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DOUBLE TAXATION AVOIDANCE: OECD MODEL vs. UN MODEL

SENIOR THESIS

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ABSTRACT

This thesis is devoted to the methods of avoiding a double taxation. It compares the OECD Model and the UN Model. Double taxation is "a taxation principle referring to income taxes that are paid twice at the same source of earned income."[1] The main purpose of these treaties is to ensure the avoidance of double taxation - to promote international trade and investment by reducing tax barriers to free international exchange of goods and services. Tax relief encourages the development of trade and investment. Each state which is involved in international trading, from taxation point of view, acts as income or revenue taxation authority for residents and as taxation authority for non-residents.

This research paper identifies particular the OECD Model, where the tax base is considered to be the principle of residency. This allows a country to tax profits of taxpayer gained in another country. Total abolition or reduced tax rates of withholding tax are used for repatriation of profits as interests, dividends or royalty

The other model is the standard "UN Model convention on double taxation of income and capital (1980)."[2] This model on the other hand uses principle of territoriality that allows to tax profits gained on the territory of developing countries. The higher tax rate is used for repatriation of profits. But it has several shortcomings, e.g., several states consider one individual as subject of taxation or taxing object could be taxable by legislation of two states.

The author concludes that the provisions of the OECD Model Convention are conceptual in nature and in fact guided by the country:

a) With a developed system of social market economy;

[1] http://www.investopedia.com/terms/d/double_taxation.asp, last visted on April 20
[2] http://finbook.so/finansovyiy-menedjment_733/mejdunarodnyie-nalogovyie-soglasheniya.html, last visited on March 4

b) The availability of tax legislation, promoting institutional reforms in the economy, allowing the adaptation of the European rules and regulations to the realities of specific states.

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INTRODUCTION

Subject matter

While entering the global market, the Kyrgyz Republic faces common problems as other developing countries do such as problems of double taxation. The Kyrgyz Republic is developing the tax legislation through interaction and cooperation of tax relations with the Russian Federation, Republic of Belorussia, Republic of Kazakhstan, Uzbekistan and etc. The Kyrgyz Republic signed 27 agreements on double taxation avoidance. During development of taxation agreements, treaties, the Kyrgyz Republic used the OECD Model as a base.

Of particular significance is the problem of taxation in the system of international relations. "The problem of double taxation may be encountered by entities engaged in foreign trade activities or by entities which receive income from real estate in a foreign country."[3] In order to avoid similar problematic agreements on double taxation, regulating issues related to taxation on a territory of two and more countries are concluded. Agreements on avoidance of double taxation are purposed to eschew cases of levied taxes from citizens and legal entities when the obligation to pay taxes and fees arises at the same time simultaneously in two or more states. Inter-governmental Agreements on avoidance of double taxation issues as taxation of profits gained from commercial activity, international logistics (transportation), dividends, interests, profits from immovable property, revenue from sale of movable and immovable property, income from royalties, profits gained by employment on a territory of countries are subject to such agreements. Limited agreements on double taxation avoidance address issues of taxation on territory of two or more states, specific taxes or taxation of specific fields of work. In particular

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[3] Banhaeva F.H, *Sravnitelnyi analiz nalogovyh system I ego znachenie dlya sovershenstvovaniiya I reformirovaniiya nalovogo zakonodatelstva* [Comparative analysis of tax law system and its significance in improving and reforming the tax laws] Nalogovyi Vestnik,2001, no 2, 32

these might be issues related to taxation of specific types of transportation or taxation of specific fields of economy, such as agriculture.

The appliance of international taxation principles of foreign entities is highly significant. The conclusion of bilateral agreements on the avoidance of double taxation is an essential condition for attracting foreign investment in the amount necessary for the development of a state, attractiveness of a domestic market and stimulation of capital growth.

In the Tax Code of the Kyrgyz Republic (hereinafter “TC KR”) Article 3 is the only article dedicated to international tax provisions, other laws and norms are involved to regulate international taxation and do not address individual articles. Norms regulating special features of taxation of foreign entities especially for different types of taxes are covered by specific parts of TC KR. Thus, it is necessary to introduce appropriate changes to TC KR.

Purpose of the thesis paper

The purpose of the thesis is to define the nature of double taxation and a mechanism of its elimination as well as to offer new solutions for the tax legislation of the Kyrgyz Republic in the field of regulating taxation process of foreign entities and individuals. In order to achieve this goal following tasks will be considered:

- Discussion of the concept of double taxation;
- Historical overview of double taxation (in the USSR and the Kyrgyz Republic)
- Evaluation of methods to eliminate double taxation, the OECD model compared with the UN model

- Analysis of Double Taxation Avoidance Agreements (hereinafter "DTAA") signed by the Kyrgyz Republic vs. signed by India.

- Case study on the example of Kumtor Operating Company.

Method and structure

In this thesis research paper following methodology was used: analysis, synthesis, historical approach, comparative analysis of DTAA signed by the Kyrgyz Republic vs. signed by India, and case study research. Case study is related to the Agreement signed between Centerra Gold Inc. and the Government of the Kyrgyz Republic and development of gold mining deposit "Kumtor".

The thesis consists of an introduction, two chapters containing four paragraphs, a conclusion and a list of sources used. The first chapter of the thesis discusses a theoretical background by defining the concept of double taxation and its characteristics. Gives a brief historical overview of double taxation within the framework of the USSR and the Kyrgyz Republic.

The second chapter focuses on the methods of elimination of double taxation in the OECD model as compared with the model of the United Nations. It is also discusses how to optimize the mechanism of the elimination of double taxation in the Kyrgyz Republic. The case study will describe a current practice of taxation existing in the Kyrgyz Republic.

In conclusion, it will set forth the main findings of this thesis work and present the prospects of the tax legislation of the Kyrgyz Republic in taxation on the sidelines of the Kyrgyz Republic in international tax relations.

CHAPTER I. GENERAL CHARACTERISTICS OF DOUBLE TAXATION

1.1 The concept of double taxation

The definition of double taxation is "a taxation principle referring mainly to various income taxes that are paid in one or more countries on the same earned income."[4] For example, when a corporation is considered separately as a legal entity and as its shareholders, a corporation pays taxes for annual earning at its level, meaning as legal entities, while corporation's shareholders pay taxes for the paid our dividends that are provided by the corporation. Even though the earnings (dividends) paid out by the corporation have already been taxed at the corporate level. Or when the excise tax is levied on goods and afterwards the value added tax (hereinafter the "VAT") is imposed on their price. These are examples of the economical double taxation.

"Juridical double taxation is referred in some sources sometimes as international double taxation means that taxpayer is levying tax in one or more countries for one object in the same period of time.[5]" Thus, this results in coincidence of a taxable object, its period and subject of taxation. For example some countries use a principle of residence for levying income tax, and other countries use territorial principles. Nevertheless, double taxation can occur when each country can affirm that profit was earned on its territory or that the taxpayer is its resident.

Therefore, different approaches are used to eliminate double taxation for the taxpayer in order to avoid the same obligations while paying taxes for the same income in two different countries.

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[4] http://www.investopedia.com/terms/d/double_taxation.asp, last visited April 26

[5] Arutyunyan V. *Problemy mejdunarodnogo dvoinogo nalogooblojeniia i puti ih resheniia* [Problems of international double taxation and its solutions.] *Statiia Problemy teorii I praktiki upravleniia* [Problems of theory and practical management.] 2004, no 2, 39

The main objective of international tax treaties is to determine a tax jurisdiction of countries which signed it and elimination or minimization of a double taxation on income and property.[6]

Consequently, double taxation is double crossed by two main problems; these are definitions of a taxable object and taxpayer. From one side, definition of taxable basis, since income could be earned abroad and in the country. From other side, distinction of taxpayers for residents and non residents that requires system of income registration and respectively tax exemptions.[7]

Double taxation does not have a beneficial effect on the exchange of goods and services for the movement of capital, technology and people, so an urgent need exists to eliminate the barrier which it creates in the development of economic relations between countries.[8] It creates constrains for the economical activity of the entrepreneurs, it impacts the price growth for goods, services, it rises tax burden on legal and physical subjects. Moreover, it violates the principle of fair taxation.

Double taxation includes not only the situation where the same operation is being actually taxed more than one time, but also the fact that a sum of these individual taxes often exceeds the amount of tax charged by other comparable operations. [9] Overuse of taxation leads to increase of tax burden on foreign capital, and on a domestic as well. This is particularly true when looking at foreign investment in the economy.

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[6]Arutyunyan V., *Problemy mejdunarodnogo dvoinogo nalogooblojeniia i puti ih resheniia* [Problems of international double taxation and its solutions.] Statiia Problemy teorii I praktiki upravleniia [Problems of theory and practical management.],2004, no 2, 40

[7] Kochetkov A.I., *Nalogovoe Pravo* [Tax Law] Conspect lektsiy [Lecture Note], Eksmo, 2002, 21.

[8] Kashin V.A., *Metody ustraneniia dvoinogo nalogooblojeniia I ih znachenie dlya zashity interesov Rossii* [Methods of double taxation elimination and its significance for interests protection] Jurnal Finansy [Magazin Finance]no5, 1997, p. 34

[9] Aliev, B.H., *Nalogii I nalogooblojenie* [Tax and the taxation] Jurnal finansy I statistika [the finance and statistics], 2007

On this basis, international taxation should be based on the following principles:

• Taxpayer can choose between investing in own country or abroad, this does not affect the issue of taxation. With perfect competition integrity in relation to the export of capital leads to its efficient allocation;

• All foreign entities and subjects in existing market or transactions are taxed at the same rate;

• Capital earnings or income is equally shared between the state and the taxpayer regardless where income was earned on domestic territory or abroad. [10]

By implementing these approaches upon taxation, the international community uses various forms and methods, which are usually fixed in the treaties for the avoidance of double taxation. International double taxation can occur in the following cases:

a) If several states expose the same individual to pay taxes for the whole income that he earns (simultaneous full tax liability);

b) If an individual is a resident of the state , receives an income or possesses a capital in another contracting state , and both states levy taxes on the income or capital;

c) If several states expose the same individual to pay a tax who is not a resident of any of these states, but he receives income upon a capital that he possesses in those states (limited simultaneous tax liability).[11]

Double taxation occurring in the case:

a) can be reduced before a situation

[10] Arutyunyan V., *Problemy mejdunarodnogo dvoinogo nalogooblojeniia i puti ih resheniia* [Problems of international double taxation and its solutions.] Statiia Problemy teorii I praktiki upravleniia [Problems of theory and practical management.],2004, no 2, 40

[11] Milyakov N.V., Uchebnik Nalogi i nalogooblojenie *[Textbook on Taxes and taxation]* 251 (Moscow, 2004)

b) application of an article of a certain tax treaty that specifies the category of a residence on the basis of certain criteria. [12]

Double taxation arising in case "b" can be eliminated by allocating tax jurisdiction between the contracting states. This distribution can be reached either by annulment of the right of taxation at a source by the state, or by location of permanent mission of state, or residency, or by division of taxation rights between two states.

Sometimes in the tax treaties, exclusive right to tax is granted to one of the contracting states. The agreement may stipulate that income is taxed in one of the Contracting States, and if the taxpayer is not a resident of this contracting state. In this case, the State of the residence exempts the individual from paying the tax. While concluding specific agreements on avoidance of double taxation, the content of each article is determined in the process of international negotiations, so it may differ to some extent from the content of articles of other agreements.[13]

Tax discrimination gives a rise to various forms of tax evasion, which is required to remove a number of additional procedures at both international and national levels. Fair tax competition supposes competitiveness between tax systems of different states based on the level of tax rates and on calculation of taxable income. At the same time high attention is paid to profit tax of companies, distribution of profits in the form of interest, dividends, royalties, tax on financial transactions. Thus, international double taxation can be defined as the imposition of comparable taxes in two (or more) states of the same taxpayer with respect to the same object for the same period of time.

[12] Milyakov N.V., Uchebnik Nalogi i nalogooblojenie *[Textbook on Taxes and taxation]* 251 (Moscow, 2004)
[13] Korotkovich E., Soglasheniia ob izbejanii dvoinogo nalogooblojeniia: prosedura primeneniia, *[Agreement on the avoidance of double taxation: application procedure]*, Vestnik Glavnyi Buhgalter [magazine main accountant] 2004, no 2, p. 87.

1.2. Historical overview of international tax treaties in the USSR and the Kyrgyz Republic

Union of the Soviet Socialistic Republics (hereinafter the "USSR") started its international experience by signing double taxation avoidance agreements in 1977 with the Organization for Economic Cooperation and Development (hereinafter the "OECD") on the 27th of May, 1977 , which are the Agreement "On the avoidance of double taxation of income and property of individuals" and the Agreement "On the avoidance of double taxation of income and property of legal persons" signed on the 19th of May, 1978. The OECD was established in 1961. This is "international organization helping governments tackle the economic, social and governance challenges of a globalised economy".[14]

Thus, it is obvious that the problem of double taxation had a legal assessment and had been already evaluated at that time. The taxation issues were highly significant in the USSR, for example, prior the moment when the USSR passed own income tax law, it reported that it had taxed foreign enterprises that had business on its territory.[15]

The normative and legislative base for avoidance of double taxation of the USSR convention considered following issues related to **income/revenue taxes** (related to individuals, legal entities, corporations, local inhabitants) signed between the Government of the Soviet Union and the Governments of following states, as:

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[14] http://www.oecd.org/about/, last visited February 20

[15] Kashin V.A., *Metody ustraneniia dvoinogo nalogooblojeniia I ih znachenie dlya zashity interesov Rossii* [Methods of double taxation elimination and its significance for interests protection] Jurnal Finansy [Magazin Finance]no5, 1997, p. 35

- Japan, on January 18, 1986, Canada on June 13, 1985, Austrian Republic on April 10, 1981, Italian Republic on February 26, 1985, the Kingdom of Belgium, on December 17, 1987, the Republic of Finland on October 6, 1987, Malaysia on July 31, 1987, the Kingdom of Norway on February 15, 1980, Spain on March 1, 1985.

- USSR signed agreement with the United Kingdom of Great Britain and Northern Ireland, on avoidance of double taxation related to income tax and capital gains on July 31, 1985.

- Multilateral Convention for the avoidance of double taxation – signed by copyright royalties (Madrid, December 31, 1979);

- Agreement between the Government of the USSR and the United Arab Emirates on air communication (Moscow, 23 June 1987);

- Algerian People's Democratic Republic – “Eliminate double taxation of income derived from the operation of international air services” (Algeria, June 11, 1988);

- Irish double taxation Aviatrans – signed by tailors businesses and their employees (Dublin, 17 December 1986);

- Argentine Republic on avoidance of double taxation in international maritime and air transport (Buenos Aires, March 30, 1979);

- Socialist Republic of Romania on air messages Bucharest, December 22, 1976);

- Spain's air traffic (Madrid, 12 May 1976);

- Hellenic Republic exemption from double taxation - position on the income from shipping and air transport (Moscow, January 27, 1976);

- The Republic of Italy for the release of the double taxation of tax - maritime sector (Moscow, November 20, 1975.);

- Agreed minute notes related to exchange between the Government of the USSR and the Government of Japan to mutual exemption on income and profits, from the operation of ships and / or aircraft to transport people (Moscow, July 31 1975);

- Republic of Iraq on the mutual exemption from taxation – signed by the Soviet and Iraqi airlines and their personnel (Moscow, September 26, 1974);

- Protocol on mutual exemption of airlines and random taxes according to the Agreement between the Government of the USSR and the Government of Norway on air (Hoslo, February 11, 1971);

- Polish People's Republic on air (Mowells, April 24, 1968);

- The Italian Republic, the release of double taxation - taxation in the operation of air traffic (Rome, 16 September 1971);

- United Kingdom of Great Britain and Northern Ireland – “Dee double taxation of air transport enterprises and their employees” (London, May 3, 1974.);

- A letter from the Ministry of Foreign Affairs of the USSR December 1, 1970 № 330 / “On exemption of Norwegian car toll”.

Thus, it can be noted that the agreements and conventions from this period were mainly related to the air and sea transport. The most recent document is the agreement signed with the Government of French Republic "On Air communication."[16] signed in Paris. These agreements do not have such regulations as a date of foundation of permanent establishment that is highly emphasized in present days; undoubtedly, it is related to the type of that period of economy.[17] Of course, conventions signed by the USSR played an important role in the development of the Kyrgyz national legislation during the preparation of draft conventions, as previously the Kyrgyz Republic has not acted as an independent state in the conclusion of tax conventions.[18]

Currently, the Kyrgyz Republic has a solid legal framework in the field of international taxation. The Kyrgyz Republic has agreements on the avoidance of double taxation with over 27 countries worldwide. Regarding taxable subjects under international agreements, the Kyrgyz Republic uses two methods of avoiding double taxation stipulated by the Model Convention on the avoidance of double taxation on income and capital (1963 and 1977), adopted by the OECD. [19]

The OECD Model assumes those tax bases are residential, in other words, subject to all of its taxable income, regardless of where they occur. Whereas in a foreign country income derived from the source country is subject to the income tax.

Thus, based on the national legislation of the Common Wealth of Independent Countries, (hereinafter "CIS") the receipt of income from sources in their territory, is a business entity

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[16] Agreement between Government of the French Republic and the Government of the Kyrgyz Republic signed at June 26, 1958 (Amendment dated from July 6, 1989).

[17] Baimuhanbetova D.A., Gosudarstvenno-pravovoe regulirovanie problem ustraneniia dvoinogo nalogooblojeniia dohodov inostrannogo investora v Respublike Kazahstan [State-legal regulation of the elimination issues of double taxation on income of foreign investors in the Republic of Kazakhstan] 56-58 (2006) Dissertation candidate of legal sciences.

[18] Ibid.

[19] http://www.oecd.org/about/, last visited April 15

receiving income from foreign trade. Which must pay income taxes in the state (for a individual - the income tax), where he is a tax resident, and pays an additional tax on the income from a specific part of this income in the state where the income arose. Consequently, there is double taxation. Differentiation of each state tax residents of one state - the CIS countries, with the object of taxation in another country - the CIS countries, is established in the agreements for the avoidance of double taxation. The agreements also set out criteria for determining tax residency in individual cases where the two states on the basis of national legislation, see it as a tax residence.[20] This is especially true for states that use the sole criterion as timeframes test in order to define tax residency.

Structure of double taxation concluded by states - participants of the CIS, the basic principles laid down in their stories are very similar to each other - at the conclusion of the agreements states use recommendations (type model) with some elements of the OECD Model and the United Nations Model (hereinafter the “UN Model”), developed by the organizations for the conclusion and implementation agreements to avoid double taxation.

The agreements ,concluded by the states which are participants of the CIS, apply to the taxation of individuals and legal entities receiving income from real property, international transport, business profits, dividends, interest, royalties and licenses, revenue from the sale of real and personal property, Directors' fees, independent of personal activities, income from employment, etc. [21] Each agreement provides a method to avoid double taxation, including provisions on non-discrimination, defined procedures for reviewing where the action of one or both Contracting

[20] Milyakov N.V., Uchebnik Nalogi i nalogooblojenie *[Textbook on Taxes and taxation]* 251 (Moscow, 2004)
[21] Jaarbekov S.M., Uchebnik Metody I shemy optimizatsii naloga *[Textbook on Methods and schemes of optimization of the taxation.*] 35 (Moscow, 2004)

States result or will result in taxation of any such - or a person of a Contracting State which is not consistent with the agreement.

Typically, states - participants of the CIS by mutual agreement set out in the agreement the following approaches to the taxation of income and property:

- Certain types of income in the agreement (profit) and the property may be subject to state income or location of the property (the right of the original collection of the state income or location of the property and then setting off in the country of tax residence); [22]

- The income (profit) or certain types of property are subject to a limited power in the state of its origin or the location (in the agreement is assigned a tax rate or the object of taxation);[23]

- Other (not mentioned above) the types of income and assets may not be subject to state income or location of the property (the right to levy granted only to the country of tax residence).[24]

Agreements are a type of common thread linking the tax systems of the two countries. The States - parties to the agreement shall determine the tax authorities competent in the application of the agreement, which allows clarifying the procedure for taxation of international transactions.

Having a huge impact on the legal nature of existing international treaties, it is essential to apply the principles of international taxation of foreign entities, among which there is the principle of equality and non-discrimination. The study of international practice suggests that the conclusion

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[22] Jaarbekov S.M., Uchebnik Metody I shemy optimizatsii naloga *[Textbook on Methods and schemes of optimization of the taxation.*] 35 (Moscow, 2004)
[23] Ibid. p.37
[24] Ibid.

of international agreements, which are subject to avoidance of double taxation, is an essential condition for attracting foreign investment in the amounts necessary for the development of the state, due to the creation of the attractiveness of the domestic market, where the prevailing capital injections to stimulate an efficient tax system.

CHAPTER II. MECHANISM OF ELIMINATION OF DOUBLE TAXATION

2.1. Methods for elimination of double taxation in the OECD Model compared with the UN Model

Recognizing the importance of international treaties regulating tax relations, states have been active in signing international tax treaties, which, in turn, significantly intensified trade between the contracting countries. States enter into these treaties in order to facilitate economic cooperation among their citizens and organizations. In view of the "inconsistencies" of the national tax laws of different states tax situation in the conduct of international commerce can be very uncertain, without these guarantees.

The League of Nations and pursued in the OECD, as well as in the UN, applied efforts aimed at eliminating double taxation as a result of these efforts were expressed in a series of models and draft models of bilateral tax conventions. The UN Model Convention and the OECD Model Convention have had a profound influence on international tax treaty practice, and have many significant terms and provisions. These models form basis for the most bilateral treaties between the countries, aiming to protect their taxpayers from double taxation, taking into account globalization, improving flow of international investments and trade, as well as technology transfer, and at the same time maintaining appropriate taxable rights of Governments. [25]

The affinity between these two Models shows the importance of achieving consistency. On the other hand, difference in provisions exemplifies and concentrates on some key differences in approach or emphasis depending on country practice. Such differences relate, in particular, to the

[25] Model Double taxation Convention between developed and developing countries, department of economic and social affairs, United Nations, New York, 2011

issue of domestic law, meaning taxing rights available under it that would avoid double taxation and create favorable investment climate and encourage foreign entities, how far country should forego, under a bilateral tax treaty.

The UN Model generally promotes maintenance of "source country" or "territorial" taxing rights under a tax treaty, meaning taxation rights of the host country are applied in comparison of the OECD Model where the taxation rights go to the "residence country" of the investor.[26] This is regarded as special significance to developing countries, although some developed countries also seek this condition in their bilateral agreements. The aim of the UN Model is to provide support to developing countries in entering bilateral tax treaties that could facilitate furtherance development of country goals.[27]

The OECD tax model is based on the principle of residency, according to which a country - a source of income greatly limits its tax jurisdiction over the income of foreign individuals and legal entities - non-residents.[28] The same income is taxed in the payers country of residence. For the repatriation of profits in the form of interest, dividends or royalties shall either reduced rates or total abolition of withholding tax.

Although many provisions of these two leading models are overlap, the Models divergence in many significant areas and reflect its priorities. The UN Model generally retains greater tax revenue share into the country, whereas the OECD Model retains more taxing rights for investors

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[26] http://www.itatonline.org/info/index.php/download-un-model-double-taxation-convention-2011/ , last visited April 18

[27] Model Double taxation Convention between developed and developing countries, department of economic and social affairs, United Nations, New York, 2011

[18] http://www.oecd.org/about/., last visited April 14

country, traders and others. Thereby, the UN Model gives more priority and rights for the developing countries over the revenue and income gained through foreign investments in the country. [29]

The standard UN Model convention on double taxation of income and capital (1980) is increasingly using the principle of territoriality, which allows to tax all income generated in the developing countries, and apply it higher than in the OECD, the tax rate on the repatriation of profits, but it has certain disadvantages. Several states may be considered one, that means the same subject could be taxpayer in one country and/or arising in the country. At the same time the could be considered as object of taxation by the legislation of the two countries. [30]

The OECD and the UN models are the two main types of bilateral agreements on avoidance of double taxation between country members. There are bilateral and also multilateral agreements for the taxation of income and capital (agreements between the countries of Northern Europe, African countries, etc.).

As discussed in the first chapter, the Kyrgyz Republic has signed agreements with more than 27 foreign countries on the avoidance of double taxation. These agreements were prepared on the basis of the OECD Model, and are applicable in the field of transport and the right of the Contracting States to differentiate tax in international traffic.

The first tax agreements developed in the early twentieth century. Since then, a lot of work has been done on the development and optimization of the standard provisions of the tax treaty. In 1963, the model tax treaty proposed to the OECD. Since then, most tax treaties should be

[29] http://www.itatonline.org/info/index.php/download-un-model-double-taxation-convention-2011/ , last visited April 10

[30] Lushnikova M.V., *Pravovye osnovy nalogovoi sistemy* [The legal basis of tax law system] Teoriia i Praktika, 41 (2000)

concluded according to this particular model. Although agreements differ in details, they have roughly the same structure, in particular the withholding tax. This model is changing with the times. In 1977, the OECD launched amended version. In revising the 1977 model year included the position of a number of countries outside the OECD, with the growing influence of the model agreement outside the OECD. The last major additions were made to the model in 2005.[31] However, the structure of the contract is unchanged.

Simultaneously by the UN recommendations were made for the conclusion of agreements on the avoidance of double taxation between the developed and developing countries. UN documents largely protect the interests of developing countries, while the OECD guidelines is made in the interest of companies from industrialized countries.[32]

The fundamental difference between the OECD Model and the UN Model is that the OECD Convention is based on the resident status in tax, which can be realized only in the relations between states, as well as politically and economically, while the UN Model uses a territorial principle of taxation, as developing countries, using this model, are interested in maximizing range of taxpayers.[33] The basic definition of a permanent establishment is contained in the OECD. The UN Model is defined as a treaty or an agreement related to international law where common interest of the relevant countries are shared. Moreover, the primacy of the OECD model drafters are recognized by other member countries. Alternative Model Convention should be considered variations on the OECD Model Convention, adapted for specific economic and

[31] http://www.oecd.org/about/, last visited April 23

[32] Lushnikova M.V., *Pravovye osnovy nalogovoi sistemy* [The legal basis of tax law system] Teoriia i Praktika, 41 (2000)

[33] Kashin V.A., *Metody ustraneniia dvoinogo nalogooblojeniia I ih znachenie dlya zashity interesov Rossii* [Methods of double taxation elimination and its significance for interests protection] Jurnal Finansy [Magazin Finance]no5, 1997, p. 35

political conditions. The two given models, UN Convention Model and OECD Model Convention differ from each other in terms of a permanent establishment for the supply of goods, construction works and services, the definition of a dependent agent.

The OECD and the UN models are now the major types of bilateral agreements on avoidance of double taxation. In addition to bilateral and multilateral agreements, exist for the taxation of income and capital (between the countries of Northern Europe, between the African and two multilateral agreements acted CMEA). [34]

The following methods of elimination of double taxation are proposed by the UN Model: the exemption method and the credit method. The chosen method of relief for double taxation depends on countries tax policy and tax structure system. Because of differences that exist in different taxation systems, bilateral taxation agreements provide the most flexible tool for reconciliation (adjustment) of contradictory tax systems and to eliminate or mitigate double taxation. [35]

The exemption method is applicable where exclusive tax (to the country of source) is applied by jurisdiction that is regulated by tax treaty, over certain income. The tax exemption might be in form of exemption with progression. One of the key disadvantages of the foreign tax credit method, according to developing countries is, that the benefit of low taxes in developing countries or special tax concessions provided, all earnings go mainly to the treasury of the capital exporting country, and not for foreign investor for whom these befits were designed. Thus the revenue (income) is given to capital exported country rather than developing country (for

[34] http://www.oecd.org/about/, last visited April 25
[35] http://www.itatonline.org/info/index.php/download-un-model-double-taxation-convention-2011/, last visited April 25

example, Kumtor Operating Company). Efficacy of tax stimulating measures introduced by most of the developing countries thus depends from interrelation of taxing system of developing countries and capital exporting countries where investments come from. It has primary importance for developing countries so that tax stimulating measures would not become ineffective by taxation in capital exporting countries using the foreign tax credit system. This could be avoided by bilateral agreements of "tax sparing" credits, with which developed country render credit not only for tax paid purposes but also for tax spared by incentive legislation in developing countries.

However, tax-sparing credits could not be considered as appropriate tool for economic development. Just as the exemption method that provides relief from double taxation but effects the residence country's taxes. [36] Whereas foreign tax credit method that is preserving the effect of the tax incentives and concessions extended by developing countries is a tax-sparing credit. This method can cope with the existing problems.

Permanent establishment exists from the moment when foreign entity begins operations in a foreign country through any fixed location.[37] At the same time, during which the preparatory work, is not taken into account, provided that these activities are quite different from the main activities of a foreign legal entity.

The most common type of permanent missions, along with offices and offices are construction sites, as well as the assembly or installation project. Every construction site since the beginning of the work is regarded as forming a separate permanent establishment. However, all the existing

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[36]Korotkovich E., Soglasheniia ob izbejanii dvoinogo nalogooblojeniia: prosedura primeneniia, *[Agreement on the avoidance of double taxation: application procedure]*, Vestnik Glavnyi Buhgalter [magazine main accountant] 2004, no 2, p. 87.
[37] Mesheryakova S.N., *The Island of Century Tax systems of the developed countries of the world*: (2005) Moscow

tax treaties provide that the construction site, SBO-term or installation project constitutes a permanent establishment only if it lasts more than a certain time. Usually this term is set in 12 months, but in some tax treaties defined a longer period.[38]

First the country granting tax stimulation (incentive) could include provisions or acts rules allowing stimulation of taxpayer only if he can show that in accordance with requirements of the tax administration, upon remittance of the his profits abroad, the legislation of the country where profits were remitted will not, directly or indirectly tax the income covered by stimulation or will give credit for tax foregone stimulation. Second, the UN model tax could include provision barring each contracting states from income taxation gained in other countries by entities, that are residents of that state, using tax incentives provided by the latter, until the revenue (income) is not repatriated or otherwise directly or indirectly remitted to the first Contracting State. Meaning that revenue is to be reinvested in the developing country in order to remain untaxed. Third, the Contracting state that is receiving profits, might be allowed to tax it, but may be required to provide a revenue-sharing agreement, to transfer to the State, where the income was produced, the tax revenue that can be considered as tax incentive granted by the country of source. [39] All these require effective interrelationship between the tax systems of the developing countries and the capital-exporting countries which use the foreign tax credit system.

However, tax issues are not decisive for investment decisions made by the enterprises and therefore, these methods could not be considered as appropriate. Other factors political and

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[38] Kashin V.A., *Metody ustraneniia dvoinogo nalogooblojeniia I ih znachenie dlya zashity interesov Rossii* [Methods of double taxation elimination and its significance for interests protection] Jurnal Finansy [Magazin Finance]no5, 1997, p. 35

[39] Polyakov V.V.& Kotlyarenko S.P.*Mejdunarodnoe mnogokratnoe nalogooblojenie* [The international multiple taxation] Uchebnik Nalogovoe Pravo [Textbook Tax Law] 354 (252)

economic stability, a judicial system play role in forming “investment climate” of country. International juridical double taxation may arise in three cases:

a) When each state taxes worldwide income or capital of the same person;

b) When person is resident of state (State of residence) and earns income from state of source and both States impose tax on that income;

c) When each state taxes the same person that is not a resident of either Contracting State on income earned in state; for example when person is nonresident has a permanent establishment in one state through which he earns profits, taxed by other State of residence (by liability to tax person under domestic law, residence, etc). [40]

Measures used for double taxation avoidance could be unilateral measures that are related to the norms of internal taxation system (laws) and multilateral taxation systems that could be implemented by international conventions and agreements.

Unilateral measures include taxation tools foreseen by state legislation:

1. Taxation set-off (credit) meaning that taxes paid abroad will be counted in state (internal) tax liabilities; [41]

2. Tax abatement assumes that taxes paid abroad are dedicated from the profit amount that is to be taxed. [42]

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[40] Polyakov V.V.& Kotlyarenko S.P.*Mejdunarodnoe mnogokratnoe nalogooblojenie* [The international multiple taxation] Uchebnik Nalogovoe Pravo [Textbook Tax Law] 354 (2004)

[41] Arutyunyan V. *Problemy mejdunarodnogo dvoinogo nalogooblojeniia i puti ih resheniia* [Problems of international double taxation and its solutions.] *Statiia Problemy teorii I praktiki upravleniia* [Problems of theory and practical management.] 2004, no 2, 40

Multilateral measures means signature of international conventions for avoidance of double taxation, where rules and procedures of levying profits and assets. [43] International conventions signed for double taxation avoidance and for tax evasion are aimed to create conditions so that to exclude situation when juridical and physical subjects would be double taxed. These agreements and conventions regulate negotiations of states related to tax evasion and taxation discrimination in any form, and distribution of rights among negotiating countries.

International tax treaties do not create new tax laws. Their task is to provide "docking" of national tax systems of the two countries. The presence or absence of agreements on taxation is often one of the main factors that influence decision making for business relationships and investment attraction.

The most extensive network of bilateral agreements in the countries are members of the Organization for Economic Cooperation and Development (OECD), who see in such agreements a mechanism establishing correct tax jurisdiction in all countries.

Rapidly growing network of similar agreements between developing countries, which in itself is a way to convince foreign investors to its economic stability. [44] And most of these agreements are concluded between leading developing countries and developed countries. When entering into an agreement, majority of countries shall refer to a model agreement for the avoidance of double taxation developed by the OECD. Transition countries, in some cases using certain provisions of the model agreement developed under the auspices of the UN.

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[42] Arutyunyan V. *Problemy mejdunarodnogo dvoinogo nalogooblojeniia i puti ih resheniia* [Problems of international double taxation and its solutions.] *Statiia Problemy teorii I praktiki upravleniia* [Problems of theory and practical management.] 2004, no 2, 40

[43] Polyakov V.V.& Kotlyarenko S.P.*Mejdunarodnoe mnogokratnoe nalogooblojenie* [The international multiple taxation] Uchebnik Nalogovoe Pravo [Textbook Tax Law] 354 (2004)

[44] Ibid.

As a rule, the agreements do not specify the procedural issues, thus leaving the state the right to use the order that it meets all its interests and responsibilities. No state can take advantage of the benefits of an international treaty, if the taxpayer has no right to it. And the right to benefits must be confirmed, following that order, which exists in the State.

2.2 Analysis of Double Taxation Avoidance Agreements signed by the Kyrgyz Republic vs. signed by India

Primary importance in the Kyrgyz Republic is given not to the problem of double taxation but to restructuring of tax management system. Wherein the special attention is paid to VAT for export and import of goods, contradictions of tax rates for income, profit, and social taxes. Unification of these tax rates are under discussion. Implementation of the best practices on avoidance of double taxation will lead to:

- Lower dependence of the Kyrgyz Republic from international financial institutions;
- Improvement of political and legal systems of the KR;

It should be noted that for organization and implementation of state tax policy, for development of the Tax law of the Kyrgyz Republic and other foreign states, active participation in development of conventions and agreements (recommendations) was contributed by various institutions (EC, OECD and etc). But even with the huge variety of existing problems, common to all the tax laws of foreign countries, international practice and tax system methods are depending on the taxpayer.[45]

General tendency in establishment and development of tax system could be seen in following aspects:

1. One system of direct and indirect taxes and fees, VAT, income tax is unified;
2. In the USA local taxes take a significant place in the budgets of the cities and other local authorities. Local taxes form base of local budgets that are supplemented by subvention and subsidies from federal and state budgets. Whereas in European countries local taxes play

[45] Petrova G.V., Nalogovye otnosheniia: Teoriia i praktika pravovogo regulirovaniia [Tax relations: Theory and practice of legal regulation] 35 (2003) (Ph.d dissertation) Moscow

supportive role. Basic taxes are allocated according to the legislation between budgets of all levels as in Germany.[46]

1. Tax legislation of the Kyrgyz Republic is socially oriented. This is clearly seen in implementation of Strategy on pension system reform for 2008 – 2010, according to which Article 170 of TC KR introduced "standard deductions" according to Article 4 "…social payments for nongovernmental pension fund not more than 8% from base of the taxpayer is considered as "standard deductions"." [47]

The given system provided higher income in retirement, increasing the share of savings, stabilization of capital market, and economic growth through investments of pension assets.

2. Companies with low commercial turnover imposed to lower taxes in many states.[48]

Favorable investment climate is primarily determined by state policy in tax and investment spheres. Despite the fact that the Law of the Kyrgyz Republic "On investments in the Kyrgyz Republic" dated from 27.03.03. #66 was issued and Act "On investment preferences for investors" on its basis was developed. But this Act did not receive any legislative support.

The Kyrgyz Republic in order to decrease tax burden resulted from imposed taxes on investor's income from the State of residence and the State of source, where business activity is carried out, concluded several international tax treaties on avoidance of double taxation. These agreements basically aimed at defining the difference and distinction between the State of source and the State of residence to govern their respective rights to impose tax on the different

[46] Petrova G.V., Nalogovye otnosheniia: Teoriia i praktika pravovogo regulirovaniia [Tax relations: Theory and practice of legal regulation] 35 (2003) (Ph.d dissertation) Moscow
[47] Nologovyi Kodeks Kyrgyzskoi Respubliki [Tax Code of the Kyrgyz Republic]
[48] Gritsenko V.V., Konseptualnye problem razvitiia teorii nalogovogo prava sovremennogo rossiyskogo gosudarstva [Conceptual problems of development of the modern Russia State tax law theory] 35 (2005) (Ph.d dissertation) Saratov.

elements of income (or capital) earned (or owned) by a resident of one of the States from sources located in the other State. So that to avoid double taxation either through exempting the income (or capital) from tax in the State of residence (partly or fully) or granting a credit for the tax paid in the State of source.

The Kyrgyz Republic generally follows the OECD Model Tax Convention on income and on Capital, which expresses the view of developed countries, as it seeks right of the State of residence to impose tax at the expense of the State of source. In addition, the Kyrgyz Republic keeps trying to increase the number of these agreements, and keeps revising the Kyrgyz model agreement for the avoidance of double taxation in order to be in line with the legislative and economic developments in the republic.

These agreements for double taxation avoidance foresee several rules, such as:

- Profit tax is paid by foreign entities engaged in activities through a Permanent establishment in the KR. The tax base for income received on basis of the Permanent establishment is calculated on basis of profit attributed to the permanent establishment. But at the same time tax agents that pay for foreign entity income from a source in the Kyrgyz Republic that is not a permanent establishment are subject for the profit tax. Base for this tax is accounted by gross revenue without any deductions. The losses incurred by the taxpayer could be forwarded for five years, but losses related to exempt of income could not. According to the TC KR following incomes are not included into the tax base:

    1. Property that is contributed to company's charter capital
    2. Dividends received from local companies;
    3. Property contributed to a simple partnership;

4. Property given for trust management;
5. Interest income and capital gains from sale of securities that are "international listing" or "blue chip" on the date of sale;

- Tax is not imposed on international transportation of passengers, luggage and cargo, services related to the transit of flights of aircrafts, international transportation, railway transportation is not included;

- Earned income of a foreign legal entity without PE is subject to withholding tax (source in the KR). PE includes branches, management places, offices, factories, mines, and etc. PE could be defined as place through which nonresident partially or fully conducts its economic activities. According to TC of KR and DTAA following rates are applied to income of nonresidents:
  1. 10% on dividends, royalties, interests;
  2. 5% on profit gained through insurance premiums and international telecommunication services;
  3. 10% from income received through consulting and management services;
  4. 10% from income received through services and works provided in KR

- Bonus is imposed as tax for natural resources, is onetime payment basis for the right to explore mineral deposits. Tax base is based on volume of mineral reserves;

- Royalty is regularly paid tax for production from a mineral deposit; royalty is applied also for revenues received from sale of natural products, processed products and minerals. Calculation of royalty depends on type and sale of mineral.

- All cross border transactions are subject to transfer pricing regulation. In case if transaction price differs from market price tax authority have right to assess additional tax liabilities base on price that is equal to the market price. Methods for determination of transfer prices are as follows:
    1. Comparable uncontrolled price method;
    2. Resale price method;
    3. Cost plus method.
- Following payers are subject to the income tax: non-residents of the Kyrgyz republic who received income from the source of the KR, a tax agent that pay income from the source in KR to an individual. The base for income tax is gross revenue minus allowable deductions.

It is worth mentioning, finally, that the Government of the KR endeavors to enable Kyrgyz persons and bodies to avoid (double) taxation even for taxes that are not covered by double taxation agreements.

A typical DTAA between India and another country related only to the residents of India and residents of the contracting state which is entering into such agreement.[49] In other words, such agreement doesn't cover any benefit claims of non residents of India or the contracting state. Such agreement generally related to the taxation of income in respective states and dedicated for decrease of tax burden over taxpayers. Since the tax treaties are meant to be beneficial and not intended to put taxpayers of a contracting state to a disadvantage, advantageous provisions that

[49] http://www.investmentyogi.com/nri/all-about-dtaa-double-taxation-avoidance-agreement.aspx#.UX04UqJSiAg, last visited April 26

are provided under the Indian Income Tax Act will not be denied to residents of contracting state only because the corresponding provision in tax treaty is less beneficial.

Indian DTAA follows a near uniform pattern and based and guided by the UN model of double taxation avoidance agreements. Such agreements represent equilibrium of jurisdiction between the source and residence country. If such jurisdiction is given to both the states, the agreements prescribe maximum rate of taxation in the state of source which is generally lower than the rate of tax under the domestic laws of that state. The double taxation is avoided in these cases by agreement of state of residence to provide credit for tax paid in the state of source thus reducing tax payable in the state of residence for the amount of paid tax in the country of source. The same benefit is available to the resident of the other state, on income taxed in India. Nevertheless if the person has fixed base in the contracting state, the income attributable to the fixed base will be taxed in the other contracting state. Regarding income where taxes are either exempted or reduced, the state of residence will not consider the exempted income while determining the tax to be imposed on the rest of the income.

These agreements provide provisions related to taxation of the income of the nature of interest, dividend, royalty and fees for technical services to the country of residence. However, the state of source has right for such taxations but the rates are limited for those prescribed in the agreement. The rate of taxation is on gross receipts without deduction of expenses.

Tax is imposed on the foreign enterprise in case if the entity has a Permanent Establishment in the contracting state. The Permanent Establishment is considered as a distinct and independent enterprise on this basis tax is calculated. According to the India DTAA interest paid in a Contracting State to a resident of the other Contracting State is chargeable in both the States. [50]

Regarding Royalties arising in a Contracting State and paid to a resident of the other Contracting State, the three kinds of provisions are prescribed according to DTAA signed with respective country:

- Taxation in the other Contracting State.
- Taxation in the contracting State.
- Taxation in both the States.

Capital Gains will be taxed in the state where the capital asset located at the time of sale. “Withholding Tax Rates for payments made to Non-Residents are determined by the Finance Act. The rates are subject to the Parliament approval.”[51]

Profit earned from air shipment in international traffic by legal entity of the one contracting state will not be taxed by the other contracting state. The legal entity will be taxed according to the location of place of management. However some DTA agreement has provisions to tax the income earned in the other contracting state as well at a reduced rate. Dividend paid to the resident of the state by a company which is a resident of other state is subject to the taxation in both states.

The Kyrgyz Republic in order to lower tax burden on the investor's income in both countries: in the State of residence and the State of source, where he conducts his activity, provides several

[50] http://www.allindiantaxes.com/income-tax-dtaa.php, last visited April 25
[51] http://www.corporatelivewire.com/top-story.html?id=an-overview-of-indias-taxes-on-business, last visited April 25

conditions prescribed by international double taxation avoidance agreements with other countries.

Since most of the agreements are based on the OECD model and as described above this model is more dedicated fro developed countries rather than for developing. These agreements should be aimed at defining rules between the State of source and the State of residence, define governing rights of each state. Even though the Kyrgyz Republic has relatively low tax rates, it doesn’t stimulate foreign companies to invest and pay taxes for the state of source. These agreements should define respective rights to impose tax on the different types of earned income or owned capital by resident of the contracting state from the state of source. This used to avoid double taxation at the lowest possible rate either by exempting the tax for income or capital in the state of residence, this could be granted either fully or partially, or by crediting paid tax in the state of source.

The Kyrgyz Republic should revise the existing agreements and together with respective governmental authorities adopt new provisions that would be combination of the two models of the OECD, that is used by developed countries and supports right of the state of the residence. It imposes taxes on expenditure of the state of source and the UN model which is used by most of the developing countries and supports its economy by giving right to the state of source to impose tax.

The Kyrgyz Republic should appoint responsible Commission that would take more active part in coordination of work between with Ministry of foreign affairs, ministry of economy, ministry of finance, tax authorities and ministry of justice. In order to review all and foresee all problematic issue that would rise during preparation phases of the agreement. Activities include these stages: negotiation, initializing and signature and ratification of the agreement. The commission appointed should keep revising the model agreement in order to improve double taxation avoidance system and be in line with the legislation and economic development and best practices used in the Kyrgyz Republic and foreign countries.

The advantages gained could be expressed not only by imposing taxes in the Contacting States but also could help to conclude agreements related to other taxes imposed by other countries with which the Kyrgyz Republic does not have the agreements.

The Agreements should foresee other options for avoidance of double taxation as non taxation or taxation at low rate for dividends paid to residents in the Kyrgyz Republic, shareholders by other companies which are residents in other contracting states. The same benefits and advantages should include non taxation or taxation at a reduced rate for similar payments as interest paid to the residents in the Kyrgyz Republic with the exemption of interest that is paid to the state of residence.

It should be prescribed by Agreements to allow Kyrgyz and resident companies in the Kyrgyz Republic to avoid tax payment not only by residency but double way through foreign tax deductions from the tax subject to pay in the State of residence. It should be noted that, many foreign companies, individuals conducting its activities in the country of source and gaining through its activities in the permanent establishment registered in the Kyrgyz Republic avoid tax payment motivating by condition that they are not residents of the country.

“In addition, double taxation agreements preserve tax incentives granted to members of diplomatic missions and consular posts abroad in accordance with international law or special agreements."[52] Agreements should ease negations and dispute settlement processes between Kyrgyz companies and taxation authorities of the contracting states through mutual procedures. Moreover, government should conduct international negotiations in order to enable Kyrgyz nationals as well as, legal entities to avoid double taxation even for those taxes that are not mentioned and covered by double taxation agreements.

[52] http://www.mof.gov.qa/en/index.php/2012-09-11-07-19-02, last visited April 25

CHAPTER 3. CASE STUDY

3.1 Kumtor Operating Company overview

Does the Kyrgyz Republic have favorable tax regime? Does it provide tax benefits? Does it have low tax rates? In order to answer these questions let us consider a case on example of Kumtor Operating Company. The Kyrgyz Republic's tax regimes generally are consisting of two types: general regime and special tax regimes (private entrepreneurs, patent taxation form, free economic zones and etc.). The case study is related to the Kumtor Operating Company as an example of foreign investing company based in the Kyrgyz Republic.

The first negotiations related to the Kumtor mine started in (1992-1993):

- first General Agreement on Kumtor was signed at December 3, 1992 by T.Chyngyshev, former prime minister of the KR, the another agreement on Kumtor was signed at December 4, 1992 by T. Chyngyshev, D. Sarygulov, A. Dzhumagulov.

According to the official data provided by the State Geology Agency Kumtor mine has the potential for 953 tons of gold. The development of Kumtor deposit was granted by the Government of the Kyrgyz Republic without any competitive tendering process was given a Canadian corporation "Cameco".

According to paragraph 5.3. of the General agreement, the Government has agreed to "Cameco" and its related companies, representatives of foreign contractors creditors or foreign experts were not subject to royalties, taxes, fees, royalties or payments required, directly or indirectly related to the Kumtor project (including income tax, a tax on the export of dividends) during the period beginning on the date of the General Agreement (since 1992), and after 5 years (2003), following the start of commercial production (since 1997) at the Kumtor project. VAT, tax on the use of roads and land tax are not included in clause 5.3. of the General Agreement. In other words the Kyrgyz Republic didn't receive any profit or tax payments during first 5 years of the project.

In accordance with the General Agreement CJSC "Kumtor Gold Company" (hereinafter referred as "KGC") was created, which acquired the right to develop the mineral resources of Kumtor in Central area on the basis of the Concession Agreement. Project management of Kumtor Gold was executed by JSC "Kumtor Operating Company" that was created according to the General Agreement and for a fee, calculated at the rate of 4.5% of total expenditure. In addition, the Executive Committee established by the general agreement, the members of the executive committee consisting from three members: 1 member appointed by "KyrgyzAltyn", 1 member is appointed by "Cameco", 1 member is appointed by the JSC "Kumtor Gold Company".

The proposed scheme of the Kumtor project management has limited rights of Kyrgyz side as the owner of two thirds of shares of CJSC "Kumtor Gold Company." The given scheme shows that the general meeting of shareholders was replaced by the Executive Committee, where two members were representatives of "Cameco".

An Executive Committee was contrary to the law "On Joint-Stock Companies in the Republic of Kyrgyzstan", as the delegation of authority of the general meeting of shareholders, within its competence, is not allowed. The established formula for determining the remuneration of Kumtor Operating Company for project management increased costs, including non-productive[53].

[53] Law "On Joint-Stock Companies in the Republic of Kyrgyzstan"

The concession agreement was signed in violation of the legislation of the Kyrgyz Republic. For example, paragraph 3.4 of Part 3 of the General Agreement states that the government after registering Kumtor Gold Company concludes and registers the concession contract, the KGC transmit all mineral rights on the Kumtor project[54].

In accordance with Article 10 of the Law "On concessions and foreign concessionary companies in the Republic of Kyrgyzstan", the decision to grant the object of a concession made by the Government in competitions and concessionaires acquire the concession contract with the concession authority.[55] Thus main principle of concession is a competitive approach to the selection of concessionaires.

Besides, no general agreement or concession agreement did not include provisions for the payment for the concession and payment for the rent, as provided in Article 11 of the Law "On concessions and foreign concessionary companies in the Republic of Kyrgyzstan," under which the concession fee and rents are some of the direct and mandatory concession fees.

According to paragraph 3.3 of the General Agreement, the initial investment of shareholders in the Kumtor Gold Company in the amount of $ 45 million was to carry out "Cameco" through the Kumtor Management Company.

Subparagraph «b», paragraph 3.3 of the General Agreement provides that the costs and expenses related to the exploration and development of the Kumtor deposit, and are not covered by loans financed in proportion to their respective shares in the share capital - 2/3 "KyrgyzAltyn" and 1/3

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[54] http://www.kumtor.kg/wp-content/uploads/2013/02/%D0%9E%D1%82%D0%B2%D0%B5%D1%82_KOK_%D0%BD%D0%B0_%D0%BF%D1%80%D0%B5%D1%82%D0%B5%D0%BD%D0%B7%D0%B8%D1%8E_%E2%84%9609-1500_%D0%BE%D1%82_11_%D0%B4%D0%B5%D0%BA%D0%B0%D0%B1%D1%80%D1%8F_2012_%D0%B3.pdf, last visited April 25

[55] The Law "On concessions and foreign concessionary companies in the Republic of Kyrgyzstan"

is CJSC Kumtor Management Company . “Cameco” took liabilities to make payment in amount of $ 15 million of its contribution, and $ 30 million on behalf of “Kyrgyzaltyn”. An amount of $ 30 million to be paid in the name of “Kyrgyzaltyn” recognized an indirect concession fee that contradicts with the Article 11 of the Law “On concessions and foreign concessionary companies in the Republic of Kyrgyzstan.”

In November 1992, “Cameco” and the Kyrgyz Republic signed the principles of the agreement, for the first time spells out the main provisions of investing in the Kumtor project with a share of the KR 2/3 and “Cameco” 1/3, including the establishment of JSC “Kumtor Gold Company” the same commitment that the Kyrgyz Republic will provide exclusive rights to the gold deposits of the project[56].

The building factory was mostly done for credit line. Thus, the amount of $ 437.5 million invested capital (equity) amounted to only $ 45 million financing structure looked so that “Cameco” has invested its own funds to the project in the form of share capital only by 3.4%. Equity loan to “Cameco”, was in the amount of $ 107,430,000[57].

The loss of the 1992-1994 agreements:

1) Kumtor project was handed over to the implementation of the corporation “Cameco”, which specialized in the extraction of uranium. Offers from other companies that specialize in gold mining on more favorable terms (“Grayberg Production Corp”, Anglo American, Nemmont, etc.) have been rejected by the KR. The agreements are clearly specified that the governance issues, such as approval of feasibility studies, annual plans, financial reports, approval of capital

[56] http://tazabek.kg/news:345493/ , last visited April 26
[57] http://www.centerragold.com/operations/kumtor-history, last visited April 26

expenditures, changes in the agreement was carried out not less than four fifths of shareholders (80%), that is, in any case, with the approval of the “Cameco”;

2) The formula of “equity” participation is not consistent with the interests of the KR - when the net profit (not income and not the produce section-gold) after all deductions, including the cost of maintenance and investment share (issued by the “Cameco”) loans for the development of the project, divided between the Kyrgyz Republic and “Cameco”. The funding structure of the Kumtor project for its commercial launch (feasibility study, construction of factories, etc.) has been organized in such a way that means “Cameco” invested in the development of the project, in fact amounted to 3.4% of the total cost, while raising funds engaged in “Cameco” secured by the deposit itself. KOC / KGC received administrative fee of 4% before the construction of the factory, and 4.5% after costs of the project;

3) In May 2002, following the expiration of tax holidays the Government of the Kyrgyz Republic adopted a change in the Kumtor project agreement for reimbursement of certain taxes - 1/3 of the KGC, and 100% of KOCs, which made commitments on the part of the Kyrgyz Republic on December 31, 2002 of $ 2.4 million and at December 31, 2003 of $ 2.5 billion, only $ 4.9 million This was done to reduce the risk of non-payment of investment loans and interest on them, including equity loan from the “Cameco” in the amount of $ 107.5 million at an interest rate of Libor 6%[58].

However, Kumtor Operating Company conducts its activity under special Agreement signed in 2009 by the Government of the KR (hereinafter the “Agreement”). This agreement was ratified

[58] http://enews.fergananews.com/news.php?id=1140, last vsisted April 26

by the Parliament of the KR, according to the Law #89 "On international agreement of the Kyrgyz Republic" dated from 21 July, 1999[59]:

"Article 3: International agreements of the Kyrgyz Republic are concluded with foreign states and with international organizations… (Intergovernmental, interstate, inter parliament agreements and etc)…International agreements that are subject to ratification are follows:

- Investment agreements;

- agreements about use of natural resources by other subjects of international right and foreign companies;"

In order to give international status for the Agreement, it was ratified by the Parliament. Although according to the Law only international agreements are subject for ratification. As Sariev said "it was specially stipulated by the Agreement that in special conditions compensation should be paid for the termination of the Agreement, so that the government could not do anything with Kumtor project" [60].

Moreover, special conditions are provided for work and tax payment of Kumtor, tax burden is as follows: 13 % is paid from turnover of the company as taxes and 1% is paid to the Development Fund of Issyk Kul oblast, whereas on other companies pay 17 – 20 percents. On the use of funds of the Development Fund of Issyk-Kul region, the analysis shows that the fund has been used mainly on the socio-cultural financing of health, education and culture. Total contributions to the fund during the period 1997-2012 amounted to $ 23 million and 141.8 million soms.

[59] Law #89 "On international agreement of the Kyrgyz Republic" dated from 21 July, 1999
[60] http://kabar.kg/kabar/full/48995, last visited April 26

Besides, to environmental crisis it was found out that Kumtor never provided considerable profits to the Kyrgyz Republic, although it is main profit generating project of the Centerra Gold Inc. In 2011 profit share was 92% of general income. In addition to the generous tax regime, Kumtor was granted fixed environmental charges in amount of USD 310 000 per year, as well as extended permission to operate the open-pit mine till 2026. Moreover, this Agreement even didn’t secure the recultivation of lands after mine closure. The amount given for this item is unbelievingly low. Although, Kumtor has high output of gold (gold component in the ore is 2,9 g per ton and even more), and comparatively low production costs (USD 502 per ounce).

Although the Kumtor project is considered to be non profitable we cannot omit mentioning it’s obvious benefits as provision of work places for local employees, owning assets as shares (at country level) and taxes paid for local employees (income tax, taxes for Social Fund), attraction of new investors and creating positive image of the country as favorable for investment.

The obvious negative factors could be considered as follows:

- Management is limited for the local employees, meaning that local representatives are not placed in key positions that involved in development of financial, technical and social security parts of the company.

- Expected involvement of economic sectors of the Kyrgyz Republic did not acquit: for example, involvement of transport sector, processing sectors, refining sector and etc. In other words this company did not become integrated into economy of the Kyrgyzstan, but closed company standing alone.

- Impact to the balance of payments of the country is negative in other words we have export of the gold produced but no equivalent income received by the country.

Based on assumption that the given structure does not have positive impact into the economy of the country and from the primary calculation the company had high rate of return. There was no need for provision of high preferences for it, in terms of tax exemption and further reducing tax rates, and etc.

Under the agreements from the years 1992-1994 (signed T.Chyngyshev, M.Davletov) the whole scheme of financing and management of the project has been constructed in such a way that “Cameco”, KOC and KGC in contrast to the KR received strong cash flows and their interests are well protected from the point of view of risks and controls. Adopted at the time the formula of “equity” participation, when net income was divided between the parties did not meet the interests of the Kyrgyz Republic, with tax holidays for 5 years after the industrial production, and after their completion provides for compensation on the part of taxes. Despite the fact that two thirds of the project and management through the executive committee and the board of directors of the KGC and the KOC has been for the KR, important decisions were made by at least four fifths of shareholders (80%), that is, with the approval of “Cameco”. An increase in factory built over the original feasibility study was $ 175.6 million

Among the three agreements signed for development of Kumtor deposit the most advantageous agreement is from 1992. Where the amounts of taxes and mandatory payments of dividends financial losses from the subsequent restructuring of the Kyrgyz Republic (2003 and 2009) can be estimated to approximately $ 174 million is in addition to “KyrgyzAltyn” lost a majority stake in Kumtor, and instead of 66.7% the direct control of today has a 32.75% share of indirect participation.

Since the inception of “Centerra” to present a strategic problem is not solved and the concentration dependence on one field - Kumtor, which gives 90% of cash flow “Centerra.” With the approach of the end of the project life cycle Borough (Mongolia) “Centerra” remains with the only active asset Kumtor and almost exclusively on income Kumtor will be financed acquisition of new fields, all exploration, all capital and operating expenses, including administrative expenses as a “Centerra”, and the other operating companies. “KyrgyzAltyn”, as the largest shareholder and owning 32.75% of shares of “Centerra” de facto exercise the rights minority shareholders[61].

Considering above mentioned facts, we can answer our questions stated at the beginning. Yes, the Kyrgyz Republic has favorable tax regiment. And it provides tax benefits. And, yes, it has low tax rates. But, the Kyrgyz Republic gains relatively low from such agreements. In order to achieve higher economical profits and at the same time, create favorable condition for the foreign investments the interests of the country as state should be reconsidered. Such agreements should prescribe following conditions:

- Tax regiment should be reconsidered every 3 years, (as incentives for the investing companies), upon receipt of profit the tax regiment should be reconsidered and equalized with local rates;
- Tax payments as royalties and profit tax should be fixed;

[61] http://tazabek.kg/news:345493/, last visited April 27

- Recultivation costs should cover all expenses and expressed as fixed percentage from total profit gained over the agreement period;

The above mentioned recommendations cover just small part of the whole picture. But even these small steps could easy the tax burden of the local companies and increase tax levies.

CONSLUSION

Consequently, international agreements on the avoidance of double taxation provide benefits to tax income taxpayers' country of residence (permanent residence) of legal entities and individuals. The increase in tax revenues of the country of residence of the taxpayer is at the expense of the country's income. Therefore, the international agreements on the avoidance of double taxation will always contain a certain mechanism of taxation, which is applied in the same order to all parties to the Agreement.

Although many states have adopted laws regulating international operations and providing unilateral relief from international double taxation, these unilateral efforts do not always achieve this goal. Therefore one of the goals of the international treaty on avoidance of double taxation is to solve the conflicts of residence in the context as taxation.

In cases where a resident of one country derives, income in another country, the tax treaty usually prevents the potential double taxation, either by the exclusive right to collect taxes in one country (e.g., only the country of residence may tax the interest income paid by the taxpayer in the other contracting state) or by retaining the ability to tax in both states, but limiting to this tax maximum size in one of the states (for example, in relation to dividends paid by the taxpayer to the country - source of income).

Tax agreements also provide for a degree of certainty and predictability, which allows taxpayers to plan their actions. Clauses in these contracts provides for the exchange of information between countries, help the Contracting Parties to provide for the application of certain provisions of the domestic tax laws.

The ongoing adaptation of the tax system to the changing conditions of society and the state, affects the interests of all participants in tax relations. Given the multidimensional nature of relations governed by the tax law, as well as the significant impact of the international experience in the process of tax reform, the definite trend is established that is primarily aimed at drawing public and government attention to the problems of taxation in general.

Theoretical analysis reveals some aspects of the interaction of national and international law in the field of taxation. We select some of them:

1. To date, one of the important gaps in the tax legislation of the Kyrgyz Republic is its contradiction in implementation of the national and international taxation principles in areas of control of taxation and investment management. National legislation requires significant changes to the use of incentive tax rules in investment.

2. Domestic tax law contains no direct instructions on how to treat investment contracts for the purposes of taxation. Specifically the size and due date of profit acknowledgement of investor for profit taxation. In addition, problems arise during taxation of activity of investor in case of re-investment. Thus, international treaties signed by the Kyrgyz Republic and local domestic tax law are two separate institutions or legal parties. In this regard, these tow systems should interact with each other. This interrelation should go through legislative process to introduce appropriate changes in the TC KR in strict accordance with international standards to promote investment by certain tax arrangements (provision of tax incentives, fair competition, mechanism of double taxation avoidance, etc.). In TC KR only one rule, namely Article 3 deals with international tax norms, others involved in the regulation

of international taxation, are not allocated to the individual articles. However, in the present TC KR and the rules governing the taxation of foreign entities especially for different types of taxes, but they are spread across the features of the TC KR. On this point, we consider it necessary to make appropriate changes to the tax legislation of the Kyrgyz Republic, and gather them in one section of the TC KR. Our proposed change in the structure of TC KR would provide rational correspondence between the norms of the TC KR and a huge array of interstate governmental agreements on tax matters;

Thus, the analysis of the study showed that the tax provisions of the Kyrgyz Republic, directly participating in international agreements, result in a certain dependence of the national tax legislation and its mediating international law. In this regard, it is important to prevent the rollback process for the state public - legal tax obligations of the participants of international tax law to private agreements that infringe to some extent the financial interest of the Kyrgyz Republic and individual taxpayers.

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