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Recent Developments in International Taxation

AZERBAIJAN

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Recent Highlights

This Report covers main tax amendments for the period of starting from May 2018 to May 2019.

In December 2019, more than 200 articles of the Azerbaijani Tax Code has been amended by the Parliament, which is a significant shift in the tax policy of the country. The amendments are effective from 1 January 2019 (hereinafter "Tax Amendments 2019").

As a general nature, the government has declared the directions of these changes as follows:¹

1. Support of business;
2. Prevention of tax evasion and shadow economy;
3. Expanding of tax base;
4. Improvement of tax administration;
5. Efficiency improvement of the current and future tax exemptions.

Corporate Profit Tax

Small businesses with annual income below 200 000 AZN were taxed at 4% (in Baku) and 2% rate (in peripheries) of their turnover in the form of simplified tax. The Tax Amendments 2019 abolished such differential rates between the capital city Baku and the regions reducing it to common 2%. In parallel, new law subjected taxpayers, who were previously paying simplified tax from their turnover, providing services to other taxpayers (businesses) to 20% corporate tax with qualification for exemptions.

The new major exemptions from the corporate tax are as follows:

- 75% of the profit of micro businesses;
- The profit of micro-businesses and small businesses which obtain official "Startup" Certificate enjoy exemption for 3 years;
- The profit of SME Cluster Company enjoys exemption for 7 years;
- The profit of SME (Small and Medium Enterprise) cluster participants which is received from SME Cluster Company and directed towards capital expenses enjoys exemption for 7 years;
- The profit of educational institutions, provided that such net profit is not distributed to the shareholder as a dividend;
- Social transfers under CSR policy of the company to scientific, educational, health and sports organizations, the criteria of which to be determined by the Cabinet of Ministers, not exceeding the amount of 10% of the annual net profit.

One of the main development regarding the deductible expenses is related to the loans received from abroad, i.e. non-residents. According to the new regulation, where the amount of loan received abroad exceeds the two-fold value of the net assets, interests calculated over the loan may only be deducted as an expense of the company for the maximum amount of two fold of the net asset value.

¹ <http://www.taxes.gov.az/VM2019/VM2019.pdf> (Ministry of Taxes, 2019 Tax Amendments: Questions and Answers, last access 07.03.2019)

Personal Income Tax

Before The Tax Amendments 2019, personal income was charged at 14 % rate for the income below 2 500 manat monthly (30 000 manat annually) and 25% for the income amount that exceeds 2 500 manat monthly (30 000 manat annually).

New law provides exemption for the personal income tax of employees working at private non-oil industry for 7 years, provided that their monthly income does not exceed 8 000 manat.

Moreover, The Law on Social Insurance has modified the mandatory social payment share between the employer and employee for the employees benefiting the above exemption. Where the monthly salary of the employee is below 200 manat, social insurance payment is distributed as 3% from the employee's salary and 22% to be paid by the employer on top of the salary. Where the monthly salary is above 200 manat, for the amount exceeding this figure the social insurance payment share would be 10% from the employee's salary and 15% to be paid by the employer on top of the salary.

Another important development is the elimination of 25% tax rate which was imposed on the non-entrepreneurship activity (non-business income) of physical individuals for the amount exceeding 30 000 manat annually. The Tax Amendments 2019 provide for 14% tax rate notwithstanding the amount of income. ²

Taxation of Share Transfer

Until the Tax Amendments 2019, the Tax Code and the interpretation thereof was ambiguous regarding the taxation of the share transfer at local legal entities.

The new law imposes corporate tax/income³ tax as the capital gains for the transferor (seller) of shares where net asset value of the shares is above the nominal (par) value of shares. Where the shares are transferred for the price exceeding the net asset value of shares, the difference between the actual transfer price and the nominal (par) value of the shares is taxable income. If the actual transfer price of shares is below the proportionate net asset value of shares, then the difference between the net asset value and the nominal (par) value of shares is the taxable income.

The transferor is entitled to 50% discount such taxes where it has owned the transferred shares for a minimum period of 3 years.

Such taxation is applicable to resident and non-resident owners of the shares conducting the share transfer.

Transfer Pricing

² Income from non-entrepreneurship activity (non-business income) includes income from interests, dividends, property rental fees, royalty and other income specified in sub-clause 99.3 of the Tax Code. Notwithstanding this clause, where some of these income is taxed at the source of payment by local resident companies, 10% rate is applied (e.g. for interests and dividends).

³ 20% corporate tax for legal entities and 14% income tax for physical individuals that own the transferred shares are imposed.

The transfer pricing clause and related regulations are effective from 2017 and were applicable to controlled transactions with the minimum value of 500 000 manat until the amendments. The Tax Amendments 2019 removed such threshold for the application of transfer pricing rules, only maintaining it for the filing purposes, i.e. a separate report on controlled transactions the total price of which exceeds 500 000 manat must be submitted.

The applicability of transfer pricing rules over the loans have been clarified. The legislator approved that the transfer pricing rules may be applied for the purposes of restricting the interest expenses deriving from the loans. By doing so, it was also made clear that general rule⁴ regarding the restriction of the interest expenses would not be applicable to controlled loan transactions for the purposes of transfer pricing.

Double Tax Treaty (“DTA”)

The Republic of Azerbaijan signed DTA with the Republic of Turkmenistan on 22 November 2018, which entered into force on 12 March 2019, with the effective date of 1 January 2020.

International Tax Cooperation

As being full member of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, Azerbaijan⁵ voluntarily committed to and exchanged first information in 2018.

⁴ According to sub-clause 110.1, for loans received from abroad or from related parties, the maximum interest rate as deductible expense should not exceed 125% of the inter-bank loan rate effective during the period of interests and published by the Central Bank of Azerbaijan for the identical currency and similar loan duration (for the purposes of this note, we call this provision as “general rule”).

⁵ As a developing country not hosting a financial center, Azerbaijan was not required to commit to exchange of information by a certain date, but committed and exchanged voluntarily. OECD Tax Transparency Progress Report 2018.

<http://www.oecd.org/tax/transparency/global-forum-annual-report-2018.pdf> (Last access 23.05.2019)