



Azerbaijan Tax & Legal Update



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Tax Protocols to PSAs



New Tax Protocols to Azeri, Chirag and Guneshli PSA

- New tax protocols for the Azeri-Chirag-Gunashli PSA became effective from 1 April 2010
- The Protocols introduced new templates of tax returns which have been prepared in accordance with statutory tax returns
- VAT Protocol – VAT exemption certificates issued to sub-contractors will be valid for the term of the sub-contractor's contract not exceeding a year (three years previously)
- Protocol Concerning Taxation of Foreign Employees – reimbursable expenses include not only travel and accommodation expenses, but also all other expenses that are not part of the main profit generating business activity

New Tax Protocols to Azeri, Chirag and Guneshli PSA

Protocol Concerning Taxation of Employees and Physical Persons

Definition for a “permanent employee” was introduced:

- A person working under employment agreement with an employer or its representative in Azerbaijan in appropriate working place permanently located in Azerbaijan and earning income from this employment;
- He/she becomes a resident after the 90th day of presence in Azerbaijan within a calendar year;
- A permanent employee is liable for Azerbaijan PIT on all income earned as a result of his or her employment in Azerbaijan during the calendar year, including income earned during the ninety days of employment before becoming a tax resident;
- Employers are required to provide the tax authorities with summary of PIT payments for resident foreign employees together with IV Quarter report not later than 20th of January (1 February in the old protocol)

Protocol on Import Export Duties and Taxes

- On 14 February 2011, BP and the State Customs Committee signed new Protocol on Import-Export Duties and Taxes for Azeri, Chirag and Guneshli PSA
- Parties also signed Protocols on Import-Export for Shah Deniz PSA, BTC and South Caucasus Pipeline HGAs

Absheron PSA and Tax Protocols

Taxation of foreign subcontractors under the Absheron PSA

- WHT rate for income from provision of works and services – 5.5%
- WHT rate on mark-up on supply of goods – 22%
- Otherwise – 5.5% WHT on total income from supply of goods
- Tax returns and financial statements must be audited by the internationally recognized accounting firm, although the tax authorities do not enforce this requirement

Import & Export protocol

- Only direct subcontractors can receive Import and Export Exemption Certificate
- Import and Export Exemption Certificate issued to the operating company and contractor parties for five years and to subcontractors for one year or the terms of its contract
- Contractors and operating company must give preference to local suppliers even if the price is higher up to 10% in comparison with foreign suppliers

VAT protocol

- VAT Exemption Certificate issued to the operating company and contractor parties for the term of the PSA and to subcontractors for one year maximum with right to renewal

Tax Protocols to Inam, Binagadi and Bahar PSAs

Protocol Concerning Taxation of Foreign Subcontractors to Inam PSA

- Profit Tax – beginning from the commencement of development and production, or
- 8% WHT for income from supply of services and mark-up on supply of goods if duration of the contract is up to six months or the value of the contract is less than USD 100,000

Protocol Concerning Taxation of Employees

- Provides for framework for taxation of employees and reporting

Protocol Concerning Import – Export Duties and Taxes to Bahar PSA

- Only direct subcontractors can receive Import and Export Exemption Certificate
- Contractors and operating company must give preference to local suppliers even if the price is higher up to 10% in comparison with foreign suppliers

Important changes in the legislation

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Tax Appeal Council

- By the Order of the Minister of Taxes dated 27 September 2010 the Appeal Council for proceeding appeals from lower tax bodies was established
- The Appeal Council has made several decisions in favour of taxpayers

Listing of Taxpayers

- The Ministry of Taxes began to make a listing of the taxpayers for the purposes of accuracy in the registry of taxpayers

Unified body for state registration of companies

- On 25 January 2011, the Division for Registration of Commercial Legal Entities of the Baku City Department was appointed as unified body for registration of companies of all commercial entities with foreign investments, financial-industrial groups, banks, investment funds, insurance and audit organizations across the country

Important changes in the legislation

Mandatory disability insurance for employment injuries and occupational diseases

- The Law “On mandatory disability insurance for employment injuries and occupational diseases” adopted on 11 May 2010 came into force on 3 July 2010
- The Law covers all employees including expatriates (except expatriates listed in the Law on Social Insurance as exempted from social insurance contributions), individuals working based on service agreements, individuals engaged in entrepreneurial activity, etc.

Insurance tariffs

- Depending on the type of economic activity, tariffs range from 0.4% to 2% for the “workers” category, and from 0.2% to 0.5% for the “servants” category

Insurance premium

- Insurance premium is calculated by multiplying the annual salary fund of a particular employee by the above mentioned tariff

Licensed insurers

- Limited number of licensed insurers

Important changes in the legislation

Control over state authorities' audits

- Decree of the President “On some measures to regulate inspections in the field of entrepreneurship and ensure protection of consumers' rights” dated 13 April 2010 # 246 provides for establishment of single register of inspections/audits of businesses

Changes at customs

- Decree of the President of Azerbaijan of 25 February 2011 #388 requires creation of one-stop shop for customs processing, payment of customs duties via bank transfer or by use of plastic cards and creation of electronic management system

Application of indirect profit calculation method

- Decree of the Cabinet of Ministers dated 1 March 2001 # 55 providing rules for calculation of conditional profits of taxpayers by using indirect method amended to include calculation of profit from gambling business

IFRS Transition

- Rules adopted by the Decree of the Cabinet of Ministers dated 27 May 2010 # 97 on presentation, reporting period and publication of annual financial statements require commercial organizations to submit annual financial statements and consolidated financial statements to their parent companies or founders not later than 30th of April and 30th of June (respectively) of the following year

Important changes in the legislation

Penalty for avoiding audit

- The Law on Amendments and Changes to the Law “On Audit” and the Code of Administrative Violations that came into force on 15 April 2011 sets a penalty from AZN 1,500 to AZN 2,500 for legal entities for failure to comply with mandatory audit requirements

New law on investment funds

- Mutual Investment funds and joint stock investment funds are recognized
- Mutual investment fund is not subject to profit tax since it is not a legal entity
- VAT exemption applies for management of investment funds
- However, no clear legal framework exists for taxation of investment funds

Import VAT and duty exemption

- Certain agricultural products and equipments are exempt from import duties and VAT in accordance with the Decrees of the Cabinet of Ministers # 91 and # 11
- These exemptions are valid until 2014

Important changes in the legislation

Registration of government-funded projects

- Presidential Decree dated 24 November 2010 # 358 requires submission of contracts for government-funded projects with > AZN 50,000 value to the Ministry of Taxes

E-audit

- The Ministry of Taxes in collaboration with the Government of the Kingdom of the Netherlands prepares e-audit system
- E-audit will facilitate tax audit process and ensure fast and cost efficient tax audits

The Constitutional Court decisions

- The Constitutional Court decision of 2 December 2010 ruled that the penalty set by Article 53.8 of the Code of Administrative Offences varying from AZN 30,000 up to AZN 35,000 for failure to obtain a work permit for a foreign employee is not compatible with the Constitution and recommended the Parliament to revise the rate of the penalty
- The Constitutional Court decision of 12 January 2011 provides that taxes, interests, and financial sanction not collected within five years after a reporting deadline must be written off

Trends in tax audits

Trends in tax audits

Arbitrary tax assessments on FSC

- Assessment of additional personal income tax in case when bank statements are not provided by a taxpayer
- The tax authorities scrutinize profitability of foreign subcontractors and expect extensive accounting records despite simplified withholding tax on turnover

Taxation of Head Office funding

- The tax authorities have attempted to tax funding coming from the Head Office to local PE
- The authorities consider a PE provides a deemed representation services to the Head Office

Capital gains taxation

- In case of disposal of shares in an Azerbaijani resident subsidiary by non-resident to another non-resident, the tax authorities attempted to impose tax on the subsidiary

Challenges in taxation of EPC contracts

- Serious challenges are faced in determining onshore and offshore service fees
- Absence of rules for attribution of profits between local PE and Head Office
- The tax authorities regularly attempt taxing offshore supply of goods

Trends in tax audits

Tax assessment for incorrectly issued tax receipts

- Filing adjusted tax reports with lower PIT liability following issuance of tax receipts for greater amounts may trigger tax liability for the amount of the difference, although illegal

New Double Tax Treaties and Practical Issues



New Double Tax Treaties and Practical Issues

1994-2011 – 40 DTT are signed and 37 of them are effective

Negotiations – Malta, Spain, Morocco, Macedonia, Kyrgyzstan, Turkmenistan and etc.

Major DTTs – Netherlands, Luxembourg, Switzerland, UAE, UK, etc.

Recent trends

- More favourable provisions in the DTTs signed or negotiated in recent years
- More opportunities for making efficient inbound and outbound tax structures
- Exemptions for certain interest payments
- Reduced rates for royalty payments
- Exemption for capital gains

Withholding tax rates under some DTTs

Types of Income	Netherlands	Luxembourg	Switzerland	UK	UAE
Dividend	5-10%	5-10%	5-15%	10-15%	5-10%
Royalties	5-10%	5-10%	5-10%	5-10%	5-10%
Interest	10%	10%	5-10%	10%	7%

New Double Tax Treaties and Practical Issues

Application of DTTs to PSAs:

- PSAs contain provisions on application of DTTs
- In case of absence of DTT, provisions of the OECD Model Convention must apply
- DTTs may provide tax exemption for short-term operations
- However, in practice the application of DTTs to PSA operations has not been tested

Deductibility of overhead expenses

- Any expenses wherever incurred for a PE should be considered by the source state
- Deduction must be allowed if national legislation recognizes deductibility of expenses
- Overheads must be supported by primary documents
- Statement issued by the Head Office's auditor is no longer sufficient
- However, deducting overhead expenses is problematic and challenged by the tax authorities

Branch remittance tax

- DTTs prohibit taxation of profits repatriated by a PE to the Head office
- The tax authorities are reluctant to apply this provision of the DTT

Special offshore activities provision in the DTTs

- Several DTTs provide for offshore activities provisions
- These provisions restrict application of DTTs to offshore activities

Anticipated changes in the Tax Code

Anticipated changes in the Tax Code

E-payments

- Presidential Decree dated 24 November 2010 # 358 charges the Ministry of taxes and Central Bank to develop the legislation designed to restrict cash and stimulate bank transactions

Switch to cash basis for VAT calculation

- One of the possible changes in the Tax Code is a change to cash basis for calculation of VAT liability

Differentiated VAT rates

- Possibly there will be differentiated VAT rates for Baku and the province

Push to reduce PIT and SIC rates

- Increasing calls to reduce uncompetitive rates of PIT and SIC

Draft Customs Code

Draft Customs Code

- The Draft Customs Code is expected to be effective from 1 July 2011

Customs audit

- The Draft Code provides grounds for the customs authorities to audit taxpayers – potential issues for PSA engaged entities
- General and special audits are differentiated

Authorised Economic Operators

- To ensure security and efficiency in supply chain, persons can apply to become the AEO in accordance with the rules and standards of International Customs Organisation
- Simplified procedure is applied for AEO
- AEO can submit simplified customs declarations

E-Governance

- Substantial provisions are devoted to establishment of a unified information system of the customs authorities
- Access to the information system, use and confidentiality of the information are provided

Draft Customs Code

Customs Regimes

- Free Turnover, Re-export, Transit, Storage, Free Zone, Special Use, Processing, etc.

Rights of customs authorities

- Conduct primary criminal investigation, suspend a crime suspect

Liaison with Customs

- Customs Representative, Customs Broker, Customs Carrier

Latest changes to visa rules



Simplified procedures for tourist visa application

- Introduced by the amendments of 8 April 2011 to the law on “Law on Coming to the Country, Leaving the Country and Passports” and become effective from 1 June 2011
- Tourists are eligible for 30 days single entry visa upon provision of necessary documents to the Embassies or Consulates of Azerbaijan in their country of residency or third countries
- Personal attendance is not required for visa application
- Expatriates may apply for tourist visa either personally or through their representatives, through the travel agencies by online applications or by sending the required documents via postal service;
- Online application forms supplemented by scanned copies of the required documents are electronically submitted to the embassies and consulates of Azerbaijan
- Electronic visas are not sealed to the passport and contain specific bar code for identification during the border clearance
- The amendments set 15 days period for processing the visa application



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