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Some Aspects of Taxation of Income Gained by Foreigners Engaged for Work in Kazakhstan within a Secondment

Dear Sirs and Madams,

First of all, we would like to congratulate the organizers and participants with the Tenth Anniversary of the International Atyrau Legal Conference. We note that KPLA is one of a few professional organizations in the Republic of Kazakhstan that is effective and provides vast opportunities for the legal community to discuss the most urgent matters and exchange experience.

In this connection, we would like to express our gratitude and appreciation to Mrs. A. Bralina and Anastasia for their contribution to KPLA work that, for the last ten years, has been performed on a due professional level and has met high standards of conference organization.

Today we offer you to consider some aspects of taxation of foreigners in the Republic of Kazakhstan that have been attracted for work within a secondment.

It is known that due to some specifics, the oil and gas sector requires attraction of a wide range of specialists who are highly qualified, experienced and specialized in oil production. In this respect, this sector is the one requiring attraction of a number of foreign specialists the deficiency of whom cannot be covered by the domestic labor force market of the Republic of Kazakhstan.

For these purposes, the law provides for various means using which foreign specialists may be attracted for work in the Republic of Kazakhstan to meet the foreign labor demand and needs on the domestic market. In particular, attraction of foreign specialists by direct employment; hiring of contractors providing independent personal (professional) services; within provision of secondment services under contracts concluded by legal entities; secondment of foreign workers from a head office of a foreign company to their permanent establishments and subsidiaries in Kazakhstan and other. A certain tax burden is borne by a subsoil user in each and every case.

. Attraction of foreign labor is widely practiced by means of a secondment that became regulated by law this year, but was actually used for quite some time, especially in large oil projects. In this connection we offer to consider in details the matters related to taxation of foreigners in case of a secondment as the most urgent and requiring more accurate legal regulation.

1. Residents and Non-Residents of the Republic of Kazakhstan

It shall be first noted that taxation of foreigners is generally carried out in accordance with the residence principle that is fundamental and determines a tax regime applied to foreigners' personal income.

The tax laws of the Republic of Kazakhstan (Articles 189 and 190 of the Tax Code) provide for the following criteria for declaring a foreigner a non-resident of the Republic of Kazakhstan:

- First, non-residents are foreigners staying in the Republic of Kazakhstan for less than 183 calendar days (including the days of arrival and departure) during any consecutive twelve-month period ending within the current tax period; in this respect, such foreigners shall not have vital interests in the Republic of Kazakhstan, in particular, a residence permit in the Republic of Kazakhstan;

- Second, foreigners who are considered non-residents in accordance with the provisions of international conventions on avoidance of double taxation ("Conventions").

The provisions of the domestic tax laws determine conditions for acknowledgement of residency that follow the principles established in the common world practice.

According to a common rule, foreigners who have obtained the residency status shall bear the same tax liability as the citizens of Kazakhstan, while taxation of non-residents presupposes independent regulation and the requirement for recognition of their income gained from sources in the Republic of Kazakhstan.

In its turn, income of a non-resident foreigner gained from activities in the Republic of Kazakhstan under an employment agreement with an employer (resident or non-resident) and other income gained due to activities in the Republic of Kazakhstan are considered income from sources in the Republic of Kazakhstan (Article 192 of the Tax Code).

Taking into consideration definition of income from a source in the Republic of Kazakhstan stipulated by law, as well as wide interpretation of the meaning of "activities in the Republic of Kazakhstan", it shall be noted that regardless of a form and place of payment of income gained from activities of a non-resident individual in the Republic of Kazakhstan, according to the tax laws of the Republic of Kazakhstan, such individual bears tax liability in Kazakhstan and a tax agent is liable for income tax assessment, withholding and transfer.

Acknowledgement of the residence status of a foreign specialist has a significant practical meaning for correct tax assessment and declaration of foreigners' personal income.

2. Secondment

It shall be noted that due to introduction of new provisions to the laws of the Republic of Kazakhstan concerning migration and foreign labor attraction, the term «secondment» is not comprehensively regulated in the tax laws. In this connection, there are practically a number of matters and disputes concerning foreigners' income taxation requiring additional regulation that are discussed in more details below.

Thus, in accordance with a new version of the Procedure and Terms for Foreign Work Permit Issuance and Foreign Labor Attraction (approved by Resolution of the Government of the Republic of Kazakhstan No. 45 dated January 13, 2012) ("the Procedure"), a term «secondment» is introduced for the first time.

The Procedure determines that a secondment means a temporary transfer of a foreigner or stateless person under a letter and/or agreement of secondment from a foreign legal entity for performance of work or provision of services to a branch, subsidiary, representative office or affiliated person of such foreign legal entity that are registered in the Republic of Kazakhstan.

If a foreign company seconds its personnel to its own branch / representative office (permanent establishment) in the Republic of Kazakhstan, the foreign company bears full tax liability for its personnel through its branch / representative office.

The most of questions arise due to a secondment to an affiliated company.

Basically, a secondment is a temporary (up to three years) secondment by a non-resident of its own personnel to an affiliated person where such personnel provide work or services in the interests of the non-resident. Thus, a secondment has a number of significant differences that are listed below and do not allow qualifying it as hiring of its own personnel:

- First of all, this is a secondment of personnel which does not provide for creation of employment relations between the personnel and accepting affiliated person;

- Works and services provided by such personnel in Kazakhstan are based on a Secondment Agreement (or Letter) concluded between the seconding foreign company and its affiliated person;
- An employment agreement between the seconding foreign company and personnel and provisions thereof stay in effect regardless of the work place; in this respect, the foreign company bears liability and risks related to its personnel labor activity;
- The seconding company shall pay for labor of its seconded personnel at its location;

It shall be also noted that a secondment significantly differs from services on provision of foreign personnel for hiring, in particular:

- Work and services provided by such personnel in Kazakhstan are based on a Secondment Agreement (or Letter);
- A secondment may be carried out free of charge or on the periodic rotation principle.

Taking into account the listed differences, interpretation of a “secondment” is still a challenging matter for taxation purposes as such term is currently absent in the tax laws.

3. Definition of a Worker for Tax Purposes

The tax laws provide for the term “employee” the meaning of which is significantly broader than the one in the labor laws and Procedure. In particular, according to Clause 26 of Article 12 of the Tax Code, *an employee is an individual employed by an employer and performing work under an employment agreement (contract); a foreigner or stateless person provided for work under a contract for provision of personnel by a non-resident whose activity does not provide for a permanent establishment to a resident or another non-resident operating in the Republic of Kazakhstan through a permanent establishment.*

Since, as it has already been stated above, a secondment provided for by the Procedure is not regulated by the Tax Code and significantly differs from hiring the personnel or provision of personnel for employment, questions of classification of personnel arriving within a secondment arise for an accepting affiliated person.

Getting back to the residence principle discussed above, it shall be noted that during first 182 days of foreign personnel's stay in Kazakhstan its income may be considered as income from sources in the Republic of Kazakhstan and therefore, excluded from income tax according to the provisions of Article 202 of the Tax Code.

Upon expiry of the specified period, a foreign individual becomes a resident of the Republic of Kazakhstan. While not being an employee of an accepting affiliated person, a seconded foreigner is basically not in any employment relations with the accepting affiliated person.

However, according to Article 202 of the Tax Code, a foreigner's income is subject to income tax in the Republic of Kazakhstan under an agreement between the individual and its non-resident employer. In this respect, an employing foreign company shall provide a tax agent with notarized copies of employment agreements with a seconded individual.

Taking into account that employment relations between a non-resident company and a foreigner are kept and maintained during his/her entire stay in the Republic of Kazakhstan and payment of all or partial income outside the Republic of Kazakhstan is possible, such income may be taxable not only in Kazakhstan, but also in the country where the foreigner is a resident and where such income is paid.

In this connection, we would like to consider the issue of double taxation of foreign personnel's income in more details.

4. Avoidance of Double Taxation

Attraction of foreign personnel within a secondment causes a number of questions from the international taxation point as in most cases it is assumed that foreign personnel's income in form of payroll is paid abroad. Such questions are first of all related to risk of double taxation of income payable to foreign personnel in Kazakhstan and country of residence of such foreign personnel.

In this connection, we note the requirement to apply international conventions on avoidance of double taxation with participation of the Republic of Kazakhstan. Based on an analysis of conventions concluded by Kazakhstan with Great Britain, USA, Netherlands, Italy and Germany, it may be stated that all these conventions are based on common principles for residency determination and taxation of personal income gained at a workplace or from dependent personal services. We would like to consider only general tendencies with no regard to particular discrepancies.

According to Article 4 of each of the above-mentioned Conventions, a resident of a Contracting State is any person who under the laws of the State is subject to taxation due to his/her place of residence. At the same time, persons who are subject to taxation in such State only with regard to income from sources and capital located in such State are an exception.

According to Article 15 of each Convention, *Dependent Personal Services or Income Gained at Workplace*, foreigner's income gained in course of employment or due to performance of employment duties in Kazakhstan are taxable in Kazakhstan if the foreigner stays in Kazakhstan for more than 183 days.

Thus, double taxation of a foreigner's income gained from sources in Kazakhstan can be eliminated by application of a Convention not in Kazakhstan, but in another country where the foreigner is a resident. That is, income of a foreign individual staying in the Republic of Kazakhstan for more than 183 days gained from sources in Kazakhstan will be taxed in Kazakhstan. Double taxation is managed to be eliminated by exemption of income taxable under the laws of the Republic of Kazakhstan from taxes in a country that the Convention has been signed with by crediting taxes paid in Kazakhstan towards taxes charged such country.

5. Social Tax

According to the provisions of the Tax Code, an employing company is a payer of social tax. Such tax is charged and paid by resident and non-resident companies with a permanent establishment in the Republic of Kazakhstan.

The items taxable with social tax in Kazakhstan are employers' expenses paid to their employees, including foreign employees. If an employee stays in Kazakhstan for more than 183 days and becomes a resident, employer's expenses related to payment of his/her income is also taxable the same way as income of citizens of Kazakhstan.

Social tax also arises in connection with income of foreigners who are not residents of the Republic of Kazakhstan and who have gained income from sources in Kazakhstan: under an employment agreement in form of remuneration of a manager or management board member, any benefits due to residence in the Republic of Kazakhstan or material profit received from an employer.

Taking into account that a company accepting personnel within a secondment is not an employer for such seconded foreign personnel and is not liable for costs payable as income to the seconded foreign personnel, it shall be understood that social tax shall not be charged. However, if a secondment is interpreted as provision of personnel for hiring, such personnel's income will be subject to social tax as according to Clause 2 of Article 357 (*Taxable Items*) income of foreign personnel provided by a non-resident under a secondment contract is subject to social tax in Kazakhstan.

International conventions do not apply to social tax as taxpayers are Kazakhstani or foreign companies with permanent establishments in Kazakhstan, while taxable items are expenses of such companies or income of personnel provided by a non-resident.

To summarize the above-mentioned, it shall be noted one more time that the tax laws currently require to be amended to ensure elimination of the mentioned gaps and compliance with the labor and labor migration laws.