

# **International Bar Association Annual Conference 2022**

## **International Tax Developments**

### **Azerbaijan**

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## **Introduction**

In this short note, we introduce the latest and significant tax developments, with focus on international taxation matters in Azerbaijan.

Azerbaijan is continuing its speedy harmonisation of tax laws in line with the latest international developments and expanding international tax cooperation. Although certain base erosion and profit shifting (BEPS) related action plans and legislative developments were adopted in the previous years, in 2021 and 2022 further similar developments are observed.

On 12 March 2021, Azerbaijan signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) and has just formally joined the OECD/G20 Inclusive Framework on BEPS as associate member, which has been ratified by the Parliament in October 2022, pending presidential promulgation.

With Amendments to the Tax Code effective from 1 January 2022 (the 'Amendments'), a new set of amendments has been adopted and here we will cover only some of the main provisions, namely those related to international taxation.

## **Controlled foreign company**

Effective from 1 January 2022, the concept of Controlled Foreign Company (CFC) has been introduced into the Tax Code of Azerbaijan.

The profits of a non-resident enterprise, which is registered in jurisdictions with preferential tax regimes ('tax heavens'), would be subject to taxation in the following cases:

1. where an Azerbaijani tax resident independently or together with a resident or non-resident related party, directly or indirectly, has more than 50 per cent of the voting rights or shared capital in a foreign enterprise, enjoys a right to obtain more than 50 per cent of the profits of such foreign enterprise;
2. where the actual tax paid from the profits of a CFC is at least twice or more less than the corporate profit tax payable in Azerbaijan; and
3. where 30 per cent of profits of the CFC consists of the following income:
  - a) interest on financial assets;
  - b) royalties received from intellectual property;
  - c) income from the sale of shares and stock;
  - d) income from financial leasing;
  - e) income from insurance, banking and other financial operations; or
  - f) income from companies that receive profits from the sale of goods and services without creating any economic value.

The following income of CFC is not included in the taxable profit in Azerbaijan:

1. dividends received from a controlled foreign company;
2. the taxable profit of the CFC related to the resident company that forms part of its consolidated profit, where such resident company is a subsidiary of the CFC; and

3. income of a CFC received via its permanent establishment in Azerbaijan or from its subsidiary company incorporated in Azerbaijan, where such income is already taxed in Azerbaijan.

Moreover, in line with OECD recommendations, CFC rules provide for the prevention of double taxation in the form of tax credits.

In April 2022, Regulations on 'The Form and Procedure on the Reporting of CFC by the Individuals and Legal Entities' was approved by the Ministry of Economy. The reporting forms and list of documents to be attached to such forms are adopted by the said Regulations.

A penalty of AZN 2,000 is prescribed for the failure to provide a CFC Report in line with the requirements.

### **Low tax jurisdictions**

The Amendments specified further exemptions to the situations where additional withholding taxes (ten per cent) would not be applicable in the case of payments to the low law jurisdictions ('tax heavens').

Previously, such exemptions were applicable in the case of repayment of the principal debts and intermediary accounts of the banks. After the addendum to the Tax Code, in addition to these, in the following cases, no additional withholding tax would be deducted from the payments made to the low tax jurisdictions:

- where the payment is remitted to the bank account of the person who paid from the bank account in the low tax jurisdiction within one year;
- while individuals, who are not registered with the tax authority, buy e-commerce services;
- while payments are made by individuals not registered with the tax authority to low tax jurisdictions for the purchase of goods (works, services) for personal consumption;
- while making payments related to the acquisition of debt securities;
- payment of interest and dividend income on, respectively, investments in Azerbaijan and deposits placed with financial institutions in Azerbaijan;
- while payment of salary and pension to the residents of low tax jurisdictions; or
- while paying the fees and other charges to the state authorities, including payments related to obtaining permits and certificates.

Previously, registered taxpayers were required to withhold such additional tax while making payments. Now, the Amendments prescribe such burden on non-tax registered persons and require the payment institutions to deduct and pay such tax as their tax agent.

Additionally, the profits of resident taxpayer would include the income of the entities registered at low tax jurisdictions where, directly or indirectly, resident taxpayers own a minimum of 20 per cent of their shares or voting rights.

## **Permanent establishment**

Another element of the Amendments was related to the expansion of the permanent establishment.

It has been clarified that the client database and the organisation of work with the clients on behalf of the enterprise in Azerbaijan would amount to performing business functions of the company and, therefore, be qualified as a permanent establishment.

Moreover, a new clause has been added which specified that where a non-resident acts as a general contractor at site and contracts certain construction works to subcontractors, which are mutually related parties or where the general contractor supervises its operations, the period of works by the subcontractor shall be counted towards the period of operations of the general contractor. This clause is to be applied where the works of the subcontractor would exceed 30 days.

It must be noted that for the purposes of permanent establishment of a foreign enterprise in Azerbaijan, the general provision regarding the period of operations from a fixed place in Azerbaijan is determined as 90 days in 12 months.

## **Transfer pricing**

The controlled transactions falling under the provisions of transfer pricing regulations have been expanded to cover the transactions between Azerbaijani residents or permanent establishments of non-residents in Azerbaijan and non-residents, provided that:

1. transactions are related to the goods traded at international stock exchanges; and/or
2. the total income of a resident or establishment of a non-resident in Azerbaijan during the tax year is more than 30 million manats and the relative portion of transactions with a non-resident is more than 30 per cent of its total income (expenses).

A penalty of AZN 2,000 is imposed for the failure to provide transfer pricing documentation in line with the requirements.

## **Double Tax Treaty**

The Double Tax Treaty signed with Spain back in 2014 is finally applicable with effect from 1 January 2022.