Tax relief under the Kazakhstan-Cyprus Double Tax treaty: Case studies and proper structuring

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- Incorporation and Management of Cyprus and offshore companies;
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Kazakhstan-Cyprus double tax treaty (Main points 1)

New Double Tax Treaty signed on 15 May 2019 between Cyprus and Kazakhstan and expected to come into effect on the 1st of January 2020. Cyprus was deleted from the Kazakhstan list of black-listed jurisdictions. The new Treaty is Based on the OECD Model Convention.

Dividends

A maximum withholding tax rate of **5%** is applicable if the beneficial owner of the dividends is a company (other than a partnership) holding directly at least 10% of the capital of the dividend-paying company. In all other cases, tax is withheld at a rate of 15%.

Interest

A maximum withholding tax rate of **10%** is applicable if the recipient of the interest income is the beneficial owner of such income.

Royalties

A maximum withholding tax rate of **10%** is applicable if the recipient of the royalties is the beneficial owner of such income. Royalty payments are in consideration for: the use of, or the right to use, any copyright of literary, artistic or scientific work, software, including cinematograph films, tapes for radio or television broadcasting, any patent, trademark, design or model, etc. Royalty payments do not include payments for the use of, or the right to use, ships or aircrafts.

Kazakhstan-Cyprus double tax treaty (Main points 2)

Capital gains

As regards capital gains, Cyprus maintains the exclusive taxing rights on disposals of shares made by Cyprus tax residents, except in the following cases:

(i) non-listed shares which derive more than 50% of their value, directly or indirectly, from immovable property situated in Kazakhstan, and,

(ii) shares which derive the greater part of their value from certain offshore rights and/or movable property relating to exploration or exploitation of the seabed or subsoil or their natural resources located in Kazakhstan.

The Treaty also complies with the OECD/G20 Base Erosion and Profit Shifting (**BEPS**) project Action 6 PPT, which is a minimum standard under the BEPS project. The PPT provides that a DTT benefit shall not be granted, under conditions, if obtaining that benefit was one of the principal purposes of an arrangement or transaction.

Foreign investment in Kazakhstan via a Cyprus company

Foreign Investor → Cyprus limited liability company → Foreign Investor purchasing shares in Kazakh company via the Cyprus company

Dividends paid to the Cyprus company from profits of the Kazakh company shall be taxed at 5%, subject to the terms of the Double Tax Treaty

Repatriation of capital in Kazakhstan via a Cyprus company

Dividends paid to the Cyprus company from profits of the Kazakh company shall be taxed at 5%, subject to the terms of the Double Tax Treaty

Financing activities in Kazakhstan via a Cyprus company

Investor → Cyprus limited liability company → Investor uses Cyprus company to purchase shares of Kazakh company through loan

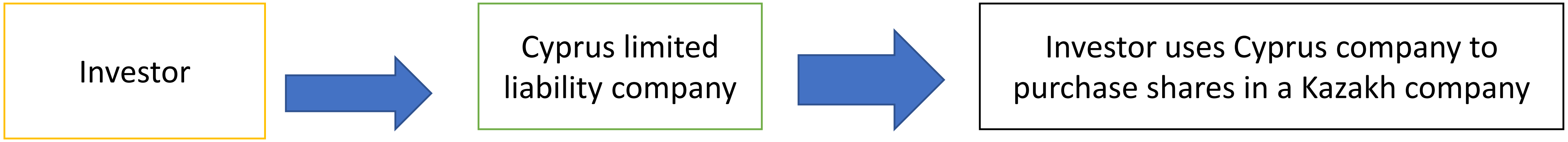
Interest paid by the Kazakh company to the Cyprus company pursuant to the Loan shall be taxed at 10%, subject to the terms of the Double Tax Treaty

Capital gains tax

Investor → Cyprus limited liability company → Investor uses Cyprus company to purchase shares in a Kazakh company owning real estate in Kazakhstan

In case of a Cyprus company, owing a Kazakh Company investing in real estate, no capital gains tax arise, when the Cyprus Company sells the shares of the Kazakh company, provided that less than 50% of the value of the shares is directly or indirectly derived from immovable property situated in Kazakhstan.

Asset protection through the use of Cyprus companies for investment in Kazakhstan



The Investor receives dividends, interest or royalties from Kazakhstan in a Cyprus company/foreign entity keeping a bank account in Luxembourg, and thus protecting its assets.

Substance over form:
Proper structuring is needed to safeguard tax reliefs and counter anti-abuse provisions of the Treaty

The anti-abuse rules of the Double Tax Treaty require substance over form, which, basically, means that as long as a company has proper substance and commercial rationale, it is eligible to benefit from the treaty. A Company should comply with the substance-over-form test, meaning:

-It should be managed and controlled in Cyprus,

-It should have fully fledged offices, and

-The effective management should be made in Cyprus.

Advantages of the KZ-CYP Double Tax Treaty over the KZ-Netherlands Treaty

Although the tax rates provided in the 2 Treaties are similar Cyprus has certain advantages over the Netherlands:

-Cyprus professionals provide more cost-efficient services,

-Cyprus has been a business-friendly jurisdiction offering high-quality professional services to Russian and former CIS countries individuals and entities for the past 20 years,

-Tax authorities in Cyprus are well versed to the application of double tax treaties,

-Substance and effective management is achieved in Cyprus on a more cost-efficient basis.

Conclusion

The entry into effect of the Kazakhstan-Cyprus Double Tax Treaty is expected to divert the attention of practitioners and businessmen towards a more cost efficient and business friendly jurisdiction such as Cyprus.

Being a member state of the EU and Eurozone and offering high quality cost efficient financial services related to Companies, Funds and investment structures, Cyprus is expected to become an attractive location for foreign and domestic investors aiming to invest in Kazakhstan.

The use of a Cyprus entity combined with a Luxembourg bank account can maximize the tax relief and asset protection offered by the Double Tax Treaty.