A Critical Analysis of CFC Legislation in Kazakhstan: Practical Challenges and Legislative Issues

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1. Introduction

1.1. Significance of the issue

A tight fiscal policy and rigid tax and regulatory regime can motivate resident taxpayers to search for more tax-efficient ways of structuring their investments, but also to shelter their income from tax liabilities in their country of residence by placing it in low-tax jurisdictions. The use of low-tax jurisdictions can be either legitimate or motivated by tax avoidance. This strategy can take the form of legitimate investment and commercial activities in jurisdictions with a low tax burden and flexible regulatory regime, making them more attractive for investment than the state of residence.

Investments motivated by tax avoidance may take the form of round-tripping[3] of investments in the home jurisdiction, or they may involve the practice of using companies located in low-tax jurisdictions to shelter income deriving from other foreign investments or commercial activities in third countries, with a view to protecting this income from domestic tax liability. This tax avoidance practice is based on attributing income earned either in the home jurisdiction of resident taxpayer[4] or in other jurisdictions to a company established in a low-tax jurisdiction. The company, as a separate legal entity and thus also a separate taxpayer from the individual who beneficially owns the company directly or

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[3] The term "round-tripping" refers to practices of using the low-tax jurisdiction by a tax resident of high-tax jurisdiction for investments in the country of residence with the objective of achieving a more tax-efficient outcome than when investing domestically. Additionally, the channeling of the investment through tax treaty partners may provide additional legal protection in the form of bilateral investment treaties (BITs).
[4] This income can be channeled through intermediary companies, that may be resident in tax treaty jurisdictions to mitigate the effect of any withholding taxation deducted at source.

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indirectly, is thus a taxpayer that is otherwise outside the reach of the tax laws of the country of residence of the beneficial owner.[5]

Such a strategy adopted by taxpayers to minimize taxes and invest in low-tax jurisdictions results in most of their investments being kept and thousands of companies being established in "tax haven jurisdictions". In 2012 investments in low-tax jurisdictions reached historically high levels, amounting to almost $80 billion. This is $10 billion lower than in 2011, but still $15 billion above the average of the pre-2007 period. Investments in offshore countries constitute about 6%.[6]

The OECD defines tax havens as jurisdictions which impose low tax rates, or none at all, that are used by corporations to avoid tax which would otherwise be payable in a high-tax country. According to the OECD, tax havens have the following key characteristics:

- nominal taxes or none at all;
- the lack of an effective exchange of information;
- the lack of transparency in the operation of legislative, legal or administrative provisions.[7]

The significant number of offshore territories and the scale of offshore business became an urgent problem in the wake of the world financial crisis. To deal with the off-shore phenomenon, numerous governments in the world have implemented strict measures concerning the taxation of offshore businesses. In addition, the international community has renewed and strengthened efforts to reduce tax avoidance and increase transparency in international financial flows. In this connection, improving tax transparency and promoting information exchange have been key features of deliberations at G-20 summits since their inception. Significant pressure has been put on tax havens by the international community, on individuals and firms by governments, and on multinationals by activist groups to limit their facilitation and the use of tax avoidance schemes.[8]

This is also the case of Kazakhstan. "*The issues with offshore territories and offshore business in general are crucial for Kazakhstan. How*

[5] Assuming this company does not have a permanent establishment and cannot be considered as tax resident based on concepts such as the place of effective management.
[6] World Investment Report 2013, UNCTAD, p.xiiii
[7] OECD Glossary of Tax Terms
[8] World Investment Report 2013, UNCTAD, p.15.

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successfully and effectively these issues can be solved partially depends on the realization of government social programmes aimed at improving the welfare of people", in the words of Daulet Yergozhin, the Vice-President of Finance of Kazakhstan and Chairman of the Tax Commission of the Kazakh Finance Ministry in 2009.

To deal with these practices, and to combat tax avoidance, many jurisdictions around the world,[9] have introduced special anti-avoidance rules, also known as Controlled Foreign Corporation rules (CFC rules). Under CFC rules, the taxpayer loses the tax shelter benefits for a company established in a low-tax jurisdiction. Instead, the income is taxed in the hands of the beneficial owner directly by the state of residence by attributing this income to the beneficial owner.

Although tax havens are not the only reason for the financial problems of governments and the erosion of the tax base, the implementation of special rules with regard to business carried out in tax havens could be a practical way to safeguard tax revenues.[10]

The Kazakh Tax Code contains a number of protective measures intended to deal with the negative effects of offshore companies. In particular it contains the following measures:

- Place of Effective Management Concept (Article 189)
- 20% withholding tax on payments made to offshore jurisdictions (Article 192 and 194)
- CFC rules (Article 224).

In addition to the strict measures targeting offshore companies, the government has adopted a number of positive amendments to national tax law, reducing the level of tax rates and creating domestic special tax regimes. In general the new Kazakh Tax Code adopted in 2009 is aimed at increasing the attractiveness of the Kazakh economy, while containing measures to discourage the use of offshore companies.

[9] Australia, Austria, Canada, China, Denmark, Finland, France, Germany, Hungary, Korea, Italy, New Zealand, Portugal, Spain, South Africa, Sweden, USA,

[10] Lang M., Aigner H-J., Scheuerle U., Stefaner M., CFC Legislation, Tax Treaties and EC Law, 2004.

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1.2. Development of CFC legislation in Kazakhstan

The first CFC provisions appeared in the Kazakh Tax Code in 1995.[11] They thus have a long history, with several amendments being incorporated into the norm over time. The initial CFC provision[12] was not clearly drafted and left many questions unanswered. The rule provided no guidelines on the calculation and definition of taxable income, nor any indication for determining the taxable period for which the taxpayer was liable.

With regard to offshore tax havens, countries can be considered to be tax havens if they have enacted laws on the confidentiality of information, or the rate of corporate income tax is one-third of the rate applicable in Kazakhstan. The rate of corporate income tax was 30% at that time and thus an offshore could be considered any jurisdiction where the rate of corporate income tax was lower than 20%.

The initial rule attracted criticism from local legal scholars. This was because as it was worded the rule could lead to double taxation in Kazakhstan.[13] This is because the rule was intended to tax the net profits of foreign companies in the hands of Kazakhstan residents, and the rule did not distinguish whether the income was actually distributed or not. This income was supposed to be attributed on a per share basis, but the same income could be taxed as dividends in the case of actual distribution and no adjustment was provided by the tax code, neither for individual, nor for corporate taxpayers.

Over a period of almost 20 years the rule had gradually been amended and more details on the implementation of the rule have been introduced. Briefly, the major changes were that the shareholding threshold was reduced from 20% to 10%, a black list was introduced in November 2003, individual taxpayers were granted the right to eliminate double taxation within Kazakhstan, and details on the determination of taxable income were introduced.

[11] Art. 39, Law of Kazakhstan on Taxes and other obligatory payments to the budget
[12] Art. 39, Law of Kazakhstan on Taxes and other obligatory payments to the budget
[13] Masalin E., *Kazakhstan analogue of controlled foreign corporation,* Yurist, 1/2005

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2. CFC present status in relation to the Tax Code of Kazakhstan as of 15 July 2014

2.1. Determination of Controlled Foreign Companies

For the purposes of Kazakh tax law, a "controlled foreign company" could be any entity[14] which simultaneously meets the following conditions:

1) it is registered in a territory with privileged taxation;
2) 10% or more of its authorized capital or voting shares belong directly or indirectly to the Kazakh resident.

The Kazakh CFC rule thus addresses any form of organization, incorporated or non-incorporated, as well as entities which do not have separate legal personality. Thus, for example, entities such as partnerships are also covered by the rule.

In addition, it is interesting to note the term used is "belong": the law thus does not strictly establish the term of "legal ownership" and seems to use a broader term that may cover the concept of economic ownership. As a result, what counts is not merely the legal form and the right of ownership, but the actual possession of shares/voting rights. The authors are of the opinion that ownership of offshore companies through trust structures is not sufficient to avoid the application of CFC rules.

However, the weakness of the rule is the fixed 10% threshold, which tests the applicability of the CFC rule against a strict 10% ownership criterion rather than constructive ownership, where one or more related parties may each own 9.99% of the shares of the offshore company, but are outside of the scope of the application even if they jointly own 100% of the offshore company. This technique is often used in structuring offshore companies, successfully circumventing anti-avoidance measures, with the ownership of the CFC allocated to family members and close relatives.

[14] Art. 224 (1), p.3, Tax Code, Including legal entities and organizations that do not have a separate legal personality.

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2.2. Shareholders

Kazakh CFC rules apply equally to individual and corporate taxpayers, who are liable to unlimited taxation in Kazakhstan.[15] Individuals or corporations fall within the scope of CFC provisions if they hold directly or indirectly 10% or more of the authorized capital or voting shares in the non-resident legal entity deemed to be an offshore company.

However, the rule does not apply to residents of Kazakhstan who own the shares in such a company indirectly though other Kazakh residents.[16] The other resident entity holding the CFC is thus assumed to be subject to CFC rules, and the provision exempting the indirect ownership was in all probability intended to prevent the double application of CFC rules.

However, the way the law is drafted results in a legal loophole, whereby an individual or entity can own several other resident legal entities, each of them in turn owning less than 10%. In cases in which the Kazakh resident owns more than 10% of the CFC indirectly, the CFC rules apply neither to the beneficial owner indirectly owning more than 10% of the CFC, nor to the entity directly owning less than 10%. Both are placed outside the scope of CFC rules by the current wording of this provision.

2.3. Definition of "privileged taxation"

Under Kazakh tax law, the definition of a country with privileged taxation (hereinafter, a "low-tax jurisdiction") is any state or its administrative unit, where under the laws of that state or administrative unit:

1) the corporate income tax rate does not exceed 10%; or alternatively
2) there is a law on confidentiality of financial information or any other kind of law which protects the secrecy of the actual owner

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[15] It should be noted that this was the case also with the original version of the provision, starting in 1995. However, over time, the provision was gradually moved to the section dealing with Corporate Income Tax law and as a result a number of tax professionals advised their (individual) clients to ignore this provision, since it was argued that the provision was not applicable to individuals due to its inclusion in the part of the tax code dealing with Corporate Income Tax. Art. 130, The Tax Code of Kazakhstan and other obligatory payments to the budget dated 12 June 2001, No.209-II 3RK

[16] Art. 224 (1), p.4 Tax Code of Kazakhstan - The provisions of this paragraph shall not be applicable to indirect participation of the resident in authorized capital of a non-resident located and/or registered in a state with preferential tax treatment and/or to indirect holding by a resident of voting shares of such non-resident through another resident.

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of an income, property or actual owners, members, partners, shareholders of the companies and organizations.[17]

The law does not clarify whether the 10% tax rate is a *nominal* rate or the *effective* rate. A literal interpretation of the law may lead to the conclusion that only the nominal rate is considered, meaning that a number of tax jurisdictions will fall outside of the scope of the application of the CFC rules due to the fact that they may have nominal tax rates higher than 10%.[18]

Pursuant to the law, the provisions of point 2) above do not apply to states or administrative units with which Kazakhstan has concluded an agreement for the exchange of information. Exceptions are allowed in cases in which the state or its administrative unit has denied or failed to provide the requested information within a period of two years.[19] The tax code also provides that the list of countries with privileged taxation is to be determined by the government of Kazakhstan.[20]

A "black list" was introduced in 2010 including the countries and administrative territories falling under the definition of countries with privileged taxation. The status of this list is not entirely clear. The tax code provides that the list of low-tax jurisdictions is to be drawn up by the government.[21] Arguably, the authority to determine which countries qualify as low-tax jurisdictions was delegated to the government, and it is the government that determines the countries to which the CFC rules are applicable. Alternatively, it could be argued that the list is not exhaustive and any territory could qualify as a tax haven if it satisfies the Kazakh criteria as an offshore jurisdiction, since the tax code provides objective criteria, while the list drawn up by the government may not properly reflect the status of the tax rates and the exchange of information of countries placed on the blacklist. It is significant that Kazakhstan has blacklisted several of its treaty partners. However, on

[17] Art. 224 (4), p.1 Tax Code of Kazakhstan.
[18] This can be also the case of Cyprus, which previously applied a nominal tax rate of 10%, though this was increased to 12.5% as from 1 January 2013.
[19] Art. 224 (4), p.1 Tax Code of Kazakhstan.
[20] Resolution of the Government of the Republic of Kazakhstan of 10 February 2010 No. 52 "On approving the list of countries with preferential tax treatment".
[21] Art. 224 (4), Tax Code of Kazakhstan.

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closer examination, it should be noted that the territories mentioned are mostly excluded from the territorial scope of the applicable tax treaties:

1. Spain (only part of the Canary Islands);
2. China (only parts of the special administrative regions of Macau and Hong Kong);
3. Malaysia (only part of the Labuan enclave);
4. The Netherlands (only parts of Aruba and the dependent territories of the Dutch Antilles);
5. Singapore (removed from the list in 2012);[22]
6. United Kingdom of Great Britain and Northern Ireland (only part of the following territories): Anguilla; Bermuda; British Virgin Islands; Cayman Islands; Chagos; Channel Islands (Guernsey, Jersey, Sark, Alderney), George's Island, South; Gibraltar; Isle of Man; Montserrat; Turks and Caicos Islands; South Sandwich Islands;
7. The United States of America (only the following territories): Guam; Puerto Rico; State of Delaware; State of Wyoming; U.S. Virgin Islands;
8. France (only part of the following territories): French Guyana; French Polynesia; Kerguelen Islands;
9. Luxemburg;
10. Switzerland (removed from the list in 2010).[23]

The possible blacklisting of tax treaty partners (as in the case of Luxemburg) raises questions as to whether this practice constitutes a violation of principles of the tax treaty or discrimination pursuant to the principles enshrined in the Partnership and Cooperation Agreement between the EU and Kazakhstan.[24]

2.4. Income subject to tax

International practice is characterized by two approaches with regard to the design of CFC rules:

[22] Decree of the government of Kazakhstan, No.960 dated 23 July 2012.
[23] Decree of the government of Kazakhstan No.870 dated 1 September 2010.
[24] The European Union and Kazakhstan Partnership and Cooperation Agreement, 1999.

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- the Transparency Approach (allocating CFC income to residents of the country for tax purposes as income earned directly by the resident, disregarding the CFC);
- the Dividend Approach (the income earned by the CFC is deemed to be immediately received by the tax resident as a dividend distributed by the CFC and thus becomes subject to tax as a dividend).

The CFC approach adopted in Kazakhstan appears to follow the fiscal transparency approach, where the Kazakh resident is taxed on income earned/received from the CFC.

The tax law does not provide clear guidance as to how the income is to be classified, in particular whether the income received from the CFC retains its nature (dividend, capital gains, business profits) when taxed in the hands of the resident for tax purposes. The classification of the income may have further consequences in the sense that domestic tax law allows significant exemptions in respect of income received by both individuals and legal entities.

CFC rules merely provide that income generated by offshore companies should be included in the taxable income of Kazakh residents and be taxable in Kazakhstan. The rule provides guidance on the permissibility of utilizing tax carried forward against the income derived from the CFC and subject to tax. However even here the tax law does not provide guidance on the classification of income vs. losses, while under domestic law, several categories of losses are laid down and are ring-fenced based on the type of income.

The CFC rules provide guidance only in respect of the proportion of income to be allocated to the Kazakh tax resident, which are to be determined based on the participatory interest of the Kazakh resident in the authorized capital or the portion of voting shares in the offshore company.

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A special formula is provided in the Kazakhstan tax code for the calculation of taxable profit deriving from an offshore jurisdiction and taxable in the hands of the local shareholders.[25]

П = П1 x Д1 + П2 x Д2 +…+ Пn x Дn,

where:

П = income to be consolidated;

П1, П2, Пn = income in the reporting period after taxation recognized in separate financial accounts of each non-resident located and/or registered in a state with preferential tax treatment;

Д1, Д2, Дn = share of direct or indirect participation of the resident in the authorized capital of each non-resident entity located and/or registered in a state with preferential tax treatment, or the share of the direct of indirect holding by the resident of the voting shares in such non-resident entity.

Based on the formula, the resident taxpayer should be taxed on the aggregate amount of income derived separately from each non-resident CFC qualifying company.

At first glance this provision appears to reflect a positive attitude to the taxation of offshore income, since the taxation is designed to cover only the profits of the offshore company and each offshore company is considered individually. As a result, since there is no requirement to calculate the tax on the consolidated profits of an ultimate offshore company: the income of other non-offshore companies (possible subsidiaries of the considered offshore company) should not be subject to taxation in Kazakhstan.

However, this will be the case only until the time when income from such non-offshore subsidiaries is transferred to the offshore company in the form of passive/investment income. In this case, the profits of such non-offshore subsidiaries are transferred in the form of passive income to the offshore company, thus becoming taxable in Kazakhstan.

[25] Art. 224 (1), p.5 Tax Code of Kazakhstan.

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In addition, the income of the CFC offshore subsidiaries may be subject to double taxation in Kazakhstan. First, as active income of a CFC offshore subsidiary, and second after transfer in the form of passive income to the CFC itself.

The formula also provides the rule on the determination of the taxable period if the taxable period in the offshore jurisdiction differs from the period effective in Kazakhstan.[26] In addition, the rule provides a formula for the determination of the indirect percentage of participation.[27]

2.5. Exempt Activities

Many countries applying CFC rules as a way to combat tax avoidance seek to take a balanced approach in respect of legitimate investments in foreign jurisdictions. This is achieved by means of rules permitting exemptions from the application of CFC rules in certain cases, which are bona-fide investments, and active business operations in the foreign jurisdiction.

The Kazakh CFC rules do not lay down any such exemptions, meaning that any foreign subsidiary, irrespective of whether it is a company engaged in a tax avoidance practice sheltering income from taxation in Kazakhstan or whether it is a legitimate investment in the foreign jurisdiction.

2.6. Reporting Obligations

The taxpayer must submit to the local tax authority the consolidated financial reports of the resident legal entity, in cases in which such a resident legal entity has a subsidiary located and/or registered in a country with privileged taxation, as well as separate audited financial reports and reference documents (providing the names of non-resident legal entities, tax and state registration numbers) of each non-resident located and/or registered in a country with privileged taxation.[28]

3. Do the Kazakh CFC rules comply with tax treaties?

As noted above, Kazakhstan has blacklisted several tax treaty partners. The question is whether taxpayers could challenge the current version of

[26] Art. 224 (1), p.7 Tax Code of the RK
[27] Art. 224 (1), p.8 Tax Code of the RK
[28] Art. 224 (3) p.2 Tax Code of Kazakhstan.

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CFC rules, and the fact that the income from their foreign subsidiaries is attributed to them and taxed in the current period irrespective of the fact that it is not distributed in the form of dividends.

An answer to this question could be partially derived from the guidance provided by the OECD/UN Commentaries and also the Tax Treaty Case Law adopted by courts around the world.

3.1. OECD and UN Commentaries

Kazakhstan is not a member of the OECD, and as a result the Kazakh courts may be hesitant to base their decisions on argumentation provided by the OECD Commentaries. Kazakhstan's tax treaties are based in part on the UN Model Conventions and in part on the OECD Model, though the Kazakh courts are more likely to make reference to the UN Commentary. The commentaries to the OECD Model Tax Convention were first introduced in 1992, and since then updated and supplemented several times. In the present study, the most recent version, dated 2010, is used. The commentaries to the UN Model Convention were issued in 1980 and revised only in 2001, based on the changes made to the commentaries of the OECD model in the 1990s. Since the UN Model is itself largely based on the OECD Model, the commentaries on the UN Model, especially in the part concerning CFC rules, are mostly copied from the OECD commentaries with some minor additions and clarifications.

The OECD Commentary suggests that CFC rules do not conflict with treaties and are not affected by them, since they are part of the national rules that determine which facts give rise to tax liabilities.[29] The OECD Commentary places the accent on the purpose of the CFC rule, underlining that its application is only justified in respect of actions aimed at tax avoidance.[30]

The UN Model provides a similar justification, but it also contains the provision taken from the old version of the OECD model commentaries, allowing the substance-over-form principle to be adopted in the application of CFC rules. In other words, CFC rules could be applied even

[29] Commentaries to OECD Article 1(23)
[30] Commentaries to OECD Article 1(26)

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in the absence of special provision concerning their application in Double Taxation Conventions.[31]

Since the Kazakh approach adopts the transparency principle, with the allocation of CFC income to the Kazakh tax resident, the question is whether these CFC rules may be deemed to violate principles of Article 7, paragraph 1, which do not allow one contracting state to tax business profits of the enterprise of the other contracting state, unless this enterprise has a permanent establishment in the first-mentioned contracting state. Since the CFC rules in Kazakhstan are intended to tax the profits of the foreign enterprise, the conclusion could be that Article 7 paragraph 1 does not allow this, and such rules violate the tax treaty. On the other hand, one could also argue that the transparency approach does not violate Article 7, since the transparency approach is based on the concept of allocating income to a domestic taxpayer, rather than taxing the foreign subsidiary, and thus the application of Article 7 is out of the question.

The OECD Model commentaries do not contemplate any contradiction between Article 7 and the CFC rules, because the article does not prevent the state where the shareholders are resident from taxing them on their share of the profits derived from the CFC. Since the tax is imposed directly on shareholders, the CFC profits are not infringed and the revenue of the other state is not reduced.[32]

The UN Model does not include any comments with respect to Article 7 concerning CFC rules. Since Kazakhstan currently has no case law addressing CFC rules, the discussion in the following section will review the case law in some other countries.

3.2. World Practice Cases

The case law of different countries indicates different approaches adopted by judges in considering the question of the compliance of CFC rules with tax treaties. A review of case law indicates some contradictory approaches and answers to the same questions. A few examples are provided below:

[31] Commentaries to UN Article 1(11)
[32] Commentary to OECD Article 7 (13)

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- France - Case 232 276, 28 June 2002[33]

  The French taxpayer Schneider Electric, a shareholder in a Swiss company, was taxed on its shares on portfolio investment established in a low- tax jurisdiction. The French court recognized that French CFC legislation was in conflict with Article 7 of the Switzerland-France Income and Capital Tax Treaty, which follows the OECD model. The Switzerland-France tax treaty allows France to tax the profits of a Swiss company only in cases in which the company has a permanent establishment in France, and to the extent that such profits are attributable to that permanent establishment. Since the Swiss company had no permanent establishment in France, the CFC rules were ruled to be incompatible.

- Brazil - Case, 2008[34]

  Eagle Distribuidora de Bebidas S.A, a company resident and located in Brazil, was the 100% owner of the Spanish subsidiary Jalua, considered to be resident in Spanish territory (the Canary Islands). Through Jalua, Eagle was an indirect shareholder in a company in Uruguay (Monthiers) and Argentina (CCBA). Jalua did not generate any income, while the subsidiaries in Uruguay and Argentina did not distribute any profits to Spanish CFC. The Brazilian tax authorities attributed income from the Argentine and Uruguayan subsidiaries to the Brazilian parent, disregarding the Spanish CFC. The Brazilian Court ruled that Article 7 of the Brazil-Spain Tax Treaty was not applicable, since it focuses only on business profits directly generated by the Spanish company (Jalua), not on the profits of Jalua's controlled companies. The case attracted criticism, since the Spanish CFC was unlawfully disregarded, and the Court made no attempt to test the Brazil-Argentina tax treaty. The main argument used by the administrative tax judge taking the decision was that the

[33] Conseil d'Etat, Assemblée 28 June 2002, 232 276
[34] Federal Administrative Tax Court of Brazil, 17 December 2008, No. 16327.000530/2005-28, Sentence No. 101-97070

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Brazilian concept of "controlled company" expressly includes indirectly controlled companies, i.e., companies controlled by a Brazilian company through an intermediary offshore company.

- Japan - Case 2008 (Gyo-hi) No. 91, 29 October 2009 Japan[35]

  The taxpayer was Glaxo Kabushiki Kaisha, a company resident in Japan, owning 90% of a Singaporean subsidiary. The profits after the sale of a stake in the company were taxed at the lowest tax rate in Singapore, and the Japanese tax authorities included the under-taxed profits in the Japanese parent company's taxable income pursuant to Japanese CFC rules. Pleading before the Tokyo High Court, the taxpayer argued that the application of the Japanese CFC rules were in contrast with Article 7 of the Japan-Singapore tax treaty. The Tokyo High Court held that the application of the Japanese CFC rules did not violate Article 7 of the treaty and therefore upheld the application of the Japanese CFC rules by the tax authorities. The taxpayer then appealed the judgment of the Tokyo High Court to the Supreme Court of Japan. The Supreme Court of Japan upheld the ruling of the Tokyo High Court. The Supreme Court observed that the purpose of Article 7 is to avoid international juridical double taxation of profits, as in the case of the Singapore enterprise resident in Japan. In the case discussed, however, the Japanese CFC rules were applicable to the income of the Japanese parent company, and not to the income of the Singaporean subsidiary. Since Article 7 of the treaty did not prohibit the taxation by the Japanese tax authorities of local Japanese companies, the taxation on the income of the taxpayer did not breach Article 7 of the treaty.

- Brazil, Brazilian Superior Court of Justice - *Companhia Vale do Rio Doce v. Federal Union* 2010

[35] Supreme Court of Japan, 29 October 2009, 2008 (Gyo-hi) No. 91

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A recent CFC case was heard by the Brazilian Superior Court of Justice (*Superior Tribunal de Justiça*) - *Companhia Vale do Rio Doce v. Federal Union*.

The issue in this case was the application of Brazilian CFC legislation to the situation when the CFC is a resident in a tax treaty country. The treaties relating to the dispute were those signed with Belgium, Denmark and Luxembourg. The decision was made in favour of the taxpayer and "the judges concluded that the article on business profits in tax treaties signed by Brazil prevents the application of Brazilian CFC legislation". However, it was recognized that the CFC legislation of Brazil should be applicable to CFCs located in Bermuda, since there is no tax treaty between Brazil and Bermuda.

According to the court ruling, "the Brazilian CFC legislation violates tax treaties and the principle of good faith that must rule international relations. The obligation to observe tax treaties, established by Article 27 of the UN Vienna Convention on the Law of Treaties (1969), was also referred to in the decision".[36]

The cases above point to divergent practices in the courts in the various countries, and different court practices even in the same country, e.g. Brazil. Compliance or non-compliance of the CFC with Article 7 thus still remains open to judicial interpretation in Kazakhstan.

4. Concluding remarks

The CFC rules in Kazakhstan do not seem to be fine-tuned at present. On the one hand, they leave room for tax avoidance by imperfect design, on the other hand they penalize legitimate investments in low-tax jurisdictions, by failing to exempt certain types of CFC companies or businesses active in those jurisdictions. For Kazakhstan, it is critical to improve the definitions of CFC entities as well as the definition of the shareholders covered by these rules, while the evident loophole

[36] Report by Sergio André Rocha, delivered on 28 April 2014, IBFD

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permitting indirect ownership of CFCs through domestic companies needs to be eliminated.

Furthermore, the rules need to provide proper compliance guidance on the classification and determination of the nature of income for the purpose of taxation of Kazakh tax residents so as to determine the applicable tax rates and rules for the determination of the tax base and the final tax liability.

The relevance of the blacklist remains to be clarified, both in respect of the omission of countries and territories that meet the statutory definition of CFCs, and also in respect of the inclusion of countries that have concluded tax treaties with Kazakhstan. Finally, the Kazakh courts still have to consider the compliance of the CFC rules with the tax treaties concluded between Kazakhstan and the countries placed on the Kazakh blacklist.

Abbreviations

CFC	Controlled Foreign Corporation
CIT	Corporate Income Tax
EU	European Union
MTC	Model Tax Convention
OECD	Organization for Economic Co-operation and Development
OECD commentaries	Commentaries on the Articles of the OECD MTC
PCA	Partnership and Cooperation Agreement
RK	Republic of Kazakhstan
Tax Code of the RK	The Code of the Republic of Kazakhstan On Taxes and Other Obligatory Payments to the budget, December 10, 2008, № 99-IV Law RK
UN commentaries	Commentaries on the Articles of the UN MTC

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