

The background of the entire page is a photograph of a long, straight asphalt road stretching into the distance. The road is flanked by golden-brown fields, likely wheat or corn, under a vast blue sky with scattered white clouds. The perspective is from a low angle, looking down the center of the road.

INVESTMENT IN KAZAKHSTAN

Preface

Investment in Kazakhstan is one of a series of booklets published by KPMG to provide information of interest to those considering investing or doing business in various countries. This publication has been prepared by KPMG Kazakhstan.

Every care has been taken to ensure that the information presented in this publication is correct and reflects the situation as of April 2006. Its purpose is to provide general guidelines on investing or doing business in Kazakhstan. However, the reader should be aware that the general framework of legislation and detailed regulations present in Kazakhstan are subject to frequent changes. Therefore, prior to taking specific decisions, professional advice should always be sought. If there is a significant lapse of time between determining a strategy and its implementation, any advice obtained which is critical to the strategy should be confirmed prior to the implementation.

KPMG will be pleased to advise you on any matters relating to Kazakhstan and also to provide any further information you may require.

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CHAPTER 1

Kazakhstan at a Glance

1.1 Geography and Climate

The ninth-largest country in the world and the second largest state in the Commonwealth of Independent States (CIS.), Kazakhstan is bordered by the Russian Federation to the north, the Caspian Sea to the west, China to the east and the former Soviet Central Asian republics of Kyrgyzstan, Uzbekistan, and Turkmenistan to the south. Kazakhstan is a country of contrasts, a land where Europe meets Asia. The northern half of the country is mostly steppe, the south and west are largely arid or semi-arid desert, and the majestic Tien Shan Mountains surround the southeast rim.

The remoteness of Kazakhstan from the oceans and the vastness of its territory determine the climatic conditions of the country. The climate of Kazakhstan is distinctly continental. Temperatures vary immensely by region, with the most dramatic differences between the deserts and mountains. The southern regions have milder winters and hotter summers than the northern and central regions. The steppes experience especially harsh winters due to strong, cold winds from the north. There are great variations between seasons. The summers are hot with temperatures reaching 40 degrees centigrade, and the winters are often bitterly cold, with temperatures falling to negative 40 degrees centigrade.

Tremendous natural resources and relative social and political stability in the Republic make this country one of the most attractive destinations for capital investment among the republics of the former Soviet Union. Possessing one of the largest resources of mineral wealth in the world, Kazakhstan needs further investment and development. It faces political, economic, social, and ecological challenges that must be resolved if the country is to achieve its full potential as an agricultural and industrial power driven by its enormous mineral wealth.

1.2 History

The history of the Central Asian landmass is one of prosperity, hardship and conflict, invading nomads and seasonal migrations, vast steppes, and animal husbandry. Horses were first bred and domesticated in the region. Ancient history records fair-haired and blue-eyed peoples. The migration of Turkic tribes in the sixth century brought to the region its Turkic languages. The spread of Arab culture brought Islam. For the next few centuries the region prospered. Located along the ancient Silk Route, the Turkic city-states traded with the Orient and Europe and developed a rich culture that lasted until the Mongol invasion in the 13th century. Genghis Khan's hordes devastated the region: trade withered, culture declined. The weakening of the Mongols led to the establishment of the Kazakh and Uzbek Khanates and the founding of the Kazakh nation in the 15th Century. The Kazakhs fought a century-long war with the invading Jungarian nomads before becoming Russian subjects.

Although at first the union with Russia provided the Kazakhs with external protection and a degree of internal autonomy, eventually Russia began to dominate the region, restricting the power of the native khans and sultans, appointing and dismissing Kazakh chieftains almost at will. The reforms in the early 1900s resulted in the immigration of hundreds of thousands of Slavic colonists. The transfer of fertile land in favor of the new settlers agitated relations between the largely nomadic Kazakhs and the agricultural Slavs. Discontent among the Kazakhs grew until a rebellion erupted in 1916, sparked by a Tsarist order mobilizing Kazakhs into construction units for the Russian army. Although the rebellion was put down with force, the fall of Tsarism led to the brief establishment of the Nationalist Alash Republic. However, by 1921 Kazakhstan was firmly in Soviet hands.

During the next 70 years change and turmoil transformed Kazakhstan's landscape and permanently altered the life of the Kazakh people. Soviet attempts to collectivize agriculture in the early 1930s resulted in a major famine. A million Kazakhs died of starvation; hundreds of thousands fled to

neighboring countries. The 1930s were also the beginning of major development of Kazakhstan's mining and metals industries. The relative emptiness of the steppe and the inhospitable climate made Kazakhstan a convenient dumping ground for political prisoners from all over the U.S.S.R., tens of thousands of whom died building the industries and the cities in Kazakhstan. The war years resulted in the relocation of major industries and evacuees from the European part of the Soviet Union; many of them stayed at the war's end. As part of the "virgin lands" campaign, more settlers came in the 1950s from all over the U.S.S.R., to develop agriculture in Kazakhstan's northern regions.

The Soviet legacy provided for the industrial development of Kazakhstan and a great rise in the standard of living for the indigenous people. It also included ecological disasters of major proportions. Dozens of open-air and hundreds of underground nuclear weapons tests were performed at the Semaipalatinsk test site in Northeastern Kazakhstan between 1949 and 1989. Water from the Syr Darya and Amu Darya rivers that hitherto fed the Aral Sea was channeled toward cotton production areas in Uzbekistan and southern Kazakhstan. The sea lost most of its water and shriveled to 40% of its former size. As a result, Kazakhstan now faces major ecological problems that require substantial international aid.

In 1989 Nursultan Nazarbayev became the First Secretary of the Communist Party of Kazakhstan and at the end of 1991, the country's President. The last republic to declare independence and leave the U.S.S.R., Kazakhstan found itself a new state in December of 1991, unsure of its position in the world and facing political, economic, interethnic, and ecological challenges.

The following years have been years of transition. President Nazarbayev's strong presidency has kept the country politically stable, and it has begun the difficult transition from a socialist to a market-oriented economy. No longer socialist, it has yet to become an economic powerhouse able to compete with the world's leading economies; no longer poor, it has yet to provide its people with the full blessings of its growing wealth.

The Republic of Kazakhstan has now become a member of the world community and enjoys universal recognition and the support of many of the world's leading countries. Kazakhstan is extending its cooperation with important international organizations, including the United Nations Organization, the World Bank, the International Monetary Fund, the World Health Organization, the European Community, the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development, the IAEA, the IFRCRCS, the UNICEF, the UNESCO, etc. The Government of Kazakhstan is also negotiating its planned accession to the World Trade Organization (WTO), and it is likely that the country will join the WTO in the next few years.

1.3 Population and Language

Because of its large territory, Kazakhstan is one of the least densely populated countries in the world, with a population density of 5.8 persons per square kilometer. Approximately 15 million inhabitants live in Kazakhstan: 53% of the populace are Kazakhs, 30% Russians. In addition to the two main ethnic groups, over 120 other nationalities live in the country: Ukrainians, Germans, Uzbeks, Tatars, Koreans, and others. Nearly 56% of the population lives in towns and workers' settlements; the rest reside in rural areas. Principal cities include the former capital of Almaty and the new capital of Astana (formerly Akmola), Karaganda, Shymkent, Pavlodar, Taraz (formerly Jambyl), and Semey (formerly Semipalatinsk). The state language is Kazakh. However, Russian is still used as an official language of government and commerce.

1.4 Government and Politics

In 1993 Kazakhstan promulgated its first post-Soviet constitution, which officially declared Kazakhstan an independent constitutional republic with a democratic system of government and a strong presidency. In a referendum held in August 1995, voters approved a new constitution that

provided for substantial changes in the way power is distributed among the three branches of government.

The President is the head of state and wields most political power in the country. Occupying that post since 1991, Nursultan Nazarbayev was recently re-elected for another seven-year term in December 2005. The Prime Minister heads the executive branch and is responsible to the President for the day-to-day activities of the Government. The Parliament consists of two chambers: the Majilis and the Senate, whose members are elected to five-year and six-year terms, respectively. Although nominally the Parliament is the supreme legislative body, its powers in comparison to those of the executive are relatively weak. Kazakhstan is a unitary state; however, for administration purposes the country has been divided into 14 oblasts, or regions, and the cities of Astana and Almaty, which have the equivalent of a regional status. Each region is headed by an Akim (Governor) who is appointed by the President.

1.5 Economy

Kazakhstan possesses enormous untapped fossil fuel reserves and plentiful supplies of other minerals and metals, including coal, chrome, an array of rare metals, lead, tungsten, copper and zinc. It also has considerable agricultural potential with its vast steppe lands accommodating both livestock and grain production. Kazakhstan's industrial sector largely rests on the extraction and processing of these natural resources; the consumer goods sector is relatively small but is growing. Driven in large part by the country's prosperity, the construction sector has grown tremendously over the last five years.

Skyrocketing inflation and problems with the Russian Central Bank's management of the ruble led Kazakhstan to leave the ruble zone in 1993 and introduce its own currency, the tenge, which subsequently devalued by almost 85 percent in the course of a year. Assisted in part by donor agencies such as the World Bank and USAID, the government pursued macroeconomic stabilization, which by 1996 brought inflation down to reasonable levels. Strong national institutions were established. The National Bank in particular received wide respect from international financial agencies for its inflation-fighting ability and is considered to be one of the best in the CIS. The country was able to attract substantial amounts of foreign direct investment (FDI), predominantly into the natural resource and energy sectors, and by 1997 it could boast of being the largest FDI recipient per capita in the former Soviet Union, which is still true in 2006.

From 1995 to 1997 the pace of the government program of economic reform and privatization quickened, resulting in a substantial shift of assets into the private sector. On the privatization front, the government has had mixed success. Although widespread privatization of state assets was undertaken, it failed to achieve its ambitious goal of redistributing national wealth to the citizenry.

For a time prior to the Russian currency crisis in the summer of 1998, it looked like the economic situation had stabilized and begun to improve. Over USD 7 billion had been invested in the Kazakhstan economy, primarily in the petrochemicals and mineral resources sectors. Most of the growth had been unevenly distributed, however, and remained tied to the few favored sectors, while the rest of the economy languished.

Kazakhstan's economy turned downward in 1998 with a 2.5% decline in GDP due to slumping oil prices, falling commodity prices and reduced demand for Kazakhstani products as a result of the crisis in Asia. The ruble's collapse in August 1998, and its consequences, severely tested the government's crisis-management abilities.

A well timed tenge devaluation in early 1999 and a bumper harvest that fall helped keep the economy afloat, and the year 2000's soaring oil prices fueled growth in GDP to almost 10%. As world commodity prices stabilized in 2001, Kazakhstan achieved 13.2% GDP growth, its best economic performance since 1991.

Cumulative foreign investments, high oil and commodity prices, and conservative fiscal policies allowed Kazakhstan to achieve economic stability and spectacular growth over the past five years. The post-2001 rise in oil and commodity prices has brought tremendous wealth into the country and stimulated the construction industry. Astana, the new capital, has been transformed from a sleepy Soviet provincial town to a modern city of some 700,000, tripling its population in less than a decade. The former capital of Almaty has also enjoyed tremendous growth, and life in other cities and towns has significantly improved.

Boasting one of the highest growth rates in the world, Kazakhstan's GDP has grown by 9% or more in each of the past six years and now is approximately USD 56.1 billion or about USD 3,600 per capita. The extraction of oil, gas, metals and minerals has also increased; the country's 2005 total oil production of 61.4 million tons makes it the second-largest producer in the CIS. Capital investment increased by 23% to over 12 billion USD in the past year, with the construction sector growing by 34%. *Appendix A provides Kazakhstan's GDP totals for the last ten years.*

The country's international reserves also rose to over USD 18 billion. Driven by high inflows of foreign currency into the country, the tenge appreciated by about 20% against the U.S. Dollar in the past three years, despite persistent National Bank interventions to slow down this increase.

The first country in the CIS to receive an investment grade credit rating from major international credit agencies, Kazakhstan at the end of 2005 possessed the following ratings:

- Standard & Poors: "BBB" for long-term debts in both the national currency and foreign currency;
- Moody's Investors Service: "Baa3" for long-term debts in foreign currency and "Baa1" for long-term debts in the national currency;
- Fitch: "BBB" for long-term debts in foreign currency and "BBB+" for long-term debts in the national currency.

In 2005, Kazakhstan took 61st place in the World Competitiveness Index, way ahead of the other CIS countries. However, much remains to be done before the country can meet President Nazarbayev's ambitious goals of making Kazakhstan one of the world's 50 most economically competitive countries. Although the overall economic investment and growth has been substantial, most of it has been focused on the extractive and reprocessing industries, construction and agriculture, while the other sectors of the economy have grown by much smaller margins. Since much of the GDP growth is attributable to the substantial rise in world prices for oil and other natural resources exported by Kazakhstan, the country remains vulnerable to external shocks if international prices suddenly collapse. In addition, the full measure of the country's new-found wealth is yet to trickle down to its outlying regions and rural areas and the most vulnerable population groups. While salaries and pensions have grown over the past several years – to about USD 250 as the average monthly salary and USD 70 as the average monthly pension – they are still too low by the developed world's standards, and a large middle class is yet to arise. Although the rising prosperity has led to renewed state investments into public infrastructure, education and health, substantial investments still need to be made if Kazakhstan is to realize its true potential as a Eurasian powerhouse.

CHAPTER 2

Company Law

2.1 Overview

Over the past decade, Kazakhstan has made impressive strides in creating a legal foundation for the development of a market economy. Written with the assistance of Western lawyers sponsored by the USAID, the World Bank, the Asian Development Bank, TACIS, and other donor agencies, Kazakhstan's legislation is fairly progressive when compared with that of some of the other CIS states. Key accomplishments include:

- adoption of one of the first civil codes, tax codes and customs codes in the CIS,
- adoption of progressive corporate and commercial legislation, and
- the establishment of respectable national institutions such as the National Bank and the State Investment Committee.

Much of the business-related legislation is already second- and third-generation law and is still evolving. As the economic situation changes, new laws have been introduced. If fault can be found with Kazakhstan's legal system, it lies with the inconsistencies and gaps in the legislation created by the patchwork approach to drafting legislation, and the failure of some officials to comply with the law.

Kazakhstan is a civil law jurisdiction. Judicial decisions have no basis in precedent, and consequently, the legislation is aimed at providing guidance in any and all situations of uncertainty that might arise. The Constitution is the supreme law of the land. Other sources of law include parliamentary acts, presidential edicts, and Constitutional Council and Supreme Court decisions, all of which have differing legal force in accordance with the priorities set by the *Law on Normative Legal Acts*. In addition, secondary regulatory acts are issued by government ministries and agencies to fill the gaps left by primary legislation.

The Civil Code governs most aspects of civil and commercial relations in Kazakhstan, including property and contractual relations. The Civil Code is generally progressive and provides for the freedom to contract, the inviolability of private property, and restrictions on the state's ability to arbitrarily interfere in a person's private affairs. As a general rule, civil legislation does not apply to property relations based on the state's tax, administrative, or police powers – all of which remain quite extensive.

2.2 Law Governing Legal Entities

Kazakhstan company law can be characterized as modern and corresponding closely to international principles of corporate legislation. The Civil Code and related laws permit both local and foreign entities a high degree of flexibility in structuring their business activity in Kazakhstan. Available business structures include a representative office, a branch office, a legal entity, and a simple partnership of companies (or consortium). The primary differences between these various business structures relate to the entity's legal status, the scope of its rights, the nature of the relationship between the entity and its owners, and taxation. As a general rule, the law does not discriminate between domestically owned legal entities and Kazakhstan subsidiaries of foreign legal entities.

2.3 Representative Offices

A representative office is a separate subdivision of a legal entity, which is established in a different location from the principal entity of which it is a part. It carries out the protection and representation

of the principal entity's interests and may perform transactions and other legal actions only on behalf of the principal entity. The legal address of the representative office should be the principal place where its management is located.

A representative office may engage only in representative and marketing functions on the principal entity's behalf and is not allowed to conduct revenue-generating commercial activity, although it can derive non-business income from foreign exchange gains, interest income on deposits and gains on disposals of fixed assets. The actions of a representative office create rights and obligations for the principal entity.

2.4 Branch Offices

A branch office is a separate subdivision of a legal entity, which may carry out all or part of the functions of the entity of which it is a part, including both business activity and representation functions. A branch does not have the status of a separate legal entity and operates on the basis of regulations approved by the principal entity. Its management is appointed by, and its activities should be coordinated with, the principal entity. Actions of the branch create rights and liabilities for the principal entity. A branch does not form a charter capital and is provided with property by the principal entity.

The legal address for a foreign company's activities in Kazakhstan should be the principal location of its local management. Usually, it is the city or region from which a principal portion of the branch's profits is derived. However, some foreign companies have registered their legal address at one location, such as Almaty, despite the fact that the bulk of their business activity is performed in the outlying oblasts. Foreign entities should register with the tax authorities in every region in which they conduct commercial activity.

Management Bodies of Branches and Representative Offices

Since a branch or representative office is merely a subdivision of the legal entity of which it is a part, it is governed by the principal entity's officers or management bodies who, in accordance with the entity's founding documents, have the authority to make decisions concerning the branch or representative office. This may include, for instance, the CEO, the Board of Directors, or the Management Board. The exclusive authority of these bodies or persons includes the power to amend the regulations governing the branch or representative office's activity, approve quarterly and annual reports, and reorganize or liquidate the branch or representative office.

A manager or director performs routine management of the branch or representative office on the basis of the authority provided in a power of attorney issued by the authorized officer or body of the principal entity. The manager may thus be given the right to sign lease agreements or employment contracts with local staff, acquire property required for the achievement of the branch or representative office's objectives, and conduct negotiations with potential business partners. Although there are no legal restrictions prohibiting the management of the branch or representative office by two or more co-managers, only one official should be designated as "Manager" on the statistical card required for registration of the branch or representative office. The other person or persons may perform the functions of a deputy manager at the discretion of the principal entity.

Currency Regulation of Branches and Representative Offices

Both branches and representative offices are regarded as nonresidents for currency regulation purposes. They are therefore permitted to open both tenge and foreign currency accounts in Kazakhstan and foreign banks. They are also allowed to make payments in foreign currency to both Kazakhstan residents and nonresidents. Kazakhstan's currency regulations allow nonresidents to withdraw foreign currency in cash from a bank account to pay employee salaries and to distribute

cash for business travel purposes as long as the foreign-currency cash withdrawal request is properly supported with documents confirming the purpose of the withdrawal.

2.5 Legal Entities

A legal entity may possess property under a right of ownership, business authority or operational management, and it is liable for its obligations to the extent of all its property. A legal entity may on its own behalf:

- acquire and use property and personal non-property rights and obligations,
- sue and be sued, and
- conduct any type of activity that is not prohibited by legislation or by the terms of its founding documents.

Internal governance of a legal entity is performed in accordance with its founding documents, which consist of a Charter (bylaws) and a Foundation Agreement (Memorandum of Association) if there is more than one founder. No Foundation Agreement is required if a company has only one founder. The founding documents establish the rights and obligations of the entity's founders (participants), the authorities of its management bodies, and capital contribution and profit distribution requirements. A legal entity – like branches and representative offices of legal entities – is regarded as created from the time of its registration with the territorial bodies of the Ministry of Justice of the Republic of Kazakhstan, which maintains a state register of such entities.

The most common forms of organization of a legal entity are a limited liability company (LLC) and a joint stock company (JSC). With some exceptions, the laws governing LLCs and JSCs follow the standards of corporate law generally used in North America and Europe. While these companies vary in their capitalization, personal liability of investors and management, and share transferability, they provide for stable rules of corporate governance and a degree of fiduciary responsibility for the company's management and directors.

By and large, these entities have similar corporate structures. The supreme governing body of each entity is the General Meeting of Participants or Shareholders, which has exclusive authority over the most important issues affecting the company, such as amending its charter, granting or terminating authority of executive boards and other bodies, and reorganizing or liquidating the entity. The company may also have a governing board or supervisory body such as the Board of Directors of a JSC or the Supervisory Council of an LLC, which is responsible for setting general policy during the period between the General Meetings. A director or a collective executive body such as the Management Board manages the company's day-to-day affairs. A company can also establish a monitoring body such as an internal auditor or an audit commission to monitor the company's financial and economic activities.

Limited Liability Companies

Designed primarily to be closely held companies whose participants place a special premium on control, an LLC (also known by its Russian acronym: TOO) is a legal entity whose charter capital is divided into ownership stakes, the size of which is stipulated in the founding documents. An LLC may be created by individuals or legal entities and may have only a single owner. A Kazakh LLC cannot be wholly owned by another Kazakh LLC unless the owner entity has at least two owners. Generally, the LLC participants are not liable for the entity's obligations and bear the risks associated with the company's activities only to the extent of their equity contributions to the LLC's charter capital.

As a general rule, an LLC's net income must be distributed among its participants in proportion to each participant's contribution to the entity's charter capital. However, LLC participants have some

flexibility in determining how income will be distributed and may by agreement establish the value of each contribution to charter capital. This might be particularly useful when non-monetary contributions to the LLC's charter capital, such as know-how or licenses, are involved.

One of the most attractive features of an LLC is the amount of the minimum permissible charter capital, which is only 100 monthly index factors,¹ or about USD 790 at the present rate of exchange. Although, as a general rule, the transfer of LLC ownership stakes to a third party is allowed, the exercise of that right may be restricted in an LLC's founding documents.

Joint Stock Companies

A JSC (also known by its Russian acronym: AO) is a legal entity that issues stock in order to attract the capital necessary for its activity. A JSC may be created by individuals or legal entities and may have only a single owner. As a general rule, JSC shareholders are not liable for the JSC's obligations and bear the risks associated with the functioning of the JSC only to the extent of their equity contributions to the company.

Since JSCs are designed to enable investors to raise capital relatively easily, JSC shareholders have the right to transfer their shares at any time without the consent of other shareholders. There is no upper limit on the number of shareholders that a JSC may have. The minimum charter capital of a JSC is 50,000 MIFs, or approximately USD 395,000 at the present rate of exchange.

Once a company reaches a certain size and meets certain legal requirements – for example, it has at least 500 shareholders, the total value of its assets is at least 1,000,000 MIFs, and its stock trades on an organized securities market – it must notify the authorities that it meets the qualifications for a public company within 30 days following the end of the calendar year in which the conditions are first met. A public company is governed by largely the same rules as other JSCs. However, the authorities monitor the activities of these companies more closely.

Stock and Securities

Kazakhstan company law allows JSCs to issue a wide variety of debt and equity instruments to achieve their objectives. For example, JSCs may issue warrants, options, bonds, debentures, and convertible securities. At the same time, JSCs may also issue a variety of equity instruments to their shareholders, including common stock, golden shares², and preferred shares, as long as the total value of the preferred shares does not exceed 25% of the stated charter capital of the JSC.

Before a JSC issues shares, it must obtain a national identification number from the Agency for State Regulation and Supervision of the Financial Market and Financial Organizations, which operates under the umbrella of the National Bank of Kazakhstan (National Bank). Issues and distributions of shares are not allowed until all the authorized stock from a previous issue has been distributed.

Subsidiaries

A company is regarded as a subsidiary if another company has the power to control its activities. This may be, for instance, because of the controlling entity's predominant ownership of the partnership's charter capital or in accordance with an agreement between the entities.

¹ An index known as the monthly index factor (MIF) is frequently used in Kazakhstan in calculating various levies that are established by legislation as some multiple of the MIF. For the year 2006 the MIF is set at 1,030 Kazakh tenge.

² A Golden Share grants only the right to veto a decision of the executive and governing bodies of a JSC on certain issues specified in the JSC's Charter. A Golden Share is not involved in the formation of charter capital and is not entitled to dividends.

A subsidiary is not responsible for the debts of the controlling entity. In contrast, if the controlling entity has an agreement with the subsidiary that gives it the right to require the subsidiary to perform certain actions, the principal entity is liable for transactions conducted by the subsidiary in accordance with such instructions. Similarly, if the subsidiary's bankruptcy is caused by the controlling entity's improper actions, the controlling entity is liable for the subsidiary's debts.

As a general rule, participants or shareholders of a subsidiary have the right to demand compensation or damages from the controlling entity if the loss suffered by the subsidiary is caused by the improper actions of the controlling entity.

Affiliated Joint Stock Companies

A JSC is regarded as an affiliate if another legal entity owns more than 10% of its voting shares. To prevent self-dealing by insiders, Kazakhstan company law requires independent director and shareholder majority approval of certain transactions involving affiliates, as well as the publication of notification of such transactions in the mass media.

2.6 Not-for-profit Organizations

A variety of not-for-profit organizations are permissible under Kazakhstan law. A not-for-profit organization may engage in entrepreneurial activity only to the extent that such activity contributes to the goals indicated in the organization's charter. A not-for-profit organization may be established in one of the following forms: institution, public association, joint stock company, production cooperative, public fund, religious association.

2.7 Business Participation without Forming a Legal Entity

In certain instances, Kazakhstan law also allows individuals and business entities to engage in business activities without forming a legal entity. This takes the form of individual entrepreneurial activity or a simple partnership between individuals and/or legal entities.

Entrepreneurial Activity of Individuals

Kazakhstan nationals and foreign nationals may register as individual entrepreneurs and engage in business activity without forming a legal entity. Individual entrepreneurs have similar rights and obligations as legal entities and are governed by similar rules in conducting business activity.

Under Kazakhstan law, persons engaged in entrepreneurial activities must register with the tax authorities if they either hire employees on a permanent basis or have gross annual income from entrepreneurial activity exceeding the amount of annual income that is non-taxable for individuals. Individual entrepreneurs may also need to obtain a state license if they engage in activities that require licensing.

As a general rule, an individual entrepreneur is liable for his business obligations to the extent of all his personal property (with the exception of property that is exempt under the law). Insolvency of an individual entrepreneur is grounds for his bankruptcy.

Simple Partnerships

A simple partnership under Kazakhstan law is somewhat similar to a common law partnership in that it involves two or more parties entering into an agreement to pursue a joint activity for profit. The participants' contributions of assets to the partnership, and the assets that are created or acquired as a result of such joint activity, are their common shared property with clearly defined ownership shares. No legal entity is created, and the participants are jointly liable for obligations unless the agreement

on joint activity provides otherwise. A participant may transfer its rights and obligations in the joint activity to a third party only with the approval of all the other participants.

Consortium

If all the participants of a simple partnership are legal entities, such an organization is deemed to be a consortium. A consortium is a temporary association or union of legal entities which pool together their resources and coordinate their activities to pursue specific business objectives. The consortium participants retain their legal and financial independence and may participate in other consortia or associations.

The consortium agreement regulates the rights and duties of the participants, the term for which the consortium is created, and the objectives pursued. As a general rule, consortium participants are jointly liable for the obligations related to consortium activities unless the consortium agreement provides otherwise. A consortium ceases to exist once its objectives are achieved or its participants agree to terminate it.

2.8 Registration and Licensing Requirements

Registration

All legal entities established in the territory of Kazakhstan, their branches and representative offices, and branches and representative offices of foreign legal entities operating in the country, must be registered with the governmental authorities. The procedure governing such registration is provided by the *Law on the State Registration of Legal Entities and Registration of Branches and Representative Offices*.³

Since September 2004, the Ministry of Justice has been designated as a “one stop shopping” authority responsible for the registration of legal entities and their branches and representative offices. Under the new procedures, the justice authorities should register a company and issue all registration documents, including its state registration certificate, statistical card and tax registration certificate, within 10 business days following the date when the required documents are submitted to the justice authorities.

Legal entities and branches and representative offices of legal entities are regarded as established as of the date of their registration.

As part of the registration process, applicants for registration are required to submit a standard package of documents for examination by the registering body. If the documents are in order, a registration number is assigned and a certificate of state registration is issued. The entity is then recorded in the state register of legal entities, branches, and representative offices. Alternatively, a written denial of registration may be issued.

After the state registration is completed, the registering body sends a notification to the state statistics authorities. The statistics authorities assign a unique identification code and issue a statistics card to the registering company.

The tax authorities register a company and issue a tax registration number after receiving notice from the statistics authorities. After issuing a tax registration number to a company, the tax authorities must send a registration certificate to the legal authorities, which the legal authorities will then provide to the newly registered taxpayer.

³ Law No. 2198 on the State Registration of Legal Entities and Registration of Branches and Representative Offices, dated April 17, 1995, as amended.

Business activity is not permitted until registration is completed with all of the aforementioned state bodies. An entity may also be required to obtain a state license prior to the beginning of its activity in Kazakhstan.

Licensing

Kazakhstan law provides that all persons and business entities seeking to conduct certain activities listed in the *Law on Licensing*⁴ must be licensed by the state. The performance of specified activities without a license is unlawful.

Licenses are issued by the relevant ministries and state agencies acting as licensors. Licenses may be either general or specific and can be issued for a limited or an unlimited period. If other permission is also required for the performance of an activity – for example, land allotment, radio frequency allocation, etc. – such permission may be issued only if the applicant obtains the necessary license. Otherwise, such permission is considered to be invalid.

Liability for Violation of Registration and/or Licensing Requirements

Revenues received from business activity in violation of registration and/or licensing requirements are subject to confiscation by the state. The executives of entities that fail to comply with these requirements may also face additional administrative and criminal penalties.

2.9 Changes in Corporate Structure

Kazakhstan legislation establishes straightforward rules regarding changes in corporate structure. The following types of corporate reorganization are possible: merger, acquisition, division, spin-off, and transformation into other types of business entity.

- A merger of two or more companies involves the transfer of property, rights, and obligations from existing entities to a newly created entity on the basis of a transfer act and the termination of the original companies' activity.
- An acquisition involves one company's absorption of another and the termination of the acquired company's activity, with the transfer of all property, rights, and obligations to the acquiring company in accordance with a transfer act. Amendments associated with the reorganization are introduced to the charter document of the acquiring company.
- A division involves the division of one company into two or more newly created companies and the termination of the original company's activity, with the transfer of all property, rights, and obligations to the newly created companies in accordance with a partition balance sheet.
- A spin-off involves the creation of one or more companies that separate from an existing company and the transfer to the new companies of a portion of the reorganized company's property, rights, and obligations on the basis of a partition balance sheet. Amendments may need to be introduced to the charter document of the original company.
- A transformation of a company from one type of a business entity into another – for example, from an LLC to a JSC or a production cooperative – involves the transfer of all rights and liabilities to the new company in accordance with a transfer act. A for-profit entity cannot be transformed into a not-for-profit entity or vice versa.

A company may be reorganized either on a voluntary basis by a decision of its founders or in a compulsory manner by a decision of a court of law. With the exception of an acquisition, a reorganization is effective from the date when the new entities are registered with the state. In the case

⁴ Law No. 2200 on Licensing, dated April 17, 1995, as amended.

of an acquisition, the acquiring company is considered reorganized from the date when the acquired company's termination is recorded in the official register of legal entities.

Succession of the rights and obligations of legal entities that reorganize is determined on the basis of a transfer act or a partition balance sheet. A transfer act or a partition balance sheet must contain provisions concerning succession for all receivable and payable obligations of the reorganizing entity, including disputed obligations. Unless otherwise provided by legislation or the reorganization decision, the property, rights, and obligations of the reorganizing entity transfer to the successor entity at the time when it is registered with the state. Companies that emerge as a result of a division or spin-off are jointly liable for the reorganizing company's obligations.

Failure to submit the transfer act or the partition balance sheet with the founding documents of the new entities or failure to include properly completed succession provisions may cause the registration applications for the new entities to be denied.

Involuntary Reorganization by Judicial Decision

As noted above, a company may be required to undergo a division or spin-off by a decision of a court of law. If a company's management does not comply with the court's decision within the specified time period, the court may appoint a trustee to carry out such division or reorganization. Once appointed, the trustee will be assigned management powers over the company and will represent the company in court and draft the partition balance sheet and the founding documents of the new companies. Registration of the new companies can be completed once the court approves the documents presented by the trustee.

2.10 Liquidation and Bankruptcy

Liquidation

Under Kazakhstan law, a company may be liquidated by a decision of a General Meeting of its participants or shareholders or a decision of a court of law. Voluntary liquidation implies that a company is solvent and that full settlement with creditors is made.⁵

If a company is not solvent and has insufficient property to satisfy the full amount of creditor claims, the debtor may be liquidated through a bankruptcy or a non-judicial liquidation procedure.

Voluntary Liquidation of a Solvent and Financially Sound Company

Kazakhstan legislation establishes the following process for voluntary liquidation:

- The company's shareholders or participants vote at the General Meeting to liquidate the company, appoint a liquidation commission, determine the period for liquidation, and notify the Ministry of Justice in writing of the decision to liquidate.
- The liquidation commission must place a notice of the company's liquidation in the official press specifying the procedure and the period provided for the filing of creditors' claims.
- Upon expiration of the period provided for filing claims, the liquidation commission must prepare an interim balance sheet to be approved by the company's shareholders or participants. Creditors' claims are then satisfied according to the procedures provided by law.

⁵ A company is solvent when it is able to meet its liabilities and any other monetary claims when due, including the payment of wages, compensation of damages to life and health, and obligatory payment of taxes and other payments. A company is considered to be unable to make full settlement with creditors if it fails to perform its obligations within three months following the time when such obligations become due.

- Once settlement with creditors is completed, the final liquidation balance sheet is prepared. Subsequent procedures include the destruction of the company's corporate stamp, the closure of its bank accounts, a final audit by the tax authorities, and the entry of a record of the company's liquidation in the state register of legal entities.

The company's liquidation is deemed completed from the date when an appropriate record is made in the state register.

Liquidation of a Company by Judicial Decree

A company may also be liquidated in a compulsory manner by a decision of a court of law. Any interested person may seek to liquidate a company by judicial means. Such liquidation may be conducted in cases of:

- bankruptcy;
- determination that the company's registration is invalid because of violations of legislation committed at the time when the company was created and that such violations cannot subsequently be remedied;
- conduct of prohibited activities by the company or engagement in activities without having an appropriate permit or license, or violations of law by the company.

Termination of a Company's Activity

In addition to the aforesaid, a company's activity may also be terminated on the following grounds:

- a change that affects the company's organizational structure;
- a decrease in the amount of the company's charter capital below the minimum amount stipulated by law;
- failure to fully contribute the charter capital within the timeframe provided by legislation.

Bankruptcy

As noted previously, if a company is insolvent or financially unsound, it may be declared bankrupt or liquidated in a non-judicial procedure. The *Law on Bankruptcy*⁶ specifically provides that a debtor must seek a judicial declaration of bankruptcy or liquidation outside the judicial process if the company's owners or responsible internal bodies made a decision to liquidate the company and there is not enough property to satisfy the full amount of creditors' claims. Failure by the debtor to file an application for bankruptcy when required to do so by law subjects its chief executive to liability for the debtor's obligations.

Ordinary courts consider bankruptcy cases, following the general rules governing legal proceedings and the specific requirements of bankruptcy law. Participants in a bankruptcy case include the debtor, creditors, a representative of the debtor's employees, the procurator, and a representative of the local executive authorities.

Once bankruptcy proceedings are initiated in court, the debtor company loses the right to dispose of its assets. Creditors' claims on the debtor may be submitted only within the legal framework governing bankruptcy cases; all creditors' attempts to collect funds from the debtor's accounts or to levy claims on the debtor's property outside the bankruptcy process are stayed.

⁶ Law No. 67-I on Bankruptcy, dated January 21, 1997, as amended.

Within seven days after the initiation of a bankruptcy case, the court must publish an announcement that such case was accepted and that legal proceedings have begun. The court must consider a bankruptcy case within two months after the receipt of the bankruptcy application.

Once a court issues a decision to recognize the debtor as bankrupt, liquidation of the debtor begins. The liquidation procedure must be undertaken within six months after a court's decision and is designed to satisfy creditors' demands and discharge the debtor's debts. The debtor's property is accumulated and distributed to creditors in accordance with the order of priority established by bankruptcy law.

Once all settlements with creditors are completed, the legal entity is recognized as bankrupt and is released from its debts. An entry is then made in the state register of legal entities that the debtor's existence is terminated. However, a debtor may not be released of its debts if it tried to avoid obligations by hiding or transferring property within two years prior to the filing of the bankruptcy application.

Procedures Governing the Non-judicial Liquidation Procedure

If a debtor fails to fulfill its obligations to the state budget or to non-budgetary funds within three months of when they become due, it or its creditors may apply to an authorized body to initiate a non-judicial liquidation procedure under the supervision of creditors.

The decision to trigger the non-judicial liquidation of an insolvent debtor is made by the creditors' committee in agreement with the debtor. If the decision to liquidate is made, the creditors' committee must appoint a trustee to carry out the liquidation proceedings with the involvement of the creditors' committee, the authorized management body of the bankrupt entity and any other concerned parties. Settlements with creditors and liquidation of the debtor are carried out in a manner similar to the judicial bankruptcy procedures.

CHAPTER 3

Business Environment

3.1 Overview

This chapter examines the principal aspects of the business environment in Kazakhstan: taxation, accounting and audit requirements, banking, securities regulation, and employment issues. The principal focus is on highlighting certain key aspects of legislation that may be of interest to foreign investors.

3.2 Taxation

The principal law that regulates taxation in Kazakhstan is the Tax Code⁷. Drafted with the assistance of international aid agencies, Kazakhstan's Tax Code is perhaps one of the most comprehensive in the CIS and establishes a straightforward and comprehensive taxation system. Fairly modern and easy to administer, the Tax Code imposes detailed filing and reporting requirements, which require substantial paperwork and bookkeeping effort, particularly by corporate taxpayers.

3.3 Taxation of Business Entities in Kazakhstan

Business entities in Kazakhstan (including branches and representative offices of foreign companies) are potentially subject to several taxes and fees, which include:

1. Corporate income tax,
2. Value added tax,
3. Excise tax;
4. Tax on exported crude oil and gas condensate;
5. Special taxes on mineral resource users,
6. Social tax;
7. Land tax,
8. Vehicle tax;
9. Property tax,
10. Miscellaneous fees and levies.

All these taxes have their own separate filing and reporting requirements and make record keeping time-consuming.

Corporate Income Tax

Income tax is one of the principal taxes for legal entities and branch offices of foreign companies. Representative offices can constitute a taxable presence and could face liabilities for income tax if they are not part of an entity that is resident in a country that has a tax treaty in place with Kazakhstan.

A company is deemed to be resident in Kazakhstan if it is established as a legal entity under the laws of Kazakhstan or has its principal place of management in Kazakhstan. Companies resident in Kazakhstan are subject to taxation in Kazakhstan on their worldwide income. Companies not resident in Kazakhstan are subject to taxation in Kazakhstan only on their income from sources in Kazakhstan.

⁷ Code No. 209-II of the Republic of Kazakhstan on Taxes and other Obligatory Payments to the State Budget, dated June 12, 2001, as amended.

Most legal entities pay income tax at the rate of 30 percent of net income, though various small enterprises may be subject to special tax regimes specifying lower tax rates.

The net income of domestic entities is measured as gross worldwide income less expenses connected with the generation of income. Deductible expenses include wages and salaries, research and development costs, depreciation of fixed assets, repair expenses, insurance premiums, taxes other than income taxes, and other expenses attributable to income-producing activity. Interest expense, business trip per diem allowances, entertainment expenses, repair expenses and certain other expenses are deductible only within established limits.

The definition of fixed and intangible assets corresponds to that of Kazakhstan's legislation on accounting and financial reporting, with the additional stipulation that the assets must be used for the property owner's business purposes. Taxpayers therefore have some flexibility to set their own asset capitalization policy in their accounting policy and are not bound by a strict definition in tax law.

Tax law stipulates the depreciation of fixed assets on a declining balance basis and specifies maximum depreciation rates. During the first year of use of a business asset, depreciation allowances related to new machines and equipment may be doubled, provided that such property will be used in production for at least three years.

The limit on the deduction for repair expenses ranges from 15 percent to 25 percent of the residual value of the asset subgroup to which the repairs relate and varies by asset subgroup. These rules also apply to fixed assets that a lessee acquires in an operating lease. If the lessee does not have assets of the same type on its balance sheet, its repair expenses should be capitalized into the asset subgroup and depreciated. Any remaining balance at the end of the lease period is not deductible.

The balance of an asset subgroup may be deducted in full when the balance drops below 300 MIFs, or a little under USD 2,500 at current exchange rates.

Deductible taxes include land tax, property tax, vehicle tax, business registration fees, licensing fees for the right to carry out certain activities, mineral use bonuses and royalties, and social tax.

Expenditures incurred by a subsurface user to train local staff and contributions for the development of public assets are deductible in the amounts stipulated in the subsurface use contract. A legal entity engaged in subsurface use operations has the right to deduct allocations to reserves established by the subsurface use contract for repairing damage to the environment.

In addition to deducting expenses, legal entities may carry forward and deduct operating losses for up to three years following the year when the operating loss arises. Losses incurred in connection with activities conducted under subsurface use contracts may be carried forward for up to 7 years. Losses cannot be carried back to prior years.

Taxpayers may claim a foreign tax credit for foreign taxes paid on foreign-source income, in an amount up to the amount of tax due in Kazakhstan on the foreign-source income.

Taxation of Foreign Companies' Income

The taxation of foreign companies' income from sources in Kazakhstan depends on whether the foreign entity has a permanent establishment in Kazakhstan. A permanent establishment is defined as:

- a fixed place of activity used to conduct entrepreneurial activities in Kazakhstan, including activities conducted through authorized representatives;
- any location where the production, processing, packaging, assembly, boxing, delivery or sale of goods is carried out;

- any place used for the extraction of natural resources, including mines, pits, oil and gas wells, quarries, or land or sea derricks, regardless of the duration of such activities;
- any place where activities involving pipelines (including supervision and monitoring); surveying; excavation of mineral resources; or the installation, mounting, assembly, or servicing of equipment are conducted;
- any place where activities are conducted in connection with gaming machines, computer networks, communication channels, attractions, transportation or other infrastructure, irrespective of the duration of such activities;
- construction sites, assembly establishments or project work, irrespective of the duration of such activities.

Nonresidents are also deemed to have a permanent establishment in Kazakhstan in the following cases:

- when they engage in (re-)insurance activities in Kazakhstan through an authorized agent;
- when they provide uninterrupted services in Kazakhstan for more than 90 calendar days in any period of 12 consecutive months;
- when they actively participate in a simple partnership or joint activity formed in accordance with the legislation of Kazakhstan;
- when they hold exhibitions in Kazakhstan for a fee or sell property at such exhibitions;
- when they authorize a third party to represent their interests in Kazakhstan, to act on their behalf, or to conclude contracts on their behalf.

If a foreign entity has a permanent establishment in Kazakhstan, it is subject to all Kazakhstan taxes plus an additional tax on its net after-tax profit (a so-called branch profit tax) at the rate of 15 percent, which brings its total effective income tax rate to 40.5 percent of taxable income.

A Kazakh permanent establishment of a foreign entity may deduct a portion of the general and administrative expenses that the foreign head office incurs only if an applicable tax treaty provides for such deduction.

If a foreign entity does not have a permanent establishment in Kazakhstan, it is subject to income tax at the source of payment on its gross income from sources in Kazakhstan. The payer of income is responsible for withholding and remitting the tax to the state.

The rate of tax withheld at source depends on the nature of the income paid to the nonresident. Income from providing services (other than lending, insurance and international transportation services); lease income; or income from the use of patents, trademarks, copyrights, or licenses is taxable at the rate of 20 percent. Dividends, interest income and income from a stake in a Kazakh legal entity are subject to a tax rate of 15 percent. Income from international transportation services is taxed at 5 percent. Premiums paid for insurance coverage in Kazakhstan are subject to tax at 10 percent, while premiums for reinsurance are taxed at 5 percent.

Kazakhstan has signed a number of tax treaties that provide for reduced rates of income tax on passive income and exemption from corporate income tax on active business profits if companies avoid having a permanent establishment in Kazakhstan. Many of these tax treaties also provide a reduced rate of branch profit tax. The following table shows the income tax withholding rates for dividends, interest and royalties under Kazakhstan's various tax treaties:

Country	Dividends*	Interest	Royalty
Domestic rate – no treaty	15%	15%	20%
UK	5% (10)	10%	10%
USA	5% (10)	10%	10%
Italy	5% (10)	10%	10%
Poland	10% (20)	10%	10%
Netherlands	5% (10)	10%	10%
Ukraine	5% (25)	10%	10%
Azerbaijan	10%	10%	10%
Pakistan	12,5% (10)	12,5%	15%
Hungary	5% (25)	10%	10%
Uzbekistan	10%	10%	10%
Turkey	10%	10%	10%
Russia	10%	10%	10%
India	10%	10%	10%
Canada	5% (10)	10%	10%
Lithuania	5% (25)	10%	10%
Belarus	15%	10%	15%
Kyrgyzstan	10%	10%	10%
Germany	5% (25)	10%	10%
Bulgaria	10%	10%	10%
Sweden	5% (10)	10%	10%
Iran	5% (20)	10%	10%
Korea	5% (10)	10%	10%
Mongolia	10%	10%	10%
Czech Republic	10%	10%	10%
Turkmenistan	10%	10%	10%
Belgium	5% (10)	10%	10%
Estonia	5% (20)	10%	15%
Romania	10%	10%	10%
France	5% (10)	10%	10%
Georgia	15%	10%	10%
Tajikistan	10%	10%	10%
Switzerland	10% (30)	10%	10%
Moldova	10% (25)	10%	10%
Latvia	5% (25)	10%	10%
China	10%	10%	10%
Austria ⁸	5% (10)	10%	10%
Norway ⁹	5% (10)	10%	10%

* The first number is the tax rate. The number in parentheses indicates the minimum share of capital (in percentage) that a beneficial owner must possess to qualify for the reduced tax rate, if the treaty specifies a minimum ownership requirement.

⁸ The treaty will come into effect 30 days after the date when the last required document is exchanged.

⁹ The treaty will come into effect after all the necessary procedures are completed by Kazakhstan and Norway.

Note: Under some treaties, a nonresident may qualify for 0 percent tax on dividends if it meets other requirements in addition to the minimum ownership requirement.

Filing and Payment Requirements

Advance payments of corporate income tax are due monthly. Taxpayers must submit a statement of their proposed advance tax payments by January 20 of the tax year to which the payments relate. Once the taxpayer's profit tax declaration for the prior year is submitted, taxpayers should file a revised statement of their proposed advance tax payments within 20 days following the submission of the tax declaration.

Annual profit tax declarations are due no later than March 31 of the year following the reporting year. Taxpayers must remit any outstanding tax liabilities within 10 business days following the submission of their annual tax return.

Value Added Tax

Registration as a VAT payer is required for all individuals and companies that conduct business activity and have taxable revenues in excess of approximately USD 120,000 in any period of 12 consecutive months. VAT registration is optional for all other persons.

The standard VAT rate is 15 percent¹⁰ and applies to revenues derived from the sale of goods or services within Kazakhstan and to the import of goods into Kazakhstan. Tax law provides special rules for determining when and where various types of transactions are deemed to occur.

Certain activities are exempt from VAT. The list of exempt activities includes, among others, the lease and sale of buildings (except the initial sale of a residential building), sale and lease of land and land use rights (except for land used for parking passenger vehicles), financial services, insurance services, geological surveying and exploration activities, medical services, sale of services related to infrastructure projects and sales of a company or an independently functioning part of a company.

Registered VAT payers must charge VAT on their taxable output and may claim a credit for input VAT they pay to suppliers who are registered VAT payers in Kazakhstan.

Kazakhstan VAT payers are required to charge themselves VAT on taxable transactions they conduct in Kazakhstan with nonresidents that are not VAT payers in Kazakhstan. Taxpayers may claim a credit for this self-charged VAT.

The VAT base for imported goods includes the declared customs value of the goods and any excise duties, customs duties, and customs clearance fees paid on the goods. Importers must pay import VAT before goods clear customs. VAT exemptions at the time of import are available for certain types of equipment, pharmaceuticals, raw materials and spare parts.

Depending on a taxpayer's volume of sales and corresponding VAT liabilities, VAT declarations and payments are due either monthly or quarterly. The amount due to the state is the difference between the total amount of output VAT that a taxpayer charges during the tax period and the total amount of input and/or import VAT that the taxpayer pays during the tax period.

Zero-percent VAT applies to exports of goods from Kazakhstan, international transport services and sales of goods on the territory of special economic zones.

¹⁰ In accordance with the President's March 2006 address to the nation, the government is planning to reduce VAT to 14 percent in 2007, to 13 percent in 2008, and to 12 percent in 2009.

Excise Tax

Certain items imported into or produced in Kazakhstan are subject to excise tax. These goods include, among others, all kinds of spirits and alcoholic beverages, tobacco products, petrol (except for aviation fuel), diesel fuel, motor vehicles, crude oil, and gas condensate.

Entities that produce or import excisable goods or conduct a gambling business are required to pay excise tax. Sellers of excisable goods are also required to pay excise tax, unless excise tax was previously paid in Kazakhstan on those goods.

Excise tax is based on either the customs value or quantity of imported goods, depending on the type of good, and on the selling price of finished goods produced in Kazakhstan. For example, if a company manufactures and sells fuel, excise duty applies to the amount of fuel sold in the reporting period plus fuel used for internal production purposes.

Excise tax rates generally range from 10 percent to 100 percent of an item's value or are expressed in Euros per unit of product.

Excise tax returns are due monthly. Payments are due three times per month.

Tax on Exports of Crude Oil and Gas Condensate

Individuals and legal entities exporting crude oil and gas condensate, other than subsurface users operating under a production sharing agreement or a subsoil use contract concluded before 2004, are subject to a special tax on exports of crude oil and gas condensate. The tax rate ranges between 1 and 33 percent of the Government-determined market value of the exported hydrocarbons.

Tax declarations and payments of the tax on exports of crude oil and gas condensate are due monthly.

Taxation of Mineral Resource Users

Business entities extracting minerals may additionally be required to pay bonuses (subscription bonus and commercial discovery bonus), royalties, a tax on export of crude oil and gas condensate, an excess profits tax that ranges from 0 to 60 percent, and/or the Republic of Kazakhstan's share of production under a production sharing agreement. The payment procedures and amounts are stipulated in the contract between the subsurface user and the state.

Payments made in accordance with a subsurface use contract do not release a taxpayer from the duty to pay other taxes and obligatory payments related to activities outside of the scope of the subsoil use contract.

Subsurface users pay taxes under either of two taxation regimes. The first model provides that a subsurface user must pay all taxes and obligatory payments stipulated by Kazakhstan tax legislation. The second model provides that a subsurface user must transfer the state's share of production under a production sharing agreement to the state and must pay all taxes other than land tax, property tax, excise tax, tax on export of crude oil and gas condensate, and excess profits tax.

The tax regime established in a subsurface use contract that has undergone an obligatory tax evaluation should remain valid until the expiration date of that contract. Contractual modifications may be introduced by agreement of the parties, provided that such modifications do not change the balance of economic interests initially agreed upon by the Republic of Kazakhstan and the subsurface user.

Land Tax

Entities that own or use a land parcel are required to pay a land tax. The tax rate depends on the land quality and is established in the form of annual fixed payments per unit of land area.

Local authorities may decrease or increase the tax rate, depending on the type and location of land, by up to 50 percent of the rates stipulated in the Tax Code.

Vehicle Tax

Entities that own or use vehicles registered in Kazakhstan are subject to an annual vehicle tax. The tax rate depends on the vehicle's engine volume, age and country of origin.

Property Tax

Entities owning or using fixed assets and intangible assets, other than vehicles and land, must pay property tax on such assets. The property tax rate is 1 percent and applies to the average annual book value of the taxable assets. Property tax applies regardless of whether profit is derived from the use of the assets.

Filing and Payment Deadlines

Taxpayers must submit reports of advance payments of land tax, vehicle tax and property tax by February 15 of the tax year to which the payments relate. Annual tax returns for these taxes are due by March 31 of the year following the reporting year. Advance land tax and property tax payments are due quarterly during the reporting year. Final tax settlements are due within 10 business days following the submission deadline for the annual tax return.

Miscellaneous Fees and Levies

Various other fees and levies may apply to certain types of activity in Kazakhstan. For example, there are fees for the use of wildlife, forestry fees, fees to register real estate transactions, environmental pollution charges, levies for the use of the radio frequency spectrum, and stamp duties for any number of administrative functions performed by governmental bodies, such as notarizations. In addition, companies may need to pay a license fee for the right to engage in certain specified types of activity.

3.4 Personal Income Tax

Tax Residency

Personal taxation in Kazakhstan depends on an individual's residency status. Individuals are regarded as tax residents of Kazakhstan if they spend 183 days or more in Kazakhstan in any period of three consecutive years. In determining the number of days spent in Kazakhstan, days in the current tax year are counted in full, while days in the prior tax year are counted as one-third of a full day and days in the tax year two years prior to the current year are counted as one-sixth of a full day.

To illustrate, an individual spending 90 days in Kazakhstan in the prior year would be treated as having spent 30 days in Kazakhstan for purposes of determining the total number of days that the individual spent in Kazakhstan during the three most recent years, and an individual spending 90 days in Kazakhstan in the year two years prior to the current year would be treated as having spent 15 days in Kazakhstan when calculating total days in Kazakhstan. These totals would then be added to the actual number of days spent in Kazakhstan in the current year. If they add up to more than 183 days, the individual is regarded as a tax resident for the current year. If in the current tax year a person spent

less than 30 calendar days in the Republic of Kazakhstan, such person is not recognized as resident in Kazakhstan, regardless of the number of days spent in Kazakhstan in prior years.

Individuals who are present in Kazakhstan less than the stipulated number of days are regarded as nonresidents. A person is considered as nonresident for the period following his or her last day of presence in Kazakhstan, unless the person becomes resident again in the year following the year in which that person departed from Kazakhstan.

Tax residents are subject to tax in Kazakhstan on their worldwide income. Nonresidents are subject to tax in Kazakhstan only on their Kazakhstan-source income.

Taxable Income

Kazakh-source income with respect to employment income includes all income whether received in cash or in kind for work performed in Kazakhstan regardless of where such income is paid. As a rule, all types of compensation and benefits that an employee receives for employment services constitute taxable income. These include, but are not limited to, the following:

- Cost of living allowances;
- Foreign service premiums;
- School or tuition fee reimbursements;
- Reimbursements of foreign and/or home-country taxes;
- Reimbursement of home leave costs;
- Housing allowances and the imputed value of housing provided directly by the employer;
- Company car (although there are no guidelines on how to tax the benefit);
- Provision of domestic assistance;
- Relief of an employee's debt to his employer;
- Discount element of goods provided to an employee at a reduced price or free of charge;
- Other benefits in kind.

Tax Exemptions

The following types of income are exempt from personal income tax:

- Interest on securities issued by the Government of Kazakhstan;
- Interest on deposits in banks licensed by the National Bank of Kazakhstan;
- The value of property including money, received in the form of gifts or inheritances from other individuals;
- Gains from sales of securities of companies with an "A" or "B" rating on the Kazakhstan Stock Exchange on the date of sale.

Tax Deductions

The following deductions are available to taxpayers in Kazakhstan.

- A standard deduction in the amount of one monthly index factor (currently KZT 1,030, or approximately USD 8) is granted for every employee and each of the employee's dependents for each month in which the employee earns income.
- Obligatory pension fund contributions in the amount of 10 percent of an employee's gross income must be withheld on a monthly basis from remuneration paid to local national employees.

Currently, the maximum monthly amount of income subject to obligatory pension contributions is KZT 690,000 (approximately USD 5,400).

- Interest that a resident individual pays to the Kazakhstan State Residential Construction Bank on a loan to renovate, construct or purchase a home is deductible.

Tax Rates

Personal income tax rates range from 5 percent to 20 percent of taxable income. The maximum rate applies to annual income in excess of approximately USD 58,000. The following are the personal income tax rates in effect for 2006.

<i>Taxable Income (KZT)</i>	<i>Tax (KZT)</i>
Up to 185,400	5%
From 185,400 to 494,400	9,270 + 8% of taxable income exceeding 185,400
From 494,400 to 2,472,000	33,990 + 13% of taxable income exceeding 494,400
From 2,472,000 to 7,416,000	291,078 + 15% of taxable income exceeding 2,472,000
Over 7,416,000	1,032,678 + 20% of taxable income exceeding 7,416,000

Tax Payment and Reporting Mechanism

Kazakh legal entities and representative offices and branches of foreign legal entities registered in Kazakhstan must withhold personal income tax from all payments they make to employees, regardless of the nationality of the employees. The personal income tax is due to the state by the 15th day of the month following the month in which salaries are paid. A quarterly report of personal income tax withheld at the source of payment is due by the 15th day of the month following the reporting quarter.

Foreign companies that are registered in Kazakhstan can choose between the following two options for remitting personal income tax for expatriate employees paid from outside of Kazakhstan:

- To pay the tax in monthly advance tax payments based on estimated income for the year
- To withhold tax each month based on actual income paid for the month

The first option requires the foreign company to file a report of advance tax payments with the tax authorities by January 20 of the tax year in question (or within 25 working days after the date of the employee's initial arrival in Kazakhstan). Advance tax payments are then due in equal monthly installments by the 20th of each month. By 31 March of the year following the reporting year, expatriates must submit annual tax returns. The final tax settlement is due within ten work days after the tax return filing deadline.

The second option requires the employer in Kazakhstan to withhold income tax in the same manner as for local national employees.

If an expatriate is paid by a foreign employer without a registered presence in Kazakhstan, the expatriate is responsible for calculating and remitting the tax. Such individuals must make monthly advance tax payments and submit a tax return to the tax authorities after the end of the year.

Tax-resident individuals who receive income that is not taxed at the source of payment in Kazakhstan or who have bank accounts outside of Kazakhstan during the tax year must file an annual tax return.

Annual personal income tax returns are due by 31 March of the year following the reporting year. There is no joint filing status in Kazakhstan. Instead, each spouse earning income must file a separate tax return.

Because of the comprehensive filing requirements, virtually all foreign nationals are required to file a tax return by 31 March following the reporting year.

Foreign Tax Credit

Taxpayers can receive credit for the amount of income tax paid in foreign jurisdictions on income derived from foreign-sources. Such credit, however, cannot exceed the amount of tax that would have been paid in Kazakhstan on the same income. Income pooling is not allowed, and taxpayers must compute foreign tax credits for each foreign tax jurisdiction separately.

Treaty Claims Procedure

A nonresident individual's income may be exempt from tax in Kazakhstan under an applicable tax treaty. If the income is subject to income tax at the source of payment in Kazakhstan, the individual can claim treaty relief by providing the employer in Kazakhstan with a certificate confirming his or her tax residency in a treaty country. The company is responsible for ensuring that the individual meets the conditions to qualify for treaty relief.

To obtain treaty exemption for income that is not subject to income tax at the source of payment (in other words, income that is paid abroad by an entity without a registered presence in Kazakhstan), a qualifying nonresident individual must provide the Kazakh tax authorities with a certificate confirming his or her tax residency in a treaty country.

3.5 Social Security and Social Tax

Employers in Kazakhstan must make contributions to the State Social Security Fund. Contributions are required for local employees as well as for expatriate personnel who have a permit for permanent residence in Kazakhstan. A foreign national without a permanent residence permit is not subject to this contribution requirement.

Employers must make contributions individually for each employee. Contributions are based on an employee's monthly gross salary, up to a maximum monthly income of approximately USD 720. For 2006, contributions are computed at the rate of 2 percent of applicable gross salary. This rate is scheduled to increase to 3 percent in 2007.

Kazakh employers, including foreign employers operating in Kazakhstan through a branch or representative office, must pay social tax for their employees. Social tax applies at regressive rates that range from 11 percent to 5 percent for foreign specialists in administrative, managerial, engineering, or technical roles. The social tax rates for other categories of personnel range from 20 percent to 7 percent.

The calculated amount of social tax may be reduced by the amount of the employer's social security contributions.

There is no maximum threshold for the social tax base. Obligatory contributions to pension funds in Kazakhstan and a few other minor allowances, such as compensation for unused vacation, are exempt from the social tax. These allowances include the following:

- Payments received from an employer or insurance company to compensate for occupational injuries,

- Reimbursement of medical expenses up to approximately US\$330 per year,
- Costs of travel and accommodation for business trips,
- Payments received from an employer for relocation,
- Maternity payments up to approximately US\$330 per year,
- Employer-paid premiums for occupational injury insurance.

General Social Tax Rates

Taxable Income (KZT)	Tax (KZT)
Up to 185,400	20%
From 185,400 to 494,400	37,080 + 15% of taxable income exceeding 185,400
From 494,400 to 2,472,000	83,430 + 12% of taxable income exceeding 494,400
From 2,472,000 to 7,416,000	320,742 + 9% of taxable income exceeding 2,472,000
Over 7,416,000	765,702 + 7% of taxable income exceeding 7,416,000

Social Tax Rates for Preferred Categories of Expatriate Personnel

Taxable Income (KZT)	Tax (KZT)
Up to 494,400	11%
From 494,400 to 2,472,000	54,384 + 9% of taxable income exceeding 494,400
From 2,472,000 to 7,416,000	232,368 + 7% of taxable income exceeding 2,472,000
Over 7,416,000	578,448 + 5% of taxable income exceeding 7,416,000

Social tax payments are due by the 15th day of the month following the reporting month. Social tax reports are due quarterly by the 15th day of the month following the reporting quarter.

3.6 Protection of Taxpayer Rights

Overall, Kazakhstan's tax legislation establishes a relatively well-functioning and straightforward tax collection mechanism. The legislators, however, have paid little attention to the protection of taxpayer rights. Although the Tax Code provides that a principal obligation of the tax authorities is to observe taxpayer rights, these rights are narrow in scope and largely declarative. Businesses often complain of frequent inspections by tax authorities and other officials, even though such inspections are limited in number and scope under Kazakhstan legislation. Although the Government is taking steps to rein in inspections by overzealous officials, Kazakhstan's tax system continues to suffer from excessive bureaucracy, and more work needs to be done to make the tax collection system more friendly to taxpayer interests.

3.7 Accounting Standards and Audit Requirements

Accounting Standards

Since January 1, 2006, all entities in Kazakhstan must follow International Financial Reporting Standards (IFRS).

Audit Requirements

Enterprises with foreign participation and all banks, regardless of ownership, must be audited on an annual basis and must present their independent auditor's report along with their financial statements to the tax authorities.

3.8 Banking System

The National Bank has been established as the first tier of the Kazakhstani banking system and is responsible for implementing the country's monetary policy; supporting the stability of the national currency; setting interest rates; and developing banking, currency regulation, and financial markets legislation. Other banks and financial institutions constitute the second tier of the banking system and are subject to regulation and licensing by the National Bank¹¹ and the Agency on Regulation and Supervision of the Financial Market and Financial Organizations (ARS).

At the time of this writing there are approximately 35 banks in Kazakhstan, reduced from about 220 in 1994. Major Kazakhstan banks include Kazkommertsbank, Turan Alem Bank, and Halyk Savings Bank. A number of foreign-owned banks have also established offices, including AMN AMRO Bank, Citibank, and HSBC. While certain restrictions exist on foreign investment in the banking sector, the number of foreign banks in Kazakhstan and the scope of financial services provided to clients are likely to increase.

Further consolidation of the banking system seems likely, with foreign banks taking a greater role. National Bank policy has concentrated on strengthening the country's financial system and raising it to international standards. Accordingly, all banks have been required to improve prudential management and comply with strict guidelines and general banking criteria set for all financial institutions.

The rules promoted by the National Bank target the following areas:

- Capital adequacy requirements,
- Rules governing loans,
- Protection of information,
- Audit requirements,
- Personnel requirements.

Capital Adequacy

Stricter capital adequacy requirements have been established by the National Bank. Banks in certain specified categories must maintain a minimum capital of 1 billion tenge (about US\$7.7 million). For newly established banks the minimum is 2 billion tenge. By 2007 all banks in Kazakhstan are required to meet Basel I risk-weighted capital standards.

Loan Limits

To encourage prudent lending policies, limits have been imposed on the lending ability of financial institutions. The maximum amount loaned to a single borrower may not exceed 25 percent of the financial institution's adjusted capital or 10 percent if the borrower is a related party.

Information System Requirements

The National Bank has imposed certain requirements for the security of information systems, general ledgers and auxiliary bookkeeping. The level of information technology used for accounting purposes

¹¹ In addition to banks, various financial institutions exist that perform a specific range of financial activities on the basis of a license issued by the National Bank. These activities include real estate assessment, custodial and clearance activities, pawnshop operations, currency exchange, factoring, and insurance activity. Activities associated with stock market operations require a license from the National Bank.

should support dual controls during the input-output process, use the methodology of back and front offices, and comply with the National Bank's requirements concerning information protection levels.

Audit Requirements

Stricter internal audit requirements have also been imposed. An internal audit must be performed for all major aspects of banking activity. The results of internal inspections must be available for use by external auditors and National Bank and ARS inspectors. In addition, all banks in Kazakhstan must have their annual financial statements audited by an external auditor.

Personnel Requirements

Because of the sensitive nature of financial activities, special requirements apply to bank management and personnel. At least one of the executive directors must have a university-level professional degree and three or more years of experience in a leading position at a financial institution. In addition, persons with a criminal record may not be appointed to directorship positions.

3.9 Securities Regulation

Despite continuous efforts of the government to increase the importance of Kazakhstan's securities market, it plays a relatively minor role in the country's economic development. Few popular local companies' shares are traded on the Kazakhstan Stock Exchange, and foreign investor participation is relatively low. Most transactions occur over the counter. Although in 1997 the government declared that it would place minority shares of "blue-chip" enterprises on the stock exchange, such placement has been delayed indefinitely because of the effects of the Asian and Russian financial crises. Recently a number of large Kazakh companies have announced their intention to make initial public offerings (IPOs) on foreign stock exchanges.

In 2004, the ARS was established by separating the Financial Supervision Department from the National Bank in order to create an independent and effective system of consolidated supervision of financial markets. The main tasks of the ARS are to regulate and monitor the securities market, banking activities, pension funds and insurance operations. In addition, the Ministry of Finance and the National Bank still hold the status of regulators in the field of government securities. For effective supervision, the ARS uses information obtained through licensing and the reports submitted by market participants. On-site inspections are also periodically conducted.

3.10 Employment Legislation

The Labor Law¹² is the principal legislative act regulating labor relations in Kazakhstan. Under the new amendments introduced in December 2004, labor protections were strengthened and additional burdens were imposed on employers. These changes affected primarily the following areas:

- employer responsibilities,
- conclusion and termination of employment contracts and collective bargaining agreements,
- employment of expectant mothers and women with children,
- labor remuneration.

Employment contracts concluded before December 2004 remain valid. However, they must comply with the new amendments to the Labor Law regarding the continuation and termination of employment contracts.

¹² Law No. 494-I 3RK on Labor in the Republic of Kazakhstan, dated December 10, 1999, as amended.

Under the new amendments, employers must take active measures to reduce employment-related risks. An employer may suspend an employee from work if the employee commits actions that could result in violation of work safety rules and lead to emergency situations. In addition, employers must keep precise records of each employee's work hours and overtime hours.

If a company is reorganized or changes ownership, employment relations and conditions are not suspended as a result of the change.

Employment Contracts

Prior to the introduction of the new amendments to the Labor Law, employers had the right to conclude employment contracts with their employees for a definite or an indefinite period of time as they saw fit. Under the new amendments, employers lost the ability to conclude employment contracts for a limited time period simply to avoid the provision of certain guarantees and compensations to employees. An employer using limited contract periods to avoid providing certain benefits may face administrative penalties.

As the general rule, the minimum contract period has been extended to one year. Employment contracts may be concluded for a period of less than one year only in connection with short-term or seasonal assignments or to substitute temporary hires for employees who are on temporary leave from their duties.

If an employment relationship is not terminated upon the expiration of an employment contract and the employee continues working, the contract period is regarded as prolonged for an indefinite period of time, the parties do not have the right to conclude an employment contract for a set time period and the employee may not be dismissed other than in circumstances prescribed in the law (usually for cause).

As a general rule, employees may not be required to perform other duties than those stipulated in their employment contract. However, employers have the right to temporarily transfer an employee to other duties because of production needs or as a temporary substitution for an absent employee. In addition, when production facilities are idled, employers have the right to transfer an employee to a different job without consent for a period of up to one month. Compensation for this period of time should be no less than two-thirds of the monthly salary that the employee earned in his or her previous work.

Termination of Employment Contracts

An employment contract can be terminated at the employee's initiative if the employee informs the employer in writing one month prior to the termination of the employment contract. On the employee's last working day, the employer should give the employee his or her labor log and other employment documents and pay all legally required payments and compensation.

If the employer decides to terminate an employee for cause – repeated non-fulfillment or violation of labor duties or a one-time gross violation of labor duties as specified by labor legislation – no advance notification needs to be provided to an employee prior to termination. In addition, an employer is not required to inform an employee in advance about the termination of his or her employment if another employee previously working in that position was ordered reinstated by a court decision or if the terminated employee was denied access to state secrets necessary for the performance of his or her duties. An employer may not terminate an employment contract during an employee's annual vacation, maternity leave or sick leave.

Collective Agreement

Under the amended Labor Law, employers that receive employee proposals to start negotiations on a collective bargaining agreement are required to enter into negotiations within ten days.

Participants in negotiations on collective bargaining agreements have certain guarantees. In particular, they must be released from their work duties for the period of negotiations and receive a guaranteed payment of their average monthly salary for this period. Also, the period of such negotiations is included in the determination of their seniority and entitlement to certain benefits.

Employees who are not members of a trade union have the right to authorize a trade union or its representatives to represent their interests before their employer. Under the new amendments, employees' interests can also be represented by other individuals who are not trade union members.

Once a collective bargaining agreement is signed, the employer must submit a signed copy of the agreement to the regional state labor body within a month following the signing date.

Other Labor Law Provisions

Overtime Work

The maximum amount of overtime work allowed by law remains unchanged and should not exceed 2 hours per day (one hour in cases of hard physical work or work under harmful or dangerous conditions). The labor law amendments also provide that overall no more than four hours of overtime may be worked per week (two hours per week in cases of hard physical work or work under harmful or dangerous conditions).

Vacation

Under the new amendments, if an employee has accrued vacation days, the employee may request a vacation, and the employer must grant it, regardless of the length of time for which the employee has worked for the employer. These provisions subsequently modified the requirement that employees work for at least a year before becoming eligible for vacation. Moreover, additional paid vacation should be provided to employees engaged in hard physical work or work under harmful or dangerous work conditions. Employees cannot be recalled to work during this additional vacation.

Employers are allowed to offer employees cash compensation in lieu of vacation leave; but they may not do so in two consecutive years. Thus, if an employee received cash compensation in one year, he may not be offered monetary inducements to forego vacation and must take vacation leave in the following year.

Guarantees for Pregnant Women and Women with Children

New amendments to the Labor Law stipulate the following additional guarantees for pregnant women and women with children:

- Pregnant women may perform night time work only with their written consent.
- Pregnant women cannot work overtime. Invalids and women who have children of preschool age or an invalid child under 16 can work overtime only with their written consent.
- In addition to rest breaks and lunch breaks, feeding breaks of not less than 30 minutes should be given to women who have children under the age of 18 months. These breaks should be given after each three-hour work period.
- Feeding breaks of not less than one hour should be given to women with two or more children under the age of 18 months. These feeding breaks should be treated as work time.
- Paid maternity leave of 70 calendar days prior to childbirth and 56 to 70 calendar days after childbirth must be provided to pregnant women, regardless of the amount of time they have worked for the organization.

- Additional unpaid maternity leave may be taken by mothers at any time before their child reaches the age of three years. An employer may not fire women with children under the age of three or eliminate their position while they are on maternity leave.
- Employers cannot terminate employment contracts with pregnant women or women with children except where the employer company is liquidated, the employee refuses to transfer to another job within the organization, an employee previously working in that position is reinstated by a court decision, or the employment contract is terminated for just cause.

3.11 Expatriates

Kazakhstan is undergoing a difficult transition period, which creates certain anomalies to a foreign observer. Prices for many goods are the same as or higher than in most countries and apartment rents for quality housing are generally expensive. Much of the economy still operates on a cash basis, although the number of stores and restaurants that accept credit cards is rapidly increasing. ATMs are becoming more widely available. Because of the breakdown of the subsidized health system, quality health care has declined, and despite the government's increased investment in recent years into the health and insurance service sectors, they are far below western standards. Vaccination prior to arrival in the country is generally recommended, as is health and medical evacuation insurance.

Legal Status of Expatriates

As in most countries, foreigners visiting or residing in Kazakhstan are largely subject to the same rules as the country's citizens, with the obvious restriction of certain political rights and absence of military service obligations. Although foreign citizens have a right to education, employment, and health protection, as a matter of practice, expatriates are generally required to pay for their educational and health care costs. In addition, temporary residents of Kazakhstan are not entitled to own real estate, although such benefits may be available to foreign nationals who are permanent residents of Kazakhstan.

Visa and Registration Requirements

Entry into Kazakhstan usually requires possession of a valid passport and, in most cases, a visa. A visa should be obtained at the embassy or consulate of Kazakhstan in the applicant's home country or, if no such embassy or consulate is available, at the embassy or consulate of the Russian Federation or the closest Kazakhstan embassy or consulate in another country. A letter of invitation from the organization or person inviting the expatriate to Kazakhstan must be submitted to the Ministry of Internal Affairs before a visa is issued.

Starting in 2003, new simplified procedures were established for the issuance of visas to foreign nationals from most North American and Western European countries. Nationals of these countries do not need an invitation letter from a Kazakh inviting party as a prerequisite to applying for a Kazakh visa and can apply directly to a Kazakhstan embassy or consulate in another country for a Kazakh visa.

All foreigners must register with the Department of Visas and Registration (OVIR) within three business days following arrival in the country. Saturdays, Sundays, and holidays are not included in determining the registration period. Failure to register with the OVIR could subject the unregistered expatriate to fines and possible deportation.

Foreign Employee Work Permit

A company that invites foreign specialists to work in Kazakhstan for a period of more than 45 days is required to obtain a permit allowing it to do so. The procedure for obtaining a permit includes payment of a deposit guaranteeing the departure of the expatriate. In addition, the prospective

employer must provide to the state labor authority certain documents, including evidence that no comparably qualified local candidates are available on the local labor market.

The government has introduced a list of foreign nationals who can work in Kazakhstan without a work permit, including:

- The head of a company that invests more than US\$50 million in the Kazakhstan economy;
- The director of a Kazakh legal entity with investment in specified priority sectors of the economy;
- The director of a domestic bank, insurance company, or pension fund;
- The head of a Kazakh branch or representative office of a foreign company;
- An employee of a diplomatic mission or an accredited international organization;
- An employee of an accredited humanitarian or charity organization;
- An individual entrepreneur registered in Kazakhstan;
- A foreign national holding a Kazakh residence permit.

The number of work permits issued each year in Kazakhstan is limited. The limit for 2006 is approximately 43,000 permits. This amount is not sufficient to meet the growing needs of the domestic economy and is a significant brake on the country's economic development. Diplomats and companies that employ foreign personnel, especially those involved in oil and gas operations, have frequently called for an increase in the quota levels.

Taxation of Expatriates

All foreign employees working in Kazakhstan are generally subject to personal income tax in Kazakhstan (see above for more detailed discussion of tax issues). At the time of their departure from Kazakhstan expatriates may be required to present proof that they have filed a tax declaration with the tax authorities and that all necessary taxes have been paid.

CHAPTER 4

Trade and Investment

4.1 Overview

Trade and foreign investment play an important part in the development of Kazakhstan. The vast majority of Kazakhstan's exports involve natural resources such as metals, coal, and wheat. In turn, Kazakhstan imports goods such as petrochemicals, refined oil products, machinery, vehicles, consumer durables, and food products. Trade is almost evenly split between CIS and non-CIS countries, although the role of non-CIS trade partners has grown significantly and is bound to expand in the future.

Kazakhstan is the largest per capita recipient of foreign direct investment (FDI) in the CIS, with the equivalent of over USD 40 billion invested in its economy, primarily in the oil and gas and metallurgy sectors. About half of all investment has come from the U.S., the Netherlands, and the U.K., with the balance split between other countries. More foreign investment is needed, however, particularly outside the natural resource sector.

4.2 Trade Regulation

Important aspects of international trade relations are governed by the new Customs Code¹³, which came into force on May 1, 2003 and replaced the prior customs law.

Kazakhstan customs procedures are fairly straightforward, although difficulties occasionally arise because of the burden of the documentation requirements and the unavailability of secondary legislation.

Customs Regimes

Once goods are delivered to customs by carrier, an importer must declare the import under one of 17 customs regimes. Selection of the proper regime is very important, since the importer's rights and responsibilities toward the property and the amount of applicable duties depend on the regime chosen. The most commonly used regimes are:

1. *free circulation*, which allows for unrestricted use of imported goods but also subjects the importer to the full amount of taxes and customs duties, and
2. *temporary import*, which partially relieves the importer of the payment of customs duties and VAT. The period of the temporary importation is determined by the importer and must be approved by the customs authority of the Republic of Kazakhstan. This period may not exceed three years from the date of importation of the goods, although it can be prolonged through a timely application to the customs authorities. Customs duties are payable in monthly installments of 3 percent of the duties payable under the free circulation regime. Certain assets temporarily imported into Kazakhstan under a financing lease are fully exempt from taxes and customs duties. The list of such assets is established by the Government.

Some of the other commonly-used regimes include:

- customs warehouse,
- duty-free shop,
- export,

¹³ Customs Code of the Republic of Kazakhstan, dated 1 May, 2003, as amended.

- transit of goods,
- destruction of goods,
- relinquishment of goods for the benefit of the state,
- customs-free warehouse.

Customs Clearance

A customs declaration is required for goods and vehicles when they transfer across the customs boundary of Kazakhstan or when their applicable customs regime changes. An extensive number of documents must be submitted at the time of import or export, including:

- a cargo declaration;
- a transaction passport (a prescribed currency control document) indicating the most important details of the import or export contract;
- shipping documents (for example, bills of lading);
- invoices;
- a purchase-sale agreement or a lease contract and, if necessary, a copy of an agreement between the importer and a third party paying for the goods;
- a certificate of origin.

Other documents such as a certificate of fitness for use, an import or export license, or documents required for currency controls, may be required as well.

Depending on whether payment is made before or after the completion of customs processing, the transaction passport and the related contracts and documents must be presented either to the importer's bank or to the customs authorities. After the necessary documents have been submitted, the customs authorities should inspect the goods within two days. The customs authorities then value the goods and calculate duties, taxes, and fees. Once all charges have been paid, the goods are released in accordance with the regime chosen by the importer.

Customs Duties

Customs duties vary between 0% and 100% (though the maximum rate applicable to most goods is 30%) and are imposed on the transaction value of the imported goods (the price of the goods plus all associated costs, such as transportation, etc). A customs processing fee in the amount of 50 euros for the first page of a customs declarations and 20 euros per additional page also applies.

Tariff privileges and preferences are granted exclusively by a decision of the Government of Kazakhstan on the basis of proposals from the Customs Tariff Council. Kazakhstan law allows importers of goods originating in and imported from certain countries, as well as certain classes of investors, to import goods and property duty-free or at reduced duty rates. Certain goods originating in and imported from less developed countries may be imported duty-free, while certain goods from developing countries can be imported at 75% of the regular customs rates. In addition, goods originating in and imported from other Customs Union members – Russia, Belarus, Kyrgyzstan, and Tajikistan - may be imported duty-free. Also, goods originating in and imported from other Free Trade Zone members – Russia, Moldova, Belarus, Ukraine, Kyrgyzstan, Armenia, Azerbaijan, Uzbekistan, Turkmenistan, Georgia and Tajikistan – may be imported duty-free, with the exception of certain food and tobacco products from Ukraine, Georgia, Armenia, Azerbaijan, and Uzbekistan.

Customs duties may also be reduced or waived for contracts entered into with state authorities for investment in priority sectors of the economy. Additional benefits may be provided under international agreements and treaties to which Kazakhstan is a party.

Taxation Aspects of Import and Export Transactions

Importers should consider the taxation aspects of import transactions. Most imports into Kazakhstan are subject to VAT at 15%, which is assessed on the customs value of the goods plus any applicable customs duties and clearance fees. Under certain conditions, VAT payments may be postponed. Certain delicacies, alcohol and tobacco are further subject to excise taxes.

Exports of goods and international transport services are subject to 0% VAT.

Obstacles to Trade

Although fairly straightforward, the customs system contains several potential obstacles that importers and exporters need to be aware of. Until recently, only Kazakhstan individuals and legal entities were permitted to file a customs declaration. Customs legislation now permits foreign individuals and representative offices of foreign entities to file customs declarations. Branch offices of foreign entities may not file customs declarations and must use licensed Kazakhstan customs brokers to import or export their goods.

Kazakhstan uses its own system of standards and certifications, which can differ from international standards. Imported products and equipment may need to be recertified in accordance with Kazakhstan standards. Moreover, import or export licensing may be required for certain products, which can subject an importer or exporter to additional delays in the customs clearance process. Finally, customs duties and taxes are not always uniformly applied, and any party engaging in international trade transactions is well advised to familiarize itself with customs regulations and duties rather than simply relying on customs officials' advice.

Summary

Any business planning to trade with Kazakhstan should consider a number of factors that may influence transaction structures. Foreign businesses may find the Kazakhstan legal system difficult to work with. International arbitration may provide an impartial dispute resolution forum whose decisions may be enforceable in Kazakhstan under the 1958 New York Convention on the Enforcement of Foreign Arbitration Awards. An irrevocable letter of credit from an international bank is a useful protection against the weaknesses of certain enterprises and banks. Finally, favorable financing and risk insurance from foreign government or multinational agency sources should not be ignored.

Despite many problems, Kazakhstan has made significant progress through its many legislative reforms and has unified its practices with that of many of its major trade partners. Its laws and policies continue to progress towards those of more developed countries. If an investor is prepared to deal with the problems typical of a transition economy, trade with Kazakhstan can be a profitable undertaking.

4.3 Currency Regulation

Currency regulation in Kazakhstan is governed primarily by the Law on Currency Regulation¹⁴ and the National Bank's regulations. The national currency, the tenge, is freely convertible, and few restrictions are placed on the import and export of foreign currency to and from Kazakhstan. Kazakhstan legal entities, their branches and representative offices inside and outside the country, citizens and individuals who have residence permits in Kazakhstan are considered to be residents for currency regulation purposes. This includes Kazakhstan subsidiaries of foreign companies and Kazakhstan individuals who travel or reside temporarily abroad. Foreign citizens, except for those

¹⁴ Law № 57-III of the Republic of Kazakhstan on Currency Regulation and Currency Control, dated June 13, 2005.

who have residence permits in Kazakhstan, and foreign legal entities in Kazakhstan and abroad, their branches and representative offices, are treated as nonresidents for currency regulation purposes.

Payments between residents and nonresidents may be made in any currency. In contrast, all payments in foreign currency between residents are prohibited, except for:

- transactions with the National Bank or the Ministry of Finance;
- the acquisition, sale, or redemption of securities issued by residents in foreign currency, the payment of interest on such securities, and transactions in securities issued by nonresidents;
- payments to residents that have a license allowing them to be paid in foreign currency;
- the payment of employees' expenses for business trips abroad.

The purchase, sale, or exchange of foreign currency in Kazakhstan may be conducted only through authorized banks and currency exchanges that are licensed by the National Bank to perform foreign-currency transactions. The purchase, sale, or exchange of foreign currency other than through authorized bodies is prohibited.

Both residents and nonresidents may have foreign currency and tenge accounts in Kazakhstan banks, which they can use for their personal and business needs. Certain international bank payments and transfers between residents and nonresidents can be executed without restriction. These include:

- payments for goods and services which are made within 180 days following the delivery of goods or the performance of services;
- the provision or receipt of loans to/from nonresidents for a period of 180 days or less,
- transfers of dividends, interest, and other income from investments, bank deposits, loans or other transactions;
- the import and export of payment instruments to and from Kazakhstan;
- the noncommercial transfer of grants, inheritance, wages, pensions, etc.

To reduce the possibility that international trade transactions will be used as an avenue for currency flight from the country, licensing by the National Bank is required for the following transactions:

- retail sales activities and the provision of services for cash payments in foreign currency;
- the performance of foreign-currency exchange operations by authorized organizations.

In addition, until December 31, 2006, licensing will continue to be required for a resident's provision of a commercial loan of more than US\$10,000 to a nonresident for a period of more than 180 days (or more than 365 days in the case of a commercial loan for goods enumerated on a list of goods established by the Government). Starting from January 1, 2007, residents will only need to register these operations with the National Bank; no license will be required.

Prior to December 31, 2006, licensing will also continue to be required for the following operations. Starting from January 1, 2007, residents will only need to notify the National Bank of these operations:

- opening foreign bank accounts for residents, except for:
 - resident banks;
 - resident individuals opening bank accounts in a bank outside of Kazakhstan during the period of their stay in a foreign country. However, individuals wishing to retain the account after returning to Kazakhstan will need to obtain a license from the National Bank;

- resident financial organizations opening accounts in foreign banks to carry out operations with financial instruments on international securities markets;
 - resident legal entities opening bank accounts in foreign banks to finance expenditures of their foreign branches and representative offices;
 - resident legal entities opening bank accounts in foreign banks to transfer money to secure their liabilities to nonresidents for loans received,
 - resident legal entities opening bank accounts in foreign banks to transfer money as a contribution to a foreign subsidiary's charter capital, if this requirement is established by the legislation of the state where the legal entity plans to establish a subsidiary.
- A resident's participation in activities that involve:
 - an acquisition of securities issued by nonresidents;
 - a purchase of shares in foreign investment funds;
 - investments in a nonresident's charter capital; or
 - operations between residents and nonresidents involving financial derivatives.

National Bank registration is required for foreign-currency operations such as the provision of financial and commercial loans, direct investments, participation in the charter capital of companies, operations with securities, and other operations, including the acquisition of immovable property or intellectual property rights, and transfers of property for the fulfillment of obligations of a participant in a joint activity, if either of the following conditions is met:

1. the value of a foreign-currency operation related to the movement of property into Kazakhstan and/or a resident's obligation to return the property to a nonresident exceeds the equivalent of USD 300,000; or
2. the value of a foreign-currency operation related to the transfer of property from Kazakhstan and/or a resident's claims for the return of property by a nonresident exceeds the equivalent of USD 10,000.

To ensure that companies and individuals comply with currency regulations, Kazakhstan banks act as enforcement agents of currency control for the National Bank. Import-export transactions involving transfers of money between Kazakhstan and other countries in an amount exceeding the equivalent of USD 10,000 require examination of a "transaction passport" and underlying documentation by a bank or the customs authorities.

4.4 Investment in Kazakhstan

In the last several years, the foreign investment climate has undergone a change, with the government becoming more assertive with respect to foreign investors. Seeking to equalize the treatment of domestic and foreign investors, Parliament adopted the Law on Investment¹⁵ to supersede the prior Foreign Investment Law and the Law on State Support of Direct Investment. The new law has removed some of the preferential treatment hitherto available to foreign investors and made investment contracts more vulnerable to changes in domestic legislation and international treaties. In addition, the government has began to enforce investor obligations more actively, particularly those dealing with environmental protection, national content, local staff training and other requirements, sometimes in an arbitrary fashion. Consequently, it has become even more important to properly structure investment and commercial activities in Kazakhstan and to comply with the law to the greatest extent possible.

¹⁵ Law № 373-II of the Republic of Kazakhstan on Investments, dated January 8, 2003, as amended.

4.5 The Investment Law

General

The Investment Law sets out the legal framework regulating investment in Kazakhstan. It outlines state guarantees of investors' rights, provides for state support of investment activities, and establishes a dispute resolution mechanism. The primary purpose of the law is to attract investment by creating stability and transparency in the law and stimulating investment in specified priority sectors of the economy.

The law does not distinguish between foreign and domestic investors. However, it provides that in cases of conflict between provisions of the Investment Law and bilateral investment treaties ratified by Kazakhstan, the treaties shall prevail. Some of these treaties, such as the U.S. – Kazakhstan Bilateral Investment Treaty, may provide useful protections to foreign investors in addition to those provided under Kazakhstan Law.

State Guarantees

The Investment Law provides investors with certain state guarantees. Investors have the general right to invest in any object or activity unless specific provisions of Kazakhstan legislation provide otherwise. Investment in some territories may also be restricted by law for reasons of national security.

The law protects investors having a contract with a state agency against adverse changes in legislation or international agreements. However, this guarantee does not apply to changes in legislation or international treaties that amend the procedure or conditions for importation, production or sale of excise goods, or laws dealing with defense, national security, ecological safety, health protection or ethics. The law also stipulates that privileges granted in investment contracts signed prior to the introduction of the new law remain valid until the expiration of the investment contract.

In addition, the state provides the following guarantees to investors:

- a guarantee of protection provided by the Constitution, other legislative acts and international agreements that Kazakhstan has signed;
- a guarantee of compensation for damages resulting from the promulgation of acts or decrees that do not conform to the laws of Kazakhstan or from illegal actions or failure to act on the part of state officials;
- a guarantee of free use of income from investment activities, provided that all taxes and other compulsory payments have been paid, and a right to open bank accounts in the national and foreign currencies;
- a guarantee of transparency of the activities of state agencies affecting investors, including publication of normative and legislative acts relating to investors' rights and free access to information about legal entities;
- a guarantee of full compensation for damages in case of nationalization of investments and the payment of fair market value for confiscated property. The law allows nationalization and requisition of property for the state's needs only in exceptional cases provided by legislative acts of the Republic;
- a guarantee of access to international arbitration bodies in cases of investment disputes between the investor and the state.

State Support of Investment

In order to create a favorable investment climate for economic development, the law grants preferences for certain investments. Preferences are granted for investment in priority sectors of the economy on the basis of an investment contract concluded by the investor with the Investment Committee of the Ministry of Industry and Trade of Kazakhstan (the Investment Committee). The list of priority sectors of the economy currently includes industrial infrastructure, processing industries, housing construction, the social sphere, tourism, communication, and agriculture. This list is revised on an annual basis. The Government also establishes minimum investment volumes and the duration of investment preferences.

Incentives Available under the Law

The Investment Committee may grant the following preferences to investors who sign investment contracts with the state:

- tax preferences for a specified period, depending on the volume of investment in fixed assets. These preferences are not available to entities performing activities under a special tax regime or under a subsurface use contract;
- exemption from customs duties on imports of equipment and components required for the realization of an investment project;
- state grants in kind with a maximum value of up to 30% of the value of investment in fixed assets.

The Application Process

As noted above, preferences under the law are granted only to those investors who enter into a contract with the Investment Committee. To obtain these incentives, an investor must file an application with the Investment Committee in Astana, along with the following documents:

- notarized copies of the investor's state registration certificate, statistics card, and corporate charter;
- the business plan for the investment project, prepared in accordance with the requirements of the Investment Committee;
- documents substantiating the project cost estimates;
- documents establishing sources and guarantees of financing for the project (if the investor will finance the investment from his/her own sources, a document certifying the availability of such sources);
- documents certifying the amount of the state grant in kind claimed by the investor and preliminary approval of this grant;
- the applicant's balance sheet as of the first day of the quarter in which the application is filed;
- a notice from the tax authorities confirming that the investor has paid all applicable taxes, obligatory pension fund contributions, and social security contributions in Kazakhstan.

Grounds for the Investment Contract's Repeal

Once an investment contract is signed, it becomes legally binding and can be repealed only under the conditions provided by law. The Investment Committee remains responsible for monitoring investor performance and has the right to inspect all legal, bookkeeping, technical and other documents related to the investment project, as well as the investor's industrial facilities.

A contract may be repealed by agreement of the parties or unilaterally. If an investor prematurely terminates an investment contract, he may be required to pay all taxes and customs duties from which

he had previously been exempt under the contract. Additional penalties and fines may also be imposed by legislation or the contract.

The Investment Committee has the right to terminate an investment contract unilaterally upon the discovery of a misrepresentation or a concealment of information that affected the decision of the Investment Committee to grant investment preferences or upon the investor's failure to comply with contractual terms.

Dispute Resolution

Under the Law on Investments, investment disputes can be settled through negotiations, the Kazakhstani courts, or international arbitration. However, the definition of an investment dispute has been narrowed to cover disputes “ensuing from the contractual obligations between investors and state bodies in connection with the investors’ investment activities.” Disputes not falling within this category – mainly those between foreign and Kazakhstani entities – shall be resolved in accordance with the legislation of Kazakhstan. While the parties may stipulate international dispute resolution venues in their contracts and Kazakhstan has ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, arbitral award enforcement remains difficult in practice. The situation is further exacerbated by a December 2004 law on international arbitration¹⁶ that appears to provide Kazakhstani courts with the authority to review foreign arbitral decisions. Investors should therefore take proper care in structuring their transactions in Kazakhstan.

¹⁶ Law № 23-III of the Republic of Kazakhstan on International Commercial Arbitration, dated December 28, 2004.

APPENDIX A

Kazakhstan's GDP over the past ten years

