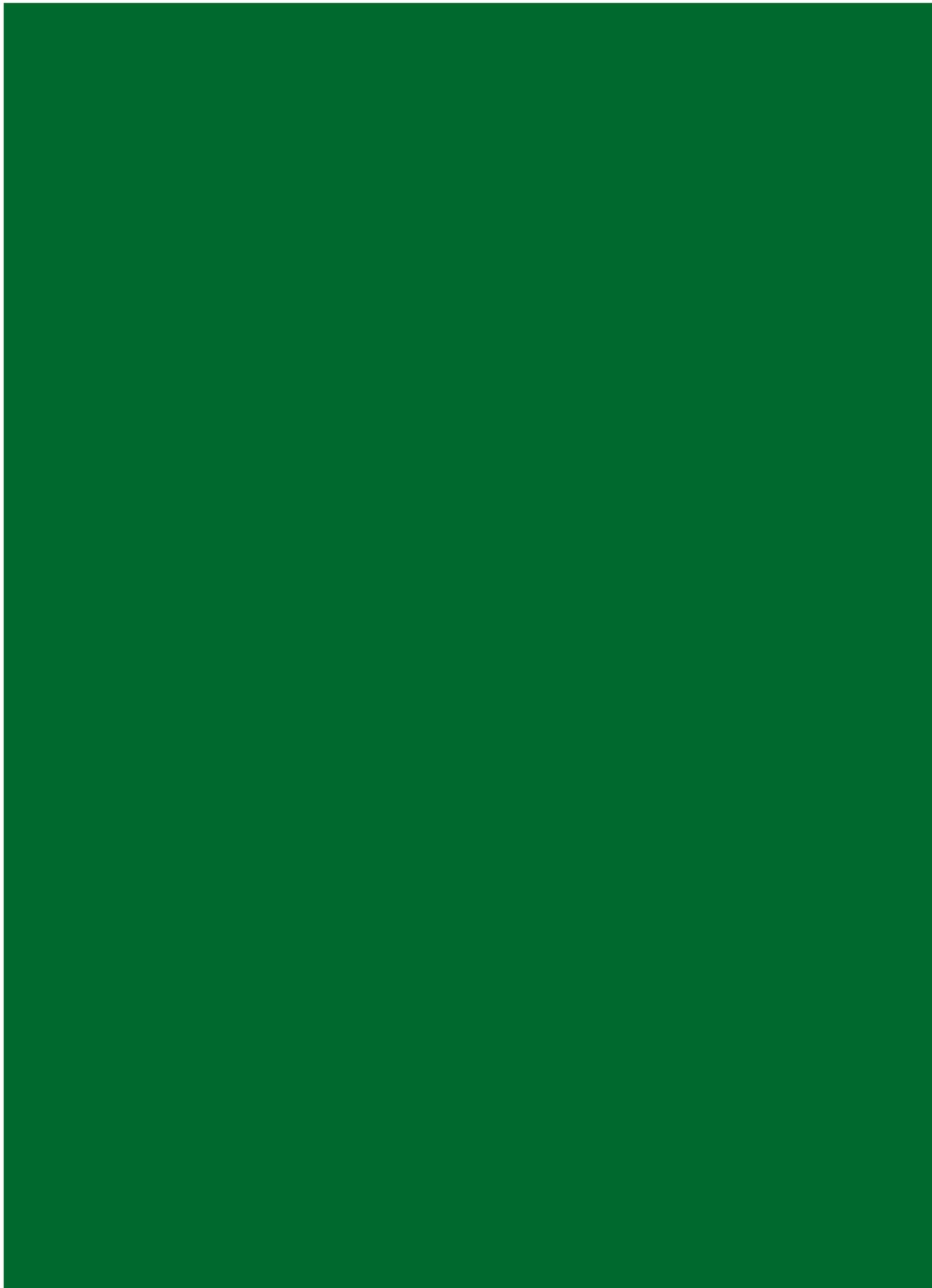




**Azerbaijan Oil and Gas**  
Taxation Guide



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# Azerbaijan

## Introduction

Azerbaijan is one of the world's oldest oil-producing countries and is a crucial oil and gas supplier in the Caspian Sea region. Its largest hydrocarbon basins are located offshore in the Caspian Sea. One of the first and largest development and production areas in the country are the Azeri and Chirag fields and the Deep Water Portion of the Gunashli Field (ACG) in Azerbaijan's Sector of the Caspian Sea oilfield, which was commissioned in 1994. Azerbaijan's Government and contractors of the State Oil Company of the Republic of Azerbaijan (SOCAR) signed an amendment to the existing ACG Production Sharing Agreement (ACG PSA) on 14 September 2017 to conduct further development of ACG until 2050. The investment potential of the project is estimated at over USD 40 billion.<sup>1</sup>

Since the signing of the ACG PSA in 1994, about 440 million tonnes of oil have been produced and a similar volume can be produced potentially. The current total oil production of Azerbaijan is approximately 36.7 million tonnes per year (according to the official data for 2017).

Azerbaijan's role as a gas production and export hub is also growing. The Shah Deniz field is located in the Caspian Sea offshore Azerbaijan. It was discovered in 1999 and has an area of approximately 860 square kilometres. Its estimated reserves hold approximately one trillion cubic metres of gas. Shah Deniz 1 is the first phase of the field's development, where gas has been produced since 2006. The second phase, Shah Deniz 2 is expected to produce 16 billion cubic meters of gas per year (bcma) in addition to the current Shah Deniz's production. Once Shah Deniz 2 is up and running, the total production from Shah Deniz field may reach 26 bcma of gas and up to 120,000 barrels of condensate a day.<sup>2</sup>

Azerbaijan was the first country of the Commonwealth of Independent States (CIS) to adopt a fiscal regime, allowing a wide use of production sharing agreements (PSA or PSAs) to attract inward investment to the onshore and offshore fields in the Caspian Sea.

The exchange rate used hereunder, is AZN 1.7 for USD 1 in accordance with the exchange rate set by the Central Bank of the Azerbaijan Republic as of 30 July 2018.

### Export routes

Azerbaijan currently operates the following export pipelines:

- The Baku-Tbilisi-Ceyhan pipeline (BTC) is used to transport the oil produced at ACG and condensate from Shah Deniz, mostly to Georgia and Turkey. Crude oil and condensate from Turkmenistan and Kazakhstan are also transported through BTC. BTC has been in operation since June 2006 and its current capacity of is 1.2 million barrels per day.<sup>4</sup>
- The South Caucasus pipeline (SCP) is a part of the Southern Gas Corridor project, which is aimed at diversifying energy supplies in Europe. Gas from Shah Deniz is exported to Georgia and Turkey through SCP, too. With the completion of Shah Deniz 2 gas exports through the SCP will exceed 20 bcma.<sup>5</sup>
- The Trans-Anatolian gas pipeline (TANAP) is also a part of the Southern Gas Corridor project. It will transport gas produced at Shah Deniz 2 and other Caspian deposits to Turkey and Europe. TANAP will reach its peak capacity of 31bcma by 2026.<sup>6</sup>
- The Trans-Adriatic Pipeline (TAP) is the European leg of the Southern Gas Corridor, which will also be used to export gas produced at Shah Deniz 2 to Europe. TAP's initial capacity is 10 bcma.<sup>7</sup>
- The Western Route Export Pipeline (WREP) is used to transport crude oil from offshore production areas to the Supsa terminal on the Georgian coast of the Black Sea. Eight million barrels of oil were exported through WREP in the first quarter of 2018.<sup>8</sup>
- The Northern Route Export Pipeline (NREP) is used to transport Azerbaijan's crude oil via Russia to Novorossiysk (a Russian Black Sea port). Its maximum throughput capacity is 105,000 barrels a day.<sup>9</sup>

### Azerbaijan key facts<sup>3</sup>



#### Population:

9,898,100



#### Territory:

86,600 square kilometres



#### Neighbouring states:

Russia, Iran, Turkey, Georgia, Armenia



#### Titular nation:

Azerbaijani (85 percent)



#### Ethnic minorities:

Russian, Lezghi, Talysh, Tatar



#### Capital:

Baku (pop. 2,262,600)



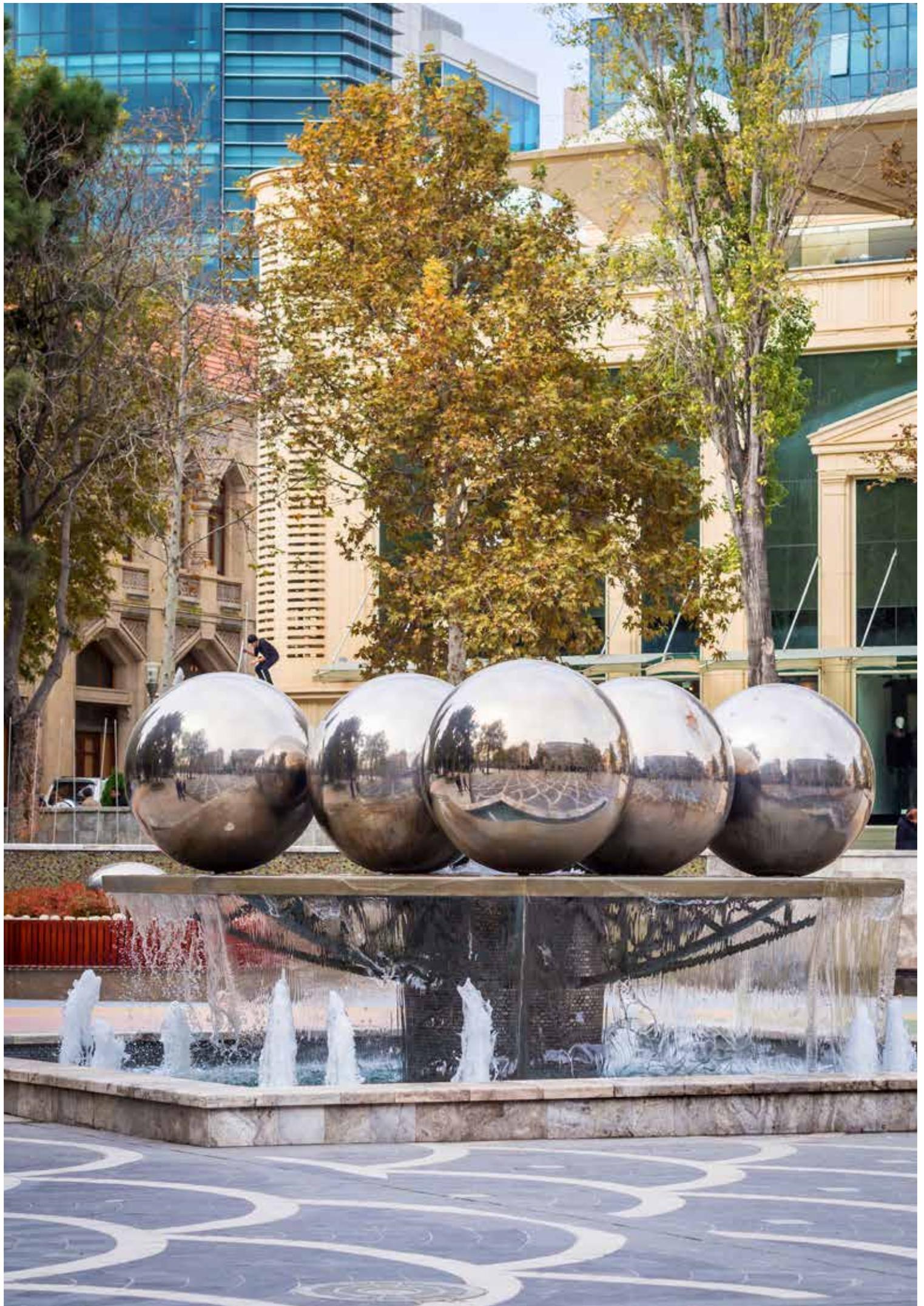
#### Other main cities:

Ganja (pop. 332,600)  
Sumgait (pop. 341,200)



#### Autonomy:

The Nakhichevan Autonomous Republic (pop. 452,800)



# Azerbaijan's oil and gas sector: the legal framework

In accordance with the legislation of Azerbaijan, ownership of all petroleum resources existing in their natural state in the underground and surface strata (including the portion of the Caspian Sea under the jurisdiction of Azerbaijan) is vested in the state of Azerbaijan.

Several international oil consortiums are engaged in the exploration and production activities in Azerbaijan's sector of the Caspian Sea and in onshore exploration. Almost all offshore consortiums operate under PSAs; however, there are several risk service agreements ("RSAs") signed for the new exploration and production areas.

There are substantial taxation differences between the PSA and non-PSA activities as the terms of a PSA typically include substantial tax reliefs for investors.

## Tax Code

In June 2000, the first Tax Code of the Republic of Azerbaijan (the Tax Code) was ratified by Milli Majlis (the Parliament), coming into force on 1 January 2001. With a few exceptions, the Tax Code is the only document governing taxation in Azerbaijan. However, Article 2.7 of the Tax Code establishes the precedence of PSAs over the provisions of the Tax Code.

## PSAs

The vast majority of oil and gas contracts signed in Azerbaijan to date were negotiated based on PSAs. Each PSA has the status of a separate law and establishes contractual relations between the foreign operating companies and SOCAR in relation to the development of a specific oil and gas field.

Although the terms of each PSA are unique, all current PSAs are similarly structured and contain many standard clauses and provisions. These include:

- The rights and obligations of the parties
- The contract area
- Development and production period
- Recovery of exploration costs and sharing of production
- Taxation
- Bonus payments





# Taxation in Azerbaijan

Azerbaijan's tax system comprises three alternative taxation regimes: the statutory tax regime governed by the Tax Code, the tax regime established by existing PSAs, and the tax regime established by the two existing Host Government Agreements (HGAs).

The HGAs on BTC (Baku-Tbilisi-Ceyhan) and SCP (South Caucasus Pipeline) signed by the Government of Azerbaijan and Main Export Pipeline (MEP) Participants provide for different taxation rules.

Below is a general overview of these taxation regimes.



# Taxation in Azerbaijan

## PSA taxation

Currently, there are more than 20 PSAs signed and ratified in Azerbaijan. PSAs contain certain provisions governing taxation. In addition, detailed taxation procedures are set out in tax protocols to PSAs. A PSA is signed by the Government of the Republic of Azerbaijan, represented by SOCAR, and a Contractor(s) – a well-known foreign oil & gas company. Also, PSAs set the taxation rules for foreign subcontractors, who perform work or render services in connection with PSAs.

### 1. Profit tax

Under a PSA, the contractor carrying out business related to petroleum operations in Azerbaijan, should pay a profit tax. The rate is negotiable and varies from 20 percent to 32 percent.

The contractor should submit its financial statements and a profit tax return (prepared exclusively in US dollars) for each calendar year, together with an appropriate auditor's report, to the tax authorities by the dates established in the PSAs.

### 2. VAT

Contractors, operating companies, local and foreign subcontractors are exempt from VAT with a zero percent rate on petroleum-related activities. These activities include:

- Supply of goods, works, and services, to or by them
- Exports of petroleum products
- Imports of goods, works, and services

To confirm their VAT-exempt status and avoid VAT charges, contractors, operating companies, local and foreign subcontractors should obtain a VAT exemption certificate, issued by the Ministry of Taxes. Only the companies registered in Azerbaijan are eligible for the exempt status.

### 3. Withholding tax

In lieu of profit tax, foreign subcontractors pay withholding tax at a rate varying from five percent to 10 percent, assessed on the gross revenues from works or services performed in Azerbaijan. Under PSAs, a foreign subcontractor is defined as a legal entity incorporated outside Azerbaijan and providing goods, works or services, directly or indirectly, to a contractor under a PSA.

Tax must be withheld by any person making a payment to such foreign subcontractor and remitted to the government of Azerbaijan. This is the final profit tax liability of a foreign subcontractor.

According to new PSAs and RSAs, a foreign subcontractor with legal presence in the Republic of Azerbaijan must pay profit tax in accordance with the provisions of the Tax Code.

### 4. Taxation of employees

The personal income tax of the local employees is calculated in accordance with the tax legislation. The personal income tax of foreign tax residents is calculated only on income earned as a direct result of their employment in the Republic of Azerbaijan. Foreign employees who do not become tax residents are not liable to pay Azerbaijani personal income tax.

#### 4.1 Tax Residency

Usually, a PSA provides for three tax residency criteria. Normally, an expatriate employee who stays in Azerbaijan for ordinary business purposes becomes a tax resident if he or she spends more than 30 consecutive days in the country 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 days in Azerbaijan in a calendar year in total are also treated as tax residents. Income earned after the 90th day becomes taxable.
- Employees working on rotational shifts and foreign employees who have their primary place of employment in Azerbaijan qualify as tax residents if they spend more than 90 days in Azerbaijan in a calendar year in total. Their income is taxable from the first day of their presence in Azerbaijan.

An employee is considered to work rotational shifts, if

- He works according to an on-and-off rotational schedule, developed and approved prior to his or her assignment/employment

- He only returns to his home country (country of residence) upon completion of assignment
- The employer/customer approves the rotation schedule and the transportation arrangements for rotational workers

#### 4.2 Taxable Income

Almost all types of income of foreign employees earned in Azerbaijan, including their salaries, bonuses, personal travel cost reimbursement, reimbursement of educational costs of family members, etc. are taxable.

#### 4.3 Tax Rates

The personal income tax rates for expatriate employees are the same as the statutory rates (see Section III, 4.3 of this Guide).

#### 4.4 Personal Income Tax Withholding

Each employer withholds the personal income tax from payments made to the local and foreign employees. Foreign

employees or their employers on their behalf 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 to the Ministry of Taxes on all Azerbaijan personal income tax payments made in respect of its local and foreign employees who are tax residents.

#### 4.6 Social Insurance and Unemployment Insurance

Foreign nationals employed by the companies engaged in the petroleum sector under PSAs are exempt from the mandatory social insurance and unemployment insurance payments.

The rates of social insurance and unemployment insurance contributions for foreign employees are the same as the statutory rates (see Section III.5 and III.6 of this Guide).

#### 4.7 Customs Duties under PSAs

PSAs exempt all imports made in connection with them from customs duties and VAT.

Contractors, operating companies, and their subcontractors may obtain a certificate of exemption from import/export duties, issued by the State Customs Committee of the Republic of Azerbaijan. Only the companies registered in Azerbaijan are eligible for the exempt status.

To claim the exemption, a contractor, operating company, or subcontractor importing goods in connection to a PSA should submit copies of its VAT and customs duties exemption certificates to the customs authorities.

## MEP and SCP taxation (HGA taxation)

### 1. Profit Tax

Profit tax is assessed on the yearly taxable profit from a MEP project at a fixed rate of 27 percent.

MEP Participants should file their profit tax return for each calendar year with the tax authorities no later than April 15 of the following calendar year.

### 2. Other Taxes

Under the Host Government Agreements (HGAs) on BTC and SCP, no taxes are charged on or withheld from payments to any contractor in connection with MEP-related activities. Contractors do not have any tax compliance or filing obligations related to their MEP activities.

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

Foreign employees of MEP participants or contractors and their family members are entitled to import into, or export or re-export from Azerbaijan, free of taxes and restrictions, any goods, works, services or technology for their own use, provided,

however, that any sale of such imported goods to any other person in Azerbaijan will be taxable (for automobiles, furniture, professional tools and instruments, a customs import tariff must be paid in accordance with Azerbaijan's laws).

The personal income tax of foreign employees is assessed only on the income earned as a direct result of their employment in the Azerbaijan Republic and only if an employee stays more than 182 days a year in Azerbaijan.

# Taxation in Azerbaijan

## Statutory taxation

The Tax Code sets out the general taxation framework. The following taxes are payable under the statutory tax regime:

- Profit Tax
- Value Added Tax (VAT)
- Property Tax
- Personal Income Tax
- Social Insurance Contributions (governed by the Law "On Social Insurance" dated 18 February 1997)
- Unemployment insurance (governed by the Law "On Unemployment Insurance" dated 30 June 2017)
- Mining Tax
- Land Tax
- Excise Tax
- Road Tax

### 1. Profit tax

#### 1.1 Tax Jurisdiction and Payers of Profit Tax

Both resident and non-resident enterprises in Azerbaijan are 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 their Azerbaijan-sourced income.

#### 1.2 Taxation of Resident Enterprises. Taxable Base

Resident enterprises are taxed on their profit, which is determined as the gross income from economic activities less deductions, at a flat rate of 20 percent. For resident enterprises, gross income includes all income, regardless of its source or place of payment, except for the income specifically exempted by the Tax Code.

#### 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 the income-generating activities, personal expenses, and entertainment expenses (unless entertainment is considered to be the taxpayer's economic activity) are not deductible. Acquisition costs of fixed assets and intangible assets are not deductible, although such assets may be depreciated.

The Tax Code also provides for rules and limitations, relating to some specific expense types: interest payments, bad and doubtful debts, reserve funds, depreciation of fixed and intangible assets, repair expenses, insurance payments, expenses on geological exploration and extraction of natural resources.

#### Deductibility of Interest Expenses

Any interest expenses paid or incurred by the taxpayer in the course of its business activities are generally deductible. However, there are some limitations. The deducted amount cannot exceed the interest computed at 1.25 the inter-bank credit auction rate set forth by the Central Bank of Azerbaijan.

#### Depreciation and Amortisation Allowance

The Tax Code uses the group method for the depreciation of fixed and intangible assets with the following rates:

- buildings, facilities, installations, and structures - up to 7 percent
- machinery and equipment - up to 20 percent
- electronic equipment and technology – up to 25 percent
- means of transport – up to 25 percent
- costs of geological exploration and preparatory works for the production of natural resources – up to 25 percent
- intangible assets with an indefinite useful life – up to 10 percent; with a finite useful life – in annual instalments pro-rata to the remaining useful life
- other fixed assets – up to 20 percent

Any expenses incurred on the acquisition, construction or improvement of assets for business use may not be deducted immediately, but should be capitalised and depreciated over time.

State-owned companies are not allowed to deduct more than 40 percent of depreciation charges on the assets acquired with state financing.

Works of art and heritage sites, as well as other wear-proof assets, may not be depreciated.

**Deductibility of Repair Expenses**

The amount of deductible repair expenses for the year is limited to a fixed percentage of the residual value of each group of fixed assets as of the previous year-end.

Any amounts in excess of the limits are capitalised at the end of the current year.

If the repair expenses are below the limit, they are deductible. Unused amounts can be carried forward to the next year.

**Net Operating Loss Carry-Forward**

The Tax Code allows carrying forward the net operating loss (up to the next five years without limitation).

**Tax Accounting Rules**

Taxpayers are required to maintain accurate and current records of their income and expenses in accordance with the Tax Code of Azerbaijan. A taxpayer may record income and expenses, using either the cash or accrual method of accounting.

**Cash Method**

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

**Accrual Method**

Contrary to the cash method, a taxpayer records income when it is earned, regardless of when it is actually received. Expenses are generally recorded when incurred, rather than when paid.

**Tax Payment & Reporting**

Enterprises pay profit tax at a rate of 20 percent and are required to make quarterly advance payments, computed either as 25 percent of the previous year's tax liability or by multiplying the amount of their income in the current

quarter by a weighted tax coefficient of the gross income for the previous year (see the formula below):

$$\text{Advance profit tax payment} = C \times (A/B),$$

where A=last year's profit tax, B=last year's gross income, C=current quarter's gross income

The annual profit tax return and the final profit tax payment are due no later than 31 March of the year following the reporting year.

**1.3 Taxation of Non-residents  
Tax Jurisdiction Over Non-residents**

A non-resident enterprise operating in Azerbaijan through its permanent establishment pays a tax on the share of its profit (i.e. on the gross Azerbaijan-sourced income) related to the permanent establishment, less the amount of expenses incurred with respect to this income, as per the Tax Code, at a flat rate of 20 percent.

The gross income of a non-resident enterprise not connected with the permanent establishment is taxed at source, no expenses are deducted.

**Permanent Establishment**

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

The Tax Code provides for the following equivalents to a permanent establishment: a place of management, a subdivision, an office, a branch or agency, a construction/repair site, an installation and assembly facility (as well as supervisory activities associated therewith), a platform, sites,

drilling equipment or vessel (used for the exploration and production of natural resources, as well as the supervisory activities associated therewith), any fixed base (location) where a non-resident individual carries out entrepreneurial activity, and premises used for the provision of consulting services. It also provides for any places of employment in which other types of entrepreneurial activity conducted in the territory of Azerbaijan, persons executing the functions of a permanent establishment for non-resident enterprises or non-resident individuals in Azerbaijan, or people acting on their behalf, authorised to enter into agreements on their behalf, and usually performing such responsibilities, as well as the places of production and sale of goods, and the delivery of works and services.

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

**Azerbaijan-sourced Income**

For withholding tax purposes, the following income types are treated as Azerbaijan-sourced:

- Interest Income
- Dividend Income
- Royalty Income
- Rent Income
- Insurance Income

# Taxation in Azerbaijan

## Statutory taxation

### Withholding Tax Rates

The following withholding tax rates normally apply to the following items of income from Azerbaijan sources payable to non-residents, provided such income is not attributable to a non-resident's permanent establishment in Azerbaijan:

Azerbaijan-sourced income	Tax rate, %
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 sources in Azerbaijan	10
Payments to persons registered in the jurisdictions with preferential taxation regimes	10

### 1.4 Tax Exemptions

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

The Tax Code also grants a seven-year tax exemption for residents of industrial or technology parks. Additionally, the part of profits that the managing companies of industrial or technology parks allocate to improving the infrastructure of such parks is also exempt from profit tax.

The legal entities holding an investment promotion certificate are granted a 50-percent exemption from profit tax for seven years.

In addition, the Tax Codes provides a five-year exemption from profit tax for the income of legal entities generated from production of agricultural products (including the industrial production of foods) starting from 1 January 2014.

### 1.5 Taxation of Cross-Border Transactions. Outbound Transactions

Since resident entities may be taxed on their worldwide income in Azerbaijan and may also be taxed by foreign countries on the income derived from sources or from carrying out business in such countries, there is a risk of double taxation.

In terms of domestic tax law, income or profit tax paid outside Azerbaijan is credited upon the payment of tax in Azerbaijan. Excess foreign tax credits may not be offset against a resident taxpayer's Azerbaijan tax liabilities or any domestic income, nor can they be carried forward or backward.

### Double Tax Treaty Relief in Azerbaijan

Azerbaijan has double tax treaties with 53 (currently 51 of them are valid) countries that generally follow the OECD Model Income Tax Convention.

	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	The Czech Republic	8	10	10
10	Denmark	5-15	8	5-10
11	Estonia	5-10	10	10
12	Finland	5-10	10	5-10
13	France	10	10	5-10
14	Georgia	10	10	10
15	Germany	5-15	10	5-10
16	Greece	8	8	8
17	Hungary	8	8	8
18	Iran	10	10	10
19	Israel	15	10	5-10
20	Italy	10	10	5
21	Japan	15	10	0-10
22	Kazakhstan	10	10	10
23	South Korea	7	10	5-10
24	Kuwait	5-10	7	10
25	Latvia	5-10	10	5-10

	Country of recipient	Dividends	Interest	Royalties
26	Lithuania	5-10	10	10
27	Luxemburg	5-10	10	5-10
28	Macedonia	8	8	8
29	Malta	8	8	8
30	Moldova	8-15	10	10
31	The Netherlands	5-10	10	5-10
32	Norway	10-15	10	10
33	Poland	10	10	10
34	Qatar	7	7	5
35	Romania	5-10	8	10
36	Russia	10	10	10
37	San Marino	5-10	10	5-10
38	Saudi Arabia	5-7	7	10
39	Serbia	10	10	10
40	Slovenia	8	8	5-10
41	Sweden	5-15	8	5-10
42	Switzerland	5-15	10	5-10
43	Tajikistan	10	10	10
44	Turkey	12	10	10
45	The UK	15	10	5-10
46	The Ukraine	10	10	10
47	The United Arab Emirates	5-10	7	5-10
48	Uzbekistan	10	10	10
49	Montenegro	10	10	10
50	Pakistan	10	10	10
51	Vietnam	10	10	10

# Taxation in Azerbaijan

## Statutory taxation

Non-residents are entitled to the tax exemptions or reduced tax rates applicable under double tax treaties with respect to the income derived from sources in Azerbaijan for all income types, including business profits, dividends, royalties, and interest.

Azerbaijan's tax legislation also establishes the rules for claiming a refund of taxes withheld from payments to non-residents, subject to the provisions of double tax treaties signed between Azerbaijan and other countries. Tax refund applications are reviewed by the tax authorities within 20 working days.

The tax refund must be made within 45 days following the submission of the application and approval of the tax authorities.

### 1.6 Transfer Pricing

Transfer pricing rules in Azerbaijan are generally in line with the OECD TP guidelines; the following transactions are treated as controlled:

- between an Azerbaijan's resident and mutually dependent non-resident persons
- between a non-resident's permanent establishment in Azerbaijan and the non-resident itself or any representative, branch or other division of such non-resident, located in other countries
- between a resident of Azerbaijan or permanent establishment of a non-resident in Azerbaijan and entities established (registered) in countries with preferential taxation regimes

Taxpayers are required to submit special forms to the tax authorities, if the volume of transactions with any related party exceeds AZN 500,000 (approx. USD 294,118) per calendar year.

Failure to comply with the filing requirements is punishable by a fine of AZN 500 (approx. USD 294).

## 2. Value added tax

### 2.1 Concept of Value Added Tax

In Azerbaijan's tax legislation, the concept of VAT is based on the principles used in most European countries. In accordance with Azerbaijan's laws, VAT payers may recover the amount of VAT paid on their purchases (Input VAT) that exceeds the VAT received from their taxable supplies (Output VAT).

### 2.2 Payers of VAT

An individual or legal entity whose taxable sales amount to more than AZN 200,000 (approximately USD 117,647) in a consecutive 12-month period must register for VAT purposes. The Tax Code also envisages voluntary registration for VAT purposes.

A taxpayer which has registered voluntarily and whose total taxable supplies during the preceding 12 months did not exceed AZN 100,000 (approximately USD 58,824) may apply for a cancellation of the registration at any time within a year after the last registration for VAT purposes, subject to some exceptions indicated in the Tax Code.

### 2.3 Taxable Base

According to the Tax Code, supply of goods (rendering of services) and import of goods are subject to VAT. Services rendered or work performed outside Azerbaijan are not taxable.

However, payments made by persons without tax registration for works and services supplied via e-commerce to non-residents that are not registered for VAT purposes (with the exception of airline tickets purchased and hotel bookings made outside Azerbaijan) are subject to VAT.

### 2.4 VAT Rate

The current rate of VAT is 18 percent. The Tax Code also provides for a zero VAT for certain transactions.

### 2.5 VAT Payment and Reporting

Registered VAT payers compute the amount of VAT to be remitted to the State Budget by reducing their output VAT liability by the input VAT credit.

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

### 2.6 VAT Invoice

A VAT payer that carries out a taxable transaction is required to issue a tax invoice to the person who receives goods or services.

The taxpayer must draw up and issue to the purchaser of the goods (works or services) a tax invoice, upon delivery or no later than five days after the delivery.

VAT invoices are issued in an electronic format. The Ministry of Taxes registers and administers them online via the taxpayers' electronic tax cabinets.

### 2.7 VAT Administration Remittance

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

Any taxable person should assess the amount of VAT to be remitted to the State Budget by reducing its output VAT liability by input VAT credit.

## 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 a current month is automatically transferred to the next three months and should be offset against the VAT liability arising during that period.

The tax authorities have the right to offset the VAT receivable from the budget against other tax liabilities, late payment penalties, financial sanctions, and administrative penalties. Taxpayers may request that the tax authorities set off the repayable VAT against other tax liabilities.

If after a three-month period, the amount of input VAT is not fully offset, the remaining amount of VAT must be refunded to the taxpayer within 20 days upon the submission of an application to the tax authorities. After that, late payment interest is accrued at a rate of 0.1 percent.

A taxpayer may claim the overpaid taxes within five years after the end of the tax reporting period.

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

## 3. Property tax

### 3.1 Property Tax for Individuals

Property tax is assessed to resident and non-resident individuals who own buildings and their parts, as well as watercraft and aircraft.

Individuals who hold an investment promotion certificate are fully exempted from property tax for the respective

properties for seven years from the date of obtaining the investment promotion certificate.

In addition, the Tax Code provides a five-year exemption from property tax for individuals with regard to the properties used in agricultural production (including the food industry), starting from 1 January 2014.

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

On buildings:

- Property tax is calculated by multiplying a certain fixed rate per square meter, varying between AZN 0.1 to AZN 0.4 depending on the building's location, by the total floor area.

On aircraft and watercraft:

- AZN 0.02 per cubic cm of the watercraft's engine replacement volume
- AZN 0.02 per cubic cm of the aircraft's engine replacement volume
- One percent of the market value, if the watercraft/aircraft has no engine

### 3.2 Property Tax for Legal Entities

For legal entities, the taxable base includes:

- the average annual value of the fixed assets recorded in an enterprise's balance sheet (except for vehicles)
- for non-resident enterprises, carrying out business activity through a permanent establishment in Azerbaijan, the average annual value of fixed assets connected with such permanent establishment

Legal entities are exempt from property tax on fixed assets for seven years from the date of obtaining an investment promotion certificate.

Enterprises pay property tax at a rate of one percent of the average annual residual value of their fixed assets, which is determined as a sum of the residual values of the enterprise's property as of the beginning and the end of the reporting year, divided by two.

### 3.3 Property Tax Payment and Reporting

Quarterly advance payments of property tax should be made at 20 percent of the previous year's property tax amount no later than the 15th day of the second month of each quarter. The annual property tax return is due by 31 March of the year following the reporting year.

## 4. Personal Income Tax

### 4.1 Tax Residency

Individuals staying in Azerbaijan for more than 182 days cumulatively in a calendar year, or those with a place of permanent residence, or vital interests, or a permanent abode in Azerbaijan, or having Azerbaijan's citizenship are considered Azerbaijan's tax residents.

### 4.2 Taxable Income and Exemptions

Azerbaijan's residents are subject to income tax on their taxable income defined as the gross income received from all sources (both in Azerbaijan and abroad) during the tax year, regardless of where the income was earned or paid. Non-residents are subject to Azerbaijan's income tax only on their Azerbaijan-sourced income.

The taxable income tax is determined as a difference between the gross income for the tax year and expenses (or deductions) for this period.

Virtually all forms of compensation are taxable for an employee, including hardship and payment of taxes on his behalf.

# Taxation in Azerbaijan

## Statutory taxation

Income of sole entrepreneurs operating in industrial parks is exempt from taxation. Moreover, a seven-year 50-percent exemption from personal income tax is granted to individuals holding an investment promotion certificate.

Moreover, interest on term deposits of individuals paid by a local bank or a branch of a foreign bank, as well as dividends, market discount income (resulting from investing in bonds below their face value), and interest paid by an issuer of investment securities are exempted from personal income tax for seven years, beginning from 1 February 2016.

### 4.3 Tax Rates

The worldwide income of tax residents and Azerbaijan-sourced income for non-residents is subject to the following marginal income tax rates:

Monthly Taxable Income	Tax Rate, %
Up to AZN 2,500 (USD 1,470)	14
Over AZN 2,500	AZN 350 + 25 percent of the amount exceeding AZN 2,500

\* AZN 173 of a salary below AZN 2500 is not taxable

Annual Taxable Income	Tax rate, %
Up to AZN 30,000 (USD 17,647)	14%
Over AZN 30,000	AZN 4,200 + 25 percent of the amount exceeding AZN 30,000

\* AZN 2,076 of an annual salary below AZN 30,000 is not taxable

### 4.4 Withholding the Personal Income Tax

The personal income tax on employment income is withheld at source. The withheld tax amounts are to be remitted to the Budget not later than the 20th day of the following month.

### 4.5 Individual Filing

Taxpayers that pay their taxes individually must complete and file their income tax declarations no later than 31 March of the following tax year.

### 5. Social insurance

According to Azerbaijan's laws, both Azerbaijan's nationals and foreign individuals must pay social insurance contributions.

Employers pay social insurance contributions at a rate of 22 percent of the employee's gross salary and 3 percent of the employee's gross salary is withheld as the employee's portion of the social insurance contribution.

Employers are also responsible for submitting quarterly reports to the social protection fund in respect of the social insurance contributions calculated and paid with regard to the local employees and foreign employees on the local payroll by the 20th day of the month following the reporting quarter.

### 6. Unemployment insurance

According to the Law "On unemployment insurance" of 30 June 2017, employees as insured parties, employers as insurers are required to make unemployment insurance contributions.

Employers must pay unemployment insurance contributions at a rate of 0.5 percent of the employee's gross salary and 0.5 percent more is withheld 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 in respect of the unemployment insurance contributions calculated and paid with regard to the local employees and foreign employees on the local payroll by the 20th day of the month following the reporting quarter.

Employers are also responsible for remitting the unemployment insurance contributions on the day of salary payment, but no later than the 15th day of the month following the calendar month of payment.

### 7. Mining tax

Legal entities and individuals extracting mineral resources in Azerbaijan and on the Caspian shelf pay the mining tax at various rates, ranging from three percent to 26 percent. The tax is paid after the extraction of minerals on a monthly basis, by the 20th day of the month following the accounting month.

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

### 8. Land tax

Land tax is assessed to owners and users of land, depending on the use, location, and the total area of a land plot. For instance, in Baku, the tax rate for plots of industrial land up to 10,000 square metres is AZN 10 and AZN 20 for each next 100 square meters.

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

Legal entities holding investment promotion certificates are exempt from land tax for seven years from the date when an investment promotion certificate is granted.

Land tax is paid semi-annually in equal instalments, no later than 15 August and 15 November.

### 9. 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 2 per litre of spirits or AZN 4 per 1,000 cigarettes produced in Azerbaijan.

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

Imported platinum, gold, jewellery and other items made of precious metals, as well as processed, sorted, framed and mounted diamonds are subject to excise tax at different rates, depending on:

- weight (for platinum)
- purity (for gold)
- size in carats (for diamonds)

Imports of fur and leather products is also subject to excise tax at a rate of 10 percent from their wholesale price.

Exports of excisable goods are not excisable.

### 10. Road tax

Road tax is paid by representatives of non-resident entities and individuals entering Azerbaijan, as well as by persons engaged in the production or import of motor petrol, diesel fuel, and liquefied gas in (to) Azerbaijan.

The tax is collected by the customs authorities at different rates, depending on the type of the vehicle, mileage, and length of stay in Azerbaijan.

The road tax for motor petrol, diesel fuel, and liquefied gas produced in Azerbaijan and used for domestic consumption is calculated by adding AZN 0.02 to the wholesale price of each litre.

The road tax for imported motor petrol, diesel fuel, and liquefied gas is calculated by adding AZN 0.02 to the customs value of each litre, exceeding the wholesale price.

### 11. Simplified taxation

Individuals and legal entities involved in entrepreneurial activity that are not registered VAT payers have the right to register as taxpayers under a simplified tax regime.

However, producers of excised goods, credit and insurance organisations, investment funds, professional securities market participants, non-governmental pension funds, and certain other persons are not entitled to this regime.

Tax under the simplified regime is assessed on the revenue from provision of goods, completion of works, rendering of services, and non-sale income at the following rates:

- In Baku – at 4 percent
- In other regions – at 2 percent
- For gambling operators (sports betting) – at 6 percent
- Income of commissioners of sports-gambling games – 4 percent

Persons engaged in trading and catering activities whose taxable turnover exceeds AZN 200,000 at any month within consecutive twelve months are entitled to the simplified taxation regime at the following rates:

- For trading activities – at 6 percent
- For catering activities – at 8 percent

Persons engaged in construction may register as simplified-regime taxpayers on a voluntary basis. The tax for them is calculated at a rate of AZN 45 multiplied by the location zone rate, which varies from 0.5 to 4.0. The rate for non-residential buildings is 1.5 regardless of location.

Persons providing transportation services (except for the international transportation) are also eligible for the simplified tax regime. The tax rates for them vary from AZN 1 up to AZN 9 per month, depending on such factors as the

number of seats in a vehicle, number of cars, and carrying capacity.

Proceeds from sale of residential and non-residential property, including from persons engaged in construction, are eligible for simplified taxation at a rate of AZN 15 per square meter multiplied by the location zone rate, which varies from 0.5 to 4.0. The rate for non-residential buildings is 1.5 regardless of location.

Legal entities and sole entrepreneurs pay a one-percent tax on cash withdrawals from their bank accounts, withheld by the banks.

Proceeds from sale of a land plot are eligible for the simplified taxation at a rate that depends on the use, location, and total area. For instance, in Baku, the tax rate is AZN 0.5 per square meter multiplied by the location zone rate, which varies from 1.2 to 4.0.

Taxpayers under the simplified regime must pay tax and file tax returns no later than the 20th day of the month following each reporting quarter.

The public notary who registers the sale of residential and non-residential property is responsible for calculating, withholding, and remitting the tax amount to the state budget within one banking day. The notary is also responsible for filing a monthly tax return with the tax authorities no later than 20th day of the month following the reporting month.

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# Footnotes

1. [https://www.bp.com/en\\_az/caspian/press/pressreleases/acg\\_psa\\_amended.html](https://www.bp.com/en_az/caspian/press/pressreleases/acg_psa_amended.html)
2. <https://www.bp.com/en/global/corporate/media/press-releases/bp-starts-up-landmark-shah-deniz-2-development-in-azerbaijan.html>
3. Figures are as of beginning of 2018
4. [https://www.bp.com/en\\_az/caspian/operationsprojects/pipelines/BTC.html](https://www.bp.com/en_az/caspian/operationsprojects/pipelines/BTC.html)
5. [https://www.bp.com/en\\_az/caspian/operationsprojects/pipelines/SCP.html](https://www.bp.com/en_az/caspian/operationsprojects/pipelines/SCP.html)
6. <https://www.hydrocarbons-technology.com/projects/trans-anatolian-natural-gas-pipeline-project-tanap/> <https://www.tanap.com/tanap-project/why-tanap/>
7. <https://www.tap-ag.com/the-pipeline>
8. [https://www.bp.com/en\\_az/caspian/operationsprojects/pipelines/WREP.html](https://www.bp.com/en_az/caspian/operationsprojects/pipelines/WREP.html)
9. <https://neftegaz.ru/en/news/view/168202-SOCAR-and-Transneft-agree-on-oil-pumping-this-year>



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