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**LAW & CONSULTING**

# **2020 TAX AMENDMENTS**

*Azerbaijan*

*Baku*

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# Tax Code of Azerbaijan: Summary of 2020 Tax Amendments

## Introduction

Starting from the 1<sup>st</sup> of January 2020, further amendments to the Azerbaijani Tax Code enter into force (“Amendments” hereinafter).

The Amendments predominantly serve to prevent the tax avoidance, enhance the powers of tax authority in international tax matters, reduce tax compliance time and bring about further elucidation regarding tax liability.

For the ease of reading and avoidance of repetition, all statements below shall be assumed as part of the Amendments. The currently existing clauses will be expressly specified and noted as being “current” (which are un-amended and would be effective after the Amendments) or “previous” (which are amended or revoked) where the context requires clarification.



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## General Principles

- ✓ Exemptions fostering business and investment promotion shall be allowed for a defined term and not be of individualistic nature;
- ✓ Amendments to the Tax Code must enter into force from the following budget year, with the exception of modifications to comply with other legislative amendments;
- ✓ Upon the request of the taxpayer, the tax authority is assigned a duty to provide reconciliation report (act) on the taxes, mandatory state, and unemployment social payments that are recalculated, paid or paid in excess, as well as financial sanctions and administrative penalties within the period specified by the Law on Obtaining Information. Under the current Law on Obtaining Information which would apply to the said duty of the tax authority, information requests must be responded within 7 workdays, with additional 7 work days prolongation where necessary;
- ✓ The definition of “Large Taxpayer” is eliminated and updated clauses regarding the centralized registry of certain taxpayers are introduced. Under the Amendments, the following taxpayers are authorized to centralized tax registration:
  1. Natural monopolies;
  2. Special tax regime entities;
  3. Where one of the following criteria is met:
    - 3.1. The minimum average number of employees being 251 or more; or
    - 3.2. The average annual residual value of assets being 5 million manats or more.

## Tax Liability

- ✓ The previous text of the Tax Code specified 3 years as the statutory limitation period for the tax liability. In practice, this has caused certain interpretational challenge regarding, *inter alia*, the institution of criminal liability which may extend beyond 3 years, i.e. statutory limitation for tax evasion crime is 7 years as per the Code for Criminal Procedure. Under the Amendments, the limitation period for tax liability (except mandatory social payments, unemployment insurance, and mandatory medical insurance) is determined as 3 years, with the exception of tax audits conducted under the criminal proceedings. The liability period is 5 years where it stems from the income obtained abroad. This period shall cover the previous 3 years (5 years in case of foreign income) from the date

of the decision to conduct on-site (field) tax audit, notwithstanding the actual date of the decision on institution of liability as a result of such audit.

- ✓ The Current text specifies 5 years for the collection of the calculated taxes, penalties and financial sanctions, which implies enforcement via tax authority. The Amendments introduced a limitation period of 5 years for the enforcement of court judgment regarding tax liabilities.
- ✓ The penalty for lack of documentation shall be extended to cover the updated duty to issue e-bills, purchase acts and acts of acceptance where the e-bill is yet to be issued as prescribed by the Amendments (non-pre-order delivery of goods, delivery of goods to agents, to processing or safekeeping).
- ✓ The Amendments introduce an exception to the principle 'personal liability' of the taxpayer, i.e. the beneficiary of operations in the non-commodity transactions may be held liable. Under the Amendments, such beneficiary of operations in non-commodity transaction shall be understood as the actual owner of income stemming from the operations without the actual involvement of goods (non-commodity transaction): the actual owner of the legal entity or the supervisor (controller) of the taxpayer.
- ✓ Operative tax control power is extended to supervise the mandatory use of POS terminals and the refusal to accept cashless payments in premises using POS terminals. Correspondingly, such powers would entitle tax authorities to impose a penalty as in the case of operations without proper documentation or operations with procedural breaches as per Article 58.7;
- ✓ It is further clarified that the banks shall perform the payment instruction of taxpayers for the amounts above the suspended ("frozen") amount in the accounts.
- ✓ A resident of a multinational company would be imposed a penalty in the amount of 500 manats where it fails to provide a filing in the form and manner specified by a relevant public body as specified by the new article 16.1.4-2.
- ✓ The established sequence of tax payments, the order of "calculated taxes in accordance with due dates - calculated delay penalties and then - financial sanctions", shall be applied to social payments, mandatory unemployment insurance, and medical insurance payments.



## Tax Avoidance

- ✓ The Amendments introduced the notion of “Non-commodity transaction”, in a sense of artificial transaction, which means a transaction serving to conceal another transaction and obtain profit without actual delivery of goods, services, and works. The documents obtained via Non-commodity transactions in this manner do not qualify for deductible expense or VAT credit utilization purposes. The Amendments authorize tax authorities to go after the owner of the legal entity or the actual individual entrepreneur for tax liabilities in cases of Non-commodity transactions.
- ✓ The Amendments introduce “High-risk taxpayer” as another new term and defines it as a taxpayer meets the criteria prescribed by the relevant authority, including taxpayers that are involved in non-commodity transactions. The list of high-risk taxpayers shall be maintained and updated by a relevant tax authority, and such information shall not be considered as a tax secret.
- ✓ Where the taxpayer is considered as a high-risk taxpayer, the tax authority would be entitled to conduct extraordinary tax audit or operative tax-control measures.
- ✓ Tax authorities would be authorized to calculate taxes of high-risk taxpayers before due dates by adopting a decision.
- ✓ Where high-risk taxpayers apply for the refund of taxes paid in excess, the refund periods shall commence after the operative tax control measures, cameral or onsite tax audits are completed.

## Documentation Requirements

- ✓ Previously required electronic tax invoicing for VAT (*vergi hesab fakturası*) purposes is eliminated, and currently available electronic billing system (*elektron qaimə-faktura*) would be used for both billing (tax invoicing) and VAT purposes;
- ✓ E-billing system, which is used for deductible tax expense purposes is currently available, requires e-bills while the delivery of goods, services, and works. Under the Amendments, E-bills must be submitted to private entrepreneurs and legal entities while the delivery of goods or provision of services and works in the following periods:
  - a) Delivery of goods - while shipment of goods;
  - b) Delivery of goods not based on pre-order- within 5 days from the date of issuing document approving the acceptance of goods;
  - c) Provision of services and works – within 5 days from the date of provision of services or works;

- d) When the goods are returned or taxable turnover is corrected – within 3 days from such date of returning goods or correction.
- ✓ Submission of e-bills would be required not only while delivery of goods or provision of services and works but also in cases of return of the sold goods; correction of taxable turnover for VAT purposes; delivery of goods from the seller to the agent; delivery of goods from the agent to the buyer and return of goods back to the seller by the agent; submission of goods for processing and return of processed goods; in case of back-dated VAT registration for the purposes of payment and refund of VAT.
  - ✓ Where the goods are purchased from non-taxpayers, the buyer shall prepare the purchase act (*Alış aktı*) in hard-copy and electronic formats within 5 days from the day of purchase. Where the non-taxpayer seller signs the printed form of the electronic purchase act, the signing of the act prepared in hard-copy paper format would not be necessary.
  - ✓ The taxpayer, using cash register machines allowing electronic and real-time (live) access to the information system of tax authorities as per the established criteria, may set-off the costs of such cash register machine against future taxes within the limits to be defined. This article shall be applicable to taxpayers replacing cash register machines which were in use until 1 January 2019 with the new ones meeting the set criteria;
  - ✓ Notwithstanding any other clause of the Tax Code, incorrectly paid taxes and mandatory social payments (including unemployment and mandatory medical insurances) due to errors in the requisites or banking operations shall be repaid back to the taxpayer within respectively 20 and 45 days in accordance with the established procedures.
  - ✓ The Amendments expand the list of information which do not qualify for tax secret with the followings:
    - Information about the VAT registration status of the taxpayer;
    - Information about the suspension of business operations or other taxable operations of the taxpayer;
    - Information about the high-risk taxpayer status of the taxpayer.
  - ✓ The search and seizure powers of tax authorities have been expanded to cover any tax control measure. Before the Amendments, as a rule, this power could only be exercised while the onsite tax audit. The duty to involve observers during such procedure was replaced with the duty to record photo and video shootings.

## Tax Exemptions and Deductible Expenses

- ✓ The taxpayer shall keep accounting for tax-exempted operations, non-commercial operations and ordinary commercial operations which are subject to taxes separately, i.e. profits and expenses shall be recorded separately for each such direction. In case of non-distributable expense, where it is impossible to attribute an expense entirely and specifically to one of these operation directions, such shared expense shall be deemed as tax-deductible with the special weight basing on the proportion of taxable profit to the general profit of the taxpayer.
- ✓ Land restoration expenses are capitalized and depreciated with the annual up to 7% rate.
- ✓ The income of non-residents, without a permanent establishment in Azerbaijan, from the lease and rental of aircraft and its engines shall be exempted from 14% withholding taxes, VAT and not subject to taxation. This exemption would not apply to financial lease arrangements.
- ✓ Tax exemption at industrial and technological parks is extended to 10 years from 7 years for the purposes of income tax, corporate profit tax, VAT, property tax and land tax.
- ✓ The VAT exemption for the sale of poultry is extended for a further 4 years, as well as, this exemption would be applied to the sale of meat. This exemption shall not apply to processed meat and poultry goods.
- ✓ The turnover part of the living and commercial spaces transferred to the government by construction developers.
- ✓ Delivery of goods, provision of services and works under an agreement with relevant body related to the Formula 1 and Formula 1 projects.
- ✓ Expenses deriving from non-commodity transactions shall not be considered as tax-deductible, and these shall be subject to tax measures as per market price and related information clauses.
- ✓ Consumers would be entitled to a 30% partial refund of VAT (i.e. 5.4%) paid while the purchase of living and commercial spaces from construction developer companies.
- ✓ Exemption from paying property taxes shall not be applied to micro-businesses owning assets with a residual value of a minimum of 1 million manat at the start of the year.
- ✓ Part of the living spaces up to 30 square meters are exempt from simplified tax while the sale by the individual persons.



## VAT

- ✓ The accrual method is replaced with the cash method for the purposes of calculation and payment of VAT. Hence, the taxable period would be the actual date of payment for the received goods, services and works.
- ✓ For VAT purposes, payment shall be deemed as made in the following dates:
  - The actual cash receipt date when made in cash; the date when the funds are available in the bank account of the receiver when made in cashless;
  - The date of termination of the duty to pay in cases of set-off;
  - The expiry date of the statutory limitation period for the unpaid receivables;
  - The actual receipt date of assets when paid in kind or via barter;
  - The actual date of receipt in cases of gratuitous transactions;
  - The date of such assignment when claims are assigned to third parties;
  - The date of inventory loss, deterioration, spoilage, delivery for non-commercial purposes, theft or write off without full depreciation;
  - A day before the tax deregistration takes effect;
  - When the debtor (buyer) of the purchased goods, services or works issues a loan to the taxpayer (seller) the payment shall be deemed made for VAT purposes as follows:
    - a) Where the loan is issued before the purchase of goods, services or works: the date of delivery of goods, services or works; or
    - b) Where the loan is issued after the purchase of goods, services or works: the date of loan transfer to the taxpayer (buyer).
- ✓ Where the payment for the goods, services or works is made in several installments, for the purposes of VAT each installment is considered as a separate payment, therefore, VAT shall be calculated and paid for each installment.
- ✓ Tax invoicing is repealed and replaced with an e-bill system for the purposes of VAT: elements of previously applied tax invoice would be reflected in the e-bill.
- ✓ No e-bill would be issued for advance payments. Advance payments shall be considered as VAT taxable payments.
- ✓ Until the Amendments, the agent (commercial representative) was not allowed to issue a tax invoice to the buyer (customers) for VAT purposes; however, the Amendments enable the agent, which has VAT registration, to issue e-bill to the buyer (customer) for VAT purposes and obtain VAT credit. Where the agent is not registered for VAT purposes, and where the buyer (customer) directly pays

the main amount to the seller via the cashless method and the VAT to the seller's VAT deposit amount, the buyer may obtain VAT credit for such payment on the base of e-bill issued by the agent.

- ✓ Input VAT would be credited against output VAT obligations where the main amount is paid to the bank account and the VAT to the VAT deposit account of the seller, provided that the VAT credit may be utilized only when it is paid in a proportionate amount.
- ✓ Documentation of non-commodity transactions or high-risk transactions shall not be considered valid for the purposes of VAT credit utilization.

### **Simplified Tax**

- ✓ Only individual persons would be subject to simplified tax while selling living and commercial spaces. Until the Amendments, the previous text specified "the persons" as taxpayers of such simplified tax which implied both individual persons, legal entities, branches and permanent establishments of non-residents. The previously available exemption to individuals with a minimum of 5 years of registration at the sold place of living is reduced to 3 years. Moreover, part of the living spaces up to 30 square meters are exempt from taxation.
- ✓ The right of the construction developer companies to pay simplified tax (as an alternative for paying VAT and corporate profit tax) for the construction of buildings is eliminated.
- ✓ Where retail industry taxpayers engage in wholesales, they shall not be entitled to register as a simplified taxpayer if the quarterly income that must be based on e-bills (i.e. billed to legal entities or individual entrepreneurs) exceeds 30% of the total revenue (excluding non-operating income).
- ✓ The taxpayer, providing services to people who are not registered as taxpayer, has provided services to legal entities and individual entrepreneurs shall not be entitled to register as simplified taxpayer if the quarterly income that must be based on e-bills (i.e. billed to legal entities or individual entrepreneurs) exceeds 30% of the total revenue (excluding non-operating income).

## **Excise Tax**

- ✓ The vast majority of excise tax duties are significantly increased, e.g. drinkable alcohol, vodka, liquor the rate of 2 manats per liter is increased to 3.2 manats, 20 manats for 1000 tobacco products and its alternatives is increased to 31 manats.

## **International Taxation**

- ✓ Where the minimum total revenue of a multinational group of companies exceeds 750 million EUR, a local resident of this group shall file a report in the prescribed form and time to the tax authorities for the purposes of implementing the treaties on automatic exchange of information. Such a figure shall be obtained from the financial statements of the multinational group of companies. The failure to file this report shall be punished in the amount of 500 manats.
- ✓ The ordinary tax liability of 3 years (i.e. limitation period) is extended to 5 years with regard to income obtained abroad basing on the information submitted by foreign tax authorities.

## **Transitional Provisions**

- ✓ VAT credits shall be utilized in accordance with previous rules for the goods, services, and works purchased until 1 January 2020.
- ✓ Simplified taxpayers, who started construction-development works until 1 January 2020, shall follow previous rules and not be subject to VAT or profit tax for the sale of living and non-living spaces of such projects after 1 January 2020.
- ✓ Companies that started construction-development works after 1 December 2019 shall notify the tax authority about the selection of the tax method in the prescribed form until 1 January 2020. Where the taxpayer fails to comply with this requirement, the Amendments would be applicable.
- ✓ Taxpayers registered for VAT purposes until 1 January 2020 shall provide the tax authority with the information about its unpaid receivables as of 1 January 2020 in the prescribed form until 31 January 2020.



## Profile

Caspian Legal Center is a Baku-based full-service Azerbaijani law and tax consultancy firm. We mainly specialize in commercial and company law matters, as well as wide-range legal support and consulting to businesses regarding the establishment and operation of commercial entities in Azerbaijan.

As a one-stop-shop consulting company, we provide [corporate law services and business-set ups](#), [immigration consultancy](#), [employment law services](#), [intellectual property services](#), [law and tax services related to oil-gas industry](#), [contract drafting and negotiations](#), [construction law support](#), [tax and accounting services in Azerbaijan](#), [dispute resolution and litigation services \(including debt recovery\)](#), consultancy legal services in [real estate and purchase of property in Azerbaijan](#).

We also provide legal advice and representation services to foreign individuals regarding family relations, employment, immigration, inheritance, recognition and enforcement of foreign judicial judgments in the Republic of Azerbaijan.

Apart from specializations, we provide full and general legal services in Azerbaijan, law consultancy, tax consultancy and advisory, immigration services and accounting services for businesses.

The majority of our clients are multinational companies, operating in Azerbaijan or having business transactions with local companies, including FORTUNE Global 500 companies. We operate in diverse industries, including oil and gas, energy and natural resources, renewable energy, ICT, construction, hospitality and HORECA, industrial manufacturing, machinery, agriculture, food industry, education industry, services industry, import and export, wholesale and retail industry, as well as consult to public and government entities. Please contact us for updated company and clients profile documents.

## Experience

CLC law firm was established by lawyers and tax consultants with extended experience in practical business law in Azerbaijan. Our team has a western legal education and are skilled in international standards and international law aspects of business operations. We are fluent in English, Russian, Azerbaijani and Turkish languages.

Strong knowledge of local legislation, case-law and court practice, and approach of government institutions, involvement in the business-friendly legislative reform initiative and representing businesses before state authorities have been a key aspect of our experience. Our team members have previously worked and provided services for several local holding groups, plants, import/export businesses, construction companies, banks (including the Central Bank of the Republic of Azerbaijan), ministries (Ministry of Economy, Ministry of Taxes, Ministry of Foreign Affairs) and law firms.

CLC advisers and attorneys are well experienced in contract negotiation (representing and accompanying client), drafting, analysis of multi-million contracts, including FIDIC contracts, and dispute resolution and debt recovery cases.

CLC intensively follows legal reforms and business incentives and advises clients on relevant opportunities, including tax and duty exemptions, free zones and other business promotional incentives. Our Legal Practice has been ranked by IFLR 1000 as Recommended Law firm for 2020, alongside with other international awards and listings of western diplomatic bodies in Baku.

CLC Tax Practice is ranked by World Tax 2020 as the only reviewed consultancy company from Azerbaijan. Moreover, our Managing Partner, Mr Farid Nabili has been appointed by the International Bar Association as Tax Reporter from Azerbaijan. We constantly update our clients about tax reforms and amendments ongoing in the country, as well as, proposing tax amendments in order to comply with the best international practices for improving the business environment in Azerbaijan.