



CONSULTATION PAPER

AFSA-G-CE-2023-0002

Proposed Enhancing the Financial Services Tax Exemption Framework

Unrestricted

31 May 2023

INTRODUCTION

Why are we issuing this Consultation Paper (CP)?

The Astana Financial Services Authority (AFSA) has released a Consultation Paper to gather input from the market regarding the proposed *Guidance on the application of the Rules on substantial presence for AIFC participants seeking tax exemptions on corporate income tax and value-added tax (VAT) (Guidance on Substance Rules)*. The purpose of this consultation is to seek suggestions and feedback from stakeholders on the Guidance on the Substance Rules.

The Consultation Paper has been approved by the Legislative Committee of the Board of AFSA, indicating the official endorsement and authorization of the consultation process. The AFSA is seeking valuable insights and recommendations from the market to shape the final version of the Guidance.

By initiating this consultation, AFSA aims to ensure transparency, inclusiveness, and the participation of relevant stakeholders in the development of the Guidance. This collaborative approach allows for a comprehensive understanding of the market's perspectives and concerns, ultimately leading to the creation of a well-informed and effective set of rules.

Interested parties are encouraged to review the Consultation Paper and provide their suggestions and feedback based on their expertise and experience. This input will contribute to the refinement and enhancement of the proposed Guidance on the Substance Rules for AIFC participants.

Who should read this CP?

The proposals outlined in this paper will be of significant interest to various stakeholders, including international tax authorities or organizations, relevant government bodies, tax and law firms, and AIFC participants.

What are the next steps?

Interested stakeholders are encouraged to provide their comments on the proposed Guidance on the Substance Rules. It is preferable for comments to be submitted in writing and sent to the specified address or email. When submitting comments via email, please use the subject line "Consultation Paper AFSA-G-CE-2023-0002" to ensure proper identification. If applicable, stakeholders may also indicate the organization they represent when providing their comments.

Please note that unless expressly requested otherwise, the AFSA reserves the right to publish the comments received, including on its website. Stakeholders are encouraged to provide comments supported by reasoning and evidence, as such submissions will carry more weight in the assessment process conducted by the AFSA.

The deadline for providing comments on the proposed framework is 3 July 2023.

Once we receive your comments, we shall consider if any refinements are required to this proposal. Comments to be addressed by post:

Government Relations Division (Attention: M Ishaq Burney, MD and CLO)

Astana Financial Services Authority (AFSA)

55/17 Mangilik El, building C3.2, Kazakhstan

or emailed to: consultation@afsa.kz

Tel: +7 7172 613741

Background

- I. The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) is a collaborative effort among more than 139 countries and jurisdictions. Its goal is to implement the BEPS Package, which consists of 15 Actions designed to address tax avoidance, enhance international tax rules, and promote transparency in taxation.
- II. Kazakhstan joined the Inclusive Framework on BEPS in January 2017, committing to comply with four minimum standards outlined in OECD Action 5 (Harmful tax practices), Action 6 (Treaty abuse), Action 13 (Transfer pricing documentation), and Action 14 (Dispute resolution).
- III. Action 5 specifically focuses on harmful tax practices and requires member countries to undergo peer reviews to identify features of preferential tax regimes that could facilitate base erosion and profit shifting, potentially undermining the tax base of other jurisdictions.
- IV. The AIFC tax regime underwent a review by the OECD's Forum on Harmful Tax Practices (FHTP) between 2018 and 2020. The FHTP Peer Review identified risks of tax base erosion and profit shifting associated with the AIFC and the Republic of Kazakhstan's tax regimes.
- V. As a result of such review, the FHTP Secretariat requested the implementation of "substantial presence" requirements by the AIFC to align with the standards set out in Action 5 of the BEPS initiative, which addresses harmful tax practices.
- VI. In November 2021, the Joint Order between the AFSA and the Ministry of Finance of Kazakhstan endorsed the *Rules on the substantial presence of the AIFC participants applying tax exemptions for the payment of corporate income tax, and value-added tax* (Substance Rules).
- VII. The Substance Rules establish the requirements for determining the substantial presence, but they do not provide detailed guidance on how to meet requirements. As a result, further clarification is needed in this regard the AFSA commenced the development of the *Guidance on the Rules on the substantial presence of the AIFC participants applying tax exemptions for the payment of corporate income tax, value added tax* (Guidance on the Substance Rules), aiming to establish a clear procedure for applying the Rules and provide comprehensive explanations to AIFC participants.

Proposal

The Substance Rules apply to the AIFC participants' income derived from the tax exempt services.

If all the following conditions specified in paragraph 6 of the Substance Rules are met, the Participant may apply for exemptions from CIT and VAT:

- a. The Core Income Generating Activities (hereinafter, CIGA) of the AIFC Participant are provided on the territory of the AIFC and consist of the services established by paragraphs 3 and/or 4 of Article 6 of the *Constitutional Statute of the Republic of Kazakhstan On the AIFC* (Constitutional Law) and paragraph 5 of Chapter 3 of the *List of Financial Services provided by participants of the AIFC* (List of Financial Services).
- b. The amount of operating expenses incurred by the AIFC Participant must correspond to the adequate amount required for performing of the CIGA.
- c. The number of qualified full-time employees of the AIFC Participant must correspond to the adequate number required for delivery of the CIGA.

- **CIGA**

According to the Substance Rules, the Core Income Generating Activities (CIGA) that generate income and business value for AIFC Participants are specified in Article 6 of the and Chapter 3 of the List of Financial Services. It should be noted that the specific set of CIGA may vary for each AIFC Participant based on their license type, business model, and other conditions.

It is proposed to recognize a participant as conducting activities within the AIFC territory if two conditions met simultaneously: the substantial presence of Officers of the AIFC Participant within the AIFC's premises performing official duties, and the substantial presence of the Board of Directors or the main executive body of the AIFC Participant within the AIFC when making major strategic and commercial decisions. Here:

- the term "substantial presence" refers to the physical presence of relevant persons within an office or premises on the AIFC territory, as defined by the terms and conditions of a labor or civil agreement and the boundaries of the AIFC set by the relevant decree.
- The definition of "Officers" includes Directors, Secretaries, Senior Managers, and in the case of liquidation or bankruptcy proceedings, may also include Interim and Bankruptcy Trustees, as well as the Liquidator of the company.
- Major strategic and commercial decisions encompass decisions made by the Board of Directors or the main executive body of the AIFC Participant that affect the conduct of CIGA, obligations and rights under licensed service agreements, and the fulfilment of agreements where the AIFC Participant acts as a contractor/subcontractor for licensed services. For AIFC Participants registered as a Recognized Company (branch) in the AIFC, major strategic and commercial decisions are limited to activities directly related to the branch's operations.
- ***Fulfillment of the condition on adequate operating expenses***

It is proposed that operating expenses incurred by the AIFC Participant should be recorded in accordance with International Financial Reporting Standards and classified as operating expenses based on the accounting policy. For meeting requirements, the expenses should be directly connected to the CIGA performed by the AIFC Participant, generating income from the licensed services.

For verification of the adequacy of operating expenses it is proposed to formalize evidence of the following:

1. Execution of CIGA required to provide the licensed service during the relevant period.
2. Sources of operating expenses recorded in the accounting records, including salaries of employees involved in performing the necessary CIGA and expenses related to assets and liabilities used for carrying out the CIGA and providing the licensed services.

- ***Fulfillment of the condition on an adequate number of qualified employees***

It is proposed to link the condition on the adequate number of qualified employees with the existing requirements set by the AFSA regarding the number of employees, their professional qualifications, work experience, certifications, and other criteria during the authorization procedure.

The proposed approach is the principles-based, aligning with the general legal framework of the AIFC. This makes it straightforward to adopt and implement.

QUESTIONS

The proposed questions for public consultation are as follows:

1. *Does the Guidance on the Substance Rules provide you with a clear understanding of how to meet the substantial presence test? If not, please specify what aspects are unclear to you.*

What additions or amendments do you think should be made to the Guidance on the Substance Rules in order to be clearer?

3. Do you find the substance requirements burdensome? If yes, please explain in what ways and suggest how they could be eased.

4. Do you believe that your business will meet the substance requirements?

These questions aim to gather feedback and insights from the public regarding their understanding of the substantial presence test, suggestions for improving the clarity of the requirements, opinions on the burden of compliance, and the readiness of businesses to meet the substance requirements by the specified year.

Annex 1.

Guidance for Applying the Rules on the Substantial Presence of the Astana International Financial Centre Participants Applying Tax Exemptions for the Payment of Corporate Income Tax, Value Added Tax

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1. INTRODUCTION

- 1) This Guidance for Applying the Rules on the Substantial Presence of the Astana International Financial Centre Participants Applying Tax Exemptions for the Payment of Corporate Income Tax, Value Added Tax (hereinafter, the Guidance) is developed in accordance with Chapter 4 (Procedure for Applying the Rules) of the Rules on the Substantial Presence of the Astana International Financial Centre Participants Applying Tax Exemptions for the Payment of Corporate Income Tax, Value Added Tax, dated 17 October 2021 (hereinafter, the Rules).
- 2) The purpose of the Guidance is to provide a procedure for applying the Rules and to explain them to the Centre Participants. The provisions outlined in the Guidance must be followed by the Centre Participants in order to fulfil the conditions of substantial presence as defined by the Rules when carrying out activities on the territory of the Centre.
- 3) During tax audits, state revenue authorities may refer to the Guidance to determine whether the conditions of substantial presence outlined in the Rules have been met.

2. GENERAL PROVISIONS

- 1) Paragraph 6 of the Rules establishes the conditions that must be simultaneously fulfilled for a Centre Participant to be recognized as substantially present within the Centre's territory (referred to as "the Conditions").

If all the Conditions specified in paragraph 6 are met, the Participant may apply for exemptions from Corporate Income Tax (CIT) and Value Added Tax (VAT) when providing specified financial services, as outlined in paragraph 3 of Article 6 of the Constitutional Statute of the Republic of Kazakhstan "On the Astana International Financial Centre" (referred to as "the Constitutional Law") and paragraph 5 of Chapter 3 of the List of Financial Services provided by participants of the Astana International Financial Centre¹ (referred to as "the List of Financial Services").

- 2) The time period for a Centre Participant to be recognized as substantially present is a calendar year. The Participant will be considered substantially present only within the tax period in which they fulfill the conditions.
- 3) Centre Participants are required to follow the Guidance to independently determine whether the conditions stipulated by the Rules have been met when conducting activities within the Centre's territory.
- 4) Tax audits by state revenue authorities is conducted in accordance with the tax legislation of the Republic of Kazakhstan.
- 5) An economic study of the project, including expense justifications and employee numbers, must be submitted to the state revenue authority at the place of registration by March 31 of the year following the reporting period. This submission should follow the provided form in Annex 1 and consider the deadlines for extending tax return submissions.
- 6) Centre Participants should make their best efforts to submit the economic study according to the procedure and deadlines outlined in paragraph 5.
- 7) Failure to submit the economic study as per the procedure and deadlines mentioned in paragraph 5 may result in administrative liability in accordance with the laws of the Republic of Kazakhstan.
- 8) Outsourcing or subcontracting services and works directly related to the Core Income Generating Activities (CIGA) is not allowed outside of the RoK.

¹ Joint Order of the AIFC, the Ministry of National Economy of the Republic of Kazakhstan and the Ministry of Finance of the Republic of Kazakhstan "On Approval of the List of Financial Services Income from which is Exempt from the Payment of Corporate Income Tax and Value Added Tax, provided by Participants of the Astana International Financial Centre".

3. CONDITIONS OF THE SUBSTANTIAL PRESENCE

1) **CIGA**

Regarding sub-paragraph 1 of paragraph 6 of the Rules, the CIGA consist of services and inherent activities outlined in paragraph 3 of Article 6 of the Constitutional Statute and/or paragraph 5 of Chapter 3 of the List of Financial Services.

CIGA are essential and valuable activities that generate income and business value for Centre Participants, as explained in paragraph 10 of the Rules. Depending on the license type, business model, and other conditions, each Centre Participant may engage in a unique set of CIGA. The Participant may perform the full list of CIGA specified in their license.

A Centre Participant will be recognized as conducting activities within the Centre's territory if the following two conditions are met simultaneously:

- a. Employees of the Centre Participant are physically present within the Centre and perform their official duties on its premises.
- b. The Board of Directors or the main executive body of the Centre Participant is physically present within the Centre when making major strategic and commercial decisions.

"Substantial presence" refers to the physical presence of the relevant person for a specific period of time as defined by the terms and conditions of a labour agreement or a civil agreement, within an office or premises located on the territory of the Centre that the person has a right to use through ownership, lease, or other legal basis. The boundaries of the Centre's territory as defined by the relevant decree.

Major strategic and commercial decisions include any decisions made by the Board of Directors or the main executive body of the Centre Participant that impact:

- a. Conducting CIGA/providing licensed services;
- b. Obligations and rights under licensed service agreements;
- c. Fulfillment of agreements where the Centre Participant acts as a contractor/subcontractor for licensed services.

For Centre Participants registered as a Recognized Company (branch) in the Centre, major strategic and commercial decisions only pertain to activities directly related to the branch's operations.

2) ***Fulfillment of the condition on adequate operating expenses***

Regarding sub-paragraph 2 of paragraph 6 of the Rules, the amount of operating expenses incurred refers to expenses recorded in the Centre Participant's accounting records in accordance with International Financial Reporting Standards. These expenses should be classified as operating expenses according to the accounting policy for the profit and loss statement.

The adequacy of operating expenses means that there is a direct connection between the expenses incurred and the CIGA performed by the Centre Participant to generate income from the services or work provided as specified in paragraph 3 of Article 6 of the Constitutional Statute and/or paragraph 5 of Chapter 3 of the List of Financial Services.

Therefore, the link between operating expenses and CIGA indicates that these expenses were incurred to carry out the CIGA and ultimately generate income from the licensed activities.

To independently verify the fulfillment of the condition of adequate operating expenses, the Centre Participant should have documented evidence of the following:

- I. The execution of CIGA required to provide the licensed service during the period.
- II. The sources of operating expenses recognized in the accounting records, including but not limited to:
 - a. Salaries of employees and individuals directly involved in performing the CIGA necessary for providing the licensed services.
 - b. Expenses related to assets and liabilities of the Centre Participant directly used to carry out the CIGA and necessary for the provision of the licensed services.

3) *Fulfillment of the condition on an adequate number of qualified employees*

Regarding sub-paragraph 3 of paragraph 6 of the Rules, it implies that the Astana Financial Services Authority's (referred to as "the AFSA") requirements regarding the number of employees, their professional qualifications, work experience, certifications, and other criteria established during the authorization procedure and license acquisition must be met during the period.

4. PROCEDURE FOR APPLYING THE GUIDANCE

For matters not addressed in the Guidance, the Centre Bodies, in accordance with the Constitutional Law, have the authority to:

- 1) Amend and supplement the Guidance in consultation with the state authority responsible for tax collection and other mandatory payments to the budget, as long as it is not contradictory to the Constitutional Statute cons.
- 2) Provide explanations and comments on the application of the Guidance within their jurisdiction.

Annex 1

*to the Guidance for Applying the Rules on the Substantial Presence
of Participants of the Astana International Financial Centre Applying
Tax Exemptions for the Payment of Corporate Income Tax, Value Added Tax*

**Form of economic study of the project,
justification of expenses and number of employees**

Section A. General information about the taxpayer

1. BIN: _____
2. Tax period for which the Form is submitted: _____
3. Name of the taxpayer: _____
4. Name of the licence issued by the Astana Financial Services Authority:

5. Licence number, date of issue: _____
6. Types of core income generating activities (according to paragraph 5 of Chapter 3 of the List of Financial Services)

Section B. Information about income

Income	Total income (excluding VAT, in KZT)
Income from licensed activities on the territory of the Centre	
Other income	
TOTAL	

Section C. Information about expenses

Description of expenses	Total income (excluding VAT, in KZT)
Total amount of operating expenses	
<i>including:</i>	
- expenses associated with the maintenance and upkeep of the office on the territory of the Centre, in which workplaces are located	
- expenses for qualified personnel (payroll, taxes)	
- depreciation charges calculated on assets used for the CIGA;	
- other expenses for goods, works, services used when carrying out the CIGA	
Other expenses	
TOTAL	

Section D. Information about qualified personnel

Expenses for employees	Headcount	Total expenses, in KZT
Payroll and tax expenses for qualified employees		
Payroll and tax expenses for other employees		
TOTAL		

Head of "_ (insert name of the legal entity)"

Full name

Seal

Submission date: