

НАЛОГОВОЕ ПРАВО

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MODIFICATION OF KAZAKHSTANI TAX TREATIES BY THE MULTILATERAL CONVENTION

Annotation

This article is devoted to the analysis of the impact of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) on Kazakhstan's tax treaties.

The author examines the provisions of the MLI aimed at countering tax avoidance. The covered articles are categorized into two categories: Mandatory provisions and optional provisions.

The study addresses key issues such as dual residence, abuse of treaty benefits, artificial avoidance of permanent establishment status, and the shifting of dividends.

Special attention is given to the fact that, under the MLI, the Republic of Kazakhstan has modified the preambles of 53 of its tax treaties, which bears significant practical importance. The new preamble notifies taxpayers and tax administrations that the main purposes which treaty partners have in mind when they conclude tax treaties are the provision of relief to taxpayers with regards to the burden of double taxation in both contracting states, and the elimination of double non-taxation or tax evasion. The article further explores artificial avoidance of permanent establishment through commissionaire arrangements and similar strategies. Amendments to the mutual agreement procedure (MAP) are examined in detail.

The author concludes with an assessment of the degree of Kazakhstan's alignment with the positions of other jurisdictions and discusses the potential legal implications for taxpayers.

Keywords: tax treaty, MLI, tax avoidance, dual residence, dividends, permanent establishment, taxation, arbitration, OECD, international law.

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ҚАЗАҚСТАННЫҢ САЛЫҚТЫҚ КЕЛІСІМДЕРІН КӨПЖАҚТЫ КОНВЕНЦИЯ АРҚЫЛЫ ӨЗГЕРТУ

Аңдатпа

Мақала салық салу базасын размыту мен пайданы жасырын шетелге шығаруға қарсы бағытталған салықтық келісімдер шеңберіндегі шараларды іске асыруға арналған.

Көпжақты конвенцияның (MLI) Қазақстанның салықтық келісімдеріне әсерін талдауға арналған.

Автор салықтық заңнамадан жалтаруға қарсы бағытталған MLI ережелерін қарастырады. Конвенцияның ережелері екі топқа бөлініп сипатталған: міндетті және ерікті ережелер.

Мақалада қос резиденттік мәселесі, салықтық жеңілдіктерді теріс пайдалану, тұрақты өкілдік мәртебесінен жалтару, дивидендтерді аудару секілді проблемалар қарастырылған. Қазақстан Республикасы MLI Конвенциясына сәйкес 53 салықтық келісімінің кіріспе бөлімдерін өзгерткеніне ерекше назар аударылады, бұл өз кезегінде нақты практикалық мәнге ие. Жаңартылған кіріспе салық төлеушілер мен салық органдарына салықтық келісімдердің негізгі мақсаттары ретінде қосарланған салық салу ауыртпалығынан босату ғана емес, сонымен қатар қосарланған жалтаруды немесе салықтан жалтаруды болдырмау екенін көрсетеді. Сондай-ақ комиссиялық келісімдер мен ұқсас тәсілдер арқылы тұрақты өкілдік мәртебесінен жалтару мәселесі жеке талданған. Өзара келісу рәсімдеріне енгізілген өзгерістерге ерекше мән берілген.

Автор Қазақстан ұстанымының өзге мемлекеттердің ұстанымдарымен қаншалықты үйлесетінін бағалап, салық төлеушілер үшін болуы мүмкін құқықтық салдарларына қорытынды жасаған.

Түйінді сөздер: салықтық келісім, MLI, салықтан жалтару, қос резиденттік, дивидендтер, тұрақты өкілдік, салық салу, арбитраж, ЭЫДҰ, халықаралық құқық.

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МОДИФИКАЦИЯ НАЛОГОВЫХ СОГЛАШЕНИЙ КАЗАХСТАНА ПОСРЕДСТВОМ МНОГОСТОРОННЕЙ КОНВЕНЦИИ

Аннотация

Статья посвящена анализу влияния Многосторонней конвенции по выполнению мероприятий в рамках налоговых соглашений для противодействия размыванию налоговой базы и выводу прибыли из-под налогообложения (MLI) на налоговые соглашения Казахстана.

Автором изучены положения MLI, направленные на противодействие уклонению от налогообложения. Перечислены статьи, которые можно разделить на две категории- обязательные и факультативные положения.

Рассмотрены проблемы двойного резидентства, злоупотребления налоговыми льготами, искусственного избежания статуса постоянного представительства и перевода дивидендов.

Обращено внимание, что Республика Казахстан в соответствии с Конвенцией MLI изменила преамбулу 53 своих налоговых соглашений, что имеет практическое значение. Она уведомляет налогоплательщиков и налоговые органы о том, что основными целями, которые преследуют партнёры по налоговым соглашениям при заключении налоговых соглашений, являются предоставление налогоплательщикам освобождения от бремени двойного налогообложения в обоих договаривающихся государствах, а также устранение двойного уклонения от налогообложения или уклонения от уплаты налогов. Рассмотрено искусственное избегание статуса постоянного представительства с помощью комиссионных соглашений и аналогичных стратегий.

Особое внимание уделено изменениям в процедуре взаимного согласования. Сделаны выводы о степени соответствия позиции Казахстана позициям других стран и потенциальных правовых последствиях для налогоплательщиков.

Ключевые слова: налоговое соглашение, MLI, уклонение от налогов, двойное резидентство, дивиденды, постоянное представительство, налогообложение, арбитраж, ОЭСР, международное право.

On 20 February 2020, Kazakhstan ratified [1] the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) [2], which intends to modify 54 of Kazakhstan's tax treaties and add some new anti-tax avoidance provisions, pursuant to OECD recommendations. The main purpose of the MLI is to prevent tax avoidance.

The MLI's anti-tax avoidance articles can be grouped in two categories:

1) Mandatory provisions, also called "minimum standard". These articles are 6, 7 (prevention of treaty abuse) and 16 (improvement of dispute resolution) of the MLI; and,

2) Optional provisions. These articles are the rest provisions of the MLI that relate to transparent entities (article 3), dual residency tie-breaker rule (article 4), method of elimination of double taxation (article 5), minimum shareholding periods (article 8), capital gains derived from immovable property (article 9), permanent establishment (articles 10, 12, 13, 14, 15), restriction of a party's right to tax its own residents (article 11) and mandatory binding arbitration (Part VI).

Under minimum standard country that signed and ratified MLI will at least update its tax treaties with articles 6, 7 and 16, while optional provisions enter into force only after both contracting states have agreed to apply the same MLI provisions. With regards to optional provisions countries have flexibility to opt out or opt in particular provisions. For instance, Kazakhstan made a reservations not to apply Article 3 (Transparent entities), Article 5 (Application of Methods for Elimination of Double Taxation) and some others provisions to all its tax treaties.

Kazakhstan's and its tax treaty partners' positions on a particular MLI article could be viewed on OECD's website in "matching database" on the following link: <https://www.oecd.org/tax/treaties/mli-matching-database.htm>. [3]

Dual Resident Entities

Article 4.3 in Kazakhstani tax treaties addresses the dual residence problem. When an entity happens to be a resident of two contracting states, Article 4.3 provides a tie-breaker rule that assigns an entity's residence to only one. The main goal of this provision is to relieve a taxpayer from double taxation in two countries, which might arise due to having residence in both contracting states.

Article 4.3 of Kazakhstan's tax treaties applies various criteria to solve the dual residence problem. Some tax treaties stipulate the place of effective management, including those with Austria, the Czech Republic and Italy, whereas other tax treaties apply the place of registration, including those with Belarus and Bulgaria, and, finally, some other tax treaties have a provision that states residence is to be determined through mutual agreement by the competent tax authorities of both nations, including those with the U.S., Japan, Estonia, Latvia and Lithuania.

Pursuant to the Law "On ratification of the MLI" and the MLI itself, Kazakhstan has stated position that it intends to modify Article 4.3 in 54 of its tax treaties [4], thus the dual residence problem is to be resolved via mutual agreement by the competent tax authorities on a case by case basis. In practice, this modification means that if an entity has dual residence, then the competent Kazakhstani tax authorities, together with their counterparts from other tax treaty partner countries, are to ascertain whether an issue qualifies as a real dual residence problem that should be addressed, or if the situation is merely a tax avoidance arrangement. In the latter case, treaty benefits are to be denied. However, not all Kazakhstani tax treaty partners have the same position regarding this article. For instance, Kazakhstan's tax treaties with the Czech Republic and Germany in Article 4 will not change since these countries did not indicate tax treaty with Kazakhstan as a "Covered Tax Agreement", while tax treaties with Canada, China and Japan will change in Article 4 since these countries has indicated similar to Kazakhstan's position.

Purpose of a Tax Treaty

This article belongs to the minimum standard. In the preamble of Kazakhstani tax treaties, limited information is presented with respect to their purpose. For instance, the preamble in the tax treaty with Ireland contains the following information regarding the purpose of the treaty:

"The Government of Ireland and the Government of the Republic of Kazakhstan, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows:"

The MLI strengthens the preamble of tax treaties with anti-tax avoidance wording.

Kazakhstan has stated that pursuant to the MLI it has modified the preamble in 53 of its tax treaties [5] with the following wording:

"[The Government of the Republic of Kazakhstan and the Government of...] intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions) [have agreed as follows:]".

The new wording of the preamble has a practical meaning as it notifies taxpayers and tax administrations that the main purposes which treaty partners have in mind when they conclude tax treaties are the provision of relief to taxpayers with regards to the burden of double taxation in both contracting states, and the elimination of double non-taxation or tax evasion. Since some of Kazakhstan's tax treaty partners, such as Georgia, Norway did not refer tax treaty with Kazakhstan as a "Covered Tax Agreement" this article will not changes existing tax treaties with those countries.

Prevention of Tax Treaty Abuse

This article belongs to the minimum standard. The MLI provides three options for signatory countries to adopt in order to prevent treaty abuse:

- A principal purpose test (PPT);
- A PPT with a simplified limitation on benefit (simplified LOB) provision;
- A detailed LOB provision supplemented with an anti-conduit rule. [6]

Kazakhstan has chosen the second approach. The LOB has strict and clear criteria for persons that wish to apply tax treaties. If a taxpayer meets the criteria listed in the LOB, then that taxpayer has the right to apply the benefits of the tax treaty. On the other hand, the PPT is a flexible rule, which allows the relevant tax authorities to take into account all facts and circumstances of a particular case in order to decide whether a transaction has any real business purpose or is designed with tax avoidance in mind.

However, most of Kazakhstan's tax treaty partners chose to apply only principle purpose test and only few countries' positions, such as Russia and India's positions, match the position of Kazakhstan.

Dividend Transfers

In some of its tax treaties, but not all, in Article 10.2(a) Kazakhstan applies reduced withholding tax rates (5% or 10%, with one exception of 12.5%) for dividends from direct investment. Investment is considered to be direct when a foreign legal entity owns a substantial quantity of shares or participation interest in a legal entity (for instance, Kazakhstan's tax treaties establish different rates of ownership ranging from 10% to 70%). Kazakhstan has stated that it intends to modify 37 of its tax treaties [7] and insert a minimum 365-day holding period, which means that the treaty benefit of a reduced withholding tax rate on dividend distribution is to be applied only if a non-resident legal entity has held a substantial quantity of shares or interest for at least 365 days prior to repatriation of funds. With respect to this article Kazakhstan's position match, for instance, with positions of Canada, Poland, Serbia, thus tax treaties with these countries will change, while Italy, Japan, Korea's positions does not match with the one of Kazakhstan, hence tax treaties with them will not change.

Capital gains from alienation of shares or interest in entities deriving their value principally from immovable property

Pursuant to Article 13.1 of Kazakhstan's tax treaties, gains from the sale of immovable property are taxed in the country where such immovable property is located. However, a taxpayer may dispose of immovable property indirectly through the sale of shares in a legal entity that primarily holds said immovable property. Such transactions pose a risk for countries where immovable property is located because a taxpayer might avoid taxes.

The MLI provides an anti-avoidance provision against indirect transfer of immovable property for two categories of entities:

- entities; and
- trusts or partnerships.

With regards to partnerships and trusts, Kazakhstan, pursuant to the Law "On ratification of the MLI" and the MLI itself, has stated that it intends to modify all its tax treaties [8] with an anti-avoidance provision that allows the source country to tax the sale of shares or participation interest if at any time during the 365 days preceding alienation, such shares or interest derived more than 50% of their value, directly or indirectly, from immovable property. In respect

to entities, Kazakhstan has noted that it intends to modify 44 of its tax treaties [9] with a similar anti-avoidance provision.

Artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies

One of the strategies of tax avoidance is the commissionaire arrangement, whereby a foreign entity empowers its agent in a source country to conduct regular meetings, represent the principal, and negotiate terms of contracts with customers, but without the right to sign a final contract. Kazakhstan, pursuant to the Law "On ratification of the MLI" and the MLI itself, has stated its intent to modify 54 of its tax treaties. [10] Pursuant to this alteration in Article 5.5 of Kazakhstan's tax treaties, a commissionaire arrangement may create permanent establishment for a foreign principal if an agent concludes contracts or plays the principal role that leads to the conclusion of contracts. This rule does not apply to an independent agent that acts in the course of its regular business, provided that such an agent does not act exclusively on behalf of one or a number of principals to which it is closely related. Kazakhstan's position with respect to this article matches with positions of the following countries, such as Belgium, France, Russia, Serbia, while Canada, Hungary, Italy's position does not match.

Artificial avoidance of permanent establishment status through specific activity exemptions

In Article 5.4 Kazakhstan's tax treaties provide a list of exceptions from creation of permanent establishment in another contracting state. Usually this occurs when a non-resident taxpayer has activities of a preparatory or auxiliary character in another country.

Kazakhstan, pursuant to the Law "On ratification of the MLI" and the MLI itself, has chosen Option A, which, provided business activities are of a preparatory or auxiliary character, states that exceptions to the creation of permanent establishment apply to:

- Activities specifically mentioned in tax treaties;
 - Maintenance of a fixed place of business;
- or
- A combination of the above activities.

Kazakhstan has stated that it is to apply this MLI provision to 54 of its tax treaties. [11] Some

of Kazakhstan's tax treaty partners' positions, for instance, Croatia, India, Italy, Japan, match Kazakhstan's position. Thus, tax treaties with them will change. Other countries' position, such as Bulgaria, Korea, Latvia does not match, thus, tax treaties with them will not change.

Splitting-up of Contracts

Some types of activities of the non-resident, such as construction and offshore activities to explore natural resources, may lead to creation of permanent establishment in source country. For instance, Article 5(3)(a) and Article 22 (3) of the tax treaty between Kazakhstan and Ireland provides the following:

"Article 5(3)(a). Permanent Establishment.

The term «permanent establishment» also includes:

- a) a building site, a construction, assembly or installation project that lasts for a period of more than twelve months;

Article 22(3). Offshore Activities.

Relevant activities which are carried on by an enterprise of a Contracting State in the other Contracting State for a period or periods not exceeding in the aggregate 30 days within any period of twelve months shall not constitute the carrying on of business through a permanent establishment situated therein".

In order to avoid creation of permanent establishment non-resident may split one contract between related parties, so that non-resident's activities will not exceed specified period of time in source country.

To prevent such tax planning MLI introduced a provision. Pursuant to this provision period of related parties' activities in the source country should be aggregated in calculation to determine whether non-residents activities create permanent establishment or not.

Kazakhstan pursuant to MLI notified that it intends to modify its tax treaties with seven countries, namely, the Czech Republic, Ireland, Latvia, Lithuania, the Netherlands, Norway and Serbia. Kazakhstan's position with Ireland, Lithuania, the Netherlands and Serbia match and thus tax treaties with these countries will be modified.

Mutual Agreement Procedure

This article belongs to the minimum standard. As per Kazakhstan's tax treaties, a taxpayer may initiate the mutual agreement procedure, pursuant to Article 25, if the person considers that taxation by one or both contracting states is not in accordance with the applicable treaty. The mutual agreement procedure allows a taxpayer to present a case to the relevant tax authorities in order to find a solution.

Kazakhstan, pursuant to the Law "On ratification of the MLI" and the MLI itself, has stated that it is to modify the article related to the mutual agreement procedure in its 54 tax treaties. In particular, with the following provisions that:

- extend the mutual agreement procedure from two to three years. [12]
- provides that when the competent authorities find a solution to a taxpayer's problem, it should be implemented without any domestic time limits, for instance, without reference to the statute of limitation in the national Tax Code [13]
- provides that the competent authorities of the Contracting Jurisdictions shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Tax Agreement [14]
- provides competent authorities may also consult together for the elimination of double taxation in cases not provided for in the Tax Agreement. [15]

Kazakhstan's position partially match and partially does not match with its tax treaty partners' position. For instance, Kazakhstan's position with regards to the first sentence of Article 16.1 match with the Netherlands' position. Prior to modification the first sentence

of Article 27.1 of Tax Treaty between Kazakhstan and the Netherlands had the following wording:

"1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 26, to that of the Contracting State of which he is a national".

After MLI modification this sentence has the following wording:

"1. Where a person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Tax Agreement, that person may, irrespective of the remedies provided by the domestic law of those Contracting Jurisdictions, present the case to the competent authority of either Contracting Jurisdiction".

In other words, previous wording suggested that taxpayer had the right to submit the case to competent authority of the state of which taxpayer was resident, while new wording suggests that taxpayer has right to submit the case to competent authority of either contracting jurisdiction.

Mandatory Binding Arbitration

Mandatory binding arbitration provides means for taxpayers to resolve the case when competent authorities could not reach an agreement over issue. Kazakhstan chose not to apply MLI provisions on mandatory binding arbitration.

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