



International tax

Series of tax newsletters on the MLI and its effect on a Kazakh tax treaty network

Dear Colleagues,

This is a second issue of a special international tax alert on the matters around the multilateral instrument implementing treaty related BEPS measures ("MLI") and its effect on the existing network of tax treaties on avoidance of double taxation ("Tax Agreements") in force with Kazakhstan.

Following the official signing ceremony held on 25 June 2018, Kazakhstan has become a signatory to MLI and has deposited a provisional list of reservations and notifications covering overall 54 Tax Agreements ("MLI position of Kazakhstan").

Further, the MLI will enter into force after completion of local ratification procedures, so that until that the MLI position of Kazakhstan will remain preliminary as some of the provisions claimed may still change during the ratification process.

Regardless of the choices made by Kazakhstan, the ultimate outcome and the MLI effect will be yet indeterminate until the partner country's final position is clear, as the "matching" principle applies.

Now, as at least the provisional list of choices and reservations made by Kazakhstan is given, below we provide a brief outline of anticipated major changes that may be introduced into the existing Tax Agreements.

PPT and simplified LOB test

Treaty abuse is one of the most important sources of BEPS concerns, and corresponding minimum standard measures to prevent this are specifically addressed in the Article 7 of the MLI.

This common intention of countries signing the MLI to prevent tax abuse shall be implemented through either adoption of a general anti-abuse rule on the principal purpose of a transaction ("PPT"), a combination of PPT and Simplified Limitation of Benefits ("simplified LOB") clause, or a Detailed LOB rule.

The general anti-abuse rule constitutes the following: "...a benefit under the Tax Agreement shall not be granted in respect of an item of income or capital if obtaining that benefit was one of the principal purposes of the arrangement or transaction".

Based on the provisional MLI position, Kazakhstan is one of the few jurisdictions, who has notified the OECD Depository of the intention to apply a simplified LOB clause in combination with the above general provision aimed to combat the treaty abuse.

That is, when determining the potential for a treaty abuse, Kazakhstan will not only use the PPT rule, but also a number of objective criteria that restrict most treaty benefits to so-called "qualified persons" specified in the MLI, as follows:

Category	Requirements
A. Individual	None
B. Contracting state, or a political subdivision or local authority	None
C. Company or other entity	If the principal class of its shares is regularly traded on one or more recognized stock exchanges
D(i) Non-profit organization	Of a type that is agreed to by the Contracting Jurisdictions through an exchange of diplomatic notes
D(ii) Pension fund ¹	Established in the Contracting Jurisdiction that is treated as a separate person under the taxation laws of that Contracting Jurisdiction
E. Entities whose shareholders meet any of the categories above (A to D)	Qualifying shareholders must own directly or indirectly at least 50% of the shares of that entity, during at least half the days of a 12-month period that includes the time when the benefit is accorded

¹ Referred to in the MLI as an entity or arrangement established in the Contracting Jurisdiction that is treated as a separate person under the taxation laws of that Contracting Jurisdiction and:
i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and

Nevertheless, a non-resident, which do not fall within any of the above categories, may still avail the benefits of the double tax treaty, if such is

- engaged in an "active conduct of a business" or
- owned by equivalent beneficiaries
- granted with a discretionary relief by the corresponding tax authorities

Yet, if the taxpayer's business activities fall under the following categories or any combination thereof, the person will not be eligible for the tax relief:

- Operating as a holding company
- Overall supervision or administration of a group of companies
- Making or managing investments (except for banks, insurance company or registered securities dealer)
- Providing group financing (including cash pooling)

Overall, at this stage there only 12 countries that adopted a simplified LOB clause, including Russia, India, Indonesia, Argentina, Armenia, Bulgaria, Chile, Colombia, Mexico, Senegal, Slovak Republic and Uruguay.

Although, most countries (e.g. Luxembourg, France, Netherlands, Singapore, UK, Ireland, Canada, Malta, Korea, China, etc.) have adopted only PPT.

Unless otherwise is mutually agreed by the contracting parties of the Tax Agreement, where the mismatch occurs, simplified LOB may not be included in tax treaties signed by Kazakhstan if the other jurisdictions do not agree for inclusion of simplified LOB. Instead, only the PPT will apply in this case.

Please see the illustrative examples below presuming that Kazakhstan applies a combination of PPT and simplified LOB provision:

Counterparty to a Kazakh tax treaty	Netherlands	Russia
Provisional choice	PPT only	PPT and simplified LOB
Outcome	No match	Match
Treaty impact	PPT only will apply, unless otherwise is agreed in the future	Combination of PPT and simplified LOB clause will apply

that is regulated as such by that Contracting Jurisdiction or one of its political subdivisions or local authorities; or
ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision

Dividend transfer transactions

The proposed provisions set out in the Article 8 of the MLI are aimed to prevent the abuse of beneficial tax treatment given under the tax treaties for dividend income, i.e. to restrict the application of a reduced dividend withholding tax rate.

It introduces a minimum holding period requirement of 365 days in relation to ownership criteria to avail the beneficial rate provided in the tax treaties.

As per the provisional MLI position, Kazakhstan have made corresponding notifications indicating the provisions of existing tax treaties, which shall be amended to adopt the minimum holding period requirement. Countries such as Canada, Cyprus, Japan, Luxembourg, Singapore, and UK have opted not to adopt these changes. Thus, this Article may impact the treaties signed by Kazakhstan, but is subject to matching.

Please see the illustrative examples below, presuming Kazakhstan did not choose to opt-out the provision on the minimum holding period, as follows:

Counterparty to a Kazakh tax treaty	Netherlands	Luxembourg
		
Provisional choice	Notification of existing provisions in listed tax agreements	Opted not to adopt this provision
	Match	No match
Outcome		
Treaty impact	Minimum holding period will apply with respect to Article 10(2)(a) of the treaty in question	Minimum holding period would not apply

Taxation of capital gains

The Article 9 of the MLI specifically addresses abuse of provisions on taxation of capital gains from the alienation of shares or interest in entities deriving their value principally from immovable property.

It merely clarifies that capital gains from alienation of shares or interest in entities whose assets are mostly represented (directly or indirectly) by immovable property, should be taxed in the jurisdiction in which such immovable property (real estate) is located, provided that the "principal value" criteria / threshold is met at any time during the 365 days preceding the alienation.

In addition, the MLI clarifies that this provision applies to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions.

Please see the illustrative examples below, which is based on the expectation that Kazakhstan has not made any reservations against adoption of the above provisions, as follows:

Counterparty to a Kazakh tax treaty	Netherlands	Luxembourg
		
Provisional choice	Notification of existing provisions in listed tax agreements	Opted not to adopt this provision
	Match	No match
Outcome		
Treaty impact	The changes will apply with respect to Article 13(2)(a) of the treaty in question	The changes would not apply

Permanent establishments

Articles 12-14 of the MLI aimed to address the issues of artificial avoidance of PE creation, in particular associated with commissionaire arrangements, splitting-up the contracts, and misuse of PE exemptions.

As per the provisional notifications, Kazakhstan would adopt these changes, subject to matching.

Please see the illustrative examples below presuming Kazakhstan has not made any reservations against adoption of the above provisions, as follows:

Counterparty to a Kazakh tax treaty	Netherlands	United Kingdom
		
Provisional choice	Notification of existing provisions in listed tax agreements	Opted not to adopt these provisions (except for PE exemptions)
	Match	No match
Outcome		
Treaty impact	Changes will apply to Article 5 of the treaty in question	Changes will not apply (except for PE exemptions)

Dispute resolution

MLI provides for the inclusion of provisions on mutual agreement procedures ("MAP") in all the covered tax treaties aimed to make dispute resolution mechanisms more effective.

Under the MAP, upon the request of a taxpayer, the competent authorities should endeavor to agree between themselves any issues regarding the interpretation or application of tax treaties on a mutually agreed basis.

As per the provisional reservation, Kazakhstan has opted not to adopt a specific provision according to which the taxpayer can approach competent authority of either of the contracting jurisdiction.

However, as this is a minimum standard, Kazakhstan has opted to implement a bilateral notification or consultation process for cases in which the competent authority to which the MAP case was presented does not consider the taxpayer's objection to be justified

(such consultation shall not be interpreted as consultation as to how to resolve the case).

How Deloitte can help

We will keep you informed on the course of subsequent news / updates accordingly.

Should you need any further support on the MLI related issues, our team is at your disposal and is always available for a discussion. You can find the contact details of our main team members below. In particular, we may help you by virtue of (but not limited to):

- Providing seminars with the detailed insights and practical examples on the application of anti-BEPS measures / provisions implemented by the MLI;
- Performing analysis of your existing and / or contemplated cross-border arrangements and assessing corresponding potential impact of the MLI provisions;
- Structuring (restructuring) of cross-border arrangements in a way to be compliant with the MLI provisions;
- Developing tax controls and procedures within the company aimed to ensure compliance with the MLI provisions and mitigate / prevent related tax and legal risks.

Related OECD materials

For the MLI itself, the explanatory statement to the MLI and related useful information please refer to <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>

The matching toolkit for application of the MLI you can find here: <http://www.oecd.org/tax/treaties/application-toolkit-multilateral-instrument-for-beps-tax-treaty-measures.htm>

Contact us:

Anthony Mahon

Partner

Tel: +7 (727) 258 13 40

anmahon@deloitte.kz

Aliya Tokpayeva

Senior Manager

Tel: +7 (7172) 58 04 80

atokpayeva@deloitte.kz

Liliya Kalbayeva

Assistant Manager

Tel: +7 (7172) 58 04 80

lkalbayeva@deloitte.kz

deloitte.kz

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