



KAZAKHSTAN

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The legal framework and legal certainty are relatively well developed in Kazakhstan, whereby there are also considerable weak points. Despite the existing legal hurdles, in 2013 an increase in the growth of German direct investments was evident.

According to information from the Delegation of German Economy in Central Asia this amounted to 750 million US dollars. German companies maintain trade relations with Kazakh partners through approx. 200 representative offices and branch offices and 400 subsidiaries located in Kazakhstan. A further 1500 companies operate on the market in Kazakhstan from Germany and/or from Russia.

Similarly as in Russia the first contact with a Kazakh business partner can be difficult in terms of communication, whereby cultural differences are apparent. Close contact to the Kazakh business partner is essential for the establishment of a successful commercial relationship.

Thorough preparation and knowledge of Kazakh business operations is decisive for a successful start-up on the Kazakh market. Instead of managing a very promising business with standard contracts and then only involving a professional consultant after the situation has resulted in a legal dispute, we highly recommend that you first of all clearly establish the creditworthiness and reliability of the Kazakh contract partner and in particular with new business relations. Already this measure may help to avoid the greater part of the difficulties which in practice are frequently experienced in cross-border delivery relationships with Kazakh partners. If you close both your eyes here, this amounts to gross negligence. Remarkably, the principle from Lenin continues to apply: "Trust is good, control is better".

In particular, there are considerable risks associated with contract design. There are reasons why there is a lack of trust in the judicial system and its independence. The reason for this distrust of the system is the high degree of corruption, inadequate qualification of judges and the inefficient enforcement of court rulings. A well-advised German company should take preventive measures to protect itself against default of payment through use of the principle of payment in advance.

When founding a company in Kazakhstan, the right form of company is important together with careful selection of the local managing director. Given that the restrictions of the representative powers of the managing director only apply to the internal relationship and the company has the burden of proof to establish that its contract partner at the time the business was concluded was aware of the restrictions in the external relationship, it is necessary to include an appropriate control mechanism in the articles of association. When concluding contracts, current proof of the right of representation or respectively the resolution concerning the appointment of the managing director should always be presented from which further information can be taken.

Rödl & Partner is represented in Kazakhstan at the locations of Almaty and Astana. Our team of Kazakh and German lawyers, tax consultants and auditors has been supporting clients since 2009 with regard to all questions about investments in one of the most important future markets between Europe and Asia – in the German language with a comprehensive service.

Practical examples

Taxes

Background facts:

A company based in Germany delivered a machine to Kazakhstan. A contract was concluded to split the price between the supplier component and the local service components (supervision, consultation and service). In connection with the performance of services in Kazakhstan a tax presence was registered in accordance with Kazakh tax law.

The invoicing for the local services was only to be made after the end of the project. The company was of the opinion that submission of a tax return was not necessary as anyway a "zero rate tax return" would be submitted. All claims for costs in connection with the whole project for the performance of the local services were only to be asserted after the conclusion of the work consequently reducing profits for the group through submission of the complete tax return in Kazakhstan. As a result, over a time period of more than two years neither quarterly nor annual tax returns were submitted for the branch office. The submission deadlines for these time periods had expired some time ago when the company contacted Rödl & Partner.

What can be done now?

After a tax audit to examine the facts, the company was informed that the deduction of company management expenses and general administrative expenses is also possible for the branch office of a legal entity which is non-resident in order to minimise the profit realised in

Kazakhstan. The company was also advised that also those costs incurred in the last two years of the branch office could be claimed as operating expenses in the tax return submitted for corporation tax and therefore were not lost. In spite of the existing basic possibility of reducing the tax base the situation arose that due to the non-submission of the zero rate tax return penalties for delay and administrative fines had to be paid.

What should one have done differently from the beginning?

The question of the deduction of the company management expenses and general administrative expenses should have been urgently discussed with expert advisors immediately after the registration of the branch office of the company as a non-resident legal entity. In such a case the company would have been advised that according to Kazakh law the recognition of expenses can be determined by two methods, namely the proportional division of expenses and the direct allocation of expenses for the purpose of deduction. The company would have had the possibility from the start of adjusting the financial accounting documents to the requirements of the commercial accounting standards in Kazakhstan and would also have been able to avoid the payment of penalties for delays and administrative fines.

Law

Background facts:

A legal firm advised an oil company which delivers lubricant oil to a Kazakh company. The oil company had a commercial contract in which the legal firm in the case of a legal dispute defined Cologne, Germany as the court of jurisdiction. After lengthy negotiations with the Kazakh contract partner the legal firm approached the Rödl & Partner team in Almaty. The team established that in the meantime the Kazakh GmbH had made an application to open insolvency proceedings.

What can be done now?

There is a no treaty between Kazakhstan and Germany regarding the mutual recognition and enforcement of court judgements. The consequences of such a choice of court agreement are that a German court ruling cannot be enforced in Kazakhstan and that the debtor in the case of the legal assertion of claims in Kazakhstan would almost certainly have raised a plea for lack of competence. The choice of a Kazakh court of jurisdiction would have been a better option.

What should one have done differently from the beginning?

It is always recommendable to explore the possibility of including an arbitration clause in the contract. In 1996 Kazakhstan adopted the New York Arbitration Convention of 1958 concerning the recognition and enforcement of foreign arbitration awards. Kazakhstan and also the Federal Republic of Germany have ratified this convention. In the present case, for example, it would have been possible to name the Kazakh international court of arbitration located in Almaty as the court of jurisdiction. This would have enabled the possibility of controlling the procedure and organisation of the court proceedings. In addition, it would have been possible to make enquiries about the solvency of the Kazakh company as debtor. As a result, it is possible to examine whether a Kazakh company is subject to legal proceedings and whether this company in the last quarters in comparison to the previous years has even paid tax. Both are important indicators of impending insolvency.

Law / Administration

Background facts:

A successful German company agrees to a Kazakh GmbH as intermediary to the ministry for the supply of equipment to print passports. The delivery of the equipment via the Kazakh GmbH to the authorities made economic sense to the German company because according to the Kazakh legal system a Kazakh company is given preferential treatment with public tenders compared to a foreign company.

At the time when the contract was signed with the Kazakh GmbH, the possibility of a guarantee agreement with the authorities was not considered. After a six-figure receivable has been outstanding for a period of more than one year, the managing director of the Kazakh GmbH gave the assurance that he would sign a payment undertaking agreement within one month and pay the liabilities of the GmbH. After the period of one month it was established that there was a change of the managing director and shareholder at the Kazakh partner and that the Kazakh GmbH was now in liquidation.

What can be done now?

The absence of a guarantee agreement and the delayed approach to the (former) managing director means that the fulfilment of the liability by the Kazakh GmbH as sole debtor has no chance of success. Due to the good co-operation between the German company and the Kazakh authorities the hope now remains that the receivable will be covered by the authorities.

What should one have done differently from the beginning?

At the contractual level there was a possibility according to Kazakh law to provide a guarantee for the intermediary company. The design of the contract of guarantee between the German company and the Kazakh authorities as end buyer should have been made to protect the interests of all those involved. The experts at Rödl & Partner therefore advise either the implementation of the payment in advance in principle or to obtain professional advice regarding international transactions.