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Recent Amendments to the Azeri Tax Code

Registration of Legal Entities

The annual amendments made to the Azeri Tax Code have already been ratified by the Parliament and published in the official press on Saturday, December 15th. These amendments will be effective from 1 January 2008. Below is a summary of the most important amendments that may be relevant to your business activities in Azerbaijan.

## Amendments to the Tax Code

### General

- *Export Driven Oil-Gas Activities and Special Economic Zones*

Following Production Sharing Agreements and Host Government Agreements, the provisions of the laws governing export driven oil & gas activities and special economic zones will also have an overriding force over the Tax Code in the case of any conflicts.

- *Offshore Bank Accounts*

The amendments impose new requirements for taxpayers opening bank accounts with non-resident banks to obtain a duplicate certificate from the tax authorities and report any movements in these accounts.

- *Fines*

Effective 1 January 2008, the fine for understatement of taxes revealed on tax audit would be increased from 25% to 50%.

The changes have also introduced a new type of fines for employers hiring personnel without concluding employment agreements. These employers would face a financial sanction of AZN 1,000 for each individual hired without a proper employment contract..

Failure to follow the sequence in which debts should be paid as envisaged by the Civil Code of the Azerbaijan Republic by using petty cash payments when the bank accounts are seized would be subject to a fine of 50% of the amount so paid.

A financial sanction of 50% would now be imposed for a failure to pay VAT on the supplier/service provider invoices following the new rules on payment of VAT using designated bank accounts.

Legal entities or physical persons using accounts with non-resident banks and credit organizations for collection of income without getting a duplicate certificate (i.e. registration of account) from the tax authorities would face a harsh penalty of 100% of the amount so accrued.

The amendments allow the tax office to request a list of assets of taxpayers (as a first step in seizing their property) failing to satisfy their outstanding tax liabilities within the established period within ten days after such period has elapsed. If the list is not presented on time, a penalty in the amount of AZN 100 will apply.

## Definitions

- *Place of management*

The amendments have clarified the application of the 'place of management test' used for tax residency purposes. Consequently, the place where principal commercial decisions are made and management of day-to-day operations is carried out will be the decisive factor in determining the residency of legal entities.

## Profits Tax

- *Loss Carry-forward*

One of the positive amendments is an extension of the loss carry-forward period up to five years (currently losses are allowed to be carried over for a maximum of three years).

## VAT

- *VAT bank account*

As some of you may be aware, a few years ago the tax office proposed to introduce a new mechanism for collection and payment of VAT amounts which is based on using designated VAT bank accounts. This proposal was previously disapproved by many taxpayers in view of the large volume of additional administration it would entail. However the tax authorities were successful in making sure that this proposed change was into the Tax Code this year and will therefore become effective as of 1 January 2008.

Even though a description of the rules and procedures for maintaining VAT bank accounts is expected to be issued by the Cabinet of Minister shortly, it is already known that each VAT-payer will be required to maintain a VAT-deposit account for collection and transferring of VAT amounts or that VAT will be creditable only if it is paid through the designated accounts.

- *Voluntary VAT Registration*

At the same time the VAT registration rules will be softened. Thus, the amendments remove an extensive document compilation requirement for voluntary registration. Moreover, the VAT registration will now in theory will only take five days.

## Personal Income Tax

- *Income Tax Band*

An increase of the personal income tax band, has eventually been enacted. From 1 January 2008, monthly income of up to AZN 2,000 will be taxed at a rate of 14%, with the 35% rate for any amount over.

- *Non-taxable income (Article 102.1.6)*

Following the amendments, non-taxable portion of the income of those who earn up to AZN 200 monthly or AZN 2,400 annually will now be tied to the required minimum salary amount (which is currently AZN 50). More specifically, the amount of non-taxable income will be fixed at AZN 50 for those earning monthly income of up to AZN 200 and AZN 600 for persons earning AZN 2,400 annually.

## Registration of Legal Entities

Beginning from 1 January 2008, registration of commercial legal entities would be carried out only by the tax authorities. The new registration process will be based on the 'one stop shop' principle and will be called a 'one window' registration. This system should in theory be a lot less bureaucratic as the registration process should only take three days. Since this has not yet been tested in practice we are to see if the three day timeline will in fact be observed.

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