

Kluwer Arbitration Blog

Tax Dispute Arbitration in Kyrgyzstan: A Potential Cure or a Looming Failure

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In 2019, a [blog post](#) discussed the push in Kyrgyzstan towards expanding the scope of arbitrable disputes. This trend has continued with the recent [Tax Code](#) reform, which allows tax disputes to be arbitrated in the country from 1 January 2023 onward. This development reflects the Kyrgyzstan government's ongoing efforts to rectify shortcomings in its judicial system by outsourcing administration of justice to private institutions. The [rationale](#) behind this move is to address the perceived judicial bias in favor of the state and to encourage greater transparency and impartiality in resolving tax disputes (see Attachment 5).

This development raises both theoretical and practical challenges related to tax disputes and arbitration. On a theoretical level, the question of whether tax disputes are suitable for arbitration is still debated. Taxation is [seen](#) as a sovereign prerogative, representing a stream of funds that forms the lifeblood of all modern political collectives. On a practical level, there may be concerns over the capacity of arbitrators to understand complex tax laws and the possible lack of consistency in arbitral awards.

This article provides an overview of the key innovations introduced by the new Tax Code, its challenges, and potential implication to arbitration in Kyrgyzstan more broadly.

Amendments to Tax Code in Kyrgyzstan

The Tax Code introduced several key amendments. First, taxpayers can challenge decisions made by tax authorities before either an arbitral tribunal or an administrative court. Second, the law explicitly recognizes and establishes the tax authorities' consent to arbitration. Until recently, such legislatively-provided consent to arbitration in Kyrgyzstan existed only in [investment law](#). Third, the arbitral institution handling the tax case must have been in operation for at least 60 months before a claim can be lodged with it. Consequently, this provision excludes the possibility of subjecting tax disputes to *ad hoc* tribunals.¹⁾

According to the parliament, one of the primary reasons for these changes is the noticeable increase in the number of lawsuits filed by taxpayers to challenge the State Tax Service's decisions on tax assessments. A review of judicial practice conducted in 2018 [revealed](#) that more than 90%

of court decisions on taxpayers' applications to invalidate the decisions of tax authorities were ruled in favor of the State Tax Service (see Attachment 5), often in gross violation of tax legislation. This skewed outcome raises concerns about the fairness and integrity of the system.

Challenges to Arbitrability of Tax Disputes in Other Jurisdictions and Potential Challenges in Kyrgyzstan

The arbitrability of public disputes is a complex matter, with variations across jurisdictions. In many countries, arbitration is primarily confined to civil or private disputes. Arbitration of tax disputes is the exception rather than the norm.

In 2011, Portugal permitted [tax arbitration](#) by [Decree-Law 10/2011](#). The Portuguese legal framework does not impose strict limitations on [the arbitrability of private disputes](#). The law established dedicated Tax Arbitration Courts that consist of a panel of professional tax arbitrators and operate with customized procedures specifically designed for public disputes. One notable aspect of the Portuguese model is the incorporation of statutory limits on the amount of tax disputes eligible for arbitration. This ensures that there is a clear and defined scope for the arbitral process.

In Kyrgyzstan, the situation is different: the legal framework generally does not provide for the arbitrability of public law disputes. According to [Article 61\(3\) of the Kyrgyz Republic's Constitution](#), only disputes arising from civil relations can be resolved through alternative dispute resolution (ADR) methods. However, recognizing the need to address this limitation, the Kyrgyz Parliament has redefined the nature of relationships between taxpayers and tax authorities through [Article 1\(7\) of the Tax Code](#), which now stipulates that matters related to tax calculation, payment, budget contributions, and tax debt recovery are rooted in civil relations.

While this legislative amendment aims to broaden the range of disputes that are eligible for arbitration, it raises certain concerns. One notable concern is that this development deviates from the conventional understanding of the relationship between tax authorities and taxpayers as falling within the realm of public law. The reclassification of this relationship indicates a potential blurring of the line between private and public law, or it may reveal a lack of understanding on the part of Kyrgyz lawmakers regarding this matter.

When determining the suitability of a dispute for arbitration, it is important to consider the parties' ability to reach a settlement. In some jurisdictions, this criterion plays a pivotal role in determining the arbitrability of disputes. For instance, under [Article 1 of the Swedish Arbitration Act \(1999\)](#), only disputes that can be settled by mutual agreement are eligible for arbitration. Similarly, in [Canada](#), the use of arbitration for tax disputes has faced obstacles due to the limited authority of tax authorities to settle such cases. This limitation stems from the requirement that taxes be assessed based on legally established criterion, with any deviation being deemed illegal. In this context, the lack of a mechanism to settle disputes between private parties and tax authorities in Kyrgyzstan also poses challenges to the effectiveness of the new system.

Kyrgyzstan's foray into tax arbitration is not unprecedented among former Soviet countries. For example, in 2005, Georgia adopted arbitration for tax disputes and provides insights on additional issues Kyrgyzstan may face.

While [Article 164\(1\) of the Georgian Tax Code \(2005\)](#) provided for the ‘costs follow the event’ principle for allocating arbitration costs, Kyrgyzstan’s new Tax Code is silent on cost allocation. The State Tax Service in Kyrgyzstan is [exempted](#) from paying legal costs in state courts (see Art. 141(17)), but it is not clear whether such an exemption will extend to arbitration.

Moreover, unlike Georgia, Kyrgyzstan currently lacks a procedure for setting aside arbitral awards. The absence of such a procedure deprives the losing party of the right to challenge the award if irregularities occur during the arbitration process. The only opportunity to raise such concerns would be during award enforcement by the prevailing party, but not all awards require enforcement.

The Georgian approach encountered challenges and [demonstrated certain shortcomings](#), which can also be observed in the new Kyrgyz Tax Code. These include the disregard for the private law nature of arbitration and the lack of the tax authority’s power to settle disputes. Ultimately, the Georgian experiment failed. The provision allowing tax arbitration was revoked a mere four months after its implementation. During this period, [only three tax disputes](#) were actually considered in arbitration.

Potential Implications to Arbitration in Kyrgyzstan

The inadequate implementation of tax arbitration in Kyrgyzstan presents a risk to the success of this initiative. Despite the initial skepticism surrounding Kyrgyzstan’s approach to addressing the judicial system’s weaknesses through arbitration, it is crucial to acknowledge the potential positive implications it carries for the development of arbitration in the country. The government has launched [a campaign](#) that positions arbitration as an effective way of solving tax disputes and highlights that tax is a matter of concern for all citizens. The heightened publicity has the power to increase public interest and awareness of arbitration as a viable mechanism for dispute resolution, which could act as a catalyst for positive reforms within the arbitration framework.

Concluding Remarks

The prospects for success of the Kyrgyz experiment with tax arbitration remain unclear. As of today, there are several potential pitfalls that could jeopardize its effectiveness and outcomes. Taking inspiration from the words of [José Miguel Júdece](#), Kyrgyzstan’s decision to address its judicial system challenges by outsourcing them to private arbitral institutions can be metaphorically compared to entering into second marriages, where hope tends to prevail despite past experiences. The government’s pursuit of this reform is driven by the pressing crisis within the judicial system, specifically concerning the resolution of tax disputes. However, it is crucial to approach such reforms with caution, as populist-driven experiments lacking economic justification and a solid theoretical foundation can potentially undermine the public’s trust in arbitration. Careful consideration of the long-term consequences and implementation of reforms grounded in sound principles are essential to ensure the effectiveness and credibility of the arbitration process.

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References

In Kyrgyzstan, there are currently four registered institutional arbitration courts: the ICA CCI KR (established in 2002); the Jalal-Abad Regional Arbitration Court (2013); the Central Asian Arbitration Court (2015); and the Bishkek International Court of Arbitration for Mining and Commerce (2019). However, the law imposes a requirement that an arbitral institution must have been functioning for 60 months to be able to handle tax cases. If the term ‘functioning’ is interpreted to mean that an arbitral institution must be registered and in existence, then all four institutions, except the Bishkek International Court, meet this requirement. However, if ²¹ ‘functioning’ implies actual operational activities, it is possible that only the first institution, ICA CCI KR, fulfills the prescribed criteria. This raises concerns about the capacity of the other institutions to effectively handle tax disputes. It is worth noting that there are currently no accreditation requirements for international arbitration institutions in Kyrgyzstan. Consequently, under the unified application of laws governing both domestic and international arbitration, there are presently no legal barriers preventing an international arbitration institution from considering a tax dispute under Kyrgyz law.

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