



# Seizing opportunities

## Newsletter Kazakhstan

Latest news on law, tax and business in Kazakhstan

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## Transfer Pricing Law

From Galymbek Kereibayev, Rödl & Partner Kazakhstan

### 1. Introduction

The legal relations associated with so-called transfer pricing are governed by the Transfer Pricing Law dated July 5, 2008 (hereinafter, "TP Law"). A transfer price (recalculation price) means:

- 1) A price that is formed between the related parties, and/or
- 2) A price that differs from the objectively formed market price, taking into account the price range while settling transactions between independent parties.

### 2. Scope of application of the Transfer Pricing Law

A material scope of application of this Law, i.e. state control of pricing, covers so-called international business operations and transactions in the territory of the Republic of Kazakhstan, which are directly associated with the international transactions.

#### 2.1 Predominantly: international transactions

In accordance with Article 2, No. 31 of TP Law, the following transactions are international business operations:

- 1) Export and/or import transactions of purchase and sale of goods;
- 2) Transactions of work performance/service provision, where one of the parties is a nonresident conducting its activity in the Republic of Kazakhstan without establishing a permanent establishment;
- 3) Transactions of residents of the Republic of Kazakhstan, settled outside the Republic of Kazakhstan, on purchase and sale of goods, performance of works, provision of services.

The scope of regulation of the Law particularly includes so-called Management Agreements, which the Kazakh subsidiary concludes with its German parent company. They are treated in the TP Law as international business operations. Among other examples of the application of this Law there are purchase of works and services from a nonresident without a permanent tax establishment in Kazakhstan (hereinafter, "Nonresident"), and receipt and granting of loans in legal relations with such nonresidents.

## 2.2 Other cases

Control shall also cover transactions settled and executed in Kazakhstan, which are directly associated with international business operations. In the absence of practical probability of their application, these cases will not be studied in details in this Article.

## 3. Market price determination methods

In the course of transfer pricing control and upon determining the market price, the tax bodies of the Republic of Kazakhstan use the following transfer pricing methods. Primarily, the Comparable Uncontrollable Price Method is used<sup>1</sup>.

### 3.1 Comparable uncontrollable price method

This method allows transfer price calculation by comparing the price of the transaction used by its parties with the market price in the comparable economic conditions, with due regard to admissible deviation (differential).

The authorized bodies are entitled to adjust the price as the object of taxation only in case that the contract price differs from the market price. If the German parent company provides services to its Kazakh subsidiary at a price that is lower than the market price, the Kazakh tax bodies may include a positive difference between the market and actual price of the transaction in the total annual income of the LLP for the purpose of retrospective taxation with the corporate income tax.

This should take into account whether the Kazakh market has enough information to conduct the study for determining the market price, and whether such a study may be taken into account for the purpose of using the comparable uncontrollable price method at all. If the enterprise is audited, the tax body will have to substantiate the conformity of the price used by the parties to the contract to the market price.

For this reason, we recommend maintenance of the necessary documents to confirm that the contractor's compensation conforms to the market indicators, both for LLP and for a branch. It may be done by comparing compensation amounts for similar services paid by and between independent enterprises. Though our practical experience shows that such comparisons of prices of third-party enterprises are used

in single cases, you should weight whether the expenses on such benchmark study are comparable with the risks incurred.

### 3.2 Cost-plus method

When using the cost-plus method, the market price of the goods (work, services) is determined as the amount of costs (expenses) incurred and a markup.

### 3.3 Resale price method

A resale price method provides for the determination of a market price of goods (work, services) as a differential between the further price at which such goods (work, services) are sold by the buyer at their subsequent sale (resale) and the confirmed costs (expenses) incurred by the buyer during resale (not including the price at which the said buyer purchased goods (work, services) from the seller), as well as its margin, where such margin should correspond to the range between the maximum and minimum value of the average market margin calculated as prescribed by TP Law.

### 3.4 Profit distribution method

When using the profit distribution method, a transfer price depends on how profit will be distributed between the parties to the contract. Profit should be calculated as if the parties were independent from each other.

### 3.5 Net profit method

The net profit method is based on the net profit that the independent parties would have earned in the comparable economic conditions.

## 4. State control

State control in the field of transfer pricing is carried out by way of:

- 1) Monitoring of transactions
- 2) Tax audits
- 3) Other procedures (e.g., desktop audit of tax statements, information of governmental bodies, and other data).

Annual monitoring of transactions applies in selling raw materials, performing construction and assembly work, under advertising contracts and freight carriage contracts.

<sup>1</sup> Transfer Pricing Law, Art. 12, Cl. 2

In other cases, the parties to the contract, as mentioned above, should bear the duty of document record-keeping to support the applicable market price.

## 5. Risks related to deviation of actual payments from the market price

### 5.1 Inclusion in the total annual income

In the event of any deviation, the tax bodies shall be authorized to carry out so-called adjustment of the objects of taxation and objects related to taxation. If the services are provided or the goods are supplied to a Kazakh subsidiary at a price that is lower than the market price, the Kazakh tax bodies may include a positive difference between the market and applicable price of the transaction in the total annual income of the Kazakh LLP for the purpose of retrospective taxation with the corporate income tax.

### 5.2 Taxation of dividends, as per subclause 14, clause 1 of Article 12 of the Tax Code

Pursuant to subclause 14, clause 1 of Article 12 of the Tax Code, a positive difference between the market price and the price at which such services have been sold to a related party is regarded as hidden payment of income (constructive dividends under the Tax Code), which is subject to taxation in the source of payment at a rate of 15%.

In the absence of payment necessary to withhold tax from the source of payment, subclause 1, clause 2 of Article 192 of the Tax Code specifies that the tax due from the source may be paid by the tax agent<sup>2</sup> with its own funds. Therefore, in the event of a hidden payment of income (constructive dividends), payment of a tax from the source shall be paid with own funds of the Kazakh subsidiary (without withholding).

### 5.3 Sanctions under the Administrative Offenses Law

In the event of price deviation, the tax bodies, in pursuance of a reference in TP Law, may apply Article 278 of the RoK Administrative Offenses Code (Understatement of tax amounts and other mandatory fees to the budget), under which they may impose a fine in the amount of up to 50% of the amount of tax accrued.

## 6. Possibility to conclude a transfer pricing agreement

TP Law<sup>3</sup> provides for a possibility to conclude a transfer pricing agreement with the tax bodies (subclause 26) of clause 2 of TP Law). In this case, the pricing method may be preliminarily agreed upon with the tax bodies<sup>4</sup>. It may reduce the risk of deviation of the applicable price of transaction from the market price, and thus, sanctions of the tax bodies. In spite of these advantages, this provision of TP Law is rarely used by the taxpayers.

## 7. Duty to keep records

TP Law<sup>5</sup> prescribes that the parties to an international transaction shall keep records supporting the applicable price of the transaction and submit such records within 90 calendar days upon request of the competent bodies. For this reason, we strongly recommend keeping the necessary records supporting that the compensation that has been actually paid conforms to the market prices. It may be done by comparing compensation amounts for similar services between independent enterprises.

## 8. Conclusion

So it is evident that transfer pricing requires thorough record-keeping of documents that allows to confirm that the price or compensation actually paid by the German parent company conforms to the market prices. Such fairness may be shown by comparing remuneration amounts for similar services between independent enterprises.

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<sup>2</sup> Tax agent means a person paying income and thus being obliged to withhold tax from the source of income.

<sup>3</sup> Transfer Pricing Law, Art. 4, Cl. 1, subclause 6.

<sup>4</sup> Procedure for concluding such agreements is governed by the Resolution of RoK Government No. 1197 dated October 24, 2011.

<sup>5</sup> Transfer Pricing Law, Art. 5, Cl. 3, subclause 4.

## > Changes in the Laws of Kazakhstan in the Field of Support of Renewable Energy Sources

From Zhandos Iskakov, Rödl & Partner Kazakhstan

In our July 2016 issue we wrote about changes in the laws of Kazakhstan in the field of renewable energy sources due to introduction of annual indexing of fixed tariffs with regard to fluctuations of tenge (KZT) foreign exchange rate. However, back then at the moment of introduction of indexing the mechanism of its implementation was not defined.

Only on 17 April 2017 Decree No. 207 of the Government of the Republic of Kazakhstan amended the **Rules for Specification of Fixed Tariffs (Decree No. 271 of the Government dated 27 March 2014)**. These changes specify a formula for indexing of fixed tariffs.

### > Indexing Formula

Decree No. 271 of the Government dated 27 March 2014 has been completed with Clause 11-2 providing for indexing of fixed tariffs once a year with regard to inflation and changes in exchange rate of the national currency. Indexing shall be applicable to the projects with loan liabilities in foreign currency if fluctuation of foreign exchange rate of the national currency is equal to 25% or higher compared to the previous year. In such cases indexing shall be calculated by the following formula:

$$T_{t+1} = T_t * (1 + 0.7 * \frac{(CPI_t - 100\%)}{100\%}) + 0.3 * \frac{USD_{t+1} - USD_t}{USD_t}, \text{ where}$$

$T_{t+1}$  is the indexed fixed tariff calculated by the formula specified above and rounded downward to integer tiyns;

$T_t$  is the effective fixed tariff approved by the Government of the Republic of Kazakhstan considering the indexing made before, if any;

$CPI_t$  is the Consumer Price Index for twelve months prior to 1st October of the year of indexing; the CPI is estimated according to the data received from the authority in the sphere of state statistics;

$USD_{t+1}$  is the current tenge-to-US dollar exchange rate by 1st October of the year of indexing specified by the data of the National Bank of the Republic of Kazakhstan;

$USD_t$  is the average tenge-to-US dollar exchange rate calculated for the period of twelve months prior to the date of indexing and specified by the data of the National Bank of the Republic of Kazakhstan.

Indexing shall not be applicable to fixed tariffs of solar power station projects assuming use of solar modules made from Kazakh silicon (Kaz PV) with total capacity of 37 MW for conversion of solar radiation energy.

Indexing of fixed tariffs and indexed fixed tariffs are calculated and published by the accounting and financial center at its official website at <http://www.rfc.kegoc.kz> on or before 15 October of a corresponding year.

### > Advantages:

The provisions on indexing will facilitate financing of renewable energy projects.

### > Disadvantages

The Act of the Government of the Republic of Kazakhstan on amendment of the approved fixed tariffs shall be **effective not earlier than two years after its first official publishing in printed periodicals**.

It is still to see the reaction of investors to long expected indexing of fixed tariffs. Rödl & Partner will provide all necessary support in case of any further questions.

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## Inadmissibility of taxation of the amounts funded to the representation office by the foreign parent company

From Galymbek Kereibayev, Rödl & Partner Kazakhstan

For many years the Kazakh tax authorities uphold the position that the amount of unused funds shall be taxed in Kazakhstan at the end of the tax period. This plays a significant role for companies that finance a representation office in Kazakhstan through a foreign parent company.

Regarding the terms of the Double Taxation Agreement, Tax and Civil Codes of the Republic of Kazakhstan, and Kazakh Law "On Accounting and Financial Statements" this position of the Kazakh Ministry of Finance causes profound concerns.

According to the Kazakh Tax Code and the Double Taxation Agreement, legal persons (residents) or permanent establishments of a foreign legal entity obtaining profits attributable to the state through entrepreneurial activities are regarded as taxpayers. This view is already lacking in the presence of a residence status of the representation office, since its head office is located abroad. A power of attorney may be issued to the manager of the representation office certifying and restricting his/her power and authority to activities of preparatory or auxiliary character.

As a result, the entrepreneurial activities are carried out by the parent company with its head office (location of the actual management board) abroad. This results also in the fact, that the representation office does not generate any revenue in Kazakhstan.

If, at the end of the tax period, surpluses arise from the funding provided by the parent company, they cannot be regarded as revenue, since increases in form of contributions from individuals involved in the equity are expressly excluded in the definition of the

term "revenue" in the Kazakh legislation.

Even if we would assume that the amounts allocated for funding the representation office can be considered as a revenue of the representation office and this revenue shall be declared, which results in the payment of the corporate income tax, then the return of the unused funding amounts from the representation office to the parent company would have to be considered as a tax deduction, reducing the total annual income of the representation office. However, the Kazakh Tax Code does not provide such deduction.

In general, it should be noted that according to the Kazakh Constitution, international agreements ratified by Kazakhstan precede over the Kazakh national law. Thus, in questions of taxation of the surpluses of a representation office the provisions of the Double Taxation Agreement are to be preferred over the rules of Kazakh law.

Also, the taxation of surpluses of a representation office would result in a double taxation (first abroad at its head offices' country and second – at the location of the representation office funded by the parent company (Kazakhstan)) and is considered a double charge compared to the charge on local enterprises whose offices are not subject to separate taxation, which finally is a direct violation of the non-discrimination principle of the DTA.

Consequently we can conclude that the legal proposition of the Kazakh tax authorities, whereas the amounts funded to the representation office by the foreign parent company are regarded as taxable income of the representation office, leads to double taxation de facto, and causes illegitimate legal and administrative practices.

Rödl & Partner recommends an early consultation, even before the opening of a representation office in Kazakhstan and expert support in regard of accounting the funds provided to the representation office by the parent company in order to avoid risks and disputes and to ensure a successful participation at the Kazakh market.

You can find the full version of this article under the following link:

[http://www.roedl.com/fileadmin/user\\_upload/Documents/Publikationen/Inadmissibility\\_of\\_taxation\\_of\\_the\\_amount\\_funded.pdf](http://www.roedl.com/fileadmin/user_upload/Documents/Publikationen/Inadmissibility_of_taxation_of_the_amount_funded.pdf)

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## Electronic VAT-invoices in Kazakhstan from 2016 to 2019

From Aliya Kiikova, Rödl & Partner Kazakhstan

The regulations relating to e-VAT (value-added tax)-invoicing came into force on July 01, 2014 in Kazakhstan and were voluntary practice before 2016. On October 16, 2015 the heads of states of the Eurasian Economic Union (EEU) have signed the documents on the implementation of tariff commitments in the framework of Kazakhstan's accession to the World Trade Organization (WTO). Therefore, Kazakhstan committed to prevent the export of 1,347 items (this amount will be 3,800 in 2017) indicated in the list of seizure goods, to which reduced rate of duty apply, into other EEU countries. To implement these solutions, Kazakhstan must establish an accounting system for goods included in the list of goods and exported to other EEU member countries.

Considering the fact that on the date of the documents' signing Kazakhstan already had implemented the e-VAT-invoicing informational system, it was agreed on using this system as a basis for creating the accounting system to control the goods flow and developing an "Virtual Warehouse" module.

The goods indicated in the list of goods will be imported to the Republic of Kazakhstan either at the WTO rates (but without the right to export them from Kazakhstan) or at the rates of the EEU common customs tariff for their further selling in the EEU member countries. Due to this reason, after January 11, 2016: goods imported to Kazakhstan at the WTO rates will be prohibited to export from Kazakhstan; goods imported to Kazakhstan at the rates of the Common Customs Tariff (CCT) must be accompanied by a copy of the customs declaration and e-VAT-invoices when exported to the EEU customs area. To ensure customs control and clearance of goods imported to Kazakhstan at the WTO rates a separate customs declaration form must be documented. E-VAT-invoices must indicate the number of the customs declaration and the sequence number of the goods line as mentioned in the goods declaration as well as the WTO or EEU CCT customs duty rate.

These documents must be certified by the State Revenue Authorities and are deemed as shipping documents in crossing the border of the EEU member countries afterwards. Currently the e-VAT-invoicing informational system is used to control the goods flow within the EEU area.

Today this regulation of e-VAT-invoicing is mandatory for certain categories of taxpayers.

### In 2016 e-VAT-invoicing is mandatory for the following:

- > From January 01, 2016: for taxpayers, authorized as economic operators;
- > From January 11, 2016: for all taxpayers making transactions with goods listed in the list of goods and imported to the Republic of Kazakhstan from Third Countries and EEU member countries;
- > From July 01, 2016: for taxpayers authorized as economic operators, customs representatives, customs carriers, owners of the temporary warehouses, owners of customs warehouses (Article 6 of the Kazakh Law No. 432-V dated December 03, 2015).

### In 2018 e-VAT-invoicing will be mandatory for the following:

- > From January 01, 2018: for major taxpayers, which are monitored.

### In 2019 e-VAT-invoicing will be mandatory for the following:

- > From January 01, 2019: for entities being registered as value-added tax payers in the Republic of Kazakhstan, such as:
  - Individual entrepreneurs;
  - Resident legal entities, except governmental entities;
  - Non-residents operating in the Republic of Kazakhstan through their branch, representation office;

- Trust managers realizing turnovers with goods, works and services under trust management agreements with trustees or beneficiaries or in other cases of trust management.

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