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A blurred section of a trading interface showing control buttons for 'Bid', 'Ask', 'Auto', and 'Shift' with small red and green arrows next to them.

Bid Ask Auto Shift

A blurred trading data box showing '1.45053' in a red box, '1.00' in a blue box, and '1.4500' in a blue box, with 'SL/TP' and 'AV' labels to the right.

1.45053 1.00 1.4500 SL/TP AV

A blurred candlestick chart with blue and yellow bars and a yellow trend line, set against a dark background with other blurred market data.

BDO TAX LIGHTHOUSE
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AMENDMENTS TO THE TAX CODE OF THE REPUBLIC OF AZERBAIJAN APPROVED

On 20 December 2018 the President of the Republic of Azerbaijan approved the Law “On Amendments to the Tax Code of the Republic of Azerbaijan” dated 30 November 2018 (the “Law”). As the Law introduces a plethora of changes in the Azerbaijani taxation landscape, it is now more than ever necessary for businesses to remain abreast of tax developments.

As noted by the Ministry of Taxes, the amendments focus on promoting entrepreneurship, scaling down tax evasion and shadow economy, broadening the taxable base, improving tax administration and raising efficiency of tax deductions.

This publication provides an overview of main changes made to the Tax Code effective 1 January 2019 and canvasses the key impacts for taxpayers.

COVERAGE

Certain provisions of the Tax Code, including, in particular, tax payment rules, rights and obligations of taxpayers and state tax authorities, forms and methods of tax control, liability for violation of tax law, appealing actions and inaction of state tax authorities, now apply also to mandatory state social insurance contributions (“SIC”) and unemployment insurance from 1 January 2019 the tax authorities will be responsible for controlling compliance of taxpayers with social insurance and unemployment insurance legislation.

KEY DEFINITIONS

The wording of certain key definitions was broadened as well as new definitions were added. The most noteworthy ones are as follows:

- ▶ The term “**dividend**” now includes also such cases as distribution of property (assets), acquired at the expense of net profits, at the time of a legal entity’s liquidation, as well as monetary and other forms of payment to shareholders in case of buy back of shares (or participation interest) at their nominal value, that has been increased at the expense of net profits.
- ▶ The wording of the term “**Azerbaijani source income**” triggering additional¹ 10% rate withholding tax (“WHT”) levy on direct or indirect payments to persons incorporated (registered) in low tax jurisdictions has been expanded to include also direct or indirect payments to branch offices or representative offices in other countries as well as to bank accounts in low tax jurisdictions. However, a clarification has been given underlining that this 10% rate WHT will not apply to repayment of principal amounts on debts (without late payment interest), as well as to transfers by Azerbaijani resident banks to their correspondent bank accounts abroad.
- ▶ The definition of the term “**transfer price**” has been modified to bring more clarity to it: transfer price is the price established in transactions between persons enumerated in Article 14-1.2 of the Tax Code and being commensurate with the prices charged in comparable transactions carried out under the same conditions between independent persons;
- ▶ The new term “**capital**” has been defined as the value of net assets found by subtracting all liabilities from all assets.

¹ in addition other WHT if applicable

- ▶ The new term “**innovation activity**” has been defined as an activity aimed at creating and producing a new or enhanced commodity (work, service), technological process based on scientific research and experimental-design works and application of their results to achieve economic or social efficiency.

Other noteworthy terms include **SMB (“SME”) cluster company, SME cluster participants, start-up**, introduction of which is aimed at promoting and stimulating micro-, small- and medium-sized entrepreneurial business development in the Republic of Azerbaijan.

Criteria for identification of micro-, small- and medium-sized entrepreneurial businesses are set out in the relevant resolution dated 21 December 2018 approved by the Cabinet of Ministers of the Republic of Azerbaijan.

TAX ADMINISTRATION

Taxpayer's obligations

Amendments touched upon also taxpayer's obligations and they essentially include:

- ▶ Retail trade and catering businesses will have to replace their existing cash registers with new generation cash registers that are connected to the online information system of the tax authorities in order to transmit real-time data. The new generation cash registers shall additionally contain information about name of the entrepreneur/entity (business site), tax registration code and location, as well as a commodity's Quick Response Code (i.e. a barcode);
- ▶ Removal of the obligation to issue hard copy delivery notes: now only electronic delivery notes must be provided in connection with supply of goods (services, works) to registered businesses (legal entities and individuals).
- ▶ Banking institutions rendering customer account services, governmental agencies, local authorities and budgetary organisations supplying works and services, as well as notaries shall not be required to issue electronic delivery notes.

Alongside the above, new compliance requirements have been introduced for certain types of businesses

- ▶ **Insurers and re-insurers** will have to submit a pro-forma report to the tax authorities on insured assets of legal entities, their branch offices and representative offices no later than the 20th of the month following end of each quarter.
- ▶ **Card organisations²** will have to submit to the tax authorities a pro-forma report on cashless payments made by individuals consumers to retail trade and catering businesses no later than the 20th of the following month.

² the term defined in the Decision of the Central Bank of the Republic of Azerbaijan No. 16/3 dated 10 July 2012 (includes processing centres and international card organisations)

Commercial and/or tax secrecy

The range of authorities with which the tax authorities and their officials can share information about taxpayers has been expanded as follows:

- ▶ to the Ministry of Finance for implementing the budget system legislation;
- ▶ to the Mortgage and Loan Guarantee Fund to the extent necessary for issuing mortgage lending and entrepreneur lending guarantees;
- ▶ to credit bureaus to carry out activities envisaged in Articles 6.1 and 6.2 of the Law on Credit Bureaus.

Field tax audits

The major amendments include:

- ▶ the tax authorities' corresponding office that has initiated the field tax audit is now entitled to make a reasoned decision to suspend (to defer) a scheduled or a non-scheduled field tax audit for a period of up to 9 months in the event of temporary loss of working ability of not only a taxpayer's chief executive office, but also of his substitute or a tax officer or a finance officer.
- ▶ It is permitted to seize documents and samples of articles from a taxpayer during field tax audits and operational tax control. This may only be done during a taxpayer's actual working hours.
- ▶ The tax authorities may now pass the following decisions in respect of the results of the prior non-scheduled field tax audits:
 - to uphold the decision made during the prior field tax audit;
 - to cancel entirely or partially or to make changes to the decision made during the prior field tax audit;
 - to pass a new decision.

Harshening financial sanctions

Alongside various measures aimed at promoting entrepreneurial activities, the legislator has made a number of changes (mostly increases) in existing rates of financial sanctions, as well as introduced significant financial sanctions for violation of requirements of the tax law.

▶ Though a penalty for failure to submit tax return on time will not be imposed upon them, **individuals using own land suitable for agriculture and able-bodied members of family farming businesses** will be subject to a penalty at a rate of 3 percent of the minimum monthly salary for the first time of **failing to submit timely a report envisaged in the Social Insurance Law** within a calendar year and at a rate of 6 percent of the minimum monthly salary for the second and more times.

▶ The size of penalty for a **failure to timely submit or for submitting deliberately distorted documents** (all financial documents, accounting books, reports, estimates, cash, securities and other valuables, declarations and other documents related to the calculation and payment of taxes), including their electronic copies, as well as **documents required for performing a fiscal control and executing requests received by the tax authorities under international treaties** has been increased 10 times from AZN 100 to AZN 1,000. For the first occurrence within a year from 1 January 2019 initially a written warning is issued by the tax authorities; if repeated, the financial sanction above will be applied during tax control measures.

▶ Should it be found **from information electronically submitted by the taxpayer to the tax authorities** that the taxpayer has understated the amount of tax (including WHT) in the tax return or has evaded from declaring the amount of tax, such taxpayer will be subject to a 25% rate financial sanction on the understated or evaded amount of tax (except for the tax additionally assessed via a desk tax audit).

▶ Except for a case taking place in wholesale business, the rates of financial sanctions for **violation of cash transaction rules** have been replaced as follows:

- AZN 1,000 for the first time of violation within a calendar year;
- AZN 3,000 for the second time of violation within a calendar year;
- AZN 6,000 for the third and more times of violation within a calendar year.

For the first occurrence within a year from 1 January 2019 initially a written warning is issued by the tax authorities; if repeated, the financial sanction above will be applied during tax control measures.

▶ While the requirement of a hard copy delivery note has been removed, the financial sanctions **for concealing cash belonging to a taxpayer, not keeping records of income and expenses** in the manner envisaged in the Tax Code, **absence of purchase confirmatory documents** in respect of goods being in a taxpayer's possession (an electronic delivery note or an electronic tax invoice; pro-forma purchase certificate applicable in specific cases; customs import declaration for goods imported; as well as one of documents envisaged in case a taxpayer himself manufactures goods) have been noticeably increased:

- 10 percent of the amount exceeding AZN 1,000 if the amount exceeding AZN 1,000 has been concealed or not recorded in accounting; and 20 percent for the repeated violation within a calendar year;
- Imposed upon a buyer of the goods: 10 percent of the value (*the purchase value; if it is not identifiable then the wholesale market value*) of goods, where one of the documents mentioned above confirming purchase or receipt of goods is not available, if revealed for the first time within a calendar year; 20 percent for the second time and 40 percent for third and more times.
- If no records of income and expenses is kept in the manner prescribed in the tax law - 10 percent of the expenses not formalised for a buyer (i.e. for a failure to provide confirmatory

document to the buyer to formalise the latter's expenses).

▶ The financial sanctions imposed **upon an employer for engaging individuals to perform any works without having an employment agreement entered into force** and thereby creating conditions for concealing (understating) their employment income have also been increased: AZN 2,000 per each individual engaged so, if committed by an employer for the first time within a calendar year; AZN 4,000 for the second time; and, AZN 6,000 for the third and more times.

▶ New severe financial sanctions have been introduced for supplying the goods without **issuing an electronic delivery note or an electronic tax invoice** in the event either of these are to be issued in accordance with the Tax Code:

- Imposed upon a supplier: 10 percent of the sale value of the goods if done for the first time within a calendar year; 20 percent for the second time; and 40% for the third and more times within a calendar year.

For the first occurrence within a year from 1 January 2019 initially a written warning is issued by the tax authorities; if repeated, the financial sanction above will be applied during tax control measures.

▶ **Sale of excisable goods subject to marking without such marking, sale of goods subject to compulsory labelling (a new term) without such labelling, as well as letting the above goods out of the production premises without marking/labelling** shall now be subject to a financial sanction of 1 times of the market value of such goods if committed for the first time within a calendar year; and 2 times of the market value for the second and more times.

▶ Another noteworthy punitive provision has been introduced specifically in respect of **persons entitled to tax reductions or exemptions** under the Tax Code: should such persons not declare or understate such tax exempt income in their tax filing, they will be subject to a 6% financial sanction on the value of non-declared or understated gross income (without deduction of expenses). Agricultural and other businesses (residents of tech or

industrial parks, etc.) enjoying various tax privileges should take a special note in this respect. For the first occurrence within a year from 1 January 2019 initially a written warning is issued by the tax authorities; if repeated, the financial sanction above will be applied during tax control measures commencing from 1 January 2020.

Financial sanctions applicable to lending institutions and financial institutions

▶ The financial sanctions, imposed upon financial institutions **for opening accounts for or rendering services to legal entities and individuals without adhering to requirements of the normative acts of the Republic of Azerbaijan as well as of the international tax and financial information exchange treaties** the Republic of Azerbaijan is a party to, have been increased five times from AZN 100 to AZN 500. **A failure to submit an electronic report** to the tax authorities in respect of the above in the established manner and on time shall trigger a financial sanction increased 10 times from AZN 1,000 to AZN 10,000. In addition to that, the financial sanction for **violation of requirements of the international treaties on exchange of tax and financial information, found as a result of receipt of notification from a foreign country's competent authorities**, has been raised from AZN 100 to AZN 1,000. For the first occurrence within a year from 1 January 2019 initially a written warning is issued by the tax authorities; if repeated, the financial sanction above will be applied during tax control measures.

Collection of tax debts

Previously, if a taxpayer has not lodged a complaint with the court against taxes, late payment interest and financial sanctions assessed by the tax authorities within 30 days from the date of receipt of notification, the tax authorities were entitled to send an order (a **levy order**), representing an enforcement document, to the bank to levy the tax debts from a taxpayer's local currency and foreign currency accounts.

Now, the **tax authorities may not send the levy order if a taxpayer lodged a complaint either with the court or with the Ministry of Taxes**. Additionally, not only a court's judgment, but

also a decision of the Ministry of Taxes, serve as a basis for sending the levy order.

Moreover, now, except for cases when value-added tax (“VAT”) has been calculated, declared but not paid by a taxpayer on time and cases when there is a taxpayer’s written consent thereto, in all other cases 105% of the outstanding VAT, late payment interest or financial sanctions on VAT assessed or recalculated by the tax authorities **shall be frozen on a taxpayer’s VAT deposit account** (VAT sub-account). If the taxpayer does not lodge a complaint with the court or the Ministry of Taxes against a tax debt notification within 30 days from the date of its receipt, then the tax authorities will be entitled to levy the outstanding VAT, late payment interest or financial sanctions from the taxpayer’s VAT deposit account. If the complaint has been lodged, then the levy may be carried out based on a valid judgment of the court or a decision of the Ministry of Taxes passed in accordance with the Law on Administrative Proceedings.

According to a new introduced provision, if the **cash available in a taxpayer’s foreign currency account with a bank is not converted in the local currency within 10 days** from the date of receipt of the levy order, the next working day the bank shall convert the taxpayer’s funds frozen in its foreign currency account into the local currency, based on the foreign currency exchange rate established by the Central Bank of the Republic of Azerbaijan, and then execute the levy order. If there are no sufficient funds, the levy order will be executed each time the local currency is received into the bank account.

Taxpayers also should take a note of another new important provision of the tax law, according to which, **if the goods recorded and available in the taxpayer’s books cannot be actually found in the taxpayer’s possession** during the tax control activities carried out by the tax authorities, the taxes will be assessed for the reporting period in which this event has been revealed; if revealed as a result of a field tax audit - then assessment will be done as of the last reporting period covered by that field tax audit.

In case the minimum amount is not invested under the investment project commitments

and in case **the investment promotion document is recalled (cancelled)** by the relevant authorities, persons who have previously received the investment promotion document will have to re-calculate and pay their taxes for the entire period commencing from the date implementation of the investment project was launched.

Refund of overpaid tax

The overpaid or erroneously levied tax **refund process has been set to four months** (from the date of electronic application to tax and customs authorities) in respect of VAT refund for **taxpayers with 18% VAT applying to more than 50% of their revenues**. According to the previous regulations, this process was supposed to take three months plus 20 days for refund to be carried out.

Calculation of foreign currency in Azerbaijani Manat

The approved amendments bring **clarity to calculation of foreign exchange difference on transactions carried out in a foreign currency** and being subject to taxation in the Republic of Azerbaijan as follows:

- ▶ Foreign exchange difference on the above transactions is to be established by comparing the value of goods (works, services), as per the exchange rate set by the Central Bank of the Republic of Azerbaijan, as of the date the transaction (i.e. supply) has been carried out and the value of goods (works, services) as of the date of payment for that transaction.
- ▶ Foreign exchange difference between accounts payable and accounts receivable, respectively for goods (works, services) purchased in foreign currency and sold in foreign currency, as of the end of the reporting period is attributed to either gains (income) or losses (expenses).
- ▶ The taxpayer’s cash in foreign currency available as of the end of the calendar year is to be valued in accordance with the official exchange rate set by the Central Bank of the Republic of Azerbaijan.

Communication with taxpayers

According to the amendments, the **range of documents sent by the tax authorities to a taxpayer** has been concretised: those include any decision, report, notification, demand letter, letter or other documents (their copies). If any of these documents is handed over in writing, they must be signed and stamped by the head (his deputy) of the relevant tax office. **No stamping is any longer required in respect of the above documents forwarded electronically to the taxpayer.**

The documents shall be considered as properly received by the taxpayer in the following cases:

- ▶ If handed over in person to a taxpayer (its authorised representative) - the date of handover;
- ▶ If delivered via post to the address last registered in a legal entity's state registration documents or an individual's last registered address - five working days after handing over to the post;
- ▶ If forwarded electronically to the online office - three working days after the electronic forwarding.

The last two cases above do not apply to non-receipt or delayed receipt of an administrative order by a taxpayer.

Tax liability performance timeframes

In the event a taxpayer has brought a claim in a court in respect of the amount of taxes, late payment interest and financial sanctions assessed by the tax authorities, a period between the date of claim submission and entry of the court's judgment into force as well as other periods (failure to find a taxpayer at a registered address; temporary loss of ability to work of a taxpayer's chief executive officer, tax officer or a finance officer; etc.) will not be taken into account when calculating the statutory limitation period applicable to taxes (for calculation and/or re-calculation of taxes - three years; or for levy, refund or offset of taxes - five years).

According to the approved amendments, the statutory limitation period applicable to tax

liabilities will not apply to SIC. Thus, a question on statutory limitation period applicable to SIC remains open as it is not regulated in the Tax Code.

PERSONAL TAXATION

Taxable items³ (capital gains)

The legislator has formally brought a clarity in respect of taxation of individuals' capital gains representing an individual's non-entrepreneurial income from sale of participatory interest or stock (both hereinafter the "share") he owns in a legal entity's share capital:

- ▶ An individual's taxable income is the difference between the actual sale value of the share and the nominal value of such share, provided the sale value exceeds the value of net assets proportionate to the value of the share owned by that individual in the legal entity's share capital; if sold at a value lower (a discounted price) than the proportionately owned value of net assets - then the taxable income shall comprise a difference between the proportionate value of net assets as of the date of share sale and purchase agreement and the nominal value of share owned by the individual.
- ▶ If the share is bought at a value exceeding its nominal value, then the actual amount of expenses on share acquisition shall be considered for taxation purposes at the time of subsequent alienation (sale) of the share.

Employment income

The types of taxable employment income have been expanded. Thus, **imprest funds disbursed by an employer to an employee shall be considered a taxable employment income** to that employee if he does not return any cash remaining with him in the manner established by the Cabinet of Ministers of the Republic of Azerbaijan. The Cabinet of Ministers is yet to approve the relevant rules that set out a specific deadline for imprest holders to return the cash remaining after expending the advance for the designated purpose.

Personal income tax rates

Employment income

Landmark changes have been made to the rates of personal income tax ("PIT") in respect of

employment income of individuals working for taxpayers operating in the non-oil-and-gas industry and in the non-public sector. These new PIT rates shall apply for a seven-year period starting from 1 January 2019 are as follows:

Table A:

Size of monthly taxable employment income*	PIT rate
Up to AZN 8,000	0 percent
Income exceeding AZN 8,000	14 percent of the amount exceeding AZN 8,000

(in the non-oil and gas and non-public sectors)

PIT rates have remained unchanged in respect of employment income of the individuals working for taxpayers operating in the oil and gas industry and in the public sector.

Table B:

Size of monthly taxable employment income	PIT rate
Up to AZN 2,500 (where AZN 200 is tax exempt)	14 percent
Income exceeding AZN 2,500	AZN 350 plus 25 percent of the amount exceeding AZN 2,500

Employment income of individuals working both in the oil and gas sector or public sector and in the non-oil gas sector or non-public sector should be calculated separately based on the tables shown above.

The Cabinet of Ministers is yet to approve criteria of the oil and gas sector activities and the non-public sector.

³ Object of taxation

Non-entrepreneurial income

The PIT rate applicable to an individual's **non-entrepreneurial income** (for instance, capital gains mentioned above) **has also undergone a serious change and is now one rate fixed at 14 percent of an annual non-entrepreneurial income.**

Services/works supplied by non-registered individuals

It should also be noted that, according to the amendments, payments by legal entities and registered individual entrepreneurs for the services (works) to individuals not registered with the tax authorities shall be subject specifically to the PIT rates mentioned in the Table B above (applicable to the oil and gas and public sectors).

PIT withholding on payment for goods

Legal entities and registered individual entrepreneurs will have to **withhold and report (on a quarterly basis) a 2% rate PIT on payments for the following goods** purchased from individuals not registered with the tax authorities:

- ▶ agricultural products from agricultural producers;
- ▶ nonferrous and ferrous metal scrap;
- ▶ paper, glass and plastic products for recycling and other purposes;
- ▶ tires for recycling purposes.

PIT deductions

Deduction due to size of income

As noted above, if an individual's income at his main place of employment (where his labour record book is stored) is below AZN 2,500 per month or AZN 30,000 per annum, he will be entitled to a PIT deduction of AZN 200 (in lieu of previous one times of country-wide monthly living minimum) on his monthly income or AZN 2,400 on his annual income (in lieu of previous twelve times of country-wide living minimum).

Deduction on endowment life insurance premium

According to another and quite a noteworthy amendment, in lieu of full deduction previously applied, going forward there will be **only a 50% PIT deduction** on insurance premiums paid by an employer to insurers of the Republic of Azerbaijan **on endowment life insurance and pension insurance agreements concluded for a period not less than three years.**

Tax exemption on dividend income

From 1 January 2019 **full PIT exemption** on dividend income will apply not only on an individual's dividend income received from joint stock companies, but also **on dividend income of individual founder (shareholder) or stockholder of a resident enterprise which keeps records of income and expenses in the manner specified in the tax law, is not registered for VAT purposes and has the volume of transactions below AZN 200,000 in any month of a consecutive twelve-month period.**

PIT incentives for individual entrepreneurs' retail and/or catering business income

PIT payable by registered individual entrepreneurs engaged in goods retail and/or catering business shall be reduced by 25% for a three-year period starting from 1 January 2019 **on the ratio of cashless payments**, that the entrepreneur receives via POS terminals envisaged in the Law of the Republic of Azerbaijan "On protection of consumers' rights", in such individual entrepreneurs' total income. The amount of payments received via POS terminal by such entrepreneurs will not be considered.

Other deductions

Other important PIT deductions include, in particular:

- ▶ **50% deduction on income received from sale of the share held by a taxpayer for at least three years.**

- ▶ **75% deduction on income of individual entrepreneurs qualifying as subjects of micro-entrepreneurship;**
- ▶ **Full exemption for a three-year period on income of individual start-up entrepreneurs, qualifying as micro- and small- entrepreneurial businesses, from innovation activities, commencing from the receipt date of Start-up certificate.**
- ▶ **Full exemption for a seven-year period on income of individual start-up entrepreneurs, qualifying as micro and small entrepreneurial businesses, from innovation activities, commencing from the receipt date of Start-up certificate.**
- ▶ **Part of the income, received by an individual entrepreneur, qualifying as a participant of SME cluster, for supply of goods (work, services) based on an agreement entered into with a SME cluster company, and directed at capital expenses - for seven years;**
- ▶ **PIT deduction of AZN 400 on income of children of warriors who perished during or died after the war.**

CORPORATE INCOME TAX

Payers of corporate income tax (CIT)

Going forward non-governmental organisations receiving income from entrepreneurial activities are also considered as payers of corporate income tax.

Taxable event

Amendments similar to those made to PIT calculation approach on capital gains from alienation of shares have been made in treatment of alienation of shares, held by legal entities, for CIT purposes. An legal entity's taxable income is the difference between the actual sale value of the share and the nominal value of such share, provided the sale value exceeds the **value of net assets proportionate to the value of the share** owned by that legal entity in the other legal entity's share capital; if sold at a value lower (a discounted price) than the proportionately owned value of net assets - then the taxable income shall comprise a difference between the proportionate value of net assets as of the date of share sale and purchase agreement and the nominal value of share owned by the legal entity.

If the share is bought at a value exceeding its nominal value, then the actual amount of expenses on share acquisition shall be considered for taxation purposes at the time of subsequent alienation (sale) of the share.

CIT exemptions

Certain provisions on CIT exemption have been amended and new provisions were added as well. The noteworthy ones are as follows:

- ▶ Income of public legal entities established to operate in the name of the government (except for entrepreneurial income);
- ▶ Income of the Mortgage and Loan Guarantee Fund of the Republic of Azerbaijan;
- ▶ **Profits of educational institutions, including educational institutions**

established for education of persons with physical challenges, except for the part of profits allocated for distribution of dividends;

- ▶ Tax exemption period on **income of legal entities qualifying as manufacturers of agricultural products** (including industrially manufactured) has been further extended from five years to 10 years commencing from 1 January 2014⁴;
- ▶ With the exception of legal entities, 51% or more percent of shares of which are directly or indirectly owned by the state, and public legal entities, **part of a taxpayer's profit for the reporting year not exceeding 10 percent of such profits, transferred to enterprises, institutions and organisations, that operate in the field of science, education, health, sports and culture and meet criteria established by the Cabinet of Ministers**, is exempt from CIT for 10 years starting from 1 January 2019. This provision of the law applies only to cashless expenses (cashless transfers). The criteria are yet to be approved by the Cabinet of Ministers;
- ▶ **50% exemption on the capital gains on share/s⁵ held by the taxpayer for at least three (3) years;**
- ▶ **75% exemption on entrepreneurial profit obtained by legal entities that are subjects of micro-entrepreneurship** (micro businesses);
- ▶ **Full exemption on profits of SME cluster company - for 7 years** since the date of being included in SME cluster companies register;
- ▶ **Part of the profits, received by a SME cluster participant legal entity for goods (work, services) supplied on the basis of an agreement entered into with a SME cluster company, directed**

⁴ The same exemption period applies for assets tax

⁵ both participation share (for instance, in limited liability companies) and stock (in joint stock companies)

to capital expenditures is exempt for seven years;

- ▶ **Profits of micro- and small business start-up entities from innovation activities** is exempt from tax for three years commencing from the date of receipt of the “Start-up” certificate;
- ▶ **CIT payable by legal entities engaged in goods retail and/or catering business** shall be **reduced by 25%** for a three-year period starting from 1 January 2019 on the ratio of cashless payments, that the entity receives via POS terminals envisaged in the Law of the Republic of Azerbaijan “On protection of consumers’ rights”, in such entity’ total income. The amount of payments received via POS terminal by such legal entities will not be considered.
- ▶ **Full exemption on dividend income** will apply to dividend income of legal entities being founders (participatory interest holders) or shareholders of a resident enterprise which keeps records of income and expenses in the manner specified in the tax law, is not registered for VAT purposes and has the volume of transactions below AZN 200,000 in any month (months) of a consecutive twelve-month period.

TRANSFER PRICING

Alongside the updated definition of transfer price, other noteworthy amendments concerning transfer pricing include, in particular:

- ▶ removal of requirement to apply comparable uncontrolled price (“market price”) method to transactions on which specifically transfer pricing methods (resale price, cost-plus, transactional profit, profit split methods) are to be applied.
- ▶ The range of persons (*the “Covered Person/s”*) transactions between which are subject to transfer prices has been modified. Now the transfer price methods are to be applied with regard to transactions between the following persons:
 - transactions of residents of the Republic of Azerbaijan with their related parties qualifying as non-residents;
 - transactions of the non-resident’s permanent establishment in the Republic of Azerbaijan (the “PE”⁶) with the non-resident itself or with its branch offices, representative offices or divisions in other countries, and of **the PE with any other person that is a related party to the PE and is domiciled in another country;**
 - between the resident of the Republic of Azerbaijan or the non-resident with persons incorporated (registered) in low tax countries.
- ▶ There is **no longer an annual threshold** (previously controlled transactions exceeding AZN 500,000) **for application of transfer prices**. This effectively means that the taxpayers may well have to consider transfer price implications in respect of each transaction with the Covered Person/s carried out within the calendar year;
- ▶ Taxpayers will be required to file an annual report on controlled transactions no later than 31 March of the following calendar

(reporting) year not on the transactions value of which merely exceeds AZN 500,000 per annum per Covered Person, but ***on transactions where transfer-price-based value exceeds AZN 500,000 per annum per Covered Person***. As noted above, this requirement will necessitate undertaking a transfer pricing study for each controlled transaction not only because this has an impact on a taxpayer’s corporate income tax (profit tax), but also because of the fact that a new financial sanction of **AZN 500 shall be imposed for the failure to submit accurate information** in the abovementioned annual report. Previously this financial sanction applied only for the failure to submit this report on time.

⁶ ; for instance, a branch office of foreign legal entity in the Republic of Azerbaijan

OTHER PROVISIONS ON PERSONAL INCOME TAX AND CORPORATE INCOME TAX

Non-deductible expenses

A check issued by a cash register or a receipt (except for checks and other strict accounting forms issued by banks servicing customer accounts, notaries, as well as by state bodies, self-government bodies (municipalities) and budgetary organisations supplying goods, works, services) shall not be considered a document supporting expenses incurred on acquisition of goods (works, services).

Thin capitalisation rules

New thin capitalisation rules will apply specifically to **borrowing transactions between the Covered Persons⁷ and deductibility of interest expenses thereof shall be based on a taxpayer's leverage ratio:**

- ▶ If loans received from abroad (except for loans issued by foreign banks and credit organisations, as well as loans on bonds traded in foreign stock exchanges) exceed a taxpayer's net assets (the capital) by more than two times, then interest expenses attributable to the part of principal amount of loans, that exceeds at least twice the taxpayer's net assets, will not be deductible for CIT purposes. However, these provisions will not apply to resident banks and credit organisations.

Depreciation

Additional incentives have been given to micro entrepreneurial and small entrepreneurial businesses in respect of deduction of depreciation expenses for CIT purposes:

- ▶ **Micro entrepreneurial businesses** are entitled to multiplying their fixed assets annual depreciation expenses by two.
- ▶ **Small entrepreneurial businesses** will be entitled to multiplying their fixed

assets annual depreciation expenses by 1.5.

Insurance premiums

Insurance premiums calculated from a part not exceeding 50 percent of an individual's taxable income and paid on the basis of endowment life insurance and pension insurance agreements entered into by an individual and insurers of the Republic of Azerbaijan for a period of not less than three years, envisaging insurance payments after expiration of a three-year term from the effective date of insurance agreement, will be deducted by an employer from an individual's taxable employment income for PIT calculation purposes.

Endowment life insurance and pension insurance premiums subtracted as mentioned above from an individual's employment income by an employer are **deductible in full for CIT purposes if made by a bank transfer** to an insurance company's bank account.

Loss carry forward

According to the newly introduced provision of a clarifying nature, losses incurred, and amounts carried forward due to application of lower rate of depreciation and repair expenses by taxpayers before they have become payers of PIT or CIT are not deductible. This provision will not apply if a taxpayer is registered retrospectively (not exceeding three years back) for VAT purposes.

Dividends taxation

Going forward the **transfer of assets** acquired in the course of the entity's operations, including transfer of cash (except for disbursing or repaying loans to the entity's founder⁸), **to the founder** for purposes that go beyond the objectives of business activities, as well as repayment of the founder's own debts to other persons **are considered to be equal to dividend payments** for taxation purposes. Therefore, such transfers are subject to a 10% tax withholding at the source of payment.

⁷ those falling under the scope of transfer pricing regulations above

⁸ We assume the legislator meant an entity's participants / shareholders, as founders and current shareholders may not be the same

WHT on non-residents' income

An editorial change was made to the provision of the tax law relating to WHT applicable to payments for works or services supplied by non-residents and their other Azerbaijani source income, other than other those on which a different rate of WHT is set (e.g. risk insurance and re-insurance, international transportation, lease, etc.). The applicable WHT rate on such payments remains at 10%.

Financial leasing

The amendments made concretised the items of financial leasing. According to the reformulated provisions, **the items of financial leasing are movable and immovable property, that are attributed to fixed assets.** According to the tax law, fixed assets are tangible assets with the useful life exceeding one year and the value exceeding AZN 500.

The taxpayers carrying on financial leasing activities are to submit a pro-forma report about financial leasing agreements (except for those agreements where the lessor is a legal entity or a registered individual entrepreneur) entered into before 1 January 2019 within 15 days from that date. If they succeed in submitting the report on time, the above changes will not apply to their current financial leasing agreements entered into before 1 January 2019.

VALUE ADDED TAX

VAT payers

A clarification has been given to the provision of tax law governing the status of unincorporated joint ventures for VAT purposes. Although these provisions applicable to VAT on an unincorporated joint venture's activities existed in the tax law before, in practice there was no mechanism of its implementation for reporting purposes. An unincorporated joint venture was construed as a separate person/entity for VAT purposes. Now that separate person/entity shall be a person/entity that is keeping the books of joint entrepreneurial activities.

Compulsory VAT registration

Due to revocation of trading businesses' rights to be 6% rate simplified taxpayers regardless of the size of their revenues, corresponding amendments have also been made in compulsory VAT registration provisions.

According to another amendment, a person keeping the books of joint entrepreneurial activities must be registered for VAT purposes if participant of this unincorporated joint venture is already a VAT payer or these activities reach the compulsory VAT registration threshold.

Voluntary VAT registration

A significant amendment was made to voluntary VAT registration provisions for transportation industry.

Going forward **persons carrying on passenger and cargo transportation** (including by taxi) in Republic of Azerbaijan by motor vehicles owned or used by them, or performing transportation through other persons on the basis of an agreement, **may apply for voluntary VAT registration** if they also meet the criteria below:

- ▶ receiving the consideration for their services and paying the cost of purchased goods (works and services) in a cashless manner;
- ▶ formalising income for services rendered to other persons and related expenses on the basis of electronic delivery notes issued/received;

- ▶ keeping records of services rendered in a single centralized electronic system and providing the tax authorities with a remote access to this system.

The above persons may only submit a VAT application registration no later than 31 January and their registration become effective from 1 January onwards. However, such persons cannot apply for VAT de-registration earlier than three years from their last registration date.

Exemptions

VAT exemption period applicable to agricultural producers' sale of own output (including industrially produced) has been extended by another five years expiring on 1 January 2024.

New noteworthy exemptions include:

- ▶ import of liquefied gas-powered buses designed to carry more than 10 people, including the driver - from 1 January 2020 for five years;
- ▶ Import of machinery, technological equipment and facilities for production or processing purposes by a SME cluster company on the basis of a confirmation document issued by the Agency for Development of Small and Medium-Sized Enterprises: exemption shall apply from the date of registration as a SME cluster company in the Cluster Register SMEs for seven years;
- ▶ Import of cars powered only by an electric engine.

Zero rate VAT

The Cabinet of Ministers has been commissioned with issuing the rules on **refund of VAT paid by individuals consumers in respect of goods (except for oil and gas products) received from persons engaged in retail or catering business**. The amount refundable shall be 15% of the value of VAT paid in cashless manner and 10% of the value of VAT paid by cash.

It is critical for the above partial refund of VAT that information in the receipts collected

conform to requirements set out in the tax law, namely all of the following:

- ▶ Name of the entrepreneur/entity,
- ▶ Tax ID number;
- ▶ Date and hour of receipt;
- ▶ Name of the business site, its tax registration code and location;
- ▶ Name, unit of measure, quantity of the commodity, price per one unit and total amount (including the amount of VAT);
- ▶ Quantity and number of receipts issued for that day;
- ▶ Brand name and serial number of the cash register;
- ▶ Fiscal regime label (attribute) of the cash register
- ▶ Commodity's Quick Response Code (i.e. a barcode).

Input VAT

A new important provision was introduced in respect of offsettable (refundable) input VAT recognition for taxpayers who carry on both VATable and VAT exempt transactions. Going forward, adhering to input VAT general recognition rules, such taxpayers will be entitled to claim in full input VAT paid on goods (works, services) received for VATable transactions if they keep documented information on goods (works, services) allocating them across VATable and VAT exempt transactions.

Additional amendments include:

- ▶ Taxpayers cannot claim input VAT on goods (works, services) purchased at the expense of funds (except for subsidies and sums subject to repayment) disbursed from the State Budget.

EXCISE TAX

Excisable goods and tax rates

A list of excisable goods has been broadened as follows:

- ▶ Alcohol and non-alcohol energy drinks;
- ▶ Buses (except for liquefied gas powered buses);
- ▶ Liquids for electronic cigarettes.

Tax rates

The excise tax rates have been noticeably increased in respect of certain goods and new rates have been introduced to the excisable goods mentioned above as follows:

- ▶ Cigarettes made of tobacco and their substitutes - from AZN 12 to AZN 20 per every 1000 pieces;
- ▶ Alcohol energy drinks - AZN 2 per each litres;
- ▶ Non-alcohol energy drinks - AZN 3 per litre;
- ▶ Cigars, including cut-end cigars - AZN 1 per each piece;
- ▶ Liquid for electronic cigarettes - AZN 20 per litre.

The excise tax rates have been **significantly increased also in respect of cars and yachts** and are as follows:

Taxable items	Excise tax rate
cars with engine capacity up to 2,000 cubic cm	for every cubic cm of engine capacity - AZN 0.30
cars with engine volume up to 3,000 cubic cm	600 AZN + 5 AZN for each cubic cm for a part of 2001-3000 cubic cm of engine capacity
cars with engine capacity up to 4,000 cubic cm	5,600 AZN + 13 AZN for each cubic cm for a part of 3,001-4,000 cubic cm of engine capacity

cars with engine volume up to 5000 cubic cm	18,600 AZN + 35 AZN for each cubic cm for a part of 4001-5000 cubic cm of engine capacity
cars with engine volume over 5000 cubic cm	53,600 AZN + 70 AZN for each cubic cm for a part of the engine volume over 5,000 cubic cm
yachts for recreation or sports and other floating equipment provided for these purposes.	For every cubic cm of engine capacity - 6 AZN

New rates applicable to buses (except for liquefied gas powered buses) are as follows:

Taxable items	Excise tax rate
with engine capacity up to 4,000 cubic cm	2 AZNs for each cubic cm of engine
with engine capacity up to 6,000 cubic cm	8,000 AZN + 4 AZN for each cubic cm of a part of the engine capacity of 4001-6000 cubic cm
with engine capacity up to 8,000 cubic cm	16,000 AZN + 6 AZN for each cubic cm of the engine volume of 6001-8000 cubic cm
with engine capacity up to 10,000 cubic cm	28,000 AZN + 8 AZN for each cubic cm of the engine volume of 8001 - 10,000 cubic cm
with engine capacity above 10,000 cubic cm	44,000 AZN + 10 AZN for each cubic cm of the engine volume of more than 10,000 cubic cm

Should the manufacturing date be more than one year or the distance covered by them exceeds 100,000 km, then the applicable rate above is multiplied by 1.5.

ASSETS TAX

Exemptions

A major exemption provision was introduced in respect of the asset tax on privatised property. **The assets tax paid from 1 January 1 2019 to 1 January 2022 in respect of state-owned property, the privatisation of which was completed**, is refunded based on a taxpayer's application under the following conditions or upon his consent is carried forward to be offset against its subsequent tax obligations:

- ▶ the amount of taxes calculated and paid for other taxes in the reporting year should not be less than the amount of assets tax paid to the State Budget for this reporting year in respect of property privatisation of which has been completed;
- ▶ on the assets tax refund application date a taxpayer does not have any dues for taxes, interest thereon and financial sanctions.

Micro entrepreneurial businesses are exempt from assets tax.

SME cluster companies are exempt for seven years, commencing from the date of entry into SME cluster companies register, from assets tax in respect of property they are using in SME cluster activities.

Tax exemption period on assets being used by legal entities and individual entrepreneurs qualifying as manufacturers of agricultural products (including industrially manufactured) for manufacturing purpose has been further extended from five years to 10 years commencing from 1 January 2014.

SIMPLIFIED TAX

Payers of simplified tax

Trade businesses with revenues exceeding AZN 200,000 over any 12-month period no longer have an option to be simplified taxpayers. Trade businesses that became payers of simplified tax at a fixed 6 percent rate before 1 January 2019 are to submit a pro-forma report no later than 15 January 2019 to the tax authorities about the balance of stock remaining in their possession. Such report shall be considered a source accounting document. For these taxpayers, succeeding in filing the above report on time, VAT on sale of goods remaining in their possession before 1 January 2019 is calculated by its application to a difference between sell value and purchase value of the goods.

Going forward persons engaged in manufacturing business with an employee headcount exceeding 10 persons cannot be simplified taxpayers.

Goods wholesale businesses and businesses, activities of which require licensing (except for persons engaged in building and compulsory insurance) do not either have the right to be simplified taxpayers.

A critical change has been made to the services industry as persons supplying services to legal entities and registered individual entrepreneurs cannot be simplified taxpayers any longer.

Taxable items

Simplified tax payable by registered individual entrepreneurs engaged in goods retail and/or catering business shall be reduced by 25% for a three-year period starting from 1 January 2019 on the ratio of cashless payments, that the entrepreneur receives via POS terminals envisaged in the Law of the Republic of Azerbaijan "On protection of consumers' rights", in such individual entrepreneurs' total income. The amount of payments received via POS terminal by such entrepreneurs will not be considered.

Tax exemption period on income of persons qualifying as manufacturers of agricultural

products (including industrially manufactured) has been further extended from five years to 10 years commencing from 1 January 2014.

Dividend income of individual founder (shareholder) or stockholder of a resident enterprise which keeps records of income and expenses in the manner specified in the tax law, is not either registered for VAT purposes and has the volume of transactions below AZN 200,000 in any month of a consecutive twelve-month period is not subject to simplified tax.

Rate of simplified tax

Alongside the changes above, simplified tax rates has been reduced from 4% to 2%.



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