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Foreword

This report on Kazakhstan is part of the OECD Tax Policy Reviews series. OECD Tax Policy Reviews are intended to provide independent, comprehensive and comparative assessments of OECD member and non-member countries' tax systems as well as concrete recommendations for tax reform. By benchmarking countries' tax systems and identifying tailored tax policy reform options, the ultimate objective of the Reviews is to enhance the design of existing tax policies and to support the adoption and implementation of tax reforms.

This project was led by Sean Kennedy under the supervision of Bert Brys. The report was written by Sean Kennedy with written inputs from Bert Brys.

The analysis in this report is based upon the tax system of Kazakhstan as it was in place on 1 February 2020. The analysis is also based on OECD statistics, tax modelling tools and information collected during a mission that took place in May 2019 involving thorough fact-finding and stakeholder consultation.

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Executive Summary

The country tax policy analysis presented in this report was prepared before the outbreak of the Covid-19 pandemic and the economic crisis that resulted from it. While the health, economic and budgetary impact of the crisis remains unclear at the time of the publication of this report, it has become clear that the crisis will be costly for countries around the world, including for Kazakhstan. In light of the low tax collection and weaknesses in the design of the tax system, fundamental tax reform has become even more urgent in Kazakhstan than before the outbreak of the Covid-19 pandemic.

This tax policy review presents a general overview of the design of the tax system in Kazakhstan. The analysis focuses on the strengths and the weaknesses of the current tax system and presents recommendations for tax reform. The analysis in this report is aligned with the approach taken and the recommendations made by the (World Bank, 2017[1]) and the (IMF, 2020[2]) and it also deepens the analysis in a selection of tax policy areas. The analysis in this report confirms the international call to continue developing empirically-focused tax policy analysis in Kazakhstan, which involves strengthening the data that is available for tax policy analysis and developing empirical tax policy tools, indicators and models. This includes micro simulation models within the personal and corporate income tax, analysis of household budget surveys, tax expenditure reporting and revenue foregone estimations of all tax expenditures, cost-benefit analysis of tax incentives, tax gap analysis and general and individual tax revenue forecasting. Such an approach would allow deepening the analysis presented in this report and the OECD would be more than happy to contribute to that work over the years to come.

Recent OECD research has shown that tax policy can cushion the impact of Covid-19 and support economic recovery (OECD, 2020[3]). The most up to date overview of the measures that countries have implemented is included (OECD, 2020[4]). The OECD will continue to update its policy advice as the crisis continues and will publish this information on its website. Broadly aligned with international practice, Kazakhstan has implemented a wide range of measures in response to the Covid-19 pandemic and the corresponding economic crisis. This report does not review these measures. Instead, the report focuses on the fundamental tax reform that Kazakhstan might want to implement as part of a long-term fiscal reform once the health crisis is under control and the economy is firmly on track.

The timing of the tax policy measures might have to be adjusted according to the depth and length of the Covid-19 crisis. The tax policy reform recommendations presented in this report will support economic growth and well-being in Kazakhstan over time. However, the timing of the implementation of the tax measures presented might have to be adjusted, depending on the depth and length of the Covid-19 crisis. Kazakhstan may also want to consider additional and temporary measures to balance the budget once the economy is on a solid recovery track from the Covid-19 crisis. As at the time of publication of the report, no data was available to the authors about the impact of the crisis on tax revenues and the economy in Kazakhstan, this important analysis is left for future work.

Prior to the Covid-19 pandemic, the economy in Kazakhstan had begun to show signs of recovery, supported by the government's reforms of the tax system. The government has set ambitious targets to reduce the non-oil budget deficit, but the discretionary transfers from the National Fund (which manages Kazakhstan's oil wealth) to the budget are expected to remain significant for the foreseeable future. In

general, having a national fund that manages Kazakhstan's resources is regarded as good practice. The general idea of a non-oil deficit is to disregard oil revenues from the budget to provide a more realistic measure of the budget deficit in the absence of oil revenues. While these tax reforms are a welcome step in the right direction, reducing the non-oil budget deficit and preparing the economy and the tax system for the future will require a more ambitious fundamental tax reform for the years to come.

Tax revenues are low, undiversified and volatile in Kazakhstan by international standards. Despite rising tax revenues over the past decade, taxes as a share of GDP in Kazakhstan have decreased and remain low by international standards. The tax mix relies heavily on revenues from value-added tax (VAT) and corporate income tax (CIT) with a lower share of revenues from personal income tax (PIT), social security contributions (SSCs) and property taxes. An ambitious SSC reform strategy has been announced which will increase employee and employer SSCs significantly. Whether this reform will contribute to reducing the non-oil deficit will depend on the extent to which the increased SSCs will finance current or additional social spending. CIT and VAT revenues are generated by a relatively small group of large firms and in a small set of sectors. The undiversified tax base makes Kazakhstan vulnerable to declines in tax revenues, even when compared with other resource-rich OECD countries and emerging economies. Important sources of tax revenue, such as CIT and export duties on crude oil, rely on the extractive sectors such as mining and fossil fuels. Furthermore, CIT revenues are sensitive to the international oil price and VAT revenue volatility has increased in recent years.

Resource revenues currently fuel the National Fund and the budget. Tax and non-tax revenues generated by the oil sector are significant. Most tax and non-tax oil revenues flow to the National Fund but some go directly to the budget (namely export duty on crude oil). The assets of the National Fund are largely accumulated from taxes paid by oil sector companies (including CIT, alternative subsoil use tax, mineral extraction tax and others) and investment income from management of the assets held by the National Fund. The National Fund then allocates annual transfers to the budget. In some recent years, flows of transfers to the budget have been larger than the tax revenue flows into the National Fund. The assets held by the National Fund have therefore been decreasing, which will result in a decline in the yield of the National Fund and will in turn further increase the pressure to raise non-oil tax revenues.

Tax reform is needed to raise tax revenues to support the ambitions of the authorities including to meet revenue and expenditure goals and to reduce the non-oil deficit. Kazakhstan aspires to become one of the top 30 global economies by 2050. However, tax revenues are currently too low to support the ambitious plans of the government, to meet revenue targets and to reduce the non-oil deficit. The analysis of the non-oil deficit in this report shows it could range from 4% to 7% of GDP by 2025, compared to the authorities forecast of 6% by 2025. The forecast of the authorities may be optimistic to the extent that it is based on optimistic underlying assumptions of future expenditure and GDP. Kazakhstan should therefore strengthen the design of its tax system and start raising more tax revenues to support its medium-term goals and longer-term sustainability. As a general recommendation, this report recommends that Kazakhstan should not focus on increasing tax rates on the currently narrow tax base in the case of most taxes but rather the priority should be broadening the tax base and increasing levels of tax compliance.

Financing needs could be met by gradually increasingly some taxes that have potential for generating more revenue and that are not linked to the extraction of natural resources. Additional tax revenues could be raised from PIT, SSCs and property tax with modest increase in taxes on goods and services. Opportunities also exist to increase tax revenues across most of the major taxes by broadening the tax base and enhancing tax design. In 2019, the State of the Nation address set out a number of tax reforms including on PIT, SSCs, VAT and CIT. A set of best practice guiding principles need to be followed for these tax reforms to succeed including that they are sufficiently comprehensive across taxes, consistent, and complementary with the existing capabilities of the tax administration.

Kazakhstan could consider transitioning to a progressive PIT system to support equity and raise revenues over the medium-term but not before certain risks and limitations are addressed

including the implementation of the universal tax declaration. PIT revenues as a share of GDP are low by international standards, having fallen slowly in recent decades. The introduction of the flat PIT rate system in 2007 does not appear to have had much impact on PIT revenues in the years immediately following its introduction. A new reform introduced in 2020 will exclude 90% of taxable income from PIT for low-income taxpayers; this reform could possibly lead to large distortions as it might induce workers to under-report incomes and to hold multiple jobs simultaneously (as different revenue streams are not added up to determine tax liability) in order to benefit from the tax exemption. This issue could be addressed through the introduction of the end-of-the-year tax declaration (mentioned below). Despite the equity objectives underlying the reform, the exemption comes at a large tax revenue cost and benefits a relatively small number of taxpayers. In order to strengthen the role of the PIT in the tax system, government could consider introducing a progressive PIT system to raise additional PIT revenues, particularly among higher-income employees. Such an approach would be less distortive and fairer than the current flat-rate PIT. However, such a reform should be introduced only in the medium-term and not before the introduction of an end-of-the-year tax declaration (the 'universal declaration), measures that strengthen the tax administration and possibly when incomes are higher in the future. The decision to introduce a progressive PIT system should be underpinned by rigorous empirical evidence including the development of a PIT microsimulation model using individual tax return data.

The taxation of personal capital income needs reform. Personal capital income, such as dividends and capital gains, are mostly exempt from tax in Kazakhstan. Where tax does apply, the rates are low. Some of the exemptions on personal capital income could be removed and a single low rate or a progressive rate could be applied across all forms of personal capital income (either by taxing capital income jointly with labour income or by applying a separate progressive rate schedule on personal capital income). More generally, any tax rate change should not be considered in isolation but rather as part of the broader tax burden, which is set to increase due to the proposed increases in SSC rates over the coming years. In addition, any PIT reform should take into account the incentives for entrepreneurs to incorporate and carry out their activities through a corporate vehicle in order to earn their income in the form of lower-taxed capital income rather than in the form of a higher-taxed salary.

Kazakhstan should continue to implement its current reform of the SSC system to support the underperforming health and welfare systems while also considering broadening the SSC base. Kazakhstan is in the process of reforming its SSC system, including by introducing new SSCs and increasing current SSC rates. The reform will go some way to increasing SSC funding more closely towards the OECD average, which will provide much needed financial resources to support the underperforming health and welfare system. The timing of the reform is prudent in preparation for the longer-term given Kazakhstan's current demographic advantages including a large and expanding working-age population. However, the SSC base remains narrow by design with many generous but expensive design aspects. Examples of potential areas for SSC base broadening could include the current deductibility of pension contributions from the SSC base and the inheritability of pension payments. In recent years, the authorities have frequently proposed new SSC policies, which in several cases have been delayed, producing planning challenges for individuals and businesses. Indeed, Kazakhstan could benefit from minimising the frequency of changes and achieve more consistency in SSC and tax policymaking.

The VAT in Kazakhstan is based upon good design features, but there is scope to improve the design and administration and to raise additional revenues with a modest increase in the VAT rate. VAT as a share of tax revenues is similar to the OECD average. Nevertheless, there is scope to increase the standard 12% VAT rate, which is currently low internationally. However, an increase in the VAT rate should be considered in the context of the level of inflation, which is currently somewhat high in Kazakhstan compared to other countries in Central Asia. In addition, the revenue performance of the VAT, measured by the 'VAT productivity' indicator, is not high compared to countries in the region, which may point to weak tax enforcement and administration as well as a narrow VAT base (noting that this indicator is a relatively crude measure). Kazakhstan has made efforts to broaden its VAT base. However, there is scope to

broaden the VAT base further as many goods and services continue to be exempt from VAT, for example by bringing newly constructed residential buildings that are brought on the market for the first time within the scope of VAT. Important steps have been taken by the authorities to address the challenges of the VAT system. However, the special VAT treatment for Special Economic Zones (SEZ) is a major flaw in the design of the VAT system and recently announced measures will not address the main design weaknesses. Instead, the authorities should fully restore the VAT chain by applying the standard VAT on all transactions to and within the SEZs while simultaneously providing more timely VAT refunds. Kazakhstan is in the process of adapting its VAT rules to increased digitalisation and growing online sales, but the implementation of this reform has been delayed until 1 January 2021. This reform will broaden the VAT base by ensuring the taxation of inbound digital supplies, in line with the OECD International VAT/GST Guidelines. The VAT registration threshold in Kazakhstan remains high internationally. The tax administration could strengthen its operation so that the VAT registration threshold can be lowered along with VAT simplification measures.

Corporate income tax revenues are generated by a small number of companies and sectors and there are many corporate tax incentives. Scope exists to broaden the CIT base while maintaining the 20% CIT rate at its current level. The business economy can be characterised as having a dual economic structure, split into large firms and small firms. A small group of about 500 large companies dominate the economy, producing half of all company turnover and employment. At the same time, there is widespread small-scale self-employment and SMEs with low incomes. CIT revenues are high as a share of total tax revenues compared to the OECD average, partly because more than one-third of CIT revenues is paid by oil companies. Beyond CIT, a range of additional taxes apply to companies operating in the extractive sectors (including Mineral Extraction Tax, Excess Profit Tax and others), which go to the National Fund. In addition to oil tax revenues, there are also oil non-tax revenues (such as the share of production under concluded contracts). The statutory CIT rate in Kazakhstan remains competitive and below the average rate in the OECD, although the gap in the CIT rate between Kazakhstan and the OECD has narrowed in recent years. The statutory CIT rate could be maintained at the current rate. While the top 10% of companies produced 90% of turnover in 2018, the concentration of CIT paid by companies is even higher, with the top 10% of companies paying 99% of all CIT. This may suggest that many small and medium-sized incorporated businesses contribute little to the tax base overall, which is partly attributable to the generous and wide range of simplified taxation regimes targeted at SMEs.

Kazakhstan offers many generous tax incentives to companies that come at a significant tax revenue cost. Whether these tax incentives create significant 'additional' investment (i.e. investment that would not have taken place without the tax incentives), requires further empirical analysis. Companies that implement a "priority investment project" under one of the priority areas (as defined by the authorities) that invest in a new production facility could be exempt from CIT and land tax for up to 10 years and property tax for up to 8 years. Furthermore, in SEZs, which were established in Kazakhstan to support the development of economic sectors other than natural resources, companies can benefit from a reduction in CIT, property tax and land tax by up to 100%. The contribution of companies in SEZs to total CIT and VAT revenues was less than half of one-percent in 2017 and 2018. Overall, the tax system is likely overused to stimulate corporate investment in Kazakhstan, particularly to the extent that investors locate in Kazakhstan for resources rather than the generosity of the tax system. To support transparency and accountability, regular and systematic tax expenditure reporting could be conducted to monitor the use and effectiveness of tax incentives along with the tax revenue forgone (OECD, 2010[5]). Cost-benefit-analysis could also be conducted to evaluate whether specific tax incentives meet their stated objectives and, if not, whether they should be abolished completely or replaced by incentives that are more closely aligned with longer-term development objectives. Furthermore, there is scope to reduce the discretionary and uncertain application of some tax incentives to enhance transparency and accountability including the annually updated list of investment areas which determine company eligibility for priority investment projects.

A new tax reform implemented to shift CIT revenues paid by SMEs from central to local government would shift the most challenging tax to administer to under-resourced local tax administrations. Even if the administration of the CIT would continue to be carried out at the central government level, OECD best practice shows that local governments should be financed through taxes whose revenues are less volatile (such as recurrent taxes on immovable property). However, CIT revenues are volatile in most countries and in particular in Kazakhstan. The CIT is therefore the least preferred tax to finance local governments directly. Despite good government intentions, this reform is not a step in the right direction.

The number of special tax regimes for SMEs could be reduced. The 2019 State of the Nation address reaffirmed Kazakhstan's commitment to support the SME sector of the economy. Currently, SMEs account for the vast majority of firms and self-employment remains widespread but incomes remain low. Kazakhstan has a tiered system of special tax regimes for self-employed individuals and companies. The regimes are intended to simplify and reduce the tax burden on the self-employed while also placing them on a graduated path to expansion towards the regular system. Overall, having many special tax regimes creates complexity for businesses and enforcement and administration costs for the authorities. Therefore, Kazakhstan could consider reducing the number of special tax regimes and, in particular, the tax policy rationales for the Fixed Deduction regime seem weak and the regime could be abolished. Instead, Kazakhstan could introduce and maintain other types of tax simplification measures (such as less frequent tax payments and simplified book-keeping requirements).

In addition to reducing the number of special tax regimes for SMEs, the design of some regimes could be strengthened. The Single Aggregate Payment (SAP) regime introduced in 2019 is a generous regime that replaces most taxes by a low, simple and fixed lump-sum tax, and because of its financial attractiveness, the regime is expected to be successful in terms of its take-up. However, the annual turnover eligibility ceiling has been set too high. While the regime will support fairness by bringing more people under the protection of social insurance, the SAP might become a victim of its own success as individuals who would otherwise have transitioned to the patent regime (a regime in place for individual entrepreneurs with a PIT rate of 1% of annual revenues) have a tax-induced incentive to remain in the lower-tax SAP regime. In addition to the SAP regime and patent regimes, Kazakhstan has the Simplified Declaration regime and the Fixed Deduction regime; the extent to which these regimes achieve their objectives requires further empirical analysis. In particular, the scope for 'bunching' activity across regimes and tax planning activities to avoid being taxed in another simplified regime or the regular taxation regime should be tested empirically. Businesses face a strong tax-induced incentive to hire self-employed workers who operate under one of the simplified taxation regimes rather than employing regular employees. This may result in 'false' self-employment where workers only work for one employer but work under a self-employment contract. To encourage employment, the requirement to have no employees in the SAP and Patent regime should be removed as it might induce entrepreneurs to hire informal workers, which goes against the government's efforts to strengthen the formal economy through the introduction of the SAP regime. However, the annual turnover eligibility ceiling of the SAP, Patent and Simplified Declaration regime need to be lowered. Such a reform would allow for the reform of other design characteristics of the simplified SME taxation regimes, such as the non-hiring requirement under the Patent regime and the requirement that SAP workers can only work for individual clients and not for corporations. Indeed, these additional requirements have been introduced to prevent the regimes from becoming too generous. However, these requirements have also resulted in additional tax evasion opportunities and in an increased tax burden on the tax administration to enforce these regimes. Lowering the turnover eligibility ceilings would allow further simplification of the tax system. Overall, the tax administration that deals with the simplified regimes could be strengthened in order to monitor employees entering special tax regimes and to ensure an even level playing field across all businesses.

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1 Main Findings

This chapter presents a summary overview of the main findings from the Country Tax Policy Review. Firstly, the chapter considers the importance of raising tax revenues to support Kazakhstan's medium-term goals and longer-term sustainability. Secondly, it examines equity issues - how to share the tax burden more fairly across society. Recommendations include moving towards a broader and more progressive PIT system, raising SSCs to support the underperforming health and welfare systems and enhancing the design of the VAT. Finally, it considers competitiveness issues. Among the recommendations are to maintain CIT rates and broaden the CIT base and simplify the design of special tax regimes for SMEs.

1.1. Setting the scene for tax reform in Kazakhstan (see Chapter 2)

The country tax policy analysis presented in this report was prepared before the outbreak of the Covid-19 pandemic and the economic crisis that resulted from it. While the health, economic and budgetary impact of the crisis remains unclear at this stage of the crisis, it seems very likely that the crisis will be very costly for countries around the world, including for Kazakhstan. The lack of diversification of the Kazakh economy, the low level of non-oil tax revenues and the concentrated design of the tax system contribute to the lack of resilience of the country to deal with major challenges and call for an ambitious tax reform. Broadly aligned with international practice, Kazakhstan has implemented a wide range of measures in response to the Covid-19 pandemic and the corresponding economic crisis. This report does not review these measures. Instead, the report focuses on the fundamental tax reform that the country may wish to implement as part of the fiscal consolidation phase once the health crisis is under control and the economy is recovering.

Prior to the covid-19 pandemic, the economy of Kazakhstan was showing some signs of recovery. However, the economy remains over-dependent on natural resources, multiple inflationary pressures continue to pose risks and seemingly positive labour market outcomes may mask deeper challenges. While the authorities are focused on reducing the non-oil budget deficit, the current targets may be ambitious and discretionary targeted transfers to the budget from the National Oil Fund remain significant.

1.2. Tax revenue analysis (see Chapter 3)

Despite increases in tax revenues over the past decade, taxes as a share of GDP in Kazakhstan have decreased and remain low compared to the average for OECD countries. (As pointed out, this analysis does not take into account the drop in tax revenues linked to the Covid-19 crisis as that data was not yet available when this report was prepared).The tax mix is concentrated on tax revenues from value-added tax (VAT) and corporate income tax (CIT), with a lower share from personal income tax (PIT), social security contributions (SSCs) and property taxes. CIT and VAT revenues are generated by a relatively small group of large firms and in a small set of sectors. An undiversified tax base, even when compared with some other resource-rich countries, has made Kazakhstan vulnerable to tax revenue declines in the past. Important sources of tax revenue such as CIT and export duty taxes rely on the extractive sectors of the economy such as mining and the fossil fuel sector. Furthermore, the taxes are relatively volatile. CIT revenues are sensitive to the international oil price and VAT revenue volatility has increased in recent years following the rising share of the VAT levied on imports. For more details on tax revenue analysis, see Chapter 4.

Kazakhstan aspires to become one of the top 30 global economies by 2050. However, tax revenues are too low support these ambitions set by government, including to meet tax revenue and expenditure targets and to reduce the non-oil deficit. Kazakhstan should aim at raising more tax revenues to support its medium-term goals and longer-term sustainability. Financing needs could be met by gradually increasing some taxes that have the potential for generating more revenues and are less dependent on natural resources. For example, additional tax revenues could be raised from PIT, SSCs and property tax with modest increase in taxes on goods and services. Opportunities exist to increase tax revenues across most of the major taxes by broadening the tax base and enhancing tax design. In 2019, the State of the Nation address set out a number of tax reforms including on PIT, SSCs, VAT and CIT (see Box 4.1). A set of best practice guiding principles need to be followed for these tax reforms to succeed including that they are sufficiently comprehensive across taxes, consistent, and complementary with the existing capabilities of the tax administration (see Box 4.2).

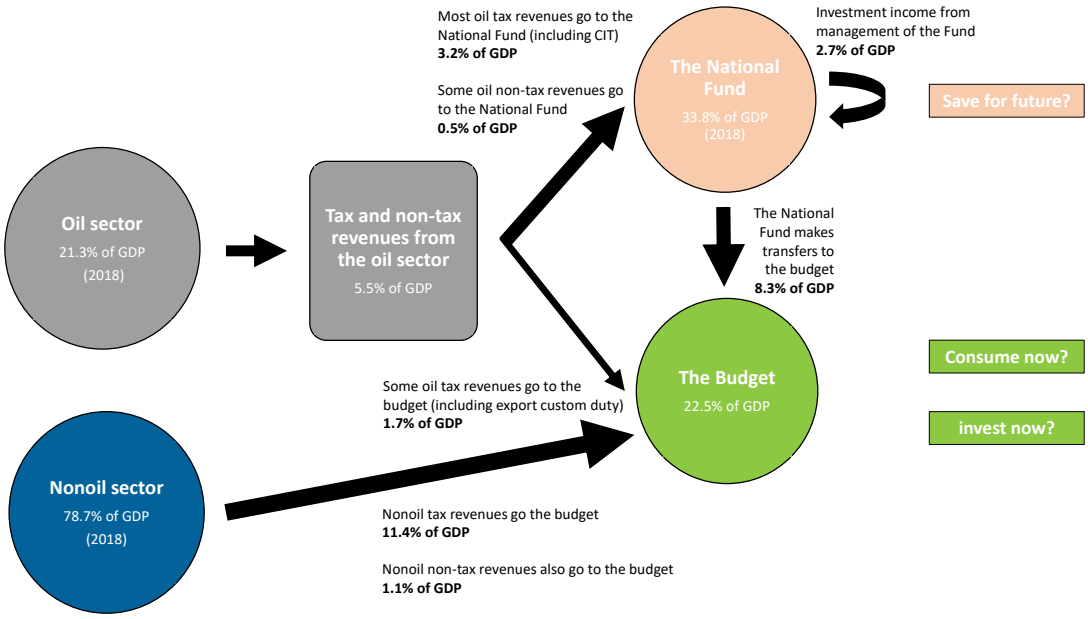
1.2.1. Increasing tax revenues to support the country's medium-term goals and ensure longer-term sustainability and welfare

Higher tax revenues are needed to meet Kazakhstan's expenditure goals and to reduce the non-oil deficit (the methodology underpinning the analysis in this section is detailed in section 3.3.2). Raising more tax revenues would allow the country to meet its revenue targets and expenditure goals and to reduce the non-oil deficit (NOD). The authorities have set an ambitious goal to increase tax collection from 18 to 25 percent of GDP by 2025 (IMF, 2020[1]). The authorities also have a wide range of ambitious expenditure goals including supporting low-income households, promoting SMEs and enhancing the quality of healthcare. In addition, Kazakhstan presently runs a budget deficit and a non-oil budget deficit (NOD). In general terms, the idea of NOD is to strip out oil revenues from the budget to provide a more realistic measure of the budget deficit in the absence of oil revenues. The authorities define the NOD as the difference between budget revenues (with the exception of loan receipts, transfers from the National Fund and export customs on crude oil) and expenditures (with the exception of repayment of loans). Reducing the NOD has been identified by government as a reform priority. To reduce the NOD, this report recommends a series of structured reforms to PIT, SSCs, VAT and CIT over the short, medium and longer-term. While financing needs have been identified based on the NOD assessment in this report, further follow-up work could consider a fiscal-tax analysis and structural tax gap assessment which takes into account the structure of the economy and projected revenues at different tax rates.

Kazakhstan needs to strike a balance between consuming resource-revenue today versus investing and consuming the revenues in the future. Resource-rich countries such as Kazakhstan face the opportunities and challenges of managing oil, gas, and mineral revenues that are volatile, finite and uncertain (Botta, 2020[2]). As the world gradually decarbonises over the long-term, Kazakhstan can decide how much resource-revenue to consume and invest now through the budget and how much to save for the future through the National Fund. The analysis in Infographic 1.1 provides an indicative snapshot in 2017 of the flows of oil and non-oil tax and non-tax revenues in the Kazakhstan fiscal system (more details are provided in section 3.3.2).

Resource revenues currently fuel the National Fund and the budget. Notwithstanding the illustrative nature of the analysis in Infographic 1.1, it highlights a number of points. The tax and non-tax revenues generated by the oil sector in 2017 are significant (5.5% of GDP). Most tax and non-tax oil revenues flow to the National Fund (3.7% of GDP) but some go directly to the budget (1.7% of GDP). Non-oil tax revenues go directly to the budget (11.4% of GDP) along with non-oil non-tax revenues (1.1% of GDP). Kazakhstan's oil wealth is managed through its National Fund. The assets of the National Fund are significant at 33% of GDP in 2017. The assets are accumulated in a number of ways. They include taxes from oil sector businesses including CIT, alternative subsoil use tax, mineral extraction tax, bonuses, export rental tax and excess profit tax. They also includes other revenues from operations carried by organisations of the oil sector, including for example violations of the terms of oil contracts in addition to other proceeds (EITI, 2018[3]). Assets also includes investment income from the management of the fund (2.7% of GDP). The National Fund annually allocates transfers to the budget (8.3% of GDP in 2017) but these do not necessarily correspond to the revenues flowing into the National Fund. Some of these transfers can be made in accordance with the decision of the President (referred to as targeted transfers). Budget revenues are estimated at 22.5% of GDP, comprised of oil tax revenues including export custom duty (1.7%), non-oil tax revenues (11.4%), non-oil non-tax revenues (1.1%) and transfers from the National Fund (8.3%) (for the year 2017, when transfers were relatively high compared to previous years).

Infographic 1.1. The flow of oil and non-oil revenues to the National Fund and the Budget of Kazakhstan



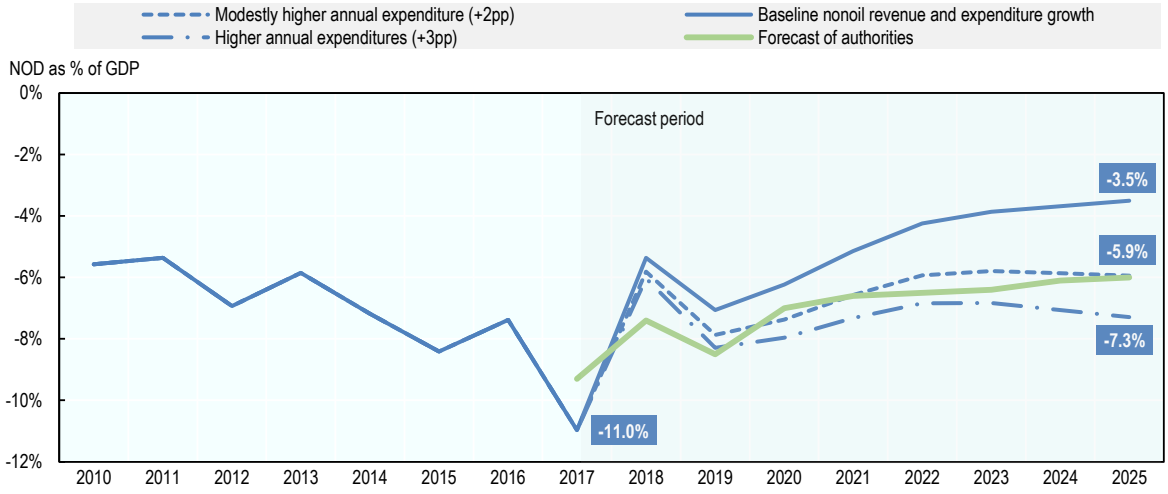
Note: More methodological details are described in the same infographic in the tax revenue analysis section of the report.
Source: OECD revenue statistics; OECD global revenue statistics database; (EITI, 2018[3]); Ministry of National Economy; National Statistics Committee of Kazakhstan; OECD multi-dimensional review of Kazakhstan 2016.

The NOD could range from 4 – 7% by 2025. A number of methodological steps are taken to estimate a new definition of the NOD to 2025 for the purposes of this report (methodological details are available in section 3.3.2). According to the baseline analysis, the NOD is 5.4% of GDP in 2018, 6.2% of GDP in 2020 and could be 3.5% by 2025[1]. However, the forecast growth in expenditures (based on IMF data) are low between 2018 and 2025, averaging 0.2% over the period, and resulting in a gradual decrease over time of expenditure as a percentage of GDP. Figure 1.1 shows the NOD if expenditure growth were 2 and 3 percentage points higher annually than the baseline growth rates. On this basis, the NOD could range from 4 – 7% of GDP by 2025.

The government NOD forecast sits in between this range, albeit the definition of NOD is different.[2] The authorities forecast the NOD at 7.4% of GDP in 2018, 7.0% in 2020, 6.5% in 2022 and 6.0% in 2025.[3] This NOD estimate is in the range of previous international estimates ranging from 5% to 8% for 2025 based on various fiscal adjustment strategies (World Bank, 2017[4]). However, these forecasts may depend on relatively optimistic forecasts of non-oil revenue, expenditures and GDP (higher GDP forecasts reduce the NOD).

Figure 1.1. The forecasts of the non-oil deficit are significant

NOD as a % of GDP, under different expenditure scenarios, 2010 - 2025



Note: The non-oil deficit and baseline scenario growth for non-oil revenue and expenditure are described in the tax revenue analysis section.
Source: OECD revenue statistics; the OECD multi-dimensional review of Kazakhstan 2016; publicly available data from the State Revenue Committee of Kazakhstan; (IMF, 2020[1]).

1.2.2. Financing the NOD by raising more tax revenues

Reducing the NOD would require raising significantly more tax revenues. The tax-to-GDP ratio is 16.4% in 2017; the figure includes the SSCs that are paid to separate social funds. On the basis of the previous simulation analysis, to eliminate fully its NOD, Kazakhstan will have to raise its tax-to-GDP ratio by 4 - 7 percentage points. This financing need for the NOD is the starting basis for the analysis below, which examines which taxes it might be raised from. Research conducted by the Economic Research Institute in Kazakhstan reach a similar result showing that the tax-to-GDP ratio could be increased by 4 – 5 percentage points within 10 years (from the level of 2018) with limited negative effects on economic growth and tax collection (Alpysbayeva, Kenzhebulat and Karashulakov, 2019[5]).

Financing needs could be met by gradually moving some taxes that have the potential for generating more revenues and are less dependent on revenues from the resource-sector. Kazakhstan's tax base is concentrated in taxes on goods and services (8.4% of GDP) and taxes on companies (4.5%) and to a lesser extent taxes on individuals (1.4%), SSCs (0.5%) and property taxes (0.5%). To support its financing needs and simultaneously increase the diversity of the tax base, Kazakhstan could support the financing of the NOD by raising tax revenues from taxes that have the potential to generate more revenue, and which are less exposed to the resource-sector and less harmful to economic growth.

There are several ways in which taxes could be raised to finance the NOD. Tax revenue increases could come from a combination of PIT, SSCs and property taxes along with a modest increase in taxes on goods and services. The analysis, detailed in Chapter 3, provides a framework for considering which taxes, and how much revenue from each tax, might need to be raised. There may be additional scope for raising tax revenues from PIT including tax on personal capital income, SSCs, property taxes and VAT. For example, one option could be increases in taxes on individuals, SSCs and property taxes while modestly increasing taxes on goods and services) and maintaining current company tax levels. The scheduled increase in SSCs may contribute to lowering the NOD.[4] If the scheduled increase in employee and employer SSCs will finance additional social spending, the reform will leave the current NOD intact, which

then will have to be financed through other tax increases. Maintaining revenues of company taxes constant over time would, in an environment of decreasing oil prices because of decarbonisation of the world economy, imply a gradual increase in company taxes paid by the non-oil sector.

1.3. Equity – how to share the burden fairly across society (see Chapter 4)

1.3.1. Towards a broader and more progressive PIT system

Kazakhstan should aim at introducing a progressive PIT system over the medium-term to raise revenues and support equity but not before certain risks and limitations are addressed. Despite positive labour market outcomes on participation and unemployment, employee incomes are low in Kazakhstan, particularly in rural areas. PIT revenues as a share of GDP are low by international standards, having fallen slowly in recent decades. The introduction of the flat PIT rate system in 2007 does not appear to have had much impact on PIT revenues in the years immediately following its introduction (see Figure 4.2). A new reform introduced in 2020 will exclude 90% of taxable income from PIT for low-income taxpayers; this reform could possibly lead to large distortions as it might induce workers to under-report incomes and to hold multiple jobs simultaneously (as different revenue streams are not added up to determine tax liability) in order to benefit from the tax exemption. Despite the equity objectives underlying the reform, the exemption undermines the role of the PIT in the tax system and comes at a large tax revenue cost. In order to strengthen the role of the PIT in the tax system, government should consider introducing a progressive PIT system that would raise additional PIT revenues, particularly among higher-income employees, that would be less distortive and more fair than the current design of the PIT. Such a reform would go hand in hand with the introduction of an end-of-the-year tax declaration and measures that strengthen the tax administration. The introduction a progressive PIT system has some limitations relative to a flat-system including increased administrative burden (on employers) and the potential for higher PIT rates (or perceived higher rates) to induce under-reporting of entrepreneurial income by the self-employed, and possibly informal activity. Recent research on the possible transition to a progressive PIT system highlights the potential risks including a reduction in local budget revenues with low wages and tax evasion (Institute of Economic Research in Kazakhstan, 2020) (Alpysbaeva et al., 2020[6]). Therefore, a reform of the PIT needs to be accompanied by measures that strengthen tax administration.

Government has been planning to introduce an end-of-year PIT declaration (the 'universal declaration') but the introduction has been repeatedly delayed. The universal declaration is currently set to be introduced in 2025. Introducing such a tax declaration, which is common in most OECD countries, would be a step in the right direction and would allow government to introduce a progressive PIT rate schedule, which is one of the key recommendations in this report. The introduction of an end-of-year tax declaration would also require investments in the capacity and resources of the tax administration.

The basic tax allowance could be turned into a basic tax credit once a progressive PIT rate schedule is introduced. The value of tax allowances are increasing in the taxpayer's marginal tax rate while the value of a tax credit is the same for both low and higher-income taxpayers. The basic allowance in the PIT has been a widely used tax policy instrument in Kazakhstan. In recent years, increases in the basic allowance have removed millions of low-income taxpayers from the PIT net while simultaneously eroding PIT revenues. Therefore, to support equity in the short-term, the use of the basic tax allowance could be maintained at its 2019 level, although the exemption of 90% of income up to a ceiling could be repealed, as its current design is distortive. Further research is available on converting the PIT basic allowance in to a PIT credit (OECD, 2006[7]) (OECD, 2004[8]).

Personal capital income, such as dividends and capital gains, are mostly exempt from tax in Kazakhstan. Where tax does apply, the rates are low. Some of the exemptions on personal capital income could be removed and a single low rate or a progressive rate applied across all forms of personal capital

income. This reform will be particularly important if a progressive PIT system is introduced to prevent high-income employees shifting their income from more highly taxed labour income to more lightly taxed capital income. A progressive rate schedule on personal capital income would complement a progressive PIT rate schedule. To raise PIT revenues in the short-run, a modest increase in the flat PIT rate could be considered. However, any PIT rate change should not be considered in isolation but rather as part of the broader tax wedge, which is set to increase due to the proposed increases in SSC rates over the coming years.

1.3.2. Raise SSCs to support the underperforming health and welfare systems

Kazakhstan should continue to implement its current reform of the SSC system to support the underperforming health and welfare systems while also considering broadening the SSC base. Kazakhstan is in the process of reforming its SSC system, including by introducing new SSCs and increasing current SSC rates (OECD, 2017[9]).[5] The reform will go some way to increasing SSC funding more closely towards the OECD average, which will provide much needed financial resources to support the underperforming health and welfare system. The reform occurs in the context of the country's significant demographic advantages including a large and expanding working-age population. However, the SSC base remains narrow by design with many generous but expensive policies in place. Notable examples where revisions could be considered to broaden the SSC base include the deductibility of pension contributions from the SSC base and the inheritability of pension entitlements. There have been frequent SSC proposed policy changes, some of which have been delayed, producing planning challenges for individuals and businesses. Notwithstanding the political challenges to SSC increases, Kazakhstan would benefit from less frequent but more consistent SSC policymaking.

The implementation timing of the tax policy recommendations might have to be adjusted in light of the Covid-19 crisis. As pointed out before, this report was prepared before the outbreak of the Covid-19 pandemic. While the crisis has strengthened the call for a fundamental tax reform in Kazakhstan, the implementation timing of the PIT and SSC measures presented in Table 1.1 might have to be adjusted in response to depth of the crisis. As at the time of publication of the report, no new data was available to the authors about the impact of the crisis on tax revenues and the economy in Kazakhstan, this analysis is left for future work.

1.3.3. The design and functioning of the VAT can be enhanced

The VAT in Kazakhstan is based upon the core features of a well-designed VAT, but there is scope to improve its design and administration and to, over time, modestly raise the VAT rate (see section 4.5). VAT as a share of tax revenues are similar to the OECD average. However, the revenue performance of the VAT, measured by the 'VAT productivity' indicator, is not high compared to some countries in the region, which may point at weak tax enforcement and administration as well as a narrow VAT base. There is scope to increase the standard VAT rate, which is currently low internationally. Any increase in the VAT rate should be considered in the context of inflation levels in the country. There is scope to broaden the VAT base as many goods and services continue to be VAT exempt, for example by bringing newly constructed residential buildings that are brought on the market for the first time within the scope of VAT. Important steps have been taken by the authorities to address the challenges of the VAT system. However, the special VAT treatment for Special Economic Zones (SEZ) is a major flaw in the design of the VAT system and recently announced measures will not address the main design weaknesses. Instead, the authorities should fully restore the VAT chain by applying the standard VAT on all transactions to and within the SEZs while simultaneously providing more timely VAT refunds. Kazakhstan is in the process of adapting its VAT rules to increasing digitalisation and online sales, and the implementation of these measures has now been set at 1 January 2021. This reform will broaden the VAT base by ensuring the taxation of inbound digital supplies, in line with the OECD International VAT/GST Guidelines. The VAT

registration threshold in Kazakhstan remains high internationally (see section 4.5.8). The tax administration should strengthen its operation so that, over time, the VAT registration threshold can be lowered accompanied by VAT simplification measures.

Table 1.1. PIT and SSC policy recommendations by implementation timing

PIT policy recommendations for consideration, by phase of possible implementation

			short-term			medium-term		
Policy options	**OECD assessment**	**Rationale**	**2020**	**2022**	**2024**	**2026**	**2028**	**2030**
PIT								
1. Phase-out the 90% taxable income exemption (for low earners)	Recommended	Enhance design efficiency	■					
2. Strengthen the capacity of tax administration to monitor employees entering special tax regimes, particularly the SAP regime	Recommended	Mitigate against regime abuse	■					
3. Strengthen the capacity of tax administration to monitor incomes and income sources	Recommended	Support options (5) & (6)	■	■				
4. Increase the flat PIT rate modestly, but taking account of a rising tax wedge due to SSC rate increases	Recommended	Increase revenue, as a short-term measure	■	■	■			
5. Introduce the yearly tax declaration after delivering on option (2)	Recommended	Enhance transparency & support option (6)			■	■		
6. Introduce a progressive PIT schedule, but taking account of a rising tax wedge due to SSC rate increases	Optional	Enhance tax revenue & equity, including targeting high-income employees				■	■	■
7. Remove exemptions on personal capital income and introduce single or progressive rate (to align with the progressive PIT system)	Recommended	Mitigate against avoidance, including income shift of high-income employees					■	■
8. Replace the basic allowance with a tax credit together with the progressive PIT system	Optional	Enhance equity, including supporting those on low-incomes				■	■	■
SSCs								
9. Maintain the proposed set of employer and employee SSC rates under the current reform but do not increase them further	Recommended	To support the financing of the SSC system	■	■	■			
10. Review the atypical deduction of pension contributions from the SSC base	Optional	To support equity	■					
11. Consider abolishing the atypical and expensive inheritability of pension payments	Optional	To raise SSC funds	■					
12. Retain the deductibility of insurance SSCs from the social tax	Recommended	To support equity	■					
13. Consider partly financing social benefits through taxation	Optional	To support the financing of the SSC system				■	■	■
14. Implement less frequent but more consistent SSC reform generally	Recommended	To support individual and business planning	■	■	■	■	■	■

Source: OECD analysis.

Property taxes on recurrent immovable property could be increased and health-related excises taxes could be used to support the financing of healthcare. Excise duties are low compared to OECD countries and arguments exist to partly finance public contributions to healthcare from excise duties on

alcohol and tobacco. Property taxes play a minor role in Kazakhstan and there may be scope to increase taxes on recurrent immovable property taxes, which is an efficient form of taxation that falls mostly on companies rather than individuals.

1.4. Competitiveness – a dual tax policy approach for a dual business economy (see Chapter 5)

1.4.1. Maintain CIT rates but broaden the CIT base

Tax revenues are concentrated in small number of companies and sectors and there are many corporate tax incentives. Significant scope exists to broaden while maintaining the statutory CIT rate at its current level. Kazakhstan has a dual business sector. A relatively small group of 500 large companies dominate the economy, producing half of all company turnover and employment. At the same time, there is widespread small-scale self-employment and SMEs with low incomes. CIT revenues are high compared to the OECD average as a share of total tax revenues (see Figure 5.3), partly because more than one-third of CIT comes from oil companies. Beyond CIT, a range of additional taxes apply to companies operating in the extractive sectors (including Mineral Extraction Tax and Excess Profit Tax and others), which go to the National Fund. In addition to oil tax revenues, there are also oil non-tax revenues (such as the share of production under concluded contracts). The statutory CIT rate in Kazakhstan remains competitive and below the average rate in the OECD, although the gap in the CIT rate between Kazakhstan and the OECD has narrowed in recent years. The statutory CIT rate could be maintained at the current rate. Tax revenues are concentrated in a small number of companies. While the top 10% of companies produced 90% of turnover in 2018, the concentration of CIT paid by companies is even higher – the top 10% of companies paid 99% of all CIT. While comparisons of concentration are challenging due to a lack of available data, these concentration levels provide suggestive evidence that many SMEs contribute little to tax revenues overall.

As Kazakhstan offers a wide range of generous tax incentives to companies, accountability and transparency could be enhanced by regular tax expenditure reporting and cost-benefit analysis. Whether these tax incentives create significant 'additional' investment, i.e. investment that would not have taken place without the tax incentives, is not entirely clear. For example, companies that implement a priority investment project under one of the priority areas (as defined by the authorities) that invest in a new production facility could be exempt from CIT and land tax for up to 10 years and property tax for up to 8 years. Furthermore, in SEZs, which were established in Kazakhstan to support the development of economic sectors other than natural resources, companies can reduce CIT, property tax and land tax by up to 100%. The contribution of companies in SEZs to total CIT and VAT revenues was less than half of one-percent in 2017 and 2018. Overall, there is evidence to suggest that the tax system may be overused to stimulate corporate investment in Kazakhstan. To support greater accountability and transparency, regular tax expenditure reports which systematically summarise the type of preferential treatment and the amount of tax revenue forgone could be established to support the monitoring, use and effectiveness of tax incentives (OECD, 2010[10]). A further step could be conducting cost-benefit-analysis (CBA) to evaluate whether specific tax incentives are fit for purpose and, if not, whether they should be abolished completely or replaced by incentives that are more closely aligned with longer-term objectives. Furthermore, there is scope to reduce the discretionary and uncertain application of some tax incentives to enhance transparency and accountability including the annually updated list of investment areas which determine company eligibility for priority investment projects. A detailed discussion and evaluation of each tax incentive is recommended as part of future work, but goes beyond the scope of this review.

A new tax reform to shift CIT revenues paid by SMEs from central to local government would transfer the administration of the CIT, which is the most challenging tax to administer, to under-resourced local tax administration which lack capacities. This reform would come with a wide range

of difficulties, including the fact that it could create domestic transfer pricing problems. Even if the administration of the CIT would continue to be carried out at the central government level, OECD best practice shows that local governments should be funded through taxes whose revenues are not volatile (such as recurrent taxes on immovable property). However, CIT revenues are very volatile in most countries and in particular in Kazakhstan. The CIT is therefore the least preferred tax to finance local governments directly. Despite the good government intentions of this reform, it is not a step in the right direction and should be re-evaluated.

1.4.2. Simplify and enhance the design of the special tax regimes targeted at SMEs

There is scope to reduce the number of Kazakhstan's special tax regimes targeted at SMEs and to enhance the design of regimes that are retained. The 2019 State of the Nation address reaffirmed Kazakhstan's commitment to support the SME sector of the economy. Currently, SMEs account for the vast majority of firms and self-employment remains widespread but incomes remain low. Kazakhstan has a tiered system of special tax regimes for self-employed individuals and companies. The regimes are intended to simplify and reduce the tax burden on the self-employed while also placing them on a graduated path to expansion towards the regular system. While strong policy rationales exist for simplified regimes targeted at SMEs, special tax regimes also come at a cost in that they create complexity for businesses and enforcement and administration costs for the authorities. Therefore, Kazakhstan could consider reducing the number of special tax regimes and, instead, introduce and maintain other types of tax simplification measures (such as less frequent tax payments and simplified bookkeeping requirements).

The Single Aggregate Payment (SAP) regime introduced in 2019 is a generous regime that replaces most taxes by a low, simple and fixed lump-sum tax, and because of it generosity, the regime is expected to succeed. However, the annual turnover eligibility ceiling has been set too high. While the regime will support fairness by bringing more people under the protection of social insurance, the SAP might become a victim of its own success as individuals who would otherwise have moved to the patent regime may have a tax-induced incentive to remain in the lower-tax SAP regime. Indeed, a further general risk across the simplified taxation regimes is the possibility of taxpayer bunching activity arising from higher tax burdens as taxpayers graduate up regimes. Such 'bunching' activity across regimes should be tested for empirically. The SAP tax administration should be strengthened to monitor employees entering special tax regimes.

To encourage employment, the requirement to have no employees in the SAP and patent regimes should be removed. While the no-hiring condition has been installed to induce entrepreneurs from growing out of the Patent regime and into the Simplified Declaration regime, the condition also provides an incentive for entrepreneurs in the Patent regime to hire workers from the informal economy, thereby counteracting the efforts of government to strengthen the formal economy through the introduction of the SAP regime.

The annual turnover eligibility ceiling of the SAP, Patent and Simplified Declaration regime are set at a high level and consideration should be given to lower the ceilings significantly. Such a reform would allow reforming other design characteristics of the simplified SME taxation regimes, such as the non-hiring requirement under the Patent regime and the requirement that SAP workers can only work for individual clients and not for corporations. Indeed, these additional requirements have been introduced to prevent the regimes from becoming too generous. However, these requirements have also resulted in additional tax evasion opportunities and in an increased tax burden on the tax administration to enforce these regimes. Lowering the turnover eligibility ceilings would allow further simplifying the tax system. Finally, the tax policy rationales for the Fixed Deduction regime seem weak and the regime could be abolished.

Businesses face a strong tax-induced incentive to hire self-employed workers who operate under one of the simplified taxation regimes rather than employing regular employees. This may result in 'false' self-employment where workers only work for one employer but work under a self-employment contract.

Table 1.2 provides a high-level summary assessment of the tax system in Kazakhstan along with selected recommendations for consideration. The assessment highlights some of the key message from the report across the major taxes.

Table 1.2. Tax policy assessment and tax policy recommendations in Kazakhstan at a glance

High-level context, assessment and selected recommendations for consideration in the Kazakhstan tax system

	Low tax-to-GDP (16.4% of GDP vs 34.2% in OECD in 2017)				
	PIT	**Personal capital income tax**	**SSCs**	**VAT**	**CIT**
Tax context	Employee incomes are low. Self-employment and informality are widespread	Most forms of personal capital income are exempt from tax and rates are low	The underperforming health and welfare system require additional financing. A major reform is ongoing	The VAT is generally well-designed but there is scope for improved design	There is a two-tier business economy. Incomes and CIT are concentrated among a few firms and there is widespread low-income self-employment
Tax-to-GDP (vs OECD)	**Low** (1.4% vs 8.2%)	**Very low** (5)	**Very low** (0.5% vs 9.2%)	**Low to moderate** (3.1% vs 6.8%) (4)	**High** (4.5% vs 3.0%), but partly driven by CIT paid by oil companies
Tax volatility (11)	Low		Low	Moderate (10)	High
Tax revenue trends (tax-to-GDP ratio trends)	**Falling slowly** in recent decades, including after intro of flat-rate PIT		**Rising** in recent decades. Expected to rise significantly in coming years with SSC reforms	**Falling slowly** in recent decades	**Falling sharply** in recent years following recession and oil price declines
Statutory tax rate assessment (relative to OECD & CIS countries)	**Low flat PIT rate** (10%); but high tax wedge when SSCs included	**Low range of rates** (5 - 10%) (6)	**Moderate to high SSC rates** (24.5% - 27.5%)	**Relatively low VAT rate** (12%)	**Mid-range CIT rate** (20%)
Effective tax rate assessment (estimated)	**Low PIT AETRs** at 6.7% (8)	**Close to zero** (~0%), due to exemptions		**Low**, based on 'VAT productivity' measure of 0.36 (9)	**Wide-ranging CIT AETRs** from 5.02% - 29.33%, depending on corporate incentives (7)
Current tax base assessment	Narrowed in recent years by allowance and exemptions for low-income taxpayers (1)	Very narrow. Most forms of personal capital income are exempt from tax	Narrowed by atypical design features (2)	Narrowed by many exemptions on goods and services	Narrowed by many corporate tax incentives
Rate recommendations	- To raise revenues, consider introducing a progressive PIT system over the medium-term	- Introduce single or progressive rate on all forms of personal capital income	- Maintain current SSC rates but do not increase further (3)	- Increase VAT rate modestly (but prioritise VAT base broadening), giving account to inflationary pressures	- Maintain current rates or reduce rates with simultaneous base broadening
Redesign recommendations (selected)	- Introduce the yearly tax declaration and strengthen the tax administration to make such a reform "work".	- Remove many of the exemptions on personal capital income	- Review and phase-out some of the atypical and costly policy designs including deduction of pension contributions from the base and the heritability of pensions.	- Remove some of the exemptions for goods and services. - Further strengthen the VAT	- Phase-out many of the corporate tax incentives. - Do not shift the administration of the

	- Abolish the 90% taxable exemption for low-income employees. - Consider introducing a tax credit		- Retain the deductibility of insurance SSCs from the base	refund system. - Fully restore the VAT chain within SEZs. - Over time, continue to lower the VAT threshold	CIT for SMEs to local governments. - Reduce the number of special tax regimes and enhance their design

Note: (1) Tax base may be further narrowed if high-income employees draw income from capital and other sources rather than from salary. (2) One example is the deductibility of pension contributions. (3) The rationale for no further increase is so as not to further increase employment costs (4) While VAT to GDP ratios are low to mid-range, VAT to total revenues are average due in part to the overall low tax to GDP ratios in Kazakhstan (5) Tax to GDP ratios not available in OECD revenue statistics (6) In some cases, rates are high as 20% for example such as capital gains on disposal of business assets by legal entities (7) Relates to capital investment projects, based on (OECD, 2017[11]) (8) Relates to the year 2019; based on simulation modelling in this report. (9) 'VAT productivity' averaged 0.36 between 2011 and 2018, which is low compared to other countries in the region. (10) But high on total goods and services, due to specific taxes on natural resource sector (11) Tax revenue volatility is based on the standard deviation of the tax-to-GDP between 1998 and 2017 using OECD revenue statistics.
Source: OECD analysis; OECD revenue statistics.

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Notes

[1] The decrease in the NOD in 2018 is largely due to the reduction in current expenditures in that year.

[2] The NOD is defined by the authorities in Kazakhstan as the difference between budget revenues (with the exception of loan receipts, transfers from the National Oil Fund and export customs on crude oil) and expenditures (with the exception of repayment of loans). These forecasts are according to the Presidential degree in 2016.

[3] This is based on a forecast provided by the Department of Macroeconomic Analysis and Forecasting. Ministry of National Economy (2019).

[4] This is the case only to the extent to which the higher SSCs will finance social spending that already takes place.

[5] The definition of social security contributions (SSCs) used is that described in the OECD Interpretative Guide. SSCs do not include the social tax.

2 Setting the scene for tax reform in Kazakhstan

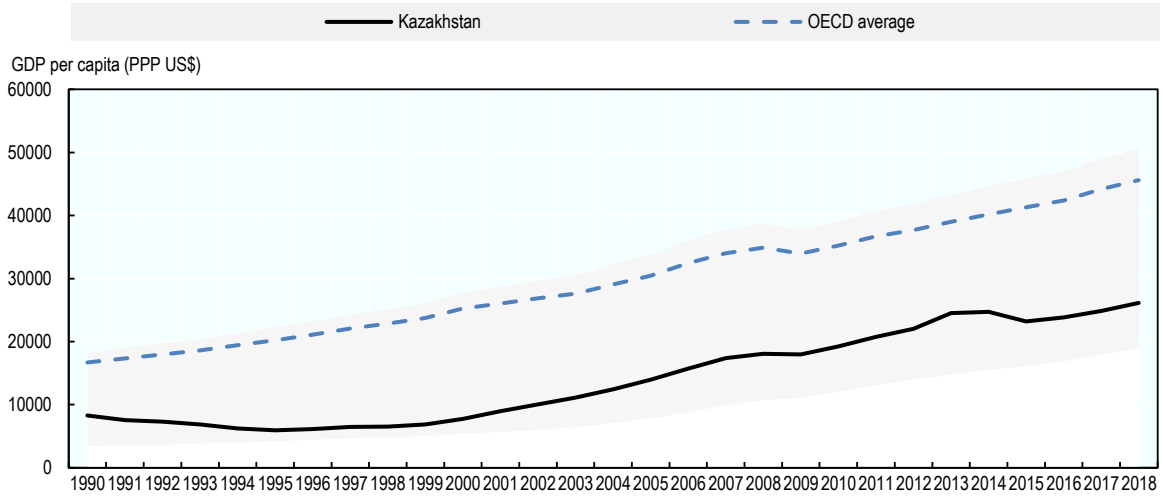
Setting the scene for tax reform in Kazakhstan. This chapter sets the scene for tax reform in Kazakhstan. The economy remains dependent on natural resources, multiple inflationary pressures continue to pose risks and seemingly positive labour market outcomes may mask deeper challenges. While the authorities are focused on reducing the non-oil budget deficit, the current targets may be ambitious and discretionary targeted transfers to the budget from the National Oil Fund remain significant.

2.1. Despite relatively strong growth in recent decades, Kazakhstan faces several economic risks

Following the financial crisis and then oil price collapse, the economy had started to show some signs of recovery. Kazakhstan is the largest economy in central Asia (Beazley, Downes and Nicol, 2019[1]). The country has been growing relatively faster than OECD countries in recent decades. Between 2000 and 2018, the compound annual growth rate (CAGR) of gross national income (GNI) per person in Kazakhstan has been 6.9%, which is more than twice that of the OECD average (Figure 2.1). Similarly, GDP per capita represented 31% of the OECD average in 2000, 56% in 2010 and 61% in 2018. In 2018, GDP per capita had increased to USD 26 147 (in PPP) compared to USD 45 624 in the OECD. However, GDP per capita includes oil exports, among other things, and is not necessarily indicative of the incomes of the average person in Kazakhstan (for more discussion on this, see section 2.1.2). Despite the relative increases in GDP per capita, the absolute gap between Kazakhstan and the OECD has remained roughly stable since 2000 and, since 2014, has increased. In more recent years, GDP per capita slowed in 2015 and 2016 due to a terms of trade shock after a sharp decline in the oil price but has since recovered growing by 4.6% and 5.2% in 2017 and 2018 respectively. Some of the reasons for this growth include high domestic demand driven by oil and gas investments in addition to government and household consumption which is supported by both wage increases and consumer lending (IMF, 2020[2]).

Figure 2.1. The economy had started to show some signs of recovery

GDP per capita in Kazakhstan and OECD countries, in PPP US $, 1990 - 2018



Note: PPP refers to purchasing power parity. The top and bottom of the grey background in the graph show the GDP per capita of high-income economies and upper middle-income economies respectively.
Source: World Development Index World Bank.

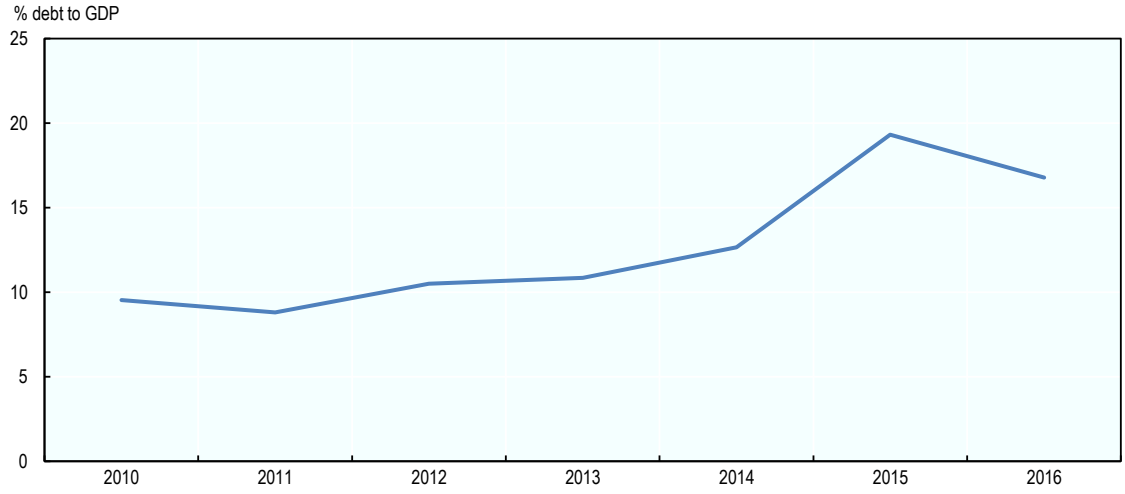
2.1.1. Multiple inflationary pressures may pose a risk to the economy

Tax policy reforms should be considered in the context of the level of inflation. This section examines selected inflationary pressures in the economy including rising government debt and expenditures in addition to rising real wages and consumption. Inflation should be taken account of in considering tax rate increases for example on VAT since a VAT rate increase represents in effect a once-off increase on consumer prices (discussed further in section 4.5).

Government debt has been rising in recent years from a low base. As shown in Figure 2.2, debt as a percentage of GDP has increased sharply from 10% in 2010 to 17% in 2016[1]. The debt-to-GDP ratio was 24.9% in 2018 and 23.7% in 2019 according to data from the Ministry of National Economy. The authorities expect this to increase to 28.6% by 2025.

Figure 2.2. The debt-to-GDP ratio has been rising but remains low

Central government debt-to-GDP ratio, 2010 - 2016



Source: International Monetary Fund, Government Finance Statistics Yearbook and data files, and World Bank and OECD GDP estimates.

Government expenditures could add to relatively high levels of inflation. Inflation has declined in recent years but remains relatively high at 5.4% in 2019, despite remaining within the National Bank of Kazakhstan's target band of 4 – 6 percent. By comparison, inflation was higher than the Kyrgyz Republic (2.0%), Armenia (3.0%), Azerbaijan (3.7%) and Georgia (4.3%) but lower than Tajikistan (8.0%), Turkmenistan (13.4%) and Uzbekistan (15.0%) (Asian Development Bank, 2020[3]) At the same time, budget expenditures are high – budget expenses from the republican budget as a share of GDP are 15.6% in 2018 and 17.3% in 2019. Table 2.1 shows selected government expenditures on additional initiatives of 1.3% of GDP between 2019 and 2021. Additional spending, which by itself may be warranted, will further increase the NOD and therefore the need to raise additional tax revenues. In addition, additional public expenditure from the government sector is expected to contribute to high levels of inflation.

Table 2.1. Government expenditure programmes starting in 2019

Selected government expenditures on additional initiatives, 2019 - 2021

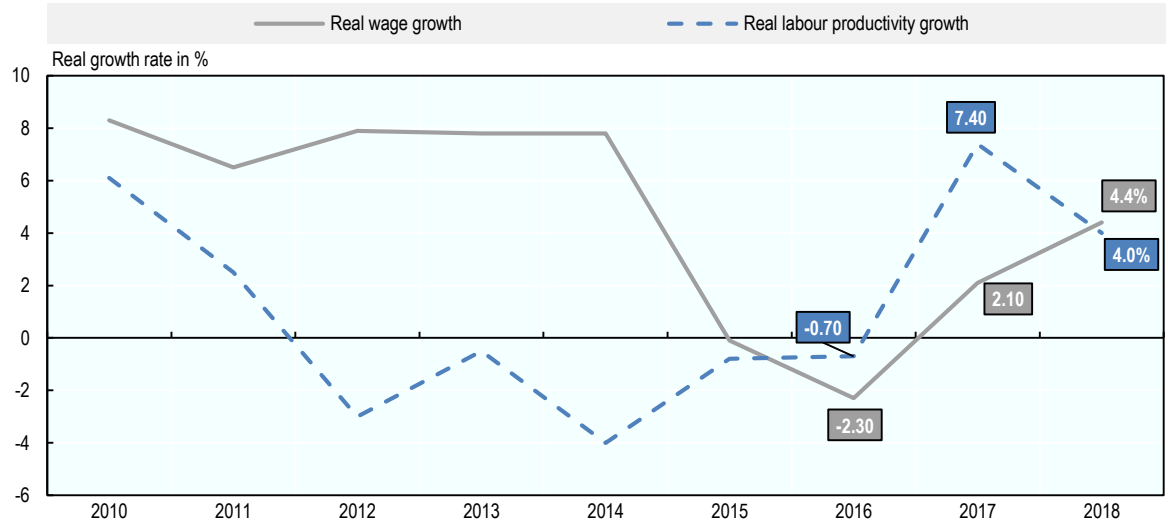
Initiatives	KZT (billions)	% of GDP
Increases in salaries of public sector employees	980	0.5%
Social security	300	0.2%
Development of public health	120	0.1%
Development of all regions	920	0.5%
Other programmes*	100	0.1%
Total	**2 460**	**1.3%**

Note: An estimate for nominal GDP for the years 2019 – 2021 is calculated by applying the forecasts of NAC Analytica for 2019, 2020 and 2021 (3.9%, 2.4% and 4.5% respectively) to 2018 GDP based on the Statistics Committee of Kazakhstan and then adding GDP for these years together. *Other programmes refers to two programmes as follows: (1) The 'Nurly Zher' programme includes building rental apartments, mainly for low-income families. (2) The 'Auyl – Yel Bessigi' programme includes financing for local villages including building, communication systems and social facilities.
Source: NAC Analytica, Nazarbayev University.

Household consumption is rising partly fuelled by credit. Consumption has increased in recent years and there is evidence to suggest that consumption may be fuelled in part by increases in bank lending to individual consumers. For example, in Q1 2018 and Q1 2019, consumer bank lending to individuals increased by 17% and 14% according to data from the National Bank of Kazakhstan.[2] During the same quarter periods, nominal (and real) household consumption increased by 13% (11%) and 12% (10%). In addition, the overall value of consumer bank loans, which comprises 6.5% of GDP in Q1 2019, had increased on Q1 2018 (6.0%) and Q1 2017 (5.2%).

Growth rates in real wages and productivity are rising. In 2010, the growth rates in real productivity and wages were high. Between 2010 and 2014, real productivity growth declined sharply while real wage growth remained stable. Since 2015, the growth rates in real productivity and real wages have started to rise again and are currently growing at about the same rate. Between 2017 and 2018, the growth rate of real wages increased while the growth in real productivity fell.

Figure 2.3. Growth rates in real wages are rising



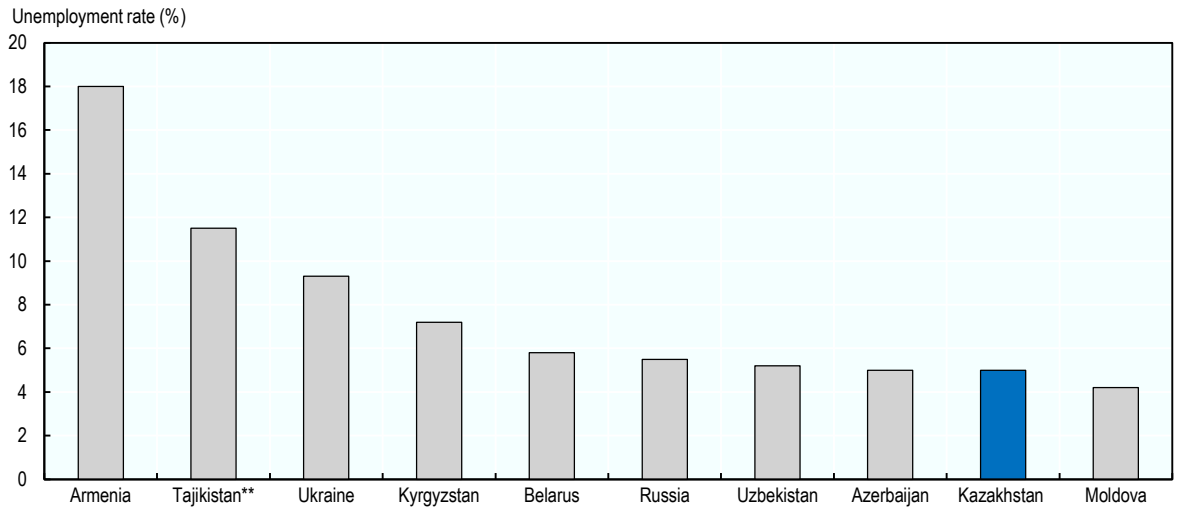
Source: Ministry of National Economy, Department of Macroeconomic Analysis and Forecasting.

2.1.2. Positive labour market outcomes mask deeper challenges

Labour market outcomes on unemployment and activity are positive. The unemployment rate in Kazakhstan, calculated as the number of people employed as a share of those actively seeking work, has been stable in recent years and is 4.9% in 2018.[3] It is forecast to remain stable between 2019 and 2021.[4] Figure 2.4 shows that the unemployment rate is one of the lowest among the Commonwealth of Independent States (CIS) countries and is similar to that of Uzbekistan, Azerbaijan and Moldova. The unemployment rate is similar to the OECD average of 5.2% in 2019. In addition, the labour force participation rate in Kazakhstan, that is the proportion of the population that is economically active (aged over 15 years), is 71% in 2018. It has also remained stable at about 70% throughout economic cycles over the past decade. Kazakhstan has a large and expanding working-age population, which represents an opportunity for the country (see section 4.4 on Financing the welfare system through Social Security Contributions).

Figure 2.4. Unemployment is low compared to CIS countries

Unemployment rate in CIS countries, 2016



Note: Data for Tajikistan relates to 2009.
Source: Statistics Committee of Kazakhstan.

However, these positive labour market outcomes mask challenges. The positive outcomes related to employment and activity mask a deeper set of labour market challenges in Kazakhstan. For example, incomes remain low for many workers and the poverty rate is high, particularly in rural areas. Furthermore, informality is widespread and informality and self-employment tend to be focused in some of the least productive sectors of the economy and among some of the most vulnerable groups including among the young, older workers and the low-skilled (OECD, 2017[4]).

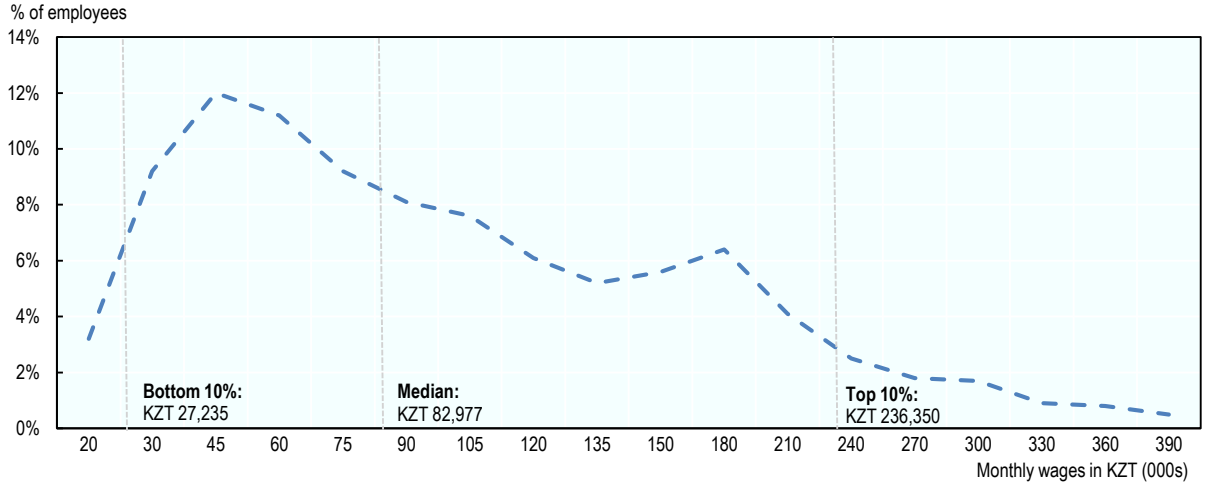
Employee incomes are low. Figure 2.5 shows the gross monthly income distribution in Kazakhstan for 2017 based on grouped data. The median monthly income is KZT 82 977 (USD 215); the mean monthly income is KZT 162 673 (USD 423); the top 10% is KZT 236 350 (USD 615) and the bottom 10% is KZT 27 235 (USD 71). Two key income indicators are used in Kazakhstan for calculating certain taxes, benefits, social payments and administration fees. The first is the minimum monthly salary (MMS), which is the minimum wage for workers guaranteed by the State. The MMS is KZT 42 500 in 2019, having

increased by 50% on last year. The second is the monthly calculation index (MCI) of KZT 2 525, which increased by 5% in 2019 (a table of information on income indicators is provided in the Annex). The low levels of employee incomes observed have implications for PIT reforms including the extent the equity of increasing PIT rates and the extent to which PIT revenues could be raised (discussed further in Chapter 5).

Employee gross incomes appear unequal when tax data are used due to many low-income employees. One way of measuring the concentration of income inequality is comparing inter-decile ratios, which have the advantage of being both direct and intuitive. These measures are internationally popular. (Piketty and Saez, 2014[5]) argue that the 'simplest and most powerful measure' of inequality is the share of total income going to the top decile. According to analysis of the income distribution, based on data from a study from (Institute of Economic Research, 2018[6]), the P90/P10 ratio is 8.7, which is high internationally while the P90/P50 ratio is 2.9, which is more moderate. On the basis of these gross income data, Kazakhstan would be regarded as unequal relative to OECD countries. This level of income inequality appears to be driven by those on low incomes. For example, over one-third of employees (2.2 million) earn KZT 60 000 per month or less and close to one-half (52.9%) earn less than KZT 90 000 per month, which is slightly above the median. Furthermore, 4 in 5 employees (83.8%) earn KZT 180 000 or less.

Figure 2.5. Income from employment is low

The distribution of employee monthly gross income in Kazakhstan by wage group, 2017

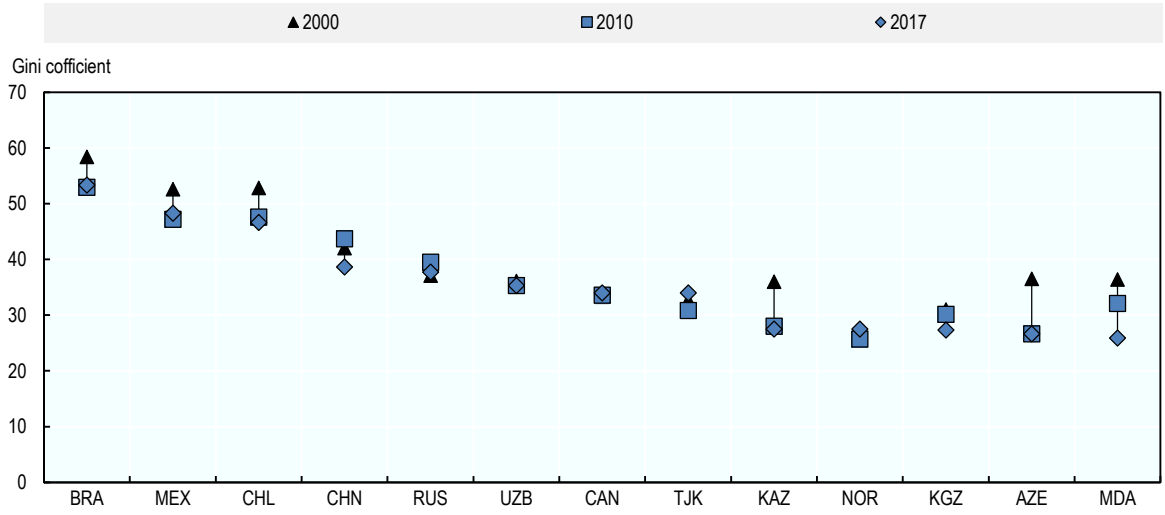


Note: Chart reproduced approximately based on visual inspection. Horizontal axis shows income brackets. The distribution of wages is based on 5.9 million hired workers. 4% of workers earn in excess of KZT 390,000 per month which is not shown for the purpose of this analysis.
Source: (Institute of Economic Research, 2018[6])

Disposable income inequality is low having fallen in recent decades. Disposable income inequality, measured using the Gini coefficient, is low in Kazakhstan (Figure 2.6). It has fallen since 2000 and then stabilised since 2010. This places Kazakhstan close to the level of OECD members with the lowest inequality. Market income distribution data based on survey data also suggest that income inequality is low.

Figure 2.6. Disposable income inequality is low

Gini coefficient of disposable income, selected countries, 2000 – 2017



Note: Where figures for a given year were unavailable, data for the nearest year is used.
Source: World Bank development indicators; Statistics Committee of Kazakhstan.

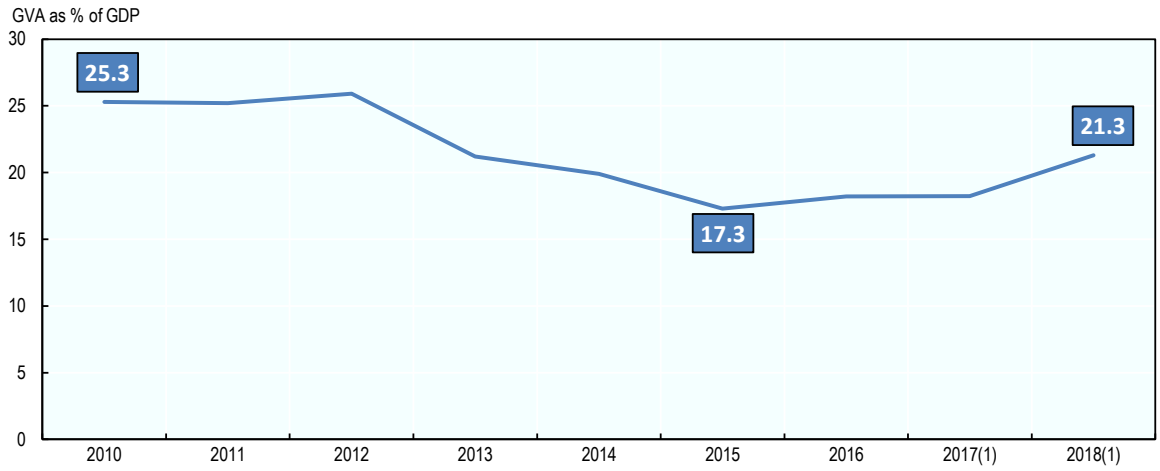
2.2. Oil tax revenues fuel the National Fund and the budget

2.2.1. The economy would benefit from diversification

The economy relies heavily on natural resources. Much of the economic success of the country in recent decades is attributable to the oil and gas sector. At the macroeconomic level, exports of goods and services amounted to 19.9 billion in 2017. The value of fuels exports – largely oil, gas and minerals - represented half (51%) of all exports (Figure 2.9). A broader definition of the natural resource sector including materials could imply a contribution as high as three-quarters (76%) of all exports.[5] Under this wider definition, exports from the oil and the natural resource sector represented about 29% of GDP comprised of fuels (19%) and materials (9.6%). According to data from the Statistics Committee, the gross value added (GVA) of the oil and gas sector represented 21.3% of GDP in 2018 (Figure 3.8). Therefore, the non-oil and gas sector represented 78.7%.

Figure 2.7. The economy relies on the oil and gas sector

Gross value added (GVA) of the oil and gas sector as a share of GDP, 2010 - 2018

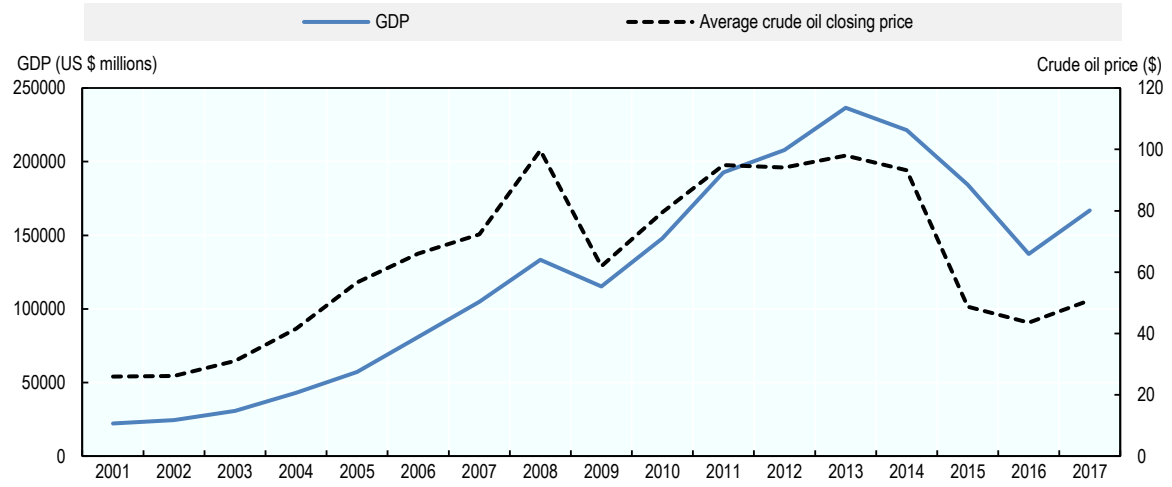


Note: Figures for 2017 and 2018 based on new methodology.
Source: Statistics Committee of Kazakhstan.

GDP and exports are sensitive to global oil prices. GDP growth in Kazakhstan is correlated with changes in the global oil price over time (Figure 2.8). Similarly, exports and particularly fuel exports correlate with the global oil price. For example, between 2014 and 2015 when the global oil price fell by half (48%), the value of fuels exports fell in similar proportion (46%). Similarly, between 2016 and 2017 when the global oil price recovered (17%), so did the value of fuel exports (24%). Furthermore, non-fuel exports also correlate with the global oil price which reflects the integrated nature of the economy with the oil sector. With respect to imports, a significant two-thirds (in value terms) relate to goods related to industry, much of which is the oil and gas sector, such as machinery and vehicles (22%), material and other manufacturing (32%), chemicals (8%) and fuels (4%) in 2017. Taxes including CIT and taxes on goods and services are also sensitive to global oil prices (see section 3.3.1 for further discussion).

Figure 2.8. GDP is associated with the global oil price

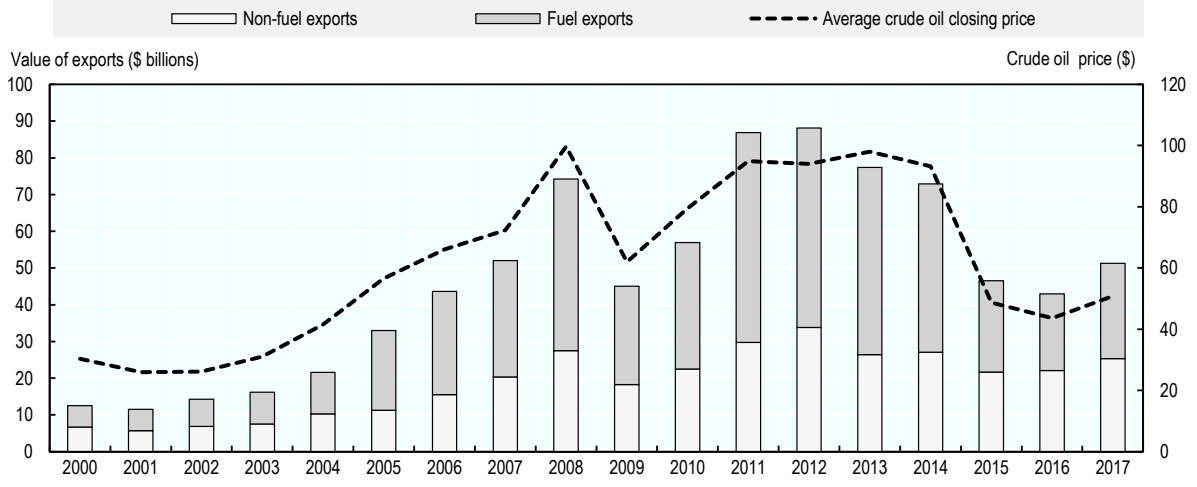
GDP and the average annual crude oil price, 2001 - 2017



Source: Macro Trends data; World Bank databank.

Figure 2.9. Exports are associated with the global oil price

Fuel exports, non-fuel exports and the average annual crude oil price, 2000 - 2017



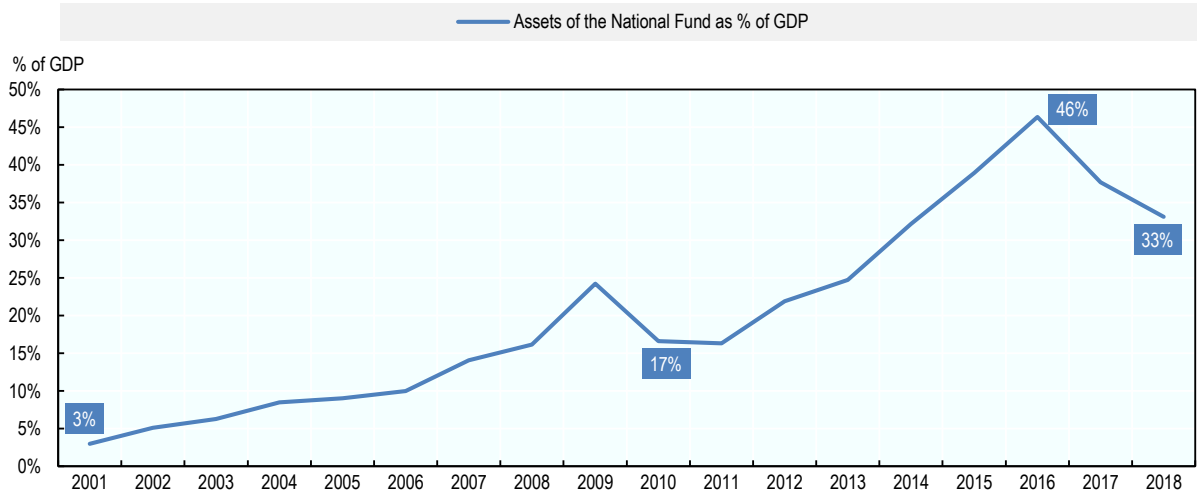
Note: Fuel includes petrol products and related materials and gas, natural and manufactured.
Source: Macro Trends data; "The Atlas of Economic Complexity," Center for International Development at Harvard University.

2.2.2. Oil revenues fuel the National Fund and the budget

The assets of the National Fund remain significant as a share of GDP despite a decline in oil prices in recent years. Kazakhstan's oil wealth is managed through the National Fund, which operates according to legislative criteria and is managed by the National Bank. The Fund was established in 2000 as both a stabilisation fund and a savings fund. The National Fund accumulates part of the revenues generated by

the extractive sector of the economy so that they can be saved for future generations and used to maintain the necessary level of government spending (including social spending) in the event of a fall in oil prices (EITI, 2018[7]). Oil tax and non-tax revenues generated by the extractive sector are paid to the National Fund (with the exception of export customs duty on crude oil which goes directly to the republican budget). The overall assets of the National Fund as a share of GDP have been rising steadily over the past two decades, with the exception of a fall in 2010 due in part to the financial crisis and between 2016 to 2018 due to the fall in oil prices. Assets of the National Fund represent 33% of GDP in 2018. The assets of the National Fund are accumulated in a number of ways. They include taxes from oil sector organisations including CIT, alternative subsoil use tax, mineral extraction tax, bonuses, export rental tax, excess profit tax. They also includes other revenues from operations carried by organisations of the oil sector, including for example violations of the terms of oil contracts in addition to other proceeds (EITI, 2018[7]).[6]

Figure 2.10. The assets of the national fund remain significant

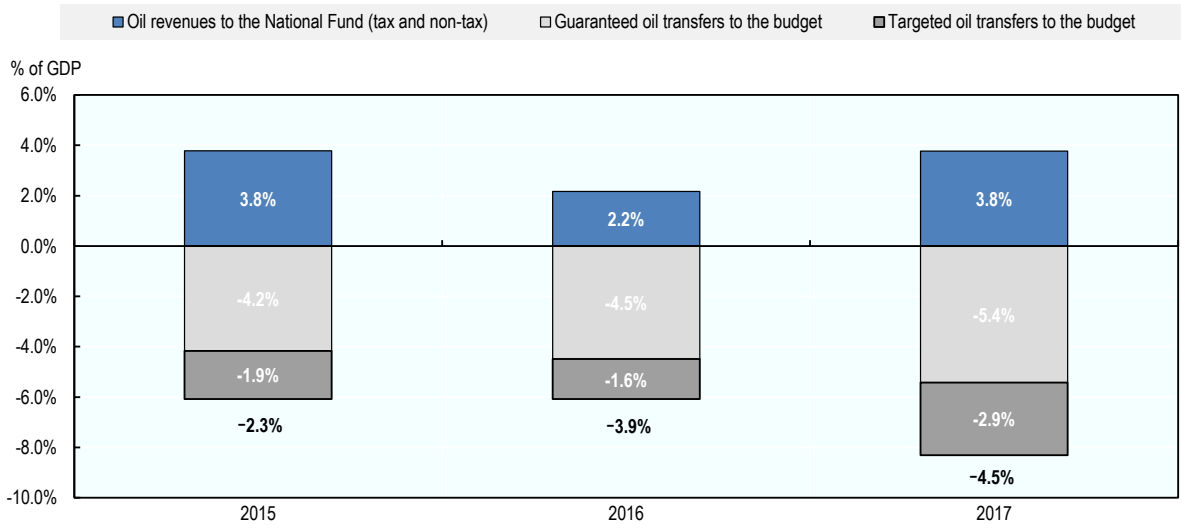


Note: The assets of the national fund are taken from January of each year.
Source: National bank of Kazakhstan; World Bank databank.

Oil revenues flowing in to the National Fund may be less than transfers flowing out to the budget. A goal of the authorities is to reduce budgetary dependence on oil revenues. This is reflected in, for example, the adoption of a number of rules for transfers to the budget including the *'Concept for the Formation and Use of the National Fund'* and the introduction of a limit on the amount of guaranteed transfer to the budget each year to commence in 2020. However, budget revenues remain supported by transfers from the National Fund. In 2017, transfers to the budget represented 8.3% of GDP. There are two types of transfers - guaranteed and targeted. Targeted transfers are allocated for financing anti-crisis programs during periods of economic downturn, socially significant projects of a national scale and strategically important infrastructure projects. A key difference is that the latter have a discretionary element - they provide the authorities with the flexibility to increase the overall transfer of resources beyond the guaranteed amounts. Figure 2.11 shows that oil revenues flowing in to the National Fund are less than the transfers flowing out to the budget between 2015 and 2017, which resulted in a significant drop in the assets of the National Fund.

Figure 2.11. Oil revenues flowing in to the National Fund may be less than transfers flowing out to the budget

Oil tax and non-tax revenues to the National Fund and transfers to the budget, as a % of GDP, 2015 - 2017



Note: Oil tax revenues to the National Fund are equal to tax revenues in OECD revenue statistics that go to the National Fund. Oil non-tax revenues are estimated at 14.5% of total oil tax and non-tax revenues based on data from (EITI, 2018[7]).
Source: OECD revenue statistics; Ministry of National Economy.

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Piketty, T. and E. Saez (2014), *Inequality in the long run*, http://topincomes. (accessed on 21 November 2018). [5]

Notes

[1] International Monetary Fund, Government Finance Statistics Yearbook and data files, and World Bank and OECD GDP estimates.

[2] Based on the Bank of Kazakhstan, 'Consumer Loans extended by banks to individuals and interest rates for January to May 2019' available here: https://nationalbank.kz/?docid=3370&switch=english.

[3] Statistics Committee of Kazakhstan.

[4] The NAC Analytica forecast unemployment to be 4.8% in 2019, 9.1% in 2020 and 9.6% in 2021.

[5] Based on the combined value of fuels, material manufacturing (metals, iron and steel) and crude materials (ores and metal scarp and minerals).

[6] For example, proceeds from the sale of agricultural land and investment income from the management of the National Fund.

3 Tax Revenue Analysis

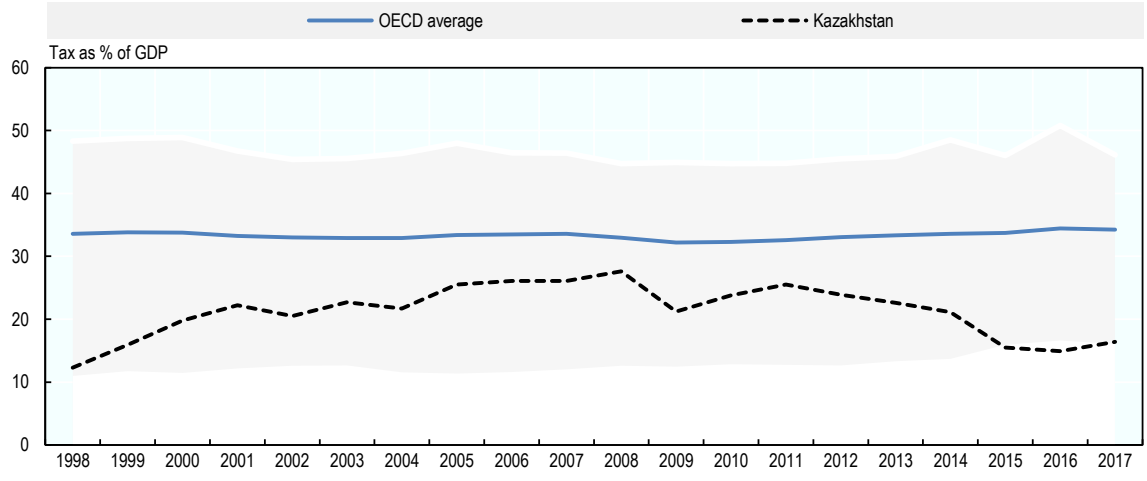
This chapter considers tax revenue trends and the tax mix in Kazakhstan. Taxes as a share of GDP in Kazakhstan remain low by international standards. The tax mix is concentrated on value-added tax (VAT) and corporate income tax (CIT) and much less so on Personal Income Tax (PIT), Social Security Contributions (SSCs) and property taxes. At the same time, important sources of tax revenue such as CIT and export duty taxes rely on the extractive sectors of the economy such as mining and the fossil fuel sector. Kazakhstan aspires to become one of the top 30 global economies by 2050. However, tax revenues may be too low to support the ambitions of the authorities including to meet tax revenue and expenditure targets and to reduce the non-oil deficit. Raising more taxes will be necessary to support the country's medium-term goals and longer-term sustainability.

3.1. Tax revenues have increased over the past decade but the tax-to-GDP ratio remains low

Historically, tax revenues have been lower and more volatile in Kazakhstan than in comparison to the average for OECD countries. Kazakhstan has undergone considerable economic change over the past two decades. Figure 3.1 shows that the tax-to-GDP ratio in Kazakhstan has been low, volatile and more sensitive to economic cycles. The broad trend over the period has been that the tax-to-GDP ratio rose gradually between 1998 and 2008 and declined gradually thereafter to 2017. GDP declined in 2009 following the global financial crisis and then again 2014 in part due to falling oil prices. The decline in the tax-to-GDP ratio from a high of 27.6% in 2008 to 16.4% in 2017 has also occurred in part because economic growth rose more quickly than tax revenues.

Figure 3.1. Kazakhstan raises taxes at a level close to the lowest level found in the OECD

Total tax revenue as a % of GDP in Kazakhstan and the OECD, 1998 - 2017

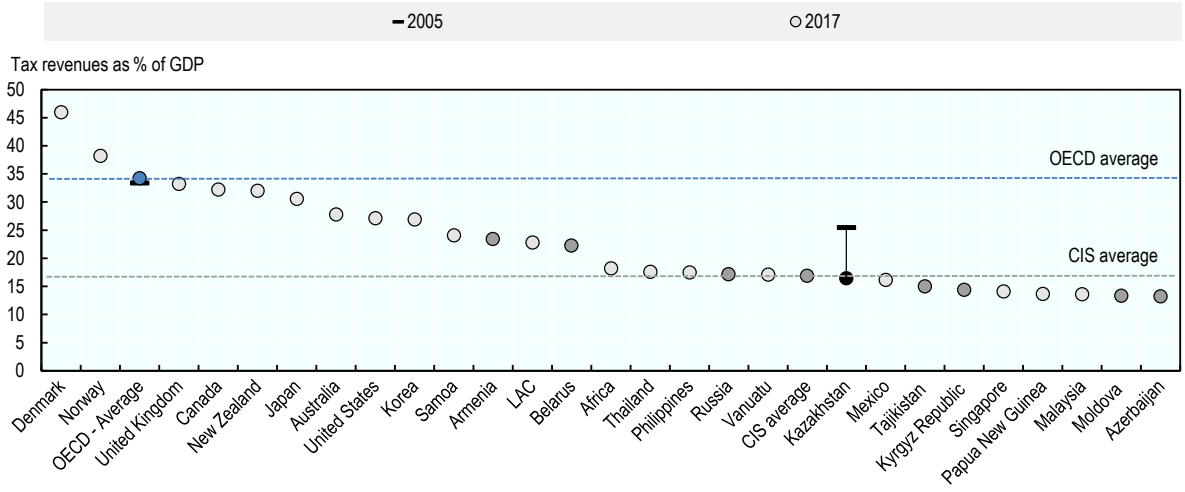


Note: The shaded area shows the tax revenue as a percentage of GDP range among OECD countries (i.e. the maximum and minimum) in a given year.
Source: OECD global revenue statistics.

The tax-to-GDP ratio in Kazakhstan is similar to the average of the Commonwealth of Independent States (CIS)[1]. Following the decline in the tax-to-GDP ratio since 2008, Kazakhstan has a tax-to-GDP ratio of 16.4% in 2017, which is similar to the average of CIS countries (Figure 3.2). For example, it is higher than Azerbaijan (13%), lower than the Republic of Armenia (23%) and similar to Russia (17%). It is also broadly similar to selected Asian and Pacific economies, such as Indonesia (12%), Thailand (18%), the Philippines (18%) and Malaysia (14%) and Singapore (14%). However, the tax-to-GDP ratio in Kazakhstan is low compared to the OECD average (34.2%) and resource-rich OECD countries such as Norway (39%), Canada (33%) and Australia (29%).

Figure 3.2. The tax-to-GDP ratio in Kazakhstan is similar to the CIS average but below the OECD average

Tax-to-GDP ratio, 2005 and 2017 for Kazakhstan (2017 for all other countries)



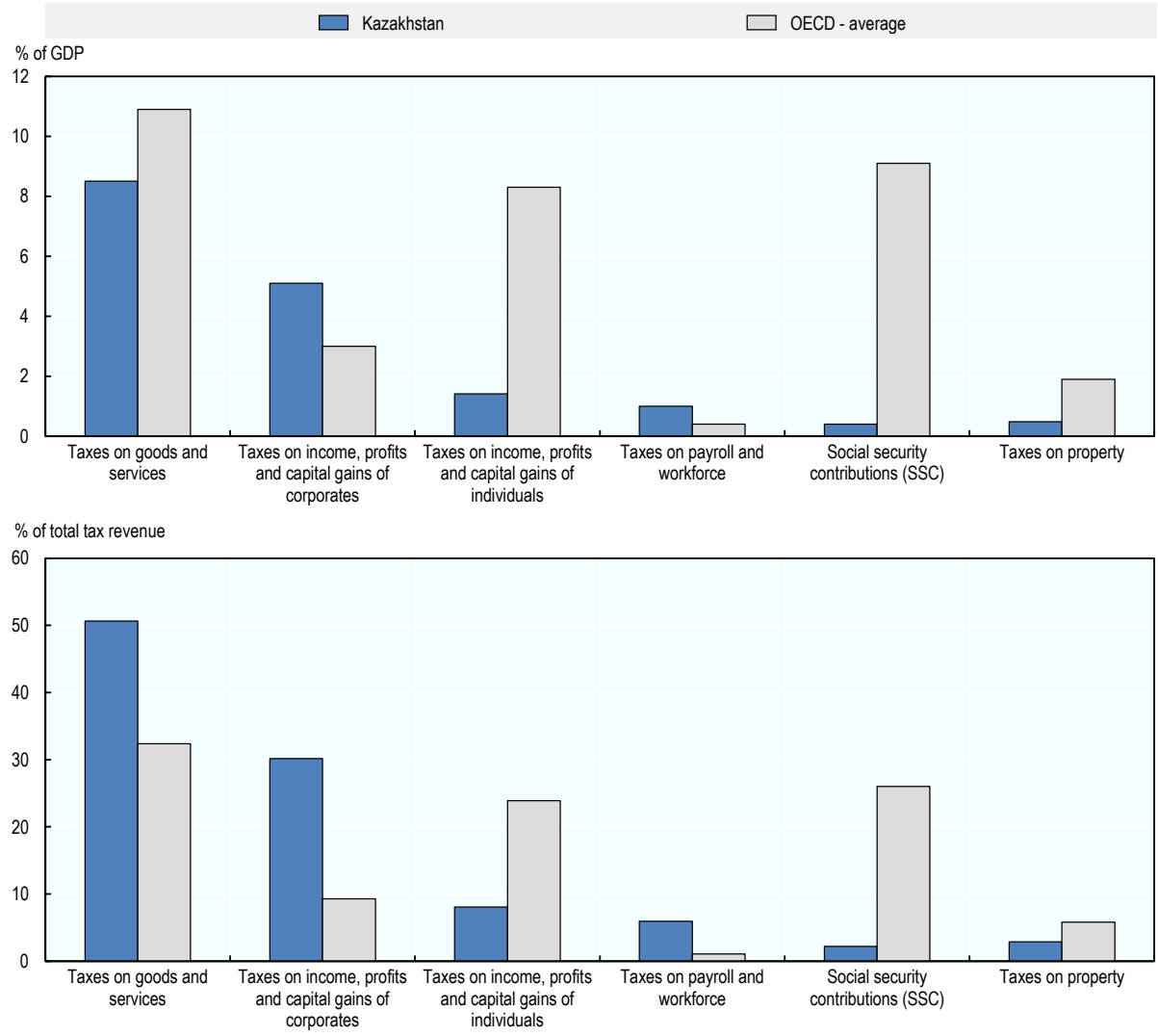
Note: For Australia, Japan and Africa, data for 2016 is shown as data for 2017 is unavailable. Data for CIS countries is for 2015. For CIS countries, ratio is presented without consideration of social payments and local taxes as they are not covered by the competence of tax authorities. CIS average based on selected countries in the figure.
Source: OECD revenue statistics and State Revenue Committee.

3.2. The tax mix is concentrated

The tax mix is concentrated on VAT and CIT with a lower share from PIT and SSCs.[2] Taxes on company profits as a share of GDP are high at 5.1% compared to only 3.0% in the OECD. Oil companies contributed to about one-third (35%) of all CIT revenue in 2017. Taxes on goods and services as a share of GDP are 8.5%, which is lower than the OECD average of 10.9%. However, as a share of total tax revenues, taxes on goods and services are relatively high, in comparison to the OECD average. Taxes on the income of individuals are low at 1.4%, compared to 8.3% in the OECD. Similarly, SSC funds are low and represent 0.4% of GDP compared to 9.1% in the OECD.

Figure 3.3. The tax mix is concentrated on taxes on goods and services and corporate income taxes

Tax revenues compared to the OECD average, as a % of GDP and as a % of total tax revenue, 2018



Note: OECD figures for 2017.
Source: OECD global revenue statistics database.

Kazakhstan's tax mix is less diversified than in resource-rich OECD countries. As mentioned previously, Kazakhstan aspires to become one of the top 30 global economies by 2050. Figure 3.4 shows developments in taxes for Kazakhstan and a selection of resource-rich OECD countries and emerging economies between 2000 and 2017. A diversified tax mix reduces the potential impact of a decline in any one tax. In Kazakhstan, 81% % of tax revenues come from two taxes – taxes on goods and services and taxes on companies – based on OECD revenue statistics data. In Norway, Canada and Mexico, the tax revenues from the same two taxes are lower at 43%, 35% and 58% respectively. The reduced degree of tax concentration among these countries provides them with greater protection from potential shocks.

The lack of diversification in the tax mix have led to larger declines in tax revenues than in resource-rich OECD countries and emerging economies. While PIT and SSCs have both been relatively stable in Kazakhstan and Norway in recent years, an important difference arises in the size of the contribution of these taxes to total tax revenues. Combined, PIT and SSCs represent over 20% of GDP in Norway in 2017 but less than 2% in Kazakhstan. When the international oil price declined between 2014 and 2016, this combination of a proportionately high (relative to total taxes) and stable tax base provided Norway with additional protection for tax revenues. As a result, during the period 2012 to 2017, total tax revenues fell by a third (from 23.9% of GDP to 16.4%) in Kazakhstan compared to just 3% in Norway (from 41.5% to 38.8%).

3.3. Tax revenues depend on potentially volatile extractive sectors

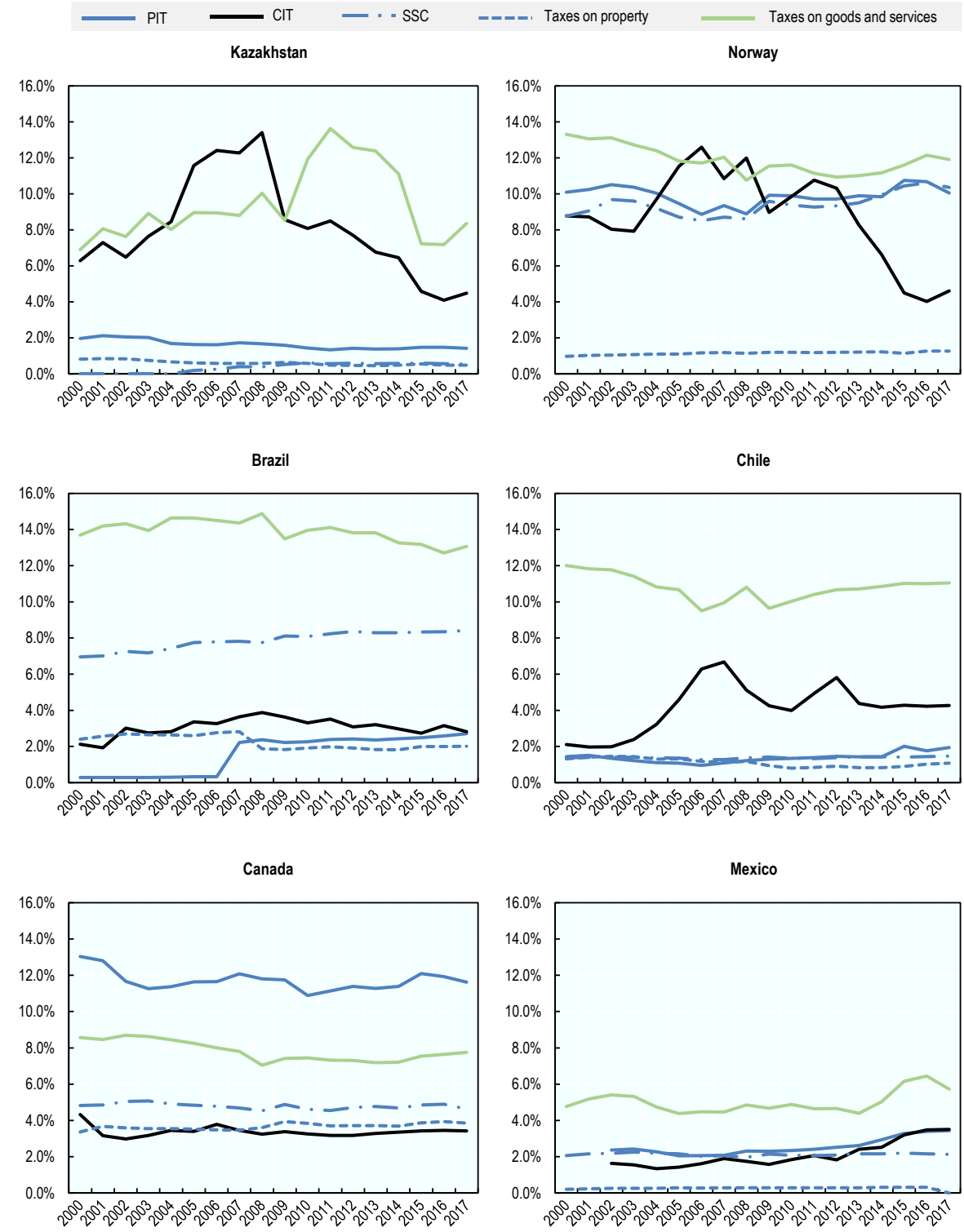
CIT and export duty tax (on oil) revenues depend on the oil sector. Figure 3.5 shows the contribution of oil production to different taxes based on data provided by the authorities. Overall, 42% of total tax revenues are related to the oil sector in 2018[3]. This has fallen from a recent peak of 54% in 2011. In the case of PIT revenues, 9% is related to the oil sector and the figure has remained relatively stable over time. For revenues from the CIT, 45% is related to the oil sector and the trend has followed overall tax revenues trends over the period. In the case of VAT revenues, the proportion is 11% having increased from negative values (one possible explanation is because of large VAT refunds for VAT paid on inputs). For export tax revenues, virtually all revenues are derived from the oil sector (97.9%). Export custom duties relate to taxes on crude oil and oil products (these taxes are levied on the basis of the quantity exported). Taken together, CIT and export taxes represent over 90% of all taxes from the oil sector.

3.3.1. Tax revenues are more volatile than in resource-rich OECD countries and emerging economies

Oil and non-oil tax revenues are sensitive to changes in the oil price. The international crude oil price has a strong positive correlation with overall tax revenues in Kazakhstan over time, particularly with tax revenues from the oil sector (Figure 3.6). For example, between 2014 and 2016, the oil price fell by 48% and 11% and oil tax revenues fell similarly by 48% and 23% respectively. When the oil price recovered in 2017, so did oil tax revenues, albeit more quickly. The impact of the oil price on the economy and total tax revenues operates through various channels including through increased company profits which are subject to tax (for more details on company taxation see Chapter 5). The data also show that the oil price has a positive correlation with taxes from the non-oil sector, which reflects the integrated nature of oil in the Kazakhstan economy.

Figure 3.4. Kazakhstan's tax base is less diversified than in a selection of other resource-rich countries

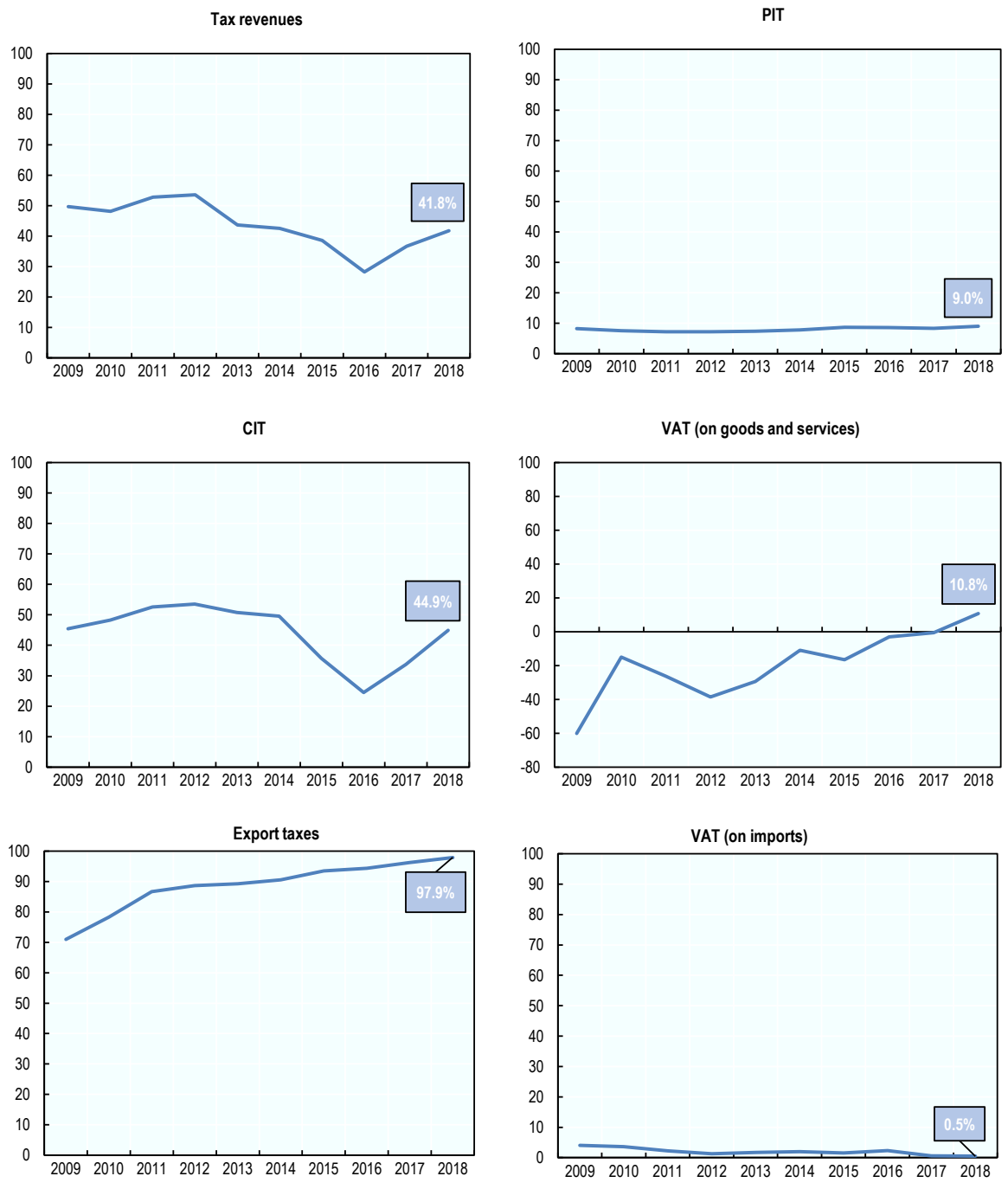
Taxes as a % of GDP in Kazakhstan and selected OECD countries and emerging economies, 2000 - 2017



Source: OECD global revenue statistics database.

Figure 3.5. Oil contributes significantly to tax revenues through CIT and export custom duties levied on oil

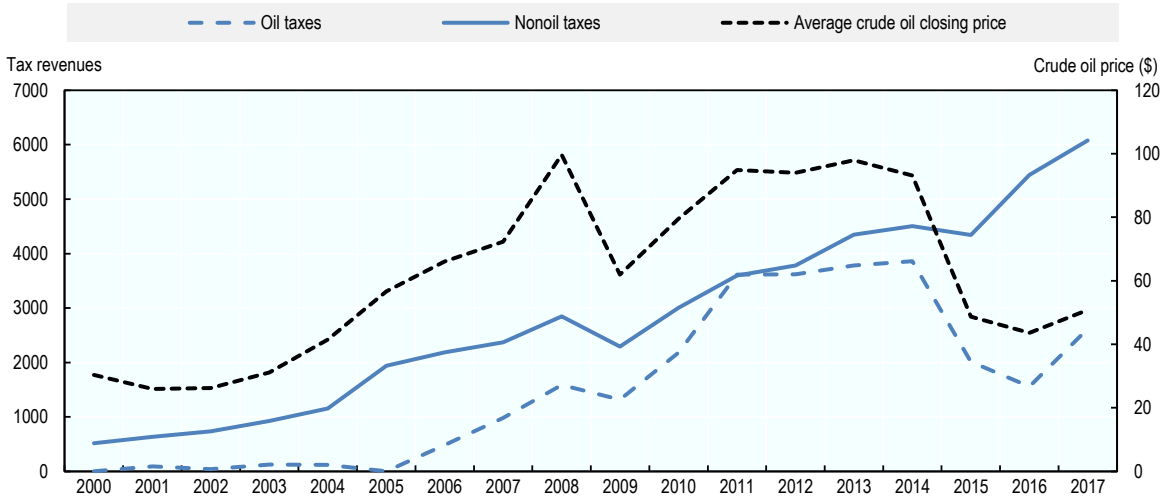
% of taxes related to oil production, 2009 - 2018



Source: State Revenue Committee of Kazakhstan.

Figure 3.6. Oil and non-oil tax revenues are sensitive to changes in the world-market oil price

Oil and non-oil taxes and the average crude oil price, 2000 - 2017



Note: Oil taxes are estimated using OECD revenue statistics as the share of tax revenues that go to the National Fund plus 'taxes on exports excluding those to the National Fund' (because these include export duty taxes on crude oil). It is worth noting that the definition of what constitutes tax and non-tax revenues differ in Kazakhstan and the OECD revenue statistics.
Source: OECD revenue statistics; Macro Trends data.

The volatility of CIT revenues is high. Among the selected resource-rich countries, Kazakhstan and Norway have had similarly high degrees of CIT revenue volatility, measured based on the standard deviation in revenues over the 2000 to 2017 period (Table 3.1). The standard deviation was 2.7 and 2.5 in each country respectively over the 18-year period. The trend can also be observed in the tax-to-GDP ratios: between 2012 and 2017, for example, CIT revenues fell from 7.7% to 4.5% in Kazakhstan and from 10.3% to 4.6% in Norway, which is a broadly similar relative decline. By comparison, Chile has had a more moderate CIT revenue volatility and Brazil and Canada have had low CIT revenue volatility.

Taxes on goods and services are more volatile than in other resource-rich countries. Between 2014 and 2015 when the international oil price fell, taxes on goods and services fell sharply in Kazakhstan by 33%; while in Norway they rose modestly by 3.0%. More generally, goods and services appears to be more volatile in Kazakhstan than in other resource-rich countries, based on the standard deviation over the 18-year period from 2000 to 2017 (Table 3.1).

Table 3.1. Revenues from company taxes and taxes on goods and services are more volatile in Kazakhstan than in other resource rich countries

Standard deviation of CIT and taxes on goods and services revenues over time, selected countries, 2000 - 2017

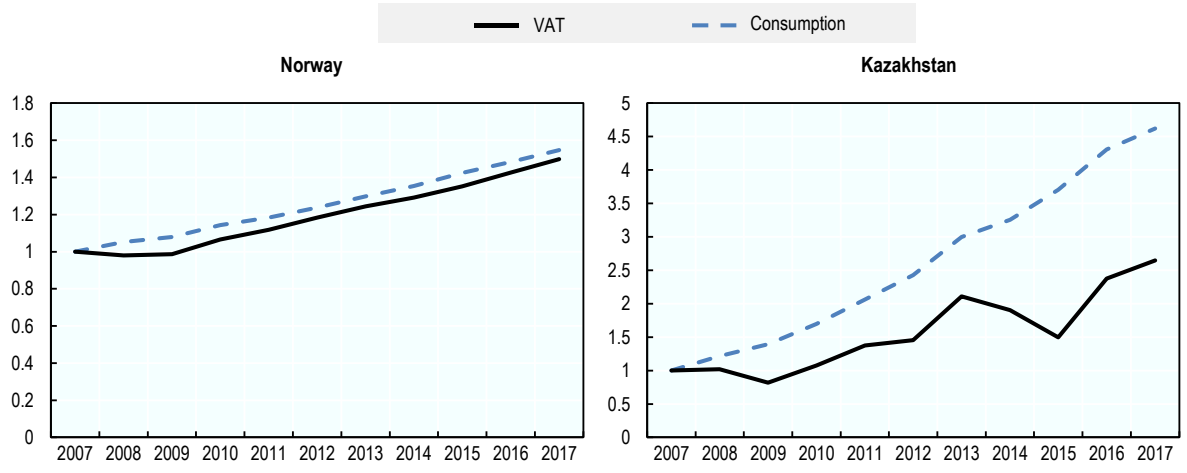
	Company taxes as % of GDP		Taxes on goods and services as % of GDP	
	2017	SD (2000 – 2017)	2017	SD (2000 – 2017)
Kazakhstan	4.5	2.7	8.4	2.0
Norway	4.6	2.5	11.9	0.8
Chile	4.3	1.4	13.1	0.7
Brazil	2.8	0.5	13.1	0.6
Canada	3.4	0.3	7.8	0.5

Note: Standard deviation is calculated based on the levels of company taxes and taxes on goods and services as a share of GDP in each year. A caveat to this volatility analysis is that some countries may levy taxes other taxes on the oil sector, such as royalties, and therefore company taxes to GDP may be less important in those countries.
Source: OECD global revenue statistics database.

VAT represents a relatively stable form of tax that is linked to the overall level of domestic consumption in many OECD countries, but this does not seem to be the case in Kazakhstan. To take one example, in Norway VAT and consumption have been closely correlated over the past decade Figure 3.7. In Kazakhstan, however, VAT is correlated with the general level of consumption but less so than in other resource-rich countries such as in Norway. One explanation for this could be the rise in the importance of imports in the VAT base that has occurred in recent decades. For example, VAT on imports as share of total VAT increased from 26% in 1998 to 78% in 2008 to 61% in 2017.

Figure 3.7. VAT revenues in Kazakhstan are less correlated with general consumption than in some other countries

Trends in VAT, consumption and exports in Kazakhstan and Norway (index 2007 = 1.0), 2007 - 2017



Source: Statistics Norway; OECD Statistics

3.3.2. Increasing tax revenues to support the country's medium-term goals and ensure longer-term sustainability and welfare

Higher tax revenues are needed to meet Kazakhstan's expenditure goals and to reduce the non-oil deficit. (see Infographic 2.1). Raising more tax revenues would allow the country to meet its revenue targets and expenditure goals and to reduce the non-oil deficit. The authorities have set an ambitious goal to increase tax collection from 18 to 25 percent of GDP by 2025 (IMF, 2020[1]). The authorities also have a wide range of ambitious expenditure goals including supporting low-income households, promoting SMEs and enhancing the quality of healthcare. In addition, Kazakhstan presently runs a budget deficit and a non-oil budget deficit (NOD). In general terms, the idea of NOD is to strip out oil revenues from the budget to provide a more realistic measure of the budget deficit in the absence of oil revenues. The authorities define the NOD as the difference between budget revenues (with the exception of loan receipts, transfers from the National Fund and export customs on crude oil) and expenditures (with the exception of repayment of loans). Reducing the NOD has been identified by government as a reform priority.

A further reason to raise tax revenues is that government debt has been rising in recent years albeit from a low base. Furthermore, over the long-term, the low-carbon transition and technological advancements in fossil fuel extraction are likely to generate downward pressure on fossil fuel demand, prices and the associated tax revenues (Botta, 2020[2]). To prepare for decarbonisation of the world economy over the longer-term, Kazakhstan has recognised that it should gradually raise more tax revenues from non-resource related sources to finance its budget. The resource revenues should provide additional time for a gradual transition towards raising higher non-oil related tax revenues in ways that do not harm growth, respect fairness and is aligned with the capacity of the tax administration to operate a modern and well-designed tax system. A broader set of macroeconomic risks exist including the potential for increases in international interest rates, oil price shocks and trade wars.

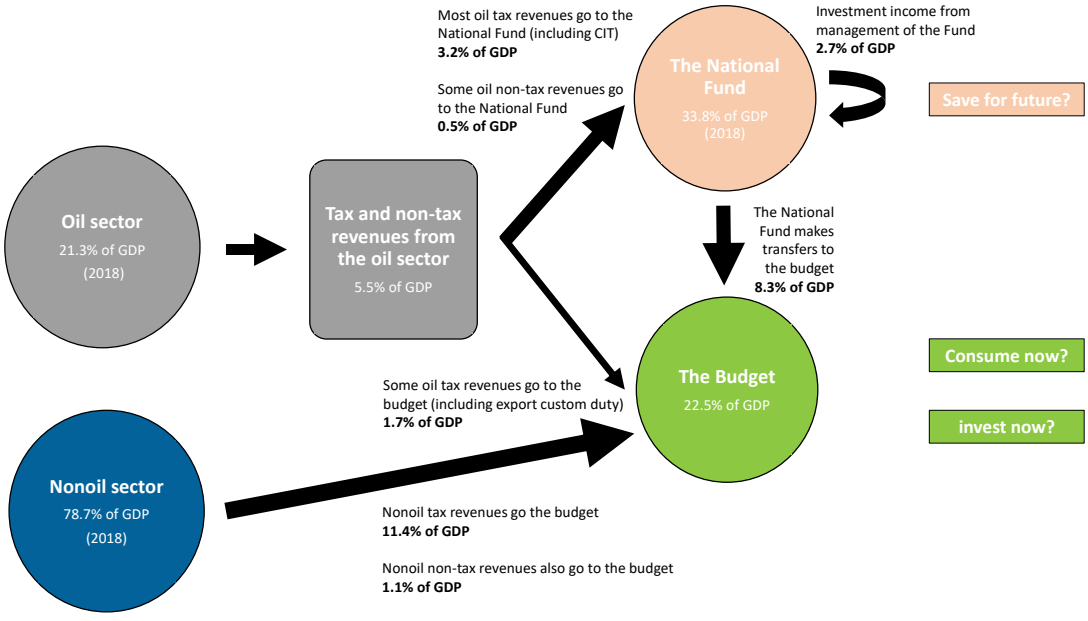
Infographic 3.1. Advantages of raising more tax revenues in Kazakhstan

Source: OECD analysis.

Kazakhstan needs to strike a balance between consuming resource-revenue today versus investing and consuming the revenues in the future. Resource-rich countries such as Kazakhstan face the opportunities and challenges of managing oil, gas, and mineral revenues that are volatile, finite and uncertain (Botta, 2020[2]). As the world gradually decarbonises over the long-term, Kazakhstan can decide how much resource-revenue to consume and invest now through the budget and how much to save for the future through the National Fund. The analysis in Infographic 2.2 provides an indicative snapshot in 2017 of the flows of oil and non-oil tax and non-tax revenues in the Kazakhstan fiscal system. Some caveats are worth noting. The GDP shares shown in Infographic 2.2 are derived based on different sources (including OECD revenue statistics for the budget and most tax revenues) so they cannot necessarily be combined. Similarly, the GDP shares are for the year 2017 (unless otherwise stated) and are not necessarily representative of other years, partly because of the volatility of the economic activity and profitability of the oil sector (for example, investment income under management of the National Fund and transfers to budget can change significant in a given year).

Resource revenues currently fuel the National Fund and the budget. Notwithstanding the **illustrative** nature of the analysis in Infographic 2.2, it highlights a number of points. The tax and non-tax revenues generated by the oil sector in 2017 are significant (5.5% of GDP). Most tax and non-tax oil revenues flow to the National Fund (3.7% of GDP) but some go directly to the budget (1.7% of GDP). Non-oil tax revenues go directly to the budget (11.4% of GDP) along with non-oil non-tax revenues (1.1% of GDP). Kazakhstan's oil wealth is managed through its National Fund. The assets of the National Fund are significant at 33% of GDP in 2017. The assets are accumulated in a number of ways. They include taxes from oil sector organisations including CIT, alternative subsoil use tax, mineral extraction tax, bonuses, export rental tax, excess profit tax. They also includes other revenues from operations carried by organisations of the oil sector, including for example violations of the terms of oil contracts in addition to other proceeds (EITI, 2018[3]). Assets also includes investment income from the management of the fund (2.7% of GDP). The National Fund annually allocates transfers to the budget (8.3% of GDP in 2017) but these do not necessarily correspond to the revenues flowing into the National Fund. Some of these transfers can be made in accordance with the decision of the President (referred to as targeted transfers). Budget revenues are estimated at 22.5% of GDP, comprised of oil tax revenues including export custom duty (1.7%), non-oil tax revenues (11.4%), non-oil non-tax revenues (1.1%) and transfers from the National Fund (8.3%) (for the year 2017, when transfers were high relative to previous years).

Infographic 3.2. The flow of oil and non-oil revenues to the National Fund and the Budget of Kazakhstan



Note: Unless otherwise stated, data refer to year 2017. In the case of the oil and non-oil sectors, figures refer to the GVA of the oil and gas sector (and non-oil and gas sector) as a share of GDP in 2018. Tax figures are from OECD revenue statistics and OECD global revenue statistics database for 2017. OECD revenue statistics data include SSCs, whereas Kazakhstan does not classify SSCs as tax revenues. Oil non-tax revenue is estimated based on data from (EITI, 2018[3]). Investment income from management of the national fund and transfers to budget are also based on data for 2017 from (EITI, 2018[3]). While investment income from management of the National Fund was positive in 2017, this is not the case in all years. Transfers to the budget were high in 2017. National fund estimate as a share of GDP is based on data from the Ministry of National Economy. Non-oil non-tax revenues is from the OECD multi-dimensional review of Kazakhstan 2016.
Source: OECD revenue statistics; OECD global revenue statistics database (OECD, 2020[4]); (EITI, 2018[3]); Ministry of National Economy; National Statistics Committee of Kazakhstan; OECD multi-dimensional review of Kazakhstan 2016.

Tax revenues flow to the budget and the National Fund. Tax revenues from the oil sector in Kazakhstan go to the National Fund with the exception of export customs duty on crude oil. Therefore, oil tax revenues equal total tax revenues that go to the National Fund plus export customs duty on crude oil that go to the budget. The corollary is that non-oil tax revenues are total tax revenues less oil tax revenues. Table 3.2 shows the components of oil and non-oil tax revenues in Kazakhstan between 2010 and 2017 using OECD revenue statistics data. Export customs duty on crude oil can be approximated using OECD revenue statistics with taxes on exports excluding those that go to the National Fund.[4]

Table 3.2. Non-oil tax revenues

Components of oil and non-oil tax revenues in Kazakhstan, in millions of KZT, 2010 - 2017

	2010	2011	2012	2013	2014	2015	2016	2017
Total tax revenue	5 182 314	7 212 132	7 398 056	8 130 544	8 364 983	6 352 921	7 006 053	8 690 678
of which:								
Tax revenues that flow to the National Fund	2 158 783	3 115 678	3 161 542	3 194 606	3 079 887	1 319 871	871 055	1 710 160
Tax revenues that flow directly to the general government budget (and not to the National Fund)	3 023 531	4 096 454	4 236 514	4 935 938	5 285 096	5 033 050	6 134 998	6,980,518
of which:								
Taxes on exports (excluding those to the national fund)	22 060	499 207	457 410	585 857	778 853	692 855	688 122	904,476

Note: Total tax revenues in OECD revenue statistics include the republican budget, local budget and the National Fund. Tax revenues to the National Fund include significant proportions but not all of profits on corporates (1210), taxes on exports (5124) and other taxes (5128).
Source: OECD revenue statistics.

An OECD definition of the NOD can be developed. A number of methodological steps are taken to estimate a new definition of the NOD to 2025 for the purposes of this report.) First, using OECD revenue statistics data, non-oil tax revenues are calculated as the amount of tax revenues that do not flow to the National Fund but directly to the general government budget (see Table 3.2). Second, non-oil non-tax revenue is added to non-oil tax revenue to give total non-oil revenues. It is worth noting that the definition of what constitutes tax and non-tax revenues differ in Kazakhstan and the OECD revenue statistics[5]. Third, 'taxes on exports excluding those to the National Fund' are also deducted from the non-oil tax revenue estimate as these relate to export tax duties on crude oil from the oil sector. Finally, state budget expenses based on State Revenue Committee data are deducted to give an estimate of the non-oil deficit. Based on these steps, the definition of the NOD can be expressed as follows:

NOD = tax revenues to budget + non-tax revenues to budget – taxes on export duties – expenditures [6]

The NOD is presented in Table 3.3 for years up to 2017, using actual data and forecasts the NOD for the period 2018-2025. After 2017 (the latest year for which there is OECD revenue statistics data), non-oil tax revenues, GDP and expenditures are grown-forward annually based on international data and forecasts (IMF, 2020[1]).

Table 3.3. Estimating the non-oil deficit

Non-oil deficit estimates, 2014 – 2025, as a % of GDP

	2014	2015	2016	2017	2018f	2019f	2020f	2021f	2022f	2023f	2024f	2025f
(A) Non-oil tax revenue (1)	13.3%	12.3%	13.1%	13.1%								
(B) Non-oil non-tax revenue (2)	1.1%	1.1%	1.1%	1.1%								
(C) Total non-oil revenue (A + B)	14.4%	13.4%	14.2%	14.2%	13.8%	12.4%	12.5%	12.6%	12.7%	12.1%	11.8%	11.6%
(D) Taxes on exports (not to NF)	2.0%	1.7%	1.5%	1.7%	1.6%	1.5%	1.5%	1.5%	1.5%	1.4%	1.4%	1.4%
(E) State budget expenses (3)	19.6%	20.1%	20.1%	23.5%	17.5%	18.0%	17.2%	16.2%	15.4%	14.5%	14.1%	13.7%
(F) OECD NOD estimate (C - D - E)	-7.2%	-8.4%	-7.4%	-11.0%	-5.4%	-7.1%	-6.2%	-5.1%	-4.2%	-3.9%	-3.7%	-3.5%

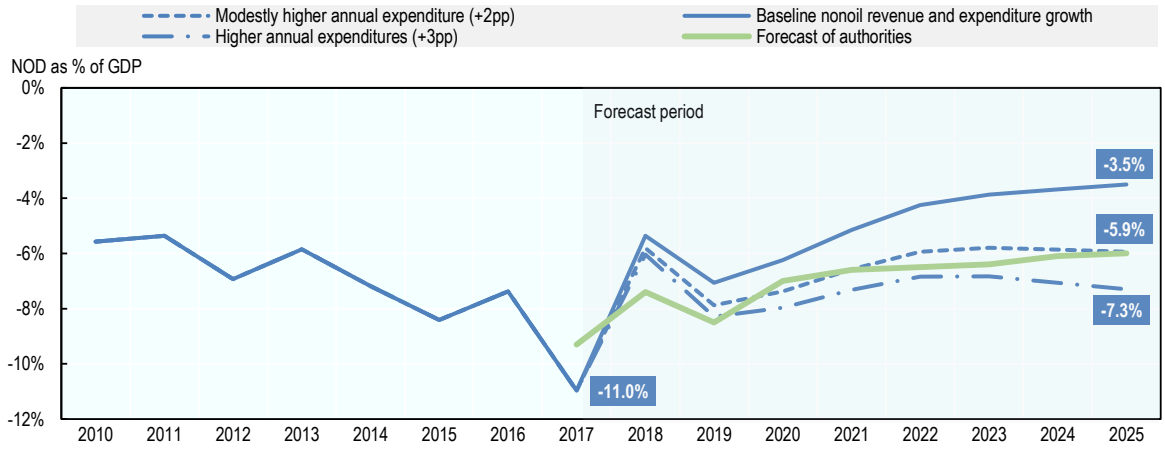
Note: (1) The proportion of tax revenues from the non-oil economy (A) is estimated using OECD revenue statistics data as follows: (total tax revenues not from the national fund) / (total tax revenues) (2) Non-oil non-tax revenue (B) was 1.1% of GDP between 2012 and 2014 based on the OECD multi-dimensional review of Kazakhstan 2016. It is assumed to remain at this level over the period of the analysis. (3) State budget expenses are from publicly available data on revenues to the State Budget from the State Revenue Committee. In terms of the forecasts, non-oil revenues and export customs duties for 2017 are grown-forward annually using IMF forecasts for non-oil revenues. State budget expenses are grown-forward annually using IMF forecasts for current expenditures. GDP for 2010 – 2017 is based on revenue statistics data and grown-forward thereafter annually using IMF forecasts for real GDP growth.
Source: OECD revenue statistics; the OECD multi-dimensional review of Kazakhstan 2016; publicly available data from the State Revenue Committee of Kazakhstan; (IMF, 2020[1]).

The NOD could range from 4 – 7% by 2025. According to the baseline analysis, the NOD is 5.4% of GDP in 2018, 6.2% of GDP in 2020 and could be 3.5% by 2025.[7] However, the forecast growth in expenditures (based on IMF data) are low between 2018 and 2025, averaging 0.2% over the period, and resulting in a gradual decrease over time of expenditure as a % of GDP. For that reason, Figure 1.1 extends the analysis from Table 3.3 and adds a simulation analysis to show the NOD if expenditure growth were 2 and 3 percentage points higher annually than the baseline growth rates. On this basis, the NOD could range from 4 – 7% of GDP by 2025 (estimates are rounded).

The government NOD forecast sits in between this range, albeit the definition of NOD is different.[8] The authorities forecast the NOD at 7.4% of GDP in 2018, 7.0% in 2020, 6.5% in 2022 and 6.0% in 2025.[9] This NOD estimate is in the range of previous international estimates ranging from 5% to 8% for 2025 based on various fiscal adjustment strategies (World Bank, 2017[5]). However, these forecasts may depend on relatively optimistic underlying forecasts of non-oil revenue, expenditures and GDP (higher GDP forecasts reduce the NOD).

Figure 3.8. The forecasts of the non-oil deficit are significant

NOD as a % of GDP, under different expenditure scenarios, 2010 - 2025



Note: The non-oil deficit and baseline scenario growth for non-oil revenue and expenditure are calculated as described in Table 3.3. In the 'modestly higher annual expenditure' scenario, 2 percentage point are added to the baseline expenditure growth forecast in each year (for example, if the expenditure growth is 5.0%, it is increased to 7.0%). Similarly, in the 'higher annual growth' scenario, 3 percentage points are added to the baseline non-oil revenue growth in each year.
Source: OECD revenue statistics; the OECD multi-dimensional review of Kazakhstan 2016; publicly available data from the State Revenue Committee of Kazakhstan; (IMF, 2020[1]).

3.3.3. Financing the NOD by raising more tax revenues

Reducing the NOD would require raising significantly more tax revenues. The tax-to-GDP ratio is 16.4% in 2017; the figure includes the SSCs that are paid to separate social funds. On the basis of the previous simulation analysis, to eliminate fully its NOD, Kazakhstan will have to raise its tax-to-GDP ratio by 4 - 7 percentage points. This financing need for the NOD is the starting basis for the analysis below, which examines which taxes it might be raised from. Research conducted by the Economic Research Institute in Kazakhstan reaches a similar result showing that the tax-to-GDP ratio could be increased by 4 – 5 percentage points within 10 years (from the level of 2018) with limited negative effects on economic growth and tax collection (Alpysbayeva, Kenzhebulat and Karashulakov, 2019[6])**.**

Financing needs could be met by gradually moving some taxes that have the potential for generating more revenues and are less dependent on revenues from the resource-sector. Kazakhstan's tax base is concentrated in taxes on goods and services (8.4% of GDP) and taxes on companies (4.5%) and to a lesser extent taxes on individuals (1.4%), SSCs (0.5%) and property taxes (0.5%) (see Chpater 3). To support its financing needs and simultaneously increase the diversity of the tax base, Kazakhstan could support the financing of the NOD by raising tax revenues from taxes that 'underperform' relative to the OECD average and which are less exposed to the resource-sector.

There are several ways in which taxes could be raised to finance the NOD. Tax revenue increases could come from a combination of PIT, SSCs and property taxes along with a modest increase in taxes on goods and services. Table 3.4 shows the *additional* taxes as a share of GDP that would be required to cover a NOD of 6% of GDP for example, which lies between the 4 – 7% of GDP shown in the previous simulation analysis. For example, taxes on goods and services as a share of GDP are 8.4% in 2017. According to the analysis shown in Table 3.4 an additional 0.6% in taxes on goods and services would be needed to finance the NOD by 2025, along with the other increases in tax revenues shown. This analysis

provides a framework for considering which taxes, and how much revenue from each tax, might need to be raised. A range of revenue raising alternatives are possible across the different taxes. As part of the recommendations in this report, there is additional scope for raising tax revenues from PIT including tax on personal capital income, SSCs, property taxes and VAT. For example, one option could be increases in taxes on individuals, SSCs and property taxes while modestly increasing taxes on goods and services) and maintaining current company tax levels. The scheduled increase in SSCs may contribute to lowering the NOD, but only to the extent to which the higher SSCs will finance social spending that already takes place. If the scheduled increase in employee and employer SSCs will finance additional social spending, the reform will leave the current NOD intact, which then will have to be financed through other tax increases. Maintaining revenues of company taxes constant over time would, in an environment of decreasing oil prices because of decarbonisation of the world economy, imply a gradual increase in company taxes paid by the non-oil sector in Kazakhstan. While reaching the OECD average should not be thought of as a goal in itself, it provides a framework for identifying where there may be potential to generate more tax revenues from less volatile tax revenue sources.

Table 3.4. Ways to finance the NOD by increasing revenues from underutilised taxes

Estimated NOD as % of GDP, future financing needs & additional tax required to close gap with OECD average levels

	Additional NOD financing needs		Additional taxes that would be need to close gap with OECD average		
	Total Tax Revenues in 2017 (1)	Additional Tax Revenues needed to Finance NOD by 2025	Reach 1/4 way to OECD average	Reach 1/3 way to OECD average	Reach OECD average
Total	16.4%	6.0%	4.9%	6.5%	19.5%
Taxes on individuals (1100)	1.4%	2.1%	1.7%	2.3%	6.8%
SSCs (2000)	0.5%	2.3%	2.2%	2.9%	8.6%
Taxes on property (4000)	0.5%	1.0%	0.4%	0.5%	1.4%
Taxes on goods and services (5000)	8.4%	0.6%	0.7%	0.9%	2.6%
Taxes on companies (1200)	4.5%	0.0%	0.0%	0.0%	0.0%

Note: Figures are rounded. Company taxes as a share of GDP is assumed to remain constant. (1) Since not all taxes are included for the purposes of this analysis, total taxes do not sum exactly to the total.
Source: OECD statistics.

Box 3.1. Proposed tax reforms of the authorities in the coming years

In 2019, the State of the Nation address set out a number of tax reforms including on PIT, SSCs, VAT and CIT. Prior to this, the 100 concrete steps were set out by former President Nursultan Nazarbayev. This box highlights some of the key proposed reforms.

PIT

- Reduce the tax burden on low-income earners, perhaps by introducing a progressive personal income tax scheme (2018).
- Consider how to produce a more equitable distribution of national income (2019).
- Introduce legislation to exempt SMEs from PIT for up to three years (2019).
- Consider providing incentives for employers to increase employee wages (2019).

SSCs

- Postpone the introduction of additional pension contributions at a rate of 5% until 2023 (2019).
- Consider the growing number of social contributions, which may push some business into the informal economy (2019).
- Consolidate the extra-budgetary SSCs by creating a unified social fund and introducing one social payment (2019).
- Improve the effectiveness of the pension system generally (2019).

VAT

- Consider applying simpler and faster VAT refunds (2019).
- Track imported goods when they enter Kazakhstan up until their sale (2018).
- Consider introducing a sales tax instead of a VAT (2018).

CIT and Land Tax

- Transfer of SME CIT revenues from the central to the local budgets starting in 2020 (2019).
- Consider how the tax system could stimulate companies to invest in human capital, in raising labour productivity and exports (2019).
- Introduce tax credits for enterprises implementing new investment projects (2019).
- Consider the low level of direct tax on land (2019).

Source: State of the Nation Address 2019; 100 concrete steps 2018.

Box 3.2. Guiding principles for successful tax reform in Kazakhstan

Adopt a comprehensive approach to tax reform. Tax reforms should be introduced as part of a holistic and comprehensive tax reform package rather than in isolated elements (Alt et al., 2008[21]). Different tax reforms across taxes should be evaluated together where possible. For example, tax systems should ensure that the overall tax burden on capital income (taking into account the business tax rate and the taxes on capital income at the individual shareholder level) is aligned with the tax burden on labour income (in particular at the highest income levels). Alternatively, in considering raising more tax revenues, introducing a progressive PIT system could provide an alternative to a VAT rate increase in an already inflationary environment. Similarly, given a number of special tax regimes for individuals and SMEs, the addition of the new Single Aggregate Payment (SAP) regime in Kazakhstan, while a good policy in principle (discussed in greater detail in 5), will have implications for all other regimes. Tax reform should be consistent and phased-in gradually.

Frequent and sporadic tax policy changes produce uncertainty and undermine planning for both businesses and individuals who need to understand and respond to them. Kazakhstan may benefit from putting in place a consistent tax policy plan over the medium-term, which to the extent possible, does not change over the period of the plan. In addition, tax reforms may benefit from being phased-in gradually. Some reforms can be implement immediately, but other reforms require good planning and preparation, such as the introduction of a recurrent tax on immovable property.

Keep the design of the tax system as simple as possible. A complex tax system, where enforcement capacity is relatively limited, creates opportunities for tax evasion. In addition, complexity increases compliance costs for taxpayers, which in turn reduces the efficiency and potentially fairness of tax systems. For instance, high compliance costs may bear disproportionately upon certain categories of individuals or firms, in particular small firms. Tax systems should aim to be efficient by limiting distortions in the behaviour of individuals as much as possible. In general terms, this can be achieved by broadening the tax base and keeping tax rates as low as possible. For example, broad bases simplify the system by reducing the number of allowances, deductions and other exemptions, and reduce compliance costs for individuals and businesses related to understanding qualifying and reporting requirements. Furthermore, when special tax provisions are provided, tax rates must be higher than otherwise would have been the case to compensate for the tax loss associated with them, which produces a deadweight loss. In this way, reduced tax rates can increase efficiency and limit distortive behaviour in the tax system (Brys et al., 2016[7]).

Tax policy design and tax administration are complementary. Good tax policy involves ensuring that tax policy designs are administratively feasible, which is a relevant principle in the case of Kazakhstan. Tax policy changes may have unintended effects if they are not accompanied by tax administration improvements including through third-party reporting and strengthened auditing capacity. For instance, higher tax rates may lead to lower revenues if the tax administration's verification capacity is limited and taxpayers can easily avoid or evade taxes.

Source: OECD analysis.

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Notes

[1] The CIS include Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[2] It should be noted that the definition of what constitutes tax and non-tax revenues differ in Kazakhstan and the OECD revenue statistics. The share of the Republic of Kazakhstan under production sharing contracts of oil companies, the bonuses of oil and non-oil sector companies, the levy for the use of the radio-frequency spectrum, the payment to compensate for historic costs as well as certain other items are classified as non-tax revenues according to the OECD Interpretative Guide, but are considered as tax revenues in Kazakhstan.

[3] Note that the OECD global revenue statistics database show that oil sector tax revenues are 33% of total tax revenues in 2018.

[4] In 2017 for example, taxes on exports excluding those to the National Fund (OECD revenue statistics) and exports custom duty on crude oil (State Revenue Committee of Kazakhstan) were KZT 904 476 and KZT 854 530 respectively, a difference of only of 5.8%.

[5] The share of the Republic of Kazakhstan under production sharing contracts of oil companies, the bonuses of oil and non-oil sector companies, the levy for the use of the radio-frequency spectrum, the payment to compensate for historic costs as well as certain other items are classified as non-tax revenues according to the OECD revenue statistics Interpretative Guide. The classification used by Kazakhstan does consider these revenues as tax revenues. This report follows the tax definition and classification from OECD revenue statistics.

[6] Under this definition, tax revenues to the budget exclude taxes paid by the oil sector (but include export duties on crude oil) and non-tax revenues paid to the general budget exclude non-taxes paid by the oil sector.

[7] The decrease in the NOD in 2018 is largely due to the reduction in current expenditures in that year.

[8] The NOD is defined by the authorities in Kazakhstan as the difference between budget revenues (with the exception of loan receipts, transfers from the National Oil Fund and export customs on crude oil) and expenditures (with the exception of repayment of loans). These forecasts are according to the Presidential degree in 2016.

[9] Forecast of Department of Macroeconomic Analysis and Forecasting. Ministry of National Economy (2019).

4 Equity – sharing the tax burden fairly across the population at large

This chapter examines equity issues in Kazakhstan and how the tax burden might be shared more fairly across the population. It focuses on personal income taxes, social security contributions and value added taxes. Recommendations to strengthen the design of these taxes are provided in the table overleaf.

Box 4.1. Recommendations to strengthen to design of the PIT, SSCs and VAT

PIT

PIT design

- Strengthen the capacity of tax administration to monitor incomes and income sources to support the introduction of an end-of-year tax declaration.
- Introduce the end-of-year tax declaration as soon as administrative feasible to support the introduction of a progressive PIT system; do not continue to defer its introduction.
- To raise the currently low levels of PIT revenues, introduce a progressive PIT rate schedule over the medium-term.
- Turn the basic tax allowance into a basic tax credit and design the progressive PIT rate schedule such that the 90% exemption of income for a targeted group of taxpayers becomes unnecessary.
- As a short-term measure, consider increasing the flat PIT rate modestly.
- For any PIT rate reform, take account of the overall tax wedge, which is rising due to the proposed increased SSC rates.
- Before introducing a progressive PIT system, develop a PIT microsimulation model using individual-level tax return to more robustly cost PIT reform proposals and measure distributional impacts.

Personal capital income tax design

- Abolish the exemptions on personal capital income including the exemption for capital gains from the sale of shares held for more than 3 years and for government securities, bonds and shares officially listed on a Kazakhstan stock exchange.
- Replace the current set of differentiated rates on different forms of personal capital income with a proportional capital income tax rate or a progressive tax rate schedule. Consider taxing personal capital income jointly with labour income, or introduce a separate progressive tax rate schedule for capital income at the individual level

SSCs

Continue with the reform of the SSC system

- To support the financing of the welfare system with increased SSC funds, continue to implement the reform for a new SSC system.
- Maintain the employer and employee SSC rates on insurance, health and pension at the currently proposed rates but do not increase the SSC rates further so as not to add further to the rising employment costs for firms.

The SSC base is narrow by design and could be broadened

- Consider reviewing the atypical deduction of pension contributions from the SSC base.
- To raise SSC funds, consider abolishing the atypical and expensive inheritability of pension payments.

Other SSC reform considerations

- Consider partly financing social benefits through taxation (in the medium or longer run when the role of the PIT in the tax system is strengthened).
- Implement less frequent but more consistent SSC reform.

VAT

Consider increasing VAT rates

- Consider increasing the standard VAT rate, which is low by international standards, but any VAT rate increase should be modest given the inflationary environment.
- Continue to strengthen the design and operation of the VAT following international best practice and do not introduce a sales tax.

Broaden the VAT base

- Broaden the VAT base by removing various exemptions for goods and services including for example the exemption for newly constructed residential buildings that are brought on the market for the first time.
- Fully restore the VAT chain by applying the standard VAT on all transactions to and within the Special Economic Zones (SEZs) (i.e. by including zero-rated supplies for transactions within the standard VAT system).
- Build on progress to date by applying simpler and faster VAT refunds.
- Continue to lower the VAT registration threshold (conditional upon the capacity of the tax administration to bring more VAT payers into the system).
- Consider implementing additional VAT simplification measures such as a VAT flat-rate scheme.
- Review the VAT exemption for goods imported by individuals 'not for entrepreneurial purposes', which may incentivise avoidance in its current form.

Strengthen VAT compliance

- Continue to adapt the VAT rules to increasing digitalisation and online sales. This reform will broaden the VAT base by ensuring the taxation of inbound digital supplies, in line with the OECD International VAT/GST Guidelines.
- Consider making digital platforms liable for the VAT on sales by online traders.
- Consider adopting new tools to tackle sales suppression and invoice falsification.

Excise, property and carbon taxes

- Consider partly financing healthcare with excise duties on alcohol and tobacco.
- Raise additional tax revenues from recurrent taxes on residential immovable property in the medium-run; develop a fiscal cadastre and record information related to the market values of property and make the information available for tax purposes.
- Envisage the introduction of a carbon tax and increase environmentally-related tax rates.

4.1. To finance the NOD, PIT revenues could be raised through a broad and progressive PIT

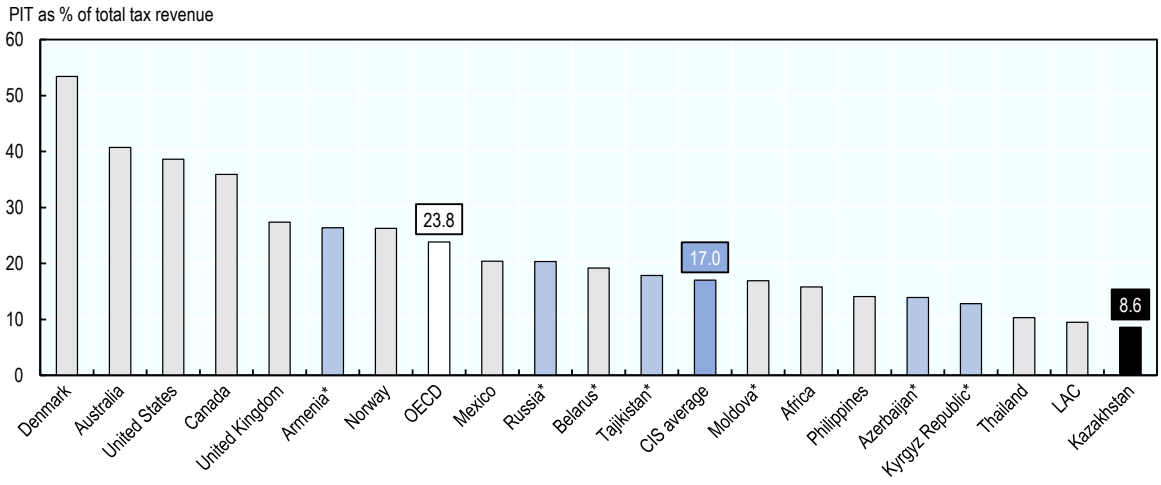
There may be scope to finance the NOD by raising the currently low levels of PIT revenues. The PIT-to-GDP ratio in Kazakhstan is 1.4%, which is low compared to the OECD average of 8.2%. As discussed, the non-oil budget deficit (NOD) could remain at as high as 6% by 2025 (under moderate revenue and expenditure conditions). In order to finance this deficit, Kazakhstan could consider modestly increasing the PIT-to-GDP ratio in the direction of the OECD average. This could for example be done by increasing the PIT-to-GDP ratio by between 1 to 2 percentage points to reach approximately 3% of GDP between now and 2025. Such a PIT-to-GDP level would still be significantly less than half of the OECD average.

4.1.1. Personal income tax revenues are low

PIT as a share of total tax revenues are low. Taxes on the income of individuals are low in Kazakhstan, making it an outlier relative to international and regional comparison countries. Low PIT revenues reflect low incomes in Kazakhstan (discussed in 2.1.2). PIT accounted for 8.6% of tax revenues in Kazakhstan in 2017, below the OECD average of 23.8% and the CIS average of 17%. In Kyrgyz Republic, Azerbaijan and Russia for example the PIT share is higher than in Kazakhstan.

Figure 4.1. Taxes on individuals are low by international and regional standards

PIT as a % of total tax revenues, selected countries including from OECD and CIS, 2017



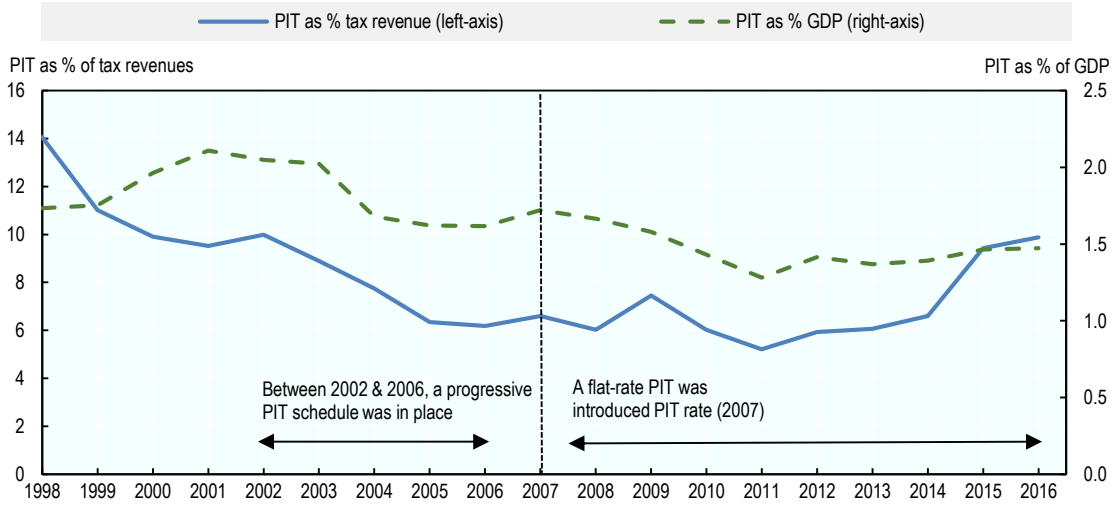
Note: CIS data other than Kazakhstan relate to 2015. CIS average based on countries shown in chart only. Data for Australia, Canada, OECD relate to 2016. Africa relate to 2015. For non CIS countries, PIT refers to 1100 Taxes on income, profits and capital gains of individuals.
Source: OECD revenue statistics; data on CIS countries from State Revenue Committee of Kazakhstan.

PIT revenues have been declining slowly in recent decades. Over the period 1998 to 2016, PIT revenues as a share of GDP have declined slowly. More recently, and since 2012, PIT revenues have plateaued at a rate of just below 1.5% of GDP. While a greater degree of volatility is seen in PIT as a share of total revenues, this arises largely due to the associated volatility in total tax revenues. During the period 2002 to 2006, when a four-bracket progressive PIT was in place with rates ranging from 5% to 30%, PIT as a share of tax revenues declined (Institute for Economic Research in Kazakhstan). The current flat PIT rate system was introduced in 2007. However, in the years immediately prior to and after 2007, PIT as a

share of tax revenues remained relatively flat indicating that the new system might have had little discernible impact on tax revenues (discussed further below).

Figure 4.2. PIT revenues have been declining slowly over time

PIT revenues as a proportion of tax revenues and GDP in Kazakhstan, 1998 - 2016



Source: OECD revenue statistics.

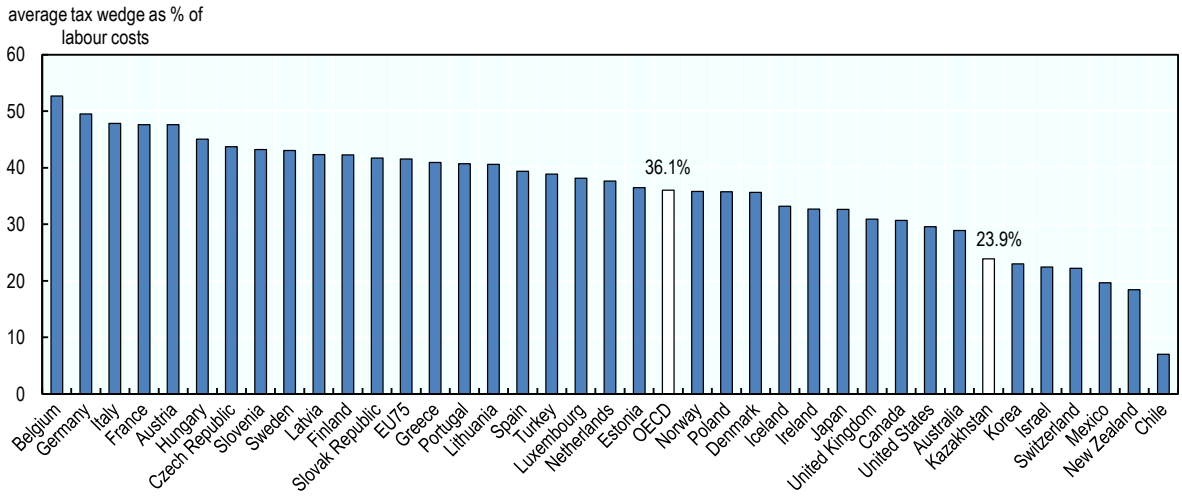
4.1.2. The effective tax burden on labour income remains relatively low

The implicit tax rate on labour is similar to the lowest rate countries in the EU. The effective tax burden on labour can be approximate in various ways. One method is the implicit tax rate (ITR) on labour, which is an overall aggregate indicator used in the national accounts. The ITR is a so-called back-ward looking indicator as it uses information from the past. The ITR on labour can be defined as taxes and SSCs on employed labour income divided by total compensation of employees and payroll taxes. Under the OECD revenue statistics definition, payroll taxes are largely comprised of the social tax in Kazakhstan[1] In Kazakhstan the ITR on labour is 24.5% in 2018.[2] The ITR on labour in Kazakhstan is similar to some of the lower rate countries in the EU such as Bulgaria and Malta (24.3% in both) and the United Kingdom (25.9%) in 2017 but lower than the EU-28 average which was 36.3%.

Forward-looking tax wedge indicators confirm that the average tax burden on labour income in Kazakhstan remains significantly below the average in the OECD. A further way to measure the effective burden on labour is to estimate the average tax wedge, which is a forward-looking indicator that models the combined effect of tax rates and rules (including SSCs) for workers who earn a particular income. The tax wedge can be defined as PIT, total SSCs and payroll tax as a proportion of labour costs (where labour costs is gross income plus employer SSCs plus payroll taxes). The tax wedge differs from the ITR in that it includes employer SSCs in the denominator and does not use National Accounts information but makes assumptions on the income that is earned by the worker.

Figure 4.3. The average tax wedge on labour income in Kazakhstan remains relatively low compared to the OECD average

Tax wedge, single person at 100% of average earnings, 2018



Note: Using 2018 payroll data from the State Revenue Committee, the tax wedge in Kazakhstan is calculated as follows: *(PIT + payroll tax + total SSCs) / (payroll fund + payroll tax + total SSCs x 59%)*. Since total SSCs paid are not disaggregated into employee and employer in the data, employer SSCs are estimated at 59% of the total (which reflects the SSC rate ratio between employer and employees).
Source: OECD Taxing Wages; State Revenue Committee.

4.2. New PIT reforms are being introduced that will narrow the PIT base

4.2.1. Key design features of the PIT

Personal income tax is levied on a worldwide basis in Kazakhstan, which means that residents are taxed on their worldwide income. Non-residents are subject to tax only on their income sourced in Kazakhstan. This is the most common system internationally (Shum, Fay and Man Ching, 2017[1]).

The flat-rate PIT system has not altered PIT revenues in the years immediately following its introduction. Having previously had a progressive PIT rate system, Kazakhstan shifted to a 10 percent flat PIT rate in 2007. A main rationale for the reform was to simplify the PIT system. Based on a simple visual inspection of PIT revenues over time, the flat-rate reform does not appeared to have significantly altered PIT revenues in the immediate years following its introduction. However, there are challenges to drawing causal interpretations from a simple before and after inspection of PIT revenues. To illustrate this with an example, in 2001 Russia replaced its higher PIT rates with a flat PIT rate of 13% and PIT revenues increased by 26% in the following year. However, an econometric analysis of the reform demonstrated that the PIT revenue increase was not attributable to the flat-tax reform but rather to other changes occurring at the same time such as measures that strengthened the capacity of the tax administration (Ivanova et al., 2005[2]).

Similar to most OECD countries, a minimum amount of income is exempt from PIT through a personal basic allowance. The main personal allowance for employment in Kazakhstan is the basic allowance, which allows employees to deduct one Minimum Monthly Salary (MMS) from gross income each month. The total amount of tax deduction per year must not exceed 12 MMS (USD 1 315) over a

calendar year. While this structure suits employees who have a consistent regular monthly income, it may penalise employees who have no income in some months of the year.

The basic allowance is high having been increased recently. The amount of the allowance has been increased in recent years along with increases in the MMS. The MMS increased moderately between 2016 (KZT 22 859) and 2018 (KZT 28 284) before increasing sharply in 2019 (KZT 42 500). The rate of increase has outstripped inflation. For example, on average between 2016 and 2019, the basic allowance increased by 20% annually while inflation was 8.4% annually over the same period.[3] The current basic allowance is relatively high, and represents about one-quarter (26%) of the mean wage, half (52%) of the median (KZT 82 977) or one-fifth (18%) of the top 10% of employment incomes.[4]

4.2.2. Proposed PIT reforms

Plans exist to introduce an end-of-the year tax declaration for individuals, which would align the administration of the PIT with common practice in the OECD. In recent years, the authorities have announced plans to introduce an end-of-the-year tax declaration whereby the tax administration would add all sources of income earned throughout the year to determine the individual taxpayer's end-of-the-year tax liability. The taxes that are withheld during the year would be deducted from the final tax liability and individual taxpayers would be required to pay the remaining tax liability to the tax administration or they would receive a tax refund in case too high taxes have been withheld during the year.

However, the proposed plans have been repeatedly delayed. Most recently, the end-of-the-year tax declaration was due to be introduced in 2020. However, its introduction has since been delayed until 2025. While an end-of-the-year tax declaration increases the burden on the tax administration and, therefore, requires strengthening the capacity of the tax administration, the reform would bring many advantages. Government should therefore implement the necessary measures such that the end-of-the-year tax declaration can be introduced as soon as possible. This will involve strengthening the capacity of the tax administration and in particular its IT system as well as hiring and training the staff of the tax administration to successfully perform the new tasks.

An end-of-the-year tax declaration is a necessary condition for the PIT to play its key role in the tax system. The introduction of the general tax declaration is a necessary foundation for any successful introduction of a progressive PIT rate schedule, as it will allow applying the progressive rate schedule on the combined sources of income earned throughout the year. In addition, the reform would allow government to achieve broader objectives by using the tax system (e.g. through the introduction of measures to alleviate the burden on families with children). The general tax declaration will complement third-party reporting and the current withholding tax system, which should be maintained.

4.3. Towards a progressive PIT system to enhance fairness

4.3.1. General PIT reform considerations

Broadening the tax base is preferable to increasing tax rates. Broad tax bases and low tax rates is considered best tax policy; the arguments have been well documented in other reports and will not be repeated here. In countries with somewhat high informality such as Kazakhstan, raising revenues through tax rate increases comes with additional risks. In Kazakhstan, 90% of PIT comes from employees with only 9% from self-employed, despite widespread self-employment, indicating possibly high informality (according to research from the Institute of Economic Research in Kazakhstan). Raising tax rates on the formal sector would reinforce the distortions between the formal and the informal economy; it would strengthen the incentives for businesses and workers to operate in the informal economy. In contrast, broadening the tax net to a larger number of taxpayers makes it possible to collect more revenues while avoiding that tax rates would have to be increased on the formal sector. Informal workers, defined as those

who do not pay SSCs and unregistered self-employed, account for 20% of total employment in the country by some estimates (OECD, 2017[3]). A discussion on the general consequences of informality are provided in Box 4.2.

Kazakhstan could turn its basic tax allowance into a tax credit. Many OECD countries have replaced their tax allowances with tax credits. The main argument in favour of tax credits, which are deductible from tax liability (unlike tax allowances, which are deductible from taxable income), is that the value of tax credits is independent of income while the value of tax allowances is increasing in the taxpayer's marginal tax rate if PIT rates are increasing with higher incomes. Therefore, unlike tax credits, tax allowances typically benefit those on higher incomes more. If Kazakhstan introduces a progressive PIT system, discussed later in this Chapter, it could simultaneously turn its basic allowance into a tax credit to support fairness across the income distribution.

Box 4.2. The consequences of informality

Informality generates greater inequality. Workers employed in the informal sector have limited access to social protection, relatively lower wages and are vulnerable when they lose their job or retire. High levels of informality may also reduce workers' access to training, which can worsen skills shortages, leading to greater societal inequalities.

Informality affects productivity and growth. Informal sector production can generate inefficiencies, either because companies limit their size below their optimal efficiency scale to avoid being detected or because they use outdated production technologies (Andrews, Caldera Sánchez and Johansson, 2011[4]). The relative cost advantages enjoyed by informal companies may allow them to stay in business even if they are not productive (Andrews, Caldera Sánchez and Johansson, 2011[4]). However, companies operating in the informal sector also have a more limited access to finance which constrains investment and to qualified labour.

Informality reduces tax revenues. In addition to informal workers not paying taxes, many may also receive social benefits, adding to the state fiscal burden. In Kazakhstan, the informal sector tends to have low incomes however which means that the tax revenue loss is likely to be limited.

Informality erodes trust. Finally, high levels of informality, when observed by formal workers, can result in an erosion of trust in public institutions and result in lower tax morale, which may lower revenues through other channels. Importantly, the larger the informal sector, the more incentives people have to remain or become informal, particularly if there is a view among some that the informal sector is tolerated.

Source: OECD analysis.

4.3.2. After the new PIT reform of 2020, a significant numbers of low-income earners will pay little to no PIT

A new reform will exclude 90% of taxable income for low-income taxpayers. To reduce the tax burden on low-income employees, Kazakhstan introduced a new reform in 2020 that will exclude 90% of taxable income from PIT for employees with gross income up to 25 MCI (or KZT 63 125). Those on higher gross incomes above the threshold do not benefit from the income exemption. This tax exemption comes on top of the relatively high basic tax allowance as well as the deduction of pension contributions from taxable income; both measures together imply that taxpayers with monthly gross income up to KZT 48 000 do not pay PIT.

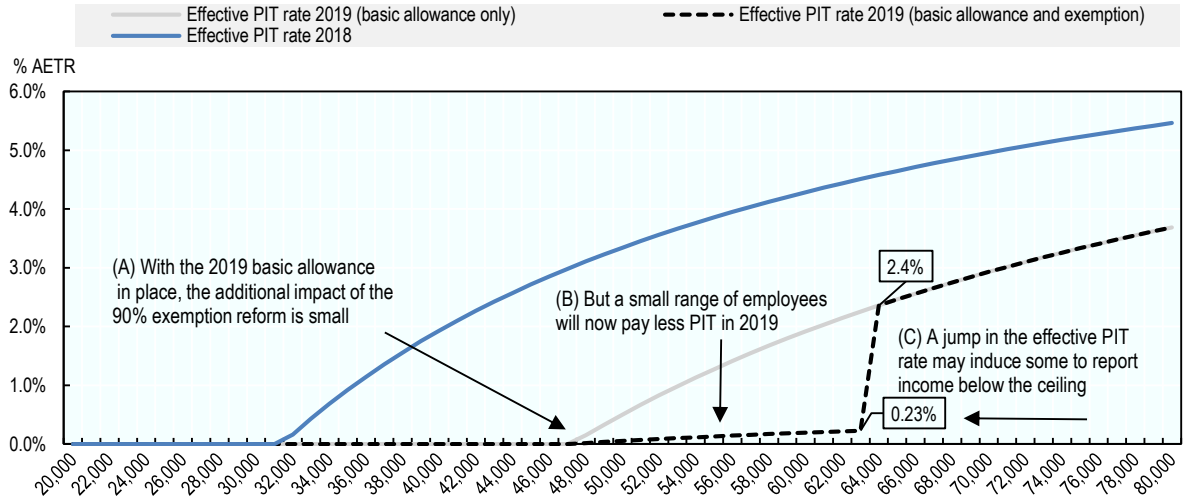
The reform reduces average effective PIT rates significantly, but albeit for a narrow-range of incomes only. The reform implies that an employee with income of KZT 63 125 will pay an effective average PIT rate (on gross income) of one-fifth of one percent (0.2%). The tax due and effective tax rates are calculated by first taking into account the deduction for the pension contributions and the basic tax allowance; the remaining taxable income is then reduced by 90%. For example, gross income equal to KZT 63 125 will be first reduced with the 10% obligatory pension contribution (KZT 6 312), and then with the basic tax allowance (KZT 42 500). The remaining taxable income of KZT 14 312 will be reduced by 90% to KZT 1 431 and then the 10 percent PIT rate is applied. This results in an average effective tax rate of about 0.2%. Figure 5.4 shows that the reform will only affect the effective PIT rate for a small band of employees with incomes between KZT 48,000 and KZT 63 125, as workers with monthly gross earnings below KZT 48 000 do not pay PIT as a result of the deduction of pension contributions and the basic tax allowance. As a result, the reform is likely to affect roughly 11.2% of employees, based on the limited picture that grouped distributional data can provide.

The reform might be distortive. Unlike in the case of increasing the basic allowance, the reform to exclude 90% of taxable income for low earners exempts a large part of income from PIT for low-income workers without giving any tax reduction to those on higher incomes. Therefore, relative to other reforms options such as the basic allowance,[5] the reform is more equitable because it provides no advantage to those on higher incomes. However, it is relatively less efficient because of its potential to distort behaviour because it produces a high marginal effective tax rate (METR) at the ceiling of KZT 63 125, which reduces the incentive for taxpayers to earn more income beyond that point.

The reform may incentivise employees to keep income below the maximum ceiling and to have multiple jobs to reduce PIT liability. The reform to exclude 90% of taxable income for low earners will produce a change in the effective and marginal effective PIT rates above and below the 25 MCI ceiling (Figure 4.4). For example, an employee earning KZT 63 000 will pay KZT 142 while an employee earning an additional KZT 1 000 (KZT 64,000) will pay more than ten times the PIT (KZT 1 510). From an incentives perspective, this encourages employees to report income just below the threshold, known as 'bunching'. This could occur for example if the taxpayer did not declare income past this amount (for instance by working part-time in the informal economy). It could also occur through a reduced incentive for employees to work more hours or find better-paid employment. Many countries have found evidence of individual taxpayers and companies 'bunching' below points of discontinuity (kinks or notches) in tax systems (Boonzaaier et al., 2017[5]) (Kleven, 2016[6]). However, despite the large jump in the tax rate at the threshold, the overall actual amount of PIT paid remains small relative to income, which may limit the extent of this effect. Furthermore, if the reform applies separately across jobs, it may incentivise employees to take two jobs at incomes below the threshold to avail of a lower PIT liability.

Figure 4.4. The reform may encourage some employees to report income below the ceiling

Average effective PIT rate in 2018 and 2019 by income threshold



Note: Analysis is based on reducing gross income by the 10% pension contribution and then the basic allowance at all income levels. The basic allowance is KZT 28 284 and 42 500 in 2018 and 2019 respectively.
Source: OECD analysis.

The standard approach to increasing PIT progressivity would be to replace the flat PIT rate with a progressive PIT rate schedule where higher tax rates in higher taxable income brackets. Most OECD countries apply progressive PIT rate schedules. Indeed, the PIT is the main source of progressivity in the tax system in most OECD countries. The advantage of a progressive PIT schedule reform is that it could increase progressivity and PIT revenues simultaneously by increasing PIT on the highest earning employees while at the same time preventing peaks in marginal effective tax rates, as is the case with the 90% taxable income exemption in Kazakhstan. The introduction of a PIT rate schedule would need to go hand in hand with the end-of-the year tax declaration, as pointed out above. In the short run, Kazakhstan could consider replacing the 90% exemption of taxable income for low-income workers with an additional tax allowance that would be decreasing for higher incomes. If well designed, such an additional tax allowance would reduce tax liabilities for taxpayers that benefit from the 90% exemption but, as it tapers out for higher incomes, would avoid the sharp peak in effective tax burden at the eligibility threshold.

4.3.3. Simulating the introduction of a progressive PIT rate schedule

This section produces various simulations to estimate the potential impacts of PIT rate and base changes in Kazakhstan. The analysis will evaluate the introduction of alternative PIT reforms. The analysis is for illustrative purposes. It could have been carried out for alternative designs of the PIT rate schedule.

The analysis is based on the grouped monthly income distribution data for the year 2017, shown previously in Figure 2.5. To recap the summary statistics from these data, the mean income is KZT 16 673 (USD 423), the top 10% is KZT 236 350 (USD 615) and the bottom 10% is KZT 27 235 (USD 71). For the purposes of the analysis, the number of employees is based on data from a study by the (Institute of Economic Research, 2018[7]), which shows that there are 8.6 million employees in 2017.

The simulation analysis is based on a number of methodological steps. The methodological approach taken involves the estimation of monthly average incomes, the calculation of effective PIT rates and finally the estimation and evaluation of total PIT paid. These are described in turn below.

1. ***Estimation of monthly average gross and taxable incomes.*** First, a midpoint monthly income is calculated for each income category (for example, KZT 82 500 is approximately the midpoint of KZT 75 000 and KZT 90 000). Total monthly income in each category is estimated by multiplying the midpoint income by the number of employees. For example, 9% of employees have monthly income between KZT 20 000 – 30 000, so assuming all employees earn the midpoint income in this range of KZT 25 000 and then multiplying by 12 months gives annual income of KZT 237 million for all of the employees in that particular income category. Total annual income is estimated by following the same approach across all categories and summing them together. Next, average monthly taxable income is calculated at each category by subtracting the obligatory pension payment (10% of gross monthly income) and the basic allowance from the monthly gross income.[6]
2. ***Calculation of effective PIT rates.*** The effective PIT rate is calculated at each income category by applying the progressive PIT rates and brackets to the midpoint monthly taxable income. For example, applying the progressive rate schedule and brackets from Table 4.1, the employee will pay PIT of 1% on the first KZT 42 500, 10% on the next KZT 57 500 up to KZT 100 000 and so on. The same approach is applied to all income categories to give new estimates of PIT and the effective PIT rate at the employee level.
3. ***Estimation and evaluation of total PIT paid.*** Finally, to estimate total PIT paid in Kazakhstan in each income category, the calculated effective PIT rate for the hypothetical employee is applied to the estimate of total annual income. This modelling approach can be evaluated by comparing estimated and actual PIT revenues. Applying the flat PIT rate to total taxable income gives a total PIT estimate of KZT 784 817 million, which is less than actual PIT of KZT 838 394 million in 2017 (based on data from the State Revenue Committee).

A number of modelling scenarios are considered. The simulation analysis is used to model the potential impact of various reforms on effective tax rates and tax revenues. The modelling scenarios considered include the following:

- The level of the basic allowance and the impact of the 90% taxable income exemption;
- Increases in the flat PIT rate from 10% to 15% and 20%; and
- The introduction of a progressive PIT rate schedule shown in Table 4.1.

Table 4.1. Simulated PIT rate schedule (monthly gross income)

Bracket (KZT)	Progressive PIT schedule
Bracket 1 (up to 45 000)	5%
Bracket 2 (455 00 – 100 000)	10%
Bracket 3 (100 000 – 200 000)	15%
Bracket 4 (200 000 – 300 000)	20%
Bracket 5 (300,000 and above)	25%

Source: OECD analysis.

The simulation analysis comes with caveats due to limited data. The simulation analysis presented has several caveats. First, from an analysis perspective, the precise income of individuals was not available to the authors and it is assumed that taxpayers in each category earn the midpoint monthly income. This assumption means that the PIT simulation are based on an approximate rather than actual income distribution. For example, the broad nature of the grouped distribution data mean that small changes in the effective rate, for example related to bunching activity, should be interpreted with considerable caution. The analysis also assumes no behavioural change arising as a result of the tax rate changes. In addition, the analysis is restricted to employees (self-employed are not included) and consideration is not given to

SSCs and allowances other than the basic allowance and compulsory pension contribution. Notwithstanding these methodological limitations, the averages calculated based on the grouped data are similar to the actual averages in the distribution. For example, the mean monthly income based on the grouped mid-point income data is KZT 174 000, which is similar to the actual mean of KZT 162 673. Overall, the approach provides suggestive but not conclusive evidence of the likely direction and magnitude of PIT revenues arising from moving towards a progressive income tax schedule.

Kazakhstan could consider developing a microsimulation model to cost reform proposals. Kazakhstan could consider developing a microsimulation for individuals by combining individual-level tax return, SSC and survey data. Such a simulation model would have the potential to rigorously cost different PIT and SSC reform options along with the likely distributional impacts.

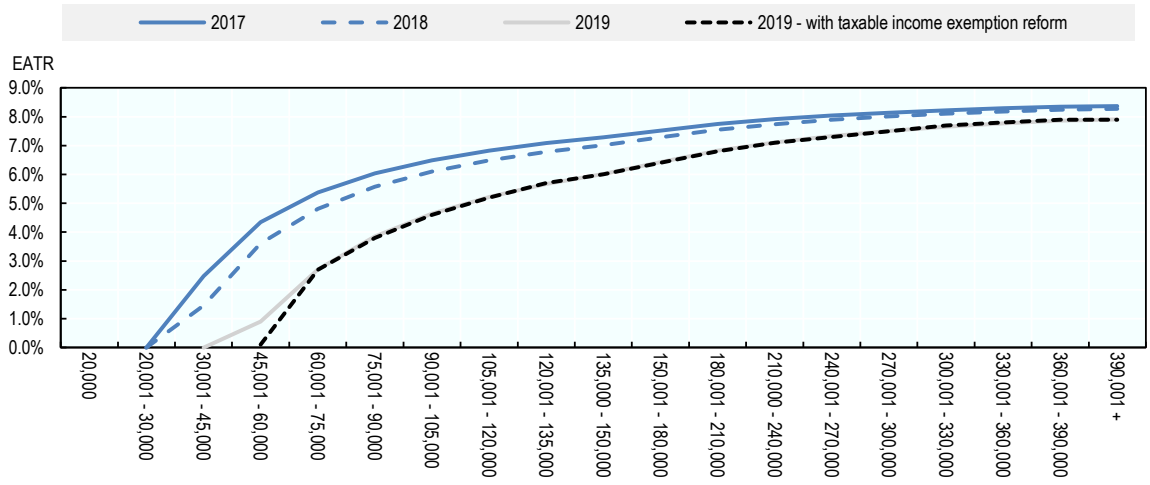
The increased basic allowance has reduced effective average tax rates for all taxpayers

The increased basic tax allowance reduces the effective tax rate on all employees. In general, basic tax allowances are regressive in the sense that all taxpayers benefit from them. In particular, taxpayers that face higher marginal statutory tax rates benefit more in nominal terms. Figure 4.5 shows the simulated average effective PIT rate across the income distribution based on increases in the basic allowance in 2017 (when it was KZT 24 459), 2018 (KZT 28 284), 2019 (KZT 42 500) and finally in 2019 including the both the basic allowance and the 90% taxable income exemption. For each of these four scenarios, the results show that the overall average effective PIT rate across the distribution falls from 7.60% to 7.40% to 6.75% to 6.73% respectively. The increased basic allowances in 2018 and 2019, but particularly in 2019, had the largest impact on reducing the overall effective PIT rate. The increased basic allowances also have the general effect of shifting the effective PIT rate downwards across the distribution but not changing the shape of the distribution by too much. It can also be seen that the average effective PIT rate increases with higher incomes – in 2019 for example, the average effective PIT rate ranges from 1% at low incomes up to 7.9% at higher incomes[7]. Overall, the increased basic allowance will reduce PIT paid and increase the take-home pay for all employees while also increasing the point at which employees begin to pay PIT.

Increases in the basic allowance have eroded PIT revenues. Figure 4.6 simulates the PIT revenue reduction associated with increasing the basic allowance in 2018 and 2019 relative to the 2017 basic allowance scenario (i.e. taking into account the flat 10% PIT rate). The results are shown for each of the selected income brackets shown in Table 4.1. Overall, relative to the 2017 basic allowance scenario, the PIT revenue loss associated with the 2018 allowance, the 2019 allowance and finally the 2019 allowance plus the 90% taxable income exemption is estimated to be about 4%, 19% and 20% of total 2017 PIT revenues, respectively.

Figure 4.5. The increased basic allowance reduces the effective tax rates on all taxpayers, not just those on low incomes

Estimated average effective tax rate changes arising from increased basic allowance between 2017 and 2019



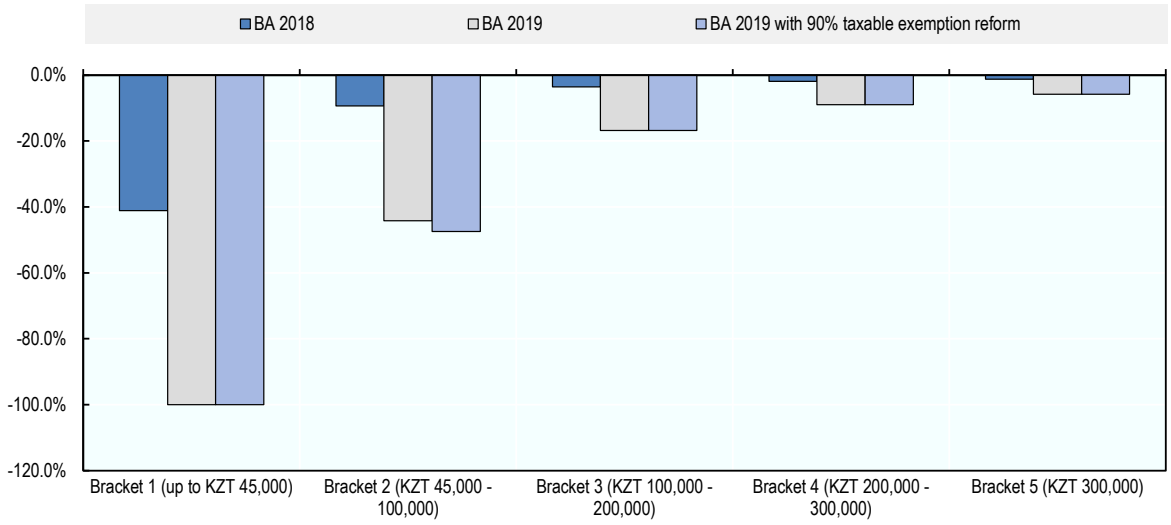
Note: Deductions other than those mentioned are not considered for the purposes of the analysis. The broad nature of the grouped distribution data mean that small changes in the effective rate should be interpreted with caution, for example related to bunching activity.
Source: OECD analysis of data from the authorities.

The increased basic allowance narrows the PIT base by removing millions of low-income taxpayers from the PIT net. The effects of introducing the basic allowance are likely to be substantially different across the income distribution and the selected income brackets shown in Table 4.1. Based on the 2017 allowance, some low-income taxpayers in the first bracket (up to KZT 45 000) would have previously paid some PIT. The simulation shows that the combined effects of the increase in the basic allowance in 2018 and 2019, plus the taxable income exemption reform, fully reduce PIT revenues from those earning less than the lowest bracket of KZT 45 000 and further reduce PIT revenues by over 40% from those in the second bracket. In the third bracket, where some 40% of all PIT is paid based on the distribution data, the simulation analysis indicates that there could be a further 16% revenue loss.

The increased basic allowance will blunt the impact of the new taxable income exemption reform. Of the recent basic allowance increases, the 2019 allowance produces the largest PIT loss (Figure 4.6). The analysis also show that once the 2019 basic allowance is in place, the additional impact of the 90% taxable income exemption reform is minimal because many of the same low-income taxpayers are already benefiting from the substantial increased in the basic allowance, as pointed out before.

Figure 4.6. Recent reforms will significantly reduce PIT revenues

Estimated cumulative loss in PIT revenues (base scenario is basic allowance for 2017) taking into account the income distribution in 2017



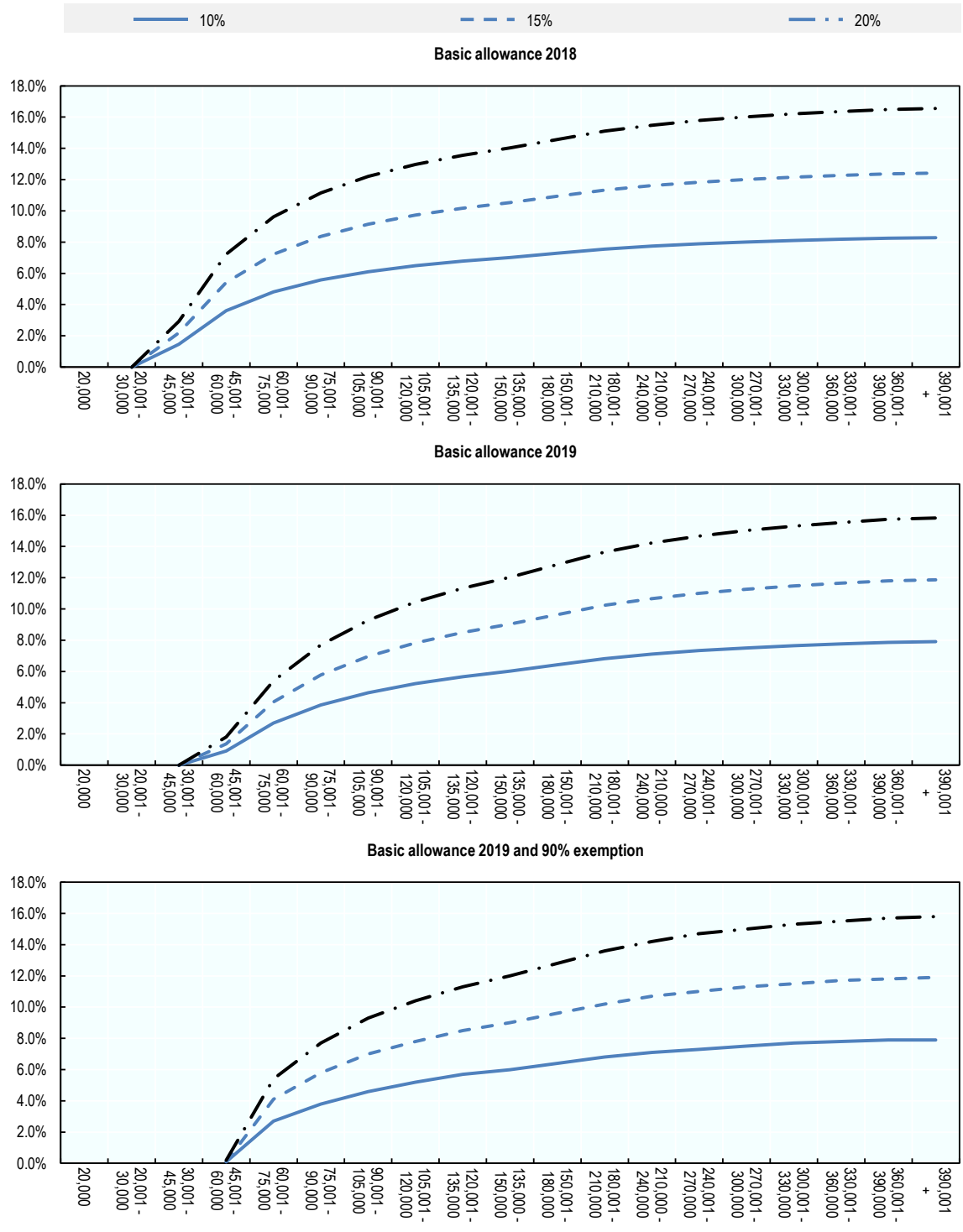
Note: Deductions other than those mentioned are not considered for the purposes of the analysis.
Source: OECD analysis of data from the authorities.

Introducing a new progressive PIT system could increase PIT revenues while supporting equity

Increasing the flat PIT rate would increase the tax burden across the income distribution. Figure 4.7 shows simulations for different flat-tax rates of 10%, 15% and 20% under the 2018 basic allowance, the 2019 basic allowance and the 2019 basic allowance under the taxable income exemption. First, and as expected, for all levels of the basic allowance, increasing the flat PIT rate to a higher 15% or 20% will have the effect of increasing the tax burden across the income distribution thereby increasing PIT revenues. Second, the analysis highlights how a combined flat rate and basic allowance produce progressivity in the PIT system, as is already the case in Kazakhstan. Third, and as demonstrated in Figure 4.5, the effect of the increased allowance in 2019 and the 90% taxable income exemption in excluding increasingly larger shares of taxpayers from the PIT net can also be seen by looking across the three graphs in Figure 4.7.

Figure 4.7. Flat PIT rate simulations

Simulations of EATR under different flat PIT rates and basic allowances and exemptions



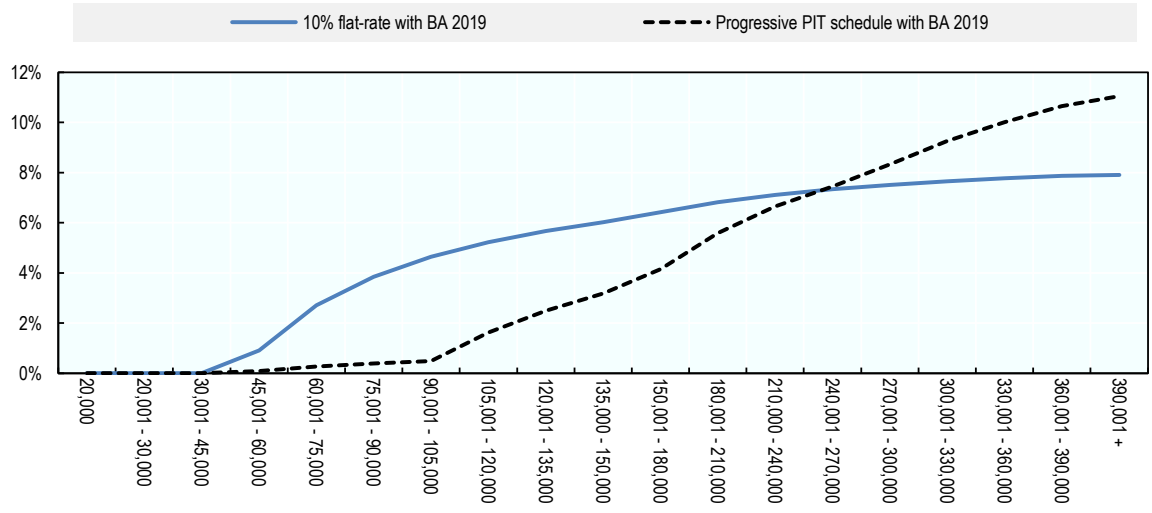
Source: OECD analysis of data from the authorities.

Introducing a progressive PIT rate schedule could increase progressivity by shifting the tax burden from lower to higher income employees. Under the current system in Kazakhstan, the flat PIT rate, basic allowance and the 90% taxable income exemption effectively produce progressivity in the PIT system while exempting low-income taxpayers from paying any PIT. However, an alternative approach is also possible. Figure 4.8 shows a proposed progressive income tax schedule based on a rate schedule of 5%, 10%, 15%, 20% and 25% (shown in Table 4.1), while maintaining the basic tax allowance at its 2019 level of KZT 42 500. The analysis shows that, compared to the current flat-rate system, a progressive PIT rate schedule has the potential to further shift the tax burden from lower to higher earners while maintaining PIT revenues at about the same level (assuming no behavioural change).

Figure 5.9 shows that the increase in PIT revenues from the second-highest and highest income **brackets**, those with incomes between KZT 200 000 and KZT 300 000 and in excess of KZT 300 000 respectively, could be as much as 12% and 42% respectively relative to the current flat rate with the basic allowance. Taxpayers that fall in the third bracket would on average pay less PIT because the low 5% PIT rate (instead of the 10% flat rate) in the first tranche of taxable income reduces their tax liabilities more than the higher 15% PIT rate in bracket 3.

Figure 4.8. Introducing a progressive PIT rate schedule could increase progressivity while maintaining current levels of PIT revenues

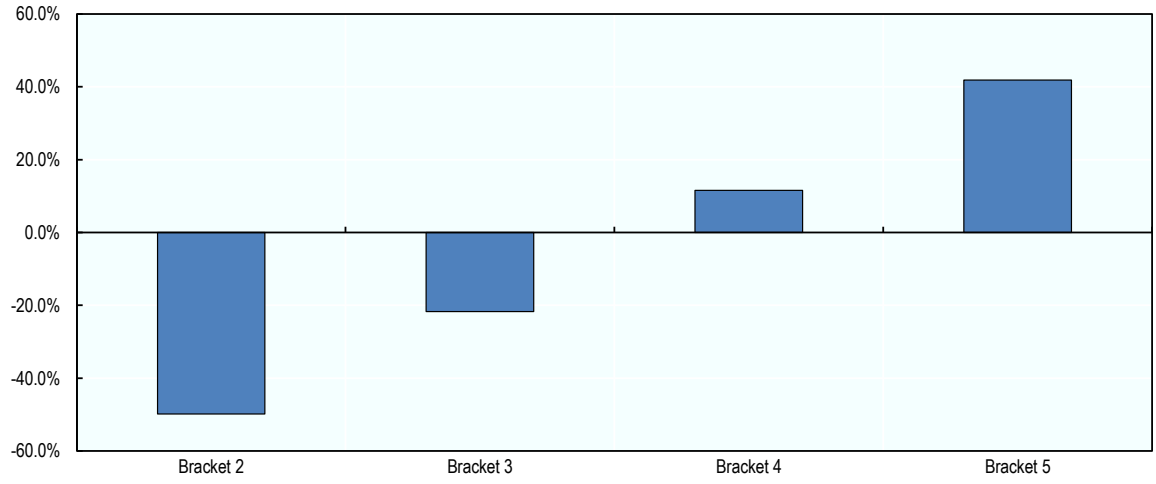
Estimated average effective tax rate changes arising from a progressive PIT rate schedule



Note: The broad nature of the grouped distribution data mean that small changes in the effective rate should be interpreted with caution, for example related to bunching activity.
Source: OECD analysis of data from the authorities.

Figure 4.9. A progressive PIT schedule would shift the tax burden from lower to higher earners

Estimated change in PIT revenues from a progressive PIT rate schedule (base scenario is current flat-rate with basic allowance 2019)



Note: The first bracket is not shown for the purposes of a percentage comparison because the first bracket ceiling is set at KZT 42,500 at which point no PIT is paid in the base scenario because of the basic allowance.
Source: OECD analysis of data from the authorities.

Before implementing a progressive PIT system, limitations and risks should be addressed including the introduction of the universal tax declaration to allow full visibility on the incomes of all citizens. There are however several challenges with regard to moving to a progressive PIT system in the short-term given the current income distribution in Kazakhstan. For example, a study by the Institute of Economic Research shows there is a significant 33% of workers classified as 'working poor' in Kazakhstan in 2017 and there is a large gap between the minimum and median wage. In addition, research on the possible transition to a progressive PIT system highlights potential risks including a reduction in local budget revenues with low wages, increased costs for tax administration and tax evasion (Alpysbaeva et al., 2020[8]). As mentioned earlier, greater clarity on the extent of these challenges could be gained through the development of a PIT microsimulation model using individual-level tax return data. Therefore, the transition to a progressive PIT system should be considered over the medium-term and not before these risks and limitations are understood and addressed.

Kazakhstan may also want to re-evaluate the rules that define when an individual is resident for income tax purposes. According to article 217 of the Tax Code, tax residents are individuals who permanently reside in Kazakhstan or who non-permanently reside in the Republic of Kazakhstan but whose centre of vital interests is located in Kazakhstan. The rules that define the latter conditions, in particular regarding the ownership of immovable property, might have to be revised and aligned with international best practice. An in-depth analysis is left for further work

4.3.4. Personal investment income is mostly exempt from tax in Kazakhstan

Many common forms of personal capital income are exempt from tax in Kazakhstan and where personal capital income is taxed, tax rates are low. Personal capital income is largely exempt from tax in Kazakhstan because of a generous set of exemptions for income generated in the form of dividends, capital gains and interest. Capital gains from the sale of shares of Kazakh companies are exempt provided the shares are held for 3 years or more and the company fulfils certain criteria. In addition, government securities, government bonds, and shares officially listed on a Kazakhstan stock exchange are exempt

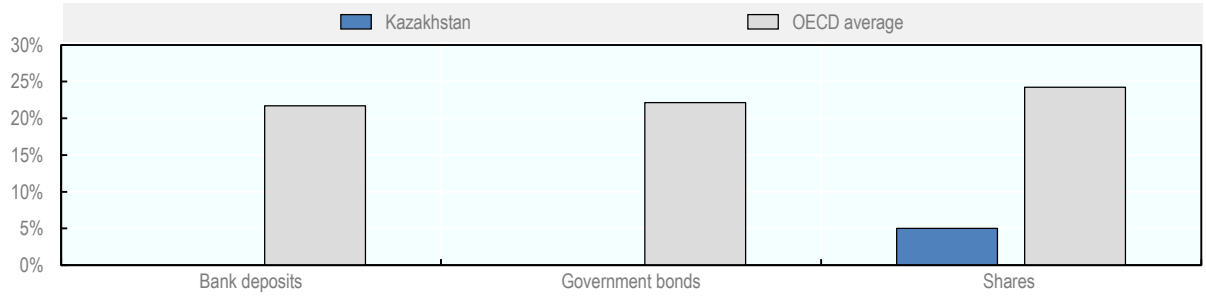
from capital gains tax. Interest from shares issued by government are exempt from taxes on income, as are interest on bank deposits and debt securities. Where personal capital income is taxed, the rates are low. For example, the dividend tax rate for residents is only 5% and the capital gains tax rate is 10%.

Low effective tax on personal capital income may distort behaviour and create avoidance opportunities. As capital income is taxed at low and often zero effective rates, it is taxed more lightly than labour income and the difference is larger for high-income employees whose labour income is taxed at relatively higher effective tax rates. This could create economic distortions and raises questions of equity, particularly for low-income taxpayers who may be less likely to generate capital income. This may provide an incentive for an employee to setup a company in a non-subsurface area and pay themselves through untaxed dividends.

Compared to OECD countries, marginal effective tax rates (METRs) on savings in Kazakhstan are low. The OECD calculates METRs on household savings to assess the impact of a wide range of taxes and tax design features on the incentives to save in different assets (OECD, 2018[9]). The METR calculations take into account a range of taxes levied on household savings, deductions and variations in the tax base, different asset holding periods and the potential build-up of untaxed or tax-deferred returns. METRs also incorporate the impact of inflation, which can impose a substantial additional tax on the return to savings. Figure 5.10 presents METRs on bank deposits, government bonds and shares in Kazakhstan compared to the unweighted OECD average. Due to differences in average rates of inflation between Kazakhstan and OECD countries, inflation is set to zero to improve comparability. The exemption of common savings vehicles from personal income taxation discussed above results in an effective tax rate of zero across most savings vehicles. Even when the holding period for shares does not reach the 3 years required for a tax exemption, the marginal effect tax rates in Kazakhstan are low compared to the OECD average.

Figure 4.10. Marginal effective tax rates on savings in Kazakhstan are low

Marginal effective tax rates (METR), 100% of the average wage, inflation 0%; interest rate 3%; holding period 6 months



Note: Inflation is 0%; real interest rate is 3%; holding period is 6 months.
Source: OECD modelling based on (OECD, 2018).

Taxes on personal capital income could be increased by expanding the tax base and introducing a single flat rate on all forms of capital or a progressive rate alongside a progressive PIT rate schedule that applies to labour income. The taxation of personal capital income varies substantially in OECD countries. Some countries tax all personal capital income at a flat rate and wage and pension income at progressive rates (dual income tax systems) and other countries tax all or most capital income together with labour income at a progressive PIT rate schedule (comprehensive income tax systems) (OECD, 2004[10]). Given that most forms of capital income are exempt from tax, and where it is taxed rates

are low compared to OECD counties, Kazakhstan could consider expanding the capital income tax base and increasing tax rates. This could for example include removing some of these exemptions and introducing a single flat tax rate on all forms of capital income rather than the current differentiated set of rates (for example, where dividend tax rate for residents is 5% and capital gains tax rate is 10%). Alternatively, and if the year-end tax declaration and the progressive PIT rate schedule are introduced, Kazakhstan could choose to tax capital income together with labour income. A further option could be to tax capital income at a separate progressive capital tax rate schedule, where the top rates should be sufficiently high to reflect that capital income is generally earned by higher-income individuals.

Automatic exchange of information (AEOI) provides opportunities for Kazakhstan to strengthen the fairness of its tax system. Previously, tax administrations had to request information from their residents on capital income earned in other jurisdictions (exchange of information on request). Under the new automatic exchange of information rules, it has become more difficult for an individual to conceal capital income abroad and tax administrations have become more effective at verifying compliance. In the future, this could present opportunities for Kazakhstan to increase the level of taxation of capital at the individual level. However, the level of taxation of capital at the individual level is low and almost all foreign assets held by Kazakh residents is in real estate. KZT 62.2 billion is held in real estate by Kazakh residents compared to KZT 5.1 billion in shares and KZT 2.9 billion in securities according to data from the Ministry of National Economy.

4.4. Financing the welfare system through Social Security Contributions

While the current reform of the SSC system in Kazakhstan will help to raise financing for the underperforming health and welfare systems, options exist to broaden the base (OECD, 2017[11])**.**[8] The SSC-to-GDP ratio is 0.5% in Kazakhstan, which is very low compared to the OECD average of 9.2%. Furthermore, SSCs account for 3.2% of total tax revenues compared to 26.2% for OECD countries. However, these figures do not take into account the employer payroll tax (i.e. the social tax). Currently in 2020, Kazakhstan is in the process of reforming its SSC system which includes the introduction of new SSCs while also increasing current SSC rates. This reform will go some way to shifting the SSC-to-GDP ratio to align more closely with the OECD average, which will provide much needed financial resources to support the underperforming health and welfare systems. The timing of the reform may be prudent given Kazakhstan's significant demographic advantage compared to many other developed and OECD countries. It has a large and expanding working-age population, which is an opportunity for the country, and the old-age dependency rate remains low and is not yet a significant challenge relative to many other countries. However, the SSC base remains narrow by design. To take two examples which are atypical internationally, pension contributions are deductible from the SSC base and pension payments can be inherited. Such policies are generous but expensive for the State. A number of alternative policy designs could be considered to increase financial resources by broadening the SSC base. Furthermore, there have been frequent and significant SSC proposed policy changes in recent years, some of which have subsequently been delayed, which produces unnecessary administrative complexity and planning challenges for individuals and businesses. Instead, Kazakhstan could benefit from less frequent but more consistent SSC policymaking.

4.4.1. Increasing the performance of the welfare system will require more financial resources

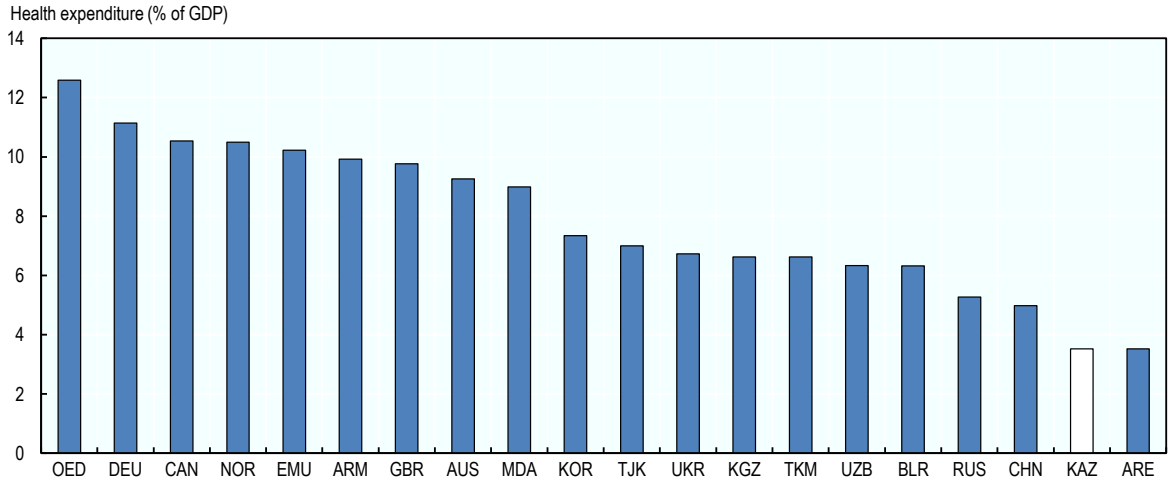
Despite becoming a policy priority in recent years, health outcomes are poor and health expenditures remain low. Health outcomes in Kazakhstan fall well short of OECD countries, with the average life expectancy more than 6 years below the OECD average. In addition, many countries with similar levels of income such as Hungary, Poland or Turkey, continue to outperform Kazakhstan on health

outcomes (OECD, 2018[12]). The average life expectancy at birth is 63.4 years in 2016, compared to an average of 69.7 for the OECD and CIS countries shown in Figure 4.11. The levels of expenditure on healthcare are low in Kazakhstan (Figure 4.12). Health expenditure as a share of GDP are 3.5% in Kazakhstan in 2016 compared to CIS countries (5.3% in Russia, 6.3% in Uzbekistan and 6.7% in the Ukraine) and 12.6% in the OECD. Moreover, public health spending is only 1.8% of GDP, thus contributing only 58% of total health expenditure, and leaving high out-of-pocket costs for patients (OECD, 2018[12]).

Healthcare, social welfare and pension system demands will rise gradually over the longer-term with demographic changes. Populations are ageing rapidly across advanced economies and many emerging market economies because of rising life expectancy and declining fertility (Colin and Brys, 2019[13]). Unlike many OECD and developed countries, Kazakhstan does not have an aging population. However, it should prepare for aging over the next decade as the number of older-people and pensioners begins to rise. Although the country has a low current old-age dependency ratio, it is expected to increase over the next decade, which will come with a rising demand for healthcare. In addition, social welfare demands are rising. Over the past 5 years, the number of recipients of targeted social assistance has grown from 77 000 to 1.4 million. The amount of funds allocated from the budget for social support since 2017 has increased more than 17 times according to the (State of the Nation, 2019[14]).

Figure 4.11. Health expenditure is low in Kazakhstan compared to CIS and OECD countries

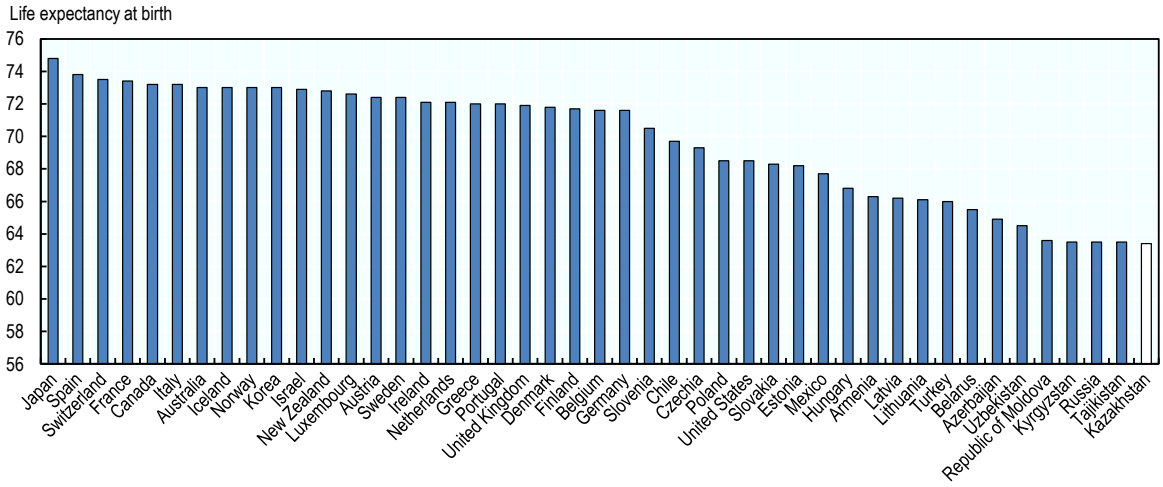
Health expenditure as a share of GDP, 2016



Source: World Health Organization (WHO) Global Health Expenditure database.

Figure 4.12. Despite economic growth, health outcomes remain relatively poor

Life expectancy at birth in OECD and CIS countries, 2016



Source: World Health Organisation, Global Health Observatory data repository.

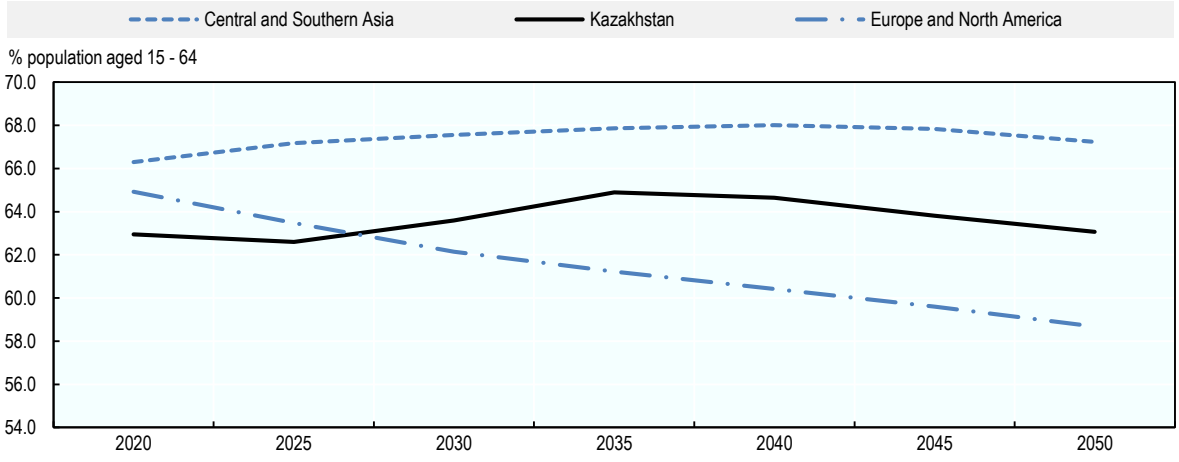
Compulsory pension contributions have been rising in nominal terms. Pension contributions have been rising in nominal terms in recent years, from KZT 597 billion (USD 1.5 billion) in 2014 to KZT 849 billion (USD 2.2 billion) in 2018, according to data provided by the authorities. However, as a proportion of GDP, pension contributions have remained more stable (1.5% of GDP in 2014 and 1.4% in 2018). 95% of all pension contributions are compulsory pension payments; the remainder is comprised of compulsory professional pension contributions (4.6%) and voluntary pension contributions (0.04%).

Kazakhstan has a key demographic advantage over many countries with its large and expanding working-age population, which is an opportunity for the country. Kazakhstan has a high proportion of people of working age in 2020, which is similar to other Central and Southern Asian economies (Figure 4.13). The proportion is also set to expand further to 64.9% by 2035 before declining back to 63.1% in 2050. This trend contrasts with Europe and North America, where the working age population is contracting – 64.5% of the population in Europe and North America are of working age in 2020 but this is expected to decrease steadily to 61.2% by 2035 and to 58.7% by 2050 (Figure 4.13).

The old-age dependency rate is low. The proportion of the population aged over 65 in Kazakhstan is low at 7.9% in 2020, below developed countries in Europe and North America (18.3%), but above Central and Southern Asian countries (6.1%). Despite its low current level, the old-age dependency rate is expected to increase slowly to 9.3% in 2025, 11.1% in 2030 and 11.9% in 2035 (same data source as Figure 4.13). Overall, Kazakhstan does not face ageing related challenges at present.

Figure 4.13. Kazakhstan has a large and expanding working age population

Working age population (aged 15 – 64) projections in Kazakhstan and elsewhere, 2020 - 2050



Source: United Nations, probabilistic population projections based on world population prospects 2019.

4.4.2. Social security rates are low but rising

SSC rates are low by international standards. The SSC mix relies more heavily on employer rather than employee SSCs in Kazakhstan, which is common in most other OECD countries. Employer and employee SSC rates and payroll taxes are 14.5% and 10% in Kazakhstan in 2019. Taken together, these are currently below the OECD average (17.8% for employers and 9.8% for employees).

The current SSC rates are to be increased considerably, particularly for employers. For employers, the employer SSC rates for the existing insurance SSC and health SSC will be increased to 5% and 2% by 2020 respectively. Furthermore, the payroll tax will increase from 9.5% to 11% in 2025. In the past, employer payroll tax and health SSCs have been set with consideration given to each other. In 2018 for example, the social tax was reduced from 11.0% to 9.5% due to the introduction of the employer health SSC of 1.5%. In addition, the employer health SSC will be increased by a further 1% to 3% in 2022. The employee pension SSC will remain unchanged.

A new set of SSCs are to be introduced for employees and employers. A new employee health SSC, which will be withheld and paid by the employer, will be introduced at a rate of 1% starting from 2020 and then increasing to 2% in 2021. In addition, a new employer pension SSC will also be introduced in 2023 at a rate of 5%. The pension SSC was previously due to be introduced in 2020 but was postponed in 2019 due to concerns of the authorities related to the rising number of SSCs.

Box 4.3. The current SSC (and payroll tax) system

There are a number of SSCs and a social tax in Kazakhstan.

1. **Employer payroll tax, also known as the social tax, is taxed at a rate of 9.5%.** Taxes on payroll are generally defined as taxes paid as a proportion of payroll that do not give entitlement to social benefits. Payroll taxes are relatively uncommon in OECD countries. The employer payroll tax in Kazakhstan, also known as the social tax, is paid by employers on behalf of employees at a flat 9.5% rate in 2019. The rate is set to increase to 11% in 2025. As part of the 2007/2008 tax reform, a regressive payroll tax schedule at the time was replaced with a flat 11% rate. The rate was then reduced to 9.5% in 2019 in conjunction with the introduction of the new employer health SSC described below. Employer insurance SSCs (described below) are fully deductible from the payroll tax.

2. **Employer health SSCs is tax at a rate of 1.5%.** The employer health SSC, referred to as Obligatory Social Medical Insurance (OSMS), has a rate of 1.5% in 2019. The rate will increase further to 2% and 3% in 2020 and 2022 respectively. Employers remit the amount of the health SSC to the *Social Medical Insurance Fund* on a monthly basis.

3. **Employer insurance SSCs are taxed at a rate of 3.5%.** Employer SSCs, referred to as Obligatory Social Insurance Payments (OSCI), have a current rate of 3.5% in 2019. Following announcements in the 2019 State of the Nation Address, they are to be increased to 5% in 2020.[9] These SSCs apply to local workers, citizens of CIS member countries and foreign workers with a permanent residence. As a result, foreign nationals with no permanent residence in Kazakhstan are not required to join certain SSC plans such as the pension plan.

4. **Employee pension SSCs are taxed at a rate of 10%.** For employees, the obligatory pension contribution (OPC) is levied at a rate of 10% on gross salary in 2019. For employers, a new mandatory employer pension contribution of 5% (of the income of employees) is to be introduced from 2023.

Source: OECD analysis.

If the proposed SSC rates increases are enacted, they will move above the OECD average. While both employee and employer SSC rates will be increased, overall increases will be greater for employers (Table 4.2). Currently, the total SSC rates for employees and employers are 10% and 14.5% respectively in 2019. These will increase to 11% and 16.5% respectively in 2020 and then further to 12.0% and 24.0% by 2025. In the case of employer SSC rates, insurance SSCs are deductible and these are shown separately. Overall, if these proposed SSC rates are implemented, they would push the overall SSC rate in Kazakhstan from below the OECD average to above it. This could occur as follows. The current combined rates of employee and employer SSCs are 24.5%, which is below the OECD average of 27.5%. However, SSC rates are expected to increase to 27.5% in 2020, which is about the same as the OECD average. By 2025, SSC rates in Kazakhstan will surpass the OECD average based on the current proposals. An obligatory professional pension contribution for employers, which applies to workers who work in dangerous working conditions, is also due to be introduced in 2020. However, this is not included in the analysis since it does not apply to all workers.

Table 4.2. SSCs in Kazakhstan

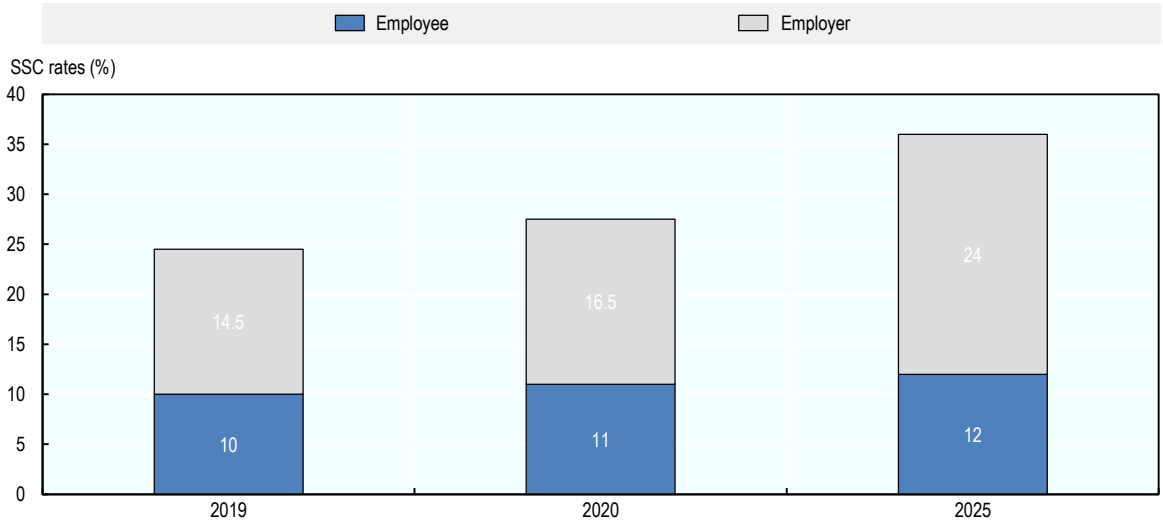
Current and proposed employer and employee SSCs in Kazakhstan, 2019 - 2025

Type	SSC Category	Name	Status	2019 rates	Proposed rates (year of introduction)	Tax base	Tax base formula	Maximum cap	Remitted to
Employer	Payroll tax	Social tax	Current	9.5%	11% (2025)	Gross income less pension contributions and insurance SSCs deductible	[(Gross Income + Fringe benefits – Employee Pension Contributions) x 9.5%] - Insurance SSC	None	State Revenue Committee
	Health SSC	Obligatory social medical insurance	Current	1.5%	2% (2020) & 3% (2022)	Gross income less pension contributions	(Gross Income + Fringe benefits – Employee Pension Contributions) x 1.5%	15 MMS	Social Medical Insurance Fund
	Insurance SSC	Obligatory social insurance payments	Current	3.5%	5% (2025)	Gross income less pension contributions	(Gross Income + Fringe benefits – Employee Pension Contributions) x 3.5%	10 MMS	State Social Insurance Fund
	Pension SSC	SSC pension fund	Proposed		5% (2023)	Gross income		50 MMS	State Pension Fund
Employee	Health SSC	Obligatory social medical insurance	Proposed		1% (2020) & 2% (2021)	Gross income less pension contributions	(Gross Income + Fringe benefits – Employee Pension Contributions) x 1%	15 MMS	Social Medical Insurance Fund
	Pension SSC	Obligatory pension contribution	Current	10%		Gross income	(Gross Income + Fringe benefits) x 10%	50 MMS	State Pension Fund

Notes*:* Pension contributions refer to obligatory pension contributions of employees. The obligatory professional pension contribution is not included as it applies only to a specific set of workers who work under dangerous working conditions. According to the Ministry of Healthcare, the State will make contributions for certain categories of socially vulnerable people including children, retired individuals and women on maternity and the contribution rates will be 4.0% in 2020, 4.5% in 2022 and 5% in 2025.
Source: OECD analysis; Ministry of Healthcare of Kazakhstan; IBFD; IMF (2020), Republic of Kazakhstan, Selected Issues.

Figure 4.14. The Government plans to increase overall SSC rates over the coming years

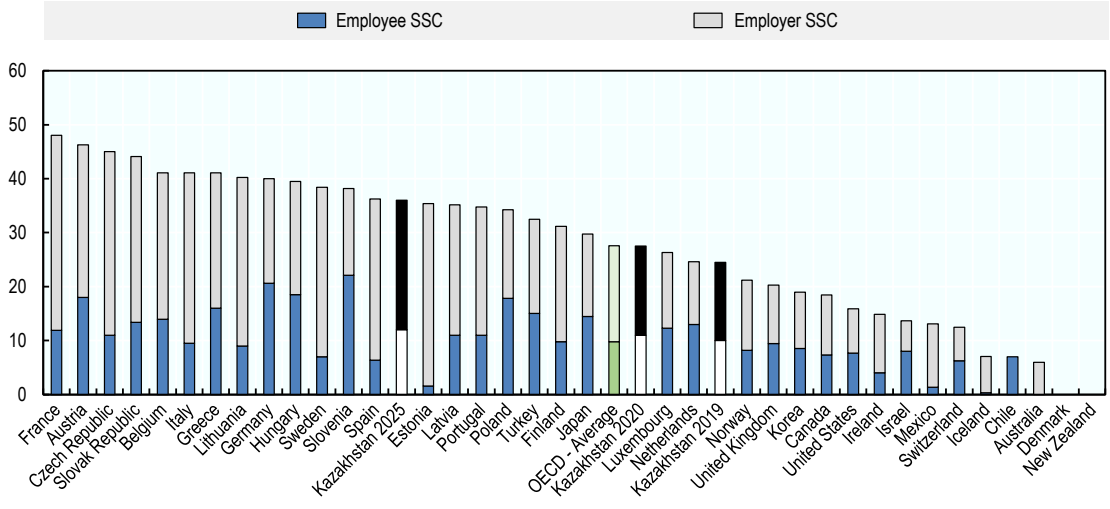
Employer and employee % SSC rates, 2019 - 2025



Note: While the total sums all of the employer SSC rates together, it should be noted that insurance SSCs are deductible from social tax. 2020 rates are based on Government announcements.
Source: OECD analysis.

Figure 4.15. SSCs rates are scheduled to increase from below to significantly above the OECD average

Employee and employer SSC rates, % of gross income, 2018



Note: While the total sums all of the employer SSC rates together, it should be noted that insurance SSCs are deductible from social tax. For the purpose of this analysis, headline employer SSC rates are used for Kazakhstan. Effective SSC rates would be lower due to the deduction of the obligatory pension from the SSC base. Note also that SSC ceilings apply in Kazakhstan and these have not been reflected in the data.
Source: OECD statistics.

Table 4.3. Employer SSC rates are expected to increase with the introduction of a new employer pension SSC and rate increases across other SSCs

Employee and employer % SSCs rates, 2019 - 2025

	Employee SSC rates (%)			Employer SSC rates (%)		
SSC type	2019	2020	2025	2019	2020	2025
Payroll tax				9.5	9.5	11.0
Insurance SSC				3.5	5.0	5.0
Health SSC		1.0	2.0	1.5	2.0	3.0
Pension SSC	10.0	10.0	10.0			5.0
Total rates1	**10.0**	**11.0**	**12.0**	**14.5**	**16.5**	**24.0**
Total rates (less employer insurance SSCs)	**10.0**	**11.0**	**12.0**	**11.0**	**11.5**	**19.0**

Notes: (1) While the total sums all of the employer SSC rates together, it should be noted that insurance SSCs are deductible from social tax. 2020 rates are based on announcements of authorities. Employer insurance SSCs and health SSCs are 5.0% and 2.0% from 2020 respectively. Employer pension SSC has been delayed to 5.0% from 2023. Employee health SSCs are 1% from 2020 and 2% from 2021. The obligatory professional pension contribution is not included in the total as it applies only to workers who work in dangerous working conditions (at a rate of 5%).
Source: Announcements of the authorities; IBFD; IMF, Republic of Kazakhstan, Selected Issues, February 2020.

4.4.3. The social security system is narrow by design

Some SSC contributions have ceiling caps. SSC ceiling caps, which place a limit on SSC contributions, are a policy design choice which are opted for by some but not all OECD countries. In Kazakhstan, maximum ceiling caps are applied to SSC contributions for insurance, health and pensions but not to payroll tax. The application of the maximum ceiling caps for pension SSCs and health SSCs are the same for employees and employers. The maximum gross income thresholds for SSC insurance (employer only), SSC health (employer and employee) and SSC pension (employer and employee) are 10, 15 and 50 MMS respectively. One rationale for the current set of SSC caps in Kazakhstan is the extent to which the social benefit is returned to the contributor in the future. This likelihood that the contributor receives the benefit at some point over the longer-term forms a basis for the divergence in the SSC caps. For example, pension SSC contributions are often returned to the contributor in the form of future pension payments, providing a basis for the higher maximum cap, whereas health SSC contributions are only returned when activated.

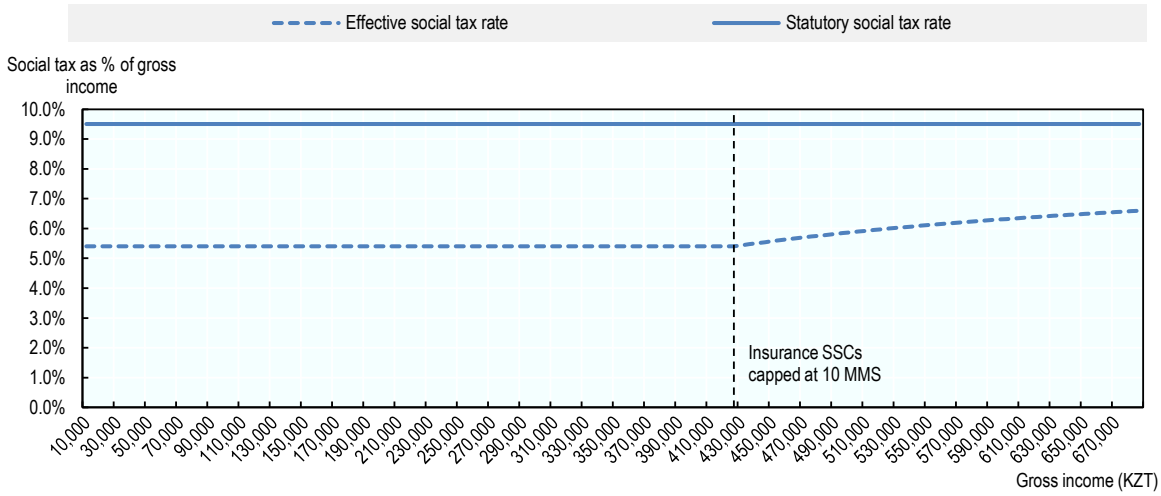
Review the deduction of employee pension contributions from the SSC base, which is atypical in OECD countries. In most OECD countries, employer SSCs are levied on gross income. In Kazakhstan, the SSC base for calculating SSC contributions is gross income less obligatory employee pension contributions. This approach to deduct employee pension contributions from the SSC base may imply that the pension contributions are seen as deferred income. If deferred pension income is not taxed today under employer SSCs, it would imply that a rationale exists to tax pensions upon distribution with the same employer SSCs that are levied on non-deferred wage income, such as health employer and employee SSCs.

Despite the social tax having a flat rate, the effective rate becomes progressive for higher incomes due to the deductibility of insurance SSCs, which have a maximum cap. Payroll taxes are typically levied at a flat rate on wages, which produces a constant average tax burden. As part of the previous 2007/2008 tax reform in Kazakhstan, the regressive social tax (or payroll tax) schedule at the time was replaced with a flat rate. Currently, insurance SSCs in Kazakhstan are deductible from social tax and therefore do not represent an additional burden on the employer (i.e. total employer social tax payable = social tax due – SSC insurance contributions). Since social tax and SSC insurance contributions are levied on the same tax base (i.e. employee gross salary plus fringe benefits less pension contributions) at 9.5% and 3.5% respectively, the overall effective social tax payable for employers is 6.0% (i.e. 9.5% - 3.5%). Furthermore, since social tax is not capped but SSC insurance is capped (at 10 MMS), the overall effective

social tax payable will mechanically increase at higher incomes because the absolute amount of the deductible insurance SSC remains fixed above the cap and therefore becomes smaller relative to rising income. Consequently, the cap in effect produces a progressive social tax schedule (Figure 4.16).

Figure 4.16. Despite having a flat rate, the social tax becomes progressive at higher incomes

Payroll statutory and effective rates, for different income levels



Source: OECD analysis.

4.4.4. The 2020 social security reform will increase the financing of the SSC system but further measures need to be considered

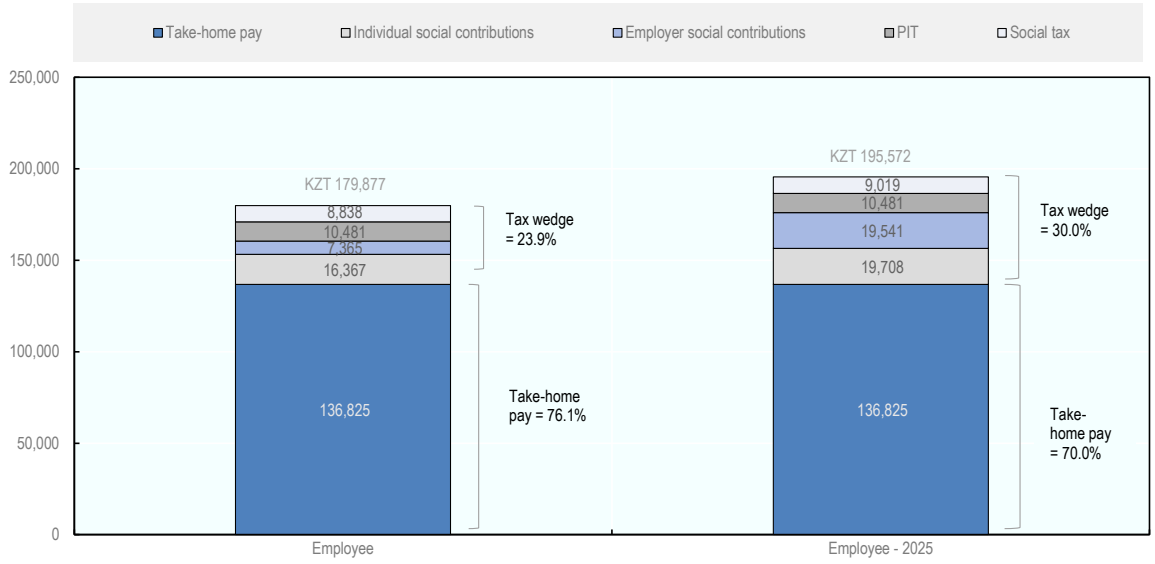
The inheritance of pension payments is generous, rare and expensive. One atypical policy design in Kazakhstan is that pension entitlements can be inherited, which is rare by international standards. It will require increasing SSC rates in order to finance this provision. Consideration could be given to abolish the inheritance of pension entitlements.

Employment costs for firms will rise over the coming years. Figure 4.17 shows the decomposition of the total employment cost for firms in 2019 and 2025 in Kazakhstan for single taxpayers without children that earn the mean gross wage in Kazakhstan into two main components: an individual's take-home pay from labour (net of PIT and SSCs) and the tax wedge. The tax wedge is broken down further into its components, which consist of PIT and SSCs. On the basis of the analysis, employees have a tax wedge of 23.9% in 2019, a take-home pay of 76.1% and a total employment cost of KZT 179 877 (employment cost is gross mean wage plus social tax and employer SSCs). This means that almost one quarter of the total employment cost of an employee that earns the mean wage in the country goes to government as a result of taxes and SSCs, while just over three-quarters goes to the individual worker as their take-home pay. As evidenced in Figure 4.17, the category that contributes the most to the tax wedge in 2019 is individual SSCs (i.e. mainly pension employee SSCs) (KZT 16 367), followed by PIT and payroll tax. As discussed in section 4.4.2, between 2019 and 2025, a number of new SSCs will be introduced and current SSC rates will increase. For example, employer SSCs rates (excluding social tax) will increase from 5.0% to 13.0% and individual SSCs rates will rise from 10% to 11.8%. Since the insurance SSC (3.5% in 2019 and 5.0% in 2025) is deducted from the social tax (9.5% in 2019 and 11.0% in 2025), the effective social tax will remain the same at 6.0% of the tax base. In 2025, due to the introduction of the new SSCs and increases in the rates of SSCs existing in 2019, the tax wedge will rise to 30% and the total employment cost to KZT 195 572. Whereas the category of employer SSCs was a small contributor to the tax wedge in

2019, this category is substantial in 2025 (KZT 19 541 as opposed to KZT 7 365). Overall, employment costs are expected to increase by 8.7% based on the analysis. While increases in employee SSC rates are modest and may therefore not have a strong impact on labour market participation rates, the significant increase in employer SSC rate increases could reduce job creation in the private sector.

Figure 4.17. The tax wedge and total employment costs will rise in the coming years

Decomposition of total employment cost, employees in 2019 and 2025

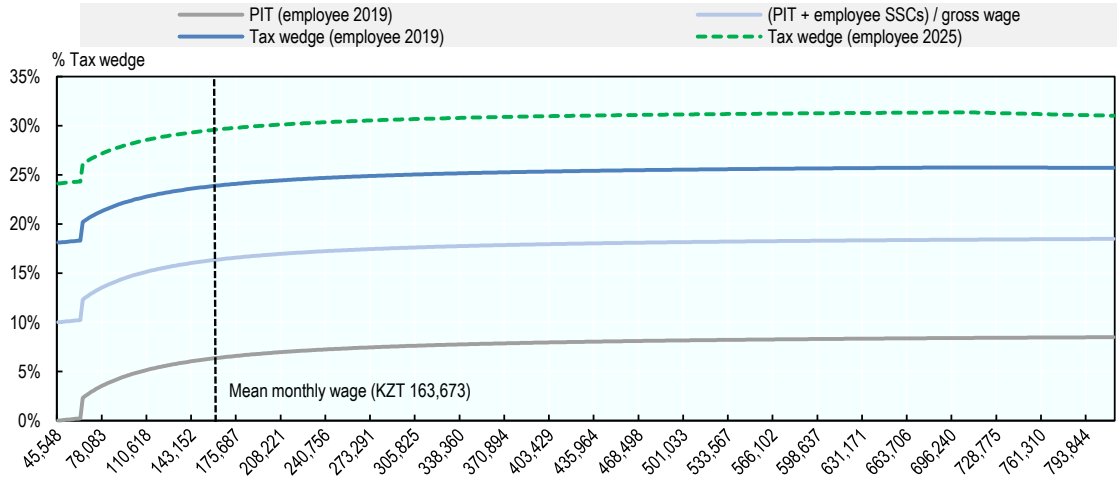


Note: Note: Individual social contributions include pension and health SSCs while employer social contributions include pension SSCs, health SSCs and insurance SSCs. In this analysis, the employee's take-home pay is equalised at KZT 136,825 in order to consider an employee that is equally well off across the two periods (2019 and 2025) and how the total employment cost of an employee compares. The labour taxation of an employee in 2019 is calculated assuming the mean wage (KZT 163,673).
Source: Milanez and Bratta, 2019.

The tax burden is flat across income levels. Figure 4.18 extends the analysis in Figure 4.17 by showing the tax wedge for employees in 2019 and 2025 for different levels of gross income. The average effective PIT rate and the personal average tax rates (which takes into account the PIT and employee SSCs as a share of gross wage) in 2019 are also presented. The analysis begins from about KZT 45,000 and the sharp increase in the average effective rate at KZT 63,125 is produced by the withdrawal of the 90% taxable income exemption, as discussed previously in (Figure 4.4). The analysis shows that the tax burden is relatively flat across different income levels, in particular once the strong progressive impact of the basic tax allowance is less dominant at higher incomes and because of the flat PIT and SSC rates. The analysis also highlights how the PIT rate burden is relatively low but the overall tax burden is high once SSCs are included.

Figure 4.18. The tax burden is flat across income levels

Decomposition of total employment cost, by gross income level (KZT), employees in 2019 and 2025



1.The analysis starts from KZT 45 548. 106. In 2019, employer insurance and health SSCs are capped at KZT 14 875 (10 MMS and a rate of 3.5%) and KZT 9 563 (15 MMS and a rate of 1.5%) respectively. In 2025, employer insurance SSCs, employee health SSCs and employer health SSCs are capped at KZT 21 250 (10 MMS and a rate of 5%), KZT 12,750 (15 MMS and a rate of 2.0%) and KZT 19 125 (15 MMS and a rate of 3.0%). The 50 MMS cap is too high to be reached in the income range under examination.
Source: Milanez and Bratta, 2019.

Frequent SSC policy changes coupled with delays increases administrative complexity and undermines economic activity. In recent years, there have been frequent and significant SSC proposed policy changes such as the introduction of new SSCs and changing current SSC rates (see Table 4.2). The increased number of SSCs to be calculated, remitted and paid by employers increases administrative complexity and the costs of doing business. Furthermore, some of these proposed policies have not be enacted or delayed. For example, the new employer pension SSC was previously due to be introduced in 2020 but was postponed until 2023 due to a concern of the authorities surrounding the rising number of SSCs. In addition, the SSC health contributions for individuals and the self-employed was delayed from 2018 to 2020. This combination of frequent proposed policy changes coupled with delays makes it challenging for individuals and businesses to plan for the future and undermines economic activity more generally.

The schemes that pay for the healthcare rely on a mix of different financing sources in OECD countries. Health systems can be financed through SSCs, general taxation or a combination of both sources of financing. Different approaches bring both advantages and disadvantages, as shown in Table 4.4. Government schemes typically receive budget allocations out of the overall government revenues. Social health insurance is usually financed out of social contributions payable by employees and employers. These schemes may also receive a varying proportion of their revenues from governmental transfers. Some countries are planning to reduce their reliance on wage-based contributions in the face of shrinking labour markets and financial shocks, and are increasingly looking for ways to diversify their revenue base (OECD, 2017[15]) (OECD, 2015[16]).

Table 4.4. Different ways of financing health systems

	Pros	Cons
General taxation	- Pool risks for whole population - Potential for administrative efficiency and cost control - Redistributes between high and low risk and high- and low- income groups in the covered population	- Risk of unstable funding and often underfunding due to competing public expenditure - Inefficient due to lack of incentives and effective public supervision
Health SSCs	- Generate stable revenues - Often strong support from population - Provides access to a broad package of services - Involvement of social partners - Redistributes between high and low risk and high- and low- income groups in the covered population	- Poor are excluded unless subsidized - Payroll contributions can reduce competitiveness and lead to higher unemployment - Complex to manage governance and accountability can be problematic Can lead to cost escalation unless effective contracting mechanisms are in place

Source: International Labour Organisation. Adapted from (OECD, 2018[17]).

Arguments exist for financing social benefits through general taxation. Financing health insurance through a progressive PIT system could reduce labour and increase employment for low-income employees. There are some arguments to support the idea of financing social benefits through general taxation. For example, financing social benefits through general taxation, instead of SSCs, can reduce the tax burden on labour income through lower employer and employee SSCs that provide greater incentives for employers to hire workers and for workers to participate in the labour market. In the case of Kazakhstan, replacing flat SSCs with a progressive PIT also has the potential to enhance progressivity. The arguments for financing social benefits through general taxation are stronger when there is no strong link between the contributions made and the benefits received (Brys et al., 2016[18]). In general, when the contribution-benefit link is not strong, as is the case with health insurance in Kazakhstan, financing social security through a progressive PIT (or using taxes that bear not only on labour but also on capital income) could help reduce labour costs at low-income levels and increase employment, while also ensuring the financing of social security systems. On the other hand, benefits for retirement, disability and unemployment, which tend to be more strongly related to earnings, could remain financed in large part through SSCs. On the other hand, there are also limitations to fully shifting the financing of social protection from SSCs to PIT. The PIT base is narrow in Kazakhstan and has been further reduced by recent tax reforms to reduce the burden on low-income workers, which might not allow financing the same level of social protection. Generally, SSCs offer higher levels of social protection and give taxpayers an incentive to pay into the system. In addition, in a changing world of work, financing social benefits partly through general taxation could also ensure that welfare support remains available for a large number of people. Indeed, structural changes in the economy including digitalisation and automation are resulting in an increasing number of workers which make smaller SSC contributes (self-employed, temporary workers and workers with irregular working hours). These structural changes in the economy present new sustainability challenges for welfare systems that are financed primarily through SSC contributions.

4.5. Improve the design and functioning of the VAT

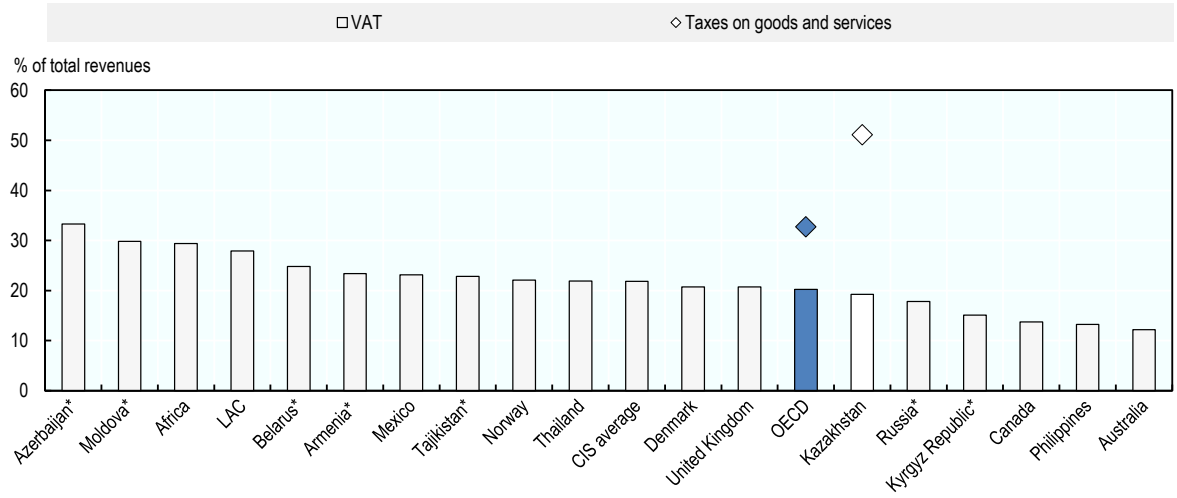
The design and functioning of the VAT can significantly be improved. The VAT in Kazakhstan is based upon the core features of a well-designed VAT, but there is scope to improve its design and administration. Most importantly, there is scope to broaden the VAT base by removing costly, ineffective and distortive preferential regimes. Probably the most important area where the VAT base can be broadened is the special VAT treatment for Special Economic Zones (SEZ). The current VAT treatment of SEZs constitutes a major flaw in the design of the VAT system and recently announced measures will not address the main design weaknesses. Instead, the authorities should fully restore the VAT chain by applying the standard VAT on all transactions to and within the SEZs while simultaneously providing more

timely VAT refunds. Other areas for VAT base broadening include newly constructed residential buildings that are brought on the market for the first time and online sales of digital services and goods. Kazakhstan is currently in the process of adapting its VAT rules to bring inbound digital services and goods within the scope of the VAT. This reform will broaden the VAT base in line with the OECD International VAT/GST Guidelines. Significant scope also exists to improve the quality and capacity of the VAT administration. Although VAT revenue as a share of tax revenue is similar to the OECD average, the revenue performance of the VAT, measured by the 'VAT productivity' indicator, is relatively low, which points not only at a narrow VAT base but also at a weak tax enforcement and administration. Important steps have been taken by the authorities to address the challenges of the VAT refund system, and these efforts should continue. The VAT registration threshold in Kazakhstan remains high internationally, and continuing efforts to improve the VAT administration, to bring more firms within the formal economy and to simplify the VAT system should eventually allow Kazakhstan to lower the VAT registration threshold. Finally, there is scope to increase the standard VAT rate, which is currently low internationally. However, VAT base broadening measures and measures to increase VAT compliance should be implemented first before considering increasing the VAT rate. Moreover, any increase in the VAT rate should be considered in the context of inflation levels in the country.

VAT as a share of tax revenues are in line with OECD countries. VAT as a share of total tax revenues are similar to the OECD average and below the CIS average. VAT to total revenues is 19.2% in Kazakhstan compared to 20.2% in the OECD in 2017. Two-thirds of VAT relates to VAT on imports (68%) rather than domestic VAT (32%). However, VAT to GDP is lower than the OECD average (3.10% vs 6.8% in 2017) in part due to low overall taxes to GDP in Kazakhstan. VAT also comprises a relatively small 38% of the total taxes on goods and services. Most taxes on goods and services relate to taxes on specific goods and services for example on excises and customs duties, much of which comes from the natural resource sector. As a result, tax revenues on goods and services as a share of total taxes are high in Kazakhstan internationally at 51% compared to 32% in the OECD.

Figure 4.19. Taxes on VAT as a share of total taxes are in line with the OECD

VAT as % of total tax revenues, selected countries including from OECD and CIS, 2017



Note: Commonwealth of Independent States (CIS) data other than Kazakhstan relate to 2015. CIS average based on countries shown in chart only. Data for Australia, Canada, OECD relate to 2016. Africa relate to 2015. For non CIS countries, PIT refers to 1100 Taxes on income, profits and capital gains of individuals.
Source: OECD Revenue Statistics; data on CIS countries from State Revenue Committee of Kazakhstan.

The VAT in Kazakhstan is based upon the core features of a well-designed VAT, but there is scope to further improve its design and administration. In a not so distant past, the authorities had considered reintroducing a sales tax similar to the tax that was levied before the introduction of the VAT in 1992. However, these plans have not been pursued, which has been the right decision, as sales taxes are distortive in contrast to a well-designed VAT. Instead, Kazakhstan has continued strengthening the design and operation of its VAT, following international best practice. This includes, for instance, the implementation of the reverse-charge collection method for cross-border B2B supplies of services. In light of the key role that the VAT plays in the total tax take in Kazakhstan, these efforts should continue including through further VAT base broadening and improved VAT collection mechanisms including for non-resident digital suppliers (see section 4.5.7 below).

VAT revenues have been increasing over time, largely aligned with growth and the general increase in price levels. The largest share of VAT revenues comes from imported goods and services although in recent years domestic VAT revenues are growing faster than VAT on imports.

Table 4.5. VAT performance indicators 2011 - 2018

KZT millions

	2011	2012	2013	2014	2015	2016	2017	2018
1. Net VAT revenues	865 087	914 194	1 327 433	1 197 258	943 051	1,495 682	1 664,699	2 034 314
Domestic	257 237	190 890	508 304	407 956	275 646	634 881	646 823	909 355
Imports	607 850	723 304	819 129	789 302	667 404	860 801	1 017 876	1 124 959
2. Refunds	306 000	451 000	249 000	n.a.	n.a.	498 378	612 084	505 011
3. Gross VAT revenues (1+2)	1 171 087	1 365 194	1 576 433	n.a.	n.a.	1 994 060	2 276 783	2 539 325
4. Non-oil and gas GDP	18 573 940	20 515 382	25 352 092	28 726 497	31 644 167	35 839 381	41 348 586	42 865 786
5. Net VAT collections as % of non-oil GDP (1/4)	4.66	4.46	5.24	4.17	2.98	4.17	4.03	4.75
6. Standard VAT rate (%)	12	12	12	12	12	12	12	12
7. VAT productivity (5/6)	0.39	0.37	0.44	0.35	0.25	0.35	0.34	0.40
8. Refunds as % of gross VAT revenues in % (2/3)	26.1	33.0	15.8	n.a.	n.a.	25.1	26.9	19.9

Notes: The domestic revenues reflect the sum of the categories "domestic VAT" and "other VAT" revenues as reported in the OECD Revenue Statistics database. Non-oil and gas GDP refers to the Gross Value Added (GVA) of the non-oil and gas sector as a share of GDP.
Source: State Revenue Committee of Kazakhstan; OECD Revenue Statistics database.

The revenue performance of the VAT in Kazakhstan, as measured by the 'VAT productivity' indicator, is relatively low. VAT revenue performance is defined as actual VAT revenues over non-oil and gas GDP divided by the standard VAT rate. It indicates the VAT revenues as a percentage of non-oil and gas GDP that is collected by each percentage point of the standard VAT rate (i.e. the share of the VAT-to-GDP ratio that is collected by each percentage point of the 12% standard rate). The VAT productivity ranged between 0.25 and 0.44 over the 2011-2018 period, with an average value of 0.36. This result is aligned with the average VAT productivity of 0.37 over the 2005-2013 period that has been found in (World Bank, 2015[19]) (the World Bank analysis applied data for non-oil GDP, while our analysis also excludes the gas sector from the analysis). The VAT productivity varies significantly over time but no clear (neither increasing or decreasing) trend can be observed. The VAT productivity measure represents an initial indicator and more work needs to be done to analyse the VAT compliance and policy gaps through a VAT tax gap analysis.

Box 4.4. The main features of a VAT

Although there is a wide diversity in the way VAT systems are implemented, VAT can be defined by its purpose and its specific tax collection mechanism. The OECD International VAT/GST Guidelines (2015) provide an overview of the core features of VAT, which are summarised below.

A broad-based tax on final consumption

A VAT is a tax on final consumption by households as, in principle, only private individuals, as distinguished from businesses, engage in the consumption at which a VAT is targeted. A necessary consequence of the fundamental proposition that a VAT is a tax on final consumption by households is that the burden of the VAT should not rest on businesses.

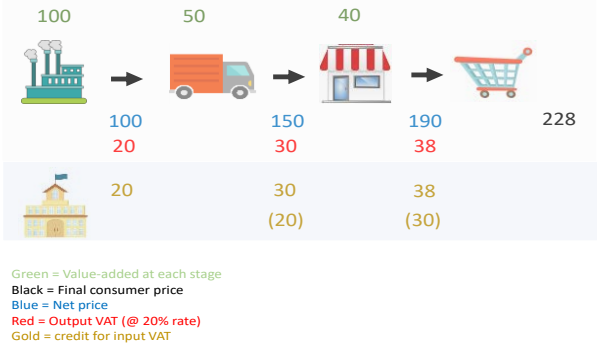
As a broad-based tax, the VAT is distinguishable from excises targeted at specific forms of consumption such as the purchase of gasoline or alcohol.

The staged collection process

VAT is collected by businesses through a staged process on the "value added" at each stage of production and distribution. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin i.e. on the difference between the VAT imposed on its taxed inputs and the VAT imposed on its taxed outputs (see Figure below).

In general, jurisdictions with a VAT allow the deduction of VAT on purchases by all but the final consumer. This design feature gives to the VAT its essential character in domestic trade as an economically neutral tax. The full right to deduct input tax through the supply chain, except by the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain, and the means used for its delivery (e.g. retail stores, physical delivery, Internet downloads). As a result of the staged payment system, VAT thereby "flows through the businesses" to tax supplies made to final consumers. In practice, however, the right to deduct input tax may be restricted in a number of ways. Some are deliberate and some result from imperfect administration.

Infographic 4.1. VAT's staged collection process – domestic supplies



The destination principle in international trade

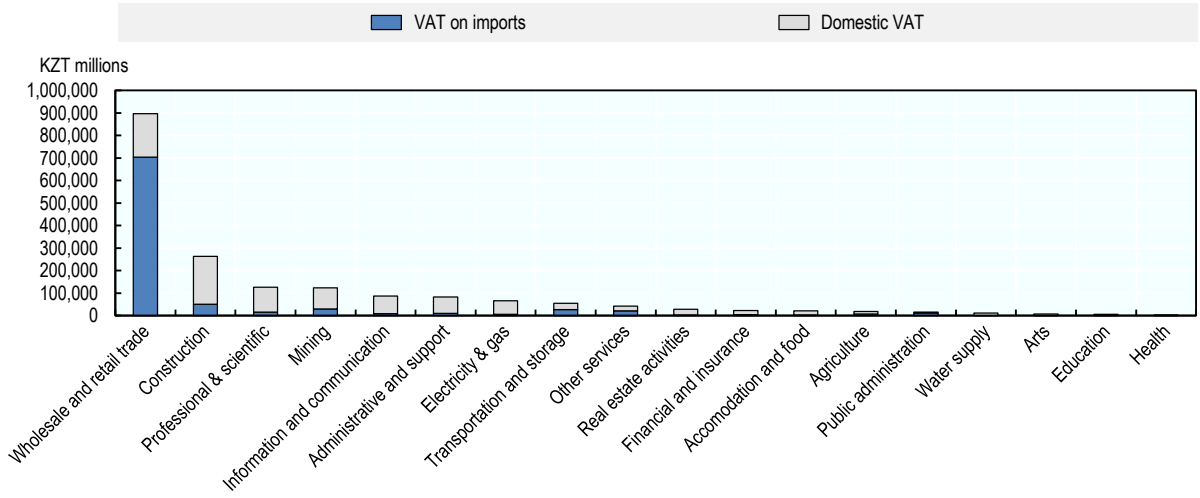
According to the destination principle, the VAT taxing rights on cross-border supplies are to be allocated to the jurisdiction where the use or final consumption occurs. For cross-border supplies of goods, the tax is collected where the goods are imported. For supplies of services and intangibles, according to the OECD International VAT/GST Guidelines, taxation should occur where the business customer has located its permanent business presence for business-to-business supplies. For business-to-consumer supplies, the Guidelines recommend that the taxing rights over "on-the-spot supplies" be allocated to the jurisdiction in which the supply is physically performed; and that the taxing rights over all other supplies and services be allocated to the jurisdiction in which the customer has its usual residence. These include remote supplies of services and digital products over the Internet (e.g. apps, streaming of music and movies, online gaming) by foreign suppliers. The Guidelines recommend that these foreign suppliers be required to register and remit VAT in the jurisdiction of taxation and that countries implement a simplified registration and compliance regime to facilitate compliance for non-resident suppliers.

The relatively low VAT productivity (see Table 5.4) points at relatively high tax fraud and non-compliance and, linked to that, weak tax enforcement and administration as well as a narrow VAT base mainly because of the wide scope of VAT exemptions. Moreover, the fact that the VAT productivity indicator is not significantly increasing over time indicates that efforts should continue to strengthen the design (broadening the base and further lowering the VAT threshold) and administration of the VAT. Nevertheless, the VAT productivity indicator has jumped up from 0.34 in 2017 to 0.4 in 2018; data for 2019 will have to confirm whether the result for 2018 is an outlier or whether it may reflect a more permanent increase in VAT productivity. That being said, the VAT productivity indicator is a crude indicator that does not allow inferring the exact underlying drivers, and their changes over time, for the relatively weak VAT performance, so its results should be interpreted with care.

VAT revenues are predominantly paid by a few sectors and in particular the wholesale and retail sector. Other sectors, such as agriculture, accommodation and food and real estate activities contribute relatively little. Over half (56%) of all VAT relates to VAT on imports in Kazakhstan. However, the ratio is higher in some sectors. For example, in the wholesale and retail trade sector, which contributes more than any other sector to overall VAT revenues (44% of VAT in total), 78% of VAT relates to VAT on imports. Hence, a significant share of VAT revenues in Kazakhstan are paid by importing wholesale and retail companies that subsequently sell into the Kazakh economy (Figure 4.20).

Figure 4.20. Most VAT comes from the wholesale and retail sector and it is mostly VAT on imports

Gross VAT, domestic and imports, by sector in Kazakhstan, 2018



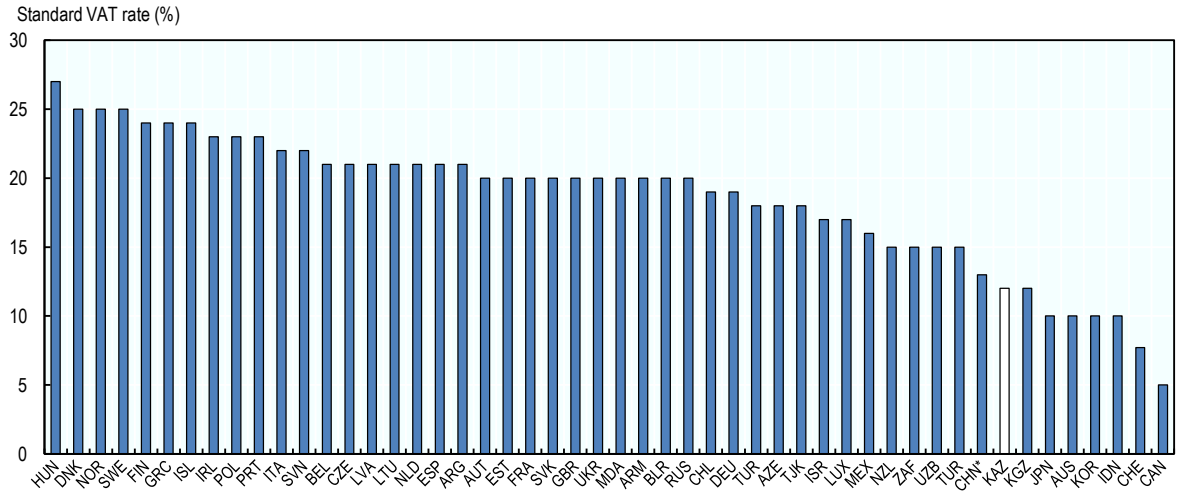
Note: The manufacturing sector is not included because the data show that VAT on imports is larger than total VAT.
Source: State Revenue Committee data.

4.5.1. VAT rates

The VAT rate is low. The standard VAT rate of 12% is low compared to the CIS average of 17% and the OECD average of 19.3% in 2019. The rate is the same as in Kyrgyzstan but lower than the 15% applied in Uzbekistan and Turkmenistan, 18% applied in Azerbaijan and Tajikistan and the 20% rate applied in Ukraine, Moldova, Armenia, Belarus and Russia. In the case of Russia, an important tax policy change was undertaken in 2019 as part of the Russian Tax Code to increase the general VAT rate from 18% to 20%.

Figure 4.21. The VAT rate is low compared to the CIS and OECD average

Standard VAT rate in Kazakhstan, CIS countries and OECD countries, 2020



Source: OECD Tax Database.

There are no reduced VAT rates but certain goods and services are zero-rated. A number of transactions are subject to a zero rate including exports of goods and services, international transport services, the sale of goods to businesses located in Special Economic Zones (SEZs) and amongst businesses within the SEZs, and the sale of goods produced in Kazakhstan to subsurface users that have the right to VAT-exempt importation of goods.

There is scope to increase the standard VAT rate in Kazakhstan in order to raise more revenues to finance the non-oil deficit. Until 2006, the standard VAT rate was 15 per cent, after which it was reduced by one percentage point each year, and has been stable at 12 per cent as from 2009 onwards. As part of a tax reform strategy that would narrow the non-oil deficit, government could consider increasing the VAT rate back to 15 per cent. For an average VAT productivity of 0.36 (see above), an increase in the standard VAT rate by 3 percentage points would raise additional revenues of 1.1% of GDP (under the assumption that such a change would not result in large behavioural changes). However, as tax distortions are typically increasing in the tax rate, VAT base broadening measures and measures to increase VAT compliance should be implemented first before considering increasing the VAT rate. Indeed, VAT rate increases might just exacerbate the distortions that result from the narrow base and weak compliance, so it is important that efforts are taken in these areas first. Otherwise, a VAT rate increase might just further increase the informal economy without leading to more tax revenues. Policymakers might be tempted to introduce a reduced VAT rate when they increase the standard VAT rate, but such a reform would not be efficient nor fair.

A VAT rate increase should be considered in the context of an inflationary environment. Increasing the VAT rate is in effect a once-off increase on consumers. However, the inflation rate in Kazakhstan is high at 7.4% in 2017 compared to the CIS average of 5.7% and the OECD average of 1.8%. Furthermore, and as discussed in Chapter 2, there are a number of inflationary pressures in the Kazak economy including expansive government expenditure programmes and rising credit and government debt. While Kazakhstan may tempted to follow the recent example of Russia by increasing the VAT rate to raise revenues, it should be noted that inflation is considerably lower in Russia at 1.8%.[10]

4.5.2. VAT exemptions

Many goods and services continue to be exempt from VAT, and Kazakhstan has taken efforts to broaden its VAT base by bringing certain goods and services, such as gambling, within the VAT base. While all VAT regimes have VAT exemptions and VAT reduced rates are more the rule than the exception in the OECD, there remains scope in Kazakhstan to broaden its VAT base. The goods and services that are VAT-exempt in Kazakhstan include, amongst others, the sale of newly constructed residential buildings that are brought on the market for the first time, financial services (including banking and insurance), funeral services, social services provided by non-profit organisations and services provided in the cultural, science and education sector. Duty-free goods are also VAT exempt as well as goods and services related to medical and veterinary activities (including medicine and medical assistance), and certain services performed by tourism operators.

In general, the use of reduced VAT rates or exemptions should remain limited. As with any preferential tax treatment, reduced VAT rates and exemptions narrow the tax base and reduce potential revenues. Reduced VAT rates and exemptions are introduced for a wide range of purposes, but overall they have been found to be poorly targeted instruments to support low-income households, to support consumption or support certain business activities or sectors. This applies also for VAT reductions that apply to basic necessities. At best, rich households receive roughly as much benefit – in absolute value – from a reduced rate as do poor households. At worst, rich households benefit vastly more than poor households. This result is unsurprising as better off households consume more, and often more expensive, products than poorer households. Thus, while poorer households may benefit from reduced VAT rates on necessities, the wealthier gain even more (OECD/KIPF, 2014[20]). Targeting support at low-income households is often best achieved through the transfer system (e.g. direct cash transfers), particularly in countries with well-developed social security systems.

VAT exemptions lead to cascading effects (except if applied in the final stage of supply changes) and can encourage the granting of further exemptions to prevent this issue. Unlike reduced VAT rates or a zero-rate where suppliers charge the VAT to their customers at a reduced or zero rate but keep the full right to deduct the VAT paid on their purchases, under the VAT exemption the suppliers do not charge any VAT to their customers but are not allowed to recover any VAT on their inputs. As a consequence, the input VAT becomes a cost for businesses selling VAT-exempt products. This input VAT is likely to be embedded in the price of exempt products. In fact, businesses might either shift that extra tax burden onto their customers by raising sale prices or bear (part of) the cost of unrecovered VAT themselves through a reduction of their profit margin. As a result, VAT exemptions distort the input choices of businesses that face an incentive to buy inputs with little or no tax on them (including inputs purchased from the informal sector). Exemptions also create the incentive for businesses to undertake activities they otherwise would outsource. Exemptions can also discourage investment, as sellers of VAT-exempt products will not recover the VAT paid on the purchases of new investment. In some countries, this has led to pressures to grant further VAT exemptions on the inputs used by suppliers of VAT-exempt products, but such a strategy just aggravates the distortions introduced by exempting certain transactions.

Kazakhstan should continue its efforts to broaden the VAT base. In line with previous analysis (World Bank, 2008[21]), there are a number of goods and services that could be brought within the scope of the VAT aligned with international VAT best practice. These include newly constructed residential buildings that are brought on the market for the first time and tourism services provided to foreigners and, possibly to a lesser extent, insurance-related services and cultural activities. Government is encouraged to evaluate each VAT exemption from an efficiency, equity and revenue perspective. Such an in-depth cost-benefit analysis would then provide objective arguments against or in favour VAT base broadening. Another VAT base broadening measure would be to continue lowering the VAT registration threshold (see section 4.5.8 later in the chapter), which currently remains high and may partly explain why the agriculture, accommodation and food and real estate activities contribute surprisingly little to the VAT revenues.

VAT base broadening might allow raising additional VAT revenues without having to increase VAT rates to finance the non-oil deficit. A moderate increase in the VAT productivity indicator from the average value of 0.36 (over the 2011-2018 period) (see Table 4.4) to 0.4 (i.e. an increase by 0.04), for instance, would yield additional VAT revenues equal to 0.48% of GDP (i.e. 0.04 times the standard 12% VAT rate) if the VAT rate would remain 12%. The VAT base broadening would yield higher additional tax revenues if, at the same time of the VAT base broadening, the standard VAT rate were to be increased.

4.5.3. The VAT refund system

A well-designed VAT refund system is an essential part of a well-functioning VAT system. The **VAT** is collected by businesses through a staged process on the "value added" at each stage of production and distribution. In general, a VAT registered business is allowed to offset the VAT paid on its inputs against the VAT collected from its customers, and remits the difference to tax authorities. In cases where input VAT exceeds output VAT, a VAT credit arises. In order to protect the revenue base against false VAT input claims, tax administrations typically audit businesses before making a payment of a VAT credit.

Kazakhstan follows best practice and pays VAT credits only after a tax audit. However, the maximum allowed refund period is quite long (155 calendar days) but businesses that export more than 70 per cent of their turnover receive a refund of excess VAT within 55 days. In addition, Kazakhstan implements a simplified VAT refund procedure that does not require a tax audit. This regime applies to businesses that are monitored as large taxpayers or businesses that fall under the horizontal monitoring program. In general, delays in VAT refunds imply an opportunity cost for businesses in terms of the time value of money and can generate significant cash-flow problems. It increases incentives for artificial integration of businesses in order to be able to offset tax credits on exports against VAT on domestic sales. It can also constitute a drag on investment and provides businesses with a tax-induced incentive to spread investment over time rather than investing more quickly. As a result, Kazakhstan could continue to reinforce its auditing activities such that a more timely VAT refund can be implemented for small and large firms, irrespective of whether they sell to the domestic or foreign markets.

The wide range of activities that are VAT zero-rated, in particular activities that take place in Special Economic Zones, increase the size of the VAT refund claims considerably. When a business sells zero-rated goods to businesses located in a SEZ, it can claim a refund for the VAT paid on its inputs, which prevents the distortions created by VAT exemptions, as discussed above. However, the zero-rating of transactions breaks the VAT chain, which will have a negative impact on VAT revenues (see below), but it also increases the challenges faced by the VAT refund system. Restoring the VAT chain by including zero-rated supplies for transactions with businesses in SEZs within the standard VAT system will therefore prevent too large VAT refund claims, which will also free-up the tax administration's audit capacity.

While the challenges of the VAT refund system have been identified for many years as one of the areas of policy reform in Kazakhstan, important steps have been taken already. For instance, the time to obtain a VAT refund has recently been shortened to 30 days for businesses that issue and receive exclusively electronic VAT invoices for the tax period for which a refund is claimed. Overall, the recent introduction of electronic VAT invoicing in Kazakhstan is a step in the right direction and the efforts to streamline it across all businesses should continue.

Nevertheless, the VAT refund system can be further strengthened as, in practice, obtaining refunds continues to require significant efforts. This was acknowledged in the State of the Nation address 2019, which has highlighted the need to apply a simpler and faster VAT refund procedure. A possibility to help enhance the efficiency of VAT refunds even further could be to introduce a system that would identify low-risk businesses and refund them faster; this could be part of a strategy that implements a well-organised refund system based on clear design principles within a risk-based compliance management strategy.

In addition, Kazakhstan implements a number of limits to its VAT refund system, both in the amount of the refund and the timing of the refund (e.g. with respect to input VAT regarding transactions whose place of supply is not in Kazakhstan, VAT levied on imports, etc.) in order to protect its VAT base and avoid VAT fraud. Over time, when the VAT audit system is further strengthened, these limitations could be revisited and, possibly, changed. In addition to the analysis included in this report, there is merit to conduct an in-depth evaluation of the VAT refund system in Kazakhstan. This is left for future work.

The pressures on the VAT refund system should be tackled at source by improving the design of the VAT in Kazakhstan. Part of the pressures on the VAT refund system are a consequence of the flaws in the design of the VAT in Kazakhstan, including the VAT treatment in relation to SEZs. Improving the design of the VAT will then also alleviate some of the pressures on the VAT refund system. The level of refunds can be reduced through several measures, for instance by introducing a deferred payment system for imported capital goods combined with a reverse-charge mechanism which transfers the VAT liability from the import stage to the domestic buyer who is allowed a VAT input credit against any output VAT levied on its sales (World Bank, 2015[19]). Abolishing the VAT zero-rating of activities that take place in SEZs and any other VAT zero-rating for domestic transactions would be another reform that would reduce the pressure on the VAT refund system in Kazakhstan.

4.5.4. Special economic zones

The special VAT treatment for Special Economic Zones is a major flaw in the design of the VAT in Kazakhstan. Transactions from the domestic economy with businesses located in a SEZ, as well as transactions amongst businesses in a SEZ, are zero-rated. This break in the VAT chain puts pressure on the VAT refund system. As businesses in the domestic economy might face difficulties in obtaining a VAT refund, SEZ suppliers might simply add the 12% VAT rate, or part thereof, in the price they charge. Moreover, it creates opportunities for fraud, as goods and services sold by businesses located in a SEZ to the domestic economy might get untaxed. It creates incentives for domestic businesses to create a subsidiary in a SEZ to engage not only in profit shifting, but also to organise transactions such that the overall VAT liability is minimised (in light of the weaknesses in the VAT refund system). Moreover, it increases the risk that zero-rated inputs for businesses in a SEZ are diverted to the domestic market without the payment of the VAT. Because of these risks for VAT fraud, the tax administration is required to devote valuable resources to administer and enforce the VAT system despite the fact that the SEZs themselves are, to some extent, outside of the VAT system. Further strengthening the VAT refund system such that businesses located in a SEZ receive a VAT refund in a timely manner when they export their goods and services is a much better strategy than the current zero-rating.

Recently announced measures will not address the main weaknesses in the VAT design for SEZ businesses. As from April 2019, government allows suppliers of certain goods to businesses located in a SEZ to opt for the standard rather than the 0% rate. This option is available only if the goods are fully used by the activities carried out within the SEZ business. The reform measure will reduce the need to refund VAT for businesses that sell goods to businesses located in a SEZ as they can charge output VAT from which they can deduct their input VAT. However, the reform merely shifts the excess VAT credit to businesses from outside to businesses within the SEZ. SEZ businesses are VAT 0%-rated and therefore only charge VAT on their sales to the domestic market (and possibly to other businesses within the SEZ if they would qualify for the above measure). SEZ businesses that have to pay input VAT but do not charge output VAT will very likely need to be reimbursed for the input VAT paid.

This reform indicates that government is aware of the major challenges created by the 0%-rating in SEZs, but in order to address the challenges, more far-reaching measures are required. Although this measure creates an incentive for SEZ businesses to charge the standard VAT rate, the reform is only a partial solution that further increases complexity, tax uncertainty for businesses and tax administration costs. Instead, government should fully restore the VAT chain by applying the standard VAT rules to SEZs,

which means levying the standard VAT rate on all transactions to and within the SEZs and providing a timely VAT refund, for instance when goods are exported.

The introduction of a deferred payment system for imported capital goods should also apply for businesses that are located in a SEZ. Such a reform will therefore not only reduce the pressure on the VAT refund system, but it would also take away one of the main arguments in favour of a preferential VAT treatment of capital-intensive businesses located in SEZs. It is important to keep in mind that such a deferred payment system is complex to operate in practice and extremely vulnerable to fraud. Its introduction would there require a well-prepared and efficient VAT administration as a prerequisite. Overall, further strengthening the VAT refund system, as discussed above, will prevent the need for a special VAT treatment for SEZs, which is a key reform priority.

Box 4.5. The distributional effects of reduced VAT rates in OECD countries

With the exception of Chile, all OECD countries have one or more reduced VAT rates to support various policy objectives. A major reason for the introduction of a differentiated rate structure is the promotion of equity. Countries have generally considered it desirable to alleviate the tax burden on goods and services that form a larger share of expenditure of the poorest households (e.g. basic food, water). Countries also often decide not to tax medicine, health services and housing at high rates. Reduced VAT rates have also been used to stimulate the consumption of “merit” goods (e.g. cultural products and education) and other non-distributional objectives such as promoting locally supplied labour-intensive activities (e.g. tourism) and correcting externalities (e.g. energy-saving appliances).

In general, VAT exemptions, zero-rates and reduced rates are not a well-targeted tool to support low-income households. Reduced rates that are implemented in countries for the distinct purpose of supporting the poor (i.e. to address distributional goals) typically do have the desired progressive effect. For example, reduced rates for basic food provide in general greater support to the poor than the rich as a proportion of household income or expenditure. However, despite this progressive effect, these reduced VAT rates are a very poor tool for targeting support to poor households. At best, rich households receive roughly as much benefit – in absolute value – from a reduced rate as do poor households. At worst, rich households benefit vastly more than poor households. This result is unsurprising as better off households can be expected to consume more, and often more expensive, products than poorer households. Thus, while poorer households may benefit from reduced VAT rates on “necessities” the wealthier gain even more.

Cash transfer programmes that cover the entire population, if well-functioning, are a more effective tool to compensate poor households for the VAT they have paid. If poor households can be compensated directly through a cash transfer programme, it is more efficient and fair to tax all goods and services at the standard VAT rate and compensate the poor directly through cash transfers (and/ or reductions in personal income taxes, etc.), especially if the standard VAT rate is not particularly high. It should immediately be noted, however, that compensating all (and only the) losers of a reform through a transfer programme might in practice be very difficult to achieve.

With regard to preferential VAT provisions for social, cultural and other non-distributional goals, richer households benefit considerably more from VAT exemptions and reduced rates. Those tax provisions often provide so large a benefit to rich households that the reduced VAT rate actually has a regressive effect – benefiting the rich more both in aggregate terms and as a proportion of expenditure. For example, reduced rates on hotel accommodation and restaurant food benefit the rich vastly more than the poor, both in aggregate and proportional terms, in all OECD countries in which they are applied. Similar results, but of less absolute magnitude, are found for reduced rates on books, cinema, theatre and concerts.

Finally, VAT rate differentiation might not be the best policy instrument to correct negative externalities. VAT rate differentiation may improve efficiency if it means that the private marginal costs of an activity are brought closer to the marginal costs for society. However, VAT is a blunt instrument for addressing environmental externalities, as it may be hard to target the actual source of pollution. For example, reduced rates on energy-saving appliances may boost demand or them and therefore stimulate the consumption of these goods. The reduced VAT rate may give incentives to shift from more to less energy-consuming items (consumers might replace their old refrigerator with a new one, for instance). However, this may also lead to an increase in the purchase of energy-intensive products (e.g. consumers may replace their old refrigerator with a new refrigerator and a freezer).

Source: OECD/KIPF (2014)

4.5.5. Cross-border trade in services and intangibles

Kazakhstan is in the process of adapting its VAT rules to increasing digitalisation and online sales, but the implementation has been delayed until 1 January 2021. Regarding cross-border trade in services and intangibles, Kazakhstan is in the process of reforming its VAT rules and practices to levy VAT on inbound digital supplies, such as software provided over the internet, online advertising, and online data storage, downloads of media and e-books, and website services. Foreign providers and digital marketplaces will be required to register, charge VAT and pay the amount to the tax administration in Kazakhstan.

This reform will broaden the VAT base by ensuring the taxation of inbound digital supplies, in line with the OECD International VAT/GST Guidelines. According to the OECD International VAT/GST Guidelines, taxing rights on cross-border business-to-consumer (B2C) supplies of services and intangibles (including digital supplies, e.g. apps, streaming of music and movies, online gaming) are to be allocated to the jurisdiction in which the customer has its usual residence. The OECD Guidelines recommend that these foreign suppliers be required to register and remit VAT in the jurisdiction of taxation and that countries implement a simplified registration and compliance regime to facilitate compliance for non-resident suppliers.

4.5.6. Cross-border sales of low-value goods

Regarding cross-border sales of goods, most countries have been operating VAT relief regimes for imports of low-value goods, as the costs of collecting VAT on those items through traditional customs processes were often likely to outweigh the VAT actually collected. At the time when most of these relief regimes were introduced, online shopping did not exist and the level of imports benefitting from the relief was relatively small. However, there has been a significant and rapid growth in the volume of imports of low-value goods subject to these VAT relief regimes. This has resulted in large potential VAT revenues not being collected and growing risks of unfair competition for domestic retailers that are required to charge VAT on their sales to domestic consumers.

Digitalisation is pushing governments to revise their VAT rules on cross-border trade in low-value goods. Countries that wish to collect VAT on low value imports, particularly imports from online sales by foreign vendors, could do so by increasing the efficiency of the processes of VAT collection on these imported items. The OECD has developed internationally agreed standards that allow countries to improve the VAT collection by moving the requirement to collect and remit the VAT away from the order (customs procedures) to the online vendor or an intermediary (such as a digital platform; see below). These standards were included in the BEPS Action 1 Report and in two subsequent OECD reports that were adopted by the Inclusive Framework and by the Global Forum on VAT as consensus solutions.

These standards are now gradually implemented across the OECD, which could inspire Kazakhstan to follow this best practice. Australia was the first OECD country to implement these standards, effective as of July 2018, and has already reported revenues amounting to AUD 81 million in the first quarter of operation of the regime. New Zealand has introduced a similar regime in 2019 and the European Union announced its introduction in 2021. Kazakhstan may wish to assess whether the current VAT relief regime for imports of low-value goods (or the import of all goods by individuals "not for entrepreneurial purposes") poses issues. In particular, authorities could evaluate the extent to which the VAT relief regime puts domestic businesses at a competitive disadvantage and how much VAT revenue they forego because of that measure.

4.5.7. Digital platforms

Digital platforms have the potential to further increase the efficiency of VAT collection on online sales given that the majority of these sales occur through a relatively limited number of platforms. The OECD has started in 2017 to develop agreed standards on the potential role of platforms in facilitating and improving VAT collection and compliance. Involving digital platforms could imply, for instance, that if goods are purchased via an online marketplace, the online marketplace will be treated as the supplier of the goods and will therefore be responsible for collecting and remitting the VAT. A key reasoning behind this approach is that the platform is viewed as taking the role of a 'store' with an offering of different supplies and in many cases act as the sole point of contact with the end consumer ((OECD, 2019[22])). Several jurisdictions have already introduced or announced the introduction of measures involving the digital platform in the collection of VAT on sales of digital services via platforms. In addition to setting the standards, the OECD provides practical guidance to tax authorities on how to make digital platforms liable for the VAT on sales made by online traders through them, along with other measures that include data sharing and enhanced cooperation between tax authorities and digital platforms (Box 4.6).

In addition to digital platforms involved in the supply of B2C cross-border supplies, online booking platforms could be involved in the collection of VAT on the sales that they facilitate. In this case, for example, the VAT could be levied on the price inclusive of the booking platform's margin. Involving booking platforms in the collection of VAT would also help address informality. Under a system where digital platforms would be fully liable for collecting and remitting VAT, VAT would be imposed on all online sales, including those by informal suppliers operating through a platform. A threshold could be set at the platform level, under which no VAT would be levied. As mentioned above, digital platforms could also provide information to the tax administration, as third party reporting is a key way to strengthen tax compliance.

Box 4.6. OECD report on 'The role of digital platforms in the collection of VAT/GST on online sales'

The OECD has provided guidance in the International VAT/GST Guidelines (the "Guidelines") to jurisdictions wishing to collect VAT on cross-border supplies of services and intangibles. The Guidelines include recommended rules and mechanisms for the effective collection of VAT on business-to-consumer (B2C) supplies of services and intangibles (including digital supplies) by foreign suppliers. The Guidelines were complemented by the 2017 report on Mechanisms for the effective collection of VAT/GST where the supplier is not located in the jurisdiction of taxation and the 2019 report on The role of digital platforms in the collection of VAT/GST on online sales, which provide guidance on implementation to jurisdictions.

It was indeed recognised that platforms may significantly enhance the effectiveness of VAT/GST collection given their important role in generating, facilitating and/or executing online sales. In fact, a number of jurisdictions have already implemented measures to involve digital platforms in collecting VAT/GST on online sales and have reported positive outcomes in securing tax revenue. Other jurisdictions are considering the introduction of such measures. These reports of course do not aim to provide detailed prescriptions for national legislation, but rather seek to present a range of possible approaches as a reference point to assist policy makers.

4.5.8. Registration thresholds

In general, setting the VAT registration threshold at an adequate level is a complex task. The main reason for excluding small businesses from the VAT system is that compliance costs for small businesses may be disproportionate compared to their turnover, and that the costs for the tax administration of having very small businesses pay VAT may be disproportionate compared to potential VAT revenues. On the other hand, a VAT registration threshold introduces competitive distortions between small businesses under and above the threshold. Overall, the VAT registration threshold should minimise competitive distortions and be set so that the revenues collected are higher than the administrative costs of ensuring that small businesses properly collect and remit VAT. In general, a higher threshold is considered more appropriate in countries where the tax administration tends to be weaker.

The VAT registration threshold in Kazakhstan has been decreasing over time but remains high internationally. Registration as a VAT payer is required for all individuals and companies that conduct business activities in Kazakhstan and have cumulative taxable revenues in excess of MCI 30 000 in 2019 (~USD 200 000) in any consecutive 12-month period. Taxpayers whose annual turnover is less than this amount can voluntarily register for VAT (World Bank, 2015[23]).

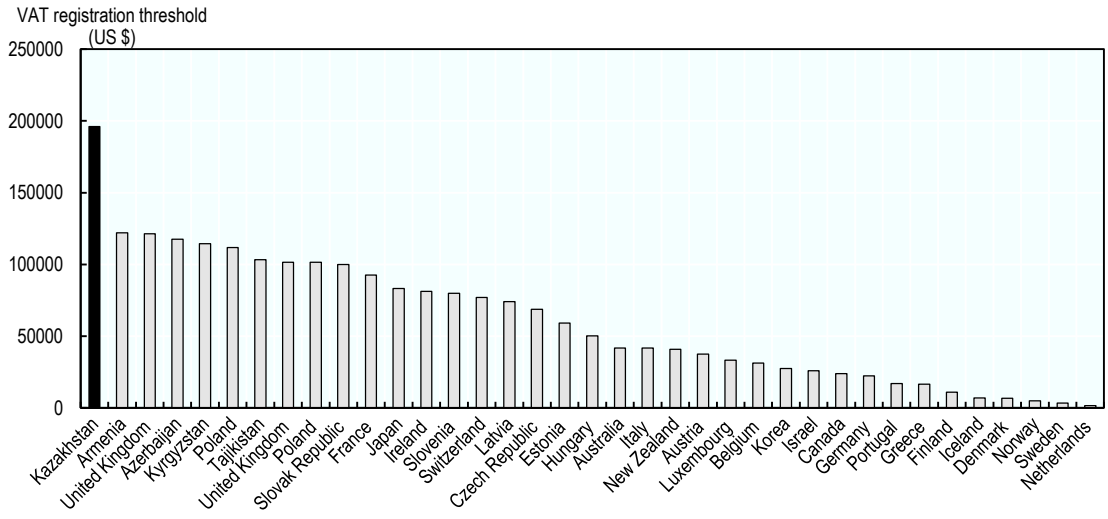
The tax administration should strengthen its operation so that the VAT registration threshold can gradually be lowered over time. As the tax administration's capacity becomes stronger, Kazakhstan could consider lowering the VAT exemption threshold. In addition, with the rise of the sharing economy and the possible increase in the number of small operators below the VAT registration threshold, the revenue loss and distortions caused by a high VAT registration threshold might become more problematic.

A lower VAT registration threshold could also be accompanied by VAT simplification measures. In Kazakhstan there are potentially significant administrative costs associated with registering for VAT including penalties for late issuance of electronic invoices and the exclusion of the amount of VAT from the credit if transactions with a noncompliant counterparty are revealed. As a result, lowering the VAT registration threshold should be accompanied with simplification measures. One possibility would be the introduction of a VAT flat rate scheme. A flat rate scheme allows eligible businesses (e.g. below a certain turnover threshold) to apply a fixed and lower VAT rate, typically to turnover, to determine VAT due (OECD,

2015b). In principle, under such schemes, businesses give up the right to reclaim VAT on their inputs. Businesses therefore keep the difference between what they have charged their customers and what they pay to the tax administration. Variable flat rates may be applied, and are intended in most cases to reflect the average VAT rate in specific industries or sectors after taking into account the recovery of VAT on inputs. From a tax compliance perspective, a major advantage of these schemes for small businesses is that they are not required to keep detailed records of sales and invoices. However, creating a special regime that may over-compensate small businesses provides new opportunities for tax avoidance and evasion and may reduce firms' incentives to grow. Alternative measures may be preferred to simplify compliance and administration, including for instance less frequent filing of VAT returns and simplified accounting methods.

Figure 4.22. The VAT registration threshold is high

Compulsory VAT registration thresholds in US dollars



Source: OECD consumption tax trends 2018; CIS country data from various sources.

4.5.9. Strengthening VAT compliance

VAT fraud takes many forms. Common forms of VAT fraud involve businesses that should be registered for VAT not registering, by remaining completely informal, artificially splitting activities into smaller businesses or under-reporting sales to remain under the compulsory VAT registration threshold. Non-compliance may also occur with VAT-registered businesses: some may for instance under-report taxable supplies (e.g. through automated sales suppression devices or "zappers") or overstate purchases for which they can deduct input VAT (through false invoices); others may even disappear without remitting VAT to the government.

There are available tools to deal with sales suppression. At a basic level, sales suppression can be as simple as not recording some cash sales with the intention of under-reporting the amount of sales and thereby under-reporting the corresponding tax liability. More sophisticated methods have also become prevalent, with sales suppression being undertaken through electronic tools that can alter evidence of transactions whether paid in cash or card, without leaving a trace of the alteration. The most common counter-suppression tool used to address electronic sales suppression is data recording technology. This tool records and secures the sales data immediately as the transaction occurs and stores it in a manner that means it is tamper proof. There are different types of tools that are being used to perform this function,

which are referred to in different countries and by different service providers as a fiscal control unit, an electronic fiscal device, or sales data controller. This type of technology should be applicable to any type of cash register, such as traditional electronic cash registers (ECRs), computer-based point of sales systems, or those that are tablet or smartphone-based. These tools are also being used to send data automatically to the tax authority, connecting cash registers online to their data server systems. This can occur either in real time or in bulk scheduled transfers, e.g. at the end of the day or each month. The tax authority then has the opportunity to access the data remotely for compliance and audit purposes. Results from these devices have been impressive. For instance, in Hungary, electronic cash registers were installed with a fiscal control unit. After the first year of operation, VAT revenue increased by 15% in the targeted sectors (OECD, 2017[24]).

Kazakhstan has introduced the e-system of invoicing aligned with international best practice. There are other tools to deal with businesses falsifying invoices. Whereas sales suppression techniques seek to under-report revenue, false invoicing seeks to over-report deductions, and to falsify invoices to mask non-deductible personal expenses as legitimate deductions. A solution to address the problem of false invoicing is requiring electronic invoicing. Generally, businesses must retain records of transactions with customers and provide an invoice to a customer, either in electronic or paper form. An electronic invoice documents the transaction in electronic format. The electronic invoicing system should have additional features to ensure the integrity of the data and the identity of the creator. This can be done by using a digital signature to ensure the authenticity of the invoice and that it has not been altered after its creation. Electronic invoicing will be most effective where the invoices must be registered or otherwise provided to the tax authority. The detection of false over-reporting of deductible expenses can be achieved by automatically matching the data for the purchaser and seller. Where this is undertaken through periodic or real time data transfers, the tax authority has substantially enhanced visibility of its taxpayers, and can perform audits, analytics and tax return functions in an efficient way. Electronic invoicing has been implemented in a number of countries, with evidence beginning to be collected on its impact.

Kazakhstan should continue to develop its risk management system. Risk-based approaches enable tax authorities to better identify high-risk businesses and fraudulent behaviours and therefore contribute to targeting limited government resources more effectively. The risk-based analysis system can be based on crossing digitalised data collected by tax authorities with data from other sources, including data from the customs administration, data from real estate and vehicle registers, data from different business databases, etc. In this context, machine learning can also be a powerful tool to uncover hidden patterns in the existing data. Kazakhstan introduced a 'Risk Management System' in 2018 using data mining, mathematical modelling and predictive analytics, *inter alia*. The system has recovered an additional KZT 47 billion and KZT 98 billion in 2018 and 2019 respectively. (Division of Automation of Business Processes, State Revenue Committee).

4.6. Other indirect taxes

4.6.1. Revenues from excise duties support the financing of the healthcare system

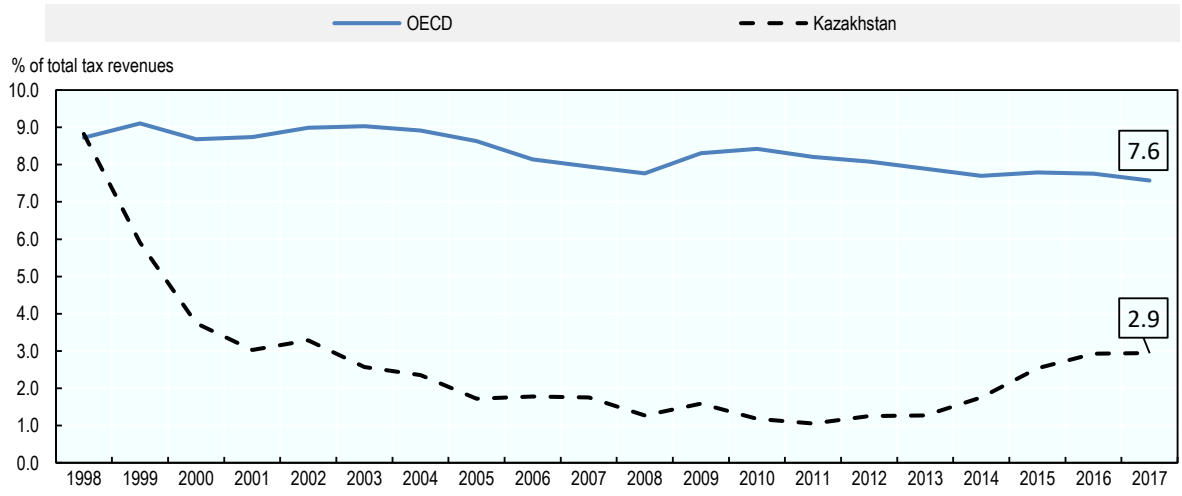
Excise taxes are low compared to OECD countries and could be an area of future analysis and reform. Excise taxes apply to the sale and import of crude oil, gas, petrol, diesel, alcohol, tobacco and passenger cars (exports are not subject to excise taxes; export customs duties on oil relate to oil products and are not included for this analysis). For domestically produced and sold excisable goods, the tax base is volume. Excise taxes are levied on the pre-VAT selling price. Excise taxes represented 2.9% of total tax revenues in 2017 in Kazakhstan, significantly less than the OECD average of 7.6%. In 1998, the share of excise taxes in total revenues was similar to the OECD average but has fallen significantly as the economy grew over recent decades. Excise taxes are mostly comprised of tobacco (54%), alcohol (23%) and

petroleum products (23%). Excise taxes could be an area for future analysis and reform in Kazakhstan in part because excises are relatively straightforward to administer and most excisable goods are inelastic.

Arguments exist to finance public healthcare partly with excise duties on alcohol and tobacco. Most excise tax revenues in Kazakhstan come from alcohol and tobacco in 2017 (77%). Excise duties on these goods internalise some of the costs that their consumption imposes on society. For example, the consumption of alcohol and cigarettes increase healthcare costs directly while also indirectly reducing labour market productivity through sick leave. At the same time, improving Kazakhstan's healthcare system will require more financial resources (discussed in section 4.4). Consequently, there may be a case for using some portion of excise duties to support healthcare, as is currently done in some OECD countries (OECD, 2015[16]). On the other hand, arguments also exist against the earmarking of tax revenues. Earmarking can reduce flexibility in government budgeting if, for example, more revenue is raised than necessary in a particular year and the excess revenue cannot be used elsewhere to support budget shortfalls.

Figure 4.23. Excise tax revenues are low

Excise taxes as a share of total tax revenues, Kazakhstan and the OECD, 1998 - 2017



Note: Excise taxes (5121) from OECD revenue statistics. This analysis does not include customs duties on exports of oil, which relate to taxes on crude oil and oil products, and are levied on the basis of the quantity exported.
Source: OECD revenue statistics.

4.6.2. Strengthen the role of recurrent taxes on residential property

Property and land taxes play a minor role in Kazakhstan. Recurrent taxes on business immovable property are paid each year at low and progressive tax rates, ranging from 0.1% to 1.5% depending on the taxpayers activities. Recurrent taxes on business property constitute the largest share of all property taxes paid in Kazakhstan. Recurrent taxes on household immovable property are, however, very low. In addition, income received by an individual (who is not an entrepreneur) from renting out immovable property is treated as business income. The capital gains realised from the disposal of immovable property (other than a taxpayer's permanent residence) are taxable. Taxpayers that own land must also pay land tax each year at varying rates (depending on the use, size and quality of the land). Overall, property tax revenues are low, representing 3.0% of total tax revenues in 2017, compared to the OECD average of 5.8% (Figure 4.24). The share of property tax in total tax revenues has remained stable in recent years in both

Kazakhstan and the OECD. Land taxes as a share of total revenues were very low at 0.17% of total tax revenues in 2017.

Almost all property taxes in Kazakhstan are paid by companies instead of households. According to data from the State Revenue Committee, 96% of property tax revenue is paid by 135,900 companies in 2018. The remaining 4% of property tax revenue is paid by 3.15 million households. This is also reflected in OECD revenue statistics data, which shows that household recurrent taxes on immovable property (4110) are very small in Kazakhstan at 0.05% of tax revenues. Furthermore, and as shown later in Table 5.2, taxes on property are highly concentrated with 99% of all property taxes paid by companies in the top turnover decile and 59% of all property taxes paid the top 100 companies in terms of turnover.

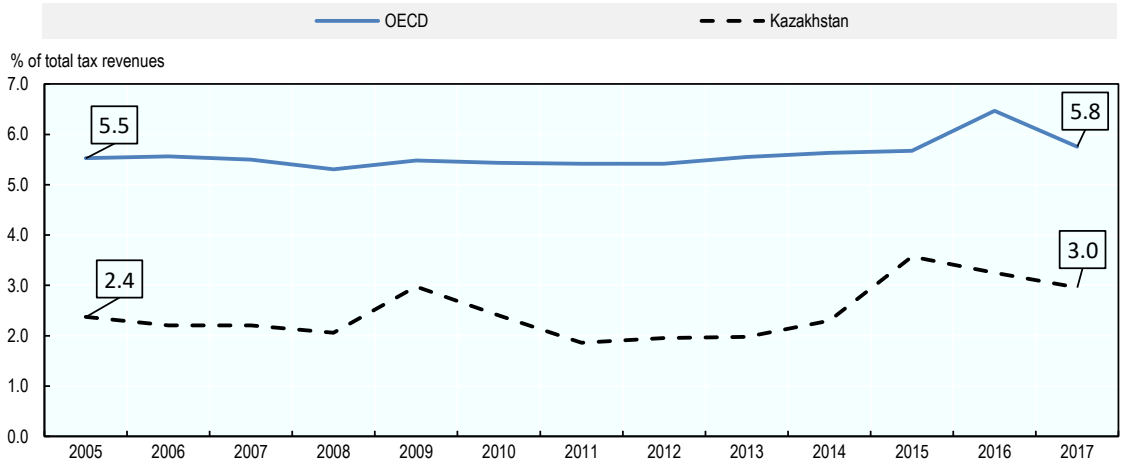
Recurrent taxes on residential property are an efficient form of taxation. In OECD countries, empirical analysis concluded that recurrent taxes on immovable property, in particular when owned by households, were the least damaging tax for long-run economic growth, compared to consumption taxes, personal income taxes and corporate income taxes (Johansson et al., 2008[25]). Recurrent taxes on immovable property can be efficient because the tax base – typically land and improvements – is immobile, which limits the behavioural response to the tax. The visible nature of immovable property also makes the tax harder to evade. If properly designed, recurrent taxes on immovable property can also be designed in a fair manner. This can be achieved by, for instance, exempting a certain amount of residential property wealth from tax.

Recurrent taxes on business property might discourage investment. While recurrent taxes on residential property might be the least harmful tax for economic growth, this might not hold for recurrent taxes on immovable property levied on business property. Depending on their design, these taxes might create an additional tax burden on investment, which is levied irrespective of the profits earned by the business. These taxes should be kept as low as possible. Transaction taxes are also distortive and their rates should be kept low, except perhaps in situations of housing price bubbles. Inheritance taxes, on the other hand, do have a role to play in a well-designed country tax system.

Kazakhstan should strengthen the role of recurrent taxes on residential property. Increasing the role of recurrent taxes on residential immovable property would allow Kazakhstan to increase total tax revenues without creating large economic distortions and/ or to rebalance its tax mix away from more distortive taxes such as the CIT. However, before such a policy could be adopted, Kazakhstan will need to develop a fiscal cadastre that contains information about the characteristics of the property as well as put systems in place that determine the market value of immovable property and make them available for taxation purposes.

Figure 4.24. Revenues from taxes on property are low

Revenues from taxes on property as a share of total tax revenues, Kazakhstan and OECD, 2005 - 2017



Note: Property taxes (4000) from OECD revenue statistics.
Source: OECD revenue statistics.

4.6.3. Increase scope of carbon prices

The introduction of a carbon tax as a price floor could be complementary to the existing trading system in Kazakhstan. The carbon pricing should be broad based. Countries can choose to price carbon emissions through fuel or carbon taxes or emissions trading systems (ETS). Carbon prices put a price on emissions, so they increase the price of carbon-intensive products and assets relative to low-carbon ones. This steers behaviours and investments towards the latter and reduces emissions. Carbon prices that apply to a broad emissions base provide stronger incentives for investment in clean technology. Kazakhstan currently uses an ETS as a carbon pricing instrument, which it relaunched in 2018 following its suspension in 2016 (after the fall in oil prices). In the absence of a price stability support measure, ETS tend to produce volatile carbon prices that can fail to send a stable signal to invest in low-carbon options (Flues and Van Dender, 2020[26]). ETS have a number of advantages, but given their base is emissions, they generally involve higher administrative and compliance costs than carbon pricing via the more widely used fuel-based approach (for more details, see Box 4.7). To encourage the decarbonisation of the economy (including industrial processes, household energy use, transport or electrical generation) and incentivise investments in low-carbon technologies the emissions base covered by carbon prices should be as broad as possible.

An increasing number of jurisdictions levy explicit carbon taxes in addition to emissions trading systems, for example as carbon price floors or to expand the base to which carbon prices apply (OECD, 2019[27]) (OECD, 2018[28]). While there are different approaches to designing carbon taxes (Box 4.7), if such a tax were introduced in Kazakhstan, it could be integrated with existing excise duties. Indeed, most of the countries that currently have explicit carbon taxes collect them from fuel suppliers in the same way as fuel excise taxes. Countries that follow this fuel-based approach do not tax carbon emissions directly, but put a price on fossil fuels depending on the carbon content of each fuel and convert that price into regular commercial units, for instance by reference to kilogrammes for solid fuels, litres for liquid fuels, and cubic metres for gaseous fuels. This reduces costs linked to measurement of emissions.

Carbon pricing can help to align investment and consumption choices with climate objectives. Broadening the carbon pricing base to sectors that are currently not covered (OECD, 2019[27]) (OECD,

2018[28]) would increase revenue while providing signals to reduce harmful emissions over time. Evidence from several countries suggests that transferring a part of the additional revenues from higher carbon or energy taxes on heating fuels and electricity to poor households is often sufficient to alleviate energy affordability concerns and offset the additional burden these taxes put on low-income households (Flues and van Dender, 2017[29]). Gradual price increases can also alleviate concerns over industry competitiveness, while helping to strengthen the ability of industry to thrive in a context of decarbonisation. Too many energy users do not pay the energy and carbon taxes needed to curb dangerous climate change, even when comparing carbon price signals against a low-end carbon benchmark of EUR 30 per tonne of CO2 . This benchmark is unlikely to reflect the climate damage caused by a tonne of CO2 emitted at present, and will not be sufficient to meet the objectives of the Paris Agreement (OECD, 2019[27]).

Box 4.7. The different approaches to designing carbon taxes

Fuel approach

The most common approach to carbon taxation has been to levy carbon taxes on specific fossil fuels, primarily oil, gas and coal, and their derivative products. Countries that follow this fuel-based approach do not tax carbon emissions directly, but put a price on fossil fuels depending on the carbon content of each fuel and convert that price into regular commercial units, for instance by reference to kilogrammes for solid fuels, litres for liquid fuels, and cubic metres for gaseous fuels.

Under this approach, carbon taxes are collected from fuel suppliers in the same way as pre-existing fuel excise taxes, which lowers administrative and compliance costs. Indeed, the countries that have introduced a carbon tax have generally added it to already existing excise duties, either as part of the general excise duty (e.g. in France) or as a separate tax (e.g. in the Nordic countries).

Direct emission approach

The other approach to carbon taxation consists in taxing carbon emissions directly, by relying on the direct measurement of emissions from certain types of stationary installations/facilities. Given the need to measure (or calculate) emissions, these carbon taxes often apply to emitters above a certain emissions threshold or to installations that fulfil certain technological criteria. Countries that pursue such an emissions-based approach with their carbon taxes include for instance Chile, Estonia and Latvia.

One of the advantages of emissions-based approaches is that they can readily be extended to non-energy and non-carbon emissions, e.g. in agriculture or industry. On the other hand, administrative and compliance costs tend to be somewhat higher than with fuel-based approaches. Whether such differences in administrative and compliance costs are relevant in practice may depend on pre-existing reporting obligations for other purposes. Indeed, the additional effort of reporting carbon emissions for tax purposes may be negligible for facilities that already have reporting obligations for other reasons (e.g. requirements to measure emissions by Integrated Pollution Prevention and Control regulations or by national environmental codes). More generally, administrative and compliance costs become relatively less significant as carbon tax levels increase.

In practice, the choice between fuel-based and emissions-based carbon taxes will also be influenced by political and legal/ constitutional considerations. For instance, in many countries, fuel-based carbon taxes fall under the responsibility of finance ministries, whereas emissions-based carbon taxes (and emissions trading systems) may be under the remit of environment ministries.

Source: OECD Taxing Energy Use 2019 and UN Committee of Experts on International Cooperation in Tax Matters.

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Notes

[1] Taxes on payroll are generally defined as taxes paid as a proportion of payroll that do not give entitlement to social benefits. Payroll taxes are relatively uncommon in OECD countries.

[2] The calculation is as follows: [PIT + payroll tax + total SSCs] / [payroll fund + payroll tax]).

[3] The average inflation rate over the period is based on data from the Asian Development Bank data library.

[4] The mean wage is taken from the Statistics Committee for the full year 2018.

[5] Or, as another example if an additional tax bracket was introduced with a lower PIT rate for those in low incomes.

[6] For example, in the KZT 180 000 – KZT 210 000 income range, a taxpayer is assumed to earn KZT 195 000. Subtracting the obligatory pension payment and basic allowance for 2017 gives taxable income of about KZT 151 000.

[7] Based on data for 2019 without including the exemption for low-income employees.

[8] The definition of social security contributions (SSCs) used is that described in the OECD Interpretative Guide.

[9] They were previously 5% before 2018.

[10] Data based on World Bank development indicators consumer price inflation for 2017. Uzbekistan not included and Tajikistan rate is for year 2016.

5 Competitiveness chapter

This chapter examines tax competitiveness issues in Kazakhstan. It considers companies, SMEs and the self-employed. Recommendations to strengthen the design of the corporate income tax and SME taxation regimes are provided in the table overleaf.

Box 5.1. Recommendations to strengthen the design of the CIT and the SMEs taxation regimes

Simplify CIT design

- Maintain the statutory 20% CIT rate, which remains internationally competitive, or consider reducing it modestly along with base broadening reforms to increase competitiveness.
- Conduct regular and systematic tax expenditure reports to monitor the use and effectiveness of corporate tax incentives. Collect tax revenue and other data related to corporate tax incentives and SEZ privileges and evaluate their direct and indirect costs and benefits empirically on an ongoing basis to ensure that they provide value for money and are aligned with longer-term national objectives.
- Consider broadening the CIT base by scaling-back or removing some of the costly corporate tax incentives and Special Economic Zones (SEZ) privileges.
- Abolish the newly proposed tax reform that will shift SME CIT revenue from central to local government.
- Retain cost base incentives but remove profit based tax incentives such as tax holidays and exemptions.
- Reduce discretion and uncertainty in the application of tax incentives to enhance transparency and accountability. For example, eligibility for priority investment projects is based on areas of investment that are updated annually. However, the uncertain and discretionary aspects of such a policy reduce the effectiveness of incentives and raise costs for investors.

Enhance design aspects of the special tax regimes for SMEs

- Given the high levels of self-employment in Kazakhstan and significant participation in the special tax regimes, the design of each regime should be reviewed both independently and with respect to all other regimes.
- Consideration could be given to reducing the overall number of existing special tax regimes for SMEs, in particular by abolishing the Fixed Deduction regime.
- Continue to implement the Single Aggregate Payment (SAP) regime, which is a promising regime to reduce informality and promoting fairness by bringing more people under the protection of social insurance.
- Review empirically the extent of participant bunching activity below the maximum thresholds for the different special tax regimes including the extent to which participants choose to remain in the SAP regime rather than graduating to the Patent regime, and for businesses in the Patent regime that try not to grow into the Simplified Declaration regime.
- Strengthen monitoring across the special tax regimes to mitigate against potential avoidance and evasion strategies.
- Review the requirement to have no employees in the Single Aggregate Payment (SAP) and Patent special regimes, which could undermine formal employment and induce entrepreneurs to hire informal workers instead.
- Reconsider the requirement of SAP workers to offer services only to individuals and not to corporations.
- Lower the annual turnover eligibility ceilings of various special regimes including the SAP regime, Patent regime and Simplified Declaration regime. This reform is a necessary condition in order to lift the limitations on the SAP and Patent regime.

5.1. The economy is dominated by relatively few firms

Kazakhstan has a "dual" business sector. The business economy can be characterised as having a dual economic structure, split into large firms and small firms (Table 5.1). On the one hand, less than 500 large companies produce half of all firm income and employ almost half of all employees in Kazakhstan. On the other hand, there is widespread small-scale self-employment and SMEs with very low incomes. The data shows that about one-third of SMEs are incorporated and these SMEs have far higher incomes and produce more employment. In terms of the CIT contributions by firm size, most CIT is paid by a small number of large companies (see Table 5.2 later in the section). SMEs currently represent about 10% of total CIT revenues.

Table 5.1. The business economy has a dual economic structure

Firm numbers, income and employment in Kazakhstan, 2017

	No. Firms	%	Income (EUR bn)	%	Employment (mn)	%
Total Firms (A + B)	885 096	100%	223.1	100%	4.5	100%
(A) Large companies	478	0.1%	118.7	53.2%	2.1	46.3%
(B) SMEs (C + D)	884 618	99.9%	104.4	46.8%	2.4	53.6%
Of which:						
(C) Company SMEs[1]	276 789	31.3%	93	41.7%	2.3	51.8%
Income < EUR 100K	217 858	24.6%	2.2	1.0%		
(D) Individual SMEs	607 829	68.7%	11.4	5.1%	0.1	1.9%
Income < EUR 100K	584 417	66.0%	5.1	2.3%		

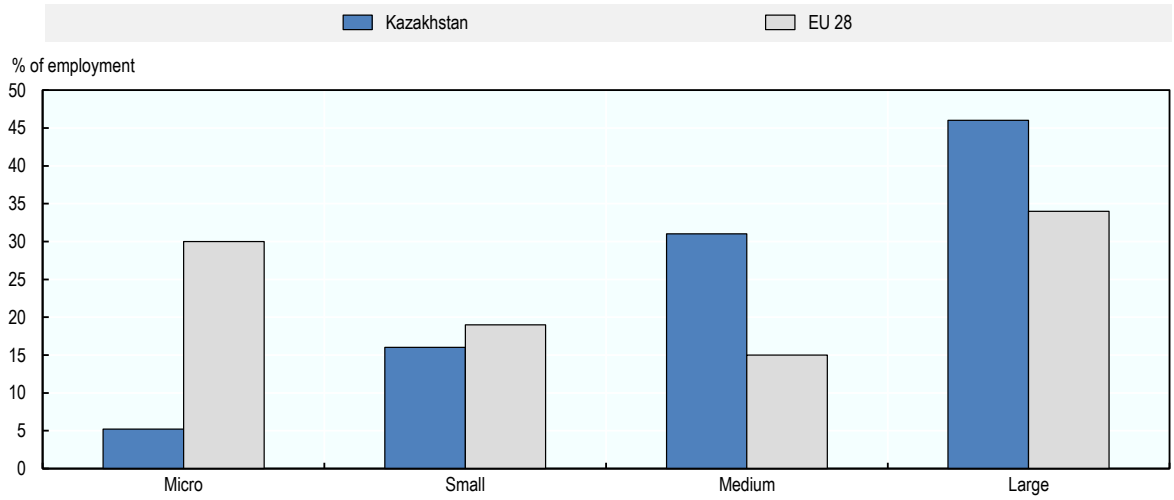
1.Company SMEs refers to legal entities.
Note: Partnerships are considered legal entities in Kazakhstan. The European Commission (EC) definition is used. The EC classification defines micro, small and medium-sized enterprises based on their number of employees and either turnover or balance sheet total. According to this classification, SMEs are enterprises that employ fewer than 250 persons and have an annual turnover below EUR 50 million (and/or an annual balance sheet total below EUR 43 million). For the purposes of the analysis in this section, the income definition is used for the number and income of firms and the employment definition is used for employment.
Source: State Revenue Committee data.

The share of employment in larger firms is high by international standards. Large firms, defined as those with more than 250 employees, employed almost half of employees (46%) in 2017 (Figure 5.1). This is high compared to the EU-28, where the proportion was one-third (33%). Furthermore, one-third of all employment (34%) is in companies with 50 to 250 employees, which is also considerably above the corresponding share in the EU (at 17%). On the other hand, only 20% of employees is employed by micro or small firms in Kazakhstan, which is significantly below the share in the EU-28.

Firm income concentration is high. A small number of large firms hold a large share of all firm income. For example, in 2017, half (53%) of all income is earned by less than 0.1% of all firms in Kazakhstan. Part of the economy is dominated by large State-Owned Enterprises (SOEs), which may partly explain the high levels of firm income concentration. Most SOEs tend to be in the economic sectors of telecommunication, mining and transportation sectors.

Figure 5.1. Larger firms provide a high share of employment by international standards

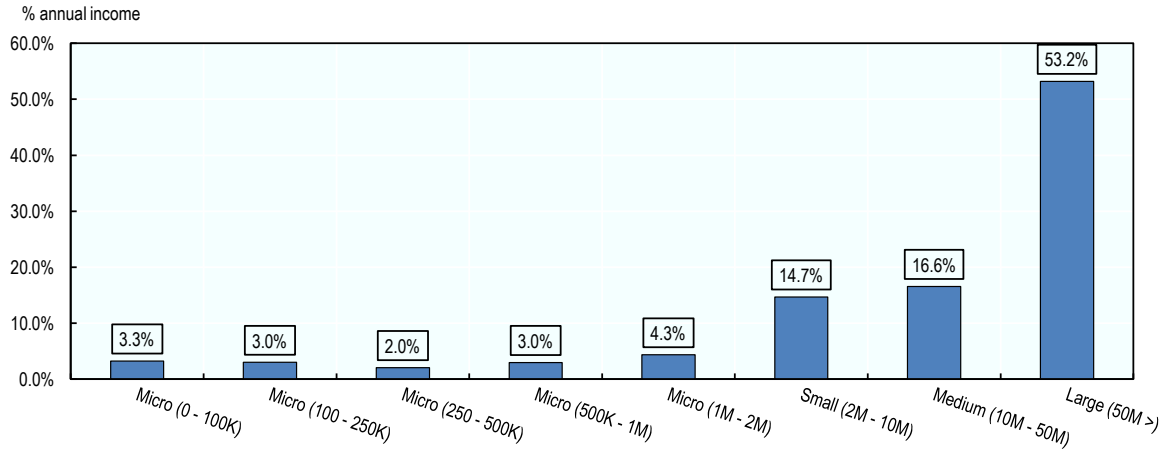
Share of employment, by firm size, 2017



Note: SMEs categorised based on European Commission definition of number of employees: micro (0 – 9 employees), small (10 – 49 employees), medium (50 – 250 employees) and large (>250 employees).
Source: Statistics Committee of Kazakhstan; European Commission 2017.

Figure 5.2. Firm income concentration is high

Income distribution of firms in Kazakhstan, by firm income size, 2017



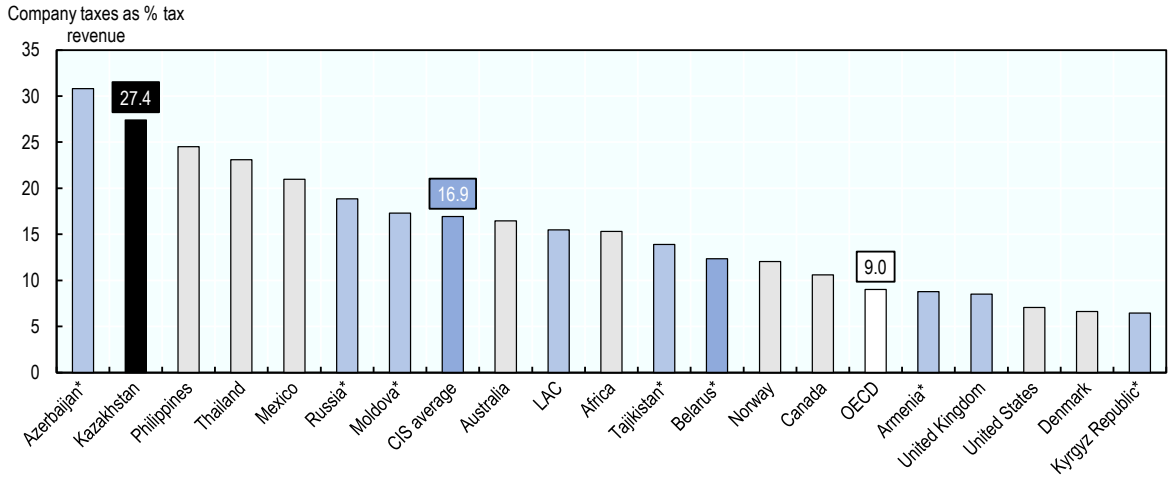
Source: State Revenue Committee data.

5.1.1. Tax revenues from companies are relatively high

Tax revenues from companies are high when compared internationally. CIT revenues are high in Kazakhstan, representing one-quarter of total tax revenues (27%) in 2017, based on OECD Revenue Statistics data. CIT revenues as a share of GDP are also high at 4.5%, compared to the OECD average of 3%. CIT is the only tax in Kazakhstan that collects more revenues as a share of GDP compared to the OECD average. About 35% of CIT is paid by oil-companies which, in addition, pay other taxes whose revenues are paid to the National Fund as well as non-tax revenues. It should be noted that the definition of what constitutes tax and non-tax revenues in the extractive sector differ in Kazakhstan and the OECD Interpretative Guide.[1]

Figure 5.3. Tax revenues from companies are high

Taxes on companies as a % of total tax revenues, selected countries including from OECD and CIS, 2017

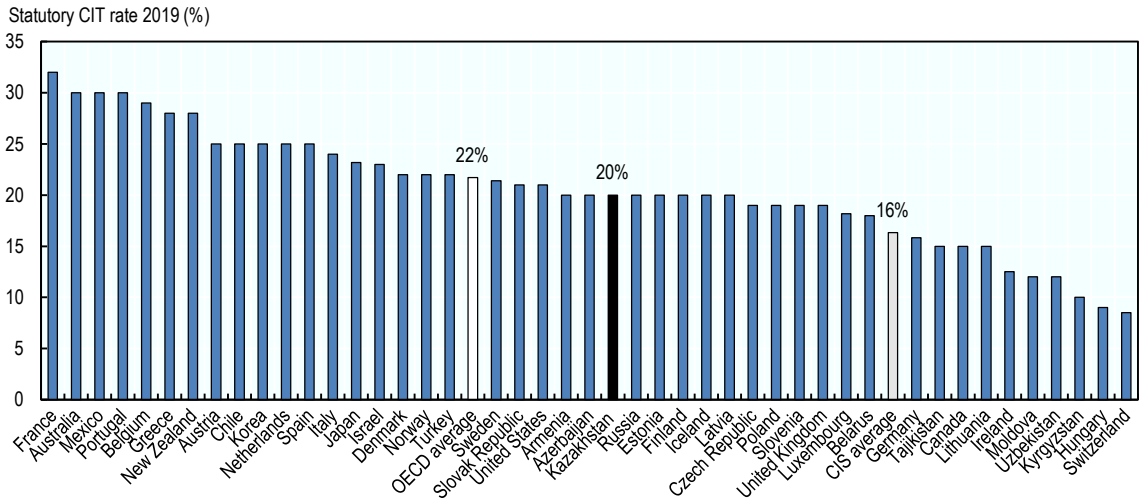


Note: Taxes on companies refers to taxes on income, profits and capital gains of companies (OECD tax reference code 1200) and does not include total revenues from companies to the National Fund including taxes on exports (5124) and other taxes (5128). Commonwealth of Independent States (CIS) data other than Kazakhstan relate to 2015. CIS average based on countries shown in chart only. Data for Australia, Canada, OECD relate to 2016. Africa relate to 2015. For non CIS countries, CIT refers to 1100 Taxes on income, profits and capital gains of individuals.
Source: OECD revenue statistics; data on CIS countries from State Revenue Committee of Kazakhstan.

The statutory CIT rate is high relative to CIS countries and similar to the OECD average. A first point of reference for a company to consider investing in a country is the statutory CIT rate. The statutory CIT rate is 20% in Kazakhstan, which falls between the rate of the OECD average (22%) and the CIS average (16%), as displayed in Figure 5.4. Kazakhstan currently has a similar rate to Azerbaijan, Russia, Armenia, Estonia, Latvia, Finland and Iceland.

Figure 5.4. The statutory CIT rate is close to the OECD average and above the CIS above

Statutory CIT rates in Kazakhstan, the OECD and CIS countries, 2019

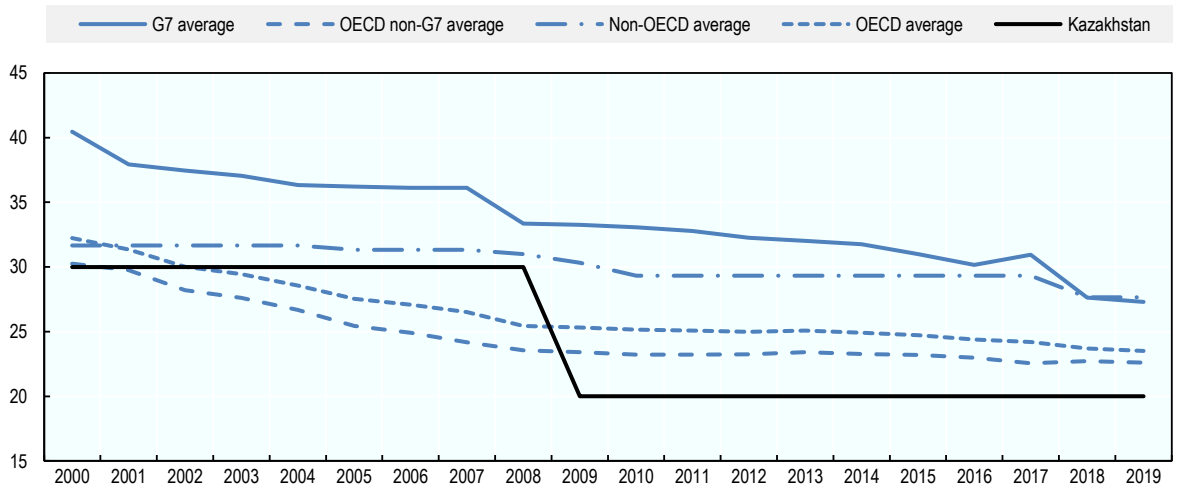


Note: Various countries provide for reduced CIT rates under certain conditions which are not included for the purposes of this analysis.
Source: OECD tax database.

Although the gap in the statutory CIT rate between Kazakhstan and the OECD has been narrowing in recent years, the statutory CIT rate in Kazakhstan remains below the average rate in the OECD. Kazakhstan reduced its CIT rate from 30% in 2008 to 20% in 2009 and it has remained at that rate since. The OECD average statutory CIT rate declined rapidly in the 2000s. This decrease slowed temporarily with the crisis, but accelerated again in recent years. Overall, the OECD average combined (central and sub-central) CIT rate declined from 32.2% in 2000 to 23.5% in 2019. In 2019, there were only two countries with CIT rates above 30%, against 22 in 2000. Meanwhile, the number of countries with CIT rates below 20% increased from two in 2000 to 11 in 2019. Unlike CIT revenue trends which have been mixed across countries, the decline in CIT rates has been widespread (OECD, 2019[1]).

Figure 5.5. There has been a steady and widespread decline in CIT rates globally

The evolution of combined statutory CIT rates in different groups of countries, 2000 - 2019

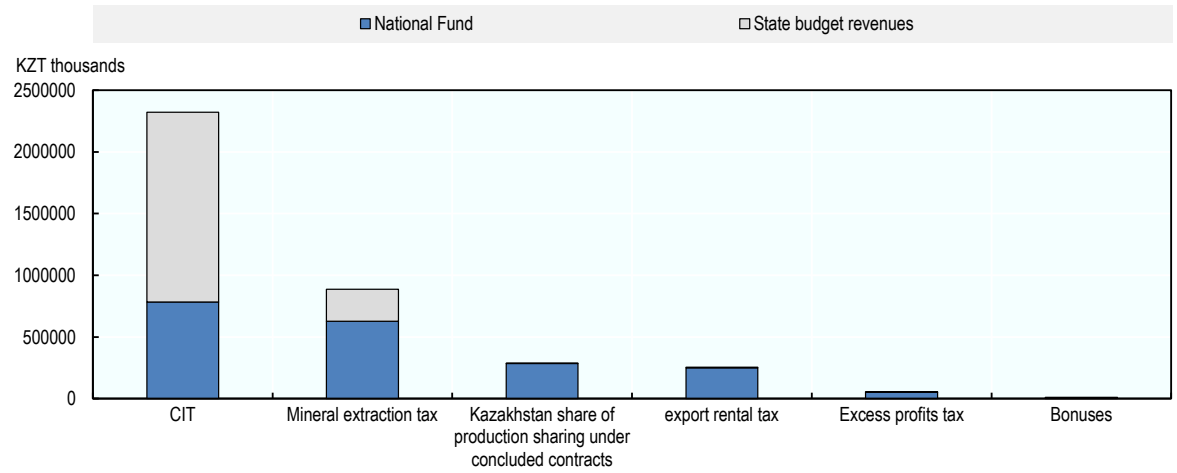


Note: The non-OECD average refers to the average of the three non-OECD countries covered in this publication: Argentina, Indonesia and South Africa.
Source: OECD Tax Policy Reforms Report 2019; OECD revenue statistics in Asian Countries 2017; Trading Economics.

There are a range of taxes on companies that operate in the extractive sectors beyond CIT. Tax and non-tax revenue from the oil sector could represent as much as 5.5% of GDP, of which 3.7% goes the National Fund and 1.7% goes the budget, based on data from OECD revenue statistics (as discussed previously in Chapter 3). Using a different data source (EITI, 2018[2]), Figure 5.6 confirms that a large share of many taxes from oil companies go to the National Fund. These include the Mineral Extraction Tax (71% goes to the National Fund), Excess Profit Tax (89%), Export Rental Tax (98%) and the Kazakhstan share of production sharing under contracts (99%).

Figure 5.6. There are many taxes on companies in the extractive sectors

The National Fund and budget shares of direct taxes from oil companies, KZT thousands, 2017



Source: The Extractive Industries Transparency Initiative (EITI) Based on data from the Extractive Industries Transparency Initiative, the 13th National Report, Report on Republic of Kazakhstan in 2018.; Statistics Bulletin of the Ministry of Finance 2018.

Box 5.2. The taxation of oil and gas in Kazakhstan

In Kazakhstan, the taxation of oil and gas companies operating in the extractive sector is provided for under the 'Taxation of Subsoil Users' in the Tax Code. The associated tax revenues, which are substantial (Figure 5.6), are derived from a range of different taxes. These include CIT, mineral extraction tax (MET), signature bonus, rent tax on exports, excess profit tax (EPT) and crude oil export duty. While a detailed investigation of oil taxation in Kazakhstan goes beyond the scope of this report, an overview of the different taxes, including their tax bases and tax rates, are discussed below.

Corporate income tax (CIT) is applied to all companies at a tax rate of 20% on taxable income. Taxable income is aggregate annual income after adjustments and less deductions. Deductions include all expenses incurred by the taxpayer in carrying out business activities. Deductions include interest expenses, expenditures on exploration operations for the extraction of mineral resource and expenditure on R&D.

Mineral extraction tax (MET) is a progressive volume-based tax that applies to crude oil, gas, metals and minerals. The rates increase for higher volumes. The MET ranges from 5% for smaller volumes up to 10% (for over 10 000 000 tons). Rates also differ depending on whether it is for export or the domestic market.

The signature bonus is a one-time lump-sum payment paid by subsurface users for the right to use the subsurface.

Export rental tax is paid by companies and individuals that export crude oil. The tax base is calculated as the export volume of crude oil products multiplied by the world price (of crude oil). The tax is volume-based, with a progressive tax rate ranging from 0% for smaller volumes up to 32% for larger volumes.

Excess profit tax (EPT) is paid annually at progressive rates on income that remain after the deduction of CIT. The taxable object is the portion of net income (if any) that exceeds 25% of deductions (where deductions are expenditures deductible for CIT purposes). The net income is calculated as annual income less deductions less CIT and branch profit tax (if any). The tax rate ranges from 0% to 60%.

Crude oil export duty is paid at a progressive rate, depending on the monthly average market price for crude oil.

Rental tax payments for the use of land plots for mining companies operating under subsoil use licenses.

Note: An alternative subsurface use tax (ASUT) may be applied by some types of oil producers as a substitute to MET, EPT and payment for compensation of historical costs.
Source: EY global oil and gas tax guide 2018; ETI; Tax Code 2019.

5.1.2. The CIT is concentrated among a small number of large companies

Turnover and taxes paid by companies are concentrated among a small handful of companies. Table 5.2 shows the share of turnover and taxes paid by turnover decile, based on data for about 440 000 companies in Kazakhstan in 2018. Total taxes relate only to those paid by companies. Overall, the total turnover of all companies is over KZT 80 trillion in 2018, which is 1.4 times GDP and total CIT revenues from companies is KZT 3.1 trillion in the same year. According to the analysis, the top 10% of companies (about 44 000 companies), produced 90% of all turnover. The top 100 companies earned over one-third of all turnover (38%). The concentration of CIT revenues paid is even higher. The top 10% of companies paid virtually all CIT (99%) and the top 100 companies paid more than three-quarters of CIT (77%). VAT

paid by companies is also highly concentrated, albeit less so than CIT. The top 10% of companies pay 89% of VAT and the top 100 companies pay about one-third of all VAT (35%). Similarly for PIT and property tax, the top 10% of companies pay 93.1% and 99.5% respectively.

The concentration of tax is higher than the concentration of turnover. Most income and employment is concentrated in large and medium-sized incorporated firms (Figure 5.2) while small and micro unincorporated SMEs tend to have very small incomes and little employment. The concentration of turnover is further confirmed in Table 5.2. Despite this high level of turnover concentration, tax concentration is even higher, which suggests that many small and micro SMEs may contribute little in terms of tax revenues. For example, the bottom 9 deciles represent 9.9% of turnover but only contribute 1.4% of CIT and 1.0% of property taxes. The bottom 9 deciles contribution relatively more to employee PIT at 7.4% but this still remains below their share of turnover.

Table 5.2. Company turnover and taxes are concentrated among the most profitable companies

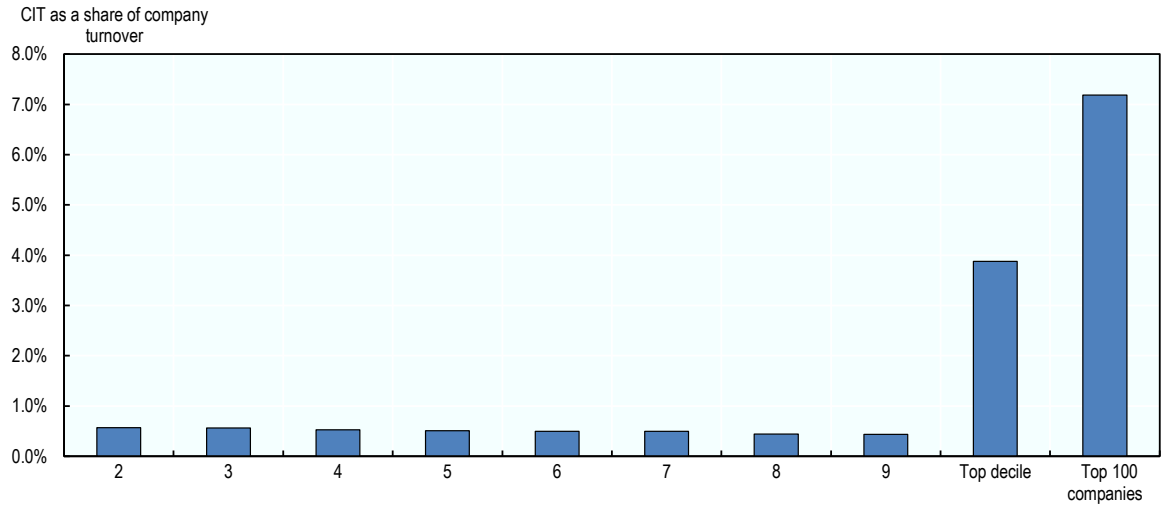
CIT, VAT, PIT and property taxes, paid by companies, by turnover deciles, 2018

Decile	Turnover	CIT	VAT	Employee PIT	Property tax
2	0.00%	0.00%	0.00%	0.00%	0.00%
3	0.10%	0.00%	0.10%	0.00%	0.00%
4	0.20%	0.00%	0.20%	0.10%	0.00%
5	0.40%	0.10%	0.40%	0.20%	0.10%
6	0.60%	0.10%	0.70%	0.40%	0.10%
7	1.10%	0.20%	1.30%	0.70%	0.20%
8	2.20%	0.30%	2.60%	1.60%	0.10%
9	5.30%	0.70%	6.30%	4.40%	0.50%
Top decile	90.10%	99.30%	88.50%	93.10%	99.50%
of which:					
Top 100 companies	37.80%	77.10%	35.00%	27.00%	59.10%
Total (%)	100%	100%	100%	100%	100%
Total (KZT trillions)	87	3.1	2	0.74	0.28

Note: Turnover refers to total annual income, including all types of income from all sources before deductions for a resident legal entity of Kazakhstan. The bottom decile is excluded from the analysis since large VAT repayments to companies in this decile produce a negative figure, perhaps due to losses and repayments. The analysis relates only to the taxes that are paid by companies.
Source: State Revenue Committee data.

Figure 5.7. CIT as a share of turnover is concentrated among the top firms

CIT as a share of company turnover, by turnover decile, 2018

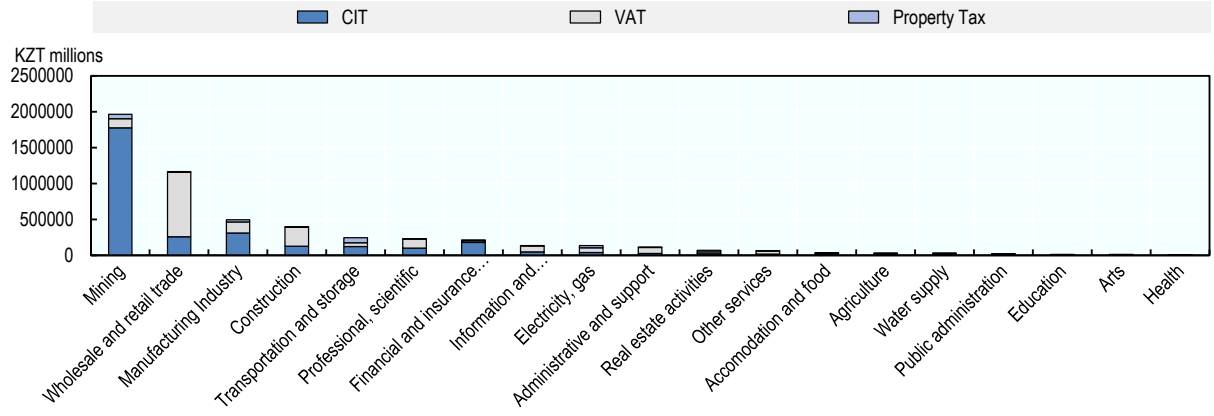


Note: The first decile is excluded since proportions are negative, perhaps due to losses.
Source: State Revenue Committee data.

Company taxes are concentrated in a few sectors. The taxes paid by companies are relatively concentrated in a few industry sectors. Taking CIT, VAT and property taxes together, 75% of all three taxes is paid in four sectors – mining, wholesale and retail trade, manufacturing and construction (Figure 5.8). The data show that the single sector of mining comprises more than one-third (37%) of all three taxes combined and 58% when the wholesale and retail sector is also included.

Figure 5.8. Company CIT, VAT and property taxes are concentrated in a few sectors

Company CIT, VAT and property taxes by sector, 2018

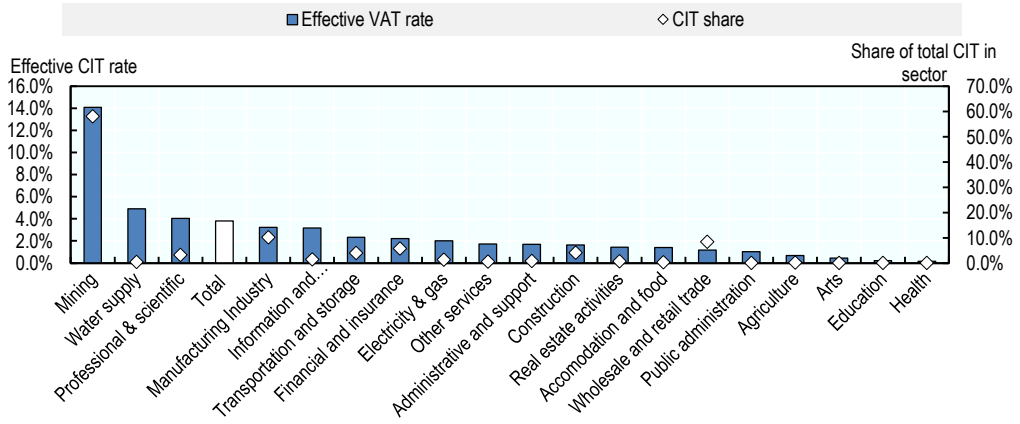


Source: State Revenue Committee data.

CIT as a share of turnover is low. CIT as a share of company turnover is 3.8% for all sectors. Notably, CIT as a share of turnover is the highest in the mining sector at 14%, perhaps because other company taxes are included related to the oil and gas sector. If the mining sector is excluded from the overall effective rate, the tax as share of turnover would fall to 1.9%.

Figure 5.9. CIT as a share of company turnover is low

CIT as a share of turnover, by sector in 2018



Note: Effective CIT is the total CIT revenues paid divided by total annual company income.
Source: State Revenue Committee data.

5.1.3. A wide range of generous corporate tax incentives

Corporate tax incentives reduce tax revenues and may create distortions and complexities. Kazakhstan offers various tax incentives to companies (Box 5.3). For example, companies that implement a priority investment project under one of the priority areas (as defined by government) that invest in a new production facility (with an investment of at least 2 million MCI) are exempt from CIT and land tax for up to 10 years and from property tax for up to 8 years. When production facilities are expanded and/or updated (with an investment of at least 5 million MCI), the company can be exempt from CIT for up to 3 years. Such incentives reduce tax revenues for a longer time period. In addition, these incentives may provide windfall profits to some firms, for example those who may have invested on the basis of resources in the country rather than the incentives in place. Revenue losses from tax incentives and concessions as a share of CIT revenues have been estimated at 32%, 51% and 36% in 2014, 2015 and 2016 respectively (World Bank, 2016[3]). The aforementioned study also finds that the sectors that benefit most from tax incentives are finance, insurance, education, healthcare and the professional and scientific sector.

Special Economic Zones (SEZ) have been established in Kazakhstan to support the development of economic sectors other than natural resources. There are 11 SEZs, each of which are from different regions and which support a wide range of investment priorities. Companies in SEZs may reduce CIT, land tax and property tax up to 100%. In addition, sales of certain qualifying goods within SEZs are subject to VAT at a rate of zero percent. They are however still required to file tax returns, which is a positive feature that may help to monitor and report revenue forgone. To register for the preferential SEZ tax treatment, companies must meet several eligibility requirements. For example, the company must undertake government-approved priority activities consistent with the SEZ where the business is located, the business cannot be a subsurface user and it must derive 90% of their sales from self-manufactured goods or services (see Box 5.3). The tax exemption in the SEZ starts applying from the moment the right has

been granted for a period of 10 years, which differs from the operation of SEZ in some countries, where the exemption only applies when profits are made. While a time limit is in principle a design feature, 10 years is an extensive period of time.

Companies in Special Economic Zones hardly pay any tax. Table 5.3 shows the contribution of SEZ companies to total CIT and VAT revenues. The CIT paid in SEZs as a share of total CIT revenues was 0.4% and 0.3% in 2017 and 2018 respectively. Similarly, VAT paid in SEZs as a share of total VAT was 0.3% in 2017 and 2018. Overall, taxes paid by companies in SEZ appear to be negligible.

Table 5.3. Taxes paid by companies in special economic zones are negligible

CIT and VAT paid in special economic zones, USD, 2017 and 2018

Tax	% of CIT revenues	% of VAT revenues
2017	0.4%	0.3%
2018	0.2%	0.3%

Source: State Revenue Committee data.

5.2. Strengthening the design of the CIT

The tax system in Kazakhstan seems overused to stimulate corporate investment. There is a wide range of tax incentives to stimulate investment in Kazakhstan. Moreover, the tax incentives are generous in terms of both the amount of taxes that are waived and the length of the tax holiday. For this reason, a cost-benefit-analysis (CBA) should be conducted to evaluate whether tax incentives are fit for purpose and, if not, whether they should be abolished completely or replaced by incentives that are more closely aligned with the objectives to stimulate “additional” investment in Kazakhstan. Indeed, there is a risk that tax incentives provide a windfall gain to capital owners and investment that would have taken place anyway. A detailed discussion of each tax incentive goes beyond the scope of this review.

The annual revision of the list for priority investment projects increases uncertainty and discretion which may undermine the effectiveness of tax incentives and increase costs for investors. Priority sectors and investments are decided by the authorities. A potential risk to this approach is the extent to which government has sufficient information to correctly select priority areas of future investment. Furthermore, some of these tax incentives lack transparency and the requirements that need to be fulfilled to qualify for them are not always clear, which runs the risk that the rules are not applied in a consistent manner across all businesses and sectors. Moreover, the annual revision of the investment areas which determine eligibility for priority investment projects increases uncertainty and discretion, which reduces the effectiveness of tax incentives and increase costs for investors. This may raise the risk of arbitrary variation in the application of tax rules and create opportunities for rent seeking and corruption.

Box 5.3.Tax incentives for investment projects

There are a number of preferential tax regimes for different types of investment projects. Tax incentives are granted under a contract between the Government and companies for investment projects that focus on priority sectors of the economy. Between 2017 to 2019, 122 investment contracts were concluded with investments in fixed assets, of which 16 contracts were granted tax investment preferences (Investment Committee, Ministry of Foreign Affairs). Priority sectors are set by the Government. The current priority list includes industrial infrastructure, processing industries, housing construction, the social sphere, tourism and production of nuclear materials. In accordance with Article 284 of the Entrepreneurial Code of the Republic of Kazakhstan, there are three types of investment projects each of which offer different preferential tax treatment and require different criteria as follows:

1. **General investment projects** relate to investments in the creation of new, expanded or updated facilities. These projects receive preferential tax treatment in that they are exempt from customs duties on imported technology equipment (and other components and raw materials) for a maximum of 5 years and are exempt from VAT on imports of certain raw materials. To be eligible for general investment projects, companies must import technological equipment.
2. **Priority investments projects** relate to company investments (above certain investment amounts) in the creation of new, expanded or updated production facilities. The priority investment list is revised annually and excludes gambling, subsoil use activates and the production of most excisable goods. The company must invest in the creation of new production of at least 2 million MCI or the expansion of existing production of at least 5 million MCI. Priority investments are exempt from CIT for 10 years for the creation of new production facilities and for 3 years for the expansion of existing production. They are also exempt from land tax for 10 years and property tax for 8 years for the investment project.
3. **Special investment projects** relate to Kazakhstan companies that are either registered in a SEZ, own a free warehouse, have concluded an agreement on the industrial assembly of motor vehicles or have carried out activities in the list of priorities approved by the government. Companies operating a special investment project are tax exempt on import customs duties for up to 15 years.

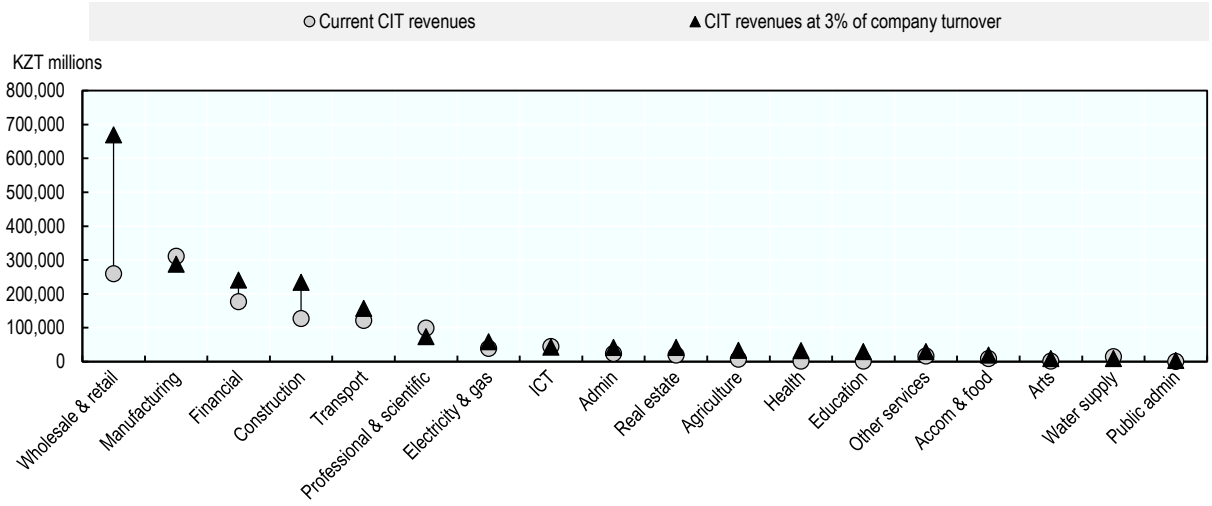
Accelerated depreciation for capital expenditure is available to subsurface users at double depreciation rates. This must be applied in the first tax period after putting the fixed assets into operation in Kazakhstan and must be directly used in subsurface operations for at least three consecutive tax periods.

Source: Investment Committee of the Ministry of Foreign Affairs of the Republic of Kazakhstan; IBFD.

Significant scope exists to broaden the tax base and collect more tax revenues from businesses across the economy. Currently, CIT revenues as a share of company turnover is 3.8% overall, but both CIT and turnover vary considerably across sectors. Hypothetically, if CIT as a share of company turnover were constant at 3% across sectors, CIT revenues would increase by one-quarter (24%) (the natural source sector is left outside of these calculations) (Figure 5.10). Based on this simple back-of-the envelope calculation, it is observed that CIT as a share of turnover is currently low in sectors such as wholesale and retail trade, finance and construction. While such a simple analysis does not allow to make in depth recommendations, it does flag that more in depth analysis is necessary to ensure that all sectors pay their fair share of CIT. More rigorous estimates could be simulated by developing a microsimulation modelling of all companies using tax records and survey data.

Figure 5.10. CIT as a share of turnover varies across sectors

CIT as a share of turnover compared to CIT as a share of turnover at a uniform 3% rate across sectors



Note: Mining sector not included.
Source: State Revenue Committee data.

Kazakhstan should review whether incentives are the right tool to attract investment and, if and where they are, profit-based tax incentives should be replaced by cost-based tax incentives. As discussed in Box 5.3, Kazakhstan has a mixture of both profit-based (tax holidays, preferential rates) and cost-based (tax allowances for investment expenses and accelerated depreciation) tax incentives. A number of cost-based incentives come under Article 274 of the Tax Code on investment tax preferences. Profit-based tax incentives generally reduce the tax rate applicable to taxable income and include tax holidays, preferential tax rates or income exemptions (IMF/OECD/UN/WB, 2015[4]). Profit-based incentives lower the tax rate for any amount of profit earned so the value of this incentive is a direct function of the company's profits. Therefore, the incentive favours companies with high profits, which least need government support. This can lead to high redundancy of expenditure on incentives since an investor anticipating high profits would have proceeded anyway. The loss in tax revenue may also be significant. The risk for profit shifting is also high since companies may attempt to artificially allocate profits within the company with the preferential rate (UNCTAD, 2015[5]). Cost-based incentives, such as tax allowances for investment expenses, special tax deductions, accelerated tax depreciation regimes and credits offer superior design features. Unlike profit-based incentives, cost-based incentives lower the cost of inputs. In this case, the magnitude of the benefit is independent of its profit level and instead depends on the size of the investment that is undertaken. In general, there are therefore strong arguments to avoid profit-based tax incentives but rather use incentives that lower the cost of investment.

Larger companies face a tax-induced incentive to register as a SME and operate under one of the simplified tax regimes in Kazakhstan. To be eligible for the simplified and fixed deduction special tax regimes, companies must have a maximum annual income of approximately USD 226 000 and USD 1 392 000 respectively in 2019. These relatively high maximum income thresholds mean that, for example, a company earning USD 1 million could opt for the fixed deduction regime and benefit from making a fixed 30% deduction without the need to provide documentation.

A new tax reform will shift CIT revenues paid by SMEs from central to local government. Following announcements in the State of the Nation Address 2019, Kazakhstan is transferring CIT revenues paid by SMEs to local government starting from December 2019 (and as cited in the Action Plan for Kazakhstan

2019). CIT revenues paid by SMEs currently represent about 10% of total CIT revenues. The rationale for this reform is to equalise the level of fiscal capacity in the regions and ensure equal fiscal opportunities in addition to increasing the level of responsibility of local executive bodies when using budget funds. In addition, local government will be entitled to spend the CIT revenues collected from SMEs. This reform shifts the most challenging tax to administer to under-resourced local tax administrations. Even if the administration of the CIT would continue to be carried out at the central government level, OECD best practice shows that local governments should be funded through taxes whose revenues are not volatile (such as recurrent taxes on immovable property). However, CIT revenues are very volatile in most countries and in particular in Kazakhstan. The CIT is therefore the least preferred tax to finance local governments directly. Despite of the good government intentions, this reform is not a step in the right direction.

Kazakhstan aims at incentivising local communities to develop their economies through the tax system. In order to achieve this objective, and to provide more funding to local communities, Kazakhstan plans to assign the CIT revenues paid by SMEs to the region where the SME is located. When SMEs grow and pay more taxes, local communities will collect more tax revenues, and they will therefore be incentivised to further develop their local economies. While this strategy might work in the short run, it comes also at a cost. First, local communities might not want their businesses to grow from SMEs to large businesses, as this would reduce local tax revenues. Moreover, it might lead to unwanted competition amongst local communities to attract SMEs (for example, in the form of infrastructure spending).

OECD research shows that the corporate income tax is the least efficient form of taxation for sub-central governments. Empirical research conducted by the OECD has shown that taxes on immovable property are generally the least distortive tax instrument in terms of per-capita GDP growth, followed by consumption taxes, personal income taxes and corporate income taxes (Johansson et al., 2008[6]). Further OECD research related to sub-central governments (SCGs) has explored the question of what are the most appropriate taxes (Blöchligeri and Petzold, 2009[7]). This research finds that the conditions for a sub-central tax to be growth-enhancing are generally the same as those for a national tax (but some additional constraints apply to make a “good” SCG tax). As a principle, SCGs should rely on benefit taxation, that is, there should be a link between taxes paid and public services received. To achieve this, the criteria for efficient SCG taxation should include that the tax is non-mobile, non-redistributive (to avoid erosion), non-cyclical and should not be exported to other jurisdictions (to avoid distortions in the tax burden) and should be evenly distributed across jurisdictions (to avoid disparities). Based on these criteria, a property tax represents an efficient form of tax whereas corporate income tax is the least efficient as it is highly mobile, highly cyclical, geographically concentrated and tends to shift the tax burden to non-residents (Blöchligeri and Petzold, 2009[7]).

Countries around the world differ in their approach to fund local communities and other sub-central governments but country best practices can be identified. Almost in all countries, local communities are funded with revenues from the recurrent taxes levied on the immovable property located in their community. However, this requires a fiscal cadastre and property valuation system (discussed in section 4.6.2). Such a system could be complemented with a system of grants or tax sharing agreements that takes into account the capacity of local communities to collect property taxes (i.e. a fiscal equalisation mechanism across municipalities) as well as the efforts taken by local communities to develop their local communities. In general, grant systems take into account a wide range of factors beyond the tax system, such as spending needs that may vary with the characteristics of the local population and the spending powers of the local governments. Guidance on the specific design of such a sub-central financing mechanism (including the balance between own taxing powers, grants and tax sharing agreements) is left for future work.

5.2.1. Selected international tax issues

A comprehensive approach to protecting Kazakhstan's corporate tax base is necessary. Base erosion and profit shifting (BEPS) arises when businesses can exploit gaps and mismatches between different countries' tax systems. BEPS negatively affects tax revenues as well as the efficiency and the ability of tax systems to create a level playing field for all firms. A comprehensive approach to addressing simultaneously different BEPS behaviours is needed.

Undertaken at the request of the G20 Leaders, the OECD/G20 BEPS Project provided 15 Actions to equip governments with the domestic and international instruments needed to tackle tax avoidance and ensure that profits are taxed where economic activities are performed and where value is created. The 15 Actions in the BEPS Project include four minimum standards as well as common approaches, best practices and new guidance in a number of areas. Working together in the OECD/G20 Inclusive Framework on BEPS, over 130 countries are implementing these 15 Actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

As a member of the Inclusive Framework on BEPS, Kazakhstan has agreed to implement the four minimum standards. These imply removing any harmful tax practices from its domestic tax regime (Action 5), amending its tax treaty rules to prevent treaty abuse (Action 6), implementing country-by-country reporting rules and exchanging the reports it receives from MNEs with other countries (Action 13), and working with other BEPS IF members to improve cross-border tax dispute resolution mechanisms (Action 14). Each of the four minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard a level playing field.

Corporate tax reforms in special economic zones should be conducted with regard to international tax reforms in other countries particularly the United States. The 2017 US tax reform contains a provision, the "Global Intangible Low Taxed Income" (GILTI), which constitutes a minimum tax on profits of foreign subsidiaries controlled by US parent companies (Controlled Foreign Corporations). Thus, under certain conditions, part of the income of a Kazak company controlled by a US company must be included in the income of the US company and declared to the US tax authorities and taxed at the rate of 10.5% by the United States (13.125% after 2025). Consequently, if the taxation of profits is too low (less than 10.5% currently), for example in the export sector where many foreign companies are located, Kazakhstan may risk losing tax revenue from companies in Kazakhstan controlled by US parent companies.

Regarding transfer pricing, Actions 8-10 seek to align transfer pricing outcomes with the value creation of the MNE group. Transfer pricing rules, which are used for tax purposes, are concerned with determining the conditions, including the price, for transactions within an MNE group resulting in the allocation of profits to companies within the group in different countries. The standard approach is to treat each enterprise within the MNE group as a separate entity. To do so, individual group members must be taxed on the basis that they act at arm's length in their transactions with each other. Actions 8-10 clarify and strengthen the existing Transfer Pricing Guidelines, including the guidance on the application of the arm's length principle, the application of the profit split method, intangibles, and an approach for appropriate pricing of hard-to-value-intangibles within the arm's length principle to ensure that what dictates results is the economic reality. These changes reduce the incentive for MNEs to shift income to shell companies with few if any employees and little or no economic activity, which seek to take advantage of low or no-tax jurisdictions. Kazakhstan is considering implementing Actions 8 – 10 and plans to hold an international round table with the participation of OECD experts on the implementation (Specialised Division, State Revenue Committee).

Box 5.4. The OECD/G20 BEPS project and the Inclusive Framework on BEPS

The OECD/G20 BEPS project produced a 15-point Action Plan including minimum standards, common approaches, best practices and new guidance in the main policy areas.

- Minimum standards were agreed upon in the areas of fighting harmful tax practices (Action 5), preventing treaty abuse (Action 6), Country-by-Country Reporting (Action 13) and improving dispute resolution (Action 14). Each of the four minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field.
- A common approach, that facilitates the convergence of national practices by interested countries, was outlined to limit base erosion through interest expenses (Action 4) and to neutralise hybrid mismatches (Action 2). Best practices for countries which seek to strengthen their domestic legislation were provided on the building blocks for effective controlled foreign company (CFC) rules (Action 3) and mandatory disclosure by taxpayers of aggressive or abusive transactions, arrangements or structures (Action 12).
- The permanent establishment (PE) definition in the OECD Model Tax Convention was modified to restrict inappropriate avoidance of tax nexus through commissionaire arrangements or exploitation of specific exceptions (Action 7). In terms of transfer pricing, important clarifications have been made with regard to delineating the actual transaction, and the treatment of risk and intangibles. More guidance has been provided on several other issues to ensure that transfer pricing outcomes are aligned with value creation (Actions 8-10).
- The changes to the PE definition, the clarifications on transfer pricing, and the guidance on CFC rules are expected to substantially address the BEPS risks exacerbated by the digital economy. Value Added Taxes (VAT) will now be levied effectively in the market country facilitating VAT collection (Action 1).
- The multilateral instrument (MLI) modifies the application of bilateral tax treaties to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies.

The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan, leading to the 2015 BEPS Action 1 Report (OECD, 2015[8]). Concrete proposals by IF members to re-design the international tax system were classified into two Pillars. Pillar One focuses on the re-allocation of taxing rights and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules. Pillar Two (also referred to as the “GloBE” proposal) seeks to comprehensively address remaining BEPS challenges by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.

5.3. The taxation of SMEs and the self-employed

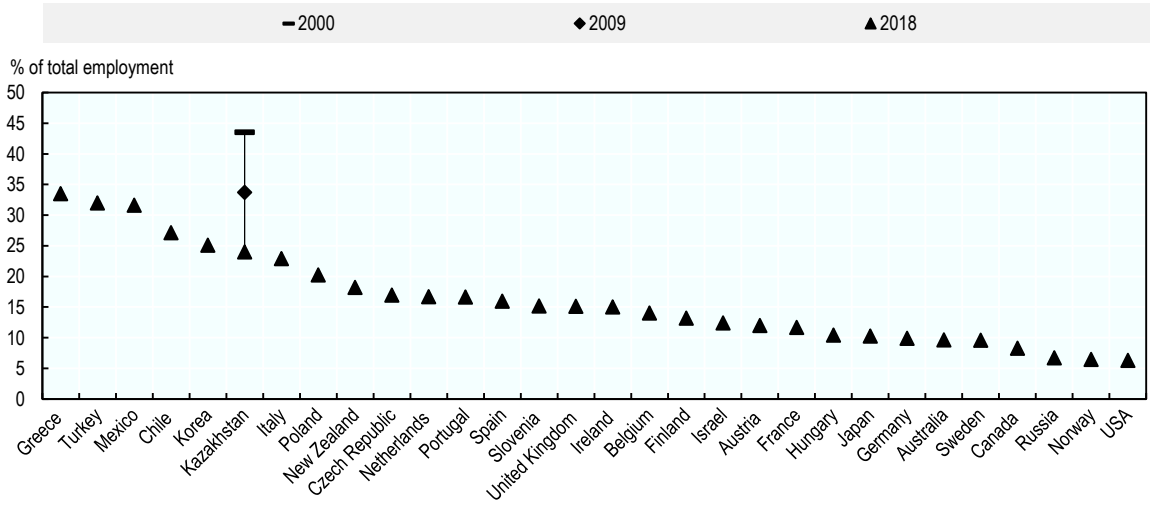
There is scope to reduce the number and enhance the design of Kazakhstan’s special tax regimes. Kazakhstan is committed to support the SME sector of the (State of the Nation, 2019[9]). The country has a tiered system of special tax regimes for self-employed individuals and companies. The regimes are intended to simplify and reduce the tax burden on the self-employed while also placing them on a graduated path to expansion towards the regular system. Overall, having many special tax regimes creates complexity for government and businesses. A further general risk across the regimes is the possibility of taxpayer bunching activity arising from higher tax burdens as taxpayers graduate up regimes.

5.3.1. There is widespread low-income self-employment

Self-employment has fallen but remains high. Currently, there about 2 million self-employed workers in 2018 in Kazakhstan, representing about one-quarter (24%) of employment. The remaining three-quarters are employees. Of the self-employed, 94% are own-account workers and 5% are employers.[2] The proportions of self-employed workers remains high despite falling over the past two decades. Since 2000, self-employed workers as a share of total employment has declined steadily from 44% in 2000 to 34% in 2009 to 24% in 2018. According to the analysis, the number of self-employed workers was stable at 2.6 million between 2006 and 2013. Since then, the numbers have declined, reaching 2.1 million in 2018. Despite this, the proportion remains high compared to OECD and other countries. Only Greece, Turkey, Mexico, Chile and Korea had higher proportions in 2018 based on the countries shown in Figure 5.11.

Self-employment is concentrated among younger workers in agriculture and trade sectors in rural areas. Self-employment is concentrated in certain sectors. For example, two-third of self-employed workers are employed in one of two sectors - agriculture, forestry and fishing (38%) or wholesale and retail trade (31%). Self-employed workers are also concentrated in rural areas. For example, only 5% of all self-employed work occurs in the major cities of Astana and Almaty. Self-employed workers also tend to be young - 72% of self-employed are aged between 25 and 54; only 2% are older than 65. Furthermore, the self-employed are working longer hours than before. After 2008, the proportion of self-employed reporting working more than 36 hours per week rose from 45% to over 80% in 2018. During the same period, the proportion reporting working 25 hours or less fell from 42% to 14%.

Figure 5.11. The proportion of self-employed workers has fallen but remains high



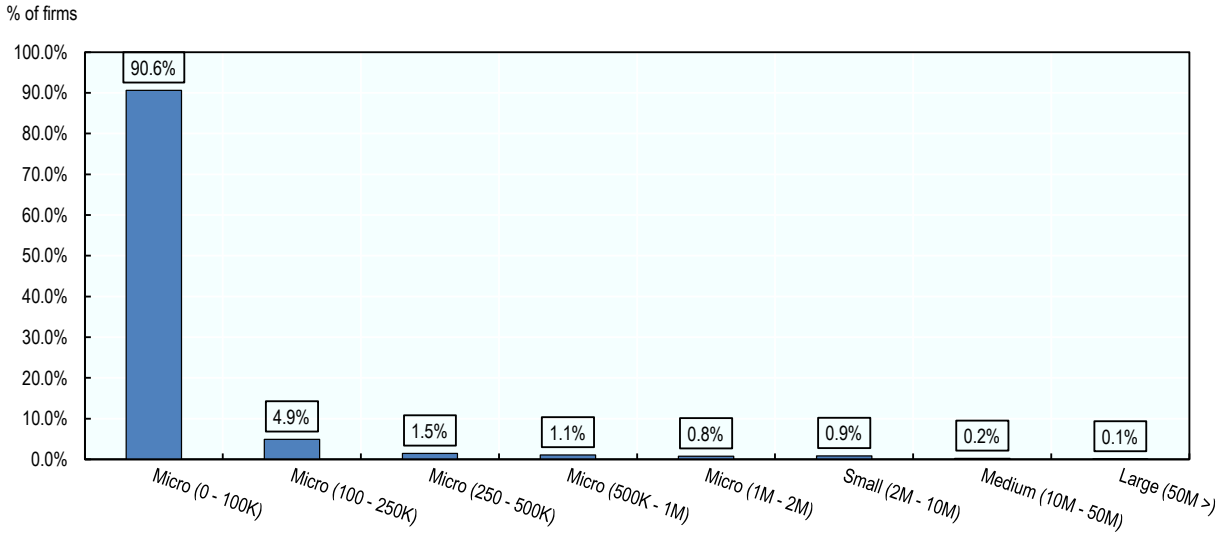
Source: OECD statistics and Statistics Committee of Kazakhstan.

SMEs play a key economic role in the economy and account for the vast majority of firms. SMEs contribute significantly to income and employment in Kazakhstan. There are about 885,000 SMEs, which employ 2.4 million people and have annual income of over EUR 100 billion in 2017. SMEs account for 99.9% of the total number firms in Kazakhstan in 2017 (see also Table 6.1), similar to the EU-28 average of 99.8% (European Commission, 2017[10]). SMEs employ half of all employees (54%), which is low compared to the EU-28 where the same figure is two-thirds (67%). Micro-businesses, those with less than 10 employees, employ about 6% of workers in Kazakhstan, compared to 30% for the EU-28. There is also a strong sector weighting of businesses towards the wholesale and retail trade and much more limited numbers of SMEs in manufacturing (OECD, 2018[11]).

Most SMEs consist of self-employed workers that earn low income. SMEs earned about half (46%) of all income in 2017, with the remainder attributable to larger firms (53%). However, the majority of SMEs are micro SMEs earning relatively small incomes – 9 in 10 earn considerably less than EUR 100 000 annually. Among companies, four in every five (79%) earned substantially less than EUR 100,000 annually. Among individuals, the proportion earning less than EUR 100 000 per year is even higher at 96% in the same year.

Figure 5.12. Most firms are SMEs with relatively small annual incomes

Distribution of firms in Kazakhstan, by size of annual income, 2017



Source: State Revenue Committee data.

5.3.2. There is a tiered system of special tax regimes

Government has announced ambitious reforms to stimulate the SME sector. As part of the State of the Nation address in 2019, the President of Kazakhstan highlighted the importance of SMEs in the economy. Several reforms of the SME sector were announced to support this ambition. In addition to financial support measures, government has announced a number of unconventional tax measures, including a PIT exemption for SME for up to three years as well as a ban on inspections of SMEs for up to three years. These tax holidays are generous and while they might stimulate entrepreneurship, they run the risk of being abused (for instance businesses that disappear before the end of the third year and then restart again) and they create an unlevelled playing field with SMEs that correctly comply with the tax code.

In practice, many individuals and SMEs choose one of the special tax regimes. Kazakhstan has a tiered system of special tax regimes that are available to self-employed individuals and companies. A brief description of some of the special tax regimes is summarised in Table 5.4 and discussed in Box 5.5. The objective of the regimes are broadly to simplify and reduce the tax burden on the self-employed by offering reduced tax rates and reporting requirements while also encouraging self-employed workers to enter the formal economy. The main special tax regimes are the patent regime, the simplified regime and the fixed deduction regime. The Single Aggregate Payment (SAP) regime (defined by articles 774 and 775 of the Tax Code) is not considered a special tax regime in Kazakhstan, although it functions as one from an economic perspective.

Table 5.4. There is a tiered system of special tax regimes

Regime name	Target group	Tax rate	Tax base	Employee eligibility	Income eligibility (KZT millions)	Monthly income eligibility (KZT millions)	Annual turnover/income eligibility ceiling ($ US)	Need to maintain accounts
SAP	Individuals engaged entrepreneurial activity (not individual entrepreneurs)	1 MCI (1)	None	None	<= 3.0	247 000	7 700	No
Patent	Individual entrepreneurs	1%	Gross income without deductions	None	<= 12.8	1 063 000	33 000	Simplified only
Simplified declaration	Individual entrepreneurs and legal entitles	3%	Gross income without deductions	<= 30	<= 86.9	7 239 170	226 000	Simplified only
Fixed deduction	Individual entrepreneurs and legal entities	10% (2)	Gross income less fixed deduction (30% of gross income)	<= 50	<= 535.5	44 625 000	1 392 000	Tax reporting once annually

The SAP is not defined as a special tax regime in Kazakhstan. 1. 0.5 MCI in rural areas. (2) 20% for companies. Based on minimum salary (MS) of KZT 42 500 and MCI of KZT 2 525 in 2019. The income thresholds for the patent, simplified and fixed deduction regimes are less than or equal to 300, 2 044 and 12 259 values of the cost of living respectively. Income eligibility rounded to nearest thousand. Converted to US dollars based on an exchange rate of KZT 1 to USD 0.0026 exchange rate. Employee eligibility refers to the average number of employees for the tax period.
Source: OECD analysis.

Box 5.5. The current special tax regimes

A number of special tax regimes exist for individuals and SMEs

- **The Single Aggregate Payment (SAP):** The SAP regime was introduced in 2019 to encourage self-employed workers to enter the formal economy while simultaneously including more workers in social and pension supports. The regime has a simplified registration whereby individuals register automatically by paying a fixed monthly amount of 1 MCI in urban areas (or 0.5 MCI in rural areas). As the name suggests, a single aggregate payment covers four types of payment – PIT, social tax, mandatory pension and medical insurance. Consequently, participants of the regime can avail of various social benefits (including related to health, disability, job loss and childcare). The regime is targeted at individuals engaged in entrepreneurial activity who are not officially registered as individual entrepreneurs (IEs). To be eligible for the regime, individuals must have no employees, perform services for other individuals and have annual incomes not exceeding MCI 1 175 in 2019 (KZT 2.97 million), *inter alia.*[3] Currently there is an estimated 500 000 – 600 000 individuals who are working informally who may be eligible for the regime.[4]

- **The patent regime.** A patent regime is in place for individual entrepreneurs (IEs). The PIT rate is currently 1% of annual gross income without applying deductions for expenses (having been reduced from 2% previously). To qualify for the scheme, IEs must have no employees and income of less than 300 'values of the cost of living' in 2019. In the trade sector, a new law was introduced in 2020 where individual entrepreneurs in the trade sector must switch to the simplified regime. Only a simplified set of accounting and financial records need to be kept.
- **The simplified declaration regime:** A simplified declaration regime is in place for IEs and legal entities (LEs)[5] with a PIT rate of 3% on annual gross income without applying any deductions for expenses. To qualify for the regime, IEs and LEs must have a maximum of 30 employees and annual income of KZT 86.9 million. Similar to the patent scheme, it is only necessary to maintain a simplified set of accounting and financial records.
- **The fixed deduction regime:** IE and LEs can alternatively choose to enter a fixed deduction regime where, as the name suggests, they make a fixed deduction from total annual income of 30% without the need to provide documentation.[6] PIT is 10% for IEs and 20% for LEs. To qualify for the regime, SMEs can have a maximum of 50 employees and 12,259 'values of the cost of living' in income in 2019. Tax reporting is once annually.

Note: There are however other smaller special regimes, which are not discussed here. For example, a special tax regime applies to individual farmers, where there is a single land tax levied at a rate of 0.15% of the land value. Under this scheme, taxpayers are not subject PIT on income from farm and other related activities (Tax Code 517.3).
Source: OECD analysis.

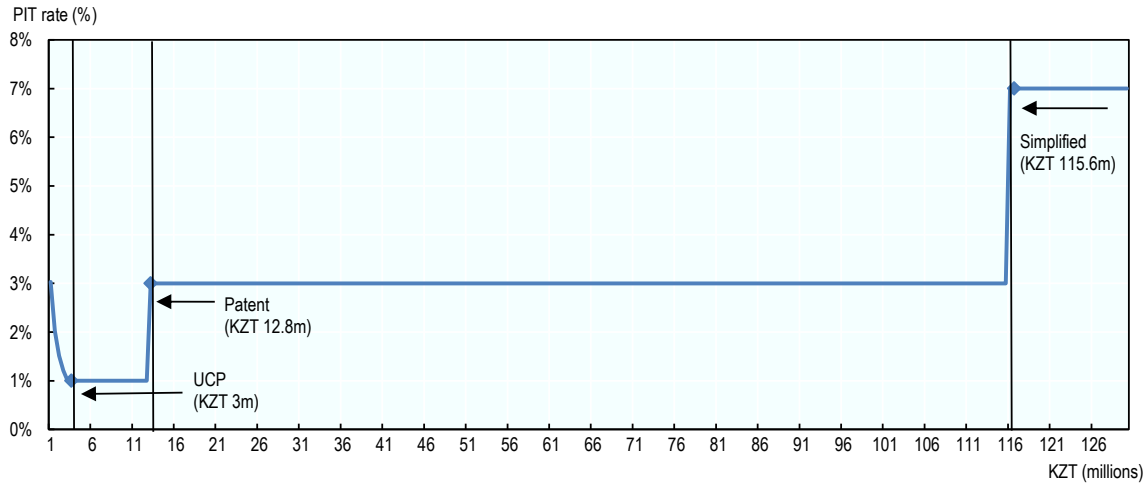
5.3.3. Strengthen the design of the special tax regimes targeted at SMEs

Kazakhstan has four main special regimes, which is more than in most other countries. Contrary to the stated goal of simplification that comes with introducing new special tax regimes, having too many special tax regimes can increase the enforcement costs and compliance burden for tax administrations and taxpayers while simultaneously undermining fairness and incentives. At the same time, having many regimes may increase opportunities for tax evasion including for example incentives to report income below the maximum income thresholds to avoid moving to the next regime. Therefore, Kazakhstan could consider reducing the number of special tax regimes and, instead, introduce other types of tax simplification measures.

Individuals typically graduate to higher statutory PIT rate regimes as turnover rise. The special tax regimes place businesses on a graduated path to expansion towards the regular system. With the exception of the SAP regime, where a fixed payment implies that the PIT rate falls for higher income levels within that regime, individuals graduate to higher statutory PIT rates as incomes (i.e. business turnover) increase and they transition from one regime to the next. Figure 5.13 illustrates the progression in the statutory PIT rates as taxpayers transition up regimes. For example, for individuals moving from the patent to simplified declaration to fixed deduction and then to a standard business, the PIT rate would rise from 1% (above USD 7,700) to 3% (above USD 33,000) to 7%[7] (above USD 300,500) and finally to 10% (above USD 1.4 million). Under the regular regime, however, the 10% tax rate would be levied on taxable income (i.e. turnover net of deductible tax expenses) rather than turnover under the simplified regimes.

Figure 5.13. Gradually higher statutory PIT rate regimes under simplified regimes as turnover rises

Effective PIT rates and max income thresholds, selected special tax regimes in Kazakhstan



Note: The maximum annual income caps for the Single Cumulative Payment (SCP), patent and simplified regimes are ~KZT 3.0 million (1,175 x MCI), ~KZT 12.8 million (300 x MS) and ~KZT 115.6 million respectively. There are also criteria for the number of employees which are not included for the purposes of this analysis. Analysis relates to individuals and individual entrepreneurs and not legal entities. 7% PIT rate is calculated for the fixed regime on the basis of the fixed 30% deduction.
Source: OECD analysis.

The SAP regime is expected to be successful in bringing workers into the formal economy. The SAP regime brings many benefits to participants, which suggests that it is likely to drive a high take-up in the coming years. There are a number of reasons for this. Firstly, payments are small, simple and fixed. The payment of 1 MCI (about USD 6.60) or 0.5 MCI (about USD 3.30) per month is likely to be sufficiently low to induce informal workers to enter the formal economy. A special regime with some similarities is applied in Mexico where 'Individual Micro Entrepreneurs' pay a fixed monthly lump-sum tax (although it varies by sector). Second, it provides an opportunity for previously informal workers to have an official status in the system while also reducing the concern of tax inspections by the tax administration. It might bring broader advantages such as facilitating the access to banking credit. Third, it provides additional financial and health security through the provision of pension and social support benefits. Nevertheless, the insurance cover may remain limited compared to the public services for standard employees who pay higher SSCs. Fourth, the registration process is simple and automatically includes workers in the regime. Since the SAP regime was recently introduced in 2019, it will take some time to determine its success. However, the early evidence is positive. According to data from the Ministry of Economy, approximately 100 000 workers have already registered in early 2019.

Entrepreneurs are not allowed to hire workers under both the SAP and Patent regime. While this requirement seems logical for the SAP regime, which is mainly targeted at bringing individual entrepreneurs within the formal economy, it is far from straightforward for the Patent regime as it prevents businesses in the regime for creating new jobs. Taking the number of individuals in the two regimes together, this could restrict at least as many as 200 000 taxpayers from creating additional employment in the economy (129,300 in the patent scheme plus an estimated 100 000 and rising in the SAP regime). This presents an employment risk considering that almost half of employment in Kazakhstan is generated by small and medium-sized business.

On the other hand, the Patent regime is generous as it levies only a 1% tax rate. By imposing this hiring restriction, government induces businesses that want to grow by hiring more workers to enter the Simplified Declaration regime, which levies a higher 3% tax rate (on turnover). Indeed, under the current design, the non-hiring condition of the Patent regime operates as an incentive for entrepreneurs to move from the Patent to the Simplified Declaration regime. However, in reality it might rather induce entrepreneurs in the Patent regime to hire workers from the informal sector. In that sense, the incentives created by the Patent regime contradict the efforts of government to bring informal workers into the regular economy through the introduction of the SAP regime. In order to strengthen policy coherence, the hiring restriction under the Patent regime could be abolished.

The Patent and Simplified Declaration regime have high eligibility ceilings. The annual turnover ceiling to qualify for the Patent regime of about USD 33 000 is high. Entrepreneurs with turnover up to that ceiling are likely in a position to employ workers, but they are refrained from doing so as the tax consequences are significant. (As pointed out, they might be inclined to hire workers from the informal economy instead). While a low 1% PIT rate on turnover might be warranted to induce workers to move from the generous SAP regime into the Patent regime, government could consider lowering the turnover ceiling of the Patent regime to below USD 33 000. It would turn the Patent regime as a stepping-stone from the SAP regime towards the Simplified Declaration regime, which levies a tax rate of 3% that is more aligned with international practice.

When reduced rates are based on turnover, they tend to penalise low profit-margin business, which end up being taxed at a higher rate than businesses with a lower turnover but higher profits. The impact of a flat turnover tax rate will therefore vary across firms and sectors. For firms that have a low profit margin (i.e. have high costs as a share of turnover), even a low tax rate levied on total turnover represents a high effective tax when the tax is expressed as a share of their profits. The opposite is true for firms that earn high margins. As profit margins typically vary across industries, some countries therefore levy a tax on turnover in their simplified regimes that differs across sectors (i.e. higher for profitable sectors and lower for sectors where the average firm has a low profit margin).

However, differentiated turnover taxes across sectors increases complexity and government therefore might want to maintain the 3% a turnover tax rate in the Simplified Declaration regime. As is the case in the Patent regime, the Simplified Declaration regime also has an eligibility ceiling that has been set at a too high turnover level. Government should consider lowering the ceiling considerable in order to induce more businesses to enter the regular tax regime.

Overall, the size-based regime ceilings in Kazakhstan have been set too high and likely constrain growth and result in tax avoidance behaviour. Limiting tax regimes to companies under a certain revenue or employee size can create barriers to the growth of SMEs. Such regimes may give businesses incentives to remain below the threshold so as to continue benefiting from such targeted regimes, both in terms of reduced compliance costs as well as tax payable. Furthermore, growing SMEs may be incentivised to split up into different companies to benefit from the preferential tax treatment or to engage in deflating revenues and inflating costs.

Higher income SAP registered workers may have an incentive not to graduate to the Patent regime. The income of most employees falls within the range to participate in the scheme since the SAP maximum monthly income threshold in 2019 is about KZT 250 000 (1 175 MCI annually), which is three-times higher the monthly median employee income (KZT 82 977). This confirms that the eligibility ceiling for the SAP regime has been set at a high level. However, the incentive not to graduate to the Patent regime will only apply to higher income entrepreneurs, who for example earn between the mean wage and the SAP maximum, since the tax burden is small on low-income workers (as analysed in Figure 5.4). Data from the State Revenue Committee indicate that 96% of all self-employed in Kazakhstan (about 580 000) have an annual income of less than or approximately USD 7 800, which is close to the SAP regime maximum threshold.

There is a general risk of bunching activity across regimes, which could undermine tax revenues. Additional empirical analysis would allow assessing and improving the design of the simplified regimes. An individual entrepreneur who transitions from the SAP to the Patent regime becomes subject to additional SSC payments, which were previously covered by the 1 MCI payment. This increase in the effective tax burden may produce an additional incentive for individuals to conceal some of their income by declaring taxable income below the maximum threshold of about USD 7 700. Additional income earned beyond this point could be earned in the informal economy perhaps through cash payments, leading to reduced tax revenues. Similarly moving from the Patent regime to the Simplified Declaration regime leads to a relatively high PIT rate increase from 1% to 3% (in particularly for sectors that have a low profit margin). The extent of this so-called 'bunching' effect could be detected empirically by examining the taxable income declarations of taxpayers just above and below the respective thresholds over the period 2018 and 2020, once data becomes available on participation in the SAP regime next year.

Within the SAP regime, the fixed payment means that the effective PIT rate decreases for higher incomes. Under the SAP regime, individual entrepreneurs pay a fixed monthly amount of 1 MCI per month or 12 MCI per year (Figure 5.13). This lump-sum tax translates into a 3% tax rate for entrepreneurs that earn an annual income of KZT 1 million (USD 2,800) (i.e. 12 MCI per year, equivalent to KZT 30 300, divided by KZT 1 000 000) compared to only 1% for individuals earning more than twice that amount (of KZT 2.9 million; i.e. about USD 7 700). This declining effective PIT rate, however, does not result in a tax-induced disincentive to growth within the SAP regime because the tax is a lump-sum tax. However, it does mean that if the tax would have been set too high for small informal workers, it might have prevented them from entering the SAP regime. However, the fixed payment is set at a low amount, so these disincentives have been avoided through the specific design of the SAP regime in Kazakhstan.

In the absence of effective tax monitoring, firms may have an incentive to contract SAP regime workers instead of hiring regular employees to reduce their tax burden. SAP regime workers are obliged to provide their labour services only to other individuals and cannot be hired by a company. However, these limitations may be challenging for a tax administration with limited resources to effectively monitor and enforce. In order to reduce tax liabilities, companies might be tempted to employ regular workers to work with company customers but to hire individual SAP workers to work with individual customers. Such an arrangement, while clearly being illegal, would reduce the tax burden on both the company and the informal individuals at the expense of tax revenues. While the requirement for SAP workers to offer services only to other individuals has a strong policy rationale, it in practice may be difficult to enforce and, at least, has further increased the burden on the tax administration.

Lowering the annual turnover eligibility ceilings would allow reforming other distortive and administrative costly design characteristics of the simplified SME taxation regimes, such as the non-hiring requirement under the Patent regime and the requirement that SAP workers can only work for individual clients and not for corporations. Indeed, these additional requirements have been introduced to prevent the regimes from becoming too generous. However, these requirements have also resulted in additional tax evasion opportunities and in an increased tax burden on the tax administration to enforce these regimes. Lowering the turnover eligibility ceilings would allow further simplifying the tax system.

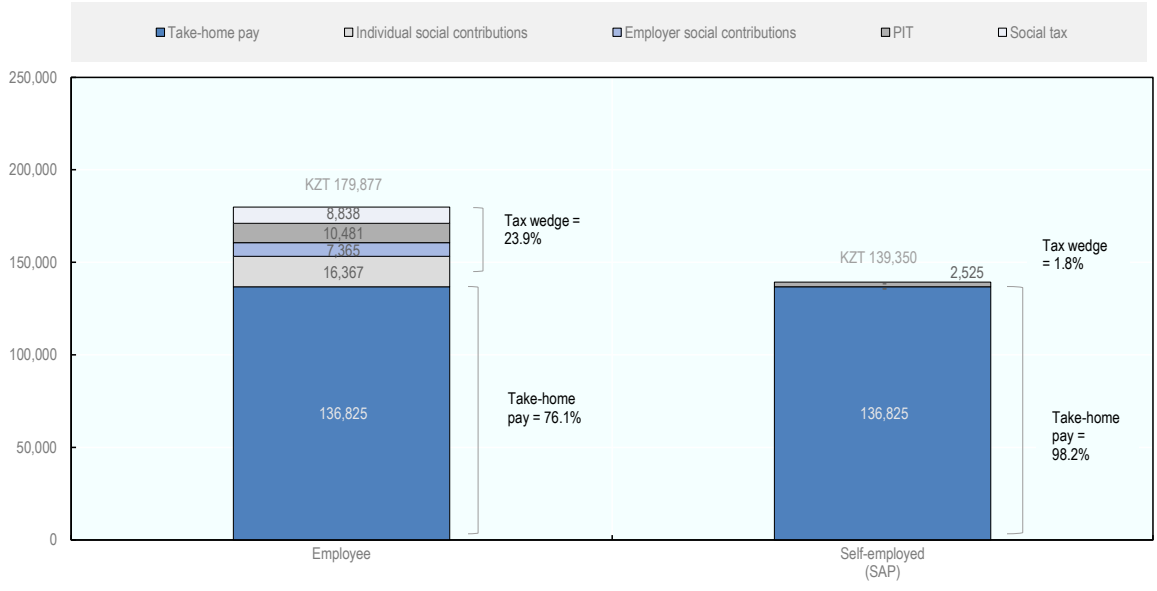
The tax burden on regular employees versus self-employed workers differs considerably. Firms face different incentives in the tax system when deciding to hire different employment types. In some OECD countries, firms that contract labour from self-employed workers instead of hiring standard employees generally tend to face lower tax burdens on per-worker basis (Milanez and Bratta, 2019[12]). Figure 5.14 illustrates the incentives facing a Kazakh firm deciding between hiring an employee or a self-employed worker in the SAP regime. To consider the employment form that is preferable to the firm, take-home pay is equalised across the employment types (KZT 136 825) and the workers is assumed to earn the mean wage (KZT 163 673). Individual social contributions include pension SSCs; employer social contributions include pension SSCs, health SSCs and insurance SSCs. Employees have a tax wedge of 23.9%, a take-home pay of 76.1 per cent and a total employment cost of KZT 179 877 (employment cost is gross mean

wage plus social tax and employer SSCs). SAP workers face a tax wedge of 1.8 per cent, a take-home pay of 98.2% and a total employment of KZT 139 350. Therefore, compared to the total employment cost of a standard employee, all else being equal, a firm would rather offer an employment contract to a SAP regime worker, thereby saving KZT 40 527 per employee in this case. Similar, although less outspoken, results would be found for workers in the Patent regime.

As part of future research, Kazakhstan could empirically investigate the tax incentives facing firms across all employment types including the Patent and Simplified Declaration regimes. Our analysis indicates that businesses face a strong tax-induced incentive to hire self-employed workers who operate under one of the simplified taxation regimes rather than employing regular employees. This may result in 'false' self-employment where workers only work for one employer but work under a self-employment contract.

Figure 5.14. Firms that contract labour from self-employed workers instead of employees could face lower tax burdens on a per-worker basis

Decomposition of total employment cost, employees and self-employed in the SAP regime, 2019



Source: Milanez and Bratta, 2019.

Finally, the tax policy rationale for the Fixed Deduction regime seem weak. Under this regime, the rate that is levied is either the flat PIT rate or the statutory CIT rate. However, instead of deducting actual expenses, businesses can deduct a fixed amount of 30% of turnover. Businesses within the regime can realise turnover up to USD 1 392 000 per year, which is high. Businesses of that size should be in a position to declare an actual tax return rather than declaring turnover in the simplified regime. This would increase transparency for government and strengthen tax compliance. In fact, the regime is likely only attractive for a narrow selection of profitable firms, as most firms that employ workers face costs (including salaries) that are higher than 30%. Moreover, it would be difficult to maintain such a regime with a progressive PIT rate schedule. Overall, consideration should be given to abolish the regime. Instead, Kazakhstan could introduce and maintain other types of tax simplification measures (such as less frequent tax payments and simplified bookkeeping requirements)

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Notes

[1] The share of the Republic of Kazakhstan under production sharing contracts of oil companies, the bonuses of oil and non-oil sector companies, the levy for the use of the radio-frequency spectrum, the payment to compensate for historic costs as well as certain other items are classified as non-tax revenues according to the OECD Interpretative Guide, but are considered as tax revenues in Kazakhstan.

[2] Statistics Committee of Kazakhstan.

[3] Certain activities are excluded from the regime including those engaged in commercial real estate, providing property for rent and those registered as individual entrepreneurs.

[4] Ministry of Labour and Social Protection. Further details can be found on the following website: https://egov.kz/cms/en/articles/taxation/edinyiplatezh.

[5] Both are treated the same.

[6] Beyond this 30% proportion, documentation is required and the maximum allowable deduction is 70%.

[7] Assuming a fixed deduction of 30%.

Annex A. Income distribution data

Table A A.1. Income indices used in Kazakhstan

Key income indices, average wages and income indicators in Kazakhstan, in KZT

Measures	KZT
Monthly calculation index (MCI)	2 525
Minimum monthly salary (MMS)	42 500
Averages and thresholds	**KZT**
Mean wage	162 673
Median wage	82 977
Bottom 10%	27 235
Top 10%	236 350
Income indices	**%**
S90/S10	8.7
S90/S50	2.9
MMS / Mean wage	0.26
MMS / Median wage	0.51

Note: The mean wage is from the Statistics Committee data 2018. The median wage is from Ministry of Finance data 2017.
Source: OECD analysis.

OECD Tax Policy Reviews

KAZAKHSTAN

This report is part of the *OECD Tax Policy Reviews* publication series. The Reviews are intended to provide independent, comprehensive and comparative assessments of OECD member and non-member countries' tax systems as well as concrete recommendations for tax policy reform. By identifying tailored tax policy reform options, the objective of the Reviews is to enhance the design of existing tax policies and to support the adoption of new reforms. This report provides an assessment of Kazakhstan's tax system and recommendations for tax reform. Chapter 1 gives an overview of the main findings and Chapter 2 sets the scene for tax reform. Chapter 3 considers tax revenue trends and analysis of the tax mix. Chapter 4 examines equity issues in Kazakhstan and provides recommendations on the personal income tax, social security contributions and value added taxes. Chapter 5 focuses on tax competitiveness issues and provides recommendations on how to strengthen the design of both the corporate income tax and special tax regimes for SMEs.

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