



## **Tax News**

### Overview of the rules on improvement of tax administration

#### **Introduction**

For the implementation of Article 2 of the Decree of the President on "The courses of reforms to be carried on in the areas of taxation in 2016", on 23 September 2016 the Collegium of the Ministry of Taxes approved the Rules "On approval of amendments to a number of legislative acts for the purpose of improvement of tax administration" ("Rules").

The Rules contain provisions concerning the procedures for carrying out off-site, on-site and electronic tax audits. Additionally, the Rules introduce novelties such as model taxpayer.

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## Off-site tax audit

**Vast majority of provisions of the Rules regarding off-site tax audit coincide with the Tax Code, but there are still a few points which can be important to take into account:**

- The Rules once again emphasize the importance of having primary documents, requested in the course of an audit, in Azerbaijani language
- As a rule, off-site tax audit can be conducted within 30 workdays upon submission of the tax return. However, the Rules do not completely rule out possibility of requesting additional information after expiration of the mentioned period. These are instances where the tax authorities obtain new documents or information from the known sources.
- Appeal of an off-site tax audit decision by a tax payer may result in the following:
- The assessment is completely cancelled;

- The assessment is partially cancelled;
- The assessment is upheld;
- The case is passed to the respective department to explore possibility of starting an on-site tax audit.

## **Risk-based approach for tax liabilities during off-site tax audit**

**Generally, off-site tax audit is conducted automatically via the designated computer software. Nevertheless, the Rules also stipulate the possibility of conducting manual off-site tax audit using a risk based approach. Below are some key risk elements used for off-site audit of different tax returns:**

### **1. Personal income tax ("PIT")**

- The rate of increase in expenses exceeds the rate of increase in income
- Loss making business activities in consecutive three years
- Decrease in the profitability, despite the growth in business for consecutive three years
- Raw material costs exceed 90% of the total expenditures

### **2. Profit tax**

- The rate of increase in expenses exceeds the rate of increase in income
- Loss making business activities in consecutive three years
- Decrease in the profitability despite the growth in a business for consecutive three years
- Raw material costs exceed 90% of the total expenditures
- Reasonableness of the energy consumption
- Reconciliation of rental income by comparing the reported data to the one reported by the payers of such income
- Statute of limitations for payables/receivables

### **3. Value Added Taxes ("VAT")**

- Reconciliation of acquired and sold goods
- Analysis of incorrect payments via VAT Deposit Account

- Weighted average of recovered VAT in total turnover
- Reconciliation of turnover reported for VAT and profit tax purposes
- Inspection of circumstances where a taxpayer recovers VAT while having no taxable income

#### **4. Asset tax**

- Comparison of the data reported in different reporting periods
- Analysis of the tax exempt fixed assets
- Reconciliation of the information reported in profit tax and assets tax returns

#### **5. Simplified tax**

- Comparison of the number of employees and payroll cost with the economic activities
- Comparison of the income stated in the tax return with the expenses of the relevant period
- Analysis of decrease in the turnover by passivating of the results for the last review with the chronometer method

#### **6. PIT (employment income)**

- Reasonableness of salary figures when compared to the number of employees
- Reasonableness of average monthly salary with the similar jobs in the market (checked based on the information obtained from the State Statistical Committee and provisions of Article 67.2 of the Tax Code)
- Whether the number of employees and payroll costs correspond to the scale of current and expected business activities of the tax payer
- Comparing the data reported in different reporting periods

#### **7. Profit tax under special regime**

- Analysis of allocation of costs incurred by the Operating Company among the Contractor parties
- Analysis of the loans received by the Contractor parties from the banks and financial institutions outside the Azerbaijan
- Correctness of the profit tax rate

## On-site tax audit

**Below are the main provisions of the Rules related to on-site tax audit:**

- On-site tax audit needs to be registered within the unified electronic register of the Ministry of Justice
- No notification is provided for extraordinary on-site tax audit and it is commenced the next day after the relevant resolution is issued.
- As a rule, tax audit report is issued within three working days upon completion of the audit. However, the rules define instances where the mentioned term can be extended up to 30 days.
- Tax authorities have the right to submit request to the bank of a tax payer to obtain information on bank transactions in the following cases:
  - Absence of accounting records;
  - Executing bank transactions during dormancy;
  - When the accounting records are destroyed or missing;
  - Taxpayer misses the deadlines for submission of the tax returns;
  - When the documents are not provided to the tax inspectors during the tax audits;
- To fulfil obligations provided in the international agreements concluded by Azerbaijan.

## Model Tax Payer

**The Rules introduce a concept of “Model Tax Payer” granted with certain privileges in terms of tax audits and certain state tax services. A taxpayer meeting eligibility criteria of a “Model Tax Payer” is granted with a certificate, confirming its status for the next three years.**

### **Eligibility criteria for a “Model Tax Payer”**

- 5 years of legitimate and continuous business activities
- Maintaining accounting records according to international or national accounting standards approved by the Ministry of Finance
- Seeking for guidance of the tax authorities in respect of unusual or new business operations and Concluding Tax Partnership Agreement

- Having in place internal audit and risk management systems or using services of outsourced auditors and consultants
- For the last three years:
  - Paying taxes on time;
  - Having profitable business;
  - Additional tax liabilities identified during the tax audits should not exceed 2% of the liabilities reported in tax returns;
  - Not being subject to financial sanction and administrative penalties because of operational tax audit.

## Privileges granted to the model tax payer

### Some benefits offered to Model Tax Payer include:

- Subject to certain exceptions, no on-site tax audit is conducted
- Written queries submitted to the tax authorities are responded within five days
- "Fast track" for different state tax services
- Designated service lines in the Call Center
- Public promotion of a tax payer
- Opportunity of attending the discussions on the development of tax legislation
- Targeted mobile services

## Electronic tax audit

**Electronic tax audit is conducted via having (distant) access to the electronic accounting data of the taxpayer. What is equally important, neither the Tax Code nor the Rules define legal status of the e-audits, and, whether or not, they replace traditional on-site and off-site tax audits.**

### **Preferred group of tax payers for the purposes of electronic tax audit:**

- Dealing with hydrocarbon activities
- Multinational companies

- Companies dealing with e-commerce
- Banks, insurance and leasing companies
- Processing centers
- Telecommunication companies
- Major tax payers
- Companies having non-cash business
- Companies which undergone e- audit before

## Some other novelties introduced by the Rules

- The rules on establishment of Outbound Call Center for the tax payers belonging to different risk groups
- Rules on obtaining of dormancy status for legal entities and individual tax payers
- Rules on online cancellation of dormancy status of legal entities and individual tax payers
- Evaluation of risks related to the business industries



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