

Ensuring the correct application of tax and environmental legislation to subsoil operations

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Most breaches of environmental regulations are unintentional. Nevertheless, infringements can lead to multi-million dollar fines, and cause (sometimes irreparable) damage to a company's reputation, both in the eyes of the public and of its business partners. For this reason, it is essential that companies understand how to apply the legislation correctly.

Environmental law

Waste generation is an inevitable outcome of subsoil operations. As such, environmental and tax law envisage strict regulation of the volume of waste recently having been recategorised as a form of environmental emission. Environmental and tax law complement each other, setting both maximum permissible emission levels and charges for exceeding them. Each subsoil user's emission limits are set by a permit issued by the state. These limits are based on the individual subsoil user's maximum permissible emission quotas, which are defined according to the requirements of their particular industry.

In other words, it is hard to overestimate the importance for subsoil users of observing environmental law, as failure to do so can result not only in significant financial risks and damage to reputation, but also in the revocation of subsoil use contracts.

However, as a result of the authorities' ambiguous interpretation of this legislation, practically every company involved in subsoil use ends up clashing with them at one time or another. One example of this ambiguity is the issue of permissible emission volumes, which is not fully covered by legislation and can be interpreted in a number of different ways.

Emission norms and limits

The Environmental Code of the Republic of Kazakhstan establishes two categories for measuring permissible emissions – namely, limits and norms.

Limits determine the maximum permitted volume of emissions for a specific period, while norms determine the maximum level of emissions at which acceptable environmental quality standards can be maintained.

Emission permits refer to limits for an entire company in grams per second, which are converted to tonnes per

annum. Norms are specified in a maximum permissible emissions (MPE) plan and are determined separately for all of a company's emission sources. As noted earlier, tax legislation only stipulates a tenfold increase in the charge when permit limits are exceeded.

Nevertheless, due to current law enforcement practice, state bodies treat the concepts of limits and norms as interchangeable, imposing the increased emission charge not only when permit limits are exceeded, but also when emission norms in MPE plans are exceeded.

Tax Code amendments

To ensure consistency on this issue, the Tax and Environmental Codes were amended on 26 December 2012 to the effect that, as of 1 January 2012, the tenfold charge now applies to emissions in excess of established norms.

Apparently, the amendments were intended to provide clarification on the object of taxation for the increased charge; however, the issue of increasing the charge in the event that limits, but not norms, are exceeded remains open. For this reason, we cannot exclude the possibility that a subsoil user, during the course of its operations, may generate emissions that exceed the limits approved by permit, while remaining within the norms established in an MPE plan.

According to the Tax Code, the object of taxation for the charge is the actual environmental emissions up to and/or in excess of the established norms. In addition, a financial value is applied to environmental damage caused in the event that the established norms are exceeded. However, exceeding the norms also results in administrative liability. Thus, there is no link between the limits set by permits and the calculation of charges or payment of damage compensation and administrative fines.

Enforcement practices of companies and state authorities

As shown by the practice of the state authorities, this has been an issue for some time. To avoid having to pay twice, certain companies converted grams per second into tonnes per annum, crediting amounts already paid for exceeding norms against amounts payable for exceeding limits. Though not strictly approved by law, this approach seemed reasonable, as it eliminated the possibility that a company would have to pay twice for the same emissions. Other companies paid for exceeding both norms and limits, which would probably be more in line with the state authorities' position.

Deloitte has significant experience in review of compliance with ecological legislation and will be happy to provide environmentally-related legal due diligence services (environmental review), which include:

- reviewing company internal policies and procedures, and health and safety department corporate structure to verify their compliance with Kazakhstan law;
- verifying that all relevant subsoil use licenses and permits are in place; confirming whether all state ecological reviews have taken place, and state environmental welfare requirements have been met;
- reviewing state notification of breaches of environmental law, including from the prosecutor's office, sanitary and emergency agencies;
- confirming the implementation of certain obligatory conditions such as industry monitoring programmes and reports, emergency response programmes for contract territories, annual environmental protection measures, including associated gas recycling and waste management programmes;
- reviewing the company's application of tax and environmental law.

Our services could help the company identify the risks it is exposed to, ensure compliance with stringent ecological regulations and mitigate any possible risks.



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