



## Azerbaijan Tax News

### Preparing for a changing landscape

#### Introduction

On 23 December 2016, the Azerbaijani Parliament approved the Law "On amendments to the Tax Code of the Republic of Azerbaijan" (hereinafter, referred to as "Law").

The Law introduces substantial changes to the Tax Code as a reflection of the reforms set forth by the Decree of the President dated 4 August 2016.

By magnitude and impact, the current changes can definitely be considered as the most substantial since the adoption of the Tax Code in 2000.

In this newsletter, we are pleased to share with you highlights of the most important changes and additions, and we trust you will find them interesting and helpful. Should you have any questions or need for clarifications relating to the changes, please feel free to contact Deloitte tax professionals for further discussion.

#### December 2016

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## 1. Transfer Pricing

The Law introduces Transfer Pricing concept. Transfer price is defined as an average price derived by division of the sum of prices set in comparable transactions conducted between independent parties based on the same conditions to the number of such transactions, and also price defined based on Article 14-1 of the Tax Code. As per the Law, transfer price will be calculated by applying the following methods:

- Comparable uncontrolled prices;
- Resale price;
- Cost plus;
- Transactional net margin method;
- Profit split.

The Tax Code considers controlled transactions as the ones taking place between:

- a. Azerbaijan resident and non-resident related parties;
- b. Permanent establishment of non-resident in Azerbaijan and this non-resident or its permanent establishment, branch office, or any other part in other countries;
- c. Azerbaijan resident or permanent presence of non-resident in Azerbaijan and entities established (registered) in the countries with preferential taxation.

Taxpayers will be required to submit a report on controlled transactions in the amount greater than AZN 500,000 in the calendar year no later than 31 March of the following year. Non-provision of this report will be subject to the financial sanction of AZN 500.

The Ministry of Taxes has been tasked to develop the rules for calculation and application of transfer pricing rules within one-month period after the Law becomes effective.

## 2. Anti-avoidance rules

A number of new provisions have been added to the Tax Code introducing new anti-avoidance rules.

Under Article 13.2.70. tax avoidance scheme means obtaining a tax privilege by signing a deal or conducting transaction. The Tax Code is also added a new definition of "Actual economic substance".

The tax authorities are now authorized making adjustments to assess additional tax liability.

As per the amendments, relevant executive authorities will be updating the list of countries and territories with preferential taxation annually.

As another measure to fight against tax evasion using low tax jurisdictions, the Tax Code treats any payment to countries with preferential taxation as Azerbaijan source income and imposes 10% withholding tax.

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## 3. Advance Tax Ruling

The Tax Code introduces the concept of Advance Tax Ruling allowing a taxpayer to confirm tax liabilities and legal consequences of application of the Tax Code in advance to carrying out a taxable operation.

Taxpayers willing to use their rights on advance tax ruling have to submit an application to the tax authorities. The following information must be reflected in the application form:

- Documents supporting transactions which are submitted for a decision on advance tax ruling;
- Notes by the taxpayer on tax liabilities and legal consequences of application of tax legislation related to taxable transaction;
- Any other information necessary for the decision;
- All documents have to be in Azerbaijani. All documents in foreign language have to be submitted in official translated form;
- Above mentioned documents are accepted within 30 working days after their submission;
- In case of missing information related to the application, the tax authorities have to inform the taxpayer about it within 10 working days after the date of application submission and the taxpayer have to provide such information within 10 working days after the receipt of request;
- Decision on advance tax ruling is made in relation to each taxpayer and taxable operation on separate basis;

- After the decision made on advance tax ruling the tax authorities inform the taxpayer in oral or written form about the taxpayer's obligation on payment of state duty. The taxpayer is obliged to pay the state duty within 3 working days and receipt confirming the payment shall be provided to the tax authorities;
- The implementation of the decision by the taxpayer is obligatory only in case the transaction about the decision made is actually carried out;
- Execution of the transaction over which the decision is made does carry an obligatory nature.

Tax authorities possess a right to reject making decision over advance tax ruling in following cases:

- In case the information stated in the application form or attached materials is not in line with legislation;
- In case of prior decision over the transaction applied for the decision or no changes took place with regard to such transaction;
- In case the transaction applied for the decision has already been carried out. Moreover, existence of decision of tax authorities or court decision in force over such transaction;
- In case the tax authorities revealed the tax minimization attempt of a taxpayer with regard to the transaction applied for an advance tax ruling;
- If the value of transaction applied for an advance tax ruling is less than AZN 10.000.000;
- In case the receipt confirming the payment of state duty is not provided within three working days;
- In case of determination of tax liabilities and legal consequences of application of tax, legislation is not within the authority of tax authorities.

In case of any change in normative-legislative acts regulating the relations with regard to the transactions over which the decision is made, before such transaction is completed, the decision on advance tax ruling shall be considered as void.

Taxpayers have a right to file a complaint to the court over the decisions made on advance tax ruling or refusal of tax authorities to make such decision.

## 4. Voluntary Tax disclosure

One of the important novelties in the Tax Code is the introduction of Voluntary Tax Disclosure.

As per Article 13.2.49-2. Voluntary Tax Disclosure means voluntary declaration of tax liability, which was not discovered by already completed on-site tax audit.

If a taxpayer makes a Voluntary Tax Disclosure, he pays only principal amount of outstanding tax liability and is exempt from paying interest and financial sanction.

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## 5. Electronic invoices

Taxpayers providing goods and services as well as performing works are required to issue electronic invoices through the web page of the Ministry of Taxes effective from 1 April 2017 and 1 January 2018 for VAT and non-VAT payers respectively. Although the government is yet to introduce detailed rules of electronic invoicing, it is already stipulated that a taxpayer acquiring goods or services without an electronic invoice may be subject to a financial sanction of up to 40% of the transaction value.

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## 6. Changes in depreciation rates

The Law has set different depreciation rates for machinery, equipment and calculation technology:

- Machinery and equipment – up to 20%
- Calculation technology which is the product of high technology – up to 25%

In addition, state owned companies are limited to take depreciation deductions up to 40% on assets acquired at the expense of the state financing.

## **7. Personal income taxation**

### **7.1. Broadening the scope of taxable income of individuals**

In addition to taxation of income from domestic sport betting, income of individuals from lottery winnings, (with exception of cash winnings on sports games betting, winnings from lotteries and from other type of competitions and contests outside of Azerbaijan) will also be subject to 10% withholding tax at the source of payment.

The amendments also provide more precise tax base for such an income by stipulating it as a difference between the winning and the principal amount paid for participation in such betting or lotteries.

### **7.2. Prolongation of tax exemption for interest income of individuals**

Annual interest income paid on deposits of individuals by local banks and branches of foreign banks in Azerbaijan, as well as dividends on investment securities, discounting (difference caused by lower placement of bonds than its nominal value) and interest income paid by issuer is prolonged from three to seven years as of 1 February 2016.

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## **8. Tax administration**

### **8.1. Tax agents authorized to pay capital gain tax**

From now on a tax agent shall also be understood as a person appointed by a non-resident for payment of taxes from non-residents taxable income, which is generated from the Azerbaijani source and not taxed at the source of payment.

By virtue of this amendment, non-residents which do not have a registered presence in Azerbaijan and those generating income from the Azerbaijani source subject to taxation in Azerbaijan can appoint a tax agent for declaring and paying taxes.

The appointed tax agent is obliged to provide a written notification document to the tax authorities in a special form within 30 days after the date of appointment.

### **8.2. Enhancement of international compliance requirements for banks and financial institutions**

New changes require banks and financial institutions, upon onboarding of customers or providing any other financial services, to maintain compliance

with respective Azerbaijani laws as well as international treaties on exchange of tax and financial information ratified by Azerbaijan (e.g. FATCA). The tax authorities are entitled to conduct necessary monitoring or audits in this regard.

Apparently, one of the key factors to implement the compliance in this area will be penalties and financial sanctions. Hence, the following penalties are introduced:

- Non-compliance with respective Azerbaijani laws as well as international treaties on exchange of tax information ratified by Azerbaijan upon onboarding of customers or providing any other financial services – AZN 100 for each such account or a transaction
- Failure to produce respective reports as required under the Tax Code – AZN 1,000
- Failure to provide financial information of customers as required under the Tax Code and international treaties – 30% of the transactions made via such accounts or AZN 400 if no transaction conducted
- If non-compliance with international treaties on tax and financial information exchange which Azerbaijan is signatory to is revealed according to the notice of other state's authority, AZN 100 will be applied per each such account

### **8.3. Tax audits**

Amended Tax Code limits the right of the tax authorities to conduct an off-site tax inspection to 30 working days from the date of submission of a tax return. Nevertheless, any errors revealed by the tax office after this period is fixed by way of sending a notification to the tax payer to file an adjusted tax return within ten days.

From now on, on-site tax inspection may be conducted distantly by way of an electronic tax audit. This implies granting full access to the tax authorities to the IT systems where the financial information is stored.

The amendments also broaden the scope of operative tax inspection, which now includes compliance with requirements on cashless transactions and electronic invoices, etc.

## 9. Excise tax

Fur and leather products are added to the list of excisable goods. Imported fur products will be subject to excise tax in the amount of 10% of the customs value not less than the wholesale market price of such products.

### **Excise tax for cars, recreation or sports type yachts and other floating facilities is increased as follows:**

- For engine volume up to 3000 cubic centimeters - 400 manats + 3 manats per each cubic centimeter of the engine volume's part from 2001 to 3000 cubic centimeters
- For engine volume up to 4000 cubic centimeters - 3,400 manats + 8.0 manats per each cubic centimeter of the engine volume's part from 3001 to 4000 cubic centimeters
- For engine volume up to 5000 cubic centimeters - 11,400 manats + 20.0 manats per each cubic centimeter of the engine volume's part from 4001 to 5000 cubic centimeters
- For engine volume over 5000 cubic centimeters - 31,400 manats + 40.0 manats per each cubic centimeter of the engine volume's part over 5000 cubic centimeters
- Rest or sports type yachts and other floating facilities intended for these purposes - 6 manats per each cubic centimeter of the engine volume

The amendments also introduce increased excise rates for platinum, gold and diamond.

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## 10. Fixed simplified tax

Certain activities (e.g. baby-sitting, photography, etc.) will be entitled to enjoy fixed simplified tax ranging from AZN 5 to 30 per month multiplied by the rates of geographical locations.

## 11. VAT

### Application of VAT on mark-up amount of goods sold by retailers of agricultural goods

Taxable base for VAT purposes for retail sale of agricultural products has been defined as trade mark-up (as opposed to gross sales amount). To enforce the new rule, the Tax Code introduces the following new definitions:

- Mark-up is defined as a difference between the VAT exclusive retail price (market price in case goods are bartered or provided on a gratuitous basis) of the goods and purchase price paid to suppliers.
- Production of agricultural goods is considered as breeding and feeding animals and, birds and fish and getting certain products (in the initial form, used as semi-finished without producing a new product, changing of chemical composition and conservation) from them when they are alive including industrially (as well as special broiler farms, automatized stall systems), cultivation of plant-growing products.
- Retail sale is sales of goods to a consumer only for his/her personal use, by providing cash receipt as stipulated in the Tax Code

Depreciation rates for machinery, equipment and calculation technology are treated separately in following way:

- Machinery and equipment – up to 20%
- Calculation technology which is the product of high technology – up to 25%

In addition, state owned companies are limited to take depreciation deductions up to 40% on assets acquired at the expense of the state financing.

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## 12. Promotion of cashless payments

As a part of the Government's efforts to combat shadow economy, a new law "On Cashless Payments" has been recently adopted. The law introduces number of restrictions for use of cash. Monthly limits of cash transaction for VAT and non-VAT payers have been set as AZN 30,000 and AZN 15,000 respectively. In addition, number of transactions are required to be carried out by wire transfer only. Some examples include salary payments, tax payments, etc. The law takes effect from 1 January 2017 and 1 April 2017 for VAT and non-VAT payers respectively.

To support the measures promoted by the above-cited law, the Tax Code stipulates certain strict penalties. Hence, a party providing goods or rendering

services may be subject to a financial sanction of up to 40% of the transaction value for violating the cashless payment regulations.

In addition to the above, the Tax Code introduces a new 1% simplified tax for cash withdrawal from bank accounts by legal entities and sole entrepreneurs. Individuals who are not registered for tax purposes are outside the scope of this tax.



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