

**TAXES AS A FACTOR OF FINANCIAL SERVICE ORGANISATIONS  
ENTERING KAZAKHSTAN**

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*The aim of this paper is to investigate tax regulation in Kazakhstan as a component of market entry strategies when foreign financial service providers entering the market. On the basis of the selected theoretical framework we will explain motives of financial service organisations entering Kazakhstan from taxes' perspective. On the basis of secondary data and questionnaires' outcomes we will reveal how foreign financial service organisations assess taxes as one of the parameters of the investment climate in Kazakhstan and what challenges they face in this market. Growing financial sector enables direct investments in different industries, and agriculture is among them. Namely, Kazakhstan is a large agricultural producer, mainly of grain and livestock.*

**Key words:** taxes, agricultural producers, financial service organisation, banking.

**НАЛОГИ КАК ФАКТОР ВХОЖДЕНИЯ ФИНАНСОВЫХ ОРГАНИЗАЦИЙ В  
КАЗАХСТАН**

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*Целью данной работы является исследование налогового регулирования в Казахстане как компонента стратегий выхода на рынок иностранных поставщиков финансовых услуг. На основе выбранной теоретической базы мы объясним мотивы въезда финансовых организаций в Казахстан с точки зрения налогов. На основе вторичных данных и результатов анкетирования мы покажем, как иностранные финансовые организации оценивают налоги как один из параметров инвестиционного климата в Казахстане и с какими вызовами они сталкиваются на этом рынке. Растущий финансовый сектор позволяет осуществлять прямые инвестиции в различные отрасли, в том числе в сельское хозяйство. А именно, Казахстан является крупным сельскохозяйственным производителем, в основном зерна и скота.*

**Ключевые слова:** налоги, сельхозтоваропроизводители, финансовая служба, банковское дело

The financial sector offer various types of transactions in such areas as consumer finance, real estate, banking, and insurance (Asmundson, 2011, p. 46)<sup>1</sup> This research will involve in particular financial service organisations such as: banks, microfinance companies, investment funds, and audit companies. The newly opened financial markets of such regions as Central and Eastern Europe, Latin America, Asia and the former Soviet Union republics have been of great interest for foreign investors. The motives for and forms of entry differ from country to country, depending on many factors. (Kladova, Parfenova, & Juščius, 2008, p. 106).

Traditionally, Kazakhstan has represented itself as an attractive destination for foreign direct investments because of the existence of vast deposits of natural resources; however, nowadays the Kazakhstani government is making efforts to diversify the economy. The government is providing favourable conditions for investors in order to develop areas other than the extractive sector of the economy. (Ernst and Young, 2014, p. 11)

It should also be noted that in 2015, after 20 years of negotiations, Kazakhstan has finally been accepted into the World Trade Organisation (WTO) (The World Trade Organization, 2015). With regards to this study, it means that more financial investments will flow into Kazakhstan after the completion of the integration processes necessary for accession into the WTO; thus, the topic of market entry strategies of foreign financial service organisations is very relevant and will start to attract more attention from the scientific and business communities.

Authors as Cerutti, Dell'Ariccia, & Peria (2007) have identified that the host country's regulations and tax rates affect foreign bank's organisational forms; moreover, they found that it is more probable that in host markets with relatively low economic risk, banks choose an entry mode such as branches, while in countries with a risky macroeconomic environment, parent banks prefer a subsidiary organisational form.

In order to reach the market economy, the following reforms have been conducted in Kazakhstan: currency convertibility; wage rate determination; involvement into the international commerce; openness to foreign investors; introduction of new regulations, including tax code developed according to the international standards; an effective bankruptcy and competition laws and other regulations (Saudabayev, 2001, p. 1).

Concerning the regulatory framework, although Kazakhstan has established adequate legislation for foreign investors, particularly for foreign financial organisations' activities, a lot of improvements in financial regulation need to be carried out, especially when Kazakhstan's accession to the WTO is taken into account (The National Bank of Kazakhstan, 2014, p. 26).

With regard to the taxation policy, there are also critics of its complicated and ambiguous interpretation. As concerns the reliability of infrastructure in Kazakhstan, some subsectors, such as regional transport corridors, urban transport systems, water supply and sanitation, solid waste management, and district heating, are still developing and require huge investments (Asian Development Bank, 2012, p. 1). In this regard, development international financial institutions as well as commercial

banks have the opportunity to present financing for local and foreign companies for the implementation of such infrastructure projects in Kazakhstan.

There are different ways of internationalizing banks' operations. One of the simplest ways is cross-border lending without having a physical presence abroad. Such operations are traditionally conducted through correspondent relations when banks are establishing credit lines for particular banks. However such type of operations limit the bank's activities, as it cannot have direct long-term relationships with customers, and can only present particular services, usually those within trade finance agreements and not a broad range of other financial products. (Hurduc & Nitu, 2011, p. 44)

At the end of February 2014, the banking sector in Kazakhstan accounted for 77 per cent of total financial assets and 44 per cent of GDP; pension funds accounted for 19 per cent of total financial assets; insurance companies - 3 per cent and other non-banking organisations -1 per cent respectively (Hamann & Muñoz, 2014, p. 10).

In a classical form, following the "stage model" of expansion, foreign banks first open a representative office in order to investigate the market, then establish a branch, and eventually open a subsidiary institution, which is incorporated separately from the parent bank (Hawkins & Mihaljek, 2001, p. 24).

According to Hurduc & Nitu (2011, p. 45), there are two forms of financial sector FDI:

1. greenfield investment, which means the establishment of an institution from scratch;
2. acquisition of a control position from a domestic bank. The size of acquisition can range from a 100% purchase of stocks to a minority stake.

As specified in the PricewaterhouseCoopers Doing Business Guide Kazakhstan (2014, p. 15), according to Kazakhstan's Civil Code foreign and local investors can set up a presence in the following organisational forms:

- limited liability partnerships (or limited liability companies);
- joint stock companies;
- representative offices and branches.

On the basis of the World Bank's assessment criteria, the following major components of investment climate were distinguished: political stability, economic stability, legal environment, taxation regulations, volume of corruption and reliability of infrastructure(The World Bank, 2005, p. 5). The choice of market entry strategy and market activities depends mainly on that factors, we will focus on one of them, these are taxes.

## **Overview of taxes in Kazakhstan**

This chapter will provide information on taxation regulations adapted in Kazakhstan, as this issue considered as one of the important factor for foreign entities in general assessment of investment climate attractiveness. According to the World Bank Enterprise Survey research firms in countries that rank better on the ease of paying taxes, consider both tax rates and tax administration as less of an obstacle(World Bank Group, 2016, p. 72).

In the “Doing business 2016” report Kazakhstan stands at 18 in the global ranking of 189 economies on the ease of paying taxes (World Bank Group, 2016, p. 73).

The Tax Code is the main document that provides stipulations on taxation regime in Kazakhstan (Mahon, 2014, p. 67).

There are following main tax types adapted in Kazakhstan:

	Tax type	Tax rate
1.	Corporate income tax (CIT)*	20%
2.	Withholding tax	5%-20%
3.	Value added tax	12%
4.	Personal income tax	10%
5.	Social tax	11%
6.	Obligatory pension contributions	10%
7.	Social security contributions	5%
8.	Property tax	1,5%
9.	Vehicle tax	Varied
10.	Land tax	Varied

\*It should be noted that the branches of non-residents are subject to the 15 per cent branch profit tax on the after-tax income. (Deloitte, 2014, p. 6)

Kazakhstan has entered into double tax treaties with approximately 46 countries (PricewaterhouseCoopers Kazakhstan, 2014, p. 46). Some of the major tax types will be considered further in details.

#### *Corporate Income Tax (CIT)*

Entities with Kazakhstan residence (with the exception of state institutions) and non-resident legal entities that operate via permanent establishments in Kazakhstan and/or receiving income from sources in Kazakhstan are subject to the Corporate Income Tax payment. The main determining factor for expense deductibility is that costs have to be related to business. Taxpayers assess and conduct advance payments during the current tax period, an annual CIT is required to be submitted by 31 March of the year following the reporting year. (Mahon, 2014, p. 67)

#### *Withholding Tax*

The income of non-residents without permanent establishment is subject to withholding tax on Kazakhstan source income that includes any income from activity

in Kazakhstan. Dividends, interest and royalties are subject to 15 per cent withholding tax, which can be reduced under double taxation treaties. (PricewaterhouseCoopers Kazakhstan, 2014, pp. 44-45) Insurance premiums, payable on insuring risks in Kazakhstan are subject to 20 per cent withholding tax, and insurance premiums, payable on policies reinsuring risks in Kazakhstan are subject to 5 per cent withholding tax. All other income are subject to 20 per cent withholding tax. (PKF International Limited, 2012, p. 4)

### *Value added Tax (VAT)*

VAT is subject to be paid by individual entrepreneurs, resident legal entities (with the exception of state institutions), non-resident legal entities operating in Kazakhstan through a branch or representative office, trust managers and entities importing goods into Kazakhstan. Some types of activities, such as banking, insurance and others, are exempt from VAT. VAT is reported and paid on a quarterly basis. (Mahon, 2014, p. 68)

### *Personal Income Tax*

All Kazakhstani citizens as well as non-residents who are present in Kazakhstan for at least for 183 days in any consecutive 12-month period are subject to personal income tax. Kazakhstan tax residents should pay personal income tax on worldwide income, while non-residents are subject only on their Kazakhstan-source income.

Employers are responsible to withhold and remit income tax and pension fund contributions (which is not applicable for foreigners) on a monthly basis. (Mahon, 2014, p. 68)

Although Kazakhstan has a relatively good position in the global ranking on the ease of paying taxes, there are still some points which have to be improved. Kazakhstan residents and non-residents consider the Tax Code and other international taxation regulations (such as those set out in double taxation treaties) as ambiguous and complicated for understanding. There is no statutory guidance in country which may provide the appropriate interpretation of domestic and international tax laws. Thus, the present interpretation of tax regulations remain a challenge for local and international investors. (Mahon, 2014, p. 67)

## **Research question, research, and discussion**

We set the following research question: *Which tax challenges do foreign financial service organisations face entering in Kazakhstan?*

The qualitative method and particularly interview by using a questionnaire has been identified as the most appropriate research method for this study. Interviews were made with experts from the 11 foreign banks or their branches in Kazakhstan.

In 2014, the EY's attractiveness survey has presented a data that 56.8% out of 78 investors established in Kazakhstan assess corporate taxation as favourable (Ernst

and Young, 2014, p. 6). However some of residents and non-residents consider the Tax Code and other international taxation regulations (such as those set out in double taxation treaties) as ambiguous and complicated for understanding. There is no statutory guidance in country which may provide the appropriate interpretation of domestic and international tax laws. Thus, the present interpretation of tax regulations remain a challenge for local and international investors. (Mahon, 2014, p. 67)

On the whole, in the “Doing business 2016” report Kazakhstan stands at 18 in the global ranking of 189 economies on the ease of paying taxes (World Bank Group, 2016, p. 73).

According to the results of the present survey, the major part of respondents, that is 36% think that taxation regulations in Kazakhstan do not represent any obstacle for conducting business, and 27% consider it as a poor obstacle. Although 36% of respondents consider taxation regulations as a moderate obstacle for doing business, in general it can be stated that assessment of taxation regulations is positive.

## Conclusion

These results are not supporting the outcomes of the Ernst and Young’s Attractiveness survey, which revealed that a corporate taxation as attractive.

Our opinion, based on the research is, the taxation policy needs to be more transparent and comprehensible, or, special documents should be provided in order to give a more clear understanding of the rules, as some of organisations consider them unclear.

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