The relationship between international tax law and the domestic legal order: the case of Kazakhstan*

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1. Introduction

The history of the independent Republic of Kazakhstan begins at the end of 1991 with the dissolution of the Soviet Union. At the time of independence Kazakhstan was left with no legislative, judicial and administrative institutions and lacked the legal structure of national government[3]. As a result, some institutions and laws were inherited from the Soviet Union, while others were created to adapt the country to the market economy[4]. Kazakhstan formally accepted the laws and norms of international law recognised by the Soviet Union[5] and still continues to follow some of them[6]. Since independence, Kazakhstan has concluded many new international agreements, including 46 double tax treaties,[7] a number of agreements on administrative assistance in tax matters,[8] and several other policy-oriented agreements influencing the tax system in Kazakhstan[9].

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[3] See *Fiscal transition in Kazakhstan*, Asian Development Bank, 1999, page 27.

[4] Ibid, page 27. Up to 1995 Kazakhstan was using the tax laws it inherited from the Soviet Union. In 1995 the new tax code of Kazakhstan was adopted, which reduced the number of taxes from 46 to 11, and covered all level of taxes applicable in the country: central, oblast and local (previously regulated through different decrees and even annual budget laws).

[5] P.2, Decree of the Supreme Council of the RK dated 16 December 1991 "On the order of implementation of the constitutional law of the RK "On governmental independence of the RK".

[6] See Treaty on conventional armed forces in Europe dated 19 November 1990; Treaty on the Non-Proliferation of Nuclear Weapons dated 12 June 1968 and others.

[7] The list of tax treaties concluded by Kazakhstan, as of 25 August 2015.

[8] See list of tax-related agreements concluded by Kazakhstan.

[9] For instance the Agreement on Partnership and Cooperation with the EU, 1999.

The relationship between international agreements and domestic law in Kazakhstan has not yet been studied,[10] either from a general or a tax perspective. As a result, the objective of this article is to study the practice of Kazakhstan with respect to the application of international tax agreements. The article will start by examining the general notion of the relationship between international agreements and the domestic legal order, and the way the domestic legal order can influence the implementation of tax treaties. This general introduction will be followed by a brief overview on the development of international tax law in Kazakhstan, after which the authors will describe and analyse the domestic legal order, examining the status and rank of international treaties under the national laws of Kazakhstan and the process by which treaties are concluded and enforced. The next section will consider how tax treaties are applied and interpreted in Kazakhstan, analysing whether the practice of treaty override exists in the country, how precisely Kazakhstan applies the norms of tax treaties in general, how easy it is for the parties to apply the norms of the treaties, and the steps Kazakhstan takes to align itself to the norms of international law. The last two sections of the article will provide an overview of how the model tax treaties have influenced the tax treaties of Kazakhstan, and also put forward the view of the authors regarding the potential influence on the Kazakh tax system of the Base Erosion and Profit Shifting (BEPS) project.

2. Relationship between international law and the domestic legal order

This part introduces the basic concepts required for an understanding of the relationship between international tax law and the domestic legal order.

With respect to tax issues, the interaction between tax treaties and the domestic legal order concerns at least three factors[11]. First of all, the national legal order defines the moment in time when the tax treaty becomes binding for the state and also its form, second, it establishes the rank of the tax treaty under the national law and finally, it determines

[10] See Zh. KEMBAYEV, *International treaties realisation in the Republic of Kazakhstan*, Law and the State, No.3 (60) 2013.

[11] S. SACHDEVA, *Tax Treaty Overrides: A Comparative Study of the Monist and the Dualist Approaches*, INTERTAX, Volume 41, Issue 4, 2013.

whether the tax treaty provisions may be displaced by domestic law[12]. The way the state enters into international agreements and the rank of the agreements in the legal hierarchy in the state concerned directly influence whether the treaty can be overruled by domestic law, the core issue in the relationship between international and domestic law.

In general, regardless of the legal order of the country concerned, the underlying principle of international law is *pacta sunt servanda* – agreements should be honoured[13]. However, this principle is not always diligently applied by states and in some cases states violate their international obligations, overruling international agreements with domestic law provisions. In international law this phenomenon is known as "treaty override".

The problem of treaty override is relevant in tax law and was first addressed by the OECD in 1989[14]. The OECD defined treaty override as: the situation where the domestic legislation of the state overrules provisions of either a single treaty or all treaties hitherto having had effect in that state. Legislation may take the form of a provision that treaty provisions are to be disregarded in certain circumstances (e.g. in case of treaty shopping or other forms of abuse). Legislation can also have the effect of overriding treaties, even where no reference is made in the legislation to treaty provision as such, because the domestic interpretation of the effect of that legislation in relation to treaty provisions has the same effect in practice.

According to the study by De Pietro,[15] the OECD provided quite a broad definition of treaty override, and she argued that it may be defined as "*unilateral amendment of an international treaty through domestic legislation adopted or applied by one of the contracting states after the moment the treaty has becoming binding upon its parties*"[16]. This made it clear that treaty override can occur by means of both legislative and judicial practice. Legislative intervention takes place at the moment when the state enacts the law that contradicts the norms of the existing treaties and is

[12] Ibid.
[13] This principle is also reflected in Article 26 of Vienna Convention on the Law of Treaties
[14] OECD Committee on Fiscal Affairs, Report on Tax Treaty Override, 1989.
[15] See C. DE PIETRO, *Tax Treaty Override*, Wolters Kluwer Law & Business, 2014.
[16] Ibid, page 216.

explicitly designed to prevent the application of the treaty,[17] whereas judicial intervention occurs when the state applies the norms of domestic law, adopted after the conclusion of the treaty, thus eliminating the treaty effect.

Scholars continue to debate the treaty override issue, whether it may be justified from the perspective of anti-avoidance policy or not, and whether states are permitted to act in this way. In this connection, the OECD has sent a clear message in the Commentaries to the OECD Model Tax Convention (MTC), stating that domestic anti-avoidance provisions may apply where the objective of such provisions is to determine the facts and circumstances to ensure the tax treaty is applied in accordance with its purposes and objectives[18].

This article will not analyse in depth the notion and theory of tax treaty override, though it will consider whether this problem exists in Kazakhstan. As a result, it is necessary to define this concept for the purposes of further analysis, and explain its causes, to enable the authors to consider whether Kazakhstan is facing or will have to face this issue.

In general, treaty override is believed to exist in countries with a dualist legal system. Theoretically, dualist states usually consider national and international laws as two separate systems of law, each of which operates independently, without being able to influence and change the norms of the other[19]. As a result, a separate domestic law is usually needed to incorporate the norms of the international agreement into the domestic legal system – so that the international agreement becomes part of the domestic legal system and thus binding[20]. From the national perspective, these states consider treaty override as permitted and legitimate practice due to the *lex posterior derogat priori* principle, which provides that the law, even one incorporating the treaty into domestic law, may be amended or overruled by a national law of the same rank[21]. In this way, states unilaterally amend the international treaty and alter their international

[17] Ibid, page 217.
[18] See Commentary to Article 1 of Commentaries to OECD Model Tax Convention (MTC).
[19] D. SLOSS, Domestic Application of Treaties, 2011.
[20] Ibid.
[21] C. DE PIETRO, *Tax Treaty Override*, Wolters Kluwer Law & Business, 2014.

obligations[22]. It should be noted that these states do not explicitly claim the right to amend the treaties and in general do not aim to breach the treaties, but at the same time they reserve the right to do so, by continuing to adopt the method they used to incorporate the international law into the domestic system[23]. States are free to choose the policy to make the international agreements binding on them, but the choices they make may in fact lead to the breach of international agreements[24].

On the other hand, monist states consider international and domestic law as one system, giving priority to one or the other – international or domestic – and thus one of systems of law prevails over the other.[25] In cases in which the international legal system prevails over domestic law, which is the case for most monist states,[26] the treaty should have the effect of direct applicability, and treaty override is not considered to be legitimate.

However, this distinction is rather theoretical and it is rare to find a state that exclusively represents either the monist or dualist model[27]. Since there are various approaches to determine the monist vs. dualist model, the authors seek to apply a test to analyse the main features of each system in order to identify which features characterise the legal system in Kazakhstan.

Test 1 - Direct/indirect effect of the law: under the monist system, international agreements are incorporated into the national legal system without any legislative act, other than the act authorising the person appointed to conclude the treaty, and are thus directly applicable. On the other hand, under the dualist legal system, treaties do not have the status of the law until a legislation is enacted to incorporate the treaty into the domestic legal system.[28]

Test 2 - Interpretation of treaties by the courts: the way treaties are enacted also influences the way treaties are interpreted by the courts.

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[22] OECD Committee on Fiscal Affairs, Report on Tax Treaty Override, 1989.
[23] C. DE PIETRO, *Tax Treaty Override*, Wolters Kluwer Law & Business, 2014.
[24] The view expressed by the C. De Pietro on the basis of her work, see C. DE PIETRO, *Tax Treaty Override*, Wolters Kluwer Law & Business, 2014, p.7
[25] D. SHELTON ed., *International law and domestic legal systems: Incorporation, Transformation and Persiasion*, 2011, Oxford.
[26] See S. SACHDEVA, supra note 11.
[27] This statement is based on the report drafted by D. Shelton, see supra note 25.
[28] See D. SLOSS, supra note 19.

Formally, judges in a dualist legal system cannot refer to an international agreement directly. They need to refer to the law which incorporated the treaty and consult the related treaty only when interpreting the meaning of the law[29].

Test 3 - Rank of international agreements in the domestic system: among monist states there is a significant variation in ranking treaties within the domestic legal order. In some countries treaties are equivalent to national legislation but ranked lower than the Constitution,[30] whereas in others, treaties may be ranked even lower than domestic laws,[31] while in some states they rank higher than legislation, but lower than the Constitution,[32] and in the Netherlands treaties are ranked higher than the Constitution[33]. Equally, the rank of the treaty in the framework of national law may not be clearly established at all[34]0 In dualist systems, since no treaty has the status of law until it is incorporated into domestic law, its rank cannot be assessed, and consequently once the treaty is incorporated into the national system it acquires the rank of other domestic law.

Test 4 - Treaty override policy: based on the above discussion, under the dualist system, treaty override is a legitimate practice, whereas under the monist system, in which the norms of international law prevail, treaty override is not permitted.

Accordingly, in section 4 we will address the issue of whether Kazakhstan can be regarded as a monist or dualist state in respect of tax law on the basis of how international agreements are enforced, the rank they have in the hierarchy of laws, and whether tax treaties can be overruled by national law.

[29] Ibid. page.5.
[30] See Austria, Egypt, Germany, and the United States, analysed by D. Sloss.
[31] South Africa, Ibid.
[32] China, France, Japan, Mexico, and Poland, Ibid.
[33] Ibid.
[34] Chile, Russia, Switzerland, Ibid.

3. Brief overview of the development of international tax law in Kazakhstan

As already mentioned in the introduction, the Republic of Kazakhstan is a young state and as a member of Soviet Union it was not present as a separate actor in the international arena. Until 1991 it did not conclude tax treaties independently,[35] although formally it could do so[36].

Until its dissolution in 1991, the Soviet Union concluded a number of tax treaties, including treaties on international transport, social security contributions, as well as comprehensive income tax treaties. To the best of our knowledge the first treaty[37] was signed with Czechoslovakia on social security contributions in 1959, which is still applicable in relations between Slovakia and the Russian Federation, while the Czech Republic terminated this treaty in 2014[38]. There are many more examples of treaties concluded by the Soviet Union which are still enforced for the former member states. For example, the first income tax treaty concluded by the Soviet Union with the USA in 1973 still applies in Armenia, Azerbaijan, Belarus, Georgia, Moldova, Tajikistan, Turkmenistan and Uzbekistan, indicating that these countries opted to continue to apply the former Soviet treaties.

It is important to note that after the dissolution of the Soviet Union, the EU and some other countries were willing to recognise the newly established republics only provided that these republics were willing, *inter alia,* to formally accept the obligations of the Soviet Union under existing international agreements, and therefore for some time the tax treaties of the Soviet Union were also applicable in Kazakhstan[39]. However, Kazakhstan has not applied most of those tax treaties since 1995. This decision was based on the ruling of the Supreme Council of the RK,[40] which found that "*tax treaties concluded by the USSR no longer comply with the new political and economical requirements of the state, they do not protect*

[35] See Abaideldinov, *Соотношение международного и национального права Республики Казахстан (проблемы становления приоритетности*), Almaty, 2005.
[36] See Soviet Constitution 1977, art. 80 and Constitution of the KazSSR 1978, art. 71.
[37] Based on the data available on www.ibfd.org.
[38] Termination date: 1 November 2014, retrieved from www.ibfd.org.
[39] For more see: R. ALIMKULOV, *Theory and practice of states' legal succession: based on example of Kazakhstan*, Russian State Library, 2003.
[40] Decision of the Supreme Council of the RK No. 217-XIII dated 3 November 1994 "On double tax conventions".

the interests of the state and partially contradict the existing national tax law"[41]. In this connection the authors reviewed the Soviet tax treaties[42] and noted that they were mainly based on the OECD Model, which was probably not appropriate for a new developing state. The new treaties of Kazakhstan reserve more taxation rights for Kazakhstan, and are based on the UN Model with some modifications. Kazakhstan had and clearly still has a strong interest in receiving foreign direct investment, but is still not able to invest so much abroad as to benefit equally from OECD-based tax treaties, and this was probably one of the reasons for terminating the application of the treaties concluded by the USSR. With regard to unfavourable treaty provisions, the authors identified the following:[43]

- The treaty with Austria inherited from the USSR (entering into force 1 October 1982) contained provisions on the exclusive taxation in the state of residence of royalties, interests, dividends, and the permanent establishment threshold was 24 months.
- The treaty with Cyprus (entering into force 26 August 1983), was based on the OECD model, where additionally exclusive taxation rights were granted to the state of residence in respect of dividends and interest.
- The treaty with Italy (entering into force 30 June 1989), was based on the OECD model, where additionally, exclusive taxation rights were granted to the state of residence in respect of interest. For certain activities the permanent establishment threshold was 36 months.

Nevertheless, treaties with some countries continued to apply even after 1995 due to the special agreements concluded by Kazakhstan on the inheritance of Soviet obligations[44]. These countries included Germany,[45] France,[46] Canada[47] and Japan[48]. Treaties with these countries were formally

[41] Zh. MELDESHEV, *Cooperaion of RK with the states of the European Union in the sphere of tax law and bilateral tax treaties*, International Public and Private Law, No.6, 2005.
[42] With the use of IBFD database, available at: www.ibfd.org
[43] Based on the review of the USSR tax treaties, available at www.ibfd.org.
[44] For more see: R. ALIMKULOV, supra note 42.
[45] The treaty with Germany was terminated on 1 January 1996. The most important articles, such as articles 5, 7, 10, 11 and 12, were based on the OECD model.
[46] The treaty with France entered into force on 28 March 1987, based on the OECD model, whereas exclusive taxation rights were granted to the residence state in respect of interest,

applicable until 1 January 1996[49]. While reviewing the treaties, the authors of this article noted that treaties with Belgium[50] and Spain[51] were applicable in Kazakhstan for even longer.

Since 1995[52] Kazakhstan has concluded 46 tax treaties and continues to negotiate new ones. Treaties concluded by Kazakhstan usually have features of both the UN and the OECD model, but in many respects they adopt the principles of a developing state and aim to fairly reflect this in the treaty provisions. The impact of the OECD and UN model tax conventions on tax treaties of Kazakhstan will be analysed further in section 4 of this article[53].

It is important to note that tax treaties and other international agreements have influenced the formation of the national tax system of Kazakhstan. This will be further discussed separately in sections 4 and 5 of this article.

4. Domestic legal order in Kazakhstan

4.1 Status of international agreements

The position of international agreements within the country is governed by several laws and acts:[54]

- The Constitution of the RK;
- Regulation of the Supreme Court No.1 dated 10 July 2008 on the "Application of the international agreements of the Republic of Kazakhstan";

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the permanent establishment threshold was 24 months, and dependent person had a right to sign contracts and avoid permanent establishment status.

[47] Entering into force on 2 October 1986, based on the OECD model, with the exception that the article on royalties provided for shared taxation rights.

[48] Treaty entering into force on 27 November 1987. The treaty reflected the OECD Model with shared taxations rights on royalties.

[49] See decision of the Supreme Council of the RK, supra note 43.

[50] The treaty (entering into force on 1 January 1991) was terminated on 1 January 2000. The treaty reflected the OECD Model, in addition it provided for a 24-month permanent establishment threshold, no services permanent establishment.

[51] Entering into force on 7 August 1986 and terminated on 23 June 2010 with the effective date 8 July 2008.

[52] The paper was drafted during the spring and summer of 2015.

[53] In 2013-2014, the Central Asian Tax Research Center carried out a detailed analysis of the Kazakh Tax Treaty network, the outcomes of which will be available in: Balco, Yeroshenko and Tyurina: Tax Treaty Network of Kazakhstan – the influence of OECD and UN MTC, to be published in 2015 by the Policy Research Center, ISBN 978-80-87909-06-5.

[54] Summarised by Zh. Kembayev, supra note 10.

- Law No.54-III of 30 May 2005 on "International agreements of the RK";
- Normative regulation of the Constitutional Council No.18/2 of 11 October 2000 on "Official interpretation of Art. 4(3) of the Constitution of the RK";[55]
- Normative regulation of the Constitutional Council No.2 of 18 May 2006 on "Official interpretation of Article 54 point 7 of the Constitution of the RK";[56]
- Normative regulation of the Constitutional Council No.6 of 5 November 2009 on "Official interpretation of art. 4 of Constitution on the order to implement the decision of international organizations and their bodies";[57]

The Constitution of Kazakhstan[58] explicitly establishes the priority of international agreements over the domestic legislation once the agreement is concluded and has entered into force. This is a general rule and should apply to all areas of law.

"*International treaties ratified by the Republic shall have priority over its laws and be directly implemented except in cases when the application of an international treaty shall require the promulgation of a law*." (Constitution, Art.4) The Constitution is clear with respect to treaties and domestic law and according to Test 1 outlined in section 1, one could theoretically consider Kazakhstan as a monist state, where treaty law is regarded as prevailing and, at least in theory, treaty override should be automatically avoided.

The same rule on the supremacy of international agreements is envisaged in the Tax Code, which provides that "*where an international treaty ratified by the RK establishes other rules than those which are contained in this Code, the rules of said treaty shall apply*"[59]. This principle reflects the Constitutional norm and makes this clear in respect of all types of taxes.

[55] Constitutional Council No.18/2 of 11 October 2000.
[56] Constitutional Council No.2 of 18 May 2006.
[57] Constitutional Council No.6 of 5 November 2009.
[58] Art. 4 Constitution of the RK.
[59] Art.2 para.5 Tax Code of RK.

This is the case because the tax law in Kazakhstan is codified in a single Tax Code and the given provision is envisaged in the general part of the Code, which equally applies to all types of taxes. In formal terms, this simplifies the application of international law and extends the benefits arising from the relevant international treaties. In this respect it may be concluded that the domestic law of Kazakhstan formally respects international law and the supremacy of tax treaties would suggest that Kazakhstan is a monist state.

Court practice in Kazakhstan also formally supports this conclusion and thus meets Test 2 outlined in section 1. In 2013 a Special Regulatory Decision was handed down by the Supreme Court on judicial practice and the application of tax legislation, stating that "*International treaties entered into by the RK should prevail over the national legislation and are directly applicable*"[60].

In respect of Test 3 the relationship between international agreements and the Constitution is debated among scholars in Kazakhstan[61]. The reason is that in its national laws, Kazakhstan recognises the supreme power of the Constitution over other national laws,[62] and also the overriding power of international agreements over national laws,[63] but it does not specify whether the Constitution prevails over international agreements. In this respect some scholars believe that since Kazakhstan has not explicitly stated the precedence of the Constitution over international agreements, there is reason to believe that international agreements will prevail over the Constitution[64]. Others do not support this radical opinion and believe in the supremacy of the Constitution[65].

To understand the conflicting debate among academics, the authors of this article propose to look further into the legislation and analyse its provisions.

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[60] Para. 2, Special Regulatory Decision No.1 of the Supreme Court of the RK dated 27 February 2013 on the judicial practice and application of the tax legislation.

[61] See works of A.A. CHERNIKOV, *Right, Law, Legality*, Almaty, Yurist, 2001, p.190.

[62] Art. 4 Law of the RK on Normative legal acts.

[63] Art. 4 Constitution of the RK.

[64] See work of A.A. CHERNIKOV, *Issues on the idea of law in the constitution of the RK*, Legal reform in Kazakhstan, 2000.

[65] See M. KEMALOV, A. ORMANOVA, *Ensuring the compliance and interconnection between the international and national law by the Constitution Council*, Legal reform in Kazakhstan, No.4 (34), 2006.

According to the Constitution, the functioning law of Kazakhstan includes "*provisions of the Constitution, the laws corresponding to it, other regulatory legal acts, international treaties and other commitments of the Republic as well as regulatory resolutions of the Constitutional Council and the Supreme Court of the Republic*"[66]. International treaties comprise a part of the functioning law of the Republic. However, there is no single provision in the Constitution, nor in any other domestic law, to establish explicitly the order or hierarchy between international agreements and the Constitution.

However, what is important in the view of the authors is that the Constitution envisages that international agreements cannot be signed, ratified and enforced if it does not comply with the Constitution[67]. This provision leads the authors to believe that although there is no provision in the law explicitly stating that the Constitution prevails over international agreements, the above norm guarantees that in case of conflict of law, it should be resolved in favour of the Constitution, since international law should comply with it.

In addition, with regard to Test 4, Kazakhstan has issued a Statement of on legal policy of the RK for the period from 2010 to 2020, specifying that it will continue its efforts towards the adjustment of national legislation with the norms of international obligations and standards *to which it is a party.* However, the Statement notes that these efforts should also be governed by the internal needs and priorities of the state, without neglecting them. This position demonstrates the intention of Kazakhstan to comply with international obligations, rather than to override them by domestic provisions, but the suggestion that internal needs and priorities should be taken into consideration suggests that Kazakhstan is keeping the door open to a possible treaty override.

At the current stage of analysis considering the tests outlined in section 1, it is possible to make the preliminary observation that Kazakhstan is a monist state, but some doubts arise after examining the procedure adopted by Kazakhstan to conclude international agreements, how it implements them,

[66] Art.4, para.1 Constitution of RK.
[67] Art. 74 Constitution of RK.

and the extent to which international agreements influence the formation of national tax legislation.

4.2 Implementation of international treaties in domestic law

International agreements in Kazakhstan are concluded, applied, amended and terminated in accordance with the Constitution, the general international norms and principles of international law, the provisions of the international agreement, the Vienna Convention on the law of treaties,[68] the law on international agreements and other acts of the RK[69].

Tax treaties may be concluded either on behalf of the Republic of Kazakhstan, or on behalf of its government. Prior to the signing of the agreement, it is subject to the required procedure, including negotiation, drafting, discussion with responsible state authorities, as well as an assessment by state experts at several levels.

Above all, the (draft) international agreement is subject to an obligatory legal opinion of the Ministry of Justice of the RK[70] to ascertain the compliance of the agreement with the legislation of Kazakhstan. This also determines the way Kazakhstan will express its consent to be bound by the agreement[71].

If the draft document passes the assessment conducted by the Ministry of Justice, it is further subject to coordination with the Ministry of Foreign Affairs,[72] to assess the expediency of concluding the agreement with respect to Kazakh foreign policy. The Ministry also expresses an opinion as to whether the agreement complies with other international agreements and other international obligations of Kazakhstan.

All agreements to be ratified, including tax treaties, are subject to an obligatory academic assessment. This is done by academic or higher educational institutions to examine the quality, validity, timeliness and legitimacy of participation in the agreement; as well as the compliance of

[68] Kazakhstan has been a member since 1994.
[69] See Preamble to the Law No.54-III dated 30 May 2005 on "International agreement of the RK".
[70] Art. 3, p.1, Ibid.
[71] Art. 3, p. 1, Ibid.
[72] Art. 3, p.2, Ibid.

the agreement with the rights and freedoms guaranteed by the Constitution and its possible efficacy. The academic advisory board also looks for any possible negative consequences of the agreement, and assesses the compliance of the agreement with the norms of domestic legislation.

Once the agreement has passed this assessment and is approved by the Ministry of Foreign Affairs, it may be submitted to the President or to the government for final approval.

Additionally, tax treaties need to be ratified to enter into force[73]. Prior to ratification, treaties may be subject to review on compliance with the Constitution by the Constitutional Council[74] and only in case of compliance can they be ratified[75]. In this respect, the Constitutional Council plays an important role in the development of the legal system of Kazakhstan, ensuring the compliance of international agreements with the Constitution.

Once the ratification has been completed,[76] the international agreement is published[77] in the official gazette[78].

This means that each treaty is incorporated into domestic law through a special ratification law, so that a separate act is adopted for each treaty to enter into force. This is clearly a feature of dualist states: Kazakhstan thus displays features of both monist and dualist systems.

4.3 Application of double tax treaties in Kazakhstan

As discussed above, tax treaties have a direct effect, with direct applicability once the process of ratification is finalised and the treaty has been published in the official gazette. Thus, taxpayers and judges have a right to rely directly on the treaty provisions.

Direct applicability, however, does not mean automatic application, by which the payer of income to non-residents can apply the treaty without any further formalities. In fact Kazakhstan adopts several modes of tax treaty application. It allows automatic application with a refund mechanism

[73] Art. 11, Ibid.
[74] By request of the President, chairman of the Senate, chairman of the Mazhilis, not less than one-fifth of the deputies of the Parliament, and the Prime Minister.
[75] Art. 12 Ibid.
[76] Art. 13 and 65 p.5 Constitution of the RK.
[77] Art. 4, p.4 Constitution of the RK.
[78] Art. 24 Constitution of the RK.

by which the payer of income is required to withhold the tax and remit it to the tax authorities and the recipient can then claim a refund. It also allows for a system which is a lighter version of the refund mechanism, known as the escrow account mechanism, by which withholding taxes are deducted, then not remitted to the tax authorities, but instead paid into a special escrow bank account, from which the amount can be released if within a given period of time the non-resident obtains approval from the tax authorities to apply the tax treaty[79].

The tax treaty application regime is being gradually liberalised. With the introduction of the new Tax Code in 2009, the automatic tax treaty application procedure was further extended to situations in which previously treaty application was possible only with the authorisation of the Ministry of Finance[80].

At present the Tax Code contains a special section regulating the application of treaties[81]. This section provides a set of procedural rules stipulating the order in which the taxpayer can apply the treaty automatically or by means of the escrow account mechanism. In addition, Kazakhstan imposes additional requirements that the taxpayer needs to fulfil in order to be able to apply the treaty – for instance, special requirements to submit the certificate of residence duly legalized or apostilled,[82]which for some countries and foreign taxpayers may be difficult to satisfy[83].

Such administrative and procedural requirements in domestic law should not be considered as violating the norms of treaties since many other countries adopt rules of this kind for treaty application. However, these

[79] In historical terms the introduction of the escrow account mechanism as an alternative to the refund mechanism was caused by the difficulties of obtaining a refund, because the money so collected by the tax authorities was simply spent and there was no special budgetary procedure to ensure that these amounts were treated as funds that may need to be refunded. This led to lengthy disputes and significant delays, giving rise to complaints by foreign investors. The escrow account mechanism ensures that the funds are effectively available for refund, when the conditions for refund are met.

[80] Before 2009, the application of tax treaties was governed by the "Rules on administration of international agreements on avoidance of double taxation and prevention of tax avoidance with respect to taxes on income and capital, concluded by the Republic of Kazakhstan", which allowed the automatic application of treaties only with respect to income paid to non-residents in the form of dividends, interest, royalties, income paid for short-term services (not exceeding five days) and services performed abroad.

[81] Chapter 26, Special provisions concerning international treaties, Tax Code of RK.

[82] Art. 219, Tax code of RK.

[83] Recent case on issues with certificate of residence 3гп-343-15, dated 30 June 2015.

additional requirements may be considered as limiting the rights of taxpayers envisaged by the treaties, especially where the tax authorities deny treaty benefits merely because of a failure to meet a specific formality. While these domestic law requirements serve to ensure the legitimate application of treaties and prevent treaty abuse, there have been reported cases where the courts have also denied the treaty benefits, because the taxpayer failed to obtain a certificate of residence within a certain timeframe. Even where the certificates of residence were submitted, but with a certain delay, the tax treaty benefits were denied by the tax authorities and this approach was upheld by the courts[84]. This practice is controversial and one could consider the extent to which such administrative practices are permissible to deny the legitimate tax treaty benefits and whether this practice could effectively represent a treaty override.

4.4 Interpretation of tax treaties

Difficulties also arise in relation to the interpretation of tax treaties especially in cases in which the rules of the tax treaty are different from the rules of the domestic law. As noted by Porokhov, although the Constitution and the Tax Code clearly provide for the supremacy of tax treaties, the tax authorities and the courts manage to neutralise the effect of treaties due to "real or artificial" problems they may encounter in understanding and interpreting the treaty. Tax treaties by their very nature are difficult to understand, but what makes them even more challenging in the case of Kazakhstan is that there is no official mechanism to interpret the treaties[85]. The current normative regulation of the Supreme Court on the interpretation of treaties provides that in cases in which there is a need to interpret technical or legal issues when applying the treaty, reference may be made to "acts and decisions of the international organizations" of which Kazakhstan is a member, and the matter may be referred to the Ministry of

[84] The problem of administrative requirements to the certificate of residence was addressed by A.Daumov, "Как избежать налоговых проблем по сделкам с иностранными контрагентами? Практические советы", September 2015.
[85] Y. POROHOV, *International taxation in Kazakhstan and practice of administering international tax treaties of the Republic of Kazakhstan,* Yurist, 2012 (12).

Foreign Affairs, the Ministry of Justice or the General Prosecutor's Office to clarify issues relating to the validity of the treaty, the list of participating countries, any reservations made by participating countries, as well as international judicial practice on the application of the treaty concerned[86].

To the best of the authors' knowledge, Kazakhstan has limited experience in applying or at least referring to international practice. First of all, international practice is often difficult to access especially for state officials (due to language barriers, for example). Additionally, the standard approach of the national authorities to the interpretation of national law in a literal approach and this makes it difficult to interpret the international law in any other way, seeking to identify the purpose of the law rather a literal interpretation.

It is not only tax officials who are responsible for this approach, but also taxpayers: they are rarely proactive, in the sense that they tend not to consider international practice and bring it to the attention of the officials, and they also tend not to exercise their rights to refer international practice to state bodies as envisaged in the normative regulation of the Supreme Court.

Except for the normative regulation of the Supreme Court referred to above, there is no other official state guidance on interpretation that would cast light on the content of the treaties, similar to the commentaries of the OECD and UN models.

However, until 2009 an Instruction was in place in Kazakhstan providing official guidelines on the order of application of double tax treaties[87]. This Instruction was issued with the sole purpose of interpreting the general principles laid down in treaties, though it explicitly provided that each individual case should be considered in accordance with the treaty governing it[88]. Nevertheless, during the period when the Instruction was in

[86] Para. 16 of the Regulation of the Supreme Court No.1 dated 10 July 2008 on "Application of the international agreements of the Republic of Kazakhstan".

[87] The Instruction on application of double tax conventions on avoidance of double taxation and prevention of avoidance of taxes on income and capital, passed by the joint order of Ministry of Finance No.643 dated 2 December 1999 and Ministry of State Revenue No. 1478 dated 2 December 1999. The Instruction was in force for 10 years from 1999 till 2009.

[88] See for instance the following articles of the Instruction: article 2(2), 3(5), 5(15), 7(31), etc.

force, there were legal concerns that when interpreting treaties the courts (and also the tax authorities) limited themselves to the provisions envisaged in the Instruction and the special section on tax treaties in the Tax Code. This could have been considered as contrary to the main purpose of tax treaties and the interests of the contracting states to balance their own interests and those of taxpayers[89]. The Instruction was repealed in 2009 with the entry into force of the new Tax Code. The reasons for repealing the Instruction related to the efforts of the Government to reduce the secondary sources of legislation, ensuring that all the relevant rules were contained in one legal source, the Tax Code[90]. Despite this rationale, the Instruction contained sections which effectively served as a commentary, often taking the statements and concepts from the Commentaries of the OECD and UN MTC. Thus the authors of this article are of the opinion that the repeal of the Instruction is a loss for Kazakhstan.

It should also be noted that neither the tax authorities nor the courts refer to commentaries on the model tax treaties in their official position. From a certain point of view this may be justified, since Kazakhstan is not a member state of the OECD and is not required to comply with its commentaries. This argument, however, would not be an excuse for not failing to comply with the commentaries on the UN model, since Kazakhstan has been a member of the UN since 1992 and the Regulation of the Supreme Court provides for the right of the parties to do so[91].

With regard to Russian practice in this respect, according to the recent study conducted by the PWC office in Russia,[92] in practice the Russian courts have started to refer more often to the OECD commentaries as the source of interpretation of the treaties[93]. From the authors' point of view, this tendency may have a positive influence on the interpretation of tax treaties also in Kazakhstan, due to the close policy, economic and social

[89] Zh. KASYMBEKOVA, Application of double tax treaties to tax disputes, Kazakhstan No.3, 2005.
[90] Decree of the Minister of Finance No.5 dated 9 January 2009 on invalidating several normative regulatory acts.
[91] Para. 16, supra note 90.
[92] See PWC report No.35 (353) dated October 2013, available at
[93] See the following cases: № A40-65284/11-91-279, № A33-7550/2012, № A56-67691/2012. In addition refer to the report prepared by PWC, supra note 96.

relations between the two countries and the exchange of ideas, as well as being an inspiration for administrative and judicial practice. It will however mainly be at the initiative of taxpayers who will need to start citing the provisions of the UN Commentaries and other evidence that can suggest that the interpretation and application of the tax treaties by the tax authorities is not in line with the purpose and objectives of the treaty.

4.5 Application of treaties in terms of administrative cooperation

4.5.1 Mutual Agreement Procedure (MAP)

The absence of procedural rules in double tax treaties and the corresponding internal regulations gives rise to another problem for Kazakhstan with respect to the realisation of certain rules provided in the treaties. This is the case in particular for the Mutual Agreement Procedure (MAP) envisaged in Article 25 of the model treaty. This procedure is also envisaged in the Tax Code of Kazakhstan,[94] though until the changes in July 2011, the Code did not comment on the status of decisions reached as part of the Mutual Agreement Procedure[95]. The current version of the Tax Code provides that decisions reached as part of the MAP should be obligatory for the tax authorities to implement[96]. On this point, the Tax Code does not provide further details about whether the MAP will also prevail over any court rulings handed down about whether the taxpayer could be simultaneously involved in the MAP and domestic legal proceedings, and whether the tax audit or decisions of the tax authorities should be postponed in cases in which an MAP is initiated. These are probably the questions that will be answered when the MAP becomes more frequently used in Kazakhstan.

4.5.2 Agreements on the Exchange of Information

In addition to comprehensive tax treaties for the elimination of double taxation, Kazakhstan has concluded a number of agreements on

[94] Art. 226 Tax Code of the RK.
[95] This was initially noted by Y. POROHOV, supra note 89.
[96] Art.226, p.13 Tax Code of the RK.

administrative assistance and the Exchange of Information on tax matters[97]. In addition to agreements with neighbouring countries,[98] Kazakhstan recently concluded the Multilateral Convention on Mutual Administrative Assistance in Tax Matters[99]. However, the effectiveness of these agreements, and especially of the Multilateral Convention, was recently questioned by the Global Forum review, which issued its report on Kazakhstan in May 2015 (Phase 1 report)[100]. The Phase 1 report noted that Kazakhstan lacks crucial elements of the legal framework required for effective implementation of the international standards for the Exchange of Information. In particular, domestic law restricts access to banking information. Additionally, it was pointed out that in Kazakhstan domestic legislation does not have a provision allowing the relevant authorities to gather tax information upon request, when there is no domestic tax at stake and no provision under the treaty similar to paragraph 4 of article 26: at least this point was not clear to the review committee of the Global Forum. Finally, legislation in Kazakhstan does not provide for sanctions in cases in which the taxpayer refuses to provide the information requested by the tax authorities when there is no Kazakh tax at stake. Finally, Kazakhstan provides for the protection of information held by lawyers and notaries without exception and this does not comply with international standards[101]. Within the Global Forum Initiative, Kazakhstan was blocked[102] from accessing Phase 2 as long as the deficiencies in national legislation are not rectified in compliance with international standards. It is interesting to consider whether Kazakhstan will take measures to comply with these requirements but this appears to be doubtful.

[97] In total Kazakhstan has 10 agreements of this kind, while several of them are multilateral.
[98] In total there five agreements on cooperation and mutual assistance in tax matters with the neighbouring countries: two multilateral agreements between the CIS and three bilateral ones, concluded by Kazakhstan with Russia, Belarus and Azerbaijan. Further information and text of the conventions available at: http://kgd.gov.kz/ru/content/mezhdunarodnye-dogovory.
[99] Convention signed on 23 December 2013 and entering into force on 1 August 2015.
[100] Report on Kazakhstan in May 2015.
[101] See http://www.oecd-ilibrary.org/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-kazakhstan-2015_9789264233560-en
[102] Ibid.

4.5.3 Court practice

From the practice of the Supreme Court of Kazakhstan, it may be observed that judges tend to refer to the norms of tax treaties as the source of law regulating and applicable to the situation, but this does not prevent them from interpreting the provisions of the treaties in a way that at times fails to take account of the object and purpose of the treaty[103].

As an example of court practice, the authors of this article wish to refer to the court case decided in 2012 with respect to the applicability of the tax treaty provisions to partnerships[104]. The case involved a US fiscally transparent partnership, which was treated as opaque in Kazakhstan. The partnership carried out activities in Kazakhstan through the local subsidiary, and according to domestic law was subject to a special profit tax on its after-tax profits in Kazakhstan at the rate of 15%, but could apply for the reduced rate of 5% provided by the US-Kazakhstan tax treaty. The matter at issue was whether the residence of the partnership could be determined in accordance with the residence of its partners. Although the text of the treaty provided for this,[105] the Supreme Court refused to accept the certificate of residence of the partners instead of the certificate of residence of the partnership, and refused to grant the treaty benefits. The decision was clearly based on an incorrect interpretation of the norms of treaty.

This was not the only example of an incorrect interpretation of the treaty with respect to partnerships and it triggered a Mutual Agreement Procedure, which led to Kazakhstan and the USA concluding an agreement in 2015 clarifying the application of treaties to partnerships, which clearly provides, though repeating the treaty provisions, that the residence of a partnership should be determined in accordance with the residence of the partners.

There have also been other cases in which the interpretation of the tax treaties by the Supreme Court is questionable. Among recent cases, mention should be made of the cases dealing with the allocation of head

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[103] For example, cases No. 3r-2122-12 or No.104/6-11 available at: www.ibfd.org

[104] For details of the case see T. BALCO, *Kazakhstan – NWKC Case*, published in 2013 by Linde Verlag, as a book chapter in *Tax Treaty Case Law around the Globe 2013* edited by Lang and Kemmeren.

[105] Art.4 p.1(1) provided: "*In the case of income derived by a partnership, trust, or estate, residence is determined in accordance with the residence of the person liable to tax with respect to such income*".

office expenses[106]. On the other hand, there are cases where the RK Supreme Court has been willing to consider new arguments, also in connection with discriminatory thin-capitalisation rules[107]. This also relates to issues of Beneficial Ownership, but the first case, where the Supreme Court addressed the issue of whether the recipient is or is not a Beneficial Owner, was addressed in the back-to-back royalty arrangement[108].

4.6 Domestic anti-avoidance rules and tax treaties

There are several special articles in the Tax Code of Kazakhstan, which may deny the treaty benefits to the taxpayer. These articles were introduced as domestic tools to prevent treaty shopping, and in particular include the rule similar to the Limitation of Benefits (LoB) clause and domestic definition of beneficial owner. In the following we briefly consider these provisions.

Article 206 of the Tax Code lays down basic requirements for the application of the treaty. Accordingly, there is a need to be resident of one or both contracting states to benefit from the treaty, as required by Article 1 in both models. The second part contains the anti-treaty shopping rule and reads as follows:

> 1. The provisions of the tax treaty should apply to persons who are residents of one or both of the contracting states.
> 2. The above paragraph should not apply to residents who are using the provisions of tax treaties for the benefits of a person who is a not a resident of the state with which the tax treaty was concluded.

In theory this article could prevent the application of treaties in the case of treaty shopping. In general, such a provision in domestic law can result in judicial treaty override[109]. However, to the best of the knowledge of the

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[106] See T. BALCO, *Kazakhstan – Allocation of Head Office Expenses to Permanent Establishments*, published in 2012 by Linde Verlag, as a book chapter in "Tax Treaty Case Law around the Globe 2012" edited by Lang and Kemmeren.
[107] See T. BALCO, *Kazakhstan – ATF Bank Case*, published in 2011 by Linde Verlag, book chapter in "Tax Treaty Case Law around the Globe 2011" edited by Lang and Kemmeren, ISBN number: 978-3-7073-1935, also published by Kluwer under ISBN 9041138765
[108] See T. BALCO, *Kazakhstan: The Oriflame Case – Beneficial Ownership in Sub-Licence Arrangements*, published in 2014 by IBFD, Amsterdam, book chapter in "Tax Treaty Case Law around the Globe 2014" edited by Lang and Kemmeren.
[109] C. DE PIETRO, *Tax Treaty Override*, Wolters Kluwer Law & Business, 2014. page 21.7

authors, the tax authorities have not invoked this provision so far and thus the judges have never had to address the question of its applicability.

In the view of the authors, it may be beneficial for the state to adopt an article of this kind in domestic law, since even if it is not invoked, it may serve as a deterrent especially for developing countries that do not have resources for the renegotiation of tax treaties and this article may serve as a limitation of benefits clause.

With regard to anti-treaty shopping provisions, of the 46 treaties concluded by Kazakhstan, only 10 contain some kind of Limitation of Benefits clause[110].

The domestic law of Kazakhstan also emphasises the beneficial ownership requirement in respect of income paid to non-residents in the form of dividends, interest and royalties[111]. The law provides that the tax agent may be eligible to directly and independently apply the provisions of the tax treaty if the recipient of the income concerned is the beneficial owner of such income and is a resident of the state with which the treaty was concluded. In addition, the Tax Code also provides the definition of beneficial owner for the purposes of this rule.

The beneficial (actual) recipient (owner) of income shall be a person who has the right to own, use and dispose of the income and is not an intermediary in respect of such income, including an agent or nominee holder.

Nevertheless, the article provides that in cases in which the income is paid through an intermediary and further transferred to the beneficial owner who is resident in a state with which Kazakhstan has concluded a tax treaty, the benefits provided by the treaty may be granted to the beneficial owner, provided that certain administrative requirements are complied with[112].

To the best of the knowledge of the authors the issue of Beneficial Ownership has been raised in two cases: the *ATF* [113] and *Oriflame* cases[114].

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[110] See tax treaties of Kazakhstan with the USA, Italy, Canada, Estonia, Latvia, Lithuania, Sweden, Turkey, the UK, and Luxemburg.
[111] Art. 212-1, p.1 Tax Code of the RK.
[112] Art. 212-2, p.2 Tax Code of the RK.
[113] See T. BALCO, *Kazakhstan – ATF Bank Case*, supra note 111.
[114] See T. BALCO: *Kazakhstan: The Oriflame Case*, supra note 112.

With regard to General Anti-Avoidance Rules (GAARs), Kazakhstan does not yet have such rules, even though there have been several attempts to introduce them, most recently in 2013, and currently the debates and efforts continue[115].

Kazakhstan is a civil law country, and thus, even though different kinds of avoidance may take place, the judicial system cannot challenge them without the proper rules provided by the legislator. While the Civil Code of the RK contains several principles that can be contemplated as anti-avoidance and anti-abuse principles,[116] they have not been invoked in tax-related matters.

As a result, there has been no opportunity to witness the interaction of domestic law with tax treaty provisions, in which domestic law would prevail over the treaty provisions.

5. Impact of the OECD and UN Models on Kazakh tax treaties

In 1992 Kazakhstan signed an agreement[117] with the other Commonwealth of Independent States (CIS) countries on the common principles of national tax policies, undertaking to follow a common model of bilateral tax treaties (the CIS Model), based on the OECD model enacted at that time.[118] However, on the basis of a review of Kazakh tax treaties, it may be noted that Kazakhstan does not follow the CIS Model and concludes treaties that deviate significantly from the established model. In addition, they are often based on the UN model[119].

In this sense Kazakhstan is not only avoiding the common principles of the unified model, but also that of other CIS countries, which prefer to be

[115] Retrieved from the note of Association of the Taxpayers of Kazakhstan.

[116] For example, the good faith principle, the prohibition of the abuse of law, the invalidation of transactions in case of attempts to evade tax liability, and the sham transactions doctrine.

[117] Agreement dated 13 March 1992 between CIS members on *Coordinated principles of tax policies*.

[118] Protocol dated 15 May 1992 on *Unification of approach to enter into agreements on avoidance of double taxation on income and capital*.

[119] For example, the CIS model provides for a Permanent Establishment (PE) in the construction industry to be set up if the threshold of 12 months is exceeded, while in some of its treaties Kazakhstan adopts a six-month threshold. Additionally, Kazakhstan systematically includes the service PE (Permanent Establishment) provisions inspired by the UN model. Another significant deviation is that Kazakhstan does not follow the residence-based taxation envisaged in the CIS model for the taxation of royalties.

guided by their own political agenda, sovereignty and investment interests. This important aspect, justifying the deviations from the CIS model, is also specific to bilateral relations in which the tax treaty partners bring their own models to negotiation and are looking for a compromise.

In the following the authors provide an overview and comment on the most important articles in the Kazakh treaties[120].

In article 5, Kazakhstan follows the UN Model in most of the treaties and systematically includes the provisions inspired by the UN Model on services PE[121]. In a limited number of treaties, Kazakhstan reduces the PE threshold to six or nine months for certain activities,[122] and excludes the term "delivery" from paragraph 4 on auxiliary and preparatory activities.[123] Additionally, some treaties include a paragraph on insurance services.[124] In this connection, the clear influence of the UN model is only evident with respect to PEs in the service sector.

In article 7, the UN Model once again had a great influence. The force of attraction rule is adopted in 22 out of the 44 treaties reviewed.[125] Neither of the treaties have been concluded or updated in accordance with the recent OECD model. Additionally, paragraph 3 in 30 tax treaties of Kazakhstan,[126] similar to the UN model, prohibits the deduction of royalties, management fees and other types of expenses incurred by a PE to buy services from the

[120] With respect to tax treaties in 2013-2014, the team of Central Asia Tax Research Centre (CATRC) has been working on a Tax Treaty project for the purpose of reviewing and comparing existing tax treaties concluded by Kazakhstan with the OECD and UN models in order to identify which model has the greatest influence on the tax treaty policy of Kazakhstan. For the purposes of this article, the authors have used the materials prepared by the CATRC team to refer to and comment on the most important treaty articles.

[121] See tax treaty with Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, China, Czech Republic, Estonia, Finland, France, Georgia, Germany, Hungary, India, Iran, Italy, Korea, Kyrgyzstan, Latvia, Lithuania, Malaysia, Moldova, Mongolia, Netherlands, Norway, Pakistan, Poland, Romania, Russia, Singapore, Slovakia, Tajikistan, Turkey, Ukraine, Uzbekistan, Sweden, Switzerland, the UK and the USA.

[122] See tax treaty with Armenia, Azerbaijan, Bulgaria, Estonia, Georgia, Latvia, Lithuania, Malaysia, Moldova, Norway, Pakistan, Slovakia, Tajikistan and Ukraine.

[123] See tax treaty with Bulgaria and Iran.

[124] See tax treaty with Iran, Mongolia, Romania and Spain.

[125] See tax treaty with Armenia, Canada, Czech Republic, Georgia, Hungary, Iran, Italy, Kyrgyzstan, Moldova, Mongolia, Norway, Pakistan, Poland, Romania, Russia, Slovak Republic, Sweden (in between the UN and OECD models), Tajikistan, Turkey, Ukraine, the USA, and Uzbekistan.

[126] Armenia, Belgium, Bulgaria, Canada, China, Czech Republic, Estonia, Finland, France, Georgia, Hungary, India, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, Netherlands, Norway, Pakistan, Poland, Romania, Russia, Slovak Republic, Sweden, Tajikistan, Turkmenistan, Ukraine, United States, Uzbekistan.

parent company. In almost all the tax treaties Kazakhstan follows paragraph 4 inspired by the 2008 OECD version, which provides that no profits should be attributed to the PE by reason of the mere purchase by that PE of goods for the parent company.

In article 12, Kazakhstan almost exclusively[127] uses the UN model for paragraph 1, allowing the taxation of royalties in the country of source. Also, in most of the treaties,[128] the definition of royalties in paragraph 2 is based on the UN model and in addition to the definition given by the OECD it includes "for the use of, or the right to use, industrial, commercial or scientific equipment".

In article 13, Kazakhstan has adopted a rather unsystematic approach. In paragraph 4, Kazakhstan follows the OECD[129] approach in 10 treaties and the UN approach in 19[130] treaties, whereas in some treaties[131] the usual wording of paragraph 4 is missing, thus giving the remaining taxation rights to the state of residence of the taxpayer even in the case of the sale of shares of land and companies with substantial real-estate assets. Some treaties follow the UN model in paragraph 5[132] and thus reserve the right to tax income from capital gains to the source state in the case of the sale of shares by non-residents in certain circumstances.

Article 23 for the elimination of double taxation follows the credit method in all of the treaties, similar to domestic law.

In article 25 on Mutual Agreement Procedures (MAP), Kazakhstan, inspired by the OECD model, has provisions on arbitration only with several countries: Canada, France, Pakistan, Switzerland, Tajikistan and the USA. This provision, however, does not follow any of the MTC provisions.

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[127] See tax treaty with Mongolia, which follow the OECD Model in article 12, paragraph 1.

[128] Armenia, Azerbaijan, Belgium, Belarus, Bulgaria, Canada, China, Czech Republic, Estonia, Finland, France, Germany, Georgia, Hungary, India, Iran, Italy, Japan, Korea, Kyrgyzstan, Latvia, Lithuania, Malaysia, Moldova, Mongolia, the Netherlands, Norway, Pakistan, Poland, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Tajikistan, Turkey, Turkmenistan, Ukraine, the UK, the USA and Uzbekistan.

[129] See tax treaty with Armenia, China, Finland, Germany, India, Iran, Japan, Korea, Spain, and Switzerland.

[130] See tax treaty with Belgium, Bulgaria, Canada, Czech Republic, Georgia, Kyrgyzstan, Moldova, the Netherlands, Norway, Pakistan, Poland, Singapore, Slovak Republic, Sweden, Tajikistan, Turkmenistan, Ukraine, the UK and the USA.

[131] See tax treaties with Austria, Azerbaijan, Belarus, Estonia, France, Hungary, Italy, Latvia, Lithuania, Mongolia, Romania, Russia, Turkey and Uzbekistan.

[132] See tax treaties with Canada, Finland, India, Japan, the Netherlands, Norway, Spain, Sweden, the UK and the USA.

With respect to article 26 on the exchange of information, many Kazakh tax treaties[133] deal with the exchange of information only in respect of taxes that are covered by the convention, but do not extend the scope to other types of taxes as envisaged by the OECD and UN models. In the opinion of the authors, this may be indicative of the general perspective of Kazakhstan towards the exchange of information.

Finally, with respect to article 27 on administrative cooperation, in many tax treaties concluded by Kazakhstan this article is missing[134].

Kazakhstan is eager to join the OECD and this may also mean greater willingness on the part of Kazakhstan to take on board OECD policy recommendations. Naturally, this will not be reflected in the existing tax treaty network since those treaties have been already negotiated. Moreover, Kazakh policy-makers are conscious of the potential revenue losses arising from the conclusions of tax treaties based solely on the OECD Model Tax Convention. As a result, it may be expected that Kazakhstan will continue to include in its tax treaties provisions based on the UN MTC.

6. Possible impact of BEPS actions on the tax system in Kazakhstan

Kazakhstan is not a member of OECD, but monitors its policy recommendations. The recommendations of the OECD in the Base Erosion and Profit Shifting (BEPS) project will not have a binding effect in Kazakhstan, unless it decides to take part in the multilateral instrument which is currently being negotiated.

The authors of this article believe that some of the recommendations discussed could be also beneficial for Kazakhstan to adopt, especially since they provide for enhanced tax base protection features.

Moreover, at the beginning of 2015 Kazakhstan and the OECD signed a Memorandum of Understanding on the Kazakhstan cooperation programme

[133] See tax treaty of Kazakhstan with Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, China, Czech Republic, Estonia, France, Germany, Hungary, Georgia, India, Iran, Italy, Korea, Kyrgyzstan, Latvia, Lithuania, Mongolia, the Netherlands, Norway, Poland, Romania, Slovakia, Sweden, Tajikistan, Turkmenistan, Ukraine and the USA.

[134] See tax treaties with Austria, Azerbaijan, Belarus, Bulgaria, Canada, China, France, Georgia, Germany, Hungary, Italy, Korea, Latvia, Lithuania, Malaysia, Moldova, Mongolia, Pakistan, Poland, Russia, Singapore, Slovak Republic, Tajikistan, Turkey, Ukraine, the UK, the USA and Uzbekistan.

for 2015-2016. The memorandum is not publicly available, but what is known from news reports is that Kazakhstan is the fourth developing country to sign this type of memorandum with the OECD. The Country Cooperation Programme provides for reforms and implementation of major projects in key areas of socio-economic development. In addition, the programme is intended to provide "Kazakhstan with an opportunity to join a number of the OECD's declarations and recommendations and participate in the work of its divisions" during the coming two years.

With respect to the BEPS action plan, we propose to examine each action, and to comment on the approach that Kazakhstan may take.

Action 1 - Address the tax challenges of the digital economy[135]*.*

This action is intended to address the challenges associated with taxation of income deriving from the digital economy. The OECD notes that with the current level of technological and e-commerce development, the modes of doing business have also changed and thus in many cases companies can provide goods services and derive profits from other countries without being physically present there and thus avoid taxation in the source countries. The OECD proposes to reconsider the current approach towards taxation of such income, and in particular change the current understanding of permanent establishment, introduce a concept such as "significant digital presence", and to impose a withholding tax on digital transactions.

With respect to indirect taxation, the OECD recommends that countries should consider implementing the OECD International VAT/GST Guidelines in place of taxation for business-to-business supplies of services and intangibles and enforce the collection of VAT on cross-border sales to individuals. There has been only limited discussion about e-commerce in Kazakhstan. As of now Kazakhstan has not adopted any specific e-commerce tax provisions.

Action 2 Neutralise the effects of hybrid mismatch arrangements[136]*.*

This action aims to address the problem of double non-taxation and long-term tax deferral resulting from hybrid mismatch arrangements*,* with the

[135] OECD (2014), *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[136] OECD (2014), *Neutralising the Effects of Hybrid Mismatch Arrangements*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

same instrument or the same legal entity taxed differently by two contracting countries. The possible measures recommended by the OECD were the linking rules, seeking to align the tax outcomes for the payer and payee under a financial instrument; the introduction of domestic GAARs that would prevent different countries from simultaneously treating the same person as resident, or the adjustment to paragraph 3 of Article 4 encouraging countries to enter into Mutual Agreement Procedures (MAP) to avoid the problem of double residence or double non-residence.

Kazakhstan does not have any special rules to deal with hybrid instruments. In fact, the current framework permits tax base erosion and profit shifting using such instruments. Similarly, in respect of hybrid entities, Kazakhstan does not currently have any special rules to address the taxation issues arising from hybrid entities and this is also an issue in tax treaty application cases[137].

Action 3 – Improving the current CFC regime[138]*.*

Action 3 addresses the problem of base erosion and profit shifting using Controlled Foreign Company (CFC) rules. For countries that do not yet have CFC rules, the OECD recommends introducing these rules in domestic tax law, while for countries that have already adopted these rules, the OECD recommends strengthening them in a particular way. For instance, the OECD recommends reconsidering the definition of what should be considered CFC rules, so that different forms of transparent entities and permanent establishments will be covered by the rules. It would thus be possible to lower the threshold requirements, ensuring that the definition of control includes not only legal control, but also economic management, as well as ensuring that legislation provides rules for calculating income, and attributing and preventing double taxation.

Kazakhstan already has CFC rules in place and these rules have been recently analysed by the present authors[139]. It is a well known fact that a number of wealthy Kazakh citizens and tax residents own companies in offshore jurisdictions, but so far there have been no reported cases of the

[137] T. BALCO: *Kazakhstan – NWKC Case*, supra note 108.
[138] OECD Discussion draft "Strengthen CFC rules", OECD 2015.
[139] See BALCO, YEROSHENKO, *A Critical Analysis of CFC Legislation in Kazakhstan: Practical Challenges and Legislative Issues*, *European Tax Studies Review*, August 2014.

application of these rules on individuals. In the light of recommendations of Action 3, Kazakhstan may review and further improve the CFC legislation.

Action 4 Limit base erosion via interest deductions and other financial payments[140]*.*

Action 4 aims to create and promote a new rule that would effectively combat the problem of excessive interest deductibility and also ensure that there are no gaps left in domestic legal systems for the double non-taxation of interest. The measures discussed include EBITDA (Earnings Before Interest, Taxation, Depreciation and Amortisation), the group-wide rule, the fixed-ratio approach, and various combinations of these rules.

Kazakhstan adopts thin-capitalisation rules, based on the debt-to-equity ratio, that can be easily circumvented by increasing the equity portion of the financing. In the past, thin-capitalisation rules in Kazakhstan applied only to cross-border transactions, although there was potential for aggressive tax planning also in domestic situations. After the Supreme Court ruled that such rules violate the non-discrimination provisions of the tax treaty,[141] they have been changed to apply also to domestic transactions. The BEPS recommendations could further enhance the thin-capitalisation rules in Kazakhstan and the EBITDA approach appears to be the most suitable solution.

Action 5 Counter harmful tax practices more effectively, taking into account transparency and substance[142]*.*

Action 5 addresses harmful tax regimes and practices. It seeks to ensure transparency and to make sure that such tax regimes do not apply where proper functional substance is lacking.

In this respect, Kazakhstan does not operate a specially designed harmful tax regime, though it allows special tax holidays and also special economic zones, where companies can benefit from a 100% tax exemption for 10 years or more. These regimes contain certain substance requiremements,

[140] Based on the OECD documents.
[141] See T. BALCO, *Kazakhstan – ATF Bank Case*, supra note 111.
[142] OECD (2014), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

mainly with reference to the percentage of turnover, that must be generated from activities taking place in such special economic zones.

While Kazakhstan does not currently play "dirty and harmful" tax games, it can be exposed to such a practice from other countries around the world. Action 5 fails to provide measures to counter such tax regimes, and as a result it does not provide much guidance for Kazakhstan.

Action 6 Prevent treaty abuse[143]*.*

This action aims to introduce or, where appropriate, strengthen measures aiming to prevent treaty abuse. In particular the measures should tackle transactions involving low-taxed subsidiaries of a multinational company, conduit companies, and the artificial shifting of income through transfer pricing arrangements. The measures discussed included the introduction of Limitation of Benefits clauses in tax treaties, the introduction of the Principal Purpose Test, or a combination of the two. Countries are also advised before entering into new treaties to evaluate whether the treaty is needed, especially with countries with preferential rates or no tax, and to reconsider the existing ones.

As discussed earlier, 10 out of 46 treaties contain some sort of Limitation of Benefits clause. Furthermore, Kazakhstan has a domestic anti-treaty shopping rule. The recommendations from Action 6 fall short of addressing the domestic law measures, apart from acknowledging their compliance with tax treaties, but some of the recommendations from this Action could inspire Kazakhstan to include a comprehensive Limitation of Benefits clause in its tax treaties.

Action 7 Prevent the artificial avoidance of PE status[144]*.*

This action should develop changes to the definition of the Permanent Establishment (PE) under the tax treaties to prevent the artificial avoidance of PE status, including transactions through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues should also address issues relating to profit attribution.

[143] OECD (2014), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[144] Based on the available OECD documents.

The practice of avoiding PE status by multinationals is common in Kazakhstan. While Kazakhstan adopts a definition of Agency PE in its domestic law,[145] there are no reported cases in which the tax authorities would challenge any company to have an Agency PE. We can however note that Kazakhstan is addressing the avoidance of the services and construction PE by contract fragmentation and has an extended definition of a related project,[146] which includes contracts that have continuity features and contracts concluded by related parties.

Action 8, 9 and 10 TP outcomes of BEPS project: Ensure that Transfer Pricing outcomes are in line with value creation[147]*.*

These Actions aim to strengthen the application of the arm's length principle to prevent BEPS through transfer pricing arrangements. This should mainly be achieved by amending the provisions of the OECD Transfer Pricing (TP) guidelines, in particular, amending chapters in respect of TP documentation – introduce requirements for global master files and country-by-country reporting, as well as a chapter on intangible property to ensure that transfer pricing outcomes are in line with value-creating activities.

Kazakhstan does have transfer pricing rules and is quite aggressively enforcing them and further elaborating them, mostly in respect of the extractive industry. In this respect, the OECD recommendations addressing commodity transactions could be of relevance to Kazakhstan. Furthermore, the attention to substance, functions and the effective management of risks could also be a useful inspiration for Kazakhstan. In respect of Action 10, Kazakhstan is likely to have an issue with the simplified procedure for the allocation of head-office expenses, where it clearly insists on benefit tests and extensive formalities, which multinationals would wish to minimise[148].

Action 11 Establish methodologies to collect and analyse data on BEPS and the actions to address it[149]*.*

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[145] Art. 191 Tax Code of the RK.
[146] Ibid.
[147] OECD (2014), *Guidance on Transfer Pricing Aspects of Intangibles*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[148] See supra note 111.
[149] Based on the available OECD documents.

This action seeks to ensure that losses to state budgets can be identified and measured. and to quantify the improvement and implementation of countermeasures.

Kazakhstan does have some statistical, monitoring, forecasting functions and capacities established by the Ministry of the Economy, but they are not currently tailored to address Base Erosion and Profit Shifting issues.

Action 12 Require taxpayers to disclose aggressive tax planning arrangements[150]*.*

Action 12 aims to design special rules for the obligatory disclosure of aggressive or abusive transactions, arrangements, or structures by taxpayers. The main purpose of these rules is to provide early information regarding tax planning schemes and to identify the promoters and users of these schemes. During the discussion it was proposed to make the disclosure and exchange of rulings of tax authorities obligatory between states, to introduce additional reporting obligations in some states, along with surveys and questionnaires, voluntary disclosures and co-operative compliance programmes.

Except for reporting obligations relating to CFC legislation and transfer pricing reporting obligations for major taxpayers, Kazakhstan does not have any special disclosure rules in place. The recommendations of Action 12 can certainly be an inspiration for Kazakhstan, though the question is to what extent such disclosure rules would actually be followed by taxpayers and their advisers.

Action 13 Re-examine transfer pricing documentation tiered approach: master file, local file and CBC report[151]*.*

This Action deals with transfer pricing documentation. The idea is to make group transfer pricing information in respect of intra-group services and other transactions available to the tax administration in the countries concerned. As a result, within this Action, rules should be developed including a requirement on the part of multinational enterprises to provide all relevant governments with the necessary information on the global

[150] Based on the available OECD documents.

[151] OECD (2014), *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

allocation of their income, business and taxes paid in the various countries according to a common template. This should be done by means of amendments to the OECD Transfer Pricing Guidelines and particular recommendations on the design of domestic rules.

While Kazakhstan does require transfer pricing documentation, it does not prescribe a specific form or content and does not refer to any international standard in this respect. Action 13 can therefore inspire Kazakhstan to further improve and elaborate on the transfer pricing documentation requirements. The implementation of Action 13 would also permit Kazakhstan to obtain information on multinationals operating in its territory.

Action 14 Make dispute resolution mechanisms more effective[152]*.*

This action plan aims to develop solutions to deal with obstacles that prevent countries from solving treaty-related disputes under MAPs, including the absence of arbitration provisions in most treaties and the fact that access to MAPs and arbitration may be denied in certain cases. Thus, it was proposed to introduce in the model treaty a new paragraph in article 25 that would emphasise the obligation of the contracting states to resolve the problem of the taxpayer, as well as a new paragraph 2 in article 9 requiring countries to make corresponding adjustments. Additionally, it was proposed to recommend countries entering into bilateral Advance Pricing Agreements (APAs), to simplify access to Mutual Agreement Procedures, as well as providing additional clarification about the MAP in the domestic legislation.

Kazakhstan takes part in Mutual Agreement Procedures from time to time, but there are no transparent statistics on these procedures. Some taxpayers seek to initiate MAPs to address situations where even the courts are not willing to take a substantive interpretation approach and some of these MAP cases have been reported, such as the recent agreement between the USA and Kazakhstan on the treatment of transparent entities. The Action 14 recommendations may further inspire Kazakhstan to improve and elaborate the domestic guidance on MAPs as suggested above.

Action 15 Develop a multilateral instrument[153]*.*

[152] OECD (2015), Public Discussion Draft BEPS action 14: "Make dispute resolution mechanisms more effective".

Since some of the BEPS recommendations will result in common recommendations regarding domestic tax law provisions and changes to the OECD Model Tax Convention, this Action is devoted to the development of a multilateral instrument to implement these changes in domestic laws and bilateral conventions simultaneously among the participating countries. The idea is that this multilateral instrument will not be limited to OECD members or G20 countries, but will also be open for developing countries to join.

Kazakhstan has joined the OECD ad hoc group on negotiation of BEPS multilateral tax treaty together with 80 other countries[154].

7. Conclusion

As argued in this article, Kazakhstan is an interesting model of a state which combines elements of both monism and dualism in its national legal order.

As envisaged by dualism, international laws are enacted in Kazakhstan by means of ratification, issuing special national law on entry into force of the treaty. Under the Constitution of Kazakhstan international agreements are considered as separate norms of law, prevailing over domestic laws in case of contradiction, and this is a feature of monist states, since in dualist systems an international agreement is not considered as a source of law as such until it is explicitly transposed into national law, and once transposed it should be treated in the same way as other national laws.

Despite certain features of dualism, the authors of this article are of the opinion that Kazakhstan is a monist state.

Judicial treaty override may be possible due to the existence of special rules in the national Tax Code, such as the anti-treaty shopping clause and beneficial ownership clause in domestic law. In this connection, judicial practice illustrates that unintentional judicial treaty override is also possible due to the mistaken interpretation of the tax treaty provisions.

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[153] OECD (2014), *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[154] Based on the information available at http://www.oecd.org/tax/treaties/work-underway-for-the-development-of-the-beps-multilateral-instrument.htm.

In general, concluding on the status of tax treaties in Kazakhstan, it may be observed that Kazakhstan is gradually improving its tax legislation in accordance with international legal norms and practice. The formal aspects come first, but Kazakhstan is constantly working on improving also the procedural and administrative aspects of the national legal system in order to introduce and enforce the obligations accepted under international agreements. There are a number of measures suggested in the BEPS action plan, that can serve as an inspiration for Kazakhstan, which may further elaborate its legislation with a view to strengthening the existing anti-avoidance measures. Tax base erosion and profit shifting is significant in Kazakhstan and the BEPS project may also provide the opportunity for Kazakhstan to adopt measures to reduce and mitigate some of this behaviour.