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**AZERBAIJAN  
ECONOMIC  
REFORMS  
REVIEW**



## AMENDMENTS AND ADDITIONS ON THE TAX CODE

The Ministry of Taxes prepared the draft law with respect to implementation of the Presidential Order № 2257, dated on August 4, 2016 “on approval of tax reforms directions in 2016” and improvement of tax administration”. The draft law on amendments to the Tax Code of the Republic of Azerbaijan contains 201 amendments including 115 new articles, amendments to 83 existing articles, and removal of 3 articles.

Diverse economic reforms in Azerbaijan include *inter alia* introduction of efficient tax policy, advanced tax legislation and development of favorable tax environment. The country made significant achievements during previous periods in terms of the adoption of large-scale concept papers, strategies and programs, introduction of best practices in national tax legislation based on international cooperation, strengthening of institutional capacities and improvement of administration.

As part of initiated economic reforms and ongoing tax reforms implemented in the country, “Directions of reforms to be implemented in the field of taxation in 2016” was approved by the Executive Order of the President of Azerbaijan on “Directions of tax reforms to be implemented in 2016 and improvement of tax administration” issued on 4 August 2016, by which the Ministry of Taxes was tasked to improve tax administration and legislation in the country.

As the result of the implementation of these tasks, **7 rules and 4 administrative regulations** were approved by Collegial Decision of the Ministry and these normative acts were registered in State Registry of Legal Acts of the Republic of Azerbaijan. Moreover, several draft laws were developed based on evaluation of international best practices and opinion of international experts.

Reforms implemented under the presented draft laws cover important areas, such as **reducing amount of cash payments, levying taxes on e-commerce, transfer pricing, improving accounting policy to make it more transparent, simplifying tax administration, expanding rights of taxpayers, increasing level of tax services provided to taxpayers complying with requirements of tax legislation**. It is also worth to note that the

ministry, in order to increase level of tax services, has already launched an introduction of “**Green Corridor**” principle to serve well-disciplined taxpayers. As set forth by draft laws, it is also planned to introduce “Green Corridor” principle to the taxpayers, who maintained a transparent accounting.

To sum up, the presented normative documents are composed of draft amendments to Tax Code, Civil Procedural Code, Administrative Offence Code and Criminal Code, as well as the law on E-commerce, Law on State duty, law on enforcement and the draft law on Cashless payments.

The draft law on amendments and additions to the Tax Code of the Republic of Azerbaijan contains **201 amendments including 115 new articles, amendments to 83 existing articles, and removal of 3 articles**. 123 articles are associated with improvement of administration and introduction of transparent accounting policy. 34 articles provide provisions to expand taxpayers’ rights, while the remaining 8 articles are about reducing tax burden, as well as tax benefits and exemptions.

The draft laws cover primarily the following directions:

### **1. Calculation of VAT from trade additive in retail business to reduce tax burden**

As known, since 1999, agricultural producers have been exempted from all other taxes, specified by the Tax Code, except for the land tax. Total value of these products is subject to VAT when they are traded in retail facilities of the shopping networks. In accordance with the effective legislation, value of VAT taxable transaction is defined on the basis of an amount which tax payer, without considering VAT, collects or has a right to collect from a

client or any other physical person. Since no other rules for defining the value of taxable VAT transactions, sales networks need to calculate VAT from total sales turnover, which in turn causes rises in retail prices.

In the light of the above mentioned, in order to incentivize small and medium enterprises, create business enabling environment for retail business and optimize tax burden, the draft law included provisions that calculate VAT from the difference between selling and purchase prices of agricultural products (i.e., from trade additive) imported to the Republic of Azerbaijan by retailers.

In addition, starting from January 1, 2017, the draft also envisages exemption from VAT the idle (toxic) assets for 3 years as part of restructuring and revitalization measures applied to banks in insolvency.

In addition, the draft included provisions such as exemption from profit tax (without term limit) for incomes of institutions providing mandatory medical insurance and health services recently established by Presidential Decrees and Orders. The draft also included 3-year VAT exemption for wheat import and sales, wheat flour purchase and selling and poultry meat selling.

Exemption from income tax for annual interest revenues of banks generated from deposits of physical persons, dividends paid for investment securities, as well as discount (obtained from the acquiring discounted traded bonds) and interest income was increased for 5 years (by February, 2021).

In addition, to reduce tax burden of businesses and stimulate export, the draft included amendments to tax refund period for over VAT payments during export transactions,

and decreased it from 45 days to 20 days. Besides, the draft contains provisions that facilitate compensation of over-payments of other persons who are involved in transactions subject to VAT with other tax obligations within 3 months and refund of the remaining amount within 20 days.

The abovementioned amendments will facilitate reduction of tax burden and efficient use of floating capital of taxpayers.

## **2. Identification of criterias distinguishing taxpayers dealing with wholesale and retail business**

Calculation of VAT from trade additive in retail business, as well as introduction of electronic invoice, as tasked by the Executive Order, help to identify the scope of taxpayers involved in wholesale and retail business.

It is also worth to note that currently, wholesale businesses, in most cases, do not use serious reporting blanks when they submit goods, which causes certain difficulties in maintaining accounts by taxpayers and other persons who had joint business transactions. For this reason, the draft included concepts defining criteria that distinguishes taxpayers involved in wholesale and retail business. According to the draft, a wholesale is a trade transaction where goods are submitted for business purposes to buyer using invoice. Retail, however, is a trade transaction where goods are transferred to buyer based on a receipt or bill.

These amendments will help to prevent from conflict of view among taxpayers and tax authorities, as well as imposition of potential financial sanctions against them.

## **3. Introduction of electronic invoice (e-invoice)**

Analysis of existing situation in the field of documentation of various transactions shows that, paper-based invoicing leads to several problems including tax evasions in the country.

To prevent such cases, the draft included provisions specifying e-invoicing when goods, works and services are provided among businesses. Furthermore, according to the new amendments in the draft, in the event of absence of invoice, e-invoice or electron tax bill-invoice, financial sanctions equal to 10 percent of purchased goods will be imposed on taxpayers who made for the first time in the calendar year. The amount of sanction will constitute 20 percent of purchased goods if taxpayer commits the same violation for the second time. The amount of financial sanction will constitute 40 percent of purchased goods, if the same offense is repeated for the third or more time in calendar year.

The draft law also includes a transitional provision on introduction of e-invoice for provided goods and services. For businesses involved in trade and (or) catering services with taxable transactions over 200.000 AZN during any month of 12 consecutive month starts from the 1<sup>st</sup> of April, 2017, while for all other legal entities and physical persons who are buyers of goods, works and services have to introduce e-invoice starting from the 1<sup>st</sup> of January, 2019.

The purpose of this amendment is to simplify documentation of transactions among businesses, ensure operational efficiency, reduce administrative costs, and prevent from conflict of view among taxpayers and tax authorities during any future tax enforcement measures and to ensure transparency.

#### **4. Pre-calculation of tax obligations**

Improper calculation of tax obligations by businesses, for any reason, results in

additional financial sanctions against such taxpayers. In order to prevent such cases, it is important to develop a mechanism that introduces pre-calculation of tax obligations for transactions that tax payers plan to conduct. This mechanism is mainly related to calculation of tax obligations for large-sum contracts prior to closing transactions as specified by those contracts. This would cause further calculation of additional taxes and financial sanctions against such taxpayers.

For this purpose, relevant provisions were included into the draft law to identify the rule for receiving consent of tax authorities prior to legal outcomes, which tax obligations could cause. Value of each such transaction should not be less than 10 million AZN and relevant state duty needs to be paid for adoption of such decision. In this regard, draft Law on amendments to the “Law on State duties of the Republic of Azerbaijan” has been prepared.

It is required to pay a state duty of 500 AZN for adoption of decision on pre-calculation of tax obligation.

It is worth to note that this mechanism has already been introduced in the legislation of countries such as Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Israel, Italy, Japan, the Netherlands, Spain, Turkey, Great Britain, United States and others.

#### **5. Completion of in-house tax audit within 30 days**

According to the effective legislation, in-house tax audit is conducted within 30 days from the day of submission to tax authority of documents necessary for calculation and payment of taxes by taxpayer. Cases, such as the failure in submission of appropriate documents by

taxpayer in due time or denial of carrying out necessary documentation cause extension of duration of in-house tax audit. To prevent such cases, it has been decided to complete in-house tax audit within 30 days based on submitted tax declarations.

For this purpose, the draft law included provisions prohibiting repeated in-house tax audit based on the same declaration after the expiry of 30 working day period.

It is also worth to note that introduction of automated system for processing of risks has been launched by tax authorities, which will further enable to complete in-house tax audit of declaration within 30 days.

After 30 days from the submission of declaration by taxpayer, 5 days prior notice about inconsistency discovered by tax authorities will be sent to taxpayer before conducting in-house audit, which is another factor that serves the protection of the taxpayers' rights.

## 6. Introduction of voluntary tax disclosure system

As known, unscheduled tax audit as set out in effective tax legislation could be carried out in case of signs when hiding (decreasing) taxpayers' incomes or taxable activities or assets are discovered by tax authority (based on any information with known source), despite the termination of in-site tax audit. In such cases, the amount evaded from tax is paid to public budget and additional financial sanction equal to 50 percent of evaded total amount is applied to that taxpayer. ***Introduction of provisions on voluntary tax disclosure, which is proposed to the existing tax code, will release taxpayers from imposition of such financial sanctions.***

Voluntary tax disclosure refers to voluntary declaration by tax payers of mistakes not discovered during tax audit, including miscalculation of taxable amount upon the completion of in-site tax audit conducted by a tax authority. In this regard, relevant amendments are proposed to the existing Tax Code, which allow taxpayers to submit declaration for periods covered by in-site tax audit on voluntary tax disclosure. Under that declaration, no ***interest and financial sanctions are imposed on taxpayers for the voluntarily disclosed taxable amount.***

It should also be noted that the similar provisions are reflected in legislation of the United States, most European countries and Turkey.

## 7. Cashless payments

According to the Executive Order, the draft Law of the Republic of Azerbaijan "On Cashless Payments" has also been prepared. The draft law specifies the concept of cashless payments, monthly amount of cash payments was limited to 30,000 AZN for VAT-registered businesses involved in trade and (or) catering services with taxable transactions over 200.000 AZN during any month of 12 consecutive months, while the amount of cashless payments for other taxpayers was limited to 15,000 AZN per month.

In addition, the draft law requires payments to be made on the cashless basis for the following: payment of administrative fines, financial sanctions, taxes, customs duties, collections, interests, debt payments for leasing transactions and credits, insurance payments, service fees and other duties, pensions, allowances, material assistance, compensations, fixed-line telephone services, education fees to government bodies, payments to the legal entities under state ownership or with control package owned by state, budget organizations

and public legal entities and tour agencies.

Furthermore, except for entities providing retail trade and catering services with the total transaction of 200,000 AZN in any month of 12 months period, salaries paid by all other persons (entities) should be based on cashless payments.

In the event of violation of the requirements of this draft law, financial sanctions equal to 10 percent of purchased goods will be imposed on taxpayers who made for the first time in the calendar year. The amount of sanction will constitute 20 percent of purchased goods if taxpayer commits the same violation for the second time. The amount of financial sanction will constitute 40 percent of purchased goods, if the same offense is repeated for the third or more time in calendar year.

Apart from the abovementioned, in order to limit cash dispensing from banks, a simplified tax with an interest rate of 1% will be deducted from legal entities and individual entrepreneurs for cash dispensing from banks as specified by the draft amendments to the Tax Code.

Restriction on cashless payments has been provided in legislation of countries such as France, Italy, Spain, Belgium, Czech Republic, Slovakia, Kazakhstan and others.

*These changes will enable the increase of the volume of cashless payments, improvement of financial state and liquidity banks, better regulation of cash turnover, introduction of transparent mechanisms in public expenditures, legalization of salaries and other payments and finally increase of international rating of the country.*

#### **8. Prevention of cases for artificial increase of expenditures (transfer evaluation)**

The Article 14 of the Tax Code governs determination of market value of goods (works and services in transactions closed among parties for the taxation purposes. The existing tax of this Article allows tax authorities to control proper distribution of incomes and expenditures in transactions closed by resident taxpayers with other taxpayers established outside the borders of the country. To prevent such cases, relevant articles were included into the draft to levy taxes introducing transfer prices for revenues generated from transactions with entities (persons) established outside country borders, including offshore countries and territories.

The draft law also envisages to **apply transfer prices to transactions with a total value over 500,000 AZN** for each person mentioned above during the calendar year.

When amendments were prepared to the draft law in this direction, recommendations of the Organization of Economic Cooperation and Development (OECD) were examined. Moreover, comments of the international experts were also taken into consideration. Transfer pricing is applied in countries such as the member states of the European Union, United States and others.

#### **9. Determination of tax obligations for physical persons as monthly fixed taxes**

According to this amendment, the draft law sets out rules of payment of taxes in simplified manner as a fixed amount by physical persons dealing with some types of activity. Operation based on receipt for payment of taxable fixed amount was related to duties of simplified taxpayers, and the Code includes the list of those types of activities and the tax rate.

These types of activities included services

provided by masters of ceremonies, musicians, dancers, ashug professionals, as well as individual photo, audio and video services, repair of home appliances, services of nurses, individual drivers, cleaners in households, gardeners and others.

According to changes, persons fulfilling simplified tax obligations on the basis of receipts of payment for fixed amount should do not submit declarations to tax authority.

These changes will contribute to **reduction of tax and administrative burden of low-income physical persons**.

#### 10. Taxation of digital economy (e-commerce)

Another draft law is about amendments to the Law of the Republic of Azerbaijan on E-Commerce. This Law specifies several norms such as expansion of the scope of e-commerce, pocket money concept introduced widely in practice.

The Tax Code also envisages provisions specifying functioning mechanism of taxation of transactions made within digital economy.

The draft Law also includes provisions on VAT taxation to the recipients of works and services realized as e-commerce transactions, as well as lotteries, other contests and competitions held as e-commerce transaction.

According to these provisions, VAT should be calculated at the expense of buyer for the amount payable to non-residents by local bank, branches of foreign bank in the Republic of Azerbaijan or national operator of postal communication when payments are made by persons, who are not registered in tax authorities.

The abovementioned changes will help to ensure transparent tax control over taxpayers using e-commerce and remove discrimination between participants of resident and non-resident e-commerce.

#### 11. Definition of borders for production and processing of agricultural products

As known, since 1999, producers of the agricultural products have been exempted from payment of all other taxes specified by the Tax Code, except for the land tax. It is worth to mention that these privileges are applied to persons who are directly involved in production of agricultural products. For resolution of contradictory views and disputes arisen in these areas, definitions such as production and sale of agricultural products were included into the draft as it became necessary to precisely identify the scope of tax privileges applied to producers of agricultural products.

Cattle and poultry breeding, generation of products when they are alive (in initial form, without converting to new product using as semi-product, without changing the chemical content, without canning), growing of planting products, including industrial method (including special broiler farm, automated barn systems) were also included into **definition of the production of agricultural products**.

#### 12. Provisions against mistreatment rights in tax legislation in line with international best practices

Some taxpayers evade paying taxes by introducing different schemes that allow mistreatment of rights granted under the tax legislation.

Concluding multistage agreements to decrease tax obligations based on exaggeration of costs



via transferring them from one taxpayer to another could be an example for such schemes.

Considering the international best practices, it is planned to include into the tax legislation the provision against ill-use of rights in order to impose transparent taxation on taxable assets and prevent hiding the tax base. This experience is applied in countries such France, Germany, the Netherlands, Belgium and others. In the event of tax evasion scheme are discovered by tax authority, provisions reflecting the right of tax authorities to calculate taxes, as prescribed by the legislation, based on actual economic implication were included into the draft legislation.

### **13. Building tax control mechanisms on transactions made in countries with privileged taxation system**

According to the Order, building efficient control mechanisms on transactions made in countries or territories with privileged taxation system (offshore zones) was also reflected as part of reform measures. Reason for introduction of such mechanisms are to identify persons who evaded taxes in the Republic of Azerbaijan from their income and profit using enterprises established in offshore zones, and ensure proper taxation of those transactions as stipulated by the relevant legislation.

For this purpose, the draft amendments included provisions, where payments made directly or indirectly by permanent representative offices of residents and non-residents in the Republic of Azerbaijan to entities, established (registered) in countries with privileged taxation regime, were related to incomes generated from Azerbaijan as the source. The provisions of the draft amendments also include withholding tax at source with an interest rate of 10 percent.

This change is one of the steps adopted

internationally to fight against income transferred to offshore enterprises with evasion from taxes. The similar provision is specified by relevant legislation of countries such as Latvia, Estonia, Kazakhstan and Georgia.

### **14. Expanding the scope of electronic audit**

As known, one of the targets of public tax policies is to minimize direct contacts among businesses and tax authorities and facilitate relationship based on electronic communication.

In this regard, Tax Code included definition of electronic audit where it was defined as a tax audit conducted with direct and distant access to electronically maintained accounting data of taxpayers using special software programs, as well as provisions defining the method of conducting electronic audit by the decision of tax authority as stipulated by guidelines of relevant executive authority.

### **15. Achievement and maintaining high international ranking on the level of transparency and information exchange in the field of tax**

As known, the Republic of Azerbaijan joined the Convention "On Mutual Administrative Support on tax issues" in 2003. This Convention specifies assistance in the field of taxes and automated exchange of information on revenues of taxpayers.

Besides, relevant Treaty on implementation of tax claims was signed between the Government of the United States and the Government of the Republic of Azerbaijan.

According to the abovementioned Treaty, exchange of bank accounts of taxpayers, as well as transactions made using those bank accounts is conducted among the parties.

In order to fulfill requirements committed under international treaties, **provisions specifying rights and duties, as well as associated responsibilities of financial institutions, including banks** have also been included in the draft of the Tax Code.

It is also worth to note that country report on Azerbaijan was placed for discussion in the meeting of Global Forum Evaluation Group held in Paris in September of this year and the Republic of Azerbaijan was awarded a score “largely compliant” with the approved decision of the Evaluation Group. This ranking was approved by Global Forum in October 28, 2016, and published in the official website of the Global Forum and OECD.

#### **16. Utilizing notaries to withhold simplified tax at source for transactions made during formalization of land sale transactions**

As known, according to the effective legislation, profit and income tax is levied on sale of land plots as a general rule. Improper indication of prices and lack of documents certifying purchase and costs causes difficulties in determination of tax obligation of persons who present this land plot during formalization of transactions. For this purpose, provisions specifying simplified taxation of land plots have been included into the draft amendments.

#### **17. Improvement of legislation on enforcement of tax obligations**

Draft law on amendments to the law **“On Enforcements” of the Republic of Azerbaijan**, specifies the following provisions:

control over tax obligations received for enforcement by respective officials;

control over enforcement documents returned

back;  
provide possible assistance to enforcement officials with receiving tax obligations;

require enforcement officials to provide the relevant tax authority with the following, in order to maintain a proper accounting:

- a copy of decision on launching of enforcement measure with respect to court decision regarding withholding the tax obligation;
- enforcement documents returned back when enforcement was not possible.

This draft law also includes provisions on sale of properties **with a total value less than 5,000 AZN in shopping networks, including in the electronic commerce networks.**

Considering the case when relevant amendments are made to the Law of the Republic of Azerbaijan on “Enforcement”, more favorable conditions will be created to ensure enforcement of court decisions in a short period of time, as well as full collection and on time payment of taxes collected by the Ministry of Taxes of the Republic of Azerbaijan to the public budget.

**Amendments to the Civil Procedural Code** are necessary to ensure consistency with the Tax Code of the Republic of Azerbaijan. Court reviews application of tax authority as specified by Article 90.1 of the Tax Code in an order as specified by the Civil Procedural Code of the Republic of Azerbaijan.

In order to ensure full and effective collection of tax obligations to the public budget, several amendments were included into the draft of the Tax Code. These amendments will ensure much simpler and more effective implementation of the enforcement of court decisions.

## 18. Provisions associated with expansion of tax base

It is also worth to note that several provisions associated with the expansion of tax base were included into the draft law on amendments to the Tax Code.

### ***These amendments are the followings:***

- increase the excise rates by 2-3 times applicable to yachts designed for rest and sport purposes, and other floating means designed for these purposes, motor vehicles with the size of engine over 2000 cubic centimeter, each gram of platinum and gold, 1 carat of diamond;
- include fur-skin goods into the excisable goods to levy an excise tax with an interest of 10 percent;
- levy property tax on legal persons who are simplified taxpayers;
- decrease amortization norm from 25 percent till 20 percent for machinery and equipment;
- Limit deduction from income by 40 percent of amortization calculated for assets purchased using investment expense of the public budget.

The abovementioned amendments to the Tax Code are considered as part of economic reforms carried out in the country.



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