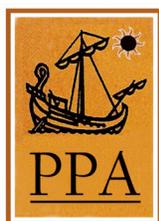


Investors Risks In Kazakhstan

(updated April 2015)



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ADVISORY**

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Foreword

Investors from different countries are continuing to establish their offices in Kazakhstan and many companies are willing to do business here. The rate of success stories for investors in Kazakhstan is good enough. However, there is always something new and unexpected when a foreign investor starts its business in an unknown country.

Pari Passu Advisory presents its updated edition of Investors Risks in Kazakhstan. Assisting foreign investors from different parts of the world to start and develop their businesses presence in Kazakhstan we have gained solid experience and knowledge. In this document we are sharing this knowledge to help investors to avoid problems awaiting them in the new environment.

We have identified 12 most frequently appearing risks in Kazakhstan. Our main purpose is not to show any particular risk or problem, but to give better understanding for investors in their efforts of doing business in Kazakhstan.

Feedbacks and questions are more than welcome. We will be happy to clarify any points given in this document or related to opening and doing business in Kazakhstan.

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1. Registration of a company

Kazakh government has made a tremendous improvement on easing registering process of a new business in Kazakhstan in recent years. Kazakh citizens and resident permit holders are able to register a company even online.

However, there are still some tricky issues investors might face during the process of Kazakh entity registration.

Tax registration for individuals

Under the article 562 (5) of the Kazakhstan Tax Code non-resident individual is required to register as a taxpayer in cases when such non-resident receives income from the source that do not withhold appropriate taxes. When registering a company the sources of income might be from (i) distribution of dividends or (ii) as a salary under the labour contract with such company. Nevertheless, these two types of sources of income are considered those that withhold individual income taxes, i.e. the dividends distributing or salary paying company is required to withhold 10% individual income tax before distributing/paying income.

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Should a non-resident individual intend to sell or otherwise dispose its proprietary rights in the company (*shares or participating interests*) to another individual or non-resident legal entity and benefit from capital gain, then such capital gain is to be considered as income from source that do not withhold capital gain tax.

Thus, if a foreign individual is intending to establish a company, Kazakh LLC, he needs to obtain IIN (*individual identification number*) first, i.e. to undergo the process of tax registration. This has to be done with the tax authorities and can take additional unexpected time and resources. Remarkably, that this rule does not always apply to foreign legal entities that form a Kazakh subsidiary. Nonetheless, when it comes to registration of branch or representative offices in Kazakhstan, foreign head companies are very often required to register with tax authorities before applying for branch/representative office establishment.

According to the recent updates to the Tax code of Kazakhstan directors, heads of branches and representative offices – foreign individuals had to register, as taxpayer is Kazakhstan, before 1st of January 2015. This rule applies also to newly appointed directors.



Business VISA requirement

When a foreign individual is visiting Kazakhstan for purchasing participating interest in Kazakh LLC or establishing new one, such foreign individual has to have a Kazakh business VISA on his passport. This rule is stipulated by article 40 (2) of the Law of the Republic of Kazakhstan 'On migration of population'. Worthy to note that under the law 'business immigrant' type of visa should be issued for such purposes. The practice of Kazakhstan registering authorities differs from one city to another. But based on our practice registering authorities of Almaty and Astana cities are paying closer attention to the business visa requirement.

Reallocation of participating interests in Kazakh LLC and other cases

According to the article 42 of the Civil Code of Kazakhstan a Kazakh LLC has to undergo the process of re-registration, inter alia, in cases of change of participants (*shareholders*) in such entity. But the legislation is silent with regards to the issue when existing participants are willing to reallocate participating interest between them.

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In fact the problem is broader. Before recent major changes to the company registration procedures, a Kazakh LLC had to, and still has to, undergo the process of re-registration in following circumstances: (a) change of company name, (b) reduction of share capital, and as already mentioned, change or participants in the company. In two following cases a Kazakh entity has to notify the registration authorities: (a) increase of share capital, (b) change of legal address. These two requirements are expressed in article 26 and article 5 respectively of the Law of the Republic of Kazakhstan 'On liability limited and additional liability companies'. Before the aforesaid amendments that into force on 1st of January 2013 all other cases, such as reallocation of participating interests and change of the name of the participant or re-domicile of the participant, were considered as '*registration of changes to constituent documents of the company*'. One of the major amendments to company registration process was abolishment of necessity to submit the charter (*articles of association*) of the company to the registration authorities. Since then, there is no way based on the legislative act how to change the information of the company in government's database regarding the reallocation of participating interest within a certain company or notification of changes occurred to the participators (*such as change of name, change of jurisdiction and other cases that business life may bring*).



2. Opening a bank account

Since Kazakhstan adopted a new legislation on AML/CTF opening a bank account has become more complicated than it was before. Companies have to provide documents such as proof of address, notarized/ apostilled/ legalized copies of particular documents. Some banks require additional documents, which are not required by laws of Kazakhstan. Only few world-recognised banks operate in Kazakhstan and it is rather difficult to become a client of such banks due to the AML rules and additional liquidity requirements of such banks.

Legalisation of documents

In some cases a Kazakh entity needs to open a bank account abroad. The Kazakh LLC's documents for opening a bank account have to be legalised for jurisdictions that are not parties to The Hague Apostille Convention (*China, Singapore, UAE*). The process of legalisation is set in Legalization Rules. Documents of a company established after 1 January 2013 do not have registration authorities stamps on company's charter (articles of association), an incorporation certificate, and a document confirming current director and participants (*shareholders*). This makes almost impossible to legalise them at Kazakh authorities.

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3. Taxes

Paying taxes and filing tax declaration requires specific knowledge. Newly established company needs to hire experienced accountant or find outsourcing company providing such services.

There are certain rules related to the presence of the company at its legal address. The practice differs from city to city. In Astana, for example, tax authorities check the presence of a newly established company at the moment of registration. In Almaty such visit may be paid within first three years of the company's life. Absence at the place of legal address may lead to the withdrawal of VAT registration (*if applicable*) and in worse cases it could be considered as pseudo-entrepreneurship.

Companies dealing with foreign counterparties and willing to benefit from Tax Convention with other countries should examine the conventions and requirements of Kazakh tax authorities request for tax residency certificate, dates and deadlines, exemptions, etc.



4. Human Resources

First issue arising before a foreign owned company is obtaining work permits for its employees. There is no work permit required for a head of a branch or a representative office of a foreign company. However, for a Kazakh LLC receiving a work permit even for its director could become a challenge. Local authorities are confusing corporate and labour law in the case. A company cannot act (*apply for a work permit*) without its director (*executive manager*) and such director cannot commence his/her office without obtaining a work permit. This process might last several months and could cost significant resources. Every other foreign employee of a branch, representative office of Kazakh LLC has to obtain a work permit.

Second issue that investors face in Kazakhstan is finding and keeping highly skilled personnel. Process of finding right people could take long time. Local and international hiring agencies could help to shorten this period and make the process easier. Keeping high skilled personnel is also a challenge as frequent moving from one company to its competitor is a common practice in Kazakhstan.

Third issue that face mainly industrial companies is dealing with workers. Workers' strikes are not very common in Kazakhstan, however, if occurs it could lead to significant consequences for the business. There are several examples during recent years with serious workers' strikes occurred in Atyrau, Aktobe, Mangystau, and Temirtau cities. In some of these examples workers' strikes led to deaths and injuries among local and foreign personnel.

In controversial cases Kazakh courts usually decide in favour of employees. It is strongly required to conduct business in compliance with the Labour Code of Kazakhstan.

5. Custom

Custom rules and requirements as many others are changing every year. The process of custom clearance became convoluted with integration of Kazakhstan into the Custom Union and Eurasian Union. Custom authorities might require additional documents and raise other requirements, which could be a surprise for an investor.



6. Currency control

Currency control rules are one of the strictest in Kazakhstan. The rules for transferring funds into the country and outside the country and even within the country in some cases require providing particular supporting documentation. Several types of transactions have to be registered at the National Bank of Kazakhstan and commercial banks are required to verify the compliance with regulations before approving any bank operation, especially with foreign currencies or between residents and non-residents.

7. Legislation

Changing of legislation and other requirements is quite common and frequent in Kazakhstan. Tax Code, Labour Code, Custom Code, different laws, rules and instructions are updated every year, many times it happens unexpectedly. Foreign investors say that the risk of changing legislation could be most challenging and expensive.

8. Language

Official state language in Kazakhstan is Kazakh. However, Russian is commonly used in business environment. English language is not widely spoken and finding English-speaking personnel is not an easy if it is not Almaty, Astana or Atyrau. English could be language of business meetings, but in most of the cases the conversation is held in Russian, so translator or local employee could also be needed.

9. Exchange rate fluctuation

The exchange rate of Kazakh Tenge (KZT) to US Dollar is generally held within trading band controlled by the National Bank. However, significant fluctuation might occur when the National Bank decides to devalue the currency. Significant devaluation happened in Kazakhstan in 1999, 2009 and 2014. Investors are advised to use in contracts appropriate indexation clauses in order to mitigate risk of significant exchange rate fluctuation.



10. Corporate Governance

Corporate Governance culture is not on the appropriate level in Kazakhstan. Meetings of board of directors are mainly held in formal way. Minor shareholders might not receive all required information. There are several examples when rights and interests of minor shareholders were not complied with.

Investors are strongly advised to conduct due diligence on acquired assets and examine their current owners. Independent review could help in making decision and in further negotiations.

11. Corruption

According to Transparency International Corruption Perceptions Index 2014 Kazakhstan is on 126th position (140th in 2013) among 175 countries. It is a big problem for both public and private sectors. Procurement process is most affected by corruption. The most popular corruption scheme in procurement is a kickback scheme. The problem is mainly exists in state owned enterprises and government agencies. Many international fraud companies have also experienced problems with procurement corruption and fraud.

Good internal control and compliance system has to be implemented in the company. Fraud risk management should also be part of this system as a preventive measure against corporate corruption.

12. Political risks

Political risks related to current political system and possible change of leadership in Kazakhstan has also to be taken into account. Political instability in the Central Asian region and in other CIS countries could also negatively affect the business in Kazakhstan. Proper structured business in Kazakhstan could help in mitigating such risk for investors.



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