

## **Business outlook in Azerbaijan**

Third issue

Deloitte CIS Research Centre  
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# Introduction



**Nuran Kerimov**  
**Managing Partner**  
Deloitte Azerbaijan

We are pleased to present the third edition of Business Outlook in Azerbaijan, the Deloitte Research Centre's macroeconomic journal.

We focus on the current trends in Azerbaijan economy and present our key research findings.

The current issue is focused on Azerbaijan's taxation system. In September 2018, Deloitte conducted a survey of top management of leading Azerbaijani companies. This allowed us to identify priority areas of the taxation system in need of improvement, to assess the business community's perception of the tax environment and to suggest measures required to increase the transparency level.

If you have any questions or suggestions regarding this research, please do not hesitate to contact us at: [cisresearchteam@deloitte.ru](mailto:cisresearchteam@deloitte.ru)

# 01 Azerbaijan in figures





## Key macroeconomic indicators

### Gross domestic product (GDP)



Source: UN statistics, State Statistical Committee of the Republic of Azerbaijan

\*Forecast: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

### Azerbaijan's Credit Rating

Agency	Rating	Forecast	Date
Moody's	Ba2	Stable	18 August 2017
S&P	BB+	Stable	26 January 2018
Fitch	BB+	Stable	27 July 2018

### Brent oil price forecast, USD/barrel

	2018	2019	2020	2021	2022
EIU	73.2	72.3	70.0	74.8	77.4
IMF	71.9	72.3	69.4	66.8	65.0
ECB	71.5	71.7	69.0	-	-

### Natural gas price forecast, USD/mmbtu

	2018	2019	2020	2021	2022
EIU	3.0	3.2	3.6	-	-
IMF	2.9	2.8	2.7	2.6	2.6
WB	3.0	3.1	3.2	3.2	3.3

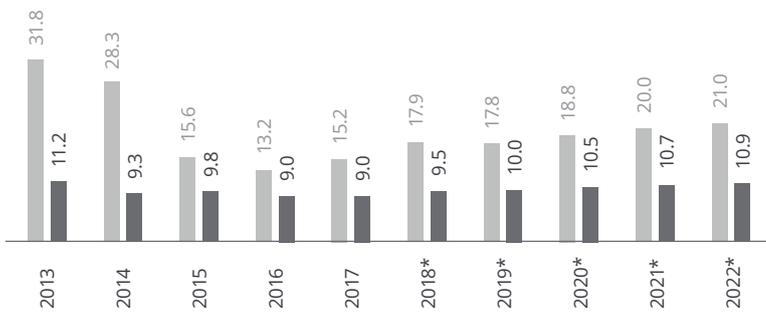
*"For Azerbaijan non-oil economy, the expectation is that if structural reforms are fully implemented, GDP growth may steadily improve and reach 3% in the medium term. With the launch of the TANAP gas pipeline, real GDP growth rates may be higher. We also assume that oil prices will remain relatively high in the short term, which will ensure current account surplus balance of payments."*

**Mohammed El Qorchi, Mission Chief,  
IMF office in the Republic of Azerbaijan**



## Key macroeconomic indicators

### Foreign trade, USD bln



Source: EIU

■ Exports of goods

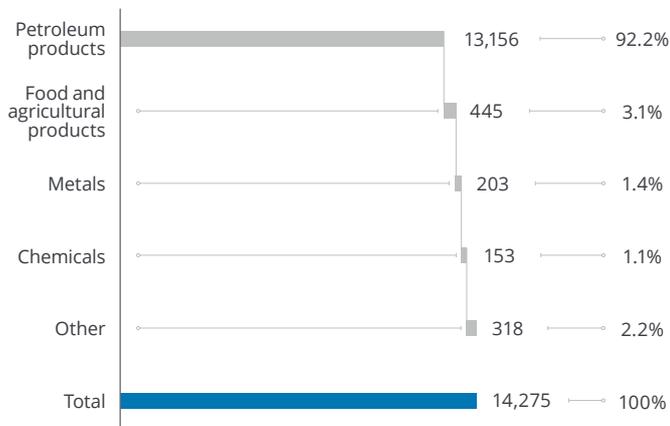
\*Forecast

■ Imports of goods

In the forecast period (2018–2022), the value of exports is expected to be almost twice as high as that of imports. That will provide a solid positive trade balance and support Azerbaijan’s financial stability.

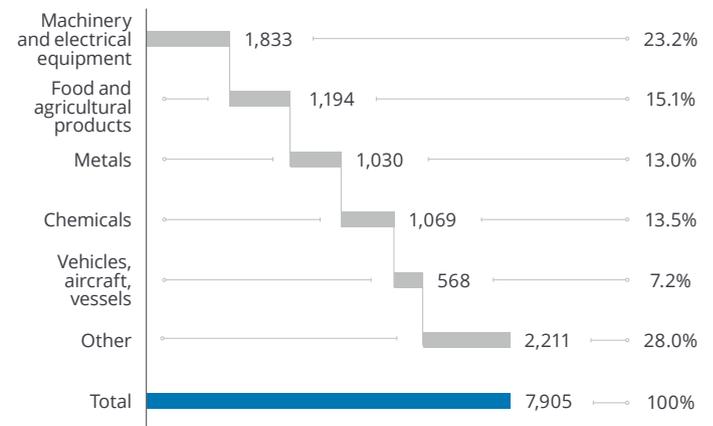
EIU estimates that in 2018–2022 exports will be adding **7 percent** per annum on average, while imports will grow by **4 percent** annually.

### Structure of goods exported in January–September 2018, USD mln



Source: State Customs Committee

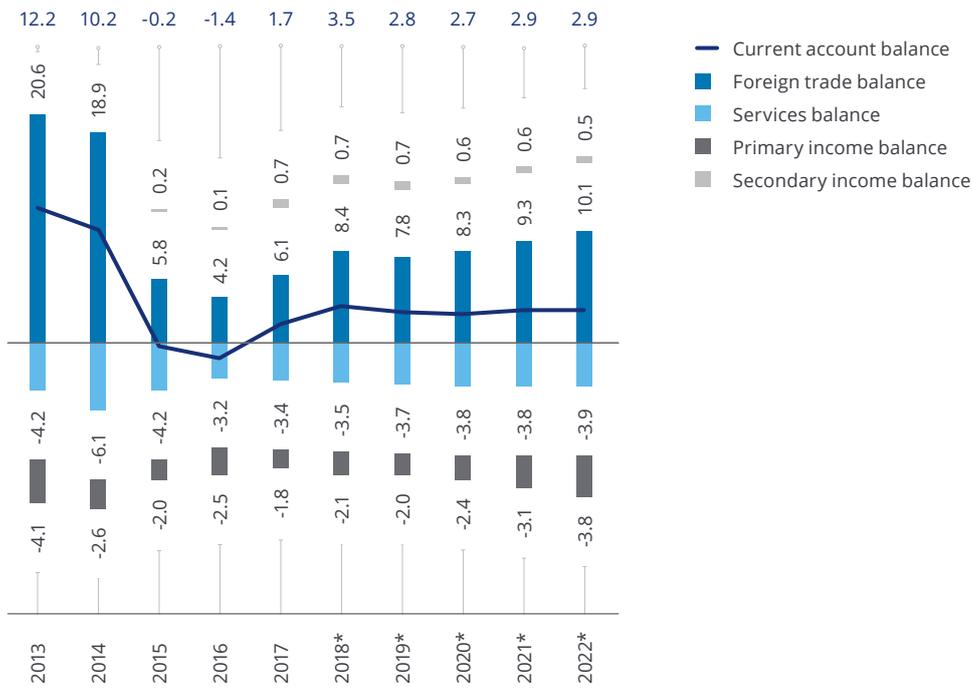
### Structure of goods imported in January–September 2018, USD mln





## Key macroeconomic indicators

### Current accounts, USD bln



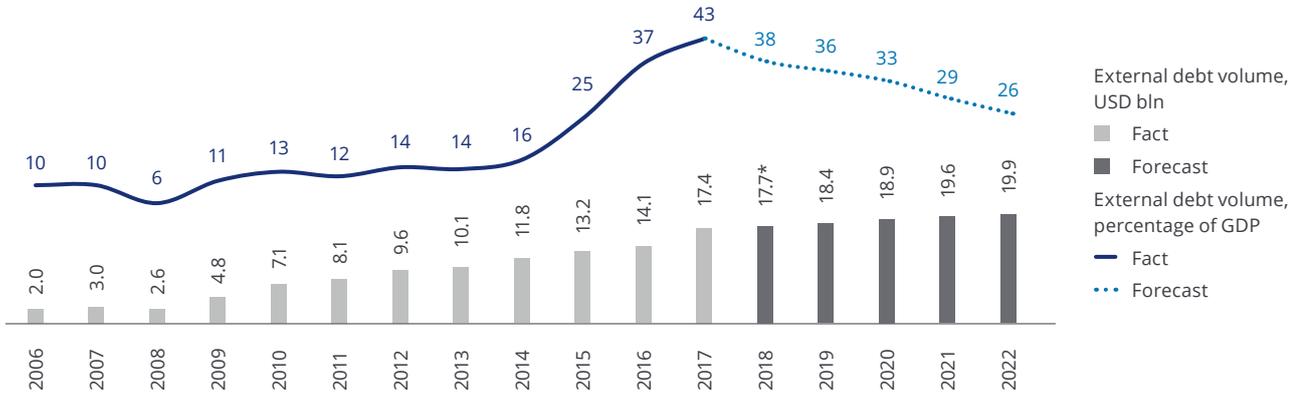
Source: EIU

\*Forecast



## Key macroeconomic indicators

### External debt



Source: EIU

\*Including USD 9.6 bln of sovereign debt as of 1 July, 2018

According to the State Debt Management Strategy, sovereign debt will reach its peak of **USD 10.1 bln** by the end of 2019 and after that will drop to **USD 6.5 bln** by the results of 2025.

### Foreign exchange reserves, USD bln



Source: Central Bank of the Republic of Azerbaijan



## Key macroeconomic indicators

### Retail trade and personal income

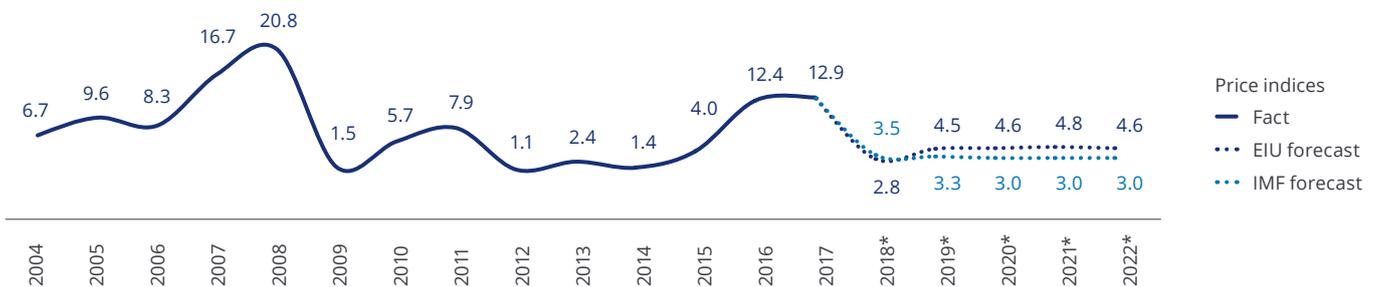


Nominal personal disposable monthly income is growing steadily: EIU expects it will increase almost 1.5 times by 2022. EIU also forecasts that in 2019–2022 real income will be adding 3.9 percent per annum on average.

Stable growth of personal disposable income will favorably affect the growth in retail sales.

Source: EIU

### Average consumer price index, %



Source: State Statistical Committee of the Republic of Azerbaijan

\*Forecast: EIU, IMF

### CPI, January-August 2018 by components

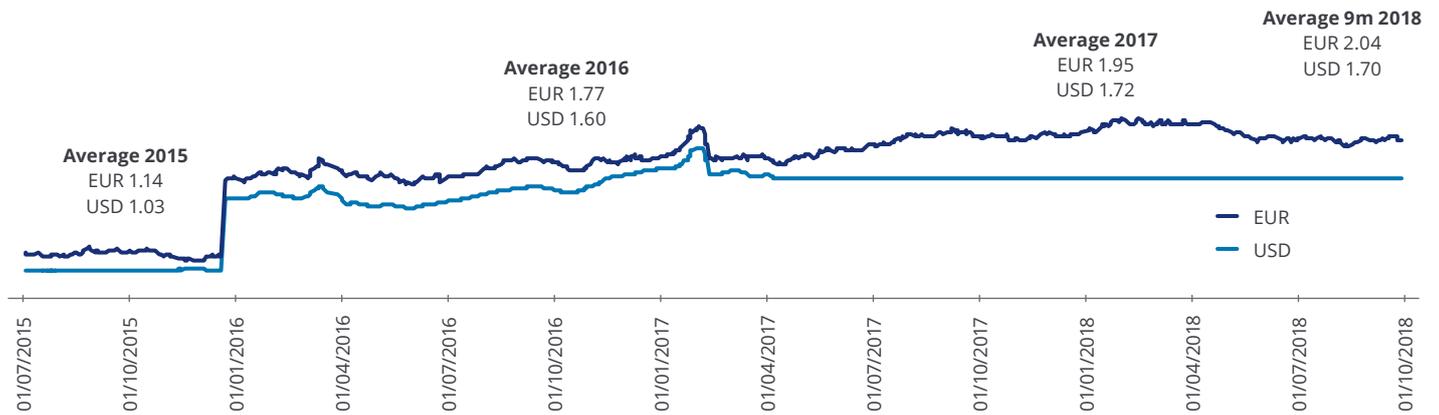
<b>Total</b>	<b>2.7%</b>
Food products, beverages, tobacco	2.7%
Non-food products	3.2%
Services	2.4%

Source: State Statistical Committee of the Republic of Azerbaijan, Central Bank of the Republic of Azerbaijan



## Key monetary indicators

### EUR and USD vs. AZN, July 2015 – September 2018



Source: Central Bank of the Republic of Azerbaijan

Since 2017 the Central Bank of the Republic of Azerbaijan has been implementing the policy of managing the manat rate. Based on the current plan, a full transition to the free floating exchange rate will happen by 2020.

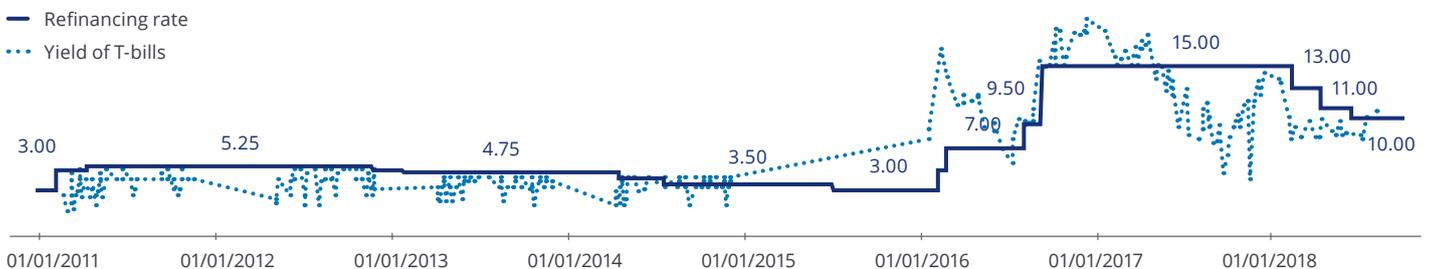
### Currency rate – EIU forecast

	2018	2019	2020	2021	2022
EUR vs. AZN	2.01	1.96	1.96	1.91	1.92
USD vs. AZN	1.70	1.65	1.61	1.58	1.55

*"If the price of oil is kept in the corridor of 60-70 dollars per barrel, there will be no problems with the transition to a free exchange rate."*

**Vahid Akhmedov**  
Member of the Milli Majlis,  
Deputy Chairman of Milli Majlis's  
Committee on Economic Policy

### Refinancing rate and yield of T-bills, %



Source: Central Bank of the Republic of Azerbaijan

Since the beginning of 2018, Central Bank of Azerbaijan decreased the refinancing rate three times in a row. On 1 August 2018, the Central Bank kept the refinancing rate unchanged at 10.00 percent.



## Glance at Azerbaijan taxation system

Tax	Tax description		
<b>Profit tax</b>	<b>Tax base:</b> gross income from economic activities less allowable deductions <b>Tax rate:</b> 20%		
<b>VAT (value added tax)</b>	<b>Payers of VAT:</b> an individual or legal entity whose taxable sales amount to more than AZN 200,000 in a consecutive 12-months period <b>Object of taxation:</b> supply of goods/provision of services and import of goods <b>Tax rate:</b> 18%		
<b>STS (simplified taxation system)</b>	<b>Tax base:</b> gross revenue during any consecutive 12-months period not exceeding AZN 200,000 <b>Tax rate:</b> Baku – 4%, other regions – 2%		
<b>Property tax</b>	<table border="0"> <tr> <td style="vertical-align: top;"> <p><i>For individuals</i></p> <p><b>Tax rate:</b> For buildings, the tax rate varies between AZN 0.1 and AZN 0.4 per square meter of the floor area, depending on its location. For water and air transport vessels, the tax rate is AZN 0.02 per cubic cm of its engine or 1% of the market value of water and air transport equipment without engines.</p> </td> <td style="vertical-align: top;"> <p><i>For legal entities</i></p> <p><b>Tax base:</b> average annual value of fixed assets for residents; average annual value of fixed assets connected with a permanent establishment in Azerbaijan for non-residents <b>Tax rate:</b> 1%</p> </td> </tr> </table>	<p><i>For individuals</i></p> <p><b>Tax rate:</b> For buildings, the tax rate varies between AZN 0.1 and AZN 0.4 per square meter of the floor area, depending on its location. For water and air transport vessels, the tax rate is AZN 0.02 per cubic cm of its engine or 1% of the market value of water and air transport equipment without engines.</p>	<p><i>For legal entities</i></p> <p><b>Tax base:</b> average annual value of fixed assets for residents; average annual value of fixed assets connected with a permanent establishment in Azerbaijan for non-residents <b>Tax rate:</b> 1%</p>
<p><i>For individuals</i></p> <p><b>Tax rate:</b> For buildings, the tax rate varies between AZN 0.1 and AZN 0.4 per square meter of the floor area, depending on its location. For water and air transport vessels, the tax rate is AZN 0.02 per cubic cm of its engine or 1% of the market value of water and air transport equipment without engines.</p>	<p><i>For legal entities</i></p> <p><b>Tax base:</b> average annual value of fixed assets for residents; average annual value of fixed assets connected with a permanent establishment in Azerbaijan for non-residents <b>Tax rate:</b> 1%</p>		
<b>Land tax</b>	<b>Tax base:</b> land plots in the territory of the Republic of Azerbaijan owned or used by enterprises and individuals <b>Tax rate:</b> for agricultural land the tax rate is AZN 0.06 per hectare. For other land plots, the tax rate varies from AZN 0.1 to AZN 20 per 100 square meters, depending on the city, region and the plot size.		
<b>PIT (Personal income tax)</b>	<b>Tax base:</b> worldwide income of tax residents and Azerbaijani sourced income of non-resident individuals <b>Tax rate:</b> 14% for monthly taxable income up to AZN 2,500 and 25% of the amount exceeding 2,500 per month; 20% for all individuals engaged in entrepreneurial activity		
<b>Mining tax</b>	<b>The rate</b> depends on the type of mineral extracted and varies from 3% to 26% of its total wholesale price		
<b>Excise tax</b>	<b>Tax rate:</b> <ul style="list-style-type: none"> <li>• tobacco products – AZN 12 per 1,000 cigarettes;</li> <li>• alcoholic beverages – varies from AZN 0.1 to AZN 6 per liter;</li> <li>• imports of passenger cars, leisure and sport yachts – different rates depending on the engine size;</li> <li>• imported platinum, gold, jewelry – different rates depending on number of grams of platinum, amount of gold in a thousand weight unit, diamond carats;</li> <li>• import of fur-leather products – 10% from its wholesale price.</li> </ul>		

*"Tax reforms will be aiming for increasing reporting requirements, that will be accompanied by a reduction in the tax burden."*

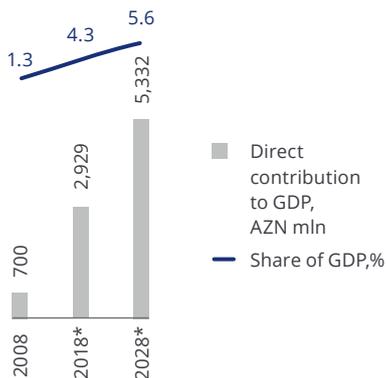
**Mikayil Cabbarov**  
**Minister of Taxes**  
**of the Republic Azerbaijan**

# 02 Key industries

## Tourism

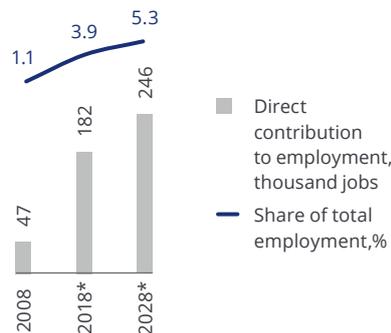
The **direct contribution of tourism to GDP** is generated by hotels, travel agencies, airlines and other passenger transport service companies, as well as by restaurant and leisure industries that deal directly with tourists. The **direct contribution to employment** is the number of jobs within travel and tourism sector.

**Direct contribution to GDP**



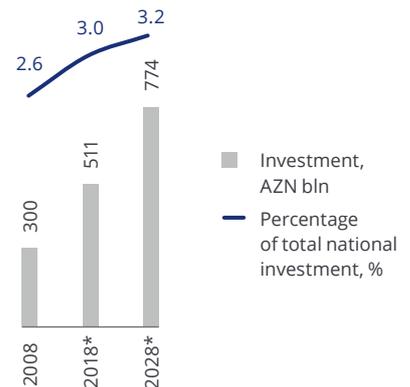
- The World Travel & Tourism council (WTTC) estimates that in 2018 direct contribution of travel and tourism to Azerbaijan GDP will be **AZN 2.9 bln (+6.3%** compared to 2017). This sector will account for **4.3%** of Azerbaijan's GDP.
- Since 2008, the share of tourism in the country's GDP increased three times.
- WTTC expects that contribution of travel and tourism to GDP will increase almost two times in monetary terms until 2028.

**Direct contribution to employment**



- WTTC estimates that the direct contribution of tourism to employment will be **181,500 jobs** in 2018 (**+4.7%** compared to 2017) accounting for **3.9%** of total employment.
- Over the past 10 years the amount of employees in the tourism sector increased almost four-fold and until 2028 the growth is expected at 35%, which will add another 64,000 jobs.

**Investments**



- WTTC expects capital investments in Azerbaijan's tourism sector at **AZN 511 mln** in 2018 (**+5.0%** compared to 2017).
- Tourism accounts for around 3% of total Azerbaijan national investment and this percentage will grow until 2028.

 According to WTTC forecast the growth rate of direct contribution from tourism to Azerbaijan's GDP will amount to 6.2 percent per annum. This is the **7<sup>th</sup> highest growth rate** in the world.

Source: World travel & tourism council

\*Estimation and forecast

### Foreign visitors arriving to Azerbaijan in 2017 by country, '000 people



- Top 5 countries account for more than 80 percent of foreign visitors in Azerbaijan.
- In 2017 a number of foreign visitors to Azerbaijan increased **by 20%** to **2.7 mln** people.
- A number of foreign visitors from the UAE and Iran significantly increased in 2017 (by 93 percent and 46 percent respectively).

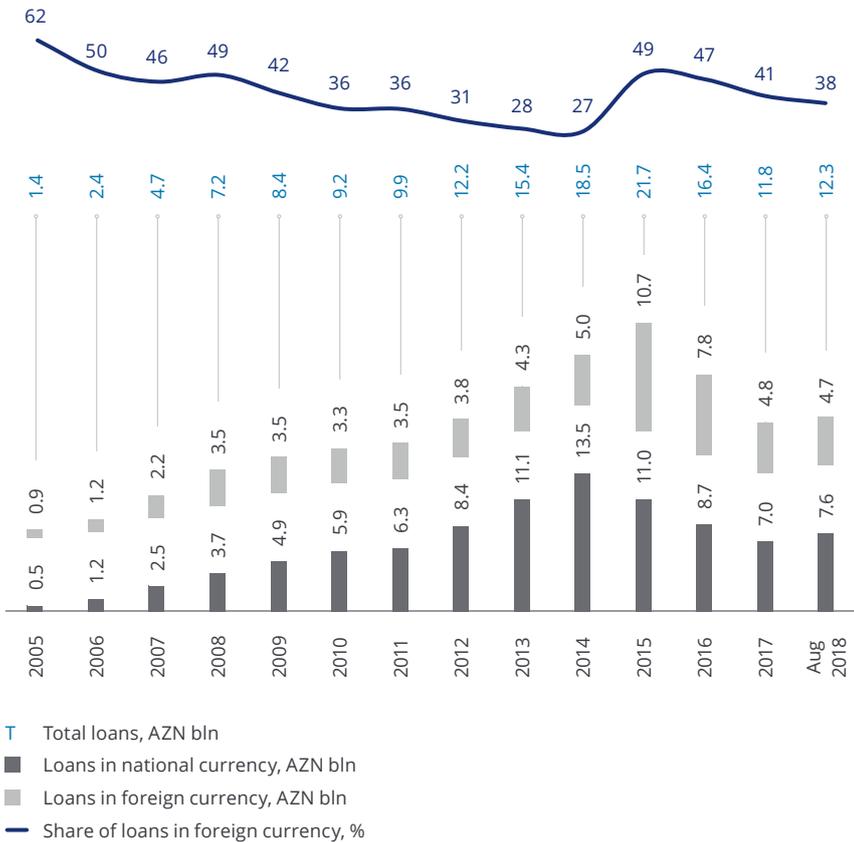
*"We have identified 18 priority travel markets for which Azerbaijan could act as a popular tourist destination in the coming years. This includes Persian Gulf states, China, Japan, South Korea, Western Europe, Israel as well as our closest neighbours. Azerbaijan's tourist offices will appear in several countries by the end of 2018."*

**Fuad Nagiyev**  
**Chairman**  
**State Tourism Agency**  
**of the Republic of Azerbaijan**



## Banking

### Loans of credit institutions



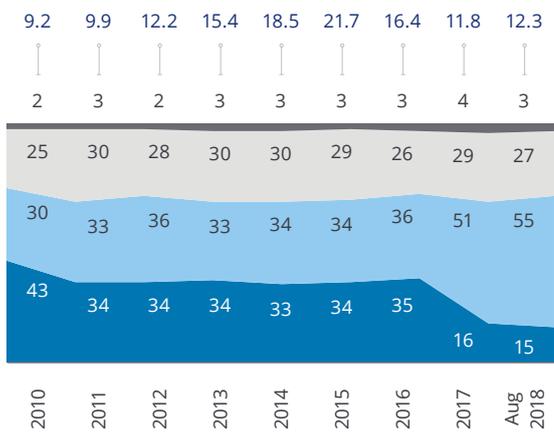
The Azerbaijani financial sector as the whole economy faced a variety of challenges following the slump in oil prices in 2014. The share of loans in foreign currency in manat terms jumped up to 49 percent in 2015 due to devaluation of the national currency but it's been gradually decreasing since then. Moreover, the total loan portfolio have fallen: in 2018 the total size of loans outstanding was almost **1.5 times** lower than in 2014.

### Overdue loans



For the period 2014–2018 the share of overdue bank loans increased almost three times and achieved 14.4 percent by August 2018. For the loans in foreign currency the share of non-performing loans even higher and amount 19.8 percent while for loans in national currency it's only 11.1 percent.

### The structure of loans in the economy by credit institution type



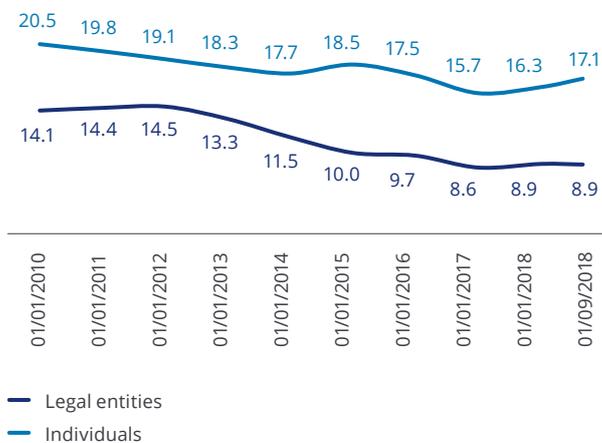
The share of state owned banks' loans fell dramatically in 2017. Nevertheless, the state's involvement in the banking sector remains significant.

T Total loans, AZN bln

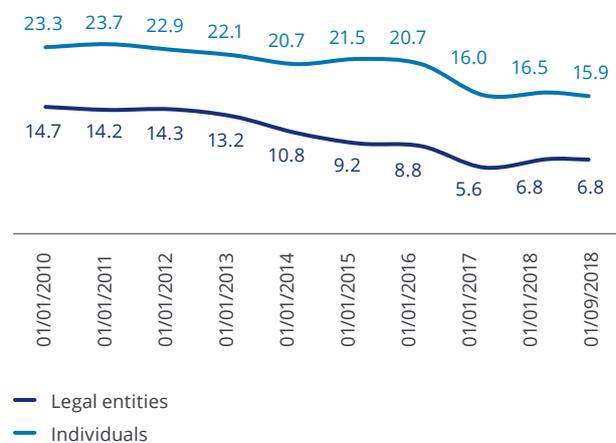
The structure of loans in the economy by credit institution type, %

- State owned banks
- Private banks without foreign capital
- Private banks with foreign capital
- Non-bank credit institutions

### Average interest rates on loans in national currency



### Average interest rates on loans in foreign currency



High interest rates mean that many businesses prefer to finance investment with their own resources. Average interest rate on national currency loans for legal entities had been decreasing between 2013 and 2017 and stabilized at around 9% in 2018 even though a weak pace of economic activity depresses demand for new financing. At the same time, the interest rate on loans for individuals increased in 2018, impeding consumer lending growth.

Average interest rates on foreign currency loans are lower than rates on national currency ones but only companies that have their earnings in US dollars can afford it, while other borrowers are afraid of high currency risks.

Source: Central Bank of the Republic of Azerbaijan, EIU

# 03 Azerbaijan Tax Transparency Survey

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Deloitte Azerbaijan would like to thank all those who participated in the survey we conducted in September 2018. We appreciate your time and interest in our research.

Taxes serve as a powerful tool influencing businesses and investment climate of a country. Therefore, most recovery processes in any economy are naturally accompanied by changes in the national taxation system. Significant changes still await Azerbaijan's tax legislation, including a decrease in payroll tax burden, simplification of tax administration and the fight against tax evasion.

There has never been a more critical time to move beyond just tracking government-initiated tax developments towards a reliable and comprehensive impact analysis of the changes already introduced to the taxation system, including forecasting the effect of the decisions that are being discussed or had been made.

The expert opinions collected in this survey allowed us to conduct an integrated analysis of Azerbaijan Tax Environment, as well as to study the sentiments and expectations of businesses regarding the changes in taxation.

We are pleased to present you with the key findings of our research. We hope that you will find this report to be useful and informative. We would be grateful if you would participate in our next survey.

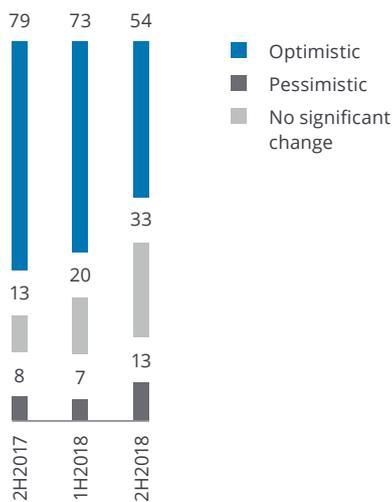
Please feel free to contact us if you have any questions.



## Financial outlook

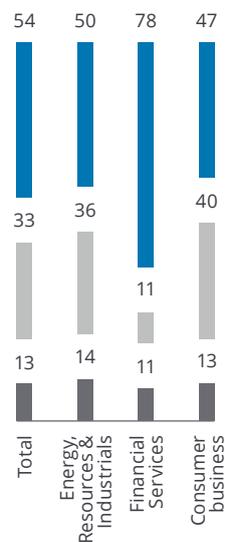
### How do you assess your company's current financial outlook compared to the situation six months ago?

Total, %

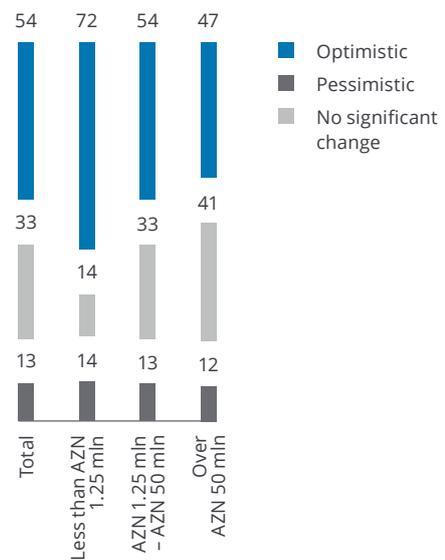


### The respondents' assessment of the financial outlook of their companies

By industry, %



By company revenue, %



### Trends

The respondents' assessment of their companies' outlook became more conservative due to the high base effect in the previous period: as more businesses assess their financial position as good, their relative outlook becomes unchanged.

### Highlights

Notably, financial services demonstrates the highest optimism among all industries – **78 percent** of optimistic responses (**24 pp** above the average).

Azerbaijani companies with an annual revenue of less than AZN 1.25 mln demonstrate the highest optimism (**72 percent** of optimistic responses).

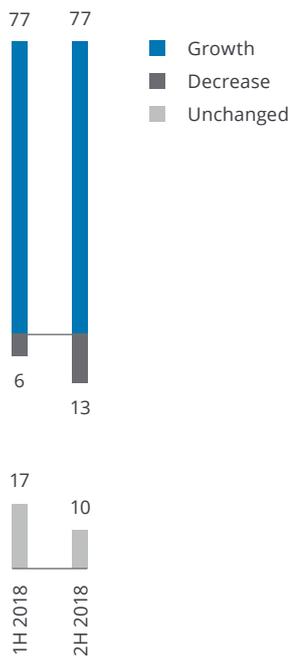


## Financial environment in Azerbaijan

### Expected change in corporate revenue, operating profit and CAPEX

The respondents were asked about expected changes in key financial metrics over the next 12 months

Revenue (in AZN), %



Our survey indicated that **77 percent** of respondents expect the revenue of their companies to increase, while only **13 percent** hold the opposite view and **10 percent** believe that it will remain the same.

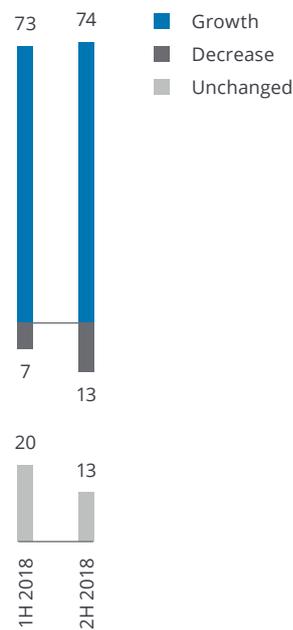
Since the first half of 2018, the share of respondents, who expect a decrease in revenue, have grown by **7 pp.**



**Specific patterns:**

Financial services experts and respondents from companies with an annual revenue of over AZN 50 mln expect an increase in revenue more often than others (**89 percent** and **88 percent** respectively).

Operating profit (in AZN), %



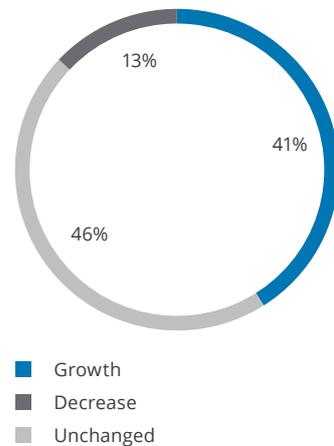
We found that the perception of operating profit changes follows the same trend as the outlook for revenue: the majority of companies (**74 percent**) believe that the operating profit will increase while **13 percent** expect a decline.



**Specific patterns:**

About one out of five (**20 percent**) Consumer business expect a decrease in the operating profit.

CAPEX (in AZN)



About half of respondents (**46 percent**) expect that the CAPEX will remain at the same level. However, another **41 percent** of experts forecast a CAPEX increase. Thirteen percent think that the CAPEX will decline.



**Specific patterns:**

About one out of three (**29 percent**) experts from Energy, Resources & Industrials companies expect a decrease in CAPEX

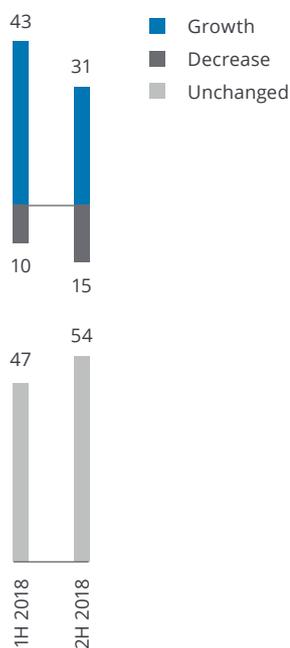


## Financial environment in Azerbaijan

### Expected headcount and payroll changes

The respondents were asked about expected changes in key financial metrics over the next 12 months

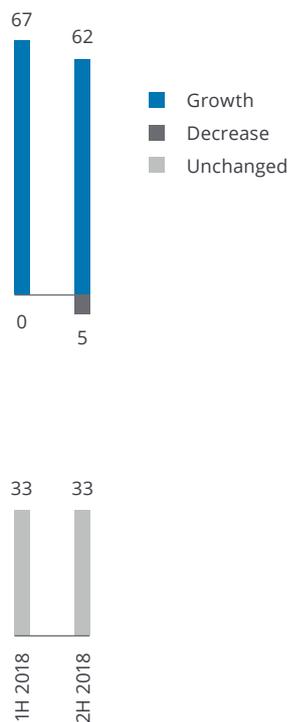
#### Number of staff, %



More than half of the companies (**54 percent**) are not planning headcount adjustments, while **31 percent** of respondents predict an increase and only **15 percent** expect the opposite.

Compared to the situation observed six months ago, the share of companies that plan to hire additional staff has fallen by **12 percentage points**.

#### Average wages (in AZN), %



The survey have identified almost the same opinions regarding payroll changes: two thirds of the respondents surveyed (**62 percent**) expect an increase in the average level of wages while another **33 percent** of companies are not considering wage adjustments. In the second half of 2018, only 5 percent of companies planned to decrease their payroll.



#### Specific patterns:

About half (**44 percent**) of the financial services companies' experts expect that the number of staff will increase.

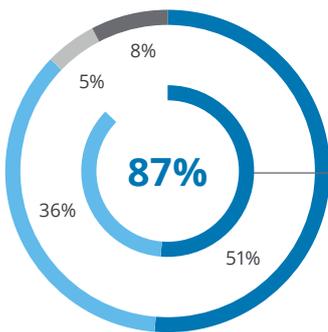
Consumer business experts expect an increase in wages more often than respondents from other industries (**80 percent**).



## Azerbaijan's tax environment

### A taxation system's benefits for society

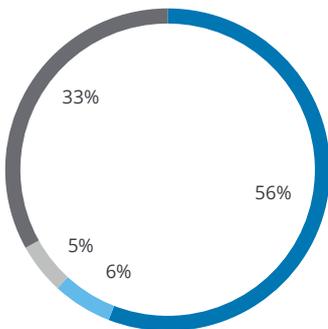
Do you agree with the statement "Taxes collected in the Republic of Azerbaijan serve as future public investments that will contribute to the country's economy"?



The majority of respondents acknowledged that taxes collected contribute to the Azerbaijan economy

- Agree
- Partly agree
- Partly disagree
- Disagree

### Effective tax rate for the 2017 financial tax year



#### Trends

With more than half (**56 percent**) pointing out that their effective tax rate was below 25 percent in 2017, only **11 percent** cited a higher effective tax rate. At the same time, every third respondent could not estimate it.



#### Specific patterns:

All the financial services and consumer business respondents, who specified their effective tax rate, stated that it was 25 percent or less.

The only respondents to report an effective tax rate above 35% were **14 percent** from energy, resources & industrials. **Fifty-seven** percent in this sector specified an effective tax rate below 25%.

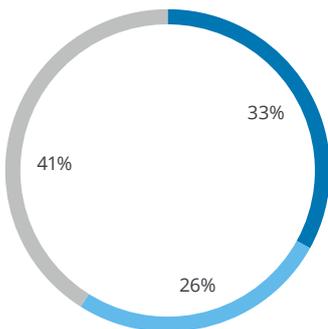
- Effective tax rate of 25% or less
- Effective tax rate of 26%–35%
- Effective tax rate of more than 35%
- Difficult to answer



## Azerbaijan's tax environment

### Tax burden

Specify whether the tax burden on your business has changed over the past five years.



- The tax burden increased significantly
- The tax burden increased insignificantly
- The tax burden remained unchanged

#### Trends

One third (**33 percent**) indicated that their companies had faced a significant increase in their tax burden over the last five years. Another **26 percent** saw a minor growth in their tax burden.

At the same time, **41 percent** did not register any change to their tax burden.

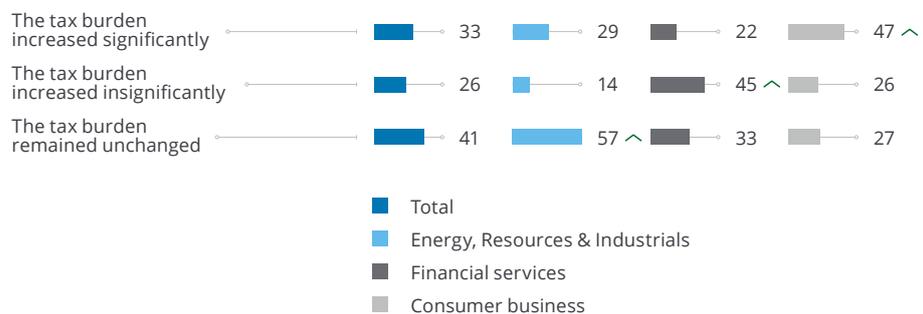
No respondents said that the tax burden on their business had decreased.

#### Highlights

Almost half of the companies (**47 percent**) in the consumer business sector noted a significant increase in their tax burden.

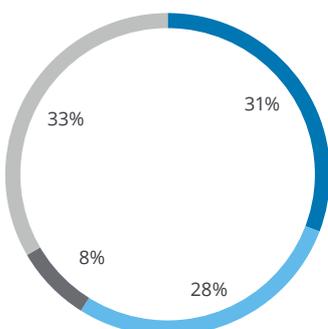
**Forty-five percent** of respondents in financial services did not notice any significant increase in their tax burden.

Respondents in energy, resources & industrials most often tend to specify that the tax burden has not changed over the last five years, with **57 percent** saying so.



### The level of tax transparency

How would you assess the likelihood of increasing the tax transparency of small and medium enterprises by providing them financing at preferential rates and conditions?



- The situation will improve
- The situation will largely remain unchanged
- The situation will worsen
- Difficult to answer

#### Trends

Respondents seem to be unsure whether preferential financing could have a positive impact on tax transparency for SMEs, with every third respondent finding it difficult to say whether this could be an efficient approach.

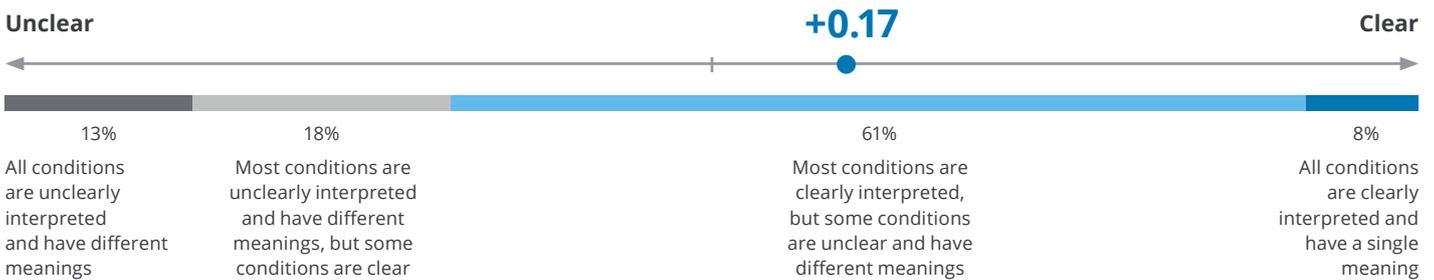
Of those who answered, **31 percent** indicated that reduced tax rates for SMEs could provide the tax authorities with more transparency on what SMEs do. At the same time, **28 percent** do not expect that this measure will produce tangible results while another **8 percent** have specified that it would be quite the opposite.



## Azerbaijan's tax environment

### Clarity of Azerbaijan's tax legislation

Specify how you assess the level of clarity of Azerbaijan's tax legislation.



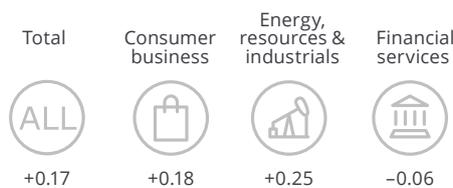
#### Trends

Perceived tax clarity has a positive average balance of 0.17 on a scale from -1 to +1. This means that the tax legislation in Azerbaijan is mostly clear, but there are some unclear conditions.

Only **8 percent** stated that the tax laws allow for complete understanding and unambiguity. At the same time, **61 percent** note some ambiguity even though they believe that tax regulations are generally clear.

**Thirty-one percent** find it rather difficult when it comes to interpreting tax rules, including **13 percent** pointing to ambiguity and a lack of clarity regarding the tax legislation.

#### Highlights



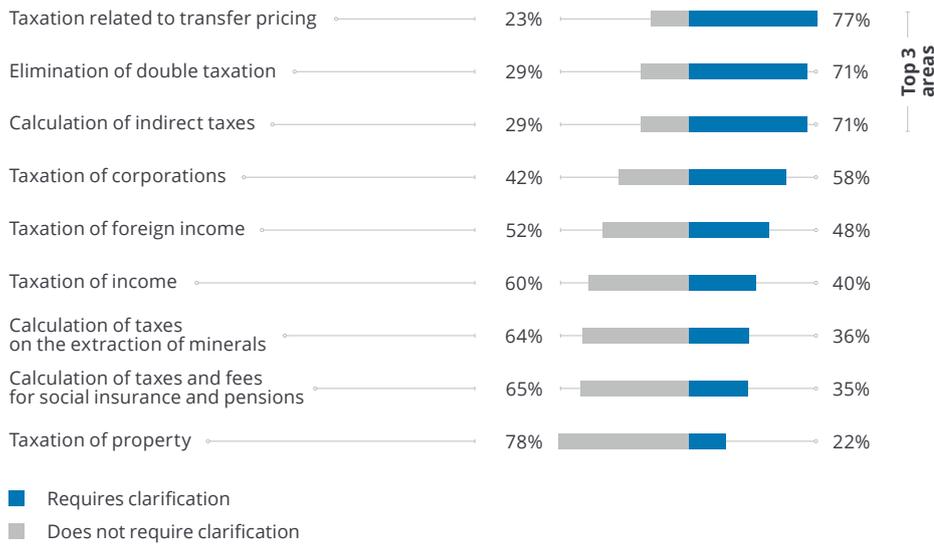
With a positive net balance of **0.25**, respondents in energy, resources & industrials believe that the tax legislation in their sector provides more clarity.

At the same time, respondents in financial services more often tend to struggle with interpreting tax laws, which is demonstrated by a negative net balance of **0.06** on perceived clarity.



## Azerbaijan's tax environment

### Priority areas in need of better clarification



Top 3 areas

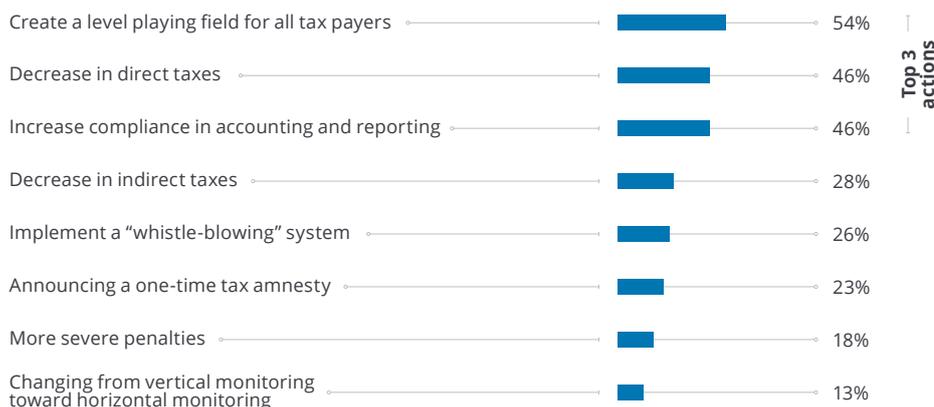
### Trends

A clear majority of respondents (**71-77 percent**) note the need for more transparency in taxation in areas such as transfer pricing, the elimination of double taxation and calculation of indirect taxes, with these three areas leading the rankings of legislation areas requiring more clarity.

Overall, respondents do not perceive the need for greater clarity as regards the taxation of income, calculation of taxes on the extraction of minerals, as well calculation of taxes and fees for social insurance and pensions.

Taxation of property is seen as providing the clearest transparency, with 78 percent stating that there is no need for further clarifications.

### Priority actions to reduce the shadow economy



Top 3 actions

### Trends

A level playing field for all tax players has been selected by respondents as a top priority measure to tackle the shadow economy (**54 percent**).

The need for decreasing direct taxes and improving accounting and reporting compliance comes second in importance, with **46 percent** indicating this.

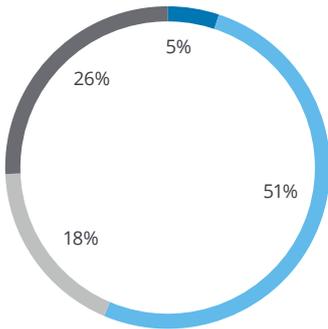
However, respondents do not believe that horizontal monitoring and stricter penalties could be efficient as regards reducing the share of the shadow economy.



## Azerbaijan's tax authorities

### Satisfaction with the quality of tax audits

Are you satisfied with the quality of the tax audits that are being conducted by the tax authorities?



- I am absolutely satisfied
- I am somewhat satisfied
- I am somewhat not satisfied
- I am not satisfied

#### Trends

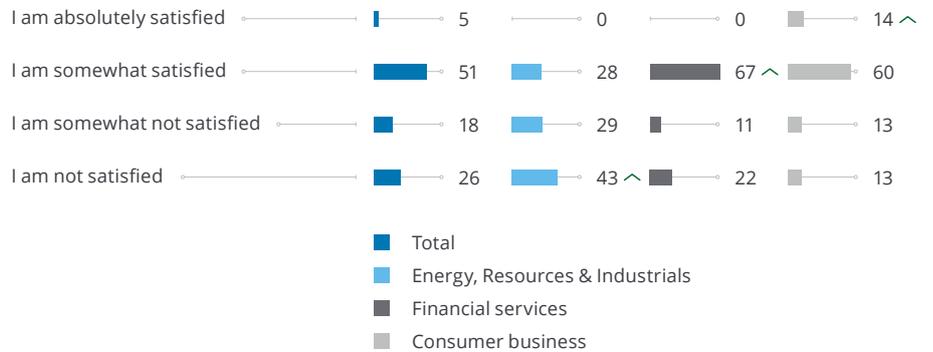
The respondents' opinions about their level of satisfaction with the quality of tax audits were divided nearly equally, with **56 percent** being satisfied, and **44 percent** – dissatisfied.

#### Highlights

Unlike respondents in the other industries surveyed, energy, resources & industrials companies (**43 percent**) more often report dissatisfaction with the quality of tax audits.

Financial services tends to have a higher share of those who are somewhat satisfied with the tax audit quality (**67 percent**).

Overall, consumer businesses more often indicate complete satisfaction with the tax audits, with **14 percent** saying so.

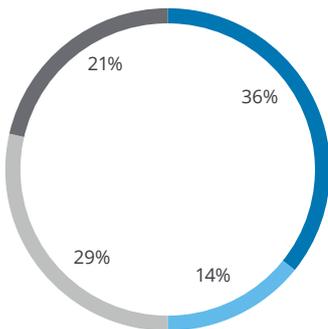




## Azerbaijan's tax authorities

### Satisfaction with the quality of tax audits

#### What is the major issue causing your dissatisfaction?



- Lack of/insufficiency of the methodology to conduct tax audits by the tax authorities
- Lack of knowledge from tax inspectors
- Unnecessary prolongation of tax audits
- Requests for unnecessary documents and calculation files during a tax audit

#### Trends

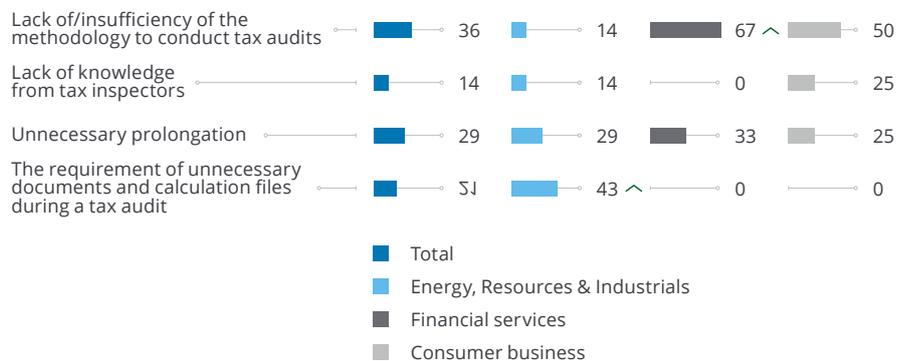
Respondents indicated a lack of/insufficiency of the methodology (36 percent) and unnecessary prolongation of tax audits (29 percent) as their key reasons for being dissatisfied with the tax audits.

Requests for unnecessary documents and calculation files during a tax audit follows closely as another source of dissatisfaction (21 percent). Fourteen percent also mentioned a lack of knowledge from tax inspectors.

#### Highlights

Respondents in energy, resources & industrials most often tend to cite requests for unnecessary documents calculation as a top reason for dissatisfaction with the tax audits (43 percent).

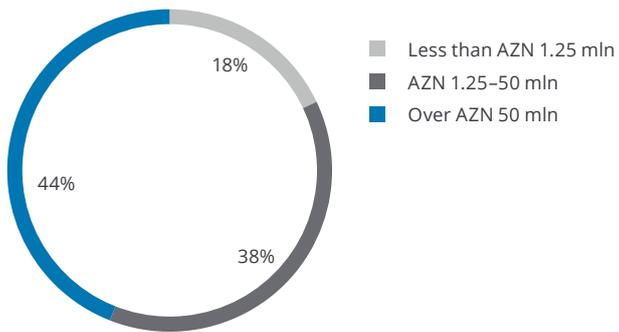
In financial services, two out of three companies (67 percent) indicated inefficient tax audit methodologies as a source of their dissatisfaction.



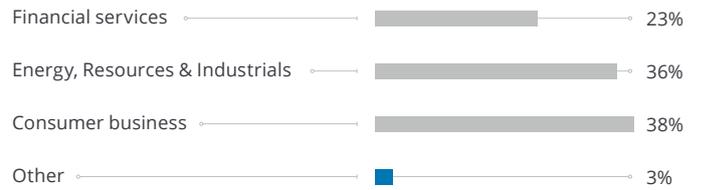


## About respondents

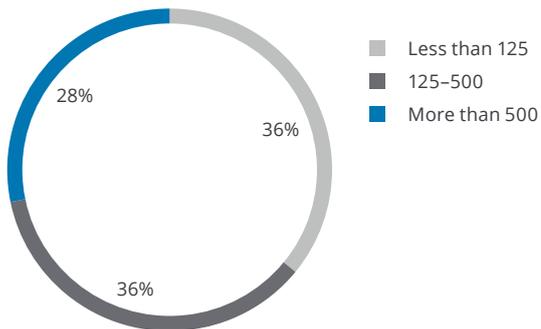
### Annual gross revenue in 2017



### Companies by industry



### Total number of permanent employees



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