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EDITION № 2

LT in Focus

Litigation Tracking

Court Practice

In the framework of Edition № 2 we will review the most interesting and noteworthy court cases for November 2015 – April 2016:

Environmental and subsoil use

- On indemnification of environmental damages
- Subsoil user administrative liability for accidental pollutant emissions
- Enforcement of the International Court of Arbitration (ICC) decision in Kazakhstan

Tax matters

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- Withholding CIT and VAT for non-residents for the services of the Russian Federation resident's carriage supply/cleaning
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Tax and Legal
November 2015 – April 2016

On indemnificiation of environmental damage

Resolution of the Supervisory Board for Civil and Administrative Cases of the Supreme Court of the Republic of Kazakhstan (“Supreme Court of the RK”) dated 25 November 2015 for case 3гп-607-15

Kolzhan limited liability partnership

Petro Kazakhstan Kumkol Resources joint stock company

Resolution on partially sustaining the claims of RGI "Department of environment for Kyzylorda Region under the Committee for Environmental Regulation and Control of the Ministry of Environment and Water Resources of the Republic of Kazakhstan" and on case referral for reconsideration to the appeal instance

Following scheduled reviews of Petro Kazakhstan Kumkol Resources Joint Stock Company ("PKKR") and Kolzhan limited liability partnership ("Kolzhan"), RGI "Department of environment for Kyzylorda Region under the Committee for environmental regulation, control and government inspection in the oil and gas complex of the Energy Ministry of the Republic of Kazakhstan (“RK”) (the "Department") discovered excess over the established limits in the environmental permit and absence of a permit for environmental discharge at sources of pollution. PKKR JSC and Kolzhan LLP were subjected to administrative penalties in accordance with article of the Code on administrative offences of the RK “Excess over the established emission limits, stated in the environmental permit, or absence of an environmental permit”. PKKR JSC and Kolzhan LLP paid the relevant administrative penalties voluntarily.

The Department filed a claim with the court for damages caused by unauthorized pollution in excess of limits. According to article 321 of the Environmental Code of the RK (the "EC"), persons that committed environmental offenses shall reimburse the damage inflicted in accordance with the EC and other legislation of the RK. Damage inflicted on the environment as a result of a breach of Kazakhstan's environmental legislation shall be reimbursed voluntarily or pursuant to a court decision on the basis of economic assessment of damage.

Officials of an authorized environment protection authority made an economic assessment of the damage inflicted in accordance with “Rules of the economic assessment of damage to the environment " №535, approved by the Government of the Republic of Kazakhstan on June 27, 2007. Not agreeing with the calculation of the damage provided by the claimant, the defendants provided their own calculations, with damage amounts lower than that alleged by the claimant. When making their decisions, local courts noted that, the calculations provided by the defendants were reasonable. Moreover, during new court consideration local courts concluded that environmental damage, namely, atmospheric pollution, was not proved in the materials of the case.

History of the review of the case:

Period	Instance	Consideration result
February 2015	Court of Appeal	Partial sustaining of the Department's claim
June 2015	Court of Cassation	Resolution of the Court of Appeal left unchanged
November 2015	Supreme Court of the RK	Partial sustaining of the Department's motion. The decision and resolution of the Appeal and Cassation Courts, respectively, reversed. The case remitted for reconsideration to the Court of Appeal

Position of the Supreme Court of the RK:

The court board of the Supreme Court of the RK established that local courts had materially breached substantive law and procedural law, and resolved that the case shall be remitted for reconsideration to the appeal court board, on the basis of the following facts:

- economic estimate of the damage was made by Akzhol LLP, which does not meet the requirements of sub clause 9 of clause 1 of article 117 of the EC (the LLP is not an authorized person entitled to determine or participate in the determination of damage) and the norms in the Code of Civil Procedure about the relevance and acceptability of evidence (there is no information about the license, years of service, and specialty of the expert, there is no signed off acknowledgment of criminal liability for knowingly giving false opinion);

- the local court concluded that atmospheric air was not polluted only on the basis of a one-time measurement, and did not assess the fact that the defendants had agreed to the reports of reviews, orders and administrative penalties with respect to that fact, without appealing against them as appropriate.

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Source: *«Judicial library of the Supreme Court of the RK»*

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Wholesale distribution of oil products

Resolution of the Supervisory Board for Civil and Administrative Cases of the Supreme Court of the RK dated 25 November 2015 for case 3на-84-15

SHNOS-Yug LLP

Decision taken in favour of the tax authority

During a tax review, it was found out that Shnos-Yug LLP (the “Company” or the “Defendant”) had breached legislation related to sale of oil products. Company, being a wholesale distributor of oil products, sold oil products without using oil product (storage) depots, which, in the judgement of the Supreme Court, explicitly contradicts the Law “On government regulation of the production and sale of certain types of oil products" of 20 July 2011.

The Defendant did not deny the fact of the breach, and was subjected to administrative penalty in accordance with part 5 of Article 281 of the Code on administrative offences of the RK, in the form of a fine of 350 monthly calculation indexes (“MCI”) and confiscation of oil products, which were direct objects of the administrative offense, and income, received as a result of the offense.

According to the tax audit report, it was established that the Company had sold oil products totalling KZT 1,004,050,425 in circumvention of oil product (storage) depots. On the basis of the information revealed, the Court of Appeal instance determined the amount of income that the defendant had received as a result of the offense, in equivalent to the relevant sum of circumvention of oil product (storage) depots. Thus, this amount was proposed for confiscation.

Subsequently, the Cassation Court Board of the South Kazakhstan regional court cancelled the additional penalty in the form of confiscation of KZT 1,004,050,425, arguing that the said amount included not only income of the Company resulting from the breach, but represented turnover of oil products over the period which was the subject to the tax audit.

History of the review of the case:

Period	Instance	Consideration result
March 2015	First instance court	Decision was taken in favour of the tax authority
April 2015	Court of Appeal	Decision of the first instance court left unchanged. The resolutive part of the decision was completed with indication of the amount of income received as a result of the offense
May 2015	Court of Cassation	The Resolution of the appeal instance court was changed. The amount of income received as a result of the offense was excluded from the resolutive part of the resolution
November 2015	Supreme Court of the RK	Partial sustaining of the deputy Prosecutor General’s protest. The Resolution of the Court of Cassation reversed, the Resolution of Court of Appeal left in force

Position of the Supreme Court of the RK:

In accordance with part 1 of Article 55 of the Code on administrative offences, administrative penalty for an administrative offense is imposed within the limits set out in the respective article of the special part of the Code on administrative offences, in full compliance with the provisions of the Code on administrative offences. As the sanction for the offense committed by The Company is mandatory, the imposition on The Company of penalty, in addition to the fine, in the form of confiscation of oil products and/or income received as a result of the offense is mandatory.

The arguments of the cassation instance that the amount of KZT 1,004,050,425 determined as a result of the tax audit represents turnover of oil products rather than income from sale, were recognized not corresponding to the actual established circumstances and obtained in breach of the legislation. As according to the Code of the Republic of Kazakhstan "On taxes and other obligatory payments to the budget" (“the Tax Code”) the aggregate annual income includes all types of the taxpayer's income, including income from sale.

On the basis of the above, the Supreme Code of the RK reversed the decision of the cassation instance and upheld the resolution of the court of appeal.

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Source: *«Judicial library of the Supreme Court of the RK»*

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Subsoil user administrative liability for accidental pollutant emissions

Resolution of the Supervisory Court Board for Civil and Administrative Cases of the Supreme Court of the RK dated 2 December 2015 for case 3на-88-15

JSC Intergas Central Asia

Cassetur breve judgement on an administrative violation

JSC Intergas Central Asia ("Intergas") has an emissions permit, which it uses in its operations with natural resources, for which it pays a fee. On 2 February 2015, a gas natural pipeline exploded in West Kazakhstan Oblast resulting in combustion and the emission of 57.7 tonnes of pollutants.

Intergas was charged with administrative liability under article 328 of the Code on administrative offences of the RK by a Resolution of the West Kazakhstan Oblast Department for Ecology of Ecological Regulation, Control and State Inspectorate Committee (the "Department") dated 17 March 2015.

History of the review of the case:

Period	Instance	Result of consideration
March 2015	Uralsk Specialised Administrative Court	Department Resolution left unchanged; Intergas appeal rejected
June 2015	Court of Cassation	Resolution of the court of first instance left unchanged
August 2015	West Kazakhstan Oblast Specialised Inter-Regional Economic Court	Department lawsuit for damages of KZT 413,949,384 sustained
October 2015	Court of Appeal	West Kazakhstan Oblast Specialised Inter-Regional Economic Court amended. Plaintiff appeal partially sustained
June 2015	Court of Cassation	Court of first instance resolution left unchanged
December 2015	Supreme Court of the RK	The case was brought to the Supreme Court of the RK by virtue of the Deputy Attorney General's protest against the decision of the Department and lower courts. Decisions of the lower courts left unchanged. Case proceedings terminated

The Department and courts of the three instances concluded that Intergas actions showed signs of a violation stipulated by article 328 of the Administrative Violations Code, in the form of environmental emissions in excess of the limits set in an ecological permit.

The West Kazakhstan Oblast Court of Appeal decreed that the "Method for calculating pollutant emissions into the atmosphere at gas transportation and storage facilities" (hereinafter – "Method No 1") be used to calculate pollutant emissions into the atmosphere, which resulted in total damage to the environment of KZT 9,495,591. The appellate court,

basing its findings on the report of the expert environmentalist, had previously decreed that environmental damage be calculated using the “Method for calculating emission parameters and gross emissions of harmful substances from hydrocarbon flares” (hereinafter – “Method No 2”) at KZT 413,949,384. The Court gave the following reasons for its decision:

1. Method No 1, according to section 1 thereof, was devised with the aim of obtaining the initial data for the assessment of the influence on the quality of atmospheric air of emissions of harmful substances from hydrocarbon flares taking place during the extracting, processing and transporting petroleum, associated petroleum gas and etc. The court decreed, on the basis of an expert opinion, that a trench that had been formed due to the explosion of the gas pipeline can not constitute a flaring device since the word ‘device’ implies a pre-planned construction (installation) of a structure.

2. Method No 2, according to section 1 thereof, was devised with the aim of establishing a unified approach to the measurement of emissions of harmful substances into the atmosphere for gas transporting system objects of the main pipeline. The Court used this method when establishing the quantum of damages to be paid by the Company due to the fact that the accidental source of emissions was classified as a stationary source since it had been formed temporarily, had been dislocated at a certain location and produced emissions of harmful substances into the atmosphere only temporarily.

3. The composition of the gas flowing in the main pipeline is significantly different from the flared gas and contains a large quantity of hydrogen sulfide, while the former is purified gas.

4. Since the damage to the environment had occurred due to an accident, the emissions of gas that took place cannot be treated as those that have been caused intentionally.

5. The Court also took into account that only those pollutants had been emitted during the accident that have been duly authorised by the ecological permit given to the Intergas.

The courts of three lower instances held the Company liable for breaching Article 328 of the Code on administrative offences of the RK, i.e. exceeding the amount of emissions produced by the Company and allowed by the relevant ecological permit and the subsequent damage to the environment. As the result of applying Method No 2, Intergas was ordered to pay KZT 9,495,591 worth of damages for the environmental damage caused.

Position of the Supreme Court of the RK:

In relation to the quantum of damages claim, the Supreme Court of the RK upheld the decision of the West Kazakhstan Oblast Court of Appeal for Civil and Administrative Cases and did not introduce any amendments thereto.

In relation to the administrative liability case, the Supreme Court decreed that the conclusion of the authorised body and lower courts did not correspond to actual case circumstances and had been made using an incorrect interpretation of material law.

It also decreed that subsoil user administrative liability under article 328 of the Administrative Violations Code only arises if emission standards exceed those in an ecological permit. In accordance with point 4 of the “Method for calculating environmental emission norms”, accidental emissions linked to possible emergencies are standardised.

Consequently, the court did not discover any signs of the administrative violation stipulated by article 328 of the Administrative Violations Code in Intergas actions because:

1. the pollutant emissions on 2 February 2015 occurred *as a result of a gas pipeline accident*, and not during normal business operations for which an emissions permit would be in place

2. the accidental emissions (57.7 tonnes) were not included in Intergas's permit due to their unplanned nature

3. the substances released by the accident had been included in the permit issued by the authorised body

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Source: *«Judicial library of the Supreme Court of the RK»*

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Protection from grey imports (parallel imports). How the exhaustion of intellectual property rights could impact your business

Resolution of the Supervisory Court Board for Civil and Administrative Cases of the Supreme Court of the RK dated 9 December 2015 for case 3гп-625-15

Chivas Holdings (IP) Limited

Resolution on satisfaction of a claim of the Chivas Regal trademark holder

In February 2013, Brig LLP (the “Defendant”) imported whisky into Kazakhstan (the “Goods” or “Products”, depending on the context), which had been purchased and introduced into public circulation in the European Union with the consent of the CHIVAS HOLDING (IP) Limited (GB) and stamped with the Chivas Regal international trademark.

“Chivas Holding (IP) Limited” (the “Right Holder”) is a company, holding the rights for national trademark “Chivas Regal”, which is registered in the RK from 27 February 1992.

The Right Holder filled a legal claim demanding to declare the use of “Chivas Regal” trademark as a violation of his trademark rights; to prohibit “Chivas Regal” trademark use.

The following was established during the hearing:

- the defendant referred to TRIPs and GATT provisions. However, at the time of the dispute (2014), they had not been duly ratified by the RK. Furthermore, TRIPs cannot be used to resolve issues around the exhaustion of intellectual property rights
- the treaty on partnership and cooperation between the RK and European communities and their member countries (Brussels, 23 January 1995) prohibiting restrictions on the circulation of goods does not cover restrictions introduced by a rights holder based on the national principle of the exhaustion of intellectual property rights
- the regional principle of the exhaustion of intellectual property rights valid in the Eurasian Union does not cover the RK
- nobody may use protected trademarks in the RK without the owner’s consent. Consequently, items of intellectual property may only be used with the right holder’s consent.

History of the review of the case:

Period	Instance	Result of consideration
May 2014	Specialized Interdistrict Economic Court of Aktobe oblast	Rejection of the lawsuit
September 2014	Court of Appeal	Resolution of the Court of first instance remained unchanged
April 2015	Court of Cassation	Appeal instance Resolution left unchanged

October 2015	Supreme Court of the RK	The Right Holder's lawsuit sustained

Position of the Supreme Court of the RK:

The Supreme Court of the RK established that the court of first instance had applied the norms of material law incorrectly, and incorrectly interpreted the norms of national and international intellectual property law. Furthermore, the courts of appeal and cassation did not correct the court of first instance's significant violations, which led to an incorrect resolution of the dispute. The Supreme Court of the RK also established that counter fact and parallel imports (grey imports) need to distinguished. Goods introduced into civil circulation in the European Union may be distributed freely within it, but, when imported into the RK, right holders need to provide their consent in accordance with the national exhaustion of Right Holder rights.

Deloitte recommends:

1. *Before using a label to distinguish a company, verify that any actions will not violate the rights of third parties to intellectual property*
2. *enter into the necessary agreements to transfer/use intellectual property in good time in accordance with Kazakhstan law*
3. *enter intellectual property into the customs register*
4. *remember that intellectual property such as trademarks, models, inventions and others are extended upon the right holder's application*
5. *know that intellectual property is an important asset, in particular, trademarks as opposed to material assets, tend to increase in price with time*

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Source: *«Judicial library of the Supreme Court of the RK»*

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Withholding CIT and VAT for non-residents for the services of the Russian Federation resident's carriage supply/cleaning

Resolution of the Supervisory Board for Civil and Administrative Cases of the Supreme Court of the RK dated 15 December 2015 for case 3гп-651-15

OJSC Magnitogorsk Metallurgical Plant

Ruling partially upholding taxpayer demands

The tax authorities carried out a comprehensive tax review of the branch of the Magnitogorsk Metallurgical Plant (the "Taxpayer"), a resident of Russia, regarding its execution of tax obligations for 2009-2014 and issued notification of the accrual of VAT for non-residents of KZT 5,176,132, late payment interest of KZT 2,736,569, and CIT on non-resident legal entities withheld at the source of KZT 8,626,888, and late payment of KZT 4,454,164.

The basis for the additional accruals was the Taxpayer's provision and cleaning of wagons to RZhD, a Russian company with no presence in the RK. The services were provided between Boskol and Tsentralnaya stations. Boskol station is in the RK but on railway tracks belonging to RZhD – South-Ural railway. The wagons were provided and cleaned at the Tsentralnaya station in Buskulskii village in Russia. Storage logs, acts of completion, invoices and payment orders confirm that based on a Protocol from 11 December 2009 *On the Procedure for Collecting Indirect Taxes on Work and Services performed in the Customs Union*, the place of sale of the services to provide and clean wagons is Russia. VAT on payment for the services is remitted to the Russian budget in accordance with the above protocol and Russian law. However, the Kazakhstan tax authorities deem the place of sale as Kazakhstan, hence the additional accrual of CIT on non-resident legal entities at the source of payment and VAT for non-residents.

The Taxpayer took legal action to have the tax authorities' actions recognised as unlawful and applied for moral damages. Specifically, the Taxpayer confirmed the tax authorities' invalid conclusions regarding its branch not calculating and withholding CIT on non-resident income with article 7 of the Double Tax Treaty between Kazakhstan and Russia, which states that service income from a non-resident should be taxed only in Russia. Furthermore, the tax authorities incorrectly showed the place where the services were performed as Kazakhstan, when they were actually provided at the Tsentralnaya station in Russia.

History of the review of the case:

Period	Instance	Result
August 2014	Specialized Interdistrict Economic Court of Kostanay oblast	Lawsuit partially upheld
October 2014	Court of Appeal	Court of first instance ruling left unchanged
February 2015	Court of Cassation	Court of appeal ruling left unchanged

December 2015	The Supreme Court of the RK	State Revenue Department for Kostanai Oblast petition partially upheld

Position of the Supreme Court of the RK:

The Supreme Court ruled to partially uphold the tax authorities' demands.

The Supervisory Board established that the courts of first, appeal and cassation instances had no legal grounds to uphold the Taxpayer's application disputing notification of the accrual of CIT and late payment interest. The tax authorities did not provide reliable evidence of the legality of its ruling to accrue VAT for non-residents.

The Supreme Court partially upheld the tax authorities' petition: the sections of court acts recognising the actions of the tax authorities unlawful regarding CIT of KZT 8,626,888 and late payment interest of KZT 4,454,163 were repealed. A decision was taken to recover state duties from the Taxpayer of KZT 130,811. The refund of state duties was reduced to KZT 79,127. All remaining sections of the court acts were left unchanged.

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Source: *«Judicial library of the Supreme Court of the RK»*

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Enforcement of the International Court of Arbitration (ICC) decision in Kazakhstan

Resolution of the the Supervisory Board for Civil and Administrative Cases of the Supreme Court of the RK of 23 December 2015 for case 3гп-704-15

MGK Limited Liability Partnership

Seha Corporation

Decision taken in favour of MGK Limited Liability Partnership. Dismissal of petition by Seha Corporation.

MGK Limited Liability Partnership (“MGK LLP") took a legal action to postpone the enforcement of a decision of the International Court of Arbitration under the International Chamber of Commerce, Paris ("ICC") of 26 May 2014 to collect USD 14,080,000 from the MGK LLP in favor of Seha Corporation (the "Company") as reimbursement for losses resulting from failure to perform an obligation, KRW 565,180,889 in judicial costs, expenses and disbursements and USD 271,250 of arbitration costs. The Company in turn made a petition for a writ of execution for enforcement of the ICC's decision.

The following was identified during the hearings:

- The MGK LLP is at the stage of mineral exploration;
- The First instance court extended the exploration period for the assessment of commercial discovery of minerals by two years till 19 February 2016;
- The ICC's decision of 26 may 2014 does not specify the period for execution of the ICC decision.

In accordance with article 238 of the CPC of the RK, enforcement of international arbitration court decisions or arbitration court decisions may be postponed, permitted to be executed by instalments or the manner and procedure of execution may be changed. Based on the provisions of the current article, first instance court and court of appeal postponed enforcement of ICC’ decision. Courts concluded that the requirement to settle the debt immediately would lead to the bankruptcy of the subsoil user's enterprise that discovered minerals at the exploration stage. This is proved by the balance sheet of MGK LLP, which indicates that MGK LLP has no property sufficient to make a one-time repayment of the Company's claims met by the arbitration decision. However, the Court of Cassation requested evidence to confirm that at the end of deferral the MGK LLP will have property sufficient to execute the judicial ruling. Therefore, the court of cassation did not take into account the fact that during the period of exploration subsoil user is unable to return funds invested in a deep well drilling and received against the Company's guarantees.

History of the review of the case:

Period	Instance	Consideration result
September 2014	Specialized Interdistrict Economic Court of Almaty	The MGK LLP's claim was upheld. The Company's petition dismissed. Enforcement of the Decision of the (ICC) deferred by 3 (three) years
February 2015	Court of Appeal	Decision of the First instance court left unchanged
November 2015	Court of Cassation	Decisions of the first instance court and the Court of Appeal overturned. Decision to dismiss the MGK LLP's claim
December 2015	The Supreme Court of the RK	Decision of the Court of Cassation overturned; decision of the First instance court and decision of the Court of Appeal upheld. The MGK LLP's claim upheld

Position of the Supreme Court of the RK:

The Supreme Court of the RK upheld the position of the first instance court and court of appeal that the requirement to settle the debt immediately will lead to the bankruptcy of the subsoil user's enterprise that discovered minerals at the exploration stage, which is proved by the balance sheet of MGK LLP. Therefore, it will only be possible to repay debt in full if MGK LLP is given a deferral of execution until the beginning of commercial production.

The Supreme Court also concluded that requirement to repay the debt immediately will lead to the MGK LLP's bankruptcy, which is contrary to the legal interests of the Company. Therefore, the debt will be repaid in full only if MGK LLP is given a deferral of execution until the beginning of commercial production.

On the basis of the above, the Supreme Court of the RK upheld the decision of the appeal court and MGK LLP’s claim.

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Source: *«Judicial library of the Supreme Court of the RK»*

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Permitted used of conditionally released goods

Resolution of the Supervisory Court Board for Civil and Administrative Cases of the Supreme Court of the RK dated 29 December 2015 in relation to case 3гп-700-15

JSC Multinational Company Kazchrome

Resolution on the partial settlement of claim

After a planned review of JSC Multinational Company Kazchrome's use of conditionally released goods, which within the framework of an investment contract with the Investment Committee of the Ministry of Industry and new Technology of the RK from March 2011 (the "Contract"), had been registered under the release for domestic customs procedure, the customs authorities assessed additional customs payments, taxes and late payment interest due to the incorrect use of the goods in question and their incorrect classification.

Kazchrome took legal action to have the customs authorities' actions recognised as unlawful, customs payments, taxes and late payment interest cancelled, and to apply for moral damages. The following was established during the hearings:

- Kazchrome did not lease the goods out, alienate them to third parties or change their permitted use
- the goods were destroyed or damaged due to an accident and during assembly, which is confirmed by accident and loss reports
- current legislation does not provide timeframes for declarants to exercise their right to register goods for destruction. At the same time, Kazchrome is entitled to file documents supporting the irretrievable loss of the goods, and consequently transfer to the destruction procedure, while contractual import customs duties and tax concessions remain valid
- Kazchrome filed documents with the customs authorities to transfer to the destruction procedure. The documents are currently under consideration with the customs authorities

History of the review of the case:

Period	Instance	Result of consideration
December 2014	Specialized Interdistrict Economic Court of Aktobe Oblast	Kazchrome lawsuit settled in part
February 2015	Court of Appeal	Court of first instance resolution left unchanged
May 2015	Court of Cassation	Court of Appeal resolution left unchanged
December 2015	Supreme Court of the RK	Court of first instance, Court of Appeal and Court of Cassation resolutions left unchanged

Three separate courts affirmed the part of Kazchrome's lawsuit recognising the permitted use of conditionally released goods and rejected the claim for moral damages.

Position of the Supreme Court of the RK:

The Supreme Court of the RK established that Kazchrome had not acted with the goods in breach of usage and (or) disposal restrictions established in connection with the use of concessions or in breach of the reasons for their provision. Thus, the Supreme Court of the RK agreed with the local courts' conclusions regarding the unlawful nature of the section of the disputed notification requiring Kazchrome to make customs payment arrears on destroyed goods and goods damaged during assembly, as they correspond to actual case circumstances and rules of substantive law.

Position and recommendations of "Deloitte"

We recommend that in the event of accidents or force majeure situations, companies receive confirmation from the customs authorities that conditionally released goods are not under customs control (point 3 of article 185 of the Customs Code). With the customs authorities' consent, the destruction customs procedures may be used in accordance with the procedure stipulated by Kazakhstan law.

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Source: *«Judicial library of the Supreme Court of the RK»*

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Customs payment and tax arrears secured by an insurance agreement

Ruling of the Judicial Board for Civil and Administrative Cases of the Almaty Oblast Court dated 24 February 2016 on case 1999-16-00-2a/7

Salem Insurance Company JSC

Ruling upholding the demands of JSC Salem Insurance Company

Salem Insurance Company JSC (the “Insurance Company”) took legal action to have the Almaty Oblast Department’s for Customs Control of the Ministry of Finance of the RK (currently known as Almaty Oblast Department of State revenue of the Committee of State revenue of the Ministry of Finance of the RK (“DCC”) demand for Alatau Insurance Company JSC (renamed to Salem Insurance Company JSC) pay customs payments, taxes as unlawful.

The Insurance Company entered into a voluntary civil liability agreement with Pakhor LLP to insure it as an authorised economic operator (“AEO”) against the customs authorities between 16 May 2013 and 15 May 2014. The insurance object was the policyholder’s property interests related to its obligation to pay customs duties and taxes in accordance with customs law. Pakhor LLP was given the status of AEO on 8 August 2013.

Pakhor LLP, between 22 January and 13 February 2014, had imported consumer goods into Kazakhstan without declaring them and making all customs payments due. AEO status was suspended on 15 April 2014

On 27 May 2014, the DCC demanded that the Insurance Company pay all customs duties, taxes and late payment interest in relation to the insurance case

On 29 May 2014, the DCC sent Pakhor LLP notification to repay overdue customs payments, taxes and late payment interest.

The Insurance Company filed a lawsuit to have the customs authorities’ demand to pay customs duties, taxes and late payment interest due cancelled as the insured event arose after the insurance agreement had expired.

History of the review of the case:

Period	Instance	Result of consideration
October 2014	Specialized Interdistrict Economic Court of Almaty Oblast	Insurance Company claim not upheld
December 2014	Court of Appeal	Court of first instance ruling left unchanged
March 2015	Court of Cassation	Court of appeal ruling left unchanged
December 2015	Supreme Court	Court of first instance, Court of Appeal and Court of Cassation rulings overruled Case returned to the Court of Appeal
February 2016	Court of Appeal	Insurance company lawsuit upheld

Position of the Judicial Board:

Judicial Board upheld the Insurance Company's claim, and recognized the demand for payment of customs payments and taxes as unlawful. In view of the fact that the goods were subject to forfeiture to the state, the obligation of Pakhor LLP to pay customs payments and taxes was terminated, therefore, the obligation of the Insurance Company to pay customs payments and taxes also should be terminated.

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Source: *«Judicial library of the Supreme Court of the RK»*

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CIT on natural gas reinjected to support seam pressure. Attributing social sphere expenses to contract activities

Resolution of the Judicial Division for Civil Cases of the Supreme Court of the RK dated 25 March 2016 for case 3гп-166-16

JSC PetroKazakhstan Kumkol Resources

Ruling partially upholding taxpayer demands

The tax authorities performed a comprehensive tax review of JSC PetroKazakhstan Kumkol Resources (the "Taxpayer") for the accuracy of the calculation and timeliness of the payment of taxes and other obligatory payments between 2009 and 2012, which resulted in notification of the accrual of corporate income tax ("CIT") of KZT 3 million, excess profits tax ("EPT") of KZT 5 million and late payment interest of KZT 2.5 million.

The Taxpayer filed a lawsuit to dispute the section of the tax audit regarding CIT, EPT and late payment interest with respect to:

1) the recognition of the reinjection of natural gas within a single field (to support oil recovery indices) as an operation to use gas for own production needs and, for this reason, to recognise income on the transaction

2) treat social sphere expenses as non-contractual expenses (while the Taxpayer treats them as expenses reducing taxable income from contractual activities)

The court of first instance partially upheld the Taxpayer's claim, specifically recognising the sections of the tax authorities' notification dealing with CIT and EPT on natural gas injected into the subsoil (within one field to increase oil recovery indices) by KZT 7 million and late payment interest of KZT 1 million as unlawful. The court of first instance left the remaining parts of the notification unchanged.

The court of first instance's ruling was unsuccessfully disputed by the Taxpayer and tax authorities.

History of the review of the case:

Period	Instance	Result
January 2015	Specialized Interdistrict Economic Court of Kyzylorda Oblast	Claim partially upheld
March 2015	Court of Appeal	Court of First Instance ruling left unchanged
August 2015	Court of Cassation	Court of First Instance ruling and Court of Appeal resolution left unchanged, rejection of the Taxpayer's cassation appeal
October 2015	Court of Cassation	Court of first Instance ruling and Court of Appeal resolution left unchanged, rejection of the tax authoritie's cassation appeal
March 2016	Supreme Court of the RK	Courts of first and second instance ruling left unchanged; Taxpayer and tax authorities petition left unchanged

Position of the Supreme Court of the RK:

In the Supreme Court, the Taxpayer applied for the cancellation of the sections of the disputed court acts regarding CIT and EPT due to an adjustment to social sphere expenses, while the tax authorities demanded the abolishment of CIT and EPT court rulings due to the reinjection of natural gas. The Supreme Court of the RK established that the tax authorities incorrectly interpreted the law in relation to reinjected natural gas. Natural gas produced at one field and reinjected into the subsoil at the same field to increase oil recovery may not be recognised as having been used for own production needs, and subsequently point 10 of article 310 of the Tax Code does not apply in this case.

At the same time, the judicial division agreed with the tax authorities' conclusions that the social sphere facilities were not in the Taxpayer's contract territory and their creation and maintenance were not its contractual obligations. For this reason, the judicial division concluded that the Taxpayer's actions to reduce taxable income from contractual activities by social sphere expenses were unlawful.

Based on the above, the Supreme Court judicial division for civil cases left the ruling of the courts of first and second instance and the Taxpayer's and tax authorities' petitions unchanged.

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Source: *«Judicial library of the Supreme Court of the RK»*

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