

Special issue: Court practice on tax disputes

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pwc

1. Company against Almaty State Revenue Department

Court instance: Almaty city court

Date: August 2016

Subject: challenge of input VAT offset due to incompliance of primary documents with legislative requirements

Tax period: 2009 - 2011

Amount of assessments: ~ KZT 627 million

Facts:

In the course of the tax audit the tax authorities sent a request to Almaty Prosecutor's office regarding the appointment of expert handwriting analysis to identify the authenticity of signature of the supplier's Head on primary accounting documents.

By the results of expert handwriting analysis it was identified that signatures on primary accounting documents do not belong to the Head of the Company's supplier, but rather made by third parties. In this regard the tax authorities challenged relevant input VAT claimed for offset by the Company, as primary accounting documents did not comply with the Kazakhstan legislation on accounting and financial reporting.

The position of the court:

The Court supported the position of the tax authorities.

PwC recommendations:

Primary documents should be certified only by the authorised persons. Taxpayers should exclude the possibility of signing primary documents by individuals not having signatory authority and request their suppliers to comply with this rule.

Taxpayers should request their counterparties for Power of Attorneys, which confirm the authority to sign primary accounting documents (acts of acceptance, tax invoices) reflecting material amounts.

2. Company against State Revenue Office of Esil region of Astana Tax Department

Court instance: the Supreme Court

Date: August 2016

Subject: assessment of CIT, EPT, royalty and commercial discovery bonus

Tax period: 2006 - 2008

Amount of assessments: ~ KZT 4.5 billion

Facts:

The tax authorities assessed **CIT** due to the following:

- The tax authorities changed the tax period when the Company's demurrage expenses should be deducted. The Company identified a tax period for CIT deduction of demurrage expenses based on date of relevant source documents substantiating their occurrence. The tax authorities transferred relevant expenses to the tax period when the Company received income from sale of crude oil in accordance with IFRS 18, based on which income and expenses related to the same operation should be recognised simultaneously.

The Court's position: the Court supported the position of the tax authorities.

- The tax authorities reduced the Company's expenses on ecological programmes, development of social sphere of regions and education of Kazakhstan citizens. The Company calculated relevant expenses via dividing the amounts envisaged by subsurface use contracts by the contractual periods. Based on responses of the Ministry of oil and gas, the tax authorities stated that contractual periods exceeds those determined by the Company.

The Court's position: the Company's position was supported by the Court, as there are no requirements on proportionate allocation of the above expenses in applicable tax legislation / subsurface use contracts.

- The tax authorities challenged the Company's deductions related to losses of crude oil during transportation, as such a right is granted to natural monopolists only, who can deduct losses within the limits established by the Kazakhstan legislation. However, in the considered situation, the natural monopolist was the supplier of transportation services, not the Company.

The Court's position: the Court supported the position of the tax authorities.

- The tax authorities challenged the Company's expenses related to reserve fund contributions, as deduction of corresponding expenses is allowed only if cash is actually transferred to the special deposit account (i.e. liquidation fund). Furthermore, the tax authorities classified the amounts, which were actually transferred by the Company, as repair expenses subject to deduction within the limit of 10% of ending balance of a group (as per the stabilised tax regime).

The Court's position: the Court supported the position of the tax authorities.

- The tax authorities challenged the Company's deductions related to depreciation of inactive wells, as such wells are not directly used in oil extraction process. At that, the tax authorities did not accept the Company's arguments, based on which inactive wells are used for production purposes, since the pressure of active wells is regulated with use of inactive ones, while oil is extracted not from a separate well, but from the aggregate of wells.

The Court's position: the Court supported the position of the tax authorities.

- The tax authorities challenged the Company's deductions tied with shooting-blasting, repair and insulation works, which were classified by the Company as expenses on current repair and deducted immediately, while the tax authorities treat such expenses as of capital nature subject to deduction via depreciation mechanism (within the limit of 10% of ending balance of a group as per the stabilised tax legislation).

The Court's position: the Court supported the position of the tax authorities.

Facts (continued):

- The tax authorities reduced the Company's deductions related to expenses on transportation of crude oil by WHT, which was reimbursed to the supplier, as such WHT was paid by the supplier at its own expense (income tax was not withheld at the source of payment) and was not included into annual aggregate income of the supplier.

The Court's position: the Court supported the Company's position and recognised the WHT as an expense on transportation services related to income of the Company from sale of crude oil.

The tax authorities also assessed other tax liabilities, namely:

TP issues, i.e. reduction of the differential by banking expenses related to opening and maintaining of letters of credit. Based on the position of the tax authorities, payment terms existing between the Company and its buyers do not have an influence on market price, so banking expenses should not be included into the differential.

The Court's position: the Court supported the Company's position stating that payment term applied in similar transactions is one of the factors influencing on the deviation of transfer price from the market level.

Royalty on associated gas, i.e. due to assessment of royalty on volume of associated gas, which was not taxed earlier. Royalty is paid as a result of extraction of hydrocarbons. Based on subsurface use contracts, hydrocarbons include crude oil and natural gas, including associated gas.

The Court's position: the Court supported the position of the tax authorities.

EPT, i.e. due to reallocation of WHT on dividends between subsurface use contracts, which is subject to deduction for EPT purposes. The Company made WHT allocation based on ratio of (i) income from sales of crude oil generated under relevant subsurface use contracts and non-contractual income (net of FOREX gain) to (ii) total annual aggregate income. Based on the tax authorities' opinion, the Company should have been allocated WHT on dividends in accordance with ratio of annual aggregate income related to contractual and non-contractual activities to total annual aggregate income.

The Court's position: the Court supported the position of the tax authorities.

Commercial discover bonus, i.e. due to approval of additional volumes of crude oil as per protocols of State Reserve Commission.

The Court's position: the Court supported the position of the tax authorities.

PwC recommendations:

Please be reminded that timely involvement of PwC specialists with the experience in tax and customs authorities may increase your chances for successful appeal in tax and customs disputes, including those considered by the Kazakhstan courts.

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