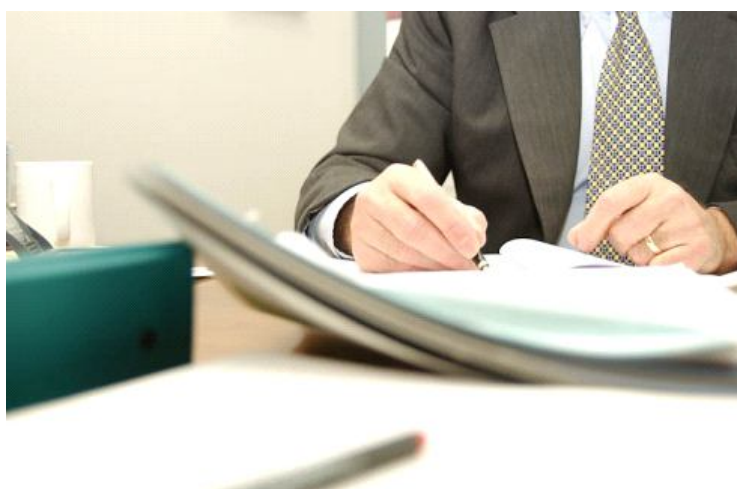


**LEGAL AND TAX ASPECTS  
OF DOING BUSINESS  
IN AZERBAIJAN**



**2011**

## Table of Contents

<b>Section I.</b>	<b>ESTABLISHING A LEGAL PRESENCE IN THE AZERBAIJAN REPUBLIC .....</b>	<b>4</b>
1.	Introduction .....	4
2.	Representative Office and Branch of Foreign Legal Entity .....	4
3.	Forming a local legal entity .....	5
3.1	Joint Stock Companies (“JSC”) .....	5
3.2	General Partnership (“GP”) .....	6
3.3	Limited Partnership (“LP”) .....	6
3.4	Limited Liability Company (“LLC”) .....	7
3.5	Additional Liability Company .....	7
3.6	Subsidiaries .....	8
<b>Section II.</b>	<b>LEGAL/LABOUR REQUIREMENTS .....</b>	<b>9</b>
1.	Introduction .....	9
2.	Labour Books .....	9
3.	Probationary Period .....	9
4.	Working time .....	9
5.	Overtime .....	9
6.	Rest time .....	10
7.	Holidays and day off .....	10
8.	Vacation entitlement .....	10
9.	Statutory sickness payments requirements .....	11
10.	Employment termination .....	11
11.	Work Permit for Foreign Nationals .....	13
<b>Section III.</b>	<b>LICENING OF COMMERCIAL ACTIVITIES .....</b>	<b>15</b>
<b>Section IV.</b>	<b>STATE LANGUAGE IN THE REPUBLIC OF AZERBAIJAN .....</b>	<b>16</b>
1.	Legal status of the state language .....	16
2.	Use, protection and development of the state language .....	16
<b>Section V.</b>	<b>COURT SYSEM IN THE REPUBLIC OF AZERBAIJAN .....</b>	<b>17</b>
1.	Court System .....	17
2.	Constitutional Court .....	18
<b>Section VI.</b>	<b>RECENT IMPORTANT CHANGES IN LEGISLATION.....</b>	<b>19</b>
1.	Usage of electronic signature in business documents circulation .....	19
2.	Abolition of the legalization requirements for foreign public documents .....	19
3.	Corruption control .....	19
4.	Amendments to the Code of Administration Violations .....	19
5.	Travel allowance rates .....	21
<b>Section VII.</b>	<b>AZERBAIJAN TAXES RELATING TO PSA .....</b>	<b>25</b>
1.	Income tax of foreign employee .....	25
2.	Local employees payroll taxes .....	27
3.	Withholding tax .....	27
4.	Value added tax (“VAT”) .....	29
5.	Import/Export taxes .....	29
<b>Section VIII.</b>	<b>AZERBAIJAN TAXES RELATING TO PIPELINE PROJECTS AGREEMENTS .....</b>	<b>31</b>
<b>Section IX.</b>	<b>AZERBAIJAN TAXES RELATING TO NON-PSA ACTIVITY .....</b>	<b>32</b>
1.	Personal income tax .....	32
2.	Corporate profit tax .....	33

---

3.	Value added tax (“VAT”) .....	34
4.	Excise tax .....	34
5.	Property tax .....	35
6.	Land tax .....	35
7.	Road tax .....	35
8.	Mining tax .....	35
9.	Simplified tax .....	36
10.	Deductibility and depreciation rules .....	37
11.	International grants or loans .....	38
12.	Field tax audit .....	38
13.	Violations of Tax Code requirements .....	38
14.	New system of tax reporting .....	38
<b>Section X.</b>	<b>IMPORT/EXPORT TAXES .....</b>	<b>39</b>
<b>Section XI.</b>	<b>TAX PLANING AND STRATEGY .....</b>	<b>40</b>
<b>Attachment 1.</b>	<b>Individual Income Tax Tables 1 And 2 .....</b>	<b>41</b>
<b>Attachment 2.</b>	<b>Rates of Road Tax applicable to owners or users of vehicles in the territory of AR .....</b>	<b>42</b>
<b>Attachment 3.</b>	<b>Rates of Simplified tax applicable to revenues received from transportation activities .....</b>	<b>43</b>

---

## **Section I. ESTABLISHING A LEGAL PRESENCE IN THE AZERBAIJAN REPUBLIC**

### **1. Introduction**

Establishing a legal presence in the Republic of Azerbaijan is regulated mainly by the *Civil Code*<sup>1</sup> effective September 1, 2000, the Law “*On State Registration of Legal Entities*” dated December 12, 2003 and other Laws of the Republic of Azerbaijan.

One may establish either a limited presence, in the form of a representative office or a branch of foreign legal entity, or a full presence in a number of other forms of Azerbaijan legal entities.

According to the Decree of the President of the Republic of Azerbaijan dated October 25, 2007 regarding the implementation of “*one window system*”, from January 1, 2008, state registration of representative office or a branch of foreign legal entity and Azerbaijan legal entities shall be carried out by the Ministry of Taxes of the Republic of Azerbaijan. In accordance with the legislation, the appropriate registering body is required to execute registration within 3 business days after the submission of the necessary documents.

### **2. Representative Office and Branch of Foreign Legal Entity**

According to Azerbaijan legislation representative and branch offices are subdivisions of a foreign legal entity. Although they are not considered to be legal entities in the Republic of Azerbaijan, they are subject to taxation, including profits tax whenever they engage in commercial activity.

Both carry out all or some of the functions of its parent “home country” foreign legal entity and can be engaged in revenue generating activities. Both a representative office and branch operate on the basis of regulations (similar to a charter) approved by their parent legal entity.

Additionally, branch and representative office of foreign legal entity should have the right to trade in Azerbaijan. Unless a foreign law implication is involved, the only restriction is applied to representative office where it would not be engaged in banking activity and would only represent and protect interests of the head organization.

#### **2.1 Registration**

Registration Requirements for setting up a representative office of foreign legal entity are identical with the registration requirements for a Branch. State fee for the registration of a representative office and branch office of foreign legal entity is AZN 220, which is approximately USD 260.00.

To register a representative/branch office in the Azerbaijan Republic the following documents should be submitted to the appropriate registering body:

1. Application form for registration of a branch/representative office
2. Charter or Memorandum and Articles of Association of a foreign legal entity
3. Power of Attorney for the chief representative
4. Board Resolution on opening a branch/representative office
5. Certificate on Incorporation or Extracts from the Trade Register in the home country of foreign legal entity;
6. Regulation of a branch/representative office
7. Passport photocopies of the chief representative of a branch/representative office
8. Document confirming legal address of a branch/representative office: lease agreement or landlord guarantee letter, along with the ownership certificates in the name of landlord
9. Bank receipt on payment of state duty

---

<sup>1</sup> Approved by the Law of the Azerbaijan Republic No.779-IQ, dated December 28, 1999.

---

All documents to be provided by a foreign legal entity must be notarized and legalized (apostilled) in the country of origin of a foreign legal entity. Any document supplied in a language other than Azerbaijan should be accompanied by a notarized translation.

### **3. Forming a local legal entity**

The Civil Code as well as other legislative acts of the Azerbaijan Republic regulates activities of Azerbaijan legal entities.

Activity of Enterprises with foreign investments are regulated by a number of the legislative acts, such as the Law on Protection of Foreign Investments dated January 15, 1992, international and bilateral agreements of the Azerbaijan Republic and contracting states.

Enterprises may carry out any business activity, as described by the charter of legal entity if not prohibited by the legislative acts of the Azerbaijan Republic.

In accordance with the legislation of the Azerbaijan Republic, enterprises may perform certain types of activities only upon obtaining special permits (License) from the appropriate government authorities.

The Civil Code of the Azerbaijan Republic provides for the following types of legal entities:

- Joint Stock Company (JSC);
- General Partnerships (GP);
- Limited Partnerships (LP);
- Limited Liability Companies (LLC);
- Additional Liability Companies.

#### **3.1 Joint Stock Companies ("JSC")**

JSC is a legal entity comprised of at least one individual and/or legal entities. JSC is a legal entity that provides its shareholders with limited liability to the extent of their shares. Shareholders are also liable for the obligations of the JSC to the extent that their shares remain unfunded. One individual or legal entity may establish a JSC provided that such individual or legal entity has purchased all outstanding shares of the JSC. JSC may be either of open or closed type.

The charter capital of a JSC is divided into a fixed number of shares of a stated par value. For a closed JSC, the minimum amount of the charter capital is approximately AZN 2000.00 and AZN 4000.00 for an open JSC. The charter capital of a JSC must be fully paid on or before the date of its state registration.

The General Meeting of Shareholders is the highest management body of JSC. The GMS must be held annually.

##### **3.1.1 Registration**

In order to register a JSC, the following documents must be submitted to the appropriate registering body:

1. Application form for registration of JSC;
2. The Resolution of founder (founders) on establishment of JSC;
3. The Charter of JSC;
4. A document evidencing payment of the JSC's charter capital;
5. A document confirming the legal address of the JSC;
6. A document evidencing payment of the state registration fee.

Foreign legal entities acting as a founder of the JSC must also submit documentation verifying that they are duly registered in their home jurisdiction. Documents must be notarized and legalized (apostilled) in the

---

home country. Any documents supplied in a language other than Azeri must be accompanied by a notarized translation of the same into Azeri.

### **3.2 General Partnership (“GP”)**

A GP is a legal entity comprised of at least two individuals and/or legal entities. An individual may participate in creation of the GP only if such individual is registered as entrepreneur. Individuals and/or legal entities may participate in only one GP. General partners are jointly and severally liable for the partnership’s liabilities. To the extent that the partnership does not have sufficient assets to cover its obligations, the partners are then personally liable for its obligations.

The supreme body of a GP is the General Meeting of Partners.

#### **3.2.1 Registration**

The following documents must be submitted for the state registration:

1. Application form for registration of GP;
2. The Resolution of founder (founders) on establishment of LP;
3. The Charter of the GP;
4. A document confirming the legal address of the GP;
5. A document confirming the legal address of the founders (if the founders are legal entities) and/or documents confirming the founder’s place of employment and identification documents (if the founders are individuals);
6. A document evidencing payment of the state registration fee.

Foreign general partners as legal entities must submit documentation verifying that they are duly registered in their home jurisdiction. All documents to be provided by a foreign legal entity must be notarized and legalized (apostilled) in the home country. Any documents supplied in a language other than Azeri must be accompanied by a notarized translation of the same into Azeri.

### **3.3 Limited Partnership (“LP”)**

A limited partnership (“LP”) has one or more general partners and one or more limited partners. The general partners are personally liable for the partnership’s obligations. The limited partners’ liability is limited to the amount of their contributions. An individual may participate as a general partner only in one LP. Similarly, a partner of the GP may not participate as a general partner in the LP.

A withdrawing general partner and remaining general partner are equally liable for the GP’s liabilities that arose prior to the withdrawal. A newly admitted general partner becomes liable for all the liabilities of the LP that arose prior to the admission of the new partner.

Limited partners have the same rights as general partners, but cannot vote in elections for members of the Board or vote on any matter that concerns only the rights of general partners, cannot participate in management and in entrepreneurial activity of LP.

The management over an LP’s activities is conducted by the general partners. The law provides for the same management structure for an LP as it does for a GP.

#### **3.3.1 Registration**

The following documents are submitted for the state registration:

1. Application form for registration of the LP;
  2. The Resolution of founder (founders) on establishment of LP;
-

3. The charter of the LP;
4. A document confirming the legal address of LP;
5. Documents confirming the legal address of the founders (if the founders are legal entities) and/or documents confirming the place of employment of the founders and their identification documents (if the founders are individuals); and
6. A document confirming payment of the state registration fee.

Documents from the foreign legal entity must be notarized and legalized (apostilled) in the home country. Any documents supplied in a language other than Azeri must be accompanied by a notarized translation of the same into Azeri.

### **3.4 Limited Liability Company (“LLC”)**

A limited liability company (“LLC”) is an entity established by one or more individuals and or legal entities contributing their shares to the charter capital. An LLC established by a physical person may not participate in another LLC in which the same physical person is the only founder of both companies. The participants in an LLC are liable only to the extent of their contributions.

A participant in an LLC has the same basic rights as those provided for a shareholder of a JSC. A participant of an LLC is not liable for the LLC’s obligations and bears the risk of loss for the LLC’s activities only to the extent of its contributions to the LLC’s charter capital.

The supreme body of an LLC is the General Meeting of Participants.

Charter capital consists of contributions of the participants. The charter capital of an LLC is divided into a fixed number of shares set forth by the LLC’s charter. All of the founding participants must make their contributions to the charter capital by the date of the LLC’s state registration.

#### **3.4.1 Registration**

In order to establish an LLC, the following documents must be submitted to the registering authority:

1. Application form for registration of LLC;
2. The foundation protocol of the meeting of the founders of the LLC;
3. The charter of the LLC;
5. Document confirming the legal address of the LLC;
6. Documents confirming the residence address, place of employment of the founders and their identification documents (if the founders are individuals);
7. Document evidencing payment of the LLC’s charter capital;
8. Document confirming payment of the state registration fee.

Additional documents must be submitted by foreign participants. Documents issued abroad must be notarized and legalized (apostilled) in the home country. Any documents supplied in a language other than Azeri must be accompanied by a notarized translation of the same into Azeri.

### **3.5 Additional Liability Company (“ALC”)**

An additional liability company (“ALC”) is an entity established by one or more individuals and/or legal entities contributing their shares to the charter capital. Legal structure of an ALC is similar to an LLC.

The major difference is that the participants in an ALC may assume liability for the company in excess of their contributions as regulated by the charter.

Registration requirements are very similar to the ones we presented in the above Article 3.4 herein, i.e. ALC.

---

### **3.6 Subsidiaries**

An enterprise established in Azerbaijan may also form subsidiaries in any of the legal forms mentioned above. A subsidiary is a separate and distinct legal entity; the parent enterprise may contribute property to its subsidiary but, typically, is not liable for the obligations of the subsidiary.

A parent company, however, may be held liable for obligations of its subsidiary in bankruptcy if such bankruptcy was caused through the fault of the parent company in connection with execution of its instructions.

Additionally, a parent company and its subsidiary are jointly and severally liable for obligations incurred by the latter as a direct result of implementation of instructions of the former even if the former is not in bankruptcy.

---



## **Section II. LEGAL/LABOR CODE REQUIREMENTS**

### **1. Introduction**

Labor relations of all workers and employees in the Azerbaijan Republic are regulated by the Labour Code<sup>1</sup>, effective July 1, 1999, as well as other Laws of the Azerbaijan Republic issued pursuant to the Labour Code.

### **2. Labor Books (Book of Employment Records)**

An employer must fill in appropriate information in labor books of local employees who are employed for the period of more than five days. An employee entering into an employment contract (except in cases where a contract is concluded for the first time) must present to employer his/her labor book, identification documents and certificate of state social insurance.

This requirement does not apply to individuals with IDP and refugee status, foreign citizens and stateless persons.

In accordance with the local legislation Labor Book should be safely kept by the HR Manager or someone who performs such a function.

All the previous, current and future job information should be recorded accordingly to enable future calculations of pensions by the appropriate bodies (applicable for the local citizens only).

### **3. Probationary Period**

As per the Labor Code requirements, a provision on probationary period must be stipulated in an employment contract, which shall not exceed three months. Employees, who don't pass such probationary period, could be terminated with an immediate effect notice.

### **4. Working time**

Normal duration of business day should not exceed 8 hours. The regular business week is 40 hours, less for certain groups of people as invalids, pregnant women, etc.

When concluded the Employment Contract as well as being in the process of labor relationship and upon obtaining mutual consent, employer and employee may agree on a part time work.

### **5. Overtime**

Only for the purposes of prevention of natural calamities, force major circumstances, production accidents and other extraordinary events and/or liquidation of their consequences, and also for the purpose of prevention of losses of perishable goods overtime work could be allowed.

However, in any case duration of overtime work should not exceed 4 hours during two consecutive days.

Overtime for the employees engaged in extra hard and harmful works is regulated as well. For employees engaged in such work duration of overtime should not exceed 2 hours during two consecutive days.

Payments for each hour of overtime must not be less than double hourly rate of employee's base pay. Compensation of overtime with extra holidays is not allowed.

---

<sup>1</sup> Approved by the Law of the Azerbaijan Republic No.618-IQ, dated February 1,1999

---

## **6. Rest time**

During the business day (shift), employees must be allowed a break for rest and lunch. Duration of rest time shall be determined by the Internal Regulations of the Company, shift schedule, employment contract and collective agreement.

## **7. Holidays and days off**

The official public holidays in the Republic of Azerbaijan:

1,2 January - New year;  
20 January - Day of National Mourning;  
8 March - Women's Day;  
9 May - Victory day over fascism;  
28 May - Republic Day;  
15 June - Day of National Salvation of the Azerbaijan People;  
26 June - National Army Day;  
18 October - National Independence Day;  
12 November - Constitution Day;  
17 November - National Revival Day;  
31 December - Day of Solidarity of Azerbaijanians  
Novruz Holiday – 5 days  
Gurban Holiday – 2 days  
Ramazan Holiday – 2 days

Please note that New Year, Day of National Mourning, Women's Day, Victory Day, Republic Day, Day of National Salvation of the Azerbaijan Republic, Armed Forces of the Azerbaijan Republic, Azerbaijan World Solidarity Day, Novruz, Gurban and Ramadan holidays shall not be considered as working days.

The exact dates of Novruz, Gurban and Ramadan for the following year shall be determined and announced to the public by the end of December by the relevant executive authority.

In accordance with the Amendments to the Labour Code dated 30 December 2005, when week ends days overlap with holidays, which are not considered as working days, such a day shall be transferred to the other working day following after holidays.

**Note:** In accordance with the Election Code of the Republic of Azerbaijan [No.461-IIQ, dated May 27, 2003] Voting Day [election/referendum] shall not be considered as a working day.

## **8. Vacation entitlement**

The minimum paid annual vacation is twenty-one calendar days and must be provided to all employees.

For the following categories of employees duration of annual vacation must not be less than 30 calendar days:

- employees engaged in agricultural production;
- senior officials, managers and specialists of enterprises;
- physicians, nurses and pharmaceuticals, etc.

For disabled people duration of paid annual vacation should not be less than 42 days.

It must be noted that certain categories of employees, especially the ones working in hazardous conditions, offshore workers, etc., shall be entitled to additional vacation days, which should be not less than 6 days.

---

## 8.1 Paid leave in connection with education

Employees who are studying and working at the same time should be entitled to the following paid leaves in connection with education:

- for attending semester exams;
- for attending finals (course exams);
- for preparing for and attending graduation exams

## 8.2 Social Vacations (Maternity Leave)

Women should be entitled to a paid maternity leave for seventy (70) calendar days prior to and fifty-six (56) days after childbirth. In the event of abnormal or multiple births, woman shall be granted seventy (70) days leave after childbirth.

## 8.3 Non-paid Leave

Should employee has to solve family, private and other social matters, he/she should be entitled to a non-paid leave.

## 9. Statutory sickness payments requirements

Employees should be entitled to certain compensations for the period of their illness. Such compensations would depend on the length of service of employee, for instance:

- Up to 5 years length of service - 60% of the salary to be paid;
- From 5-8 years length of service - 80% of the salary to be paid;
- From 8 years length of service - 100% of the salary to be paid;
- Disabled people - 150% of the salary to be paid.

Normally, such sickness benefits are provided on presentation of a Sickness Certificate.

Social allowances to employees for sickness days for the first 14 days of sickness should be made at expense of employer. Sickness allowances for all the periods exceeding 14<sup>th</sup> day of sickness should be compensated to employee by Social Protection Fund.

## 10. Employment Termination

Employer may terminate Employment Contract for the following reasons:

- liquidation of an enterprise;
- reduction in the number of employees or staff;
- decision of the Authorized Body<sup>1</sup> on non compliance of the employee with his or her position due to insufficient competency, qualification (professionalism);
- failure to execute labor function or obligations as determined in the Employment Contract by the employee or gross violations of labor obligations in the cases as specified in the Labor Code;

### 10.1 Employment Termination/Special Considerations

10.1.1. As per the Article 77 of the current Labor Code, if Employment Agreement is terminated pursuant to the paragraph (b) of the Article 70 ("reduction in the number of employees"), Employer must officially inform Employee about termination of contract not later than two months in advance;

---

<sup>1</sup> **Note:** "Authorized Body" mentioned above is meant to be an authorized attestation commission that is to be called for the purpose of determination whether or not the employee meets requirements of his/her qualification, professional skills.

---

- 10.1.2. To enable Employee to look for a job, Employer must give an Employee not less than one (1) day off during every business week of such notification period, provided that his/her base salary is fully paid;
- 10.1.3. The following allowances must be paid to Employees upon termination of their employment:
- Termination allowance in an amount of not less than one average monthly salary;
  - Average monthly salary for the second and third months from the date of termination and before starting a new job (if Employee has registered himself with the Employment Fund and Municipality and presents relevant paperwork to his Employer);
- 10.1.4. Instead of giving two months notice, Employer may, should Employee agree, pay him/her one time two-month average monthly salary allowance.

## **10.2 Special Considerations before termination of Employment Contracts (staff reduction):**

- 10.2.1 Before terminating employment contracts Employer should take into account professionalism and qualifications of Employee and should try to provide him/her with some other work (position) within the Company;
- 10.2.2 In certain cases, especially for the Employees with higher level of qualification or skills, advantages and privileges should be granted upon termination of contracts.

## **10.3 Employees whose employment contracts may not be terminated.**

The employer shall be prohibited from terminating the employment contracts for the reasons stipulated by the Article 70 of the Labour Code of the Republic of Azerbaijan:

- Pregnant women and women with a child under 3;
- Employee (single mother or father with a pre-school child), if the only source of income is the Company;
- Temporary disability of the Employee;
- If the Employee has pancreatic diabetes;
- Participation in a trade union or political party;
- During a period of vacation or business trip.

**Note:** Provisions of this article should not be applicable in case of termination pursuant to Article 70(a) [liquidation of the enterprise] and Article 73 [expiration of the fixed term employment contract] of the Labour Code of the Azerbaijan Republic.

## **10.4 Vacation entitlement upon termination**

Regardless of the reason and basis of termination of employment contract, an employee is entitled to be paid monetary compensation for any unused main vacations for all working years, with no term or limitation.

## **10.5 Employee resignation**

- 10.5.1. In accordance with Article 69 of the current Labor Code Employee may terminate Employment Contract upon serving one (1) calendar month prior written notice to the Employer;
- 10.5.2. Upon expiration of one calendar month from the date of notice, Employee is entitled to his severance pay and shall leave work accordingly;
-

- 10.5.3. If Employee retires for the reason of old age or disability, enters an educational institution to continue education, moves to a new place of residence and in other cases provided by legislation, Employment Contract may be terminated from the date specified in the termination notice.
- 10.5.4. Before expiration of notification period, Employee may revoke termination notice or upon serving of other notice may announce the latter invalid. In that case Employment Contract may not be terminated, especially if Employer did not inform Employee by written formal notice about hiring of other employee for such vacancy. Upon termination of Employment Contract in accordance with the provisions of Article 69, Employee is not entitled to revoke or announce notice of termination invalid;
- 10.5.5. Employee shall be entitled to his/her annual unused holidays for the appropriate working year (years) and termination of employment contract shall be considered at the end of such leave. Before expiration of such leave, Employee may revoke termination notice or upon serving other written notice to announce the latter invalid;
- 10.5.6. It is not permitted to terminate Employment Contract by force, intimidation or otherwise, against Employee's will.

## **11. Work Permit for foreign nationals**

As a rule, a work permit is required for foreign nationals to work in Azerbaijan [*Law of the Republic of Azerbaijan "On Labour Migration" No.724-IQ dated October 28, 1999 and Decree of the Cabinet of Ministers of the Republic of Azerbaijan "On approval of Regulations on issuance of individual work permit for carrying out paid labor activity on the territory of the Republic of Azerbaijan by the foreign nationals No. 214 dated 6 December, 2000.*].

This rule does not apply to the foreign nationals listed hereinafter:

- residents of the Republic of Azerbaijan
- private entrepreneur
- managerial staff of the organizations established on the basis of international agreements
- diplomatic representations/consulates staff
- international organizations staff
- individuals being on business trip not more than three months period
- individuals employed by respective power body
- individuals engaged in religious activity of duly registered religious organizations and societies
- accredited employees of mass media
- seamen
- sportsmen and artists
- teachers/tutors/professors invited by universities or experts carrying out research activity
- managerial staff of the foreign legal entities, branch/representative offices of foreign legal entities operating in the Republic of Azerbaijan.

### **Procedure and term of WP obtaining procedure**

The foreign nationals shall apply for obtaining of work permit through his/her employer that is duly established in the Republic of Azerbaijan.

As of July 1, 2009 State Migration Service of the Republic of Azerbaijan is authorized for issuance of work permit.

---

The set of documents required by the above stated regulations shall be submitted to the State Migration Service. If upon consideration of provided documents the said authority does not find any basis for refusal provided by the relevant legislation, then within 20 working days period after submission hereof the State Migration Service shall issue a work permit.

A work permit is generally effective for a one year period. The term of work permit may be extended 4 times, provided that each extension shall not exceed one year period.

**Note:** In accordance with Code of Administrative Violations of the Republic of Azerbaijan, the employment of foreign nationals without obtaining work permits shall impose a penalty at the rate of thirty thousand up to thirty five thousand mantas (AZN 30,000-35,000) for managerial staff.

**Section III. LICENSING OF COMMERCIAL ACTIVITIES**

In accordance with the President's Decree "On improvement of rules on issuance of special permits (licenses) on special types of activities" dated September 2, 2002, a number of types of activities that require obtaining of special permits (licenses) was reduced from 240 to 32 (the last amendments were inserted by the Presidential Decree dated 23 October, 2003). A license is granted without discrimination to any entity that meets the requirements for that specific license.

In accordance with the above Decree, the Ministry of Economic Development of the Azerbaijan Republic is given special authorities on licensing issues, i.e. to maintain centralized register of licenses in the country, to prepare draft normative legal acts on licensing issues, to control compliance with the licensing law by state bodies and economic subjects, etc.

Although the Ministry of Economic Development is authorized to regulate the above stated issues, however, under Appendix 1 to the above Decree, appropriate state agencies are authorized to consider documents submitted by applicants and to grant licenses. All licenses are valid for the period of five years, except licenses for production of alcoholic beverages and ethyl (drinking) alcohol - 3 years and for import hereof - 1 year.

The above Decree determines regulations and procedures for licensing of specific types of activities.

Applicants must submit all documents to the appropriate state bodies as specified in Appendix 1 of the above Decree and pay an application fee. If an applicant meets all of the requirements, the license should be issued within 15 days after the date of submission of the documents.

---

## **Section IV. LEGAL STATUS AND USE OF THE STATE LANGUAGE**

The President's Decree on the enforcement of the Law of the Azerbaijan Republic "On the state language in the Republic of Azerbaijan" of September 30, 2002 was issued in January 2, 2003. We hereby enclose some extracts from the above stated Law and Decree due to the importance of the issues outlined therein.

### **1. Legal status of the state language**

In accordance with Section 1 of Article 21 of the Constitution of the Azerbaijan Republic, the state language of the Azerbaijan Republic is the Azerbaijani language.

The activity connected with the enforcement of the state language in state authorities and municipalities, state bodies, political parties, non-governmental organizations (society units and funds), trade union organizations, other legal entities, their representative and branch offices, institutions in the Azerbaijan Republic shall be carried on in accordance with this Law. Record keeping and official correspondence in the above-mentioned organizations shall be in the state language.

### **2. Use, protection and development of the state language**

#### **2.1 Use of the state language in services industries, advertisements and announcements.**

In all services industries, advertisements and announcements on the territory of the Azerbaijan Republic the state language shall be used. In the appropriate services industries connected with providing of services for foreigners, along with the state language other languages may be used. In necessary cases in advertisements and announcements (on display rags, boards, placards, etc.) equally with the state language other languages may be used. However, inscriptions in foreign languages shall not take more space than the ones in Azerbaijani language and must be placed after inscriptions in Azerbaijani language.

The state language in all services industries, advertisements and announcements on the territory of the Azerbaijan Republic shall be used in accordance with the norms of the state language.

The norms of orthography and orthoepy of Azerbaijani language are approved by the appropriate executive body. Legal entities, physical persons and officials must comply with the said norms.

Labels and other inscriptions on the goods produced on the territory of the Azerbaijan Republic as well as on the exported goods equally with the appropriate foreign languages shall be written in the state language.

Labels and names on the goods and products being imported into the Azerbaijan Republic and their instruction manuals equally with other languages shall be accompanied by translation into Azerbaijani language.

#### **2.2 Use of the state language in titles of state authorities and municipalities, legal entities, their representative and branch offices, organizations.**

The titles of state authorities and municipalities of the Azerbaijan Republic, legal entities, their representative and branch offices, organizations shall be written in accordance with the norms of the Azerbaijani language. The names of the above-mentioned organizations on signboards, forms, stamps and all other record keeping documentation and property of official character shall be specified in the state language.

In accordance with the Code of Administrative Violations of the Republic of Azerbaijan, any propagation against official language, rejection of a use and development of Azerbaijan language, attempt to limit the area of its usage, as well as prevention of application of Azerbaijani Roman alphabet in the Republic of Azerbaijan shall impose a penalty at rate of twenty to forty manats for individuals, and fifty to ninety manats for officials and one hundred fifty to three hundred mantas for legal entities.

---



## **Section V. COURT SYSTEM IN THE REPUBLIC OF AZERBAIJAN**

### **1. Court System**

The basic provisions regulating the structure and activities of the judiciary are stated briefly in the Constitution and more extensively in the *Law on Courts and Judges* [No. 310-IQ, dated June 10, 1997].

The Azerbaijani system of courts of general jurisdiction incorporates four levels:

- (i) the Supreme Court of Azerbaijan;
- (ii) the Court of Appeal;
- (iii) the Supreme Court of the Nakhchivan Autonomous Republic;
- (iv) the local district (city) courts as well as a specialized court which hears cases involving serious crimes.

In addition, the *Law "On Courts and Judges"* provides courts of specialized jurisdiction including the Local Economic Courts and military tribunals.

District (city) courts and the serious crimes court are courts of original jurisdiction. Judgments may be subject to review/appeal by higher courts. The serious crimes court is a single court that, as its name suggests, has jurisdiction to trial serious crimes. However, it has no jurisdiction over serious crimes which are subject to the Nakhchivan court system.

The Nakhchivan Supreme Court exercises control over the Nakhchivan district courts and functions as a court of appeal for their decisions. It is also a court of original jurisdiction for serious crimes.

The Court of Appeal is a court for all original jurisdiction courts including the Nakhchivan Supreme Court (but not Nakhchivan district Courts).

The Supreme Court is the highest court in Azerbaijan. It acts as a court of appeals with regard to cases heard by the lower courts and is the court of last resort. Supreme Court cases are heard by the relevant (civil, criminal, military, economic and administrative) appellate collegia. The Supreme Court is headed by the Chairman and the Plenum of the Supreme Court, the highest administrative body in the Supreme Court.

#### **1.1. International Arbitration**

Foreign investors may rely on provisions of the Foreign Investment Law to govern dispute resolution pursuant to which investment disputes may be resolved either by Azerbaijan courts or in accordance with the dispute resolution procedures agreed to by the parties. This may include international arbitration at a forum selected by agreement.

International Arbitration in Azerbaijan is conducted in accordance with the *Law of the Azerbaijan Republic "On International Arbitration"* [No. 757-IQ, dated November, 1999]. Under these rules, parties may select independent arbitrators of any nationality, the proceeding may be conducted in any language chosen by the parties, the applicable material (except for the matters that must exclusively be resolved by the under Azerbaijani Laws) and procedural law may be chosen by parties, and, in general, parties may stipulate other terms of the arbitration. If no such terms were stipulated by the parties, disputes may be heard by the Local Economic Courts of the Azerbaijan Republic.

#### **1.2. Enforcement of foreign judgments and court assignments**

Procedures for enforcement of foreign judgments in Azerbaijan are established by the Civil Procedure Code of the Republic of Azerbaijan.

---

## **2. Constitutional court**

The Constitutional Court established in late 1998 and is not a part of the court system regulated by the Law on Courts and Judges.

The Law on Constitutional Court was adopted on the 23<sup>rd</sup> of December 2003.

The Constitutional Court of the Azerbaijan Republic centers its judicial activity on constitutional issues. The most crucial role of the Court is the power of scrutinizing the constitutionality of legal norms and, if required, to annul any such norms found to be in disagreement with the Constitution. Normally, this type of the constitutional justice places the emphasis on the protection of the Constitution as the highest supreme standard. According to Article 130 of the Azerbaijan Constitution, the Constitutional Court mainly plays both defensive and interpretative role. The defensive function of the Court is performed by the means of confirming legality of laws, normative-legal acts, decrees orders and decisions of the executive, legislative, and judicial branches to the Constitution of the Azerbaijan Republic. It should be underlined that the Court has no general jurisdiction to consider whether the first instance courts have committed errors of law or fact. Thus, it is not for the Court to consider the merits of the facts at the first level, it is for the Court to consider the compatibility of a given norm to the Constitution of the country.

Proceedings in the Constitutional Courts are carried out in the following forms:

- Constitutional proceedings on cases initiated by the inquiries of the President of the Azerbaijan Republic, Milli Majlis, Cabinet of Ministers, Supreme Court, Prosecution office and the Parliament of the Nakhichevan Republic, Ombudsman.

Special constitutional proceeding on cases associate with the monitoring and confirmation of the results of elections to Milli Majlis, confirmation of the results of elections of the President of the Azerbaijan Republic, cases associated with the issue of presidential resignation etc.

Besides with the purpose of restoration of violated rights and freedoms any person may appeal the normative acts of legislative and executive power bodies, municipalities and judicial acts, violating his rights and freedoms at the Constitutional Court of the Azerbaijan Republic in an order established by the legislation.

---

## Section VI. RECENT IMPORTANT CHANGES IN LEGISLATION

### 1. Amendments to the Labour Code of the Republic Of Azerbaijan

In accordance with the *Decree of the President of the Republic of Azerbaijan on making amendments to the Labor Code of the Republic of Azerbaijan dated May 14, 2009* the new amendments have come into force as of May 17, 2009 (i.e. date of publication). These changes have considerably affected provisions of the Labor Code, especially in relation to the term of employment contract, probationary period, termination of employment contract, holidays and vacation entitlements, etc. Below we have highlighted the major changes.

**(i) Article 45** [Term of an employment contract]

It shall be added Section 5 of the following content hereto:

“If a fixed-term employment contract continues for the period of more than five consecutive years, it shall be considered to have an unlimited nature.”

**(ii) Article 52** [Cases for which a probationary period shall not apply]

As per the recent changes it shall be added to the above Article the following categories of individuals to whom a probationary period shall not apply:

- pregnant women, women with child under the age of three, men raising their children under the age of three as single parents;
- individuals who are commencing their labor activity for the first time in the year of graduation as per his/her specialty;
- individuals who are elected to a public service (state authority, municipality);
- individuals who are employed for two months period.

**(iii) Article 61** [Performance of another employee's job]

In Section 1 hereof the words “for the period of more than fifteen days” shall be replaced with word “job” and this Section shall be read as follows:

“By agreement of the parties an employee may perform the job of another employee who is absent from work for a specific reason. In this case he/she shall be compensated in the order stipulated in Article 162 of this Code.”

**(iv) Article 62** [Employee Dismissal]

The following sentence shall be added to Section 3 hereof:

“If employee is dismissed due to the fact that he/she did not pass obligatory initial or regular medical examination for a valid reason, during such dismissal period he/she shall be compensated in the order being applicable as for idle time”.

**CABC Comment:** We would like to note that the original version of the above addendum has been poorly written. Thus, as per the Labour Code of AR the obligatory initial medical examination is usually required to be done prior to entering into employment contract. So, it is not possible to dismiss employee from his/her position before he/she is being employed, consequently, the above addendum partially contradicts existing provisions of the Labour Code of AR. It shall be only applied to the employees who are required to have “regular medical examination”.

---

**(v) Article 70** [Grounds for termination of an employment contract by Employer]

The other principal change has been made to the Article 70 regarding grounds for termination of employment contract. Thus, it shall be added a new paragraph of the following content:

“(e) If an employee does not satisfy requirements of his/her position during the probationary period”.

**(vi) Article 77** [Employee guarantees upon termination of an employment contract]

Certain changes have been made to Section 9 of Article 77 relating to individuals who are being called for the statutory military service, particularly:

- (i) in the first sentence of Section 9 the words “in case of reduction in the number of employees and staff” shall be withdrawn, and after the words “of employee” shall be added “statutory” and this sentence shall be read as follows:

“Regardless of the type of ownership and organizational-legal form of enterprise, the workplace and position of the employee shall be retained within the period of the statutory military service, except for the liquidation of the enterprise, in order stipulated by the legislation.”

- (ii) as well as, the following sentence has been added hereto:

“Individuals who were working for the enterprise before the statutory military service, shall be reinstated to the same or equal position at the same enterprise within the period not exceeding 60 calendar days upon returning from the statutory military service.”

**(vii) Article 79** [Employees whose employment contracts may not be terminated]

Also, the following amendments have been made to the Article 79:

- (i) paragraph 2 of Section 1 shall be as follows:

“Pregnant women and women with children under age three, and men raising their children under the age of three as single parents”.

- (ii) paragraph 7 shall be considered as paragraph 8 and the following paragraph shall be added as paragraph 7:

“employee with a disabled child under the age of 18 and Category 1 Disabled family member”.

**(viii) Article 105-1** [Voting day]

It shall be added a new Article 105-1 to the Labour Code regarding voting day of the following content:

“During elections of deputies of the Milli Mejlis of the Republic of Azerbaijan, the President of the Republic of Azerbaijan, members of municipalities in the Republic of Azerbaijan, and during referendum the voting day shall not be considered a working day in the territory where elections (referendum) are holding. The voting day shall be determined in accordance with legislation.”

---

**(ix) Articles 109** [Compensation of employees who work on days off, holidays and other days not considered working days]

As per the changes made, this Article shall be as follows:

“Article 109. Compensation of employees who work on days off, voting day, holidays that are being considered as a non working days and the day of national mourning.

Employees who work on days off, voting day, holidays that are being considered as a non working days, as well as on the day of national mourning in exceptional cases provided by the Article 107 of this Code, shall be compensated in order stipulated by the Article 164.”

**(x) Article 112** [Types of leave]

The paragraph (b) of Section 1 shall be as follows: “Social leave” (instead of “Social leave for maternity and child care”)

**(xi) Article 129** [Types of unpaid leave]

Section 2 of this Article shall be in the following reduction:

“Employee may be granted unpaid leave for the period not exceeding 6 months at the discretion of the parties and by mutual agreement of the employer and employee and in the cases provided by the collective contract, as well as under the terms of employment contracts.”

**(xii) Article 130** [Duration of unpaid leave granted at the request of employees]

(i) The first paragraph of the Article shall be amended as follows:

“During one working year, an employee, at his/her request, shall be granted unpaid leaves in the following cases and duration:”

(ii) Also, it shall be added the following paragraphs to this Article:

- (l) up to 14 calendar days, for employees with partially disabled child under the age of 18.
- (m) up to 7 calendar days for resolving family and other social issues.

**(xiii) Article 133** [Order of preference for vacations]

It shall be added Section 4 hereto:

“4. Regardless of term of employment at the enterprise, an employee, upon his request, shall be granted base vacation during the period when his wife is being on maternity leave.”

**(xiv) Article 159** [Compensation in special case]

The text of this Article shall be considered as Section 1 hereof and below sentence has been added as Section 2:

“Employees, who are working reduced working hours as stipulated by the Articles 91, 92, 93 of this Code shall be paid at the same compensation rate as it is provided for the normal working hours”.

---

**(xv) Article 164** [Compensation of employees who work on days off, holidays and other days that are not being considered as working days]

In connection with the establishment of a new Article 105-1 regarding voting day, there shall be changes made hereto. So, the heading of this Article shall be as follows:

“Article 164. Compensation of employees who work on days off, voting days, holidays that are being considered as non working days, as well as on the day of national mourning.”

Also, there shall be the following amendments to the wording of the Article:

- (i) Section 1 shall be as follows: “Compensation of employees who work on days off, voting days, holidays that are being considered as non working days, as well as on the day of national mourning shall be paid as follows:”
- (ii) Section 2 shall be as follows: “Should an employee, who works on days off, voting days, holidays that are being considered as non working days, as well as on the day of national mourning, so desire he/she may have an extra day off in lieu of pay.”

**(xvi) Article 223** [Occupational Safety Services]

The following addendums have been made to this Article:

- (i) The Section 1 hereof shall be as follows: “To organize occupational safety and monitor employee’s compliance with occupational safety regulations it shall be created occupational safety service in all spheres of the economy, in enterprises with more than 50 employees.”
- (ii) The following sentence has been added to Section 2: Position of engineer of occupational safety shall be established in enterprises with more than 50 employees and deputy chief (chief engineer) for occupational safety in enterprises with more than 500 employees.”

**(xvii) Article 105** [Public Holidays]

In accordance with the Law of AR “*On making amendments and additions to the Labour Code of the Republic of Azerbaijan*” dated 4 December 2009, it has been added to the Article 105 of the Labour Code new paragraph: “Day of State Flag of the Republic of Azerbaijan (November 9).”

---

## II. "One window system" for control of migration processes

According to the Decree of President of the Republic of Azerbaijan dated March 04, 2009 regarding the implementation of "one window system" for control of migration processes, effective July 1, 2009 all migration procedures are carried out by State Migration Service of the Republic of Azerbaijan.

In accordance with the said Decree, the authorized body shall control and be responsible for all migration procedures, including the followings:

- (i) issuance/extension of temporary residence permits in AR;
- (ii) issuance/extension of work permits in AR;

**Temporary Residence Permit.** Currently, foreign nationals staying in Azerbaijan more than 30 days are required to have temporary residence permit which replaces the former visa and police registration. The Government processing time for issuance of temporary residence permit is 20 working days. The state duty is 30 AZN for 30 days TRP, 60 AZN for 90 days TRP and 120 AZN for 1 year TRP.

**Work Permit.** As a rule, a work permit is required for foreign nationals to carry out labour activity in Azerbaijan. The Government processing time for issuance of work permit is 20 working days. The state duty is 1 000 AZN.

## III. Amendments to the Civil Procedural Code of the Republic of Azerbaijan

In accordance with the Decree of the President of the Republic of Azerbaijan dated 22 June 2009 on application of Law of AR "On making amendments and additions to the Civil Procedural Code" the following amendments have been made to the Civil Procedural Code:

1. The Judgment of Court of Appeal is deemed to be effective after 2 months from the date of decision, provided that within this period it has not been appealed.[Article 393].
2. The Judgment of Court of Appeal shall be appealed within 2 months period after the parties to a litigation have been officially served with the Judgment. [405.0.1]

## IV. Administrative Procedural Code of the Republic of Azerbaijan.

A new Administrative Procedural Code has been adopted and came into force in November 8, 2009. This Code stipulates procedural principles and regulations for consideration and settlement of administrative disputes judicially.

---

## Section VII. TRAVEL ALLOWANCE RATES

Due to the latest amendments regarding compensation for Business Trips, accepted by the Cabinet of Ministers of The Azerbaijan Republic in the Order #14, for the purpose of increasing the subsistence money, the business trip rates will be increased within the Azerbaijan Republic as well as in the foreign countries. According to the changes, the daily travel allowance standard (which includes the hotel expenses, connection, transport within the city, etc.) will now be 65 manats in Baku City, 50 manats in other major cities like Ganja, Sumgait and Nakhchivan, 45 manats in other smaller towns and in urban settlements and villages. The transport expenses (reaching the, and departing from the appointed destination within the country) are paid on the base of the introduced receipts. For workers, performing in the dangerous conditions, workers, who have difficulties with going back home after work, workers working on a rotational schedule, and other workers, performing in specific conditions, 10 additional manats per day are appended. Should be noted that business trip expenses for employees who work for governmental organizations are provided by the State budget, when travel allowance for workers who perform in a non-governmental organizations, is paid from that organization's budget.

It should be noted that these travel allowance rates are intended for local employees, and this law will come into force since 1st March 2008.

All the rates for foreign business trip expenses are provided in the following table.

### Daily Travel Allowance Rates for Foreign Countries

Row	Country	Currency	Daily travel allowance rates
1.	2.	3.	4.
1.	Russian Federation	USD	150
	Moscow and Saint-Petersburg Cities		240
2.	Tadjikistan	USD	140
	Dushanbe City		160
3.	Uzbekistan	USD	100
	Dashkand City		160
4.	Belorussia	USD	140
	Minsk City		180
5.	Ukraine	USD	160
	Kiev City		210
6.	Moldova	USD	110
	Kishinev City		150
7.	Kazakhstan	USD	130
	Almati and Astana cities		200
8.	Kirgizstan	USD	130
	Bishkek City		160
9.	Georgia	USD	140
	Tbilisi City		155
10.	Turkmenistan	USD	95
	Ashgabat City		130
11.	Latvia	Euro	105
	Riga City		140
12.	Lithuania	Euro	120
	Vilnius City		145
13.	Estonia	Euro	95
	Tallin City		140



14.	United Kingdom	GBP	170
	London Town		190
15.	Liechtenstein	Euro	200
16.	Austria	Euro	185
17.	Germany	Euro	225
18.	Belgium	Euro	215
19.	Ireland	Euro	215
20.	Monaco	Euro	195
21.	Norway	Euro	225
22.	Netherlands	Euro	225
23.	San-Marino	Euro	215
24.	France	Euro	205
	Paris City		250
25.	Turkey	Euro	150
	Ankara and Istanbul cities		165
26.	Italy	Euro	185
27.	Croatia	Euro	185
28.	Bosnia and Herzegovina	Euro	160
29.	Denmark	Euro	180
30.	Switzerland	Euro	210
31.	Luxemburg	Euro	190
32.	Macedonia	Euro	190
33.	Cyprus	Euro	160
34.	Hungary	Euro	160
35.	Malta	Euro	160
36.	Portugal	Euro	170
37.	Slovakia	Euro	160
38.	Finland	Euro	210
39.	Czech Republic	Euro	190
40.	Serbia	Euro	155
41.	Montenegro	Euro	155
42.	Andorra	Euro	200
43.	Albania	Euro	160
44.	Greece	Euro	180
45.	Iceland	Euro	190
46.	Spain	Euro	200
47.	Poland	Euro	175
48.	Sweden	Euro	225
49.	Bulgaria	Euro	135
50.	Romania	Euro	175
51.	Slovenia	Euro	145
52.	USA	USD	330
	New-York City		350
53.	Argentina	USD	195
54.	Brasil	USD	225
55.	Canada	USD	190
56.	Mexica	USD	165
57.	Other countries on American Continent	USD	165
58.	Bahreïn	USD	165
59.	Saudi Arabia	USD	165
60.	UAE	USD	235
61.	Jordan	USD	140
62.	Iran	USD	160

63.	Qatar	USD	180
64.	Kuwait	USD	180
65.	Oman	USD	170
66.	Syria	USD	160
67.	Iraq	USD	160
68.	Israel	USD	170
69.	Lebanon	USD	170
70.	Libya	USD	170
71.	Brunei	USD	155
72.	Yemen	USD	185
73.	Algeria	USD	165
74.	Morocco	USD	180
75.	Egypt	USD	180
76.	Tunis	USD	180
77.	Senegal	USD	185
78.	Sudan	USD	165
79.	Jibuti	USD	155
80.	Chad	USD	225
81.	South Africa	USD	240
82.	Other African Countries	USD	155
83.	China	USD	185
84.	Singapore	USD	235
85.	Thailand	USD	205
86.	Malaysia	USD	205
87.	Sri Lanka	USD	155
88.	India	USD	155
89.	Nepal	USD	155
90.	Bangladesh	USD	155
91.	Pakistan	USD	165
92.	Samoa	USD	145
93.	Mongolia	USD	145
94.	Laos	USD	155
95.	Vietnam	USD	155
96.	Indonesia	USD	205
97.	Afghanistan	USD	175
98.	Cambodia	USD	175
99.	Mauritania	USD	175
100.	Mali	USD	195
101.	Maldives	USD	165
102.	Gibraltar	Euro	150
103.	Democratic People's Republic of Korea	USD	225
104.	Korea	USD	245
105.	Japan	Yen	34720
106.	Phillipines	USD	210
107.	New Zealand	USD	195
108.	Australia and Oceanic	USD	195

## **Section VII. AZERBAIJAN TAXES RELATING TO PRODUCTION SHARING AGREEMENTS (PSA)**

There is total of around twenty PSAs concluded or committed between Azerbaijan Republic and consortiums of major oil companies. Conceptually, all Production Sharing type of Agreements have very similar skeletons, however sometimes provide for a different interpretation of such important aspects as cost recovery, tax deductibility, residency, applicability, etc.

We would like to offer our brief analysis of four different and, currently, the most active PSAs beginning with the overview of rules of determination of residency of foreign employees (based on the Tax Protocols of relevant PSAs):

### **1. Income Tax of foreign employees**

(ACG/Shah-Deniz/Nakhchivan/Kursangi & Karabagli/Zafar and Mashal PSAs and followed Tax Protocols)<sup>1</sup>

#### **1.1 Residency of Foreign Employees**

##### 1.1.1. 30 Consecutive Days Rule

###### ACG/Shah Deniz

- Presence in Azerbaijan for more than 30 (thirty) consecutive days during a calendar year in connection with Hydrocarbon Activities. Tax liability arises on taxable payments received in the Azerbaijan Republic in connection with Hydrocarbon Activities only after the first thirtieth (30<sup>th</sup>) consecutive days of employee's stay in the Azerbaijan Republic.

###### Nakhchivan/Kursangi & Karabagli (K & K)/Zafar-Mashal

- Differently from ACG/Shah Deniz Protocols, Nakhchivan Protocol concerning taxation of employees' personal income provides that individual income tax liability arises after **each** 30 consecutive days of stay of foreign employee in Azerbaijan until he or she has been present in the Azerbaijan Republic for a period more than 90 cumulative days.

##### 1.1.2. 90 Cumulative Days Rule

###### ACG/Shah Deniz/Nakhchivan/K&K/Zafar-Mashal

Presence in Azerbaijan for more than 90 (ninety) cumulative days during a calendar year in connection with Hydrocarbon Activity. Personal income tax liability arises on taxable payments received in connection with Hydrocarbon Activities only after the ninetieth (90<sup>th</sup>) cumulative day in the Azerbaijan Republic during a Calendar Year.

##### 1.1.3. 90 Cumulative Days Rule – Presence in Azerbaijan on a permanent or rotating basis

###### ACG/Shah Deniz/Nakhchivan/K&K/Zafar-Mashal

---

<sup>1</sup> ACG PSA dated September 20, 1994, effective December 12, 1994;  
Shah-Deniz PSA dated June 4, 1996, effective October 17, 1996;  
Nakhchivan PSA dated August 1, 1997, effective December 5, 1997  
Kursangi & Karabagli PSA dated December 15, 1998, effective April 22, 1999.

Presence in the Azerbaijan Republic on a permanent or rotating basis for a period of more than ninety (90) cumulative days during a Calendar Year. Income Tax liability arises on all taxable payments received in connection with Hydrocarbon Activities.

## **1.2 Clarifications on Protocols concerning Taxation of Employees and Physical Persons**

### ACG/Shah Deniz/Alov/Inam/SCP/BTC

The Clarification on Protocols concerning Taxation of Employees and Physical Persons is signed on 19 April 2006 by and among the Commission, comprised of representatives of the Ministry of Tax, Ministry of Finance, State Customs Committee and the State Oil Company of The Azerbaijan Republic, and Contractor Parties of ACG/Shah Deniz/Alov/Inam PSAs.

According to this Clarification on Protocols, Rotators or Rotating Employees shall mean any employee or contracted individual of an Employer who requested to perform duties in Azerbaijan for a scheduled period of time and subsequently leave the territory of Azerbaijan for a scheduled number of days on a periodical basis.

For the purpose of this Clarification on Protocols, Rotators or Rotating Employees should meet the following criteria:

1. work to a scheduled based on a Rotational Cycle (i.e. a cycle of days on duty and days off) developed and approved prior to commencement of assignment and maintained on a periodical basis (as required) during the Rotational Cycle;
2. employer/customer approves Rotational cycle and the class of transportation for rotational travel;
3. return only to home country (i.e. country of residence) upon completion of days on duty.

Important to know that according to the Clarification on Protocols the following clarifications have been provided regarding tax treatment of Rotator's or Rotating Employee's transportation expenses:

Transportation expenses incurred in relation to Rotators' travel to the assigned work place and from the assigned work place to their home country (i.e. country of residency) shall be excluded from the taxable income of such Rotator, irrespective of whether incurred directly by the Rotator or not.

Amounts paid only in respect of a Rotator travel to and from the work place to the home country (including but not limited to airfare expenses) and other business expenses (such as utility expenses, taxi, telephone call expenses, meals etc.) shall not be included into the taxable income of such Rotator.

For the avoidance of doubt, the value of tickets of the following trips should be included into the taxable income of Rotators:

1. trips of family members of Rotator, airfare of which was provided by the employer/customer;
2. trips of a rotator to any destination other than their home country provided by employer/customer.

Should be noted that the same rules are applicable under the Clarifications related to BTC/SCP Host Government Agreements. The Ministry of Taxes, the SCP/BTC Participants and the Interest Holders have agreed to enter into Protocols to establish these procedures, including this Protocol dated 19 April 2006 concerning the Clarification on Protocol Concerning Taxation of Employees and Physical Persons.

## **1.3 Personal income Tax Rates of Foreign Employees**

The Azerbaijan Personal Income tax liability shall be calculated at the rates stipulated in the Azerbaijan legislation being applicable at the date of payment of the taxable income (from 0% to 30%).

---

We should note however, that the above rates are based on the Gross Income of foreign employees. Normally, companies are responsible for the employees' income tax liabilities, accordingly, local taxing authorities consider this as being an additional income for foreign individuals, and effectively such an additional income shall be taxed too.

#### **1.4 Application of Double Tax Treaties**

##### ACG/Shah Deniz/Zafar and Mashal

Foreign Employee during a Calendar Year shall be entitled to the benefits provided by an applicable Double tax Treaty or if there is no such treaty the benefits that would have been available if a treaty equivalent to the OECD Model tax Convention on Income and Capital, updated as of 1 November 1997, were in force.

##### Nakhchivan/K&K

Where a Double Tax Treaty is applicable during a calendar year, such Double Tax Treaty shall have effect to give relief from taxes.

#### **1.5 Filing of PIT Return**

Tax Reporting deadline for ACG/Shah Deniz/Nakhchivan/K&K/Zafar and Mashal shall be by the 20<sup>th</sup> of each quarter following the end of the previous one.

### **2. Local Employees Payroll Taxes**

(ACG/Shah-Deniz/Nakhchivan/K&K/Zafar and Mashal PSAs and followed Tax Protocols)

Local employees are taxed in accordance with the Azerbaijan Tax legislation.

The income tax rates applicable to monthly income vary between 0% and 30% depending on the level of income. Income tax should be transferred to the State Treasury every month not later than the day when the salaries are actually paid.

3% Employees' Social Protection Fund contributions from their monthly Gross Income as well as 22% Employer's contribution to the same Fund must be paid not later than the date when the salaries are actually paid.

Quarterly reports must be filed within 20 days after the end of each quarter.

### **3. Withholding Tax**

#### **3.1 Requirements to Withhold Tax**

##### ACG/Shah Deniz/Nakhchivan/Zafar-Mashal

Protocol Concerning Taxation of Foreign Sub-contractors is applicable to Foreign Sub-contractors that contracted directly or indirectly by or on behalf of a Contractor Party or an Operating Company to supply work or services in the Azerbaijan Republic in connection with Hydrocarbon Activities.

Each party making such payments to a Legal Entity Foreign Sub-contractor shall withhold tax from such taxable payments.

---

K&K

Payments received by legal entities foreign sub-contractors are subject for withholding tax only to contracts duration of which does not exceed 6 months. All payments received in connection with contracts exceeding 6 months period will be taxed in accordance with regular Azerbaijani tax legislation.

### 3.1.1 Withholding Tax Applicable to Mark-up on Goods Provided in the Territory of Azerbaijan

ACG/Shah Deniz/Nakhchivan

If a foreign sub-contractor provides goods in the Azerbaijan Republic then withholding tax at normal rate shall be applicable to the mark-up on such goods.

If a foreign sub-contractor fails to provide information on the mark-up or documentation on the cost of the goods sold within the Azerbaijan Republic prior to or at the time it receives payment for such goods the full invoice amount for such goods will be subject to tax

Zafar-Mashal

Withholding tax on the full amount of such mark up at the rate of 30%. If a foreign sub-contractor fails to provide information on the mark-up or documentation on the cost of the goods sold within the Azerbaijan Republic prior to or at the time it receives payment for such goods such legal Entity foreign Sub-contractor shall be subject to Profit Tax on payments received for sales of those goods.

## 3.2 Rates of withholding tax

ACG - 5%

Shah-Deniz - 6.25%

Nakhchivan - 8%

Zafar and Mashal - 7,5%

Kursangi & Karabagli - according to the Article 15 of the K&K PSA foreign sub-contractors shall be subject for profit tax calculated in accordance with the regular tax legislation applicable in Azerbaijan.

However, if the contract for provision of works or services by foreign sub-contractor does not exceed 6 months, then withholding tax at the rate of 8% will be applicable to the payments made for such works or services.

## 3.3 Reporting on Tax Withheld

ACG/Shah Deniz/Nakhchivan/Zafar-Mashal/K&K

Each person making payment to Foreign Sub-contractor that requires withholding of tax shall notify the Tax Ministry about such payments and tax withheld within 20 days after the calendar quarter during which the payment was made.

---

### 3.3.1 Reporting on Tax Withheld from payments made by customers

#### Nakhchivan

Each legal entity foreign sub-contractor receiving a payment that requires withholding is required to provide Tax Ministry with quarterly report on payments received from customers and tax actually withheld. The report should be filed not later than 20<sup>th</sup> day of the month following the reporting quarter.

Each legal entity foreign sub-contractor receiving a payment that require withholding is required to file an Annual Profit Tax Return not later than 15 March of the year following the reporting one.

#### Zafar- Mashal/K&K

Each legal entity foreign sub-contractor receiving a payment that require withholding is required to file an Annual Profit Tax Return not later than 1 April of the year following the reporting one.

#### ACG/Shah-Deniz

No reporting on payments received from customers is required.

## **3.4 Payment of Tax Withheld**

#### ACG/Shah-Deniz/K&K

The tax withheld from payments to Foreign Sub-contractors shall be transferred to the Ministry of Tax thirty (30) days following the end of calendar month during which the payment was made to the Foreign Subcontractor. If the thirtieth day is a day other than a business day, payment of Tax withheld shall be made on the 1<sup>st</sup> business day thereafter.

#### Nakhchivan

The tax withheld from payments to Foreign Sub-contractors shall be transferred to the Ministry of Tax thirty (30) days following the date when the payment was made to the Foreign Subcontractor.

#### Zafar-Mashal

The tax withheld from payments to Foreign Sub-contractors shall be transferred to the Ministry of Tax fifteen (15) days following the end of calendar month during which the payment was made to the Foreign Subcontractor

## **4. Value Added Tax (VAT)**

(ACG/Shah-Deniz/Nakhchivan/K&K/Zafar and Mashal PSAs and followed Tax Protocols)

#### ACG/Shah Deniz/Nakhchivan/K&K

According to the Protocols Concerning Value Added Tax "Any supplies of goods, works or services directly to a Contractor Party, Operating Company or Sub-contractor in connection with Hydrocarbon Activities shall charge VAT at a zero (0)\percent on those supplies."

---

All imports and exports by a Contractor Party, its Affiliates, its agents, Operating Company or Foreign Sub-contractors or any of their respective employees or employee's family members, shall have VAT charged at a zero (0) percent.

VAT exemption certificate should be obtained from the Tax Ministry.

VAT declarations should be filed quarterly within 20 days after the end of each calendar quarter.

## **5. Import/Export Taxes**

(ACG/Shah-Deniz/Nakhchivan/K&K/Zafar and Mashal PSAs and followed Tax Protocols)

### ACG/Shah Deniz/Nakhchivan/K&K

Protocols Concerning Import and Export taxes (Duties and Fees) state that "Each Contractor Party, its Affiliates, its agents, operating Company and Sub-Contractors shall have the right to import into and export from the Azerbaijan Republic free of all taxes ... and restrictions in their own name all equipment, materials, machinery and tools, vehicles, spare parts, goods and supplies (excluding foodstuffs, alcohol

and tobacco products), works and services necessary in Contractor's reasonable opinion for the proper conduct and achievement of Hydrocarbon Activities".

"Each Contractor Party, its Affiliates, its agents, operating Company and Subcontractor and any of their respective employees and employee's family members, shall have the right to import into and export from the Azerbaijan Republic, free of all taxes ... and restrictions and at any time, all furniture, clothing household appliances, vehicles, spare parts and personal effects for personal use by Foreign Employees and their families assigned to work in, or travel to, the Azerbaijan Republic." Import/Export Tax Exemption Certificate should be obtained from the Customs Committee to enable exemption.

However, all the goods imported free of taxes under PSA regime automatically fall under the category of "conditionally released goods" for the customs purposes. That means that all the transfers of them to third parties or projects other than reported at the Customs Declarations for exemption purposes should be reported to the Customs Department. As soon as the subject goods are used for non-PSA purposes (sold to a third party, used for non-PSA project etc.) all the customs taxes and duties applicable to non-PSA importations should be paid.

Customs Department shall conduct a compulsory audit of the goods imported free of taxes under PSA umbrella upon dissolution of the importing entity. Additionally, audit may be carried by the Customs Department at any other time at their option.

---



**Section VIII. AZERBAIJAN TAXES RELATING TO PIPELINE PROJECTS AGREEMENTS**

There are two Host Government Agreements between the Government of Azerbaijan Republic and a number of international oil companies for development, construction and operation etc. of product pipeline which provide for tax regime different from ordinary PSA and non-PSA ones:

1. Baku-Tbilisi-Ceyhan (BTC) Pipeline Agreement
2. South Caucasus Pipeline (SCP) Agreement

Both agreements provide for full exemption from taxes all the legal entities providing works, services or goods in respect of relevant projects.

Foreign employees working for these projects are liable for personal income tax only on the income received in connection with their work on projects and only if they present on territory of project 183 or more days during the calendar year.

---

## **Section IX. AZERBAIJAN TAXES RELATING TO NON-PSA ACTIVITIES<sup>1</sup>**

In the event a Foreign Sub-contractor performs work or services, or conducts other business activities, in the Azerbaijan Republic other than in connection with Hydrocarbon Activities, such Foreign Sub-contractor shall be required to submit tax returns, reports and financial statements to the Tax Ministry and other Governmental Authorities, and shall be taxed in respect of such work or services, or other business activities, in accordance with the Azerbaijan Legislation.

The following taxes are applicable to legal entities since 1<sup>st</sup> January 2001:

### **1. Personal Income Tax<sup>2</sup>**

Employment income of tax residents and employment income received from the sources in Azerbaijan Republic of non-residents should be taxed at the source of payment according to the monthly rates prescribed in the Table #1 of the Tax Code (see Attachment 1).

3% Employees' Social Protection Fund contributions from their monthly Gross Income as well as 22% Employer's contribution to the same Fund must be paid not later than the date when the salaries are actually paid.

**Please note**, that since 1 January, 2005 income of foreign employees is also a subject for social contributions at the rates provided for local employees. However, currently this change does not affect foreigners working for PSA contracts, with an exception of for the period of calendar year 2006 under ACG and Shah Deniz PSA's due to effective date of clarifications on Tax Protocols regarding applicability of social contributions to foreign employees.

Also, Law on Individual Registration with the Social Protection Fund comes into force since the January 2006. According to this law social contributions should be accounted and reported individually for each employee of the company.

Social allowances to employees for sickness days for the first 14 days of sickness should be made at expense of employer. Sickness allowances for all the periods exceeding 14<sup>th</sup> day of sickness should be compensated to employee by Social Protection Fund.

Quarterly reports must be filed within 20 days after the end of each quarter.

Please, also be advised, that "any physical person staying in the territory of the Azerbaijan Republic for more than 182 cumulative days within a calendar year or those having place of permanent residence in the

---

<sup>1</sup> Tax Code dated 1<sup>st</sup> of January 2001 updated as of the 1<sup>st</sup> of January, 2005

<sup>2</sup> Tax Code, Parts VIII and X

---

Azerbaijan Republic or center of vital interests or habitual adobe” shall be considered as Residents for Tax purposes.

Effective from 2008, new type of fines for employers hiring personnel without concluding employment agreements have been introduced to the Tax Code. According to these changes such employers would be liable for financial sanction in amount of AZN 1000 for each individual hired without a proper employment contract.

Non-employment income of tax residents and income from Azerbaijan sources of non-residents which has not been taxed at the source of payment should be declared annually not later than 31<sup>st</sup> of March of the year following the year when taxable payment was made and taxed according to the annual rates prescribed in the Table #2 of the Tax Code (see Attachment 1)

Income received by physical persons from rent of movable or immovable property shall be subject for 14% withholding tax. In case if the tax is **withheld and paid properly**, no further taxes will be applicable to such income.

## **2. Corporate Profits Tax<sup>1</sup>**

The companies, whose revenue for the 12 (twelve) consecutive months period is more than AZN 150 000 and those who meet the below criteria, regardless of their turnover, are liable for annual Profits Tax:

- Producers of the goods which are subject for excise tax
- Credit and Insurance organizations, investment foundations, professional participants of security market, pawn-shops;
- Non-state pension funds;
- Those who receive income from letting of property and royalties;
- Owners of fixed assets with a net book value of more than AZN 1,000,000.

Current Profits Tax Rate is 20% of the annual profit.

Profit tax declaration is filed annually not later than 31<sup>st</sup> March of the year following the reporting year. Profit tax is paid quarterly in advance based on past year profit tax within 15 days after the end of current quarter or based on the current results. Notification on the method of calculation of advance payments of Profits Tax should be send to the Tax Ministry every year by 15<sup>th</sup> April. In case if the notification is not sent, the Tax Ministry will base its calculations of advance payments on the past year results.

The gross revenue of a non-resident enterprise that is not related to the activity of its permanent establishment shall be taxed at source without deduction of expenses in the following cases:

- **Dividends**  
Paid by a company-resident at the rate of 10%
- **Interest**  
Including interest paid for leasing of property and excluding interests paid to loans provided by bank-residents as well as income resulting from difference on insurance contributions and insurance payments on accumulative life insurance - at the rate of 10%
- **Payments for international communication**  
As well as transportation services, made by the enterprise-resident at the rate of 6%
- **Other Works and Services**  
At the Rate of 10%

---

<sup>1</sup> Tax Code, Parts IX and X

---

- **Rent**  
Relating to lease of movable and immovable property, at the Rate of 14%

- **Taxation of Profit of Non-resident Legal Entity**

Profit of permanent establishment of non-resident legal entity transferred to such a non-resident legal entity, apart from Profits Tax will be taxed at the rate of 10%.

All taxes withheld at source, including personal income tax should be transferred to the Tax Ministry not later than 20<sup>th</sup> day of the month following the month when the tax was withheld.

### **3. Value Added Tax (VAT)<sup>1</sup>**

Current Tax Rate is 18%. Legal entities whose income per 12 consecutive months is more than AZN 150 000 and individual entrepreneurs whose income per 12 consecutive months is more than AZN 90 000 shall be liable for registration as VAT payers within 10 days upon ending of such period.

Normally, VAT must be applicable to any goods or services provided or supplied in the Azerbaijan Republic except for certain cases specified by the Tax Code.

Effective from the 1<sup>st</sup> January 2008 each VAT-payer will be required to maintain a VAT deposit account for collection and transferring of VAT amounts or that VAT will be creditable only if it is paid through the designated accounts.

Effective from the 1<sup>st</sup> of January 2010 all VAT invoices must be issued in electronic form.

A financial sanction of 50% would now be imposed for a failure to pay VAT on the supplier/service provider invoices following the new rules on payment of VAT using designated bank accounts.

VAT paid from petty cash to suppliers may not be recorded for the offset purposes.<sup>2</sup>

Any person making payment to a non-resident legal entity providing services in the territory of Azerbaijan Republic without registration of the office in Azerbaijan, should account for 18% VAT on the amount of payment and then transfer the subject VAT to the Tax Department.

VAT declarations are filed and tax payments made monthly before 20<sup>th</sup> day of the month following the reporting month.

Rules of registration have been softened. The registration process may now take 5 (five) days.

### **4. Excise Tax<sup>3</sup>**

The following goods are subject for excise tax with the following rates:

- edible alcohol (including ethyl non-denaturized alcohol with the concentration of alcohol of not less than 80%; ethyl non-denaturized alcohol with concentration of alcohol of less than 80%) – 8,00 AZN per liter;
- vodka, fortified drinks and fortified drinkable materials, liqueurs and liqueur materials -0,5 AZN per liter;

---

<sup>1</sup> Tax Code, Part XI

<sup>2</sup> Tax Code, Part XI

<sup>3</sup> Tax Code, Part XII

---

- brandy and brandy materials – 0,20 AZN per liter;
- sparkling wines – 0,2 AZN per liter;
- wines and wine materials – 0,1 AZN per liter;
- beer (apart from near-beer) and other beer containing drinks – 0,08 AZN per liter;
- all types of tobacco goods – 12,5%;
- cars, yachts and other floating facilities for recreation and sports imported into the Azerbaijan Republic – at the following rates:

<b>Object</b>	<b>Tax Rate, AZN</b>
Cars:	
- with engine capacity up to 2000 sm <sup>3</sup>	0.15 per each sm <sup>3</sup>
- with engine capacity up to 3000 sm <sup>3</sup>	300 + 1 per each sm <sup>3</sup> exceeding 2000
- with engine capacity up to 4000 sm <sup>3</sup>	1,300 + 2 per each sm <sup>3</sup> exceeding 3000
- with engine capacity exceeding 4000 sm <sup>3</sup>	3,300 + 4 per each sm <sup>3</sup> exceeding 4000
Yachts and other floating facilities for recreation and sports	1 per each sm <sup>3</sup> of engine capacity

- petroleum derivatives, cars, yachts and other floating facilities for recreation and sports produced in the Azerbaijan Republic – rates are fixed by the relevant government body.

Reporting period is a calendar month.

Upon production of excise goods, excise on taxable operations for each reporting period shall be paid and Tax Declaration shall be filed not later than 20<sup>th</sup> day of the month following the reporting one.

## **5. Property Tax<sup>1</sup>**

Most of the Legal Entities shall pay an annual property tax at the rate of 1% of the average annual net book value of fixed assets (except for transportation fixed assets). Payers of property tax shall make advance payments of tax at 20% of the amount of property tax of previous year prior to the 15<sup>th</sup> of the second month of every quarter as current tax payments.

Legal entities shall submit annual property tax declarations along with the profit tax declaration to the State Tax Departments.

## **6. Land Tax<sup>2</sup>**

Land Tax shall be calculated as a fixed payment irrespective of the results of the economic activity of owners and users of land. Rate of tax on land plots used for the agricultural purposes shall be defined at AZN 0.06 for 1 conventional point.

Conventional points are defined by the respective body of Executive Authority subject to the designation, geographical location, quality, etc. of land.

Enterprises shall annually calculate tax on land on the basis of the sizes of land spot and the tax rates, and submit such calculation to tax bodies not later than 15 May of each year. Tax should be paid, in equal portions, before August 15 and November 15.

<sup>1</sup> Tax Code, Part XIII

<sup>2</sup> Tax Code, Part XIV

## **7. Road Tax<sup>1</sup>**

Tax on auto transport equipment of foreign states entering the territory of the Azerbaijan Republic is calculated at the rates depending on the type, number of seats, cargo capacity, total weight of motor transport facilities with loaded cargo, transportation of dangerous cargoes etc.,

Tax on transport facilities owned by physical and legal person's, excluding agricultural transport and transport belonging to government organizations is calculated depending on engine capacity. (see Attachment 2)

Legal Entities submit annually Road Tax declaration not later than 31st of March of the year following the reporting year. The payment of the calculated Road Tax shall be made to the State Budget by this deadline.

Physical Persons pay Annual Road Tax to the State Budget at the time of annual check-up.

## **8. Mining Tax<sup>2</sup>**

Generally, applicable to those, who are engaged in extraction of commercial minerals in the territory of the Azerbaijan Republic, including in the Sector of the Caspian Sea belonging to the Azerbaijan Republic.

Mining Tax shall be calculated based on wholesale prices or total volume of commercial minerals extracted (in m<sup>3</sup>) depending on their type.

Mining tax for accounting month shall be paid by the 20<sup>th</sup> day following the month when such minerals have been extracted.

Payers of mining tax shall submit tax declarations on a monthly basis not later than the 20<sup>th</sup> day of the month following the reporting month.

## **9. Simplified Tax<sup>3</sup>**

### **9.1. Payers of Simplified Tax**

Enterprises that were not registered for the purpose of VAT (except for the enterprises producing excisable goods, credit and insurance organizations and investment funds, professional participants of securities market, non-governmental pension funds, lessors of property, receivers of royalties, owners of fixed assets with a net book value more than AZN 1 million) shall be considered as payers of Simplified Tax.

Physical and Legal persons engaged in transportation activities (excluding international carriage of passengers and cargos) in the territory of Azerbaijan Republic are payers of Simplified Tax regardless the level of their turnover.

Persons engaged in house-building activities for personal needs or commercial purposes are payers of Simplified Tax.

The persons who are not payers of simplified tax, but have got a right to register as a simplified tax payers during the calendar year should apply to the Ministry of Tax not later than 20 April of the year following the year when the right to become a simplified tax payer arises.

Payers of Tax on Simplified System are not obligated to pay profits, property and VAT.

### **9.2. Rates of Simplified Tax**

---

<sup>1</sup> Tax Code, Part XV

<sup>2</sup> Tax Code Part XVI

<sup>3</sup> Tax Code, Part XVII

---

All payers of Simplified Tax, apart from physical and legal entities engaged in transportation activities should calculate tax for each quarterly reporting period through the application of tax rate of 4% for activities implemented in Baku city and 2% for activities implemented in all the other cities and regions of Azerbaijan Republic and Nakhchivan Autonomous Republic to gross sales for such quarterly reporting period.

Physical and legal persons engaged in transportation activities in the territory of Azerbaijan Republic shall calculate simplified tax depending on the technical characteristics and type of vehicles as per the rates provided in the Attachment 3 herewith.

The following coefficients should be applied to the tax calculated at the rates provided in Attachment 3 depending on the place where transportation services are provided (in times to the rate of tax):

- Baku city and transportations between Baku and other settlements – 2,0;
- Absheron area, Sumgait, Ganja and transportations between the said area and cities and other settlements – 1,5;
- Other cities and areas and transportations between them and other settlements – 1,0;

Persons engaged in house-building activities for personal needs or commercial purposes should pay simplified tax at the rate of 10 AZN per 1 m<sup>2</sup> of building facilities.

### 9.3. Tax Payment and Reporting Requirements

Payers of tax on simplified system (excluding persons engaged in transportations activities) shall submit Simplified Tax Declaration to the Tax Ministry not later than 20<sup>th</sup> day of the month following the reporting period and shall remit this tax to the State Treasury within the said period.

Persons engaged in transportation activities should pay simplified tax for each vehicle in possession or in use of those persons on a monthly basis. No tax returns should be filed by the subject persons in respect of their income received from transportation activities.

Persons engaged in house-building activities should file declaration to the Tax Ministry not later than 20<sup>th</sup> day of the month following the quarter when started the works on laying the foundation. The tax should be paid in quarterly installments in amount of 12,5% of the total amount of tax calculated up to the full settlement of the tax liability.

### **Requirements for Obtaining of Distinctive Badges and Special Distinctive Badges.**

All physical and legal persons engaged in transportation activities are obliged to obtain a **Distinctive Badge** for each vehicle which is owned or used based on power of attorney or rent agreement for transportation services for the **Ministry of Transport of Azerbaijan Republic**.

All physical and legal persons who are not engaged in transportation activities, but own vehicles intended for internal operation purposes are obliged to obtain a **Special Distinctive Badge** for each vehicle registered on the name of such a person.

Application for issue of Distinctive and Special Distinctive Badges should be filed in 5 days upon acquisition of a new vehicle to the Ministry of Transport.

---

## 10. Deductibility & Depreciation Rules<sup>1</sup>

Generally, the following expenses cannot be deducted from income for tax purposes:

1. Expenses related to purchase and building of fixed assets and other capital expenditures
2. Expenses unrelated to the core commercial activities
3. Meals, entertainment, living and other social expenses. Where the taxpayer's business is in the sphere of entertainment or social activity, then entertainment and social expenses incurred in the course of business activity may be deducted from income
4. Personal expenses related to individual consumption or earning salary
5. Business trips expenses above rates fixed by the relevant executive authority
6. Repair and maintenance expenses deductible from income are limited to the threshold amount of the previous year end net book value of the fixed assets category to which they relate at the rates of 0 to 5% depending on the category of fixed assets

The annual depreciation rates for major fixed assets categories are presented as follows:

1. Buildings, Installations and Structures - up to 7%
2. Machinery, equipment and computer hardware - up to 25%
3. Vehicles – up to 25%
4. Working Cattle – up to 20%
5. Cost incurred for geological exploration and preparatory works for extraction of natural resources - up to 25%
7. Intangible assets – up to 10% if the useful life of the asset is not definable, or rate based on the useful life of the assets
8. Other fixed assets - up to 20%

The following types of fixed assets are not subject for depreciation:

- equipment, exhibits, specimens, models and other visual aids used in lecture halls, laboratories for the scientific, educational and experimental purposes;
- productive cattle
- exhibit animals at zoos and other similar institutions;
- perennial plants not attained productive age;
- library stocks, cine stocks (video, audio, photo), stage props, museum exhibits;
- fully depreciated useable fixed assets;
- dormant fixed assets;
- roads in general use;
- park equipment in general use;
- fixed assets in stocks;

## 11. International Grants or Loans<sup>2</sup>

Tax Code provides for 0% rated VAT for all the goods, services, works purchased or imported on the credits and loans extended by international financial organizations, foreign governments, or foreign legal entities and individuals under interstate and intergovernmental treaties.

Purchase of goods, works and services at the expense of grants received from abroad is subject for VAT at 0% rate.

## 12. Field Tax Audits

A field audit may be conducted upon tax authority's decision. When conducting a regular tax audit, a tax authority shall give notice in writing to the taxpayer at least 15 days prior to the audit. A regular field tax audit

---

<sup>1</sup> Tax Code, Part X

<sup>2</sup> Tax Code, Part XI

---



may not be conducted more often than once a year and may not last for more than 30 business days. In exceptional cases, a field tax audit may be extended up to 90 business days.

### **13. Violations of the Tax Code Requirements**

The following financial sanctions are applicable for failing to comply with requirements of the Tax Code:

- non-filing of tax reports and declarations by the deadlines provided in the Tax Code – AZN 40;
- understatement of taxes due by the taxpayer in tax declarations and returns – 50% of the understated amount of tax;
- failing to register with the appropriate tax or other government bodies within the terms provided by the Tax Code - AZN 44;
- late payment of taxes – 0,1% of the amount of tax due for each day of delay of payment.

### **14. New system of tax reporting**

Effective 2008, procedure of submission of tax returns has been eased. Now, all the enterprises are owed to conclude a contract with the Tax Authorities, for obtaining of a software, wherein they will be able to submit tax returns to the Tax Authorities in the electronic format. It is stipulated by the contract that the enterprise will obtain a CD with special software for online tax reporting, including the secure individual password and company's code.

## **Section X. IMPORT/EXPORT TAXES<sup>1</sup>**

According to the Customs Code of Azerbaijan Republic the following fees are paid on importation of goods:

- Import Tax<sup>2</sup>

Any items imported into Azerbaijan Republic are subject to customs dues (Import Taxes). Import Tax rate varies between 0% to 15% and depends on the type of the goods being imported.

- VAT at Customs<sup>3</sup>

The goods imported into and exported out of Azerbaijan Republic are subject to VAT in accordance with the Tax Code (current rate is 18%).

- Excises<sup>4</sup>

Excise Tax is applicable to the goods transferred through the custom of Azerbaijan Republic in accordance with the Tax Code.

- Customs Procedure & Registration Fee<sup>5</sup>

All commercially and non-commercially imported goods through the customs of the Azerbaijan Republic are subject for the customs procedure and registration fees.

- Storage Fee<sup>6</sup>

---

<sup>1</sup> Customs Code, Part III

<sup>2</sup> Customs Code, Article 109

<sup>3</sup> Customs Code, Article 110

<sup>4</sup> Customs Code, Article 111

<sup>5</sup> Customs Code, Article 112

<sup>6</sup> Customs Code, Article 113

---

Storage fee is collected for the goods and transport stored at the warehouses or special sites belonging to the Customs Authorities of the Azerbaijan Republic. The Customs Department of Executive Authority based on an average cost of the services rendered normally determines storage fee.

## **Section XI. TAX PLANNING AND STRATEGY**

When developing a tax and accounting policy of the company the key point would be to distinguish between the activities falling under the different tax regimes, such as PSA and non-PSA activities.

Our view is that the most effective way to optimize tax liabilities is to implement different types of projects under separate legal entities.

Our experience is that it may be a worthwhile exercise to prepare a strategy and international tax planning in respect of the Individual Income Tax Liabilities for your foreign personnel.

It is also our view that a detailed review of the type of business activities and further structuring of your company's operations might be necessary to ensure both sufficient statutory compliance and profitability.

---

**Attachment 1****Monthly income is taxed at the following rates:****Table 1**

<b>Taxable monthly income</b>	<b>Tax</b>
Up to 2 000 manats	14%
More than 2 000 manats	280 manats +30% of the amount exceeding 2000 manats

For the persons whose monthly income does not exceed 200 AZN additional benefit is provided – first 93.50 AZN are not taxable.

**Annual income is taxed at the following rates:****Table 2**

<b>Taxable annual income</b>	<b>Tax</b>
Up to 24,000 manats	14%
More than 24 000 manats	3 360 manats + 30% of the amount in excess of 24 000 manats

For the persons whose annual income does not exceed 2 400 AZN additional benefit is provided – first 1 122 AZN are not taxable.

---

**Attachment 2****Rates of Road Tax Applicable to Owners or Users of Vehicles in the Territory of the Azerbaijan Republic**

<b>Taxable object</b>	<b>Rate of tax, AZN</b>
Passenger Cars:	
- with engine capacity up to 2000 sm <sup>3</sup>	0,01 per each sm <sup>3</sup>
- with engine capacity over 2000 sm <sup>3</sup>	20 + 0,02 AZN per each sm <sup>3</sup> exceeding 2000
Buses and other auto transport	0,02 per sm <sup>3</sup>

**Attachment 3****Rates of Simplified Tax Applicable to Revenues Received from Transportation Activities**

<b>Transportation Type</b>	<b>Monthly Amount of Tax, AZN</b>
Carriage of passengers (except for taxis), per number of seats:	
Up to 13	1,8 per 1 seat
13-31	21,6 + 0,5 per every seat from the 13 <sup>th</sup> and further
More than 31	30,6 + 0,3 per every seat from the 31 <sup>st</sup> and further
Taxis	9 per 1 vehicle
Freight Services	1 per 1 ton of carrying capacity