

# Foreign Legal Entities Engaging in the Licensed Subsoil Use Activities in Kazakhstan: Legal Opportunities vs. Practical Challenges

## Осуществление иностранными юридическими лицами лицензируемых видов деятельности в сфере недропользования. Правовые возможности vs практические трудности

Following the general legislative trend towards improving the investment climate and creating favorable regulatory background for foreign businessmen, the licensing legislation has also been changing over the past several years. For instance, on 16 May 2014 Kazakhstan adopted its Law "On Permits and Notifications" (hereinafter, the Permit Law or the Law), putting it into effect starting 20 November 2014. The primary purport of the Law was to harmonize and systematize the regulatory requirements governing the licensing, permit issuance and notification procedures and to streamline the licensing procedure, including for foreign businessmen willing to engage in the licensed types of activities in the territory of Kazakhstan<sup>1</sup>.

Let us further look into the Law regulations improving the position of foreign residents and check the possibility of their practical implementation.

### Possibility to Conduct Licensed Activities without "Legal Presence" in Kazakhstan

Foreign companies often render one-time services to Kazakh subsoil users and do not need to be permanently present in the Kazakhstan territory. The Law provisions on permits allowing foreign residents to conduct the licensed activities without the necessity to set up a branch or a local legal entity significantly simplify business, not only for

such foreign residents, but also for Kazakh subsoil users who are entitled to freely choose subcontractors, both residents and nonresidents of Kazakhstan, to render or perform the licensed services and work.

The previously effective Law "On Licensing" of 11 January 2007 (hereinafter, the 2007 Law) provided for a possibility to issue licenses to foreign residents (Article 9) and set out a principle of license issuance on equal grounds and equal terms for all persons (Article 4). However, the accompanying license-issuance terms, qualification requirements to potential licensees and the formed practice gave no legal and practical opportunities to obtain a license, including for the activities in the subsoil use area, without a Kazakh legal entity. This meant that it was necessary to set up a Kazakh legal entity, or organize activities via the already existing Kazakh legal entity, or open a branch or a representative office of the foreign legal entity in the territory of Kazakhstan.

In particular, pursuant to the 2007 Law, licenses were issued at the place of registration of an individual or a legal entity in cases where licenses were to be issued by local executive authorities or territorial bodies of the central authorized agency (Article 42), which made it impossible to obtain a license without registering a branch (representative office) or subsidiary in the RK territory.

Currently, the Permit Law not just provides for the right of foreign residents to conduct the licensed activities in the RK territory (Article 20), but expressly provides for the possibility to obtain the license at the place of performance of such licensed activities in case of absence of a Kazakh branch or representative office (Article 29).

Before the Permit Law adoption, the impossibility to effect payment

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of the mandatory licensing fee without being legally present in the territory of Kazakhstan was one of the key obstacles for foreign residents to obtain the license in practice.

Despite the fact that the Tax Code even now contains a general rule according to which the licensing fee is to be paid to the state budget at the place of the licensee location, the latest regulatory amendments entitle foreign residents to make the payment using their business identification number without the need to be mandatorily present in the Kazakhstan territory. In this case, having a branch or representative office is not requisite (Article 27 of the Law).

### Practical Difficulties for Conducting Licensed Activities without "Legal Presence"

Notwithstanding the fairly flexible licensing regulations, in practice, foreign companies are encountering difficulties when conducting the licensed activities without setting up a branch or a Kazakh subsidiary.

#### Priority of Local Subcontractors in the Procurement of Services by Subsoil Users

Pursuant to the current legislation, local subsoil users must purchase goods, work and services via procurement performed (i) through open tenders; (ii) through request for quotation; (iii) from a sole source; (iv) through the e-procurement system; or (v) through commodity exchanges. Each of the procurement methods is characterized by certain specifics, all of them, however, falling within the same essential requirement — each subsoil user, same as potential suppliers of goods, work and services, must perform procurement/sales via a special information system called the "Register of Goods, Work and Services Used in Subsoil Use Operations, and Producers Thereof" or another similar system<sup>2</sup>.

The goods, work and services procurement rules allow foreign persons to also participate in the procurement of goods, work and services as a supplier/seller. In order to participate in the procurement, the foreign resident must obtain in the RK National Certification Center an electronic digital signature and enter it into the register of registration certificates, then register with the information system as a procurement participant (service provider) and register in the same system those persons authorized to

<sup>1</sup> The licensed activities also include subsoil use operations, for example, engineering-geological and engineering-hydrogeological operations; design of main oil pipelines, oil product pipelines and gas pipelines; special operations in soils; special construction and assembly operations for laying, major repair and reconstruction of infield and main networks of oil pipelines and gas pipelines, and so on.

<sup>2</sup> One of such systems is <https://reestr.kca.kz/>.



form the information and place it on the system.

Local suppliers of goods, work and services enjoy priority over foreign suppliers by virtue of subsoil users' legislative and contractual obligations to ensure, on a mandatory basis, the "local content" when procuring goods, work and services. Failure to comply with this requirement entails imposition of fines on subsoil users and may qualify as a material breach of contractual obligations.

Therefore, in case a foreign resident is participating in a procurement tender for licensed services concurrently with a Kazakh company (several Kazakh companies), the potential subsoil user customer must (i) artificially lower the local supplier's quote, and (ii) all other conditions being equal, give preference to local supplier. In this case, recognized as a local provider of goods, work and services will be the Kazakh legal entity, even if it is 100% foreign-owned. Branches and representative offices of foreign companies do not enjoy such status.

In view of the above, the foreign resident may find it preferable to set up a subsidiary in the RK territory in order to compete on equal terms with other local providers for a contract when participating in the subsoil user procurement of goods, work and services.

#### *Migration Issues*

Services and work are provided in the Kazakhstan territory by employees (representatives) of the foreign resident. In most cases, foreign citizens require a visa to visit the RK. If the foreign resident does not intend to organize a "legal presence" in the RK territory, the longest period for its employees (representatives) to stay in Kazakhstan is 120 calendar days over one calendar year, which may be unsuitable both for the foreign resident and the subsoil user customer for the licensed work and services. There is an additional difficulty the foreign resident bumps into when issuing visa support for its employees, because such support would have to be made by the Kazakh customer company for which such actions may be cumbersome or excessive. As a consequence, when choosing contractor for the licensed activities, the subsoil user customer may give preference to the contractor who will not be obligated to comply with the limitations on its employees' periods of stay and will not encumber its customer by the necessity to issue the visa support.

#### *Customs Clearance and Equipment Certification Issues*

In the event the foreign resident needs to import into Kazakhstan some equipment in order to render

the licensed activities, it is likely to encounter difficulties with the customs clearance of such equipment. If imported on a temporary basis for Kazakh companies, the imported equipment may be cleared under the regime of release for domestic consumption or under the temporary importation regime. The obligations to perform customs clearance and pay customs charges lie with the Kazakh recipient of equipment. The temporary importation regime is also characterized by the fact that the imported equipment can be located and used in Kazakhstan with certain restrictions. In particular, the imported equipment must be actually owned and used by the declarant, i. e., the Kazakh recipient.

Moreover, some equipment is allowed to be used only on condition of its prior certification in Kazakhstan. As a general rule, certification is performed at the stage of the imported equipment customs clearance in Kazakhstan and is to be ensured by the Kazakh recipient. Taking into account that in order to perform the certification it is necessary to provide the goods samples, which makes difficult the goods certification prior to their customs clearance, in practice, the customs authority performs conditional release, i. e., issues the goods to the Kazakh recipient, imposing an obligation to provide the conformity certificate within a certain term.

All the above requirements may lead to a situation where the local subsoil user would as well prefer not to use the foreign resident's services in order to avoid extra liability and labor costs related to the necessity to perform customs clearance and equipment certification. Of course, the foreign resident may authorize a local representative to perform on its behalf all formalities to certify the equipment in Kazakhstan. However, in this case the representative's activities will qualify as the foreign resident's "permanent establishment" in the RK territory, with all stemming tax implications as described below.

#### *Tax Risks*

Pursuant to the tax legislation, certain activities performed by foreign residents in the territory of Kazakhstan and, particularly, related to subsoil use, entail the risk of such activities' recognition as a "permanent establishment" and, accordingly, application of Kazakhstan taxes. In a case where even a one-time rendering of services in the territory of Kazakhstan leads to such activity's recognition as a permanent establishment of the foreign resident, the latter will have arising a tax liability in the RK, in particular, the income from service

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will be subject to corporate income tax to the extent such income refers to the permanent establishment. The current corporate income tax rate is 20%. Moreover, the foreign resident's net income will also be subject to taxation (the net income is the taxable income less corporate income tax). The current net income tax rate is 15%.

The above implies that there exists a possibility that the tax risks of engaging in the licensed activities in the RK territory without setting up a branch, a representative office, or a local subsidiary would be higher than the risks of conducting such activities via a branch (representative office) or a Kazakh legal entity.

#### **What's the Gist?**

Despite certain changes in the legislation governing licensed activities meant to be positive for foreign residents, there exist reasonable practical obstacles for conducting such activities in the RK territory without setting up a Kazakh legal entity or opening a branch (representative office). The Law regulations on permits that offer foreign residents luring options to engage in the licensed activities without extra costs of organizing a Kazakh company or opening a branch (representative office) are but declarative provisions, because foreign residents would face practical difficulties and, in order to avoid negative consequences and additional tax burden and to compete on equal terms with local contractors, would choose in most cases a standard way to do business in Kazakhstan – via opening a branch or setting up a Kazakh legal entity. ■