

# Taxation and investment in Azerbaijan





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# Deloitte in Azerbaijan

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# Business and investment environment

## 1. General rules on investment activity and forms of business organisations in Azerbaijan

Azerbaijani legislation defines "foreign investment" as any kind of property and proprietary rights, including the right to the results of intellectual activity and other intangible rights contributed by foreign investors for the purpose of deriving profit.

Foreign investors may make investments in Azerbaijan in the following way:

- Share participation in enterprises and organisations established in collaboration with Azerbaijani companies and individuals
- Establishment of enterprises fully owned by foreign investors

- Purchase of enterprises, buildings, fixtures, equity shares in enterprises, other shares, bonds and securities, as well as other property which, according to the legislation, may belong to foreign investors

- Acquisition of rights for the use of land and other natural resources

### *Privileges for and state guarantees to foreign investors*

Foreign investors enjoy a legal regime that is as favourable as the one created for local investors. Azerbaijani law guarantees foreign investors' interests from future adverse changes in the legislation for the next 10 years. However, this does not apply to changes in legislation concerning defence, national security and public order, environmental protection, credit and finance, and public morale and health.

### *Business organisations in Azerbaijan*

Azerbaijani legislation provides for a number of different forms through which business activities may take place. They include the following:

Type of commercial organisation	Main characteristics or requirements
Open or closed joint stock company	<ul style="list-style-type: none"> <li>• Limited liability</li> <li>• One or more founders (an individual and/or a legal entity)</li> <li>• Charter and foundation agreement required</li> </ul>
Limited liability company	<ul style="list-style-type: none"> <li>• Limited liability</li> <li>• One or more founders (an individual and/or a legal entity)</li> <li>• Charter and foundation agreement required</li> </ul>
General partnerships	<ul style="list-style-type: none"> <li>• Unlimited personal liability</li> <li>• Charter and foundation agreement required</li> </ul>
Limited partnerships	<ul style="list-style-type: none"> <li>• Limited liability for partners and general partner(s) (unlimited liability)</li> <li>• Charter and foundation agreement required</li> </ul>
Companies with additional liability	<ul style="list-style-type: none"> <li>• Founders bear subsidiary liability established in the charter</li> <li>• Charter and foundation agreement required</li> </ul>
Cooperatives	<ul style="list-style-type: none"> <li>• Established by not less than five individuals and/or legal entities (property liability)</li> <li>• Charter and foundation agreement required</li> </ul>



Foreign companies may establish either a branch or a representation office. Neither branches nor representative offices are legal entities in and of themselves, but are considered to be separate divisions of the foreign legal entity they represent.

Although there is no difference between the tax treatment of branches and representative offices, a branch office is a more appropriate form for conducting commercial operations from a legal point of view. Unlike a representative office, a branch may perform commercial operations that are also conducted by its head office.

Limited liability companies and branches are the most popular forms of doing business in Azerbaijan among foreign investors.

State registration of entities is carried out by the Ministry of Taxes of Azerbaijan according to the "one stop shop" principle. The registration process takes three business days.

All of the processes necessary for state registration of entities are carried out by the Ministry of Taxes of Azerbaijan. Registration of legal entities and branch or representative offices of foreign legal entities must be completed within two days. Legal entities with local shareholders can be registered immediately through a fast e-registration process while regular e-registration is completed within one day.

## **2. Authorised Capital and Contributions of Partners**

According to Azerbaijani civil legislation, as a general rule, a company's authorised capital cannot be less than the amount of the company's liabilities to its creditors.

The minimum limit of authorised capital for joint stock companies is AZN 2,000 (approximately USD 2,550) for closed joint stock companies and AZN 4,000 (approximately USD 5,100) for open joint stock companies.

## **3. Licensing and compulsory notification of state authorities**

Certain activities in Azerbaijan (for example, banking, audit, insurance, tourism, etc.) require a license/special permit. Companies that intend to engage in activity subject to licensing should apply to the appropriate state authorities for a license following their state registration.

## **4. Acquisition of real estate in Azerbaijan**

Any purchase of immovable property should be notarized. The title to the property is considered to have been transferred to the buyer as soon as the appropriate records have been made in the State Register of Immovable Property.

Although foreign investors, including individuals, may own immovable property, they cannot purchase land in Azerbaijan. Foreign nationals and foreign legal entities may only obtain the rights to land use through a lease.

## **5. Exchange controls, bank accounts and confidentiality of bank information in Azerbaijan**

The manat, Azerbaijan's official currency, has limited convertibility. According to the Constitution of Azerbaijan, the manat is the only means of payment in Azerbaijan.

Both resident and non-resident entities of Azerbaijan have the right to open and close accounts in the national or any other foreign currency. In order to open a foreign currency bank account, entities conducting activity in Azerbaijan are obliged to submit a document confirming their registration with the respective tax authority. Residents and non-residents may import and exchange currency in accordance with the procedures established by the Central Bank of Azerbaijan.

Taxpayers engaged in entrepreneurial activity are obliged to notify the tax authorities about opening offshore bank accounts.

Foreign investors may repatriate their profits after paying the appropriate taxes.

Under current legislation, disclosure of confidential bank account information is prohibited. Such information may be disclosed only on the basis of a court ruling. However, in cases provided for by the Tax Code, tax agencies may obtain taxpayers' bank account information.

## 6. Construction activities

City building and construction activities in Azerbaijan are regulated by the City building and Construction Code of the Republic of Azerbaijan ('Construction Code') effective from 1 January 2013, other laws and regulations, technical norms and standards (collectively, Construction Standards, available at the official website of the State Committee on Town Planning and Architecture). Pursuant to the Construction Code, in most cases, other than for small-scale construction projects or construction projects with non-commercial purposes, construction works require construction permits to be obtained.

The Construction Code provides for specific regulations with respect to the following subjects of construction activity: i) customer; ii) project manager; iii) contractor.

Under the Construction Code, state authorities, municipal bodies, physical and legal entities may qualify as customers of a construction project, while the project manager and contractor are required to be legal entities registered in the republic of Azerbaijan and hold the appropriate licence. In other words, foreign legal entities or branches/representative offices of foreign legal entities do not qualify to act as project managers or contractors. Foreign legal entities may participate in construction activities in Azerbaijan only via their subsidiaries, incorporated in Azerbaijan.

Furthermore, the Construction Code introduces professional certification requirements for individuals involved in the following areas of construction activity: i) engineering/research; ii) project management;

iii) construction/installation; iv) mechanisation/transportation; v) production of construction materials, vi) construction projects expertise.

The Construction Code provides for certification of construction products and materials, so that only certified products and materials, consistent with fire safety regulations are used in construction works. Laboratories offering certification of construction materials and products must be accredited.

## 7. Competition rules

Competition on the Azerbaijani market is regulated mainly by the Law on Antimonopoly activity ('Antimonopoly Law') and the Law on Natural Monopolies along with other supplementary laws and regulations. Antimonopoly Law provides for compulsory notification and authorisation from the State Antimonopoly Services in the following cases:

- Merger/consolidation
  - Where a merger/consolidation leads to the creation of entities with a market share exceeding 35%;
  - Where a merger/consolidation takes place between market participants with total value of assets which exceed the value of 75 thousand times the minimum wage (AZN 105.00 as of 2014);
- Acquisition of shares
  - Acquiring more than 20% of the voting shares (interest) of a market participant;
  - Acquiring the main production means or non-tangible assets of a market participant, provided that such property represents more than 10% of the main production means or non tangible assets of the seller.
  - Acquiring the rights necessary to define the business and perform the functions of the highest governing management body of a market participant provided that:
    - The value of the entity's total assets exceeds 75 thousand times the minimum wage (AZN 105.00 as of 2014); or
    - One of the entity's market share exceeds 35%; or
    - The entity acquiring shares (interest) controls the activities of the entity transferring such shares (interest).



Furthermore, market participants with a dominant position or with special or exclusive rights or natural monopolies have to disclose the terms and prices for their goods and services and any modifications to them 30 days prior to issuing such terms and prices or modifications to them. A dominant position is defined as an exceptional position, which allows a market participant to use its economic potential to influence competition, so as to restrict access of other market participants to the market. Market participants with a market share exceeding 35% or other figure specified by legislation are considered as entities with a dominant position.

## 8. Immigration

According to the Migration Code of the Republic of Azerbaijan effective since 01 August 2013, every able-bodied person over 18 years of any nationality (or stateless) is entitled to work within the territory of the Republic of Azerbaijan. Foreigners or stateless persons may work in Azerbaijan provided that the following conditions are met: (i) existence of a job vacancy that is not claimed by a citizen of the Republic of Azerbaijan who has the skills and necessary qualification for such job, (ii) the employment services are unable to meet employers' need from local labour resources. In such circumstances, employers will be granted a work permit in order to employ a foreigner or stateless person.

Foreigners or stateless persons are required to have a work permit in order to work in Azerbaijan. Work permits are issued by the State Migration Service of Azerbaijan. Work permits are issued for up to one year and may be extended an unlimited number of times for a period of up to one year.

Individuals coming to Azerbaijan with the purpose of involvement in an entrepreneurial activity, or for business trips not exceeding three months in length; heads of foreign legal entities or branches/representative offices of foreign legal entities and their deputies are exempt from the requirement to obtain a work permit.

Employers (legal entities) who employ expatriates without obtaining work permits risk an administrative penalty ranging in amount from AZN 30,000 to AZN 35,000 (approximately USD 38,246 to USD 44,620).

### *Temporary residence*

Any expatriate visiting Azerbaijan on the basis of a visa or visa free regime may apply for a temporary residence permit on any of the grounds below:

- A close relationship with a citizen of Azerbaijan Republic (father, mother, husband (wife), children, sibling, niece and nephew, grandfather, grandmother etc.);
- Investment in the economy of the country of an amount of AZN 500,000 (≈ USD 600,000) or greater;
- Possession of real estate in Azerbaijan or a deposit with a bank in Azerbaijan of a minimum of AZN 100,000 (≈ USD 130,000);
- The applicant is a high-level specialist in the economic, industrial, defence, scientific, cultural, sporting or other sphere;
- The applicant is the family member of an expatriate temporarily or permanently residing in Azerbaijan;
- Holding the post of head or deputy head of a branch/representative office of a foreign legal entity in Azerbaijan;
- Involvement in entrepreneurial activity in Azerbaijan\*;
- Obtaining a work permit;
- Full-time education in an educational institution in the Azerbaijan Republic;
- Professional involvement in a registered religious institution;
- in the cases as defined by the intergovernmental agreements of the Republic of Azerbaijan;

\* Entrepreneurial activity may serve to obtain a temporary residence permit only if an applicant undertakes business activity and has at least five full time or 10 part time employees hired with appropriate employment agreements. In such cases at least 80% of the employees have to be Azerbaijani citizens.



## 9. Customs

Customs relations are regulated by the Customs Code of the Republic of Azerbaijan effective as of 1 January, 2012 and other supplementary laws and regulations issued by the respective state authorities.

Under the Customs Code, legal entities may be registered as an Authorised Economic Operator, and will then be subject to simplified customs control procedures for the purposes of delivering goods in a safe and secure manner and facilitating foreign trade. The Code sets eligibility criteria for acquiring the status of an Authorised Economic Operator.

During a Customs Audit, the customs authorities may audit goods that have previously cleared.

Under the Code, in the customs territory of the Republic of Azerbaijan ('customs territory'), customs procedures fall into two groups:

**general customs procedures:** i) export, ii) re-export, iii) temporary export, iv) release for free circulation and v) re-import procedures.

**specific customs procedures:** i) transit (international/domestic), ii) specific use (temporary import/end use), iii) processing (inward/outward), iv) warehousing (temporary/customs) and v) free zone.

## 10. Securities

The securities market is regulated mainly by provisions of Civil Code of the Republic of Azerbaijan, norms and regulations issued by the State Securities Committee and other related laws and regulations.

Under the Civil Code, securities fall into three categories:

i) registered securities, where a security is issued in the name of a certain person; ii) bearer securities, where a debtor undertakes performance of obligations in respect of any person presenting that security; and iii) order securities, where an authorised person may appoint another authorised person as his substitute with respect to a security.

Securities may take the form of investment securities, such as shares and bonds, and non-investment securities, such as derivatives (options and futures), checks, orders, promissory notes, deposits of mortgage and others.

Only stock companies (open and closed) may act as issuers of shares.

The following actions are considered to be issuing of investment securities: i) issuing of corporate bonds by legal entities of the Republic of Azerbaijan; ii) share issues by stock companies in cases of share combination or division, or increase or decrease in nominal value of shares; iii) additional share issues by stock companies in order to increase charter capital; iv) issue of investment securities in cases of re-organisation of commercial entities.

A prospectus is required for the public placement of investment securities or the issue of additional shares by stock companies.

A Public placement of shares is required for the issue of shares by open joint-stock companies (other than in cases where the issue is to establish or re-organize an OJSC or for share conversion) and is prohibited for closed joint-stock companies. Public placement of shares by an OJSC must be undertaken via a stock exchange. Azerbaijani legal entities may place investment securities outside the territory of the Republic of Azerbaijan only with the approval of the State Securities Committee.

For the purposes of increasing transparency, detection and prevention of abuse within the securities market, protection of shareholders rights and monitoring security transactions, a set of new regulations was adopted in 2012, which require reporting and disclosure to the State Securities Committee in the following cases:

- i) report and disclosure of information on security transactions by professional participants of securities market (brokers, dealers, depositaries, registrars of securities owners and those, performing the functions of a stock exchange);
- ii) Insider trading cases, where an insider enters into an agreement with respect to the shares of an issuer with whom it has a separate relationship ;
- iii) annual publication of reports on activities by issuers of investment securities;
- iv) attestation of professional participants in the securities market.

## 11. Banking issues

The banking system in Azerbaijan comprises the Central Bank of the Republic of Azerbaijan ("Central Bank") and credit institutions. Credit institutions include banks and non-bank credit institutions. Banking activity within the territory of Azerbaijan is conducted on the basis of a licence obtained from the Central Bank.

Banks can be established by a minimum of three persons (physical or legal entities) and they are required to function as Open Joint Stock Company.

Bank charter capital is set at AZN 50 (fifty) million as of 01 January 2014 in line with the Rules on Bank Capital Adequacy ("Rules"), adopted by the Central Bank on 25 July 2012.

# Taxation system in Azerbaijan

The tax system in Azerbaijan consists of three taxation regimes:

- the statutory tax regime governed by the Tax Code;
- the tax regime established by the existing Production Sharing Agreements ("PSAs");
- the taxation regime established by the two Host Government Agreements ("HGAs") such as main Export Pipeline (Baku-Tbilisi-Ceyhan) HGA ("BTC") and South Caucasus Pipeline (Shah Deniz Gas) HGA ("SPC").

Below is a general overview of the taxes applicable under these taxation regimes.

## I. Statutory taxation

The Tax Code sets out the general taxation framework in Azerbaijan and establishes the following taxes:

- Profit tax
- Value added tax ("VAT")
- Property tax
- Personal income tax
- Mining tax
- Land tax
- Excise tax
- Road tax
- Simplified tax

### 1. Profit tax

#### 1.1. Tax jurisdiction and payers of profit tax

Legal entities incorporated in Azerbaijan are normally treated as residents and are taxable on their worldwide income. Legal entities incorporated abroad are normally treated as non-residents and are taxable on income from sources in Azerbaijan.

Both resident and non-resident enterprises in Azerbaijan pay profit tax.

### 1.2. Taxation of resident entities

#### *Taxable base*

Legal entities are taxed on profit, which is determined as gross income from economic activities less allowable deductions at a flat rate of 20%.

#### *Deductible expenses*

The Tax Code allows some expenses incurred in the course of economic activities to be deducted from the gross income earned from such activities. Expenses not connected with income earning activity, personal expenses, and entertainment expenses are not deductible (unless entertainment is considered to be the taxpayer's economic activity). Deductions are also not allowed for the acquisition of fixed assets and intangible assets, although such assets may be depreciated.

The Tax Code also provides rules and limitations relating to specific deductions. Some specific allowable deductions are as follows: interest payments subject to limitations, bad and doubtful debts, insurance reserve funds, scientific research & experimental design, depreciation of fixed and intangible assets subject to limitations, repairs subject to limitations, insurance payments, geological exploration and extraction of natural resources.

#### *Deductibility of interest expenses*

Any interest expenses paid or incurred by the taxpayer in the course of their business activities is generally deductible. However, there are some limitations. The deduction of interest on loans received from abroad or related parties cannot exceed the expense calculated using an interest rate of 125% of the inter-bank credit auction rate set forth by the Central Bank of Azerbaijan.





### *Depreciation and amortization allowance*

The Tax Code provides for a group method for the depreciation of fixed assets (except buildings, which are depreciated separately). Annual depreciation rates per group of assets are as follows:

- Buildings, facilities and installations, structures: up to 7%
- Machinery, equipment and calculation technology: up to 25%
- Means of transportation: up to 25%
- Expenses on geological exploration and preparation for the production of natural resources: up to 25%
- Other fixed assets: up to 20%
- Intangible assets
  - For those with an indeterminable period of use: up to 10%
  - For those with a determined period of use: at an annual rate, pro-rata to that determined period of use

Any amount paid or incurred for the acquisition, construction or improvement of assets for business use may not be deducted immediately, but should instead be capitalised and depreciated overtime. Gains from revaluation of fixed assets are not considered in determining the value of the assets for taxation purposes.

Land, art, buildings, and facilities that are historical or architectural monuments, and other permanent assets, may not be depreciated.

### *Deductibility of repair expenses*

The amount of deductible repair expenses each year is limited to the amount defined as a certain percentage of the residual value of each group of fixed assets

as of the previous year-end. Those rates are defined as follows:

- Buildings, facilities and installations, structures: 2% of the residual value
- Machinery, equipment and calculation technology and transportation means: 5% of the residual value
- Other fixed assets: 3% of the residual value

Any amounts spent in excess of the limits are deemed to increase the residual value of the asset at the end of the current year.

In the event that the actual amount of repair expenses is less than the amount established by this limit, then the repair expenses can be deducted from income. In this case, the maximum value of deductible repair expenses in the following tax years is increased by the difference between the amount of actual repair costs and amount calculated in the established limit.

### *Loss carry forward*

The Tax Code provides the opportunity for taxpayers to carry losses forward. Losses can be carried forward for up to five years and offset against other years' profits without limitation.

### *Tax accounting rules*

Taxpayers are required to maintain accurate and up-to-date records of their income and expenses in accordance with the rules provided in the Tax Code. A taxpayer may record income and expenses under either the cash or accrual method of accounting. However, a taxpayer must use the same method for both accounting and tax purposes and be consistent in using the method throughout the tax year. The tax year is a calendar year.

#### *Cash method*

Using the cash method of accounting, a taxpayer is required to record income upon its receipt, regardless of when income was earned. Expenses are recorded when the payment is made rather than when the expense was incurred.

#### *Accrual method*

Contrary to the cash method, the general rule under the accrual method of accounting requires a taxpayer to record income when it is earned, regardless of when it is actually received. Expenses are recorded when they are incurred rather than when they are paid.

#### *Tax payment and reporting*

Companies pay profit tax at a rate of 20% and are required to make quarterly advance tax payments calculated either as 25% of the previous year's tax liability or by multiplying the amount of their income in the current quarter with a weighted tax coefficient of the gross income for the previous year. The formula below explains this calculation in more detail:

A – Last year's profit tax

B – Last year's gross income (without deduction of expenses)

C – Current quarter's gross income

Advance profit tax =  $C \times (A/B)$

The annual profit tax return is due no later than 31 March of the following reporting year.

### **1.3. Taxation of non-residents of Azerbaijan**

#### *Tax jurisdiction over non-residents*

A non-resident enterprise operating in Azerbaijan through a permanent establishment pays tax on its profit, i.e. on gross income generated from Azerbaijani sources in connection with the permanent establishment, less the amount of expenses incurred with respect to such income as per the Tax Code. The tax rate is a flat rate of 20%.

The gross income of a non-resident enterprise that is not connected with the permanent establishment

is taxed at the source of payment without the deduction of expenses. A non-resident enterprise generating income through the supply of property not connected with the permanent establishment pays tax on the said gross income received during a calendar year from an Azerbaijani source. The tax is paid after the deduction of expenses relating to income generation.

#### *Permanent establishment*

In terms of the Azerbaijani Tax Code, a foreign individual's or a legal entity's permanent establishment in Azerbaijan is an establishment through which a taxpayer's economic activity is carried out either fully or partially for 90 or more days within a 12-month period, including the activities of an authorised representative.

The Tax Code provides for any of the following to be evidence of a permanent establishment: a place of management, subdivision, office, branch or agency; construction and repair sites; installation and assembly facilities, as well as supervisory activities associated with them; platforms, sites, drilling equipment or vessels used for the exploration and production of natural resources, as well as supervisory activities associated with them; any fixed base/location where a non-resident individual carries out entrepreneurial activity; premises used for the provision of consulting services; any places of employment in which other types of entrepreneurial activity are conducted in Azerbaijan; persons carrying out the functions of a permanent establishment for a non-resident enterprise or a non-resident individual in Azerbaijan, or people acting on their behalf, authorised to make agreements on their behalf and usually conducting such responsibilities; places of manufacture and sale of goods and the execution of works and services.

A place is not considered a non-resident enterprise's permanent establishment in Azerbaijan if used (regardless of the user) exclusively to store goods or products owned by the non-resident enterprise; keep a stock of goods or products owned by the non-resident enterprise only for the purpose of their eventual processing and subsequent export from Azerbaijan by a third party; purchase of goods or manufacturing of products by a non-resident enterprise for its own needs; implementation by a non-resident enterprise of any preparatory or support activity for its own needs.

### *Azerbaijani source income*

For withholding tax purposes, the following income types are treated as received from Azerbaijani sources:

- Interest income
- Dividends income
- Royalty income
- Rent income
- Insurance income
- Other income
- Income from engineering, architectural and cultural services.

### *Withholding tax rates*

Unless otherwise specified in double tax treaties that Azerbaijan has entered into, the following withholding tax rates normally apply to the following items of income from Azerbaijani sources which are payable to non-residents, provided that such income is not attributable to a non-resident's permanent establishment in Azerbaijan:

<b>Income from Azerbaijani sources</b>	<b>Tax rate</b>
Dividends	10%
Interest	10%
International communication and transportation services	6%
Royalties	14%
Management fees	10%
Interest on financial leasing	10%
Risk insurance and re-insurance fees	4%
Income received from performing works and rendering services	10%
Other items of income from Azerbaijani sources	10%

### **1.4. Tax exemptions**

The Tax Code envisages the following exemptions from profit tax: income of charitable organisations, except for that coming from entrepreneurial activity; grants, membership fees and donations received by non-commercial organisations; income of international, interstate and intergovernmental organisations, except for that received from entrepreneurial activity and income from other similar activities.

The Tax Code also grants tax exemption for entities operating in industrial parks. Additionally, part of the profit of entities managing industrial parks which is used to improve infrastructure of the parks, is exempt from profit tax.

### **1.5. Taxation of cross-border transactions**

#### *Outbound transactions*

Since resident entities are taxed on their worldwide income in Azerbaijan, and may also be taxed by foreign countries on their income derived from sources or from carrying on business in such countries, the same income is potentially subject to double taxation.

In terms of domestic tax law, income or profit tax paid outside Azerbaijan is credited upon payment of tax in Azerbaijan. Excess foreign tax credit may neither be offset against a resident taxpayer's Azerbaijan tax liabilities on any domestic source income nor be carried forward or backward.

#### *Double tax treaty relief in Azerbaijan*

Azerbaijan has agreed double tax treaties with 46 countries that generally follow the OECD Model Income Tax Convention.

Azerbaijani tax legislation establishes rules on claiming a refund of taxes withheld from payments to non-residents who are subject to the provisions of double tax treaties signed between Azerbaijan and other countries.

Taxpayers are not entitled to avail themselves of benefits granted by double tax treaties without first withholding and paying the tax to the budget.



However, according to new rules on implementing double tax treaties, if a non-resident submits a claim for an exemption of tax from, or application of limited taxation with respect to, income derived from sources

in Azerbaijan, including dividends, royalties and interest received by a non-resident, then the non-resident may be entitled to the benefits in advance.

	Country of recipient	Dividends	Interest	Royalties
1	Austria	5% -10%-15%	10%	5%-10%
2	Belarus	15%	10%	10%
3	Belgium	5%-15%	10%	5%-10%
4	Bosnia and Herzegovina	10%	10%	10%
5	Bulgaria	8%	7%	5%-10%
6	Canada	10%-15%	10%	5%-10%
7	China	10%	10%	10%
8	Croatia	5%-10%	10%	10%
9	Czech Republic	8%	10%	10%
10	Estonia	5%-10%	10%	10%
11	Finland	5%-10%	10%	5%-10%
12	France	10%	10%	5%-10%
13	Georgia	10%	10%	10%
14	Germany	5%-15%	10%	5%-10%
15	Greece	8%	8%	8%
16	Hungary	8%	8%	8%
17	Iran	10%	10%	10%
18	Italy	10%	10%	5%
19	Japan	15%	10%	0%-10%
20	Kazakhstan	10%	10%	10%
21	Korea Republic	7%	10%	5%-10%
22	Latvia	5%-10%	10%	5%-10%
23	Lithuania	5%-10%	10%	10%
24	Luxemburg	5%-10%	10%	5%-10%
25	Macedonia	8%	8%	8%
26	Moldova	8%-15%	10%	10%
27	Netherlands	5%-10%	10%	5%-10%
28	Norway	10%-15%	10%	10%
29	Poland	10%	10%	10%
30	Qatar	7%	7%	5%
31	Romania	5%-10%	8%	10%
32	Russia	10%	10%	10%
33	Serbia	10%	10%	10%
34	Slovenia	8%	8%	5%-10%
35	Switzerland	5%-15%	10%	5%-10%
36	Tajikistan	10%	10%	10%
37	Turkey	12%	10%	10%
38	UK	15%	10%	5%-10%
39	Ukraine	10%	10%	10%
40	United Arab Emirates	5%-10%	7%	5%-10%
41	Uzbekistan	10%	10%	10%
42	Jordan	8%	8%	10%
43	Montenegro	10%	10%	10%
44	Kuwait	5%-10%	7%	10%
45	Pakistan	10%	10%	10%
46	Spain	5%-10%	8%	5%-10%

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## Non-residents operating in Azerbaijan can apply for an advanced exemption or reduced taxation in respect of dividends, interest and royalty income without creating a permanent establishment



To do this, a non-resident must complete and submit a DTA-03 form to the tax authorities of the non-resident's country of residence in order to obtain confirmation of their residence in that country. The form sealed by those tax authorities, copies of the contracts confirming that the income is to be paid to the non-resident and other relevant documents, must be submitted to the Azerbaijani tax authorities for confirmation.

The rules also allow non-residents operating in Azerbaijan without creating a permanent establishment, to apply for a tax refund based on the provisions of the applicable double tax treaties. To do this, the non-resident must complete a DTA-06 form and submit it to the tax department where the payee is registered. The tax refund must be made within 45 days of the submission of the application.

## **2. VAT**

### **2.1. Concept of VAT**

The concept of VAT according to Azerbaijani tax legislation is similar to the principles used in most European countries. In accordance with Azerbaijani law, VAT payers are entitled to recover VAT paid on purchases (input VAT) even if this exceeds the VAT generated by the sale of goods or services (output VAT).

### **2.2. Payers of VAT**

An individual or legal entity whose taxable sales amount to more than AZN 120,000 (approximately USD 152,983) in a consecutive 12 month period must register for VAT.

Taxpayers must register for VAT in advance of carrying out a taxable transaction worth more than AZN 120,000. The Tax Code also allows voluntary registration for VAT purposes.

A taxpayer that has registered but whose total taxable sales over a 12-month period do not exceed AZN 60,000 (approximately USD 76,492) may apply for the cancellation of their registration at any time within one year of their last registration for VAT purposes, subject to some exceptions indicated in the Tax Code.

### **2.3. Objects of taxation**

Under the Tax Code, the supply of goods/provision of services and import of goods are subject to VAT. Taxable transactions do not include services provided or work completed outside Azerbaijan.

### **2.4. VAT rate**

The current VAT rate is 18%.

### **2.5. VAT invoice**

Any VAT payer that carries out a taxable transaction is required to issue a tax invoice to the person receiving the goods or services. The taxpayer must draw up and issue a tax invoice to the purchaser of the goods/work/services upon delivery or within five days of delivery. VAT invoices are issued in electronic form. Registration and administration of electronic invoices is carried out by the Ministry of Taxes via the Internet.

### **2.6. Time of recognition of VAT liability**

Output VAT must be recognised at the time of the payment if such payment is made within 30 days upon the supply. If the payment was not received within 30 days VAT must be recognised at the time of the issue of the VAT invoice provided that it was issued within five days of supply.

If payment is not received within 30 days and a VAT invoice was not issued within five days of supply, the time of recognition of output VAT liability will be the actual time of the supply of goods or services.

If payment was made before the supply, VAT liability must be recognised at the time of the payment, if a VAT invoice is not issued within five days of supply.

### **2.7. VAT administration**

#### *Administration*

VAT on domestic supplies and the import of services is administered by the tax service, and VAT on the import of goods is administered by the customs service.

#### *Payment and reporting*

Registered VAT payers should assess the amount of VAT to be remitted to the budget by reducing its output VAT liability with input VAT credit.

Effective 1 January 2008, all input VAT must be paid through a VAT Deposit Account ("VDA"), a kind of an escrow bank account administered by the government. The purpose of introducing VDAs, according to official sources, is to combat VAT fraud.

The regulations require every VAT payer to have a VAT sub-account ("VSA"). A VSA is a part of a VDA. Only input VAT paid to the supplier's VDA is recoverable.

Registered VAT payers are required to submit VAT returns and pay VAT due on a monthly basis by the 20<sup>th</sup> day of the following month.

## 2.8. VAT refund

The reporting period for VAT is a calendar month. According to the Tax Code, the amount of input VAT remaining after the offset against a taxpayer's output VAT in the current month is automatically transferred to the next three months and should be offset against VAT liability arising during that period.

Taxpayers have the right to offset VAT receivable against liabilities with respect to other taxes, interest charges for late tax payment, financial sanctions and administrative penalties. Taxpayers are also entitled to request that the authorities transfer repayable VAT to pay other tax liabilities.

If after the three month period, the input VAT is not fully offset, the remaining amount must be refunded to the taxpayer within 45 days of the taxpayer's submission of an application to the tax authorities.

Daily interest of 0.1 % is payable by the tax authorities if the amount of tax due to the taxpayer is not repaid within the 45 day period. However, we are not aware of any taxpayer in Azerbaijan that has been compensated for a late tax refund in this manner.

The taxpayer can recover input VAT up to three years after it becomes due.

The right of a taxpayer to claim overpaid taxes is limited to five years from the date when the tax reporting period ended.

It should be noted that the VAT refund process in Azerbaijan is extremely difficult. The Azerbaijani Ministry of Taxes and Ministry of Finance are always reluctant to approve VAT refund applications received from taxpayers.

## 3. Property tax

### 3.1. Property tax for individuals

Payers of property taxes are resident and non-resident individuals who personally own buildings and their parts, as well as water and air transport facilities.

Individuals pay property tax in the following order and at the following rates:

*From the inventory value of the building in their ownership:*

- This tax is not levied if the value does not exceed AZN 5,000 (approximately USD 6,374). 0.1% is levied from the amount exceeding this non-taxable limit

*For water and air transport vessels:*

- AZN 0.02 (approximately USD 0.03) per cubic cm of the water transport vessel's engine
- AZN 0.02 (approximately USD 0.03) per cubic cm of the air transport vessel's engine
- 1% of the market value of water and air transport equipment without engines

### 3.2. Property tax for legal entities

In respect of legal entities, taxable objects include:

- Average annual value of fixed assets on the enterprise's balance sheet
- For non-resident enterprises carrying out business activity through a permanent representation in Azerbaijan, only the average annual value of fixed assets connected with the permanent representation

Entities pay tax at a rate of 1% of the average annual residual value of the fixed assets, which is determined by adding up the residual value of the enterprise's property (excluding vehicles) as of the beginning and the end of the reporting year and dividing the resulting sum by two.

Quarterly advance payments of property tax should be made in an amount equal to 20% of the previous year's property tax no later than the 15<sup>th</sup> day of the second month of each quarter. The annual property tax return should be submitted no later than 31 March of the next reporting year.

#### 4. Personal income tax

##### 4.1. Tax residency

Individuals who are present in Azerbaijan for more than 182 cumulative days during a calendar year, or those with a place of permanent residence, a centre of vital interests or an habitual abode in Azerbaijan, or who have Azerbaijani citizenship, are considered to be tax residents of Azerbaijan.

##### 4.2. Taxable income and exemptions

Residents of Azerbaijan are subject to income tax on taxable income, which is defined as gross income received from all sources (both Azerbaijani and non-Azerbaijani) during the tax year, regardless of where the income was earned or paid, less allowable deductions. Non-residents are subject to Azerbaijani income tax only on income received from Azerbaijani sources.

The taxable base for personal income tax is determined as the difference between gross income for the tax year and expenses (or deductions) stipulated by the Tax Code for this period.

Virtually all forms of compensation to an employee are taxable, including hardship and payment of taxes on behalf of the employee. Income of sole entrepreneurs operating in the industrial parks is exempt from taxation.

##### 4.3. Tax rates

Worldwide income of tax residents and Azerbaijani source income of non-residents received from employment are subject to the following marginal income tax rates:

##### Statutory taxation

Monthly taxable income	Tax rates
Up to AZN 2,500	14%
Over AZN 2,500	AZN 350 + 25% of the amount exceeding AZN 2,500

\* AZN 136 of a salary below AZN 250 is not taxable

Annual taxable income	Tax rates
Up to AZN 30,000	14%
Over AZN 30,000	AZN 4,200 + 25% of the amount exceeding AZN 30,000

\* AZN 1632 of an annual salary below AZN 3,000 is not taxable

\*\* USD 1 = AZN 0.7844 as of 17.01.2014

At the same time, all individuals engaged in entrepreneurial activity will be taxed at a fixed rate of 20%.

##### 4.4. Payment and reporting of personal income tax

Income from employment is subject to withholding by the employer at source. Taxes withheld are to be remitted by the employer to the budget within 20 days of the following month.

Since 1 January 2010, legal entities and entrepreneurs that are registered for VAT purposes, or simplified taxpayers paying employment income to individuals, have had to submit tax returns to the tax authorities before 31 January of the following reporting year.

Employers that are not payers of VAT or simplified tax must submit tax returns no more than 20 days after the end of each calendar reporting quarter.

#### **4.5. Individual filing**

Residents and non-residents must complete and file their income tax returns no later than March 31 of the following tax year.

#### **5. Social insurance**

According to Azerbaijani law, social insurance contributions are paid by both Azerbaijani nationals and foreign individuals.

Employers are liable for paying social insurance contributions at a rate of 22% of the employee's gross salary, and 3% is deducted from the employee's gross salary as the employee's portion of the social insurance contribution.

Employers are also responsible for submitting quarterly reports to the social protection fund authorities in respect of the social insurance contributions calculated and paid in respect of local employees and foreign employees who are on the local payroll, by the 20<sup>th</sup> of the month following the reporting quarter.

The Agreement on Cooperation in the Area of Social Insurance was signed between the governments of Turkey and Azerbaijan on 17 July 1998. According to Article 7.1 of the Agreement, Turkish citizens employed by Turkish companies operating in Azerbaijan for less than 24 months are exempt from paying Azerbaijani social insurance contributions. However, Article 7.5 of the Agreement states that this exemption will not apply if Turkish citizens are employed by a division or a permanent establishment of a Turkish company in Azerbaijan.

#### **6. Mining tax**

Legal entities and individuals extracting mineral resources in Azerbaijan and on the Caspian shelf pay mining tax at rates ranging from 3% to 26%. The tax

is paid after the extraction of minerals on a monthly basis by the 20th day of the month following the accounting month. Mining tax is deductible for profit tax purposes.

Payers of mining tax submit tax returns on a monthly basis no later than the 20th day of the month following the accounting month.

#### **7. Land tax**

A land tax is imposed on owners and users of land, the amount of which depends on the use and location of the land. For instance, in Baku, the tax rate on industrial land is AZN 10 (approximately USD 12.7) per 100 square metres.

Legal entities calculate land tax on an annual basis based on the total area of the land and the respective land tax rates and then submit their calculations to the tax authorities no later than 15 May each year.

Land tax is paid twice yearly in equal installments no later than August 15 and November 15.

#### **8. Excise tax**

All individuals and legal entities producing excisable goods in Azerbaijan or importing excisable goods are subject to excise taxes.

Tobacco products, alcoholic beverages and petroleum products are subject to excise tax at fixed rates, e.g. AZN 0.8 (approximately USD 1) per liter of spirits or 12.5% of the sales price of cigarettes produced in Azerbaijan.

Imports of passenger cars, leisure and sport yachts are subject to excise tax at different rates depending on the size of their engines.

The export of excisable goods is subject to 0% tax.



## 9. Road tax

Road tax is paid by non-resident entities and individuals entering Azerbaijan, as well as by the owners and users of vehicles in Azerbaijan.

The tax payable by non-resident entities and individuals entering Azerbaijan is collected by the customs authorities at different rates depending on the type of vehicle, distance driven within Azerbaijan and the length of time spent in the country.

The tax applicable to owners and users of vehicles in Azerbaijan is payable annually based on the following rates:

- For cars, buses and other vehicles with an engine volume of less than 2,000 cubic cm – AZN 20
- For cars, buses and other vehicles with an engine volume of from 2,000 cubic cm to 3,000 cubic cm – AZN 20 plus AZN 0.02 for each cubic cm exceeding 2,000 cubic cm
- For cars, buses and other vehicles with an engine volume of from 3,000 cubic cm to 4,000 cubic cm - AZN 40 plus AZN 0.03 for each cubic cm exceeding 3,000 cubic cm
- For cars, buses and other vehicles with an engine volume of from 4,000 cubic cm to 5,000 cubic cm – AZN 70 plus AZN 0.04 for each cubic cm exceeding 4,000 cubic cm
- For cars, buses and other vehicles with an engine volume of more than 5,000 cubic cm – AZN 110 plus AZN 0.05 for each cubic cm exceeding 5,000 cubic cm

## 10. Simplified tax

Individuals and legal entities involved in entrepreneurial activity that are not registered VAT payers have the right to pay simplified tax. However, the following entities are not entitled to do so:

- Producers of exciseable goods
- Credit and insurance entities, investment funds, professional securities market participants
- Non-governmental pension funds
- Those obtaining income from leasing property or royalty
- Those that own property with a residual value exceeding AZN 1,000,000 (approximately USD 1,274,860)

Simplified tax is calculated from the revenue obtained from the provision of goods, completion of works, rendering of services and non-sale profits at the following rates:

- Baku – 4%
- Other regions – 2%
- Revenue of operators of sports-gambling games – 6%
- Income of commissioners of sports-gambling games – 4%

People engaged in the construction of residential property, as well as those providing transportation services (except for international transportation) are payers of simplified tax. Rates for simplified tax payers providing transportation services vary from AZN 1 (approximately USD 1.27) up to AZN 9 (approximately USD 11.47), and more per month depending on such factors as the number of seats, cars and tonnage.

Simplified tax for residential housing construction is calculated by applying zonal rates established by the Cabinet of Ministers of the Republic of Azerbaijan to the amount of AZN 10 (approximately USD 12.75) for each square metre of a building. The zonal rates vary from 0.5 to 5.0.

Simplified tax payers are obliged to make simplified tax payments and file tax returns no later than the 20<sup>th</sup> day of the month following each reporting calendar quarter.



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## Parties to PSAs are the government of Azerbaijan, represented by the State Oil Company of the Republic of Azerbaijan (SOCAR) and contractors represented by various well-known foreign oil & gas companies.

### II. PSA taxation

Currently more than 20 PSAs have been signed and ratified in Azerbaijan. PSAs contain provisions governing certain taxation rules. In addition, detailed taxation procedures are set out in the PSA tax protocols. The PSAs stipulate taxation rules for foreign sub-contractors performing work or providing services in connection with PSAs.

#### 1. Profit tax

Under the PSAs, contractors carrying out business in Azerbaijan in connection with petroleum operations should pay profit tax: the rate is negotiated and varies from 25% to 32%.

Contractors should submit their financial statements and profit tax returns (drawn up exclusively in USD) for each calendar year, along with an appropriate report from an auditor to the tax authorities by the dates established in the PSAs.

#### 2. VAT

Contractors and foreign sub-contractors are exempt from VAT with a 0% rate in connection their activities in the sector. This includes the following:

- Goods, work and services supplied to or by them
- Export of petroleum
- Import and acquisition of goods, work and services

To confirm VAT exemption status, contractors and foreign subcontractors should obtain a VAT exemption certificate. This certificate is issued by the Ministry of Taxes.

It should be noted that a VAT exemption certificate is issued only to contractors and foreign subcontractors registered in Azerbaijan.

#### 3. Withholding tax

In lieu of profit tax, foreign subcontractors pay withholding tax at rates varying from 5% to 8%, calculated from gross payments received in respect of work or services performed in Azerbaijan. Under the PSAs, a foreign subcontractor is defined as a legal entity incorporated outside of Azerbaijan and providing goods, work or services directly or indirectly to the contractor who is a party to a PSA.

Income tax must be withheld by anyone making payments to a foreign sub-contractor and remitted to the Azerbaijani budget. This is the only profit tax liability of a foreign sub-contractor.

#### 4. Taxation of employees

Personal income tax of local employees is calculated in accordance with the statutory tax legislation. Personal income tax of foreign tax resident employees is calculated only on their income earned as a direct result of their employment in Azerbaijan. Foreign employees who do not become tax residents should not pay Azerbaijani personal income tax.

#### **4.1. Tax residency**

Under the PSAs, there are three tax residency rules:

- An expatriate employee of a foreign sub-contractor, who is present in Azerbaijan for ordinary business purposes, becomes a tax resident if they spend more than 30 consecutive days in Azerbaijan in a calendar year. Income earned after the 30th day is taxable in Azerbaijan.
- Individuals spending less than 30 consecutive days but more than 90 cumulative days in Azerbaijan in a calendar year are also treated as tax residents, and income earned after the 90th day becomes taxable.
- Rotating employees and foreign employees who have their primary place of employment in Azerbaijan qualify as tax residents if they spend more than 90 cumulative days in Azerbaijan in a calendar year, and they are taxable from the first day of their stay in Azerbaijan.

#### **4.2. Taxable income**

Almost all payments to foreign employees in Azerbaijan, including wages, salaries, bonuses, personal travel costs, education costs of the expatriate's family members, etc. is considered to be taxable income.

#### **4.3. Tax rates**

The rates of personal income tax are the same as the statutory rates set out above.

#### **4.4. Personal income tax withholding**

Each employer may withhold personal income tax from payments made to local and foreign employees. Foreign employees are entitled to receive a tax receipt from the tax authorities for the amount of income tax paid.

#### **4.5. Tax reporting**

Employers are responsible for reporting all Azerbaijani personal income tax payments made in respect of their local and foreign tax resident employees to the Ministry of Taxes.

#### **4.6. Social insurance**

All foreign employees employed by companies engaged in the petroleum sector under PSAs are exempt from mandatory social insurance.

Employers are required to pay social insurance contributions to the State Social Protection Fund at a rate of 22% of the employee's gross income. In addition, employers must withhold social insurance contributions from the employee's income at the rate of 3% and pay them into the same fund.

#### **4.7. Customs duties under PSAs**

All imports made in connection with a PSA are exempt from customs duties and VAT.

Contractors and foreign sub-contractors may obtain a certificate granting exemption from import/export duties. Certificates are issued by the State Customs Committee of the Republic of Azerbaijan. It should be noted that an import and export exemption certificate is issued only to contractors and foreign sub-contractors registered in Azerbaijan.

A contractor or a foreign sub-contractor importing goods in relation to the PSA should submit copies of its VAT and an import and export exemption certificates to the customs authorities during the import process.

### III. HGA taxation

#### 1. Profit tax

Profit tax is imposed on the taxable profit from the project activities of each participant in an HGA at a fixed rate of 27%.

HGA participants should submit their profit tax return (drawn up exclusively in USD) to the tax authorities for each calendar year, no later than April 15 (under BTC HGA) and April 1 (under SCP HGA) of the following calendar year.

#### 2. Other taxes

Under HGAs no taxes are imposed on or withheld from payments to any contractor in connection with HGA activities. Contractors also do not have tax compliance or filing obligations in connection with HGA activities.

HGA participants are entitled to import into or export/re-export from Azerbaijan free of taxes and restrictions, whether in their own name or on their behalf, all equipment, materials, machinery, tools, vehicles, spare parts, supplies, petroleum, fuels and lubricants to be used in connection with the HGAs and all other goods (other than natural gas), work, services or technology necessary or appropriate for use in connection with the HGA.

Foreign employees of HGA participants, contractors, and each family member of such foreign employees, have special rights with regard to import and export of goods and services. They may import into or export/re-export from Azerbaijan all goods, work, services or technology for their own use and personal consumption. They may do this personally or arrange for a third party to provide import/export services on their behalf. However, re-sale of any such imported

goods to any other person is taxable, and, in the case of the sale of automobiles, furniture and professional tools and instruments, will result in liability for customs duties, in accordance with Azerbaijani law.

Personal income tax of foreign employees is calculated only on their income earned as a direct result of their employment in Azerbaijan and only if the employees spend more than 182 days in Azerbaijan per calendar year.

#### 3. Social insurance

Foreign nationals employed in connection with HGAs are exempt from mandatory social insurance.

The employment income of Azerbaijani nationals working under HGAs is subject to mandatory social insurance. Employers are liable for payment of social insurance contributions at a rate of 22% of the employee's gross salary, and 3% of the employee's gross salary is deducted as the employee's share of social insurance contributions.

The employer is responsible for making the monthly payment of social insurance contributions on the day that the employees' salary is paid, but no later than the 15<sup>th</sup> day of the month following the month when the income was accrued.



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