

# Investment Tax Structuring in Kazakhstan: The Top 11 Questions Asked about AIFC

**kept**

 **Business Connect**



In Autumn 2022, Kept and the AIFC held a webinar for Russian and international investors on tax structuring of investments in Kazakhstan.<sup>1</sup> The speakers addressed the efficiency of structures with assets in Kazakhstan and discussed how the benefits and advantages provided by the AIFC can help improve tax efficiency and achieve the business goals of investors.

The topic sparked great interest from the audience with the participants asking a great deal of questions regarding the AIFC. We have chosen the **11 most common questions** and provided answers from Kept and AIFC experts.

## 1. Is it mandatory to provide licensed financial services for registration as an AIFC participant?

Indeed, the AIFC rules provide for licensing of certain activities<sup>2</sup>. The AIFC Law also contains a list of corporate income tax (CIT) and VAT-exempt financial services (e.g. brokerage and asset management services).<sup>3</sup> However, these activities are not a pre-requisite for registration of a company in the AIFC, so joining the AIFC is possible by carrying out other activities that are not subject to licensing.

## 2. Does the AIFC provide tax benefits to companies engaged in non-financial businesses?

In addition to tax benefits for certain types of financial activities, the Constitutional Statute on the AIFC offers tax benefits for all AIFC participants, regardless of the activities they engage in. Such benefits include:

- 1) exemption from a corporate and a personal income tax on dividends on shares and interests in an AIFC participant, and
- 2) exemption from a corporate and a personal income tax on capital gains upon disposal of shares and interests in an AIFC participant.<sup>4</sup>

## 3. Does the AIFC have the substance rules or requirements? Which companies are subject to these rules and what is the current practice of applying them?

On 1 January 2022, so-called Rules on the Substantial Presence were introduced by the AIFC, which stipulate requirements for a sufficient headcount and operating expenses of an AIFC participant in order to be eligible for CIT and VAT benefits<sup>5</sup>. In addition, these rules impose restrictions on the outsourcing of certain functions and introduce requirements for the geography of services provided.

<sup>1</sup> The Webinar record is available [via the link](#)

<sup>2</sup> Schedule 1 of the AIFC General Rules

<sup>3</sup> Paragraph 3 of article 6 of Constitutional Statute of the Republic of Kazakhstan on the Astana International Financial Centre No. 438-V ZRK of 7 December 2015 (hereinafter, the AIFC Law)

<sup>4</sup> Subparagraphs 2 and 4, paragraph 7 of article 6 of the AIFC Law

<sup>5</sup> AIFC Rules on the Substantial Presence

It is important to note that the Rules on the Substantial Presence only apply to participants that perform regulated (licensed) activities in the AIFC, those being financial services from a separate list and auxiliary professional (consulting) services. Other AIFC participants are not subject to the rules.

Given the novelty of the rules, the practice of their application has not yet been established, which complicates the process of tax administration and creates difficulties in the interpretation of the provisions of these rules by taxpayers. The AIFC is expected to issue guidelines to these rules in the near future, which will detail the requirements for participants and help make their application more predictable for businesses.

#### **4. Is it possible to redomicile an existing entity from a foreign jurisdiction to the AIFC?**

Yes, a company can be redomiciled from a foreign jurisdiction to the AIFC<sup>6</sup> (unlike the general jurisdiction of Kazakhstan, where redomiciliation is not allowed). The redomiciliation from a foreign jurisdiction to Kazakhstan is only allowed for legal forms provided for by the AIFC legislation. It is important to note that a change of registration ('domicile') is a complex procedure that requires significant work in two jurisdictions at once.

On the part of the AIFC, the key requirements for redomiciliation are:

- 1) the possibility of redomiciliation in the source jurisdiction;
- 2) the existence of a legal opinion that a company has met all the requirements for exiting the source jurisdiction;
- 3) the existence of a legal opinion that a company complies with the AIFC legislation.<sup>7</sup>

#### **5. A holding company in the AIFC intends to invest its own funds in various securities. Will such activity be subject to licensing in the AIFC, and what tax benefits can the company count on in this case?**

The management of own cash, including any investment in securities, is not a regulated activity in the AIFC, since each participant is free to dispose of its own money, and the licensing requirement is introduced where an activity associated with the risk of loss is carried out using funds received from third parties<sup>8</sup>.

This activity is also not on the list of activities exempt from CIT and VAT, and therefore income received from investments will be taxed on a general basis in Kazakhstan. Nevertheless, the holding company in the AIFC will be eligible for the same tax benefits as any other AIFC participant (see answer to question No. 2), as well as those applicable to ordinary Kazakhstani taxpayers, with some examples being tax benefits on income from securities listed on stock exchanges in Kazakhstan<sup>9</sup>, or on dividends received<sup>10</sup>.

#### **6. A foreign investment company (e.g. one incorporated in the Emirate of Dubai, UAE) plans on making investments in Russian financial instruments through a company established in the AIFC. What tax implications are there for creating such an investment entity in Kazakhstan?**

From a tax perspective, such an entity may qualify for tax benefits that would otherwise be unavailable to a UAE-incorporated company when directly investing in Russian financial instruments, e.g. reduced tax rates on dividend (10% instead of 15%<sup>11</sup>) and interest (10% instead of 20%<sup>12</sup>) distributions from Russia. At the same time, an ordinary company registered with the AIFC will be subject to the standard tax rules in Kazakhstan (for more detail, see the answer to question No. 5), which may lead to a decrease in the overall tax efficiency of the structure. With this in mind, it would make sense to assess the feasibility of creating an investment fund (Collective Investment Scheme)<sup>13</sup> in the AIFC, which, if properly structured, can reduce tax on investment income to zero in Kazakhstan.

<sup>6</sup> Sections 151–154 of the AIFC Companies Regulations

<sup>7</sup> Part 13 of the AIFC Companies Regulations and part 5 of the AIFC Companies Rules

<sup>8</sup> A list of regulated and licensed activities is provided in Schedules 1, 2 and 4 of the AIFC General Rules

<sup>9</sup> Subparagraphs 2 and 9, paragraph 2 of article 288 of the Tax Code of the Republic of Kazakhstan

<sup>10</sup> Subparagraph 1, paragraph 1 of article 241 of the Tax Code of the Republic of Kazakhstan

<sup>11</sup> Subparagraph 1, paragraph 1 of article 309 of the Russian Tax Code and article 10 of the Convention between the Government of the Russian Federation and the Government of the Republic of Kazakhstan for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Regard to Taxes on Income and Capital

<sup>12</sup> Subparagraph 3, paragraph 1 of article 309 of the Russian Tax Code and article 11 of the Convention between the Government of the Russian Federation and the Government of the Republic of Kazakhstan for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Regard to Taxes on Income and Capital

<sup>13</sup> See the AIFC Collective Investment Scheme Rules

However, one needs to consider the relative complexity of its registration, the substance requirements for a management company, as well as financial regulations (e.g. the required base capital can range from USD50 to 500 thousand). Thus, the economic feasibility of such instruments in the AIFC will depend on the size of the investment portfolio and future investment income in the structure.

**7. Is there any possibility of tax burden reduction on royalty income received by a Russian company from Kazakhstan? For example, through structuring a license agreement through a Cypriot company complying with the substance rules and involved in the development of intellectual property?**

Royalty income is subject to a 15% withholding tax in Kazakhstan. The tax treaties between Kazakhstan and Cyprus, as well as between Kazakhstan and Russia, provide for the same reduced rate for royalty income, i.e. 10%, which calls into question the feasibility of such a structure. Under other tax treaties, the withholding tax rate on royalty income is also generally 10%.

Moreover, the possibility of applying tax treaty benefits in Kazakhstan in practice should be taken into account. For example, the tax treaty between Kazakhstan and Cyprus (and many other agreements) contains the principal purpose test (PPT) rule and a requirement that the recipient of income be the actual (or the ultimate one as defined by the Tax Code of the Republic of Kazakhstan) beneficiary of this income. These rules make it possible for tax authorities of Kazakhstan to challenge the benefits and reduced rates under the treaties, especially in respect of 'interim' companies and structures.

Special mention should be made of the Astana Hub technology park, the tax regime of which provides for exemption of a non-resident's royalty income from withholding tax in Kazakhstan<sup>14</sup>. However, such benefits would require registration and operation in the park.

**8. Is it possible to create a legal entity participating in the AIFC and be a resident of special economic zones in Kazakhstan at the same time? Does Kazakhstan have special economic zones and benefits for IT companies?**

Generally, to benefit from a special economic zone (SEZ) in Kazakhstan, a company is required to be based within the boundaries of a specific SEZ. Therefore, in most cases participation in SEZs is only possible through companies registered under the laws of the general jurisdiction of Kazakhstan.

At the same time, there is an international technology park Astana Hub in Kazakhstan for IT companies, whose residents can receive various tax benefits, including exemption from CIT and VAT. However, it should be kept in mind that hub residents must perform priority activities for the technology park, as well as comply with the substance rules and some other criteria for having tax benefits.

A company can become an Astana Hub resident without significant territorial restrictions, meaning, for example, you may establish an entity in the AIFC and apply for registration in the technology park. Provided that all the conditions established by the AIFC and the technology park are met, you will be able to receive tax benefits both based on a legal form of your company (the AIFC benefits) and related to the performance of a priority activity (the Astana Hub benefits).

However, it is worth noting that in practice Kazakhstan's tax authorities pay special attention to the application of several preferential tax regimes at once, and therefore the establishment of such structures is associated with a risk of increased scrutiny to your company from the tax authorities.

**9. What are the tax residency rules in Kazakhstan for individuals, and can one become a resident of Kazakhstan without living in the country for more than 183 days a year?**

A distinguishing feature of Kazakhstan's tax residency rules is the use of the 'center of vital interests' concept. Thus, an individual may become a resident of Kazakhstan in two cases<sup>15</sup>:

- 1) they have spent 183 or more days in Kazakhstan within any 12-month rolling period, or

<sup>14</sup> Subparagraph 4-1, paragraph 2 of article 644 of the Tax Code of the Republic of Kazakhstan

<sup>15</sup> Paragraphs 2 and 3 of article 217 of the Tax Code of the Republic of Kazakhstan

- 2) they have spent less than 183 calendar days in Kazakhstan, if the following criteria are simultaneously met (the center of vital interests rules):
- an individual holds Kazakhstan citizenship or a residence permit;
  - an individual's spouse and/or close relatives live in Kazakhstan; and
  - an individual and/or their close relatives own/lease real estate in Kazakhstan available to them at any time.

Kazakhstan's tax law broadly defines close relatives, and as a rule, becoming a resident is not as difficult as ceasing to be recognized as a tax resident in Kazakhstan.

The AIFC has an alternative for private non-Kazakhstani investors, that is the AIFC investment tax residency program launched in September 2022<sup>16</sup>. This program provides an opportunity for individuals to receive a five-year investor visa and become a tax resident after staying for 90 days<sup>17</sup> (instead of 183 days) in Kazakhstan in exchange for an investment in securities and subject to payment of a duty. The program participants are also exempt from taxation of foreign income in Kazakhstan<sup>18</sup>, including not being subject to Kazakhstan's CFC rules<sup>19</sup>.

## **10. Does it make sense to transfer existing LLPs and JSCs in Kazakhstan to the AIFC jurisdiction if they are planned to be sold to a foreign investor?**

Please note that the re-registration of companies incorporated elsewhere in Kazakhstan to the AIFC jurisdiction is impossible in itself. It is possible to reorganize a company, e.g. by merging an 'ordinary' company with a legal entity incorporated in the AIFC, or to transfer the shares of existing Kazakhstani legal entities to a company established in the AIFC. Yet, whether this is reasonable from the business and tax efficiency point of view should be decided taking into account your specific facts and circumstances. Notably, there is a tax exemption for the divestment of assets in Kazakhstan: if the time of ownership of Kazakhstani companies exceeds three years, provided that these assets are not subsoil users in Kazakhstan, and their value is not attributable to subsoil users there, and a number of other requirements are met, capital gains from the divestment are not subject to tax in Kazakhstan<sup>20</sup>.

## **11. The AIFC rules stipulate that a company must operate in the AIFC. What does this mean and which aspects of a company's operations does this affect? Can an AIFC company operate outside the AIFC (for example, by opening offices elsewhere in Kazakhstan)?**

Indeed, the AIFC Companies Regulations<sup>21</sup> make it clear that an AIFC company must conduct its principal business activity in the AIFC<sup>22</sup>. In practice, this currently means that the management bodies of an AIFC company should be based in the AIFC. However, the AIFC Regulations do not prohibit a company from carrying out any auxiliary activities in the main territory of Kazakhstan (outside the AIFC).

<sup>16</sup> The AIFC Regulations on AIFC Investment Tax Residency Programme dated 14 September 2022

<sup>17</sup> Paragraph 2-1 of article 217 of the Tax Code of the Republic of Kazakhstan

<sup>18</sup> Subparagraph 5, paragraph 7 of article 6 of the AIFC Constitutional Statute

<sup>19</sup> Subparagraph 6, paragraph 2 of article 340 of the Tax Code of the Republic of Kazakhstan

<sup>20</sup> This exemption applies to capital gains received by Kazakhstani companies (subparagraph 8, paragraph 2 of article 288 of the Tax Code of the Republic of Kazakhstan), foreign companies (subparagraph 8, paragraph 9 of article 645 of the Tax Code) and resident (subparagraph 15, paragraph 1 of article 341 of the Tax Code) and non-resident individuals (subparagraph 7 of article 654 of the Tax Code)

<sup>21</sup> AIFC Companies Regulations No. 2 of 2017.

<sup>22</sup> Subsection 3 of section 24 of AIFC Companies Regulations No. 2 of 2017

Please contact us for further information

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