RECENT TRENDS IN INTERNATIONAL TAXATION

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At present, more than 130 countries including Kazakhstan have participated in the OECD's G20 *Base Erosion and Profit Shifting Project (BEPS Project)*. By taking part, member countries collaborate to implement and develop their BEPS actions on an equal footing and in parallel with OECD and G20 members.

The result is a paradigm shift towards transparency, information exchange, and clear and fair taxation. National economies today are integrating to deal with tax avoidance and tax abuse and, given the magnitude of changes, Kazakhstani companies and foreign investors cannot carry on with 'business as usual'. Firms and investors must adopt tax approaches in line with global trends.

Since 2017 – when Kazakhstan joined the BEPS Project – Kazakhstan's tax legislation has evolved to reflect these global changes in international taxation. The article below focuses on issues that have been widely discussed in the global tax community and are progressively becoming part of Kazakhstan's tax routine.

Controlled Foreign Companies

In 2018, Kazakh tax legislation introduced new controlled foreign company (CFC) regulations. Accordingly, a Kazakh tax resident owning a CFC that meets certain criteria was required to include the financial profits of that CFC in his/her taxable income. A year later, these CFC rules were amended to exclude foreign companies registered in countries with which Kazakhstan has a tax treaty. However, these amendments were in force only from 1 January 2018 to 1 January 2020.

Although the CFC rules followed OECD guidelines, taxpayers faced difficulties in their application because they lacked clarity on some issues and required further development. Therefore, Kazakhstan's Parliament is currently reviewing a draft legislative act that will introduce changes to tax law, including the CFC rules. The changes propose to clarify taxation of CFC profits and to retain the provision that CFCs registered in countries with which Kazakhstan has a tax treaty are excluded from CFC taxation if the official corporate income tax rate in that treaty-partner exceeds 75% of Kazakhstan's corporate income tax rate (i.e. more than 15%).

Country-by-Country Reporting

In Kazakhstan, three-tiered reporting has been legally binding since 1 January 2018, including notification of membership in multinational enterprises (*Notification*), a Country-by-Country report (*CbC Report*), Local and Master files. The law made significant changes to local transfer pricing reporting procedures for multinational enterprises (*MNEs*) operating in Kazakhstan by introducing requirements for MNEs to file *CbC Reports*, *Notification*, and *Local and Master files*.

One of the documents, a CbC report, should be submitted if group revenue exceeds 750 mln Euros. A CbC report can be submitted by an ultimate parent company of a group in Kazakhstan, or by a MNE member firm authorized by an ultimate parent to file the report. The first reporting year for CbC reporting is 2016, and for Local File and Master files, 2019.

Beneficial Owner of Income

There was a common approach that unjustified application of treaty benefits primarily refers to benefits on passive income (dividends, interest, royalties). As such, a number of tax treaties requires that an entity claiming tax treaty benefits should be the beneficial owner of any income (dividends, interest, royalties). Kazakhstani tax law also stipulates that non-resident recipients of passive income from Kazakhstan sources are obliged to provide a rationale for why they are the beneficial owner of this income.

Since 1 January 2018 this requirement has been extended to other types of income, including business profits and leasing payments. However, it is expected that, starting from this year (2020), the beneficial owner requirement will apply only to transactions with related parties in accordance with the proposed changes to tax legislation.

Nonetheless, current tax law does not specify the documentation that the beneficial owner should provide to its Kazakh counterpart in order to support its status, or any confirmation procedures required to prove beneficial ownership status. Since the burden of proof of beneficial owner status is on Kazakhstani tax agents, they should be ready to provide necessary documentation if the Kazakhstan tax authorities challenge beneficial owner status. This creates additional complexity for Kazakhstani tax agents working with nonresidents.

Kazakhstan's tax authorities might undertake to refer to OECD recommendations and the experience of neighboring countries. Specifically, they might refer to Russian tax authorities, who have issued clarification letters with guidance on defining the beneficial owner of income, including reference to documents and other supporting information to justify nonresidents' beneficial owner status (financial statements, tax returns, lists of employees, etc.).

Multilateral Instrument

As for treaty abuse practices, the network of current tax treaties appeared to be ineffective. New challenges required changes and as such, the OECD developed a multifunctional "tool" to introduce these changes into existing bilateral tax treaties. The *Multilateral Instrument (MLI)* is a set of provisions – mandatory ("minimum standard") and optional – that amend tax treaties in a synchronized and efficient manner. For a tax treaty to be modified by the MLI, both contracting states must be signatories to the MLI and must indicate that their tax treaty is a *'Covered Tax Agreement' (CTA).*

The MLI 'minimum standard' is obligatory for every state that agrees to implement the MLI. The objective of the minimum standard is to prevent treaty abuse and improve dispute resolution procedures. The MLI stipulates two tests to determine whether an entity is eligible to claim tax treaty benefits: the *Principle Purpose Test (PPT)* and the *Simplified Limitation on Benefits Test (SLOB).*

While the PPT focuses on the essence of the arrangement/ transaction, SLOB provides a specific list of criteria for an entity applying for benefits under a CTA. To pass the PPT, the claiming party must provide a rationale showing that the primary purpose for using the CTA in the transaction is not to acquire CTA benefits. The SLOB test, when compared with the PPT, has considerably stricter criteria and the potential to hinder many cross-border arrangements.

The PPT is mandatory for all MLI signatories, while the SLOB is optional. The good news is that SLOB will apply to a tax treaty if both jurisdictions choose to apply it. As of today, there are 14 countries that have opted for the SLOB, including Kazakhstan, Armenia and Russia. The overwhelming majority of European countries have chosen PPT alone (minimum standards), limiting their exposure to the MLI.

There are also optional provisions to prevent treaty-shopping arrangements with respect to different categories of income, including dividends and capital gains. Additionally, the MLI provides a bundle of changes for creating and operating permanent establishments.

Kazakhstan has published its official reservations and MLI notifications, and in so doing confirmed its intention to implement not only the minimum standard, but a number of optional provisions. As of today, the MLI legislative act to be ratified in Kazakhstan is under review in the Senate. It is reasonable to assume that the MLI will be ratified in Kazakhstan in 2020 and will enter into effect in 2021.

Tax Treaty with Cyprus – New Opportunities

The position of Cyprus for tax purposes in Kazakhstan has taken a 180-degree turn in recent years. Although Cyprus was once regarded as a tax haven jurisdiction, it has now been removed from the "*black list*" and has become a tax treaty partner with Kazakhstan.

Kazakhstan ratified a tax treaty with Cyprus on 30 December 2019, and on 17 January 2020 the treaty came into force. For residents of Kazakhstan and Cyprus, the treaty benefits will be available for taxes on derived income beginning 1 January 2021.

Cyprus is known as a country providing a wide range of tax benefits for foreign investors. In comparison to countries in Western Europe, which also have business-friendly tax regimes, Cyprus has many comparative advantages - low setup and operational costs, as well as simple administrative procedures. In addition to these benefits, investors from Kazakhstan can now claim lower tax rates on dividends, interest and royalties payable from Kazakhstan to Cyprus as stipulated in the tax treaty, as well as exemption for active income (income from provision of services).

Conclusion

The modification of Kazakhstan's tax legislation may have an impact on the tax strategies of Kazakhstani companies and foreign companies investing in Kazakhstan, and therefore the above changes should be carefully considered when structuring inbound or outbound investments.