

Guide on taxation and investment in Azerbaijan

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Deloitte in Azerbaijan

2007 reflected tangible growth in all sectors of Azerbaijan's economy. Remarkable economic growth was a result of the continued market-oriented reform process conducted by the government of Azerbaijan aimed at liberalizing prices, tightening budgetary and fiscal controls to limit inflation, restructuring the banking sector and improving transparency, modernizing the tax system, privatizing state-owned enterprises, and promoting foreign investment. A favorable investment climate continues to attract foreign investors to Azerbaijan.

Deloitte provides services to clients and investors in Azerbaijan from its office situated in Baku. The firm offers statutory and international auditing as well as tax and legal, accounting, consulting and financial advisory services.

Business and investment environment

General rules on investment activity and forms of business organizations in Azerbaijan

Azerbaijani legislation defines “foreign investment” as any kind of property and proprietary rights, including rights concerning the results of intellectual activity and other immaterial rights contributed by foreign investors with the purpose of deriving profit.

Foreign investors may make investments in Azerbaijan in the following ways:

- Participate in enterprises and organizations established in cooperation with Azerbaijani companies and individuals;
- Establish enterprises fully-owned by foreign investors;
- Purchase enterprises, buildings, fixtures, equity shares in enterprises, other shares, bonds, securities and other property which, according to legislation, may belong to foreign investors;
- Acquire rights for use of land and other natural resources and other proprietary rights.

Privileges and state guarantees to foreign investors

Foreign investors enjoy a “legal regime” that is no less favorable than the one created for local investors.

Azerbaijani law guarantees foreign investors’ interests from future adverse change in the legislation for the next 10 years. However, this does not apply to changes in legislation concerning defence, national security and public order, environmental protection, taxation, credit and finance, public morale and public health.

Business organizations in Azerbaijan

Azerbaijani legislation provides for a number of different forms in which business activities may take. They include the following:

Type of commercial organizations	Main characteristics or requirements
Open or closed joint-stock company	<ul style="list-style-type: none"> • limited liability; • one or several founders (an individual and/or a legal entity); • charter and foundation agreement required.
Limited liability company	<ul style="list-style-type: none"> • limited liability; • one or several founders (an individual and/or a legal entity); • charter and foundation agreement required.
General partnerships	<ul style="list-style-type: none"> • unlimited personal liability; • charter and foundation agreement required.
Limited partnerships	<ul style="list-style-type: none"> • limited liability partners and general partner/s (unlimited liability); • charter and foundation agreement required.
Companies with additional liability	<ul style="list-style-type: none"> • founders bear subsidiary liability established in the charter; • charter and foundation agreement required.
Cooperatives	<ul style="list-style-type: none"> • established by not less than five individuals and/or legal entities (property liability); • charter and foundation agreement required.

Foreign companies may establish either a branch or a representative office. Neither branch offices nor representative offices are legal entities in themselves, but are considered to be separate divisions of the foreign legal entity they represent.

Although there is no difference in the tax treatment of a branch or of a representative office, a branch office is a more appropriate form for conducting commercial operations from a legal point of view. Unlike a representative office, a branch may perform commercial operations that are also conducted by its head office.

The most popular forms of doing business in Azerbaijan by foreign investors are limited liability companies, branches and representative offices.

Beginning from 1 January 2008, the state registration of entities is carried out by the Ministry of Taxes of Azerbaijan according to the "one window" principle. This principle has simplified the registration process and shortened it by up to three days.

Authorized capital and contributions of partners

According to Azerbaijani civil legislation, as a general rule, the amount of authorized capital of a company cannot be less than the amount of the company's liabilities to its creditors.

The minimum amount of authorized capital for joint-stock companies is: AZN 2,000 (≈USD 2,457) for closed joint-stock companies and AZN 4,000 manat (≈USD 4,914) for open joint-stock companies.

Licensing and compulsory notification of the state authorities

Certain activities in Azerbaijan (for example, banking, auditing, insurance and tourism) require a license/special permit. Companies that will engage in activity subject to licensing should apply to the appropriate state authorities for a license after completing their state registration.

Acquisition of real estate in Azerbaijan

The purchase of immovable property must be notarized. The title is considered to be transferred to the purchaser once the appropriate records are made in the State Register of Immovable Property.

Although foreign investors including individuals may own immovable property, they cannot purchase land in Azerbaijan. Foreign nationals and legal entities may only obtain the right to use land through a lease agreement.

Exchange controls, bank accounts and confidentiality of bank information in Azerbaijan

The manat, the official currency of Azerbaijan, has limited convertibility. According to the Constitution of Azerbaijan, the manat is the only legal means of payment within the territory of Azerbaijan.

Resident and non-resident entities of Azerbaijan have the right to open and dispose of any accounts in their national as well as in any other foreign currency. In order to open foreign-currency bank accounts, entities conducting their activities in Azerbaijan are obliged to submit documentation of registration in the respective tax authority and State Social Protection Fund. Residents and non-residents may import and exchange currency in accordance with the procedures established by the National Bank of Azerbaijan.

Generally, Azerbaijani companies are not entitled to hold offshore bank accounts. Beginning from 1 January 2008, taxpayers engaged in entrepreneurial activity are obliged to notify the tax authorities about opening offshore bank accounts.

Foreign investors may repatriate their profits after paying the appropriate taxes.

Under the law, disclosure of confidential bank account information is prohibited. Such information may be disclosed only on the basis of a court decision. However, in cases provided for by the Tax Code, tax agencies may obtain taxpayers' bank account information.

Taxation system in Azerbaijan

The Azerbaijani tax system consists of two regimes: the statutory tax regime governed by the Tax Code, and the tax regime established by the existing Production Sharing Agreements (PSAs).

In addition, the Host Government Agreement on BTC (Baku-Tbilisi-Ceyhan) signed by the Government of Azerbaijan and MEP (Main Export Pipeline) Participants (SOCAR, BP, TPAO, Statoil, Unocal, Itochu, Amerada Hess, Eni, TotalFinaElf, INPEX, and ConocoPhillips) provide different taxation rules.

Below is a general overview of the taxes applicable under these tax regimes.

Statutory taxation

The Tax Code sets out the general taxation framework in Azerbaijan and establishes the following taxes:

- Profit tax;
- Value added tax (VAT);
- Property tax;
- Personal income tax;
- Mining tax;
- Land tax;
- Excise tax;
- Road tax;
- Simplified tax

Profit tax

1. Tax jurisdiction and 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 income from Azerbaijani sources.

Both resident and non-resident enterprises in Azerbaijan pay the profit tax.

2. Taxation of resident entities

Taxable base

Legal entities are taxed on profit, which is determined as gross income from economic activities less allowable deductions at a flat rate of 22%.

Deductible expenses

The Tax Code allows some expenses incurred in the course of economic activities to be deducted from gross income earned from such activities. Expenses not connected with income earning activity, as well as personal and entertainment expenses are not deductible (unless entertainment is considered to be the taxpayer's economic activity). Deductions are also not allowed for the acquisition of fixed or intangible assets, although such assets may be depreciated.

The Tax Code also provides rules and limitations relating to specific deductions. Some specific allowable deductions are: interest payments subject to limitations, bad and doubtful debts, insurance reserve funds, scientific research & experimental-design works, depreciation of fixed and intangible assets subject to limitations, repair expenses subject to limitations, insurance payments, geological exploration and the extraction of natural resources.

Deductibility of interest expense

Any interest expense paid or incurred by the taxpayer in the course of its business activities is generally deductible. However, there are some interest deductibility limitations. An interest deduction cannot exceed the expense calculated using an interest rate of 125% of the inter-bank credit auction rate set forth by the National Bank of Azerbaijan.

Depreciation and amortization allowance

The Tax Code provides a group method for the depreciation of fixed and intangible assets. Annual depreciation rates per group of assets are as follows:

- Buildings, facilities, installations and structures — up to 7%;
- Machinery, equipment and calculation technology — up to 25%;
- Transportation means - up to 25%;
- Costs of geological exploration and preparation work for the production of natural resources — up to 25%;
- Intangible assets — for those with an undetermined period of use — up to 10%; for those with a determined period of use — at years on amounts pro-rata to the period of use;
- Other fixed assets — up to 20%.

Any amount paid or incurred for the acquisition, construction or improvement of assets for business use may not be deducted immediately, but should instead be capitalized and depreciated over time.

Land, art, buildings, facilities representing historical or architectural monuments, as well as other such assets may not be depreciated.

Deductibility of repair expenses

The amount of repair expenses deductible each year is limited to an amount defined as a certain percentage of the residual value of each group of fixed assets as of the previous year's end. Those rates are defined as follows:

- Buildings, facilities, installations and structures - 2% of the residual value;
- Machinery, equipment and calculation technology and transportation means — 5% of the residual value;
- Other fixed assets — 3% of the residual value.

Any amount in excess of these limits should increase the value of the corresponding category of fixed assets by adding said amount to the residual value at the end of the current year.

In the event that repair expenses are less than the amount established by this limit, the actual amount of the repair expenses is deductible from income. In that case, the maximum value of deductible repair expenses for the following tax year is increased by the difference between the amount of actual repair costs and amount calculated by the established limit.

Net operating loss carry-forward

The Tax Code provides the opportunity to taxpayers for net operating loss carry-forward. Losses can be carried forward to the next five years and offset against profits of other years without limitation.

Tax accounting rules

Taxpayers are required to maintain accurate and current records of their income and expenses in accordance with the rules provided in the Tax Code of Azerbaijan. A taxpayer may record income and expenses under the cash or accrual method of accounting. However, a taxpayer must be consistent in using the same method throughout the tax year. Pursuant to the Tax Code, the tax year is a calendar year.

Cash method

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

Accrual method

Contrary to the cash method, the general rule under the accrual method of accounting requires a taxpayer to record income when it is earned, regardless of when it is actually received. Expenses are recorded when incurred rather than when the expense is paid.

Tax payment and reporting

Companies are required to make quarterly advance profit tax payments calculated either as 25% of the last year's tax liability or by multiplying their income in the current quarter by a weighted tax coefficient of the gross income for the previous year. Please see the formula below that explains this calculation in more detail:

A – last year's profit tax

B – last year's gross income

C – current quarter's gross income

Advance profit tax = $C \times (A/B)$

The annual profit tax return is due no later than 31 March following the reporting year.

3. Taxation of non-residents of Azerbaijan

Tax jurisdiction over non-residents

A non-resident enterprise operating in Azerbaijan through its permanent establishment pays tax on its profit, i.e. on gross income generated from Azerbaijani sources in relationship with the permanent establishment, less the amount of expenses incurred with respect to such income as per the Tax Code. The tax rate is a flat rate of 22%.

The gross income of a non-resident enterprise not connected with the permanent establishment is taxed at the source of payment without expenses being deducted.

A non-resident enterprise generating income through the supply of property not connected with the permanent establishment pays tax on said gross income received from an Azerbaijani source during a calendar year. The tax is paid after the deduction of expenses relating to income generation.

Permanent establishment

According to the Azerbaijani 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 90 cumulative days or more within a 12-month period, including the activities of an authorized representative.

The Tax Code provides for the following equivalents to a permanent establishment: the place of management, subdivision, office, branch or agency, construction and repair sites, installation and assembly facilities, as well as any supervisory activities associated therewith; platforms, sites, drilling equipment or vessels used for the exploration and production of natural resources, as well as any supervisory activities associated therewith; any fixed base (location) where a non-resident individual carries out entrepreneurial activity; premises used for the provision of consulting services; any places of employment in which other types of entrepreneurial activity are conducted in the territory of Azerbaijan; the location of persons executing the functions of the permanent establishment for non-resident enterprises or a non-resident individual in Azerbaijan, people acting on their behalf or authorized to make agreements on their behalf and usually conducting such responsibilities; places of goods' manufacturing and sale, and of the execution 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 the non-resident enterprise; keep a stock of goods or products owned by the non-resident enterprise only for the purpose of their eventual processing and subsequent export from Azerbaijan by a third party; for the purchase of goods or manufacturing of products by non-resident enterprise for its own needs; or for the implementation by non-resident enterprise of any preparatory or support activity for its own needs.

Azerbaijan source income

For the purpose of withholding tax, the following income types are treated as received from Azerbaijani sources:

- Interest income;
- Dividends income;
- Royalty income;
- Rent income;
- Insurance income;
- Other income — some other types of income.

Withholding tax rates

Unless otherwise specified in effective double tax treaties entered into between Azerbaijan and other countries, the following withholding tax rates normally apply to the following items of income from Azerbaijani sources payable to non-residents, provided that such income is not attributable to a non-resident's permanent establishment in Azerbaijan.

Income from Azerbaijani sources	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 Azerbaijani sources	10%

4. Tax exemptions

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

5. Taxation of cross-border transactions

Outbound transactions

Since resident entities are taxable on their worldwide income in Azerbaijan and may also be taxable by foreign countries on their income derived from sources or from carrying out business in such countries, the same income is potentially subject to 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 credit may neither be offset against resident taxpayer's Azerbaijan tax liabilities on any domestic source income, nor can they be carried forward or backward.

Double tax treaty relief in Azerbaijan

Azerbaijan has agreed to double tax treaties with over 20 countries which generally follow the OECD Model Income Tax Convention.

The list of countries with which Azerbaijan have valid double tax treaties is given in the Appendix to this guide.

Azerbaijani tax legislation establishes the rules on 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. Taxpayers are not entitled to avail themselves of benefits granted by double tax treaties without first withholding and paying the tax to the Budget. However, according to the new rules on the implementation of double tax treaties if a non-resident submits a claim for the exemption of tax from or application of limited taxation with respect to the income derived from the sources in Azerbaijan, such as dividends, royalties and interests, received by a non-resident, then a non-resident may be entitled to the benefits in advance.

Claim for the refund of taxes withheld in Azerbaijan

In accordance with Azerbaijani tax legislation, after tax is withheld from payment to a non-resident, the said non-resident should submit a claim for the refund of taxes withheld from its Azerbaijani source income to the tax authorities based on an effective double tax treaty signed between Azerbaijan and that non-resident's home country and in the manner prescribed by the Azerbaijani tax legislation. Along with the claim form prepared in a due format and legalized by the appropriate tax authority of the non-resident's home country, the non-resident should submit in the case of dividend payments: the founding documents of the entity paying dividends and documents confirming the rate and amount of interest, copies of the documents confirming the quantity of shares owned by the non-resident and the date of acquisition of those shares. If the non-resident is not the actual author of the works or products, copies of the license, contract or other documents on the transfer of the rights, confirming the rights received from the actual author of the rights should be submitted.

The non-resident is to complete three copies of the form in Azerbaijani or in English along with a notarized translation and have them approved by the foreign country's competent tax authority where the non-resident is registered.

However, since Azerbaijan is a party to the Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents effective 31 March 2004, the only procedure necessary for the authentication of a foreign document is to receive an apostille seal from the respective authorities of the foreign state where such a document is issued, provided that the state is also a signatory to the Hague Convention.

All three copies of the claim form are submitted by the non-resident (or his authorized representative) to the tax authority in which the non-resident is registered, or in cases where the non-resident does not have a tax registration in Azerbaijan, to the tax authority in which the person paying income to the non-resident is registered.

Regulations on the implementation of double tax treaties between the Republic of Azerbaijan and other states prescribe the refund of overpaid tax amounts to the bank account of the non-resident within 45 days following the submission of the claim.

Value added tax

1. Concept of value added tax

The concept of VAT according to Azerbaijani tax legislation is similar to the principles used in most European countries. In accordance with Azerbaijani law, VAT payers are entitled to recover the amount of VAT paid on purchases (Input VAT) which exceeds the VAT received from their taxable supplies (Output VAT).

2. Payers of VAT

Any legal entity or individual carrying out entrepreneurial activities, whose taxable turnover exceeds AZN 22,500 within the previous three-month period, is required to register for VAT purposes.

The Tax Code also envisages voluntary registration for VAT purposes.

A taxpayer that has registered voluntarily and whose total taxable operation during the preceding 12 months did not exceed a volume equal to AZN 45,000 may apply for the cancellation of their registration at any time within one year after the last registration for VAT purposes, subject to some exceptions indicated in the Tax Code.

3. Objects of taxation

Under the Tax Code, the supply of goods (rendering of services) and import of goods are subject to VAT. Taxable transactions do not include services rendered or works fulfilled outside Azerbaijan.

4. VAT rate

The current rate of VAT is 18%.

5. VAT invoice

A VAT payer that carries out a taxable transaction is required to issue a tax invoice to the person who receives the goods or services. The taxpayer must draw up and issue to the purchaser of the goods (works or services) a tax invoice no later than 5 days after the delivery thereof.

6. VAT administration

Administration

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

Payment & reporting

Registered VAT payers should assess the amount of VAT to be remitted to the Budget by reducing its output VAT liability with input VAT credit.

Effective 1 January 2008, all input VAT must be paid through a VAT Deposit Account (VDA) which is comparable to an escrow bank account administered by the Government. The purpose of introducing VDA, according to official information, is to combat VAT fraud.

The new regulations require every VAT payer to have a VAT sub-account (VSA). A VSA is a part of a VDA.

In accordance with the new changes, only input VAT paid through a VDA is recoverable. The changes also suppose that only VAT payers who have signed a contract for filing tax returns electronically with the Ministry of Taxes are able to manage their VSA. VAT payers who are not signed up for e-filing are deprived of the ability to utilize the funds received at their VSA.

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

7. 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 the taxpayer's output VAT in a current month is automatically transferred to the next three months and should be offset with the VAT liability arising during that period.

The tax authorities have the right to offset VAT receivable from the Budget against liabilities with respect to other taxes, interest charges for late tax payment, financial sanctions and administrative penalties. Taxpayers are also entitled to request that the tax authorities transfer the repayable VAT to the balance of other tax liabilities.

If after the three month period the amount of input VAT is not fully offset, the remaining amount of VAT must be refunded to the taxpayer within 45 days upon submission of an application to the tax authorities. A daily interest rate of 0.1% is payable by the tax authorities if the amount of tax due to the taxpayer is not repaid within 45 days of the submission of a refund application. We are not aware of any taxpayers in Azerbaijan who have been compensated for a late tax refund in this way.

The right of a taxpayer to claim overpaid taxes is limited to five years from the date when the tax reporting period in question ended.

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

Property tax

1. Property tax of individuals

Payers of property tax are resident and non-resident individuals having in their personal ownership buildings and their parts, as well as water and air transport facilities.

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

- From the inventory value of the building in their ownership:
 - Tax is not levied if the value does not exceed AZN 5,000 (approximately USD 6,142). A rate of 0.1 % is levied from the amount exceeding the above non-taxable limit.
- For water and air transport facilities:
 - AZN 0.02 (approximately USD 0.02) per 1 cub. cm. of the water transport facility's engine;
 - AZN 0.02 (approximately USD 0.02) per 1 cub. cm. of the air transport facility's engine;
 - 1% of the market value for water and air transport facilities without engines.

2. Property tax of legal entities

In respect of legal persons, taxable objects include:

- The average annual residual value of fixed assets on the balance sheet of enterprises;
- For non-resident enterprises carrying out business activity through permanent representation in Azerbaijan, only the average annual residual value of fixed assets connected with permanent representation.

Enterprises pay tax at a rate of 1% of the average annual residual value of the fixed assets which is determined by summing up the residual value of the enterprise's property (except for vehicles) as of the beginning and the end of the reporting year and dividing the resulting sum by two.

Quarterly advance payments of property tax should be made equal to 20% of the last year's property tax no later than the 15th of the second month of each quarter. The annual property tax return should be submitted no later than 31 March following the end of the reporting year.

Personal income tax

1. Tax residency

Individuals who are present in Azerbaijan for more than 182 cumulative days in a calendar year, or those with a place of permanent residence, a center of vital interests, a habitual abode in Azerbaijan or have Azerbaijan citizenship are considered to be Azerbaijan tax resident.

2. Taxable income and exemptions

Azerbaijan residents are subject to income tax on taxable income defined as gross income received from all sources (both Azerbaijani and non-Azerbaijani) during the tax year, regardless of where the income was earned or paid, less allowable deductions. Non-residents are subject to Azerbaijan income tax only on income received from Azerbaijani sources.

The taxable base with respect to personal income tax is the taxable income determined as the difference between their gross income for the tax year and expenses (or deductions) stipulated by the Tax Code for this period.

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

3. Tax rates

Worldwide income of tax residents and income from Azerbaijani sources of non-residents are subject to the following marginal income tax rates:

Monthly Taxable Income	Tax Rates
Up to AZN 2,000	14%
Over AZN 2,000	AZN 280 + 35% of the amount exceeding AZN 2,000

* AZN 75 of salary below AZN 200 are not taxable

Annual Taxable Income	Tax Rates
Up to AZN 24,000	14%
Over AZN 24,000	AZN 3,360 + 35% of the amount exceeding AZN 24,000

* AZN 900 of annual salary below AZN 2,400 are not taxable

** US\$ 1 = AZN 0,814 as at 01.09.2008

4. Withholding personal income tax

Employees' employment income is subject to withholding by the employer at source. Taxes withheld are to be remitted by the employer to the Budget within 20 days of the following month.

5. Individuals filing

Residents and non-residents must complete and file their income tax returns no later than 31 March of the following tax year.

Social insurance

According to Azerbaijani law, social insurance contributions are paid by both Azerbaijani nationals and foreign individuals.

Employers are liable for the payment of social insurance contributions at a rate of 22% of the employee's gross salary and 3% of the employee's gross salary is deducted as the employee's portion of the social insurance contribution.

Employers are also responsible for filing quarterly reports to the social fund authorities regarding the social insurance contributions calculated and paid in respect of employees by the 20th of the month following the reporting quarter. Social insurance contributions are to be remitted to the State Social Protection Fund at the time of salary payment but after the 15th day of the month when social insurance liability arises.

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 3% to 26%. The tax is paid after the extraction of minerals and on a monthly basis by the 20th day of the month following the accounting month. The mining tax is deductible for profit tax purposes.

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.

Land tax

There is a land tax imposed on owners and users of land plots. The amount of tax depends on the use and location of the land. For instance, in Baku the tax rate for industrial lands is AZN 10 (approximately USD 12.28) per 100 square meters.

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

Land tax is paid semiannually in equal installments no later than 15 August and 15 November.

Excise tax

All individuals and legal entities producing excisable goods in the territory of 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 0.8 per liter of spirit or 12.5% of the sales price of cigarettes produced in Azerbaijan.

The import of passenger cars, leisure and sport yachts are subject to excise tax at different rates depending on the volume of their engines.

The export of excisable goods is subject to 0% tax.

Road tax

The road tax is paid by non-resident entities and individuals entering the territory of Azerbaijan as well as by owners and users of vehicles in the territory of Azerbaijan.

The tax payable by non-resident entities and individuals entering the territory of Azerbaijan is collected by the customs authorities at different rates depending on type of vehicle, distance driven in the territory of Azerbaijan and the length of time spent in Azerbaijan.

The tax applicable to owners and users of vehicles in the territory of the Republic of Azerbaijan is payable annually based on the following rates:

- For cars with an engine volume of less than 2,000 cm³ — AZN 0.01 for each cm³;
- For cars with an engine volume of more than 2,000 cm³ — AZN 20 plus AZN 0.02 for each cm³ exceeding 2,000 cm³;
- For buses and other vehicles — AZN 0.02 for each cm³ of engine volume.

Simplified tax

Individuals and legal entities involved in entrepreneurial activity and are not registered VAT payers have the right to register as taxpayers under a simplified tax regime. However, the following entities are not entitled to use a simplified tax regime:

- Producers of excise goods;
- Crediting and insurance entities, investment funds, professional security market participants;
- Non-governmental pension funds;
- Those obtaining income from leasing property or royalty;
- Those owning property with a residual value exceeding AZN 1,000,000 or approximately USD 1,228,501.

The simplified tax is calculated from the revenue obtained from the provision of goods, fulfillment of works, rendering of services and non-sale profits at the following rates:

- For Baku — 4 percent;
- For other regions — 2 percent.

Persons engaged in the construction of residential property, as well as the provision of transportation services (except for international transportation) are payers of the simplified tax. Rates for simplified tax payers providing transportation services can vary from AZN 1 to AZN 30.6 or more per month, depending on such factors as the number of seats, cars and tonnage.

The simplified tax for residential housing construction is calculated by multiplying the zonal rates established by the Cabinet of Ministers of the Republic of Azerbaijan to the amount of AZN 10 for each square meter of a building. The zonal rates vary from 0.5 to 5.0.

PSA taxation

Currently, there are more than 20 PSAs signed and ratified in Azerbaijan. Parties to PSAs are the Government of the Azerbaijan Republic, represented by the State Oil Company of the Azerbaijan Republic (SOCAR), and contractors represented by various well-known foreign oil & gas companies. The PSAs contain certain provisions governing taxation rules. In addition, detailed taxation procedures are set out in the tax protocols of the PSAs. The PSAs stipulate taxation rules for foreign subcontractors performing works or rendering services in connection with the PSAs.

Profit tax

Under the PSAs, contractor parties carrying out business in Azerbaijan in connection with petroleum operations should pay a profit tax. The profit tax rate is negotiated and varies from 25% to 32%.

Contractor parties should submit their financial statements and profit tax return (drawn up exclusively in US dollars) for each calendar year together with an appropriate report from an auditor to the tax authorities by the dates established in the PSAs.

VAT

Contractors and foreign subcontractors are exempt from VAT with a zero percent rate in connection with petroleum activities. This includes:

- Goods, works and services supplied to or by them;
- The export of petroleum;
- The import and acquisition of goods, works and services.

To confirm VAT exemption status, contractor parties and foreign subcontractors should obtain a VAT exemption certificate. Such a certificate is issued by the Ministry of Taxes.

It should be noted that a VAT exemption certificate is issued only to contractor parties and foreign subcontractors registered in Azerbaijan.

Withholding tax

In lieu of a profit tax, foreign subcontractors pay the withholding tax at rates varying from 5% to 8%, calculated from gross payments received in return for work or services performed in Azerbaijan. Under the PSAs, a foreign subcontractor is defined as a legal entity incorporated outside of Azerbaijan and directly or indirectly providing goods, works or services to the contractor party to the PSA.

Income tax must be withheld by any person making a payment to a foreign subcontractor and remitted to the Azerbaijani budget. This is the final profit tax liability of a foreign subcontractor.

Taxation of employees

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

1. Tax residency

Under the PSAs there are three tax residency rules:

- Normally, an expatriate employee of a foreign subcontractor who is present in Azerbaijan for ordinary business purposes becomes a tax resident if he or she spends more than 30 consecutive days in Azerbaijan 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 cumulative days in Azerbaijan in a calendar year are also treated as tax residents, and income earned after the 90th day becomes taxable;
- Rotating employees and foreign employees who have their primary place of employment in Azerbaijan qualify as tax residents if they spend more than 90 cumulative days in Azerbaijan in a calendar year and they are taxable from the first day of their presence in Azerbaijan.

2. Taxable income

Almost all income of foreign employees earned in Azerbaijan, including wages, salaries, bonuses, personal travel costs and educational costs of the expatriate's family members is considered as taxable income.

3. Tax rates

The rates of personal income tax are the same as the statutory rates set out above.

4. Personal income tax withholding

Each employer may withhold the personal income tax amount from payments made to local and foreign employees. Foreign employees are entitled to receive a tax receipt from the tax authorities for the amount of income tax paid.

5. Tax reporting

Employers are responsible for reporting to the Ministry of Taxes on all Azerbaijan personal income tax payments made by its local and foreign tax resident employees.

6. Social insurance

According to the amendments made to the Social Insurance Law, effective 1 January 2007, all foreign employees employed by companies engaged in hydrocarbon activities under the PSAs are exempt from mandatory social insurance.

Employers are required to pay social insurance contributions to the State Social Protection Fund at the rate of 22% of the local employees' gross income subject to mandatory social contributions. In addition, employers are liable to withhold social insurance contributions from an employee's income subject to mandatory social contributions at the rate of 3% and pay to the same fund.

7. Customs duties under PSA

The PSAs exempt all imports made in connection with the PSA from customs duties and VAT.

Contractor parties and foreign subcontractors may obtain an exemption certificate from import/export duties. Such a certificate is issued by the State Customs Committee of the Republic of Azerbaijan. It should be noted that a customs duties exemption certificate is issued only to contractor parties and foreign subcontractors registered in Azerbaijan.

A contractor party or a foreign subcontractor importing goods in relation to the PSA should submit copies of its VAT and customs duties exemption certificate to the customs authorities while importing goods or equipment in relation to the PSA.

MEP taxation

Profit tax

The profit tax is imposed on taxable profit of each MEP participant for a year relating to (MEP) project activities at a fixed rate of 27%.

MEP participants should submit their profit tax return for each calendar year (drawn up exclusively in US dollars) to the tax authorities no later than April 15 of the following calendar year.

Other taxes

Under the Host Government Agreement on BTC, no taxes are imposed on or withheld from payments to any contractor in connection with project activities or any other contractor in connection with MEP activities, and contractors do not have tax compliance or filing obligations in connection with MEP activities.

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

Foreign employees of MEP participants, contractors, family members of a foreign employee or contractor and MEP participant on behalf of any such foreign employee, contractor or family member are entitled to import into or export/re-export from Azerbaijan free of taxes and restrictions, whether in its own name or on its behalf, all goods, works, services or technology for its own use and personal consumption or for the use and personal consumption of such employees, contractors and family members; provided, however, all sales by these foreign employees within Azerbaijan of any such imported goods to any other person are taxable, and, in the case of the sale of automobiles, furniture and professional tools and instruments, will result in liability for a customs import tariff, in accordance with Azerbaijani laws.

Personal income tax of foreign employees is calculated only on income earned as a direct result of their employment in the Azerbaijani Republic and only if said employee has been in Azerbaijan for more than 182 days.

Customs duties

The import of goods is subject to customs duties at different rates and to VAT at 18%. Most imports are taxed at 15%. There is an exhaustive list approved by the Cabinet of Ministers on the rates of customs duties.

The VAT paid upon the importation of goods may be offset against the importer's output VAT.

The excess of input VAT may be reclaimed. A customs processing fee of 0.15% of the customs value of the goods is payable to the customs authorities. Generally, the legislation provides for the possibility of importing goods under a temporary import regime free of customs duties and VAT for one year. This term can be extended for a further year.

Appendix

Country of Recipient	Dividends	Interest	Royalties
Austria	5% -10%-15%	10%	5%-10%
Belarus	15%	10%	10%
Belgium	5-15%	10%	5-10%
Canada	10%-15%	10%	5%-10%
China	10%	10%	10%
Czech Republic	8%	10%	10%
Finland	5%-10%	10%	5%-10%
France	10%	10%	5%-10%
Georgia	10%	10%	10%
Germany	5-15%	10%	5%-10%
Kazakhstan	10%	10%	10%
Latvia	5%-10%	10%	5%-10%
Lithuania	5%-10%	10%	10%
Moldova	8%-15%	10%	10%
Norway	10%-15%	10%	10%
Poland	10%	10%	10%
Romania	5%-10%	8%	10%
Russia	10%	10%	10%
Tajikistan Republic	10%	10%	10%
Turkey	12%	10%	10%
Swiss Federal Council	5-15%	10%	5-10%
Ukraine	10%	10%	10%
UK	15%	10%	5%-10%
Uzbekistan	10%	10%	10%

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This publication was prepared by the professional staff of Deloitte, and is designed to give you reference material on the various tax and legislative issues. The legislative framework of Azerbaijan's tax system continues to transform itself. However, there are instances where unclear statutory language and explanatory instructions may allow more than one interpretation of the law. As a result, Deloitte accepts no responsibility for any errors this publication may contain, whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person that relies on it.

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