

## Capital Gains Taxation in Kazakhstan

by E.S. Kate Habershon and Bakhytzhan O. Kadyrov

Reprinted from *Tax Notes Int'l*, October 7, 2013, p. 73

# PRACTITIONERS' CORNER

## Capital Gains Taxation in Kazakhstan

by E.S. Kate Habershon and Bakhytzhan O. Kadyrov

E.S. Kate Habershon is a partner in the London office of Morgan, Lewis & Bockius LLP's tax practice, and Bakhytzhan O. Kadyrov is an associate in the Almaty, Kazakhstan, office of Morgan, Lewis & Bockius LLP's business and finance practice.

This article describes the main features of the amended Kazakhstan capital gains tax regime, which has been in force since the start of 2013. All legislative references are to the Code of the Republic of Kazakhstan, "On Taxes and Other Mandatory Payments to the Budget (Tax Code)," dated December 10, 2008 (as subsequently amended).

### Taxation of Residents

#### Tax Rate

When a Kazakhstan legal entity realizes a capital gain, the gain is included in its aggregate annual income. Aggregate annual income less deductions and certain adjustments is subject to 20 percent corporate income tax. When a Kazakh resident individual realizes a capital gain, the gain is subject to 10 percent individual income tax; the individual must report the capital gain and pay the tax.

#### Tax Base

Capital gains may be realized as a result of a sale for cash; other transactions may also qualify as a capital gain for tax purposes (for example, the transfer of an asset by way of a contribution in kind to the charter capital of a company (such as a share for share exchange) or as part of a corporate reorganization constitutes a disposal of the asset). In general, the capital gain is the positive difference between the acquisition cost and the disposal proceeds.

#### Exemptions

The following capital gains are not taxable in the hands of Kazakh residents:

- Capital gains realized upon the sale or other disposal of shares in a legal entity or consortium (articles 133.2(6) and 156.1(15)) if the following requirements (the "CGT exemption requirements") are met:
  - the seller has owned the shares for more than three years at the date of disposal;
  - the legal entity or consortium in question is not a subsoil user (for example, engaged in mining or oil/gas production); and
  - no more than 50 percent of the value of the charter capital or shares in the legal entity or consortium in question (as of the date of the sale) is attributable to subsoil use.
- Capital gains realized upon the sale of securities through an open trade on a Kazakh stock exchange. Such securities must be included (as of the date of the sale) in the official list of the Kazakh stock exchange (articles 133.2(7) and 156.1(16)).

### Taxation of Nonresidents

#### Basis

Nonresidents' capital gains may be taxable in Kazakhstan if the nonresident sells:

- shares in a Kazakh resident legal entity or a consortium located in Kazakhstan, subject to an exemption regarding securities in a Kazakh company through an open trade on a Kazakh or foreign stock exchange (even if the securities are attributable to Kazakh subsoil use or if the seller

is a tax haven entity), provided securities are included (as of the date of the sale) in the official list of the stock exchange (articles 193.5(8) and 200-1.1(9));

- shares in a nonresident legal entity or consortium if 50 percent or more of the value of such shares or assets of the nonresident is attributable to property located in Kazakhstan (the “covered nonresident company”), subject to an exemption for listed securities that are sold by open trade on a Kazakh or foreign stock exchange;
- property located in Kazakhstan if the rights to such property or transactions with such property are subject to state registration in accordance with Kazakh law (for example, real estate located in Kazakhstan); or
- property located in Kazakhstan that is subject to state registration in accordance with Kazakh law (the “covered property”).

The taxable amount of the capital gain is calculated according to the same rules that are applicable to Kazakh residents.

### Tax Rate

In this context, it is assumed that the nonresident realizing the gain is not conducting business in Kazakhstan through a permanent establishment and does not have any other presence in Kazakhstan. The general tax rate is 15 percent. However, if a nonresident is a resident of a tax haven jurisdiction, then the tax rate will be 20 percent.<sup>1</sup> The tax is generally collected by withholding at source from the payment of the purchase price (sometimes even if the buyer is not itself resident in Kazakhstan).

### Collection of Tax

The mechanism for the collection of tax depends in part on the nature of the asset. For this purpose, “qualified property” includes the following:

- property located in Kazakhstan if the rights to such property or transactions with such property are subject to state registration in accordance with Kazakh law;
- property located in Kazakhstan that is subject to state registration in accordance with Kazakh law;
- shares in a Kazakh resident legal entity that is a subsoil user or a consortium whose participants are conducting a subsoil use business through the consortium;
- shares in a Kazakh resident legal entity or consortium, when the CGT exemption requirements are not met; and

- shares in a nonresident legal entity or consortium, when the CGT exemption requirements are not met (for example, non-Kazakh resident entities with direct or indirect Kazakh subsoil interests).

Article 197 of the Tax Code creates a special enforcement regime for the taxation of capital gains chargeable as a result of the disposal of qualified property by nonresidents.

If a non-Kazakh resident entity realizes taxable capital gains upon the sale of a qualified property, the tax must be withheld by the buyer (other than a Kazakh individual) regardless of where the buyer is located (and whether it has some presence in Kazakhstan). Tax may be withheld at the relevant rate on the entire purchase price. If the tax is not withheld (for example, the buyer is a Kazakh individual), then the nonresident entity must pay the tax itself.

There are special enforcement rules under which the target asset relates to subsoil use in Kazakhstan. In that case, the tax may be paid (in addition to the normal procedure, whereby the tax is paid by the tax agent, that is, the buyer) by the subsoil user at the expense of the tax agent (that is, the tax agent transfers the necessary funds to the subsoil user and such funds will not be considered the subsoil user’s income) or by the subsoil user at its own expense. Further, if the tax is not withheld, the tax may be collected by the tax authorities directly from the subsoil user.

## Income Tax Treaties

### General

Kazakhstan has income tax treaties in force with many jurisdictions, including the United Kingdom, the Netherlands, the United States, Germany, China, and Russia. An income tax treaty may allocate taxing rights regarding capital gains to one or both of the contracting states, and may prevent a nonresident from being subject to the Kazakh capital gains tax to which it would otherwise be subject. The benefits of a treaty will be limited to the beneficial owner of the income/gain in question. The meaning of “beneficial owner” has been clarified in the Kazakh Tax Code to cover only a person who can independently determine the means of usage and disposal of the income and excludes nominee holders, agents, and intermediaries.

Historically, particularly before the introduction of the broad exemption for nonresident shareholders, non-Kazakh investors tended to choose the Netherlands as the jurisdiction from which to hold shares in Kazakh companies. The Kazakhstan-Netherlands income tax treaty provides that the taxing rights regarding capital gains are allocated to the jurisdiction whose resident receives the income (capital gain), that is, to the Netherlands in the case of a Dutch resident selling shares in a Kazakh company or covered nonresident company.

<sup>1</sup>For Kazakhstan’s list of privileged taxation jurisdictions (tax havens), see *Tax Notes Int’l*, July 22, 2013, p. 353.

However, for real estate (including subsoil use) assets in Kazakhstan, the application of the Kazakhstan-Netherlands treaty is not clear on the allocation of taxing rights. Therefore, some investors choose to rely instead on the Austria-Kazakhstan income tax treaty because it provides for clearer protection in such cases.

Notably, on May 21, 2013, the Kazakhstan government submitted to the Kazakhstan parliament a draft law on the ratification of the Kazakhstan-Luxembourg income tax treaty (signed in 2008) and the protocol to it (signed in 2012), and the lower chamber approved them in September 2013. While Luxembourg remains on Kazakhstan's list of tax haven jurisdictions, Luxembourg will be removed when the Kazakhstan-Luxembourg treaty and protocol are ratified and become effective. Given the flexible tax regime in Luxembourg and an effective investment protection treaty with Kazakhstan, expectations are that Luxembourg might compete with other prominent holding jurisdictions (especially the Netherlands).

### Practical Experience

Note that the exemption from capital gains in Kazakhstan under an income tax treaty is not automatic (article 212.2). The tax will still need to be withheld and paid over to the Kazakh authorities. The seller will then need to prove to the Kazakh tax authorities that it is entitled to exemption under the relevant treaty. The tax will be refunded if the Kazakh tax authorities accept that the seller had a right to the benefit of the treaty and to enjoy the capital gains tax exemption in Kazakhstan.

Some countries, such as Spain, currently issue only electronic tax residence certificates, which do not per se contain a signature and stamp of the respective state body, but rather contain an electronic bar code/signature. While one may argue that local administrative provisions cannot override the application of a treaty, the Kazakh tax authorities are rather formalistic and are expected to reject any application based on electronic certification for reliance on the Kazakhstan-Spain treaty (as well as other jurisdictions that issue only electronic or other unstamped or unsigned certificates, for example, exemption from capital gains tax).

### Contractual Provisions

Parties should carry out appropriate due diligence and build suitable protection into the share purchase agreement or other documentation to address any withholding tax liabilities regarding the purchase price. For

example, if the seller does not provide the buyer with details of its own acquisition cost in order to calculate the gain, the buyer must withhold tax from the entire sale price.

### Specific Cases

#### *Migration*

One question is whether the three-year holding rule (one of the CGT exemption requirements) will apply when a foreign company that has held shares in a Kazakh company for more than three years migrates from one jurisdiction to another. Although migration generally involves the continuity of the legal personality, there is a risk that the Kazakh tax authorities will disregard the applicability of the tax exemption and will argue that the three-year holding rule should begin anew. It appears that the latter interpretation (that is, the past years of holding should not be honored) is likely to be supported by the Kazakh tax authorities, since they are, in most cases, form over substance.

#### *Liquidation*

Another question is how liquidation proceeds should be treated for tax purposes. If the direct (non-Kazakh resident) shareholder of a Kazakh company is being liquidated, there is a risk that such liquidation proceeds should be considered a capital gain in the hands of the non-Kazakh resident shareholder of the company in liquidation and taxed accordingly. However, there may also be an argument that such liquidation proceeds should be treated as dividends and, thus, outside the scope of Kazakh-source income. The definition of the term "dividends" is rather broad under the tax code and includes income from the distribution of property upon liquidation of the legal entity. Therefore, a literal interpretation suggests that the liquidation proceeds in question are dividends and, thus, no Kazakh tax applies.

#### *Tax Transparent Entities*

The tax code does not specifically address the treatment of tax transparent entities (for example, a U.S. limited liability company). There is a general definition of an "entity" ("litso" in Russian), which covers all individuals and legal entities, as well as entities that do not have the status of a separate legal entity under the laws of their home jurisdiction. Therefore, an argument can be made that an entity that is tax transparent under the laws of its home jurisdiction may still be considered a taxpayer under the tax code. Be careful when using such tax transparent entities in tax structuring, including the Kazakh capital gains tax. ♦