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# Tax and Legal Alert

## Special edition: tax and customs disputes



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### ***Court practice***

One of the services provided by PwC is consulting support during tax and customs reviews, as well as subsequent tax audit appeal to the higher tax authority.

In addition, our specialists assist in preparation of documents (claims) related to judicial proceedings in administrative, economic and higher courts.

In this edition on court cases related to tax and customs disputes, we summarized the most important and interesting court cases that have been published on the website of the Supreme Court of RK in the recent months.

This issue includes court cases, which relate to such issues as calculation of FOREX difference arising on the branch's accounts receivable accruing to the head office, assessment of customs duties on the value of services due to provision of hard copy deliverables, inclusion of branch's income accounts payable and other important issues.

This issue also includes our positive practice on protection of a taxpayer's rights.

We plan to issue a special edition on court cases on a monthly basis to keep you updated on last trends of Kazakhstan court practice.

# Tax and Legal Alert: tax and customs disputes

## Issue No. 1

### 1. Branch of foreign legal entity against Atyrau Oblast Tax Department

**Period under review:** 2008-2011

**Period of the tax audit:** 2014

**Type of review:** Comprehensive tax audit

**Amount of assessments:** about KZT 1 bln.

**Jurisdiction:** Supreme Court

**Date:** 16 July 2015

**Major issues:** deduction of FOREX arising on mutual settlements between branch and head office, and financing; assessment of a reverse-charge VAT on the value of certification services.

#### Facts:

##### Mutual settlements between the Branch and head office

The Kazakhstan branch of a foreign legal entity provided services to customers who made payments to the account of Branch's head office abroad. These accounts receivable of the Branch were used by head office for repayment of liabilities to suppliers and expatriate workers of the Branch. The Branch recognized accounts receivable from the head office in its accounts and respective FOREX which was deducted for CIT purposes.

##### Financing

Besides, the Branch issued cash calls which were further offset against accounts receivable recognized as income from provision of services was recognized in the accounts. The cash calls were classified by the Branch not as advances, but as a short-term financing received from a customer. Therefore the Branch recognized a FOREX arising on these cash calls in its accounts and deducted it for CIT purposes.

##### VAT for a non-resident

Branch purchased certification of welding technology services from a non-resident. These services were provided outside RK. The Branch did not include the cost of these services to its taxable turnover.

#### Position of tax authorities:

##### Mutual settlements between the Branch and head office

The tax authorities challenged deduction of FOREX arising on mutual settlements between the Branch and the head office due to the following:

- 1) The tax authorities could not reconcile the data reflected in the accounts of the Branch and information contained in the bank documents provided by the head office;
- 2) Branch has incorrectly recognized the moment of profit repatriation which led to misstatement of the Branch's financial statements;
- 3) The Branch's accounts receivable are not recorded in the head office's financial statements, as reporting is prepared on a consolidated basis.
- 4) Since the head office's accounts payable accruing to the Branch do not have a specific settlement date, and since there is no sufficient evidence indicating its occurrence as a result of the Branch's business operations, this liability cannot be classified as accounts receivable.

##### Financing

Cash calls may not be classified as short-term financing and hence are non-monetary items. Therefore, the Branch is not entitled to deduct FOREX for CIT purposes.

##### VAT for a non-resident

Since certification includes research, estimation and analysis, which are elements of engineering services, certification services provided by a non-resident, should be subject to VAT.

**Court position:** in favor of tax authorities with respect to all issues.

**Our recommendations:** we recommend taxpayers to analyze thoroughly, what items FOREX is accrued for, especially in cases, when significant amounts of negative FOREX are deducted for CIT purposes.

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## Issue No. 1

### 2. Company against Tax Authority (Almaty)

**Period under review:** 2011-2012

**Period of the tax audit:** 2014

**Type of review:** Comprehensive tax audit

**Amount of assessments:** appr. KZT 2.5 bln.

**Jurisdiction:** Cassation Judicial Division of Almaty City Court

**Date:** 1 July 2015

**Major issues:** deduction of interest.

#### Facts:

In 2004-2005, the Company received a loan for capital construction of a major property, plant and equipment (the "PPE") item. Interest expenses were capitalized in the cost of property, plant and equipment during construction period that was completed in 2006. In 2007-2008, Company deducted interest paid on these loans. In addition, during this period, the Company performed the construction of fixed assets related to PPE using own funds.

#### Position of tax authorities:

The tax authorities disputed interest deduction for CIT purposes based on the following grounds:

- 1) The Company has not provided evidence that fixed assets construction was performed using own funds;
- 2) Fixed assets, the construction of which was performed in 2007-2008, also relate to PPE and compose a single item with PPE;
- 3) The purpose of the loan is construction of PPE, but not of its individual part, hence borrowings were also provided for the construction of fixed assets completed in 2008.

**Court position:** in favor of tax authorities with respect to all issues.

**Our recommendations:** we recommend taxpayers to pay attention to wording of supporting documents related deduction of interest for CIT purposes.

### 3. Company against Almaty City Tax Department

#### PwC represented Company in these proceedings in the Supreme Court

**Period under review:** 2008-2009

**Period of the tax audit:** 2013

**Type of review:** Unscheduled thematic tax audit on the issues of non-execution by a taxpayer (tax agent) of notification upon the results of desk-top audit, correctness of calculation and timeliness of WHT payment

**Amount of assessments:** app. KZT 250 mln.

**Jurisdiction:** Supreme Court

**Date:** 30 June 2015

**Principal issues:** Application of tax residence certificates.

#### Facts:

The Company has exempted from WHT non-resident's income from provision of consulting services based on tax residency certificates provided by a non-resident.

These certificates have been requested by tax authorities during desk-top audit, as a result of which they were acknowledged as not complying with the tax legislation of RK, as apostil on these certificates authenticated the seal of a notary, but not the signature of a person who signed the certificates.

The Company has repeatedly apostilled certificates in 2013 with the attestation of the signature of an authorized person that signed certificates.

#### Position of tax authorities:

The Company was not entitled to apply exemption from WHT of non-resident's income, as certificates in compliance with tax legislation should be provided by 31 December of respective tax period. Since second apostillation took place in 2013, the Company was not entitled to apply these certificates.

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**Court position:** in favor of the Company with respect to all issues. The court resolved that repeated apostillation should not be grounds for the statement by tax authorities that certificates were not provided within the terms set by the Tax Code.

**Our recommendations:** we recommend taxpayers to check the correctness of residence certificates when they are provided by non-residents.

### 4. Company against State Revenue Department of Atyrau Oblast

**Period under review:** 2014

**Period of the tax audit:** 2015

**Type of review:** Scheduled review

**Amount of assessments:** over KZT 15 mln.

**Jurisdiction:** Civil and Administrative Appellate Division of Atyrau Oblast Court

**Date:** 24 June 2015

**Major issues:** assessment of customs duties and taxes on the value of services, the results of which are provided in hard copy.

#### **Facts:**

The Company purchased laboratory analysis services and measurements from samples from a non-resident. A non-resident provided these deliverables in hard copy report which was delivered to the Company via a courier service.

In the course of scheduled review, customs authorities classified a hard copy report as commodity and made additional assessments of customs duties and import VAT.

#### **Position of tax authorities:**

Customs authorities believe that the cost of services of laboratory analysis should be declared for customs purposes for the following reasons:

- 1) Laboratory analysis reports are commodity, as their provision is a mandatory condition for the performance of services as stipulated by the agreement, and if they are not provided, then agreement will be deemed as non-performed;
- 2) The results of laboratory analysis represent a result of intellectual activity, were imported to

the customs territory of the Customs Union and could be used for various production purposes within the Republic's territory;

3) Laboratory analysis reports were transferred through the customs border in hard copies using courier mail with way-bills indicating their cost;

4) The subject of transaction between the Company and a non-resident is information recorded in hard copies.

**Court position:** in favor of customs authorities with respect to all issues.

**Our recommendations:** we recommend taxpayers not to use hard copies for the receipt of intellectual property deliverables from non-resident providers.

### 5. Branch of a foreign legal entity against State Revenue Department of Almaty City

**Period under review:** 2009-2014

**Period of the tax audit:** 2014

**Type of review:** liquidation tax audit

**Amount of assessments:** over KZT 10 mln.

**Jurisdiction:** Specialized Interregional Economic Court of Almaty City

**Date:** 6 May 2015

**Major issues:** recognition of the branch's accounts payable as income for CIT purposes.

**Facts:** The Branch filed an application for the liquidation tax audit due to termination of activity. The Branch has outstanding accounts payable accruing to the head office.

#### **Position of tax authorities:**

The tax authorities believe that determination of taxable income for CIT purposes of a non-resident legal entity's permanent establishment occurs in the same way as of a legal entity resident in RK.

Thus, in accordance with the Tax Code, income from doubtful liabilities includes liabilities not demanded by creditor as of the moment of approval of liquidation during taxpayer's liquidation.

Accordingly, Branch's accounts payable to the head office is Branch's income from doubtful liabilities and are subject to CIT.

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## Issue No. 1

**Court position:** in favor of tax authorities with respect to all issues.

**Our recommendations:** we recommend branches of foreign companies to close accounts payable to head offices prior to liquidation.

### **6. Company against Uralsk City Tax Authority**

**Period under review:** 2013

**Action disputed:** Notification of non-submission of tax return

**Amount of assessments:** ---

**Jurisdiction:** Supreme Court

**Date:** 21 May 2015

**Major issues:** inclusion of underground water extraction to non-contractual activity.

#### **Facts:**

The Company is a subsurface user and performs activity under stabilized legislation of 1997 pursuant to subsurface use contract.

In accordance with the stabilized legislation, the Company pays royalty at the rate of 10% on the underground water extraction.

#### **Position of tax authorities:**

Underground water extraction is not contractual activity and hence should not be taxed pursuant to stabilized legislation.

The Company should pay MET according to the current legislation and submit tax returns accordingly.

**Court position:** in favor of the Company in full.

**Our recommendations:** we recommend taxpayers to have sufficient arguments on inclusion of income and expenses to contractual and non-contractual activities.

# *Tax and Legal Alert: tax and customs disputes*

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