It turns out that the figures had been altered in the financial statements so that the court would be more inclined to award the case to the debtor. Eventually, the court considered these facts and upheld the creditors' position.

It is therefore in the creditor's interest to identify the cause of bankruptcy by analyzing the available financial documents.

Generally speaking, bankruptcy takes one of three forms (i) accidental, (ii) negligent (iii) or intentional. Recovering assets from an accidental bankruptcy is extremely difficult, but creditors typically have more success in cases of negligence and intentional bankruptcy.

Suspicious Debtor Transactions and Operations

Most debtors, irrespective of the reasons for their bankruptcy, want to strip their companies of all remaining assets rather than liquidate them. These debtors have a number of methods at their disposal, but a transaction or arrangement of some kind is always involved. Here are some examples:

- Assets are sold at low prices prior to bankruptcy to "friendly" companies, which are subsequently liquidated, meaning there is nobody left to petition;
- A controllable debt is created, after which a "friendly" creditor petitions a court, receives its ruling and, through execution proceedings, strips the debtor's assets;
- A valuable asset is stripped through corporate reorganization, creating a new company from the bankrupt company and acquiring all its assets, leaving the debtor with nothing.

A creditor and bankruptcy administrator's goal is to discover any such transactions and return assets to debtors so they can be allocated to creditors. Any creditor discovering an unusual transaction can report findings to the bankruptcy administrator, who should then ask the court to have the transaction declared invalid. If the court rules in the bankruptcy administrator's favor, the asset is returned to the debtor's balance sheet.

In one instance a debtor, before filing for bankruptcy, significantly increased company management salaries to approximately 70 million Tenge, which, over the period of a few months, managed to cover amounts due to other creditors. The debtor's goal was to strip assets because salary arrears are considered a priority for creditors.

Joint Company Management

Furthermore, if a company is declared bankrupt, management may be made jointly liable for any outstanding company debts. For example, if a company owes 100 million Tenge, but it only has assets worth 10 million, then, if there are grounds, management may be made liable for the remaining 90 million.

Grounds in these cases usually include:

- A debtor's failure to petition a court for bankruptcy within six months of the day it became aware or should have become aware of its insolvency;
- A debtor upholding a creditor's claims, which makes it impossible for him to repay cash liabilities to other creditors;
- Management's intentional actions to bankrupt their company.

With proper research and counsel, companies can greatly increase their chances of reclaiming debts owed to them. However, it is worth noting that situations do arise when it is not advisable to wait for a debtor to declare bankruptcy. In these instances, creditors should initiate legal proceedings first if they feel their assets are at risk.

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