Insight

# Cryptocurrency mining in Kazakhstan: protections for foreign investors


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*As regulatory changes in Kazakhstan rattle the country's booming cryptocurrency industry, foreign investors may need to look to investment treaties for legal protection.*

**Shifting sands for cryptocurrency miners**

In recent weeks, Kazakhstan has tightened its regulatory regime for cryptocurrency miners operating within its borders in an about-turn from previous incentives aimed at encouraging investment.

In January 2022:

- the state-run power operator KEGOC stopped providing power to registered cryptocurrency miners, in response to the electricity shortage in the country.[1] This policy is estimated to have cost miners up to US$ 1 million daily[2] and it is unclear whether KEGOC has resumed providing power; and
- an amendment to the tax code implementing a tax on cryptocurrency mining – 1 tenge ($0,0023) per kilowatt-hour of electrical energy consumed – reportedly came into force.[3]

On 31 January 2022, the head of the digital assets department of the State Revenue Committee of the Ministry of Finance announced that the hourly rate could increase a further five or tenfold.[4] As recently as 8 February 2022, the president of Kazakhstan, Kassym-Jomart Tokayev, instructed the government to increase the current tax as soon as possible.[1]

The high electricity consumption of mining farms appears to have been a driving force behind this tax. Kazakhstan's infrastructure is struggling to keep up with the rapidly rising demand for electricity, which the authorities have blamed on mining data centres.

- Kazakhstan also reportedly plans to impose a levy on mining equipment. Mining firms will be required to report the number and type of their coin mining devices and pay the new fees on a quarterly basis.[2]
- The deputy finance minister has announced that VAT may also be charged on imports of mining hardware, which are currently exempt from this tax.[3]

Industry groups have predicted that the high levels of taxation "will kill off the crypto-mining sector in Kazakhstan."[4] Many miners have already left the country in anticipation of these measures.

**A once-favourable environment for cryptocurrency mining**

The measures outlined above represent a stark shift from Kazakhstan's initial approach towards the cryptocurrency mining industry. In 2021, Kazakhstan became the second-largest bitcoin mining hub in the world (after the United States) as a result of tax incentives and cheap electricity. Until recently, the government of Kazakhstan was eager to attract investment in the cryptocurrency space:

- In 2019, the Kazakhstan government announced generous tax incentives for miners: cryptocurrency mining was to be entirely tax-free, with taxes applied only when cryptocurrencies were converted to fiat currency.[1]

- In 2020, Kazakhstan recognised cryptocurrency mining as an "official business activity".[2] This legal recognition laid the groundwork for an influx of miners from neighbouring China, following its ban on cryptocurrency trading and mining in September 2021.

By December 2020, it was estimated that US$ 190 million had already been invested in cryptocurrency mining operations in the country[3] and Kazakhstan had in place preliminary agreements with investors worth US$ 738 million.[4] There are currently around 200 legally registered cryptocurrency miners in Kazakhstan, including miners from China, the US and Switzerland.

**Legal protections for foreign investors**

Foreign investors could benefit from seeking protection for their investments in Kazakhstan under international treaties. Kazakhstan is a signatory to several investment treaties, including bilateral investment treaties (***BIT***) with China,[1] the United States,[2] and Switzerland.[3]

Under these BITs investors may seek to resolve disputes through international arbitration under the auspices of the International Centre for the Settlement of Investment Disputes (***ICSID***) – of which Kazakhstan is a Member State – or other arbitral institutions.

The BITs to which Kazakhstan is a party generally provide substantive protections to qualifying foreign investors, having made investments within the territory of Kazakhstan. These protections usually include the State's compliance with the "fair and equitable treatment" (***FET***) standard towards foreign investors.

Subject to any exceptions or carve-outs that may exist in the relevant treaties, a violation of the FET standard can include a non-observance or frustration of an investor's "legitimate expectations". This concept refers to a situation where a State's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act on reliance of said conduct, so that a failure by the State to honour those expectations could cause the investor (or investment) to suffer damages.

This does not mean that the State is unable to subsequently modify the applicable legal framework or regulatory environment, but changes must be made in a manner that is not disproportionate to the public policy reasons for these changes. In other words, the State should aim to achieve its goal in a manner that minimises harm to affected investors, thereby accounting for the interests of investors who have committed substantial resources on the basis of the State's promised incentives.

Given the explosive growth of the cryptocurrency mining industry in Kazakhstan following the announcement of its incentives, foreign investors may have relied on the inducements enacted by the Kazakhstan government. Moreover, the "preliminary agreements" that the government entered into with investors, while not public, may contain specific commitments.

In the context of foreign investors' reliance on incentives (and possibly investment agreements), Kazakhstan has not only revoked preferential income tax treatment to cryptocurrency miners, but has also imposed:

- an income tax penalty;
- levies on mining equipment;
- mining-specific VAT charges; and
- mining-specific electricity surcharges.

Taken together, these measures could constitute disproportionate treatment that frustrates investors' legitimate expectations, thereby breaching Kazakhstan's obligation to provide FET under various BITs. Whether or not such breaches have in fact occurred will strongly depend on the circumstances specific to each foreign investor.

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