tax notes international

Volume 71, Number 3 ■ July 15, 2013

Dividends Taxation in Kazakhstan

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

Reprinted from *Tax Notes Int'l*, July 15, 2013, p. 353

Dividends 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 provisions regarding the taxation of dividends in Kazakhstan in 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).

I. General Provisions

The taxation of dividends is an important aspect of investing in Kazakhstan. The tax regime for dividends is still being developed and has undergone many changes in recent years.

The term ''dividends'' is broadly defined. In addition to covering typical items such as cash distributions out of profits to shareholders, it includes deemed income received by a shareholder (or its affiliate) from the company in the form of the excess of the market price of goods or services provided by the company over the price paid by the shareholder (or its affiliate). This means that the tax authorities could characterize a transfer of value or other provision of a benefit to a shareholder (or affiliate) as a dividend (sometimes referred to as a ''constructive dividend'').

II. Taxation of Residents

A. Dividends Paid to Kazakh Companies

When a Kazakh company pays a dividend to another Kazakh company, the dividend is not taxable at source (article 143). In other words, there is no withholding tax.

B. Dividends Received by Kazakh Companies

Generally, when a Kazakh company receives a dividend (either from a Kazakh or a foreign company), the dividend is not included in its aggregate annual taxable income (article 99.1(1)).

C. Dividends Paid to Kazakh Individuals

In general, dividends paid (either from a Kazakh or a foreign company) to individuals are subject to taxation at the rate of 5 percent (article 158.2). The dividend tax is withheld at source if paid by a Kazakh company (article 160(4)) or is self-assessed and self-reported by the individual if received from abroad (article 177(4)).

However, the following dividends are tax exempt:

- dividends that satisfy all the following conditions (article 156.1(7)) (collectively, the ''dividend exemption requirements''):[1]
  - — the taxpayer has owned the shares (participatory interest) for more than three years at the time of accrual of the dividend;
  - — the company paying the dividend has not been a subsoil user (that is, engaged in mining or oil/gas production in Kazakhstan) during the period for which the dividend is paid; and

[1]Note that only the usual types of dividends are eligible for this tax exemption, namely, distributions to shareholders out of profits, not constructive dividends.

— no more than 50 percent of the value of the assets of the company paying the dividend (as of the date of payment) is attributable to the assets of an entity that is or has been a subsoil user; and

- dividends on securities that are (at the time of accrual of the dividend) listed on the official list of a Kazakhstan stock exchange (article 156.1(5)).

If dividends have already been taxed at source, there is no further taxation in the hands of an individual recipient (article 155.3(15)). Also, Kazakh individuals are not taxable regarding dividends received from a tax haven entity when the dividend in question has been paid out of profits that have already been taxed on the individual in Kazakhstan under the controlled foreign corporation rules (articles 156.1(39) and 224). See the list of tax haven jurisdictions (countries with privileged taxation) for Kazakh tax purposes at the end of this article. This exemption does not cover non-tax-haven entities because profits received by non-tax-haven entities are not captured by the CFC rules.

III. Taxation of Nonresidents

When a Kazakh company pays dividends to a nonresident, those dividends are considered Kazakh-source income (article 192.1(9)) and are subject to tax at the rate of 15 percent (or 20 percent if paid to a tax haven resident). The tax is withheld at source (article 193.1). An applicable income tax treaty may reduce the tax to a minimum level of 5 percent (for example, the Netherlands and U.K. treaties). Generally, the tax agent paying the dividends may automatically apply the income tax treaty if the recipient is the beneficial owner of the dividends and there is a tax residency certificate (article 212-1).

No withholding tax is imposed on:

- dividends that satisfy all the dividend exemption requirements (referred to above) that are not paid to tax haven residents (articles 193.5(3) and 200-1.1(4)); and
- dividends on securities that are (at the date of accrual of the dividend) listed on the official list of a Kazakhstan stock exchange (articles 193.5(5) and 200-1.1(6)).

Dividends received by nonresidents are taxable according to the laws of the jurisdiction where the entity is tax resident.

IV. Branch Profits Tax

When nonresidents operate in Kazakhstan through a permanent establishment, they are required to pay tax on the net income of that PE (article 82(3)) — the so-called branch profits tax. This is the economic equivalent of dividend withholding tax. However, in contrast to dividend withholding tax, net income tax must be paid annually, and not only on an actual remittance of profits.

The taxable base of the branch profits tax (which is considered part of the corporate income tax) is essentially the amount of the taxable income minus the amount of the corporate income tax that would have been imposed had the PE been a Kazakh company, so in effect it is levied on what would be the after-tax distributable profit if the PE had been a subsidiary. The tax rate is 15 percent; however, as with dividend withholding tax, it can be reduced to a minimum of 5 percent under an applicable income tax treaty.

V. Specific Cases

A. Global Depositary Receipts

There is a special article addressing when dividends are paid through shares that serve as the base asset for global depositary receipts (GDRs). When such dividends are paid to a nonresident through a nominee, the Kazakh tax agent may apply a reduced rate in accordance with an income tax treaty (if any) if the recipient is the beneficial owner of such dividends and the Kazakh tax agent has a list of GDR holders (with such details as their names, number of GDRs held, identity card, and so forth) and the tax residency certificates. In that case, the Kazakh tax agent may apply a reduced tax rate under the appropriate income tax treaty (normally, from 15 percent to 5 percent under the treaty).

B. Reorganization

The two most commonly used corporate legal forms in Kazakhstan are a joint stock company (JSC) and a limited liability partnership. There is a question as to whether the three-year holding rule (one of the dividend exemption requirements) will be met if a nonresident has held the shares in a JSC for more than three years but the JSC has been converted into an LLP. From a strict legal perspective, a conversion results in the creation of a new company. Therefore, the three-year holding rule (and thus the dividend exemption requirements) will arguably not be met for another three years following the conversion.

C. Migration

There is a question as to whether the three-year holding rule (one of the dividend 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. On the one hand, migration contemplates that the legal personality remains with the migrated entity (similar to an individual changing his passport). On the other hand, 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 recommence. It appears that the latter interpretation will likely be supported by the Kazakh tax authorities, since they usually apply form over substance.

D. Liquidation

There is a question of how liquidation proceeds should be treated for tax purposes. Take, for example, a foreign company that holds another foreign company that in turn holds shares in a Kazakh company. Suppose the direct shareholder of the Kazakh company is being liquidated. The question here is how the liquidation proceeds should be treated. One argument is that the liquidation proceeds should be considered a capital gain and taxed accordingly.

Another argument is that the liquidation proceeds should be treated as dividends and therefore beyond the scope of Kazakh-source income. As noted above, 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, verbatim interpretation suggests that the liquidation proceeds in question are dividends, so no Kazakh tax applies.

Annex: Countries With Privileged Taxation

The following jurisdictions are those that Kazakhstan considers countries with privileged taxation (according to government Resolution No. 1318, dated December 31, 2008, on the Approval of the List of Countries With Privileged Taxation (as subsequently amended)):

- Andorra
- Antigua and Barbuda
- Bahamas
- Bahrain
- Barbados
- Belize
- Brunei Darussalam
- People's Republic of China (only the special administrative regions of Macau and Hong Kong)
- Colombia
- Comoros
- Costa Rica
- Cyprus
- Djibouti
- Dominica
- Dominican Republic
- Fiji
- France (only the following areas):
  - — Kerguelen Islands
  - — French Polynesia
  - — French Guiana
- Grenada
- Guatemala
- Guyana
- Ireland (only the cities of Dublin and Shannon)
- Jamaica
- Lebanon
- Liberia
- Liechtenstein
- Luxembourg
- Malaysia (only the Labuan enclave area)
- Maldives
- Malta
- Mariana Islands
- Marshall Islands
- Mauritania
- Mauritius
- Monaco
- Montenegro
- Morocco (only the Tangier city area)
- Myanmar
- Nauru
- the Netherlands (only the Aruba island area and Antilles dependency)
- New Zealand (only the Cook Islands and Niue Island)
- Nigeria
- Palau
- Panama
- the Philippines
- Portugal (only the Madeira islands)
- St. Kitts and Nevis
- St. Lucia
- St. Vincent and the Grenadines
- Samoa
- San Marin
- Seychelles
- Spain (only the Canary Islands)
- Sri Lanka
- Suriname
- Tanzania
- Tonga
- Trinidad and Tobago
- United Arab Emirates (only the Dubai city area)
- the United Kingdom (only the following jurisdictions):
  - — Anguilla islands
  - — Bermuda islands
  - — British Virgin Islands
  - — Gibraltar
  - — Cayman Islands
  - — Montserrat island
  - — Turks and Caicos Islands
  - — Isle of Man
  - — Channel Islands (Guernsey, Jersey, Sark, and Alderney islands)

— South Georgia Island
— South Sandwich Islands
— Chagos Islands

- the United States (only the following areas):
  — U.S. Virgin Islands
  — Guam
  — Puerto Rico
  — state of Wyoming
  — state of Delaware
- Vanuatu

◆