

# ***Doing Business and Investing in Azerbaijan Guide***

*2019 edition*

# Contents

## Overview

### Azerbaijan Overview

5

Introduction	6
Geography and climate	6
History	6
People	6
Currency	7
Government structure	7
The National Assembly of Azerbaijan (Milli Majlis)	7
Legal system	7
International relations	7
Visa Regime	8

## Economy

### Economy

9

Macroeconomic review	10
Oil and Gas	10
State Oil Company of the Azerbaijan Republic	10
State Oil Fund of the Republic of Azerbaijan	10
Non-Oil sector	11
Banking	11
Telecoms and IT	12
Construction	12
Agriculture	12
Tourism	13
Foreign trade relations	13

## Foreign Investment

### Foreign investment

15

Investment climate	16
Foreign investment	16
Registration of foreign investors in Azerbaijan	16
Legal forms of doing business by foreign investors	16
Business entities	16
Types of commercial legal entities	17
Types of non-commercial legal entities	17
Public Legal Entities	17
Licensing	17
Privatization	18
State Migration policy	18
Taxation	18
Customs regime	21
Labor and social relations	21
Accounting	21

## PwC Azerbaijan

### PwC Azerbaijan

22

Assurance services	23
Advisory services	23
Tax and Legal services	23

## Why to invest in Azerbaijan?

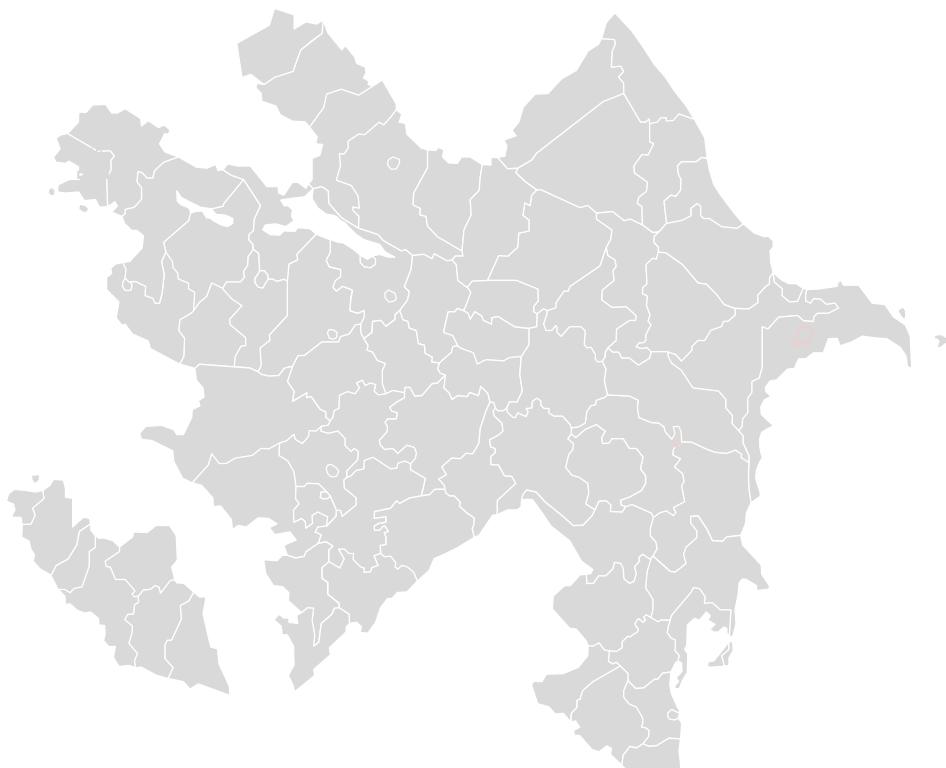
**Azerbaijan lies at the heart of the international transport corridor between Europe and Asia**

**The country enjoys favored trade status under an EU Partnership and Cooperation Agreement**

**Azerbaijan has substantial hydrocarbon reserves**

**The country has significant agricultural potential due to its fertile climate**

**Azerbaijan is growing a highly educated and skilled workforce**



### Doing Business and Investing in Azerbaijan

Our Doing Business Guide is aimed to provide timely information about Azerbaijan's business environment. For more in-depth information on doing business in Azerbaijan, please contact us at PwC Azerbaijan office in Baku.

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# Foreword



It is my great pleasure to introduce the 2018 PwC Guide on Doing Business and Investing in Azerbaijan that describes the country's geography, history, business and investment climate. I believe this guide will be helpful for everyone who is interested in doing business and investing in Azerbaijan.

In this changing environment, our Guide aims to provide comprehensive and up-to-date information on conducting business in the country. This includes the briefing on general economic and business conditions and commentary on the latest legal developments, regulatory framework, major tax and investment incentives.

## ***Movlan Pashayev***

Country Managing Partner  
PwC Azerbaijan

This publication is aimed to serve as a tool for both domestic and foreign investors. We hope it is informative and useful to you. If you have any suggestions for ways we may improve future editions, we would be pleased to receive them.

From our office in Baku, PwC Azerbaijan has been serving clients in the country since 1995. Having started with 10 people, PwC Azerbaijan now employs more than 140 staff, including three partners and a select group of international specialists from six countries. PwC Azerbaijan serves business organizations, government bodies and public associations bringing them the benefit of more than 150 years of expertise, high-end knowledge and practical experience accumulated in PwC globally.

The Firm offers a wide spectrum of professional services, which have been developed to meet the ever-growing expectations of our clients. This breadth of services has allowed us to take on and successfully complete some of the largest and most technically challenging projects in Azerbaijan to date. We would welcome the opportunity to help you explore and take advantage of the investment opportunities in Azerbaijan.



# *Azerbaijan Overview*



## Introduction

Azerbaijan is a post-soviet country that regained independence in 1991. Since 1994, the country's vast oil reserves have been attracting foreign investment to the economy, which consequentially made the oil and gas sector the main target for foreign investments. Modern-day Azerbaijan has managed to up-build relatively sophisticated communication and transportation infrastructure, as well as industrial, agricultural, educational, housing and healthcare sectors, although the oil and gas industry still accounts for the bulk of its exports.

Azerbaijan continues to develop its market infrastructure, including legal, tax and banking frameworks and links to the international business community. It presents a unique challenge to businesses entering Azerbaijan that wish to assess the real business risks and make reality-based decisions rather than relying on perceptions.

Given the region's significant potential, many around the world seem to be focusing more closely on the Caspian region as a whole. Despite the after-effects of the global financial crisis, there now appears to be a resurgence of interest in Azerbaijan among foreign investors.

The Doing Business and Investing Guide outlines the key factors that foreign companies should consider when looking at possible investments in Azerbaijan.

Rather than providing detailed coverage of any topic, the details of which are constantly in flux, the Guide strives to cover a spectrum of key issues that investors would include in their "mission checklist" when going to Azerbaijan.

## Geography and climate

Azerbaijan is located on the shore of the Caspian Sea in Southwestern Asia, between Islamic Republic of Iran and Russian Federation. The Republic of Azerbaijan covers an area of 86,600 sq. km and shares common borders with Armenia, Islamic Republic of Iran, Georgia, Russian Federation, and Turkey.

There are two main forms of relief in Azerbaijan: mountains and plains. 40% of the country is covered by mountain ranges, of which three major ones are Greater and Lesser Caucasus and the Talysh, surrounding the Kura-Araz lowland from the north, west and south-east areas.

Baku is the capital of Azerbaijan. It is located on the Absheron peninsula at the easternmost point of Azerbaijan.

The relief of Azerbaijan creates quite favorable conditions for the formation of a warm mild climate on the most part of the country. Azerbaijan has the mildest winter in the region. January is the coldest month of the year (air temperature is 0 C).

Azerbaijan operates within a single time zone. It is four hours (+3) ahead of GMT. In 2016 the Cabinet of Ministers of the Republic of Azerbaijan abolished daylight time changes.

Business offices are generally open from 9:00 am to 6:00 pm, Monday through Friday. The Azerbaijani Labour Code stipulates an eight-hour working day.

Most shops and stores are generally opened whole week including weekends and public holidays. Azerbaijan uses the metric International System.

## History

The roots of Azerbaijan stretch back to approximately the fourth century BC - the times of Caucasian Albania. Albania, also known as Arran in Azerbaijani, adopted Zoroastrianism before switching to Christianity prior to incursions by Muslim Arabs and, more importantly, Muslim Turks.

As an integral part of the Arabian Caliphate, the population of Azerbaijan underwent a mass conversion to Islam. Later Turkish conquests led to the Turkification of the nation and the creation of the Azerbaijani language, a close cuisine of Turkish. Azerbaijan then was integrated into the Russian Empire from 1813-1918. After the fall of the Romanov Tsarist rule, Azerbaijan enjoyed a brief spell of independence until 1920 when it was overwhelmed by Soviet forces and incorporated into the USSR.

The country proclaimed its independence in the early 90's, the Constitution of independent Azerbaijan was adopted in 1995 and received nationwide support in a referendum.

Since 1988, a conflict arose between Azerbaijan and Armenia because of invasion of the latter on Nagorno-Karabakh, primordially Azerbaijani lands. War broke out in 1988 when Nagorno-Karabakh tried to break away and annex itself to Armenia, and 30,000 died before a ceasefire agreement was reached in 1994. The final decision on the political status of Nagorno-Karabakh has yet to be determined.

This year the Azerbaijan Democratic Republic celebrates 100 years anniversary. The Azerbaijan Democratic Republic, the first parliamentary republic in the east was one of the first countries in the world, and the very first majority-Muslim nation, to grant women equal political rights with men.

## People

According to the State Statistics Committee, the population of Azerbaijan was estimated at nearly 10 million people in 2017.

The most populous cities in Azerbaijan as of 1 January 2017 are the following:

City	Population (thou)
Baku	2,246
Sumgait	339
Ganja	331
Lankaran	225
Sheki	184
Yevlax	127
Mingachevir	103
Nakhchivan	92

Azerbaijan is a melting pot of nationalities, cultures, and religions. While ethnic Azerbaijanis are in the majority, the country is home to many other nationalities.



Minorities include Russians, Talysh, Lezgis, Kurds, Mountain Jews, Georgians, and Udines. All minorities in Azerbaijan have the constitutional right to education, media, and cultural activities in their own language.

Azerbaijani is the official language of the country. Russian is also spoken and taught widely throughout Azerbaijan. English language literacy has been significantly rising in the past 15 years along with German and French owing to the increasing number of international companies and the popularity of overseas education.

Religion in Azerbaijan comprises different religious trends spread among the people and ethnic groups residing in the country. Those include Muslim Azerbaijanis, Lezgis, Talyshs, Kurds; Christian Slavs and European immigrants; Jews.

### **Currency**

Since 1 January 1994, Manat is the National currency and the only payment facility of the country.

In January 2006, Azerbaijan denominated its currency into the New Azerbaijani Manat (AZN), which was pegged to the US Dollar (US\$) by the monetary policy of Central Bank of the Republic of Azerbaijan(CBAR) and exchange rate against the US Dollar was maximum US\$ 1 = AZN 0.78.

In February 2015, the CBAR abandoned Manat's hard peg to the US\$ and replaced by the US\$-EUR basket due to the slump in oil prices.

In December 2015, there was the second devaluation (circa 50%) of AZN. Average January – October 2018 AZN/US\$ rate is AZN 1.70 per US\$ 1, while average AZN/ EUR rate over the same period is AZN 2.08 per EUR 1.

In January 2017, CBAR has dropped it 4% exchange rate corridor applied to commercial banks to allow the currency to float freely.

### **Government structure**

Azerbaijan is a presidential republic, with the President as the head of state and the Prime Minister as the head of the Government. Executive power rests with the President, the Prime Minister and the Government (the Cabinet of Ministers). Legislative power is vested in the parliament, the National Assembly (Milli Majlis) of Azerbaijan.

The most recent presidential election was held on 11 April 2018. The incumbent president, Ilham Aliyev, won with 86% of votes and was re-elected for the seven-year term.

Under the 1995 Constitution, the executive, legislative and judicial branches of Government in Azerbaijan are separate and independent from each other.

The President is also the Supreme Commander-in-Chief of Azerbaijan's armed forces.

### ***The National Assembly of Azerbaijan (Milli Majlis)***

Milli Majlis is the legislative branch of the Government in Azerbaijan.

The unicameral assembly currently consists of 125 deputies elected for each five-year term from single-seat constituencies.

The most recent legislative election was held in November 2015. The New Azerbaijan Party (YAP) currently holds the majority of seats in Milli Majlis.

Among the responsibilities of the Milli Majlis is the composition of the Central Election Committee, the Accounts Chamber and the Auditing Chamber.

### ***Legal system***

The legal system of Azerbaijan is broadly based on civil law.

The highest judicial authority in Azerbaijan is the Constitutional Court. The Constitutional Court resolves disputes between the legislative, executive and judicial branches of Government and gives formal interpretations of the Constitution and other laws.

Unlike the common law-based judicial systems of the United States and Great Britain, Azerbaijan's civil law based system does not extensively or exclusively rely on case law or judicial precedent. The civil law of Azerbaijan considers the 1995 Constitution, acts adopted via referendum, and legislation passed by the Milli Majlis as the primary sources of law.

The Constitutional Court, the Supreme Court, the Appellate Court, the Administrative-Economical Courts, and the General Jurisdiction Courts hear those cases that are within their jurisdiction.

The courts consider international treaties to which Azerbaijan is a signatory as a source of law. International agreements take precedence over national law in case they contradict.

### ***International Relations***

Azerbaijan is a member of the United Nations, the Organization for Security and Cooperation in Europe (OSCE), NATO's Partnership for Peace, the Euro-Atlantic Partnership, the GUAM Organization for Democracy and Economic Development, the Commonwealth of Independent States (CIS), the European Bank for Reconstruction and Development, the Council of Europe, the International Monetary Fund, the World Bank, CFE Treaty Organization of the Black Sea Economic Cooperation, the Organization of Islamic Cooperation, World Health Organization (WHO), Non-Aligned Movement, Parliamentary Assembly of Turkic-speaking Countries (TURKPA), the International Organization for Migration, and the Asian Development Bank. The country has signed a bilateral investment treaty (BIT) with the US and Partnership and Cooperation Agreement with the EU.

Since the early 1990s, 20% of Azerbaijani territory has been occupied by Armenian troops. A temporary ceasefire has been in place since May 1994. As a result of hostilities, 800,000 ethnic Azerbaijanis have been displaced from their homes.

Settling the Nagorno-Karabakh conflict is the priority of Azerbaijan's foreign policy.

One of the main points of dispute in international relations of Azerbaijan within seabed of the Caspian is the precise legal status of the latter, and particularly the territorial rights of the littoral states are subject to dispute. A fundamental disagreement over the demarcation of territorial waters

in the southern Caspian between Iran, Azerbaijan and Turkmenistan continue to pose a strategic threat to the development of offshore oil and gas fields.

#### Relations with Caspian littoral countries

Azerbaijan has taken an active part in creating a legal framework for cooperation among Caspian littoral countries. The Third Summit of the Heads of State of Caspian Littoral Countries held in Baku in 2010 made an important contribution to the strengthening of close cooperation among our countries. The "Agreement on Cooperation in the Field of Security in the Caspian Sea" was signed during that Summit. It is of great importance from the point of view of security and maintaining stability in the region. For the first time at such a high level, it envisaged conceptual agreement on sovereignty and fishing zones. Participants in that Summit also agreed on the basic principles of cooperation among littoral states in the Caspian Sea. These principles include respect for the sovereignty, independence and territorial integrity of states, the transformation of the Caspian into a place of peace, good-neighbourliness, and friendship.

#### Visa regime

Visa - an official document authorizing a foreigner or stateless person to enter or to leave the Republic of Azerbaijan, by crossing its border checkpoints in the defined way, and to stay temporarily in the country for the period indicated in the visa. CIS countries are exempt from visa regime.

The Consular Department of the Azerbaijani Ministry of Foreign Affairs (MFA) issues single and multiple entry visas for individuals wishing to visit Azerbaijan. Single entry visas are issued from 30 up to 90 days. A multi-entry visa is valid up to two years with duration, not more than 180 days.

ASAN Visa System will send electronic visa directly to the applicant's personal email within three days.

It should be noted that the service is available only to citizens and stateless persons permanently living in the countries indicated in the list of the Ministry of Foreign Affairs.

Foreign expatriates intending to travel to Azerbaijan should obtain an entry visa through the nearest Azerbaijan embassy regardless of the purpose of the trip. For some countries (for example, Turkey), it is possible to obtain the visa directly in the airports. In a case when foreign residents intend to stay in Azerbaijan for a period longer than 10 days, they should be registered at the place of the stay upon their arrival.

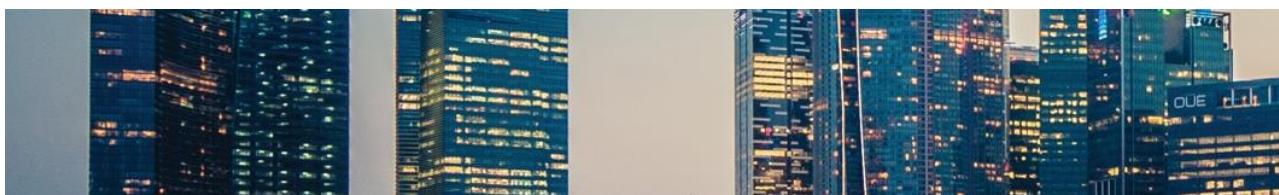
#### Public Holidays 2018

1-2 January	New Year's Holidays
20 January	Day of the Martyrs
8 March	International Women's Day
20-24 March	Novruz Bayram
9 May	Victory day Over Fascism
28 May	Republic Day
15 June	Day of National Salvation
15-16 June	Ramazan Bayram
26 June	Armed Forces Day
22 -23 August	Gurban Bayram
9 November	Flag Day
31 December	Solidarity Day





# *Economy*



## Macroeconomic Review

Throughout the 70-year Soviet period, Azerbaijan's economy had always been one of the most industrially developed in the Caucasus.

Azerbaijan's high-level economic growth has been attributed to large and growing oil and gas exports, but some non-export sectors also featured double-digit growth, including construction, banking, and real estate.

According to the State Statistics Committee report as of 1 January 2017, 34.3 % of the country's GDP share accounts for oil and gas sector. GDP of US\$ 34.7 bln, US\$ 3597.5 per capita were produced by country residents in 2016.

Azerbaijan's economy has had a turbulent few years. After a hydrocarbon-fueled boom that saw GDP average 10.9% per year between 2000 and 2014, according to International Monetary Fund (IMF) data, falling oil prices and a failure to sufficiently develop other sectors of the economy led to a dramatic fall in growth in the last few years. In 2016, the economy contracted by 3.1% and it turned to a very modest growth of just 0.1% in 2017.

Azerbaijan still faces a number of challenges for its further development. Among those are the issues with the effectiveness of state governance along with the problem of corruption and monopoly.

In addition, as shown in the PwC Azerbaijan's 2<sup>nd</sup> CEO Survey, conducted among the leaders of the businesses in both private and public sectors, exchange rate volatility, increasing the tax burden and uncertain economic are top three macroeconomic threats for growth prospect for the organizations.

## Oil and Gas

Hydrocarbons currently form the economic lifeblood of Azerbaijan's future. With the well-developed Azer-Chirag-Guneshli (ACG) oilfield serving as the country's key oil production platform, Azerbaijan pumps up to 856 thousand bbl. The main economic driver involves export through the:

- Baku-Tbilisi-Ceyhan Pipeline (BTC)
- Baku-Novorossiysk Pipeline
- Baku-Supsa Pipeline

The level of oil production in Azerbaijan has been falling since 2010. Efforts to boost Azerbaijan's gas production are underway.

The geopolitically important Southern Gas Corridor between Azerbaijan and Europe is expected to open another, albeit, smaller source of revenue from gas exports, however, this is unlikely to compensate for the revenues that the oil sector has provided.

BP operates the Shah Deniz project (28.8% stake). Other partners in the PSA include TPAO (19%), Petronas (15.5%), SOCAR (10%), Lukoil (10%), Naftiran Intertrade Co. (10%) and SGC Upstream (6.7%). The South Caucasus Pipeline (SCP) operates to transfer Shah Deniz reserves

from Baku to Erzurum, Turkey, via Tbilisi. The maximum discharge of the pipeline is 20 bln cubic meters per year. Shah Deniz Stage 2, or Full Field Development (FFD) is a large-scale project that will add a further 16 bcm of gas production to the approximately 9 bcm produced by Shah Deniz Stage 1.

The project is planned to be launched in late 2019 and is expected to supply 400 bcm of natural gas to Europe and Turkey while generating around 200 billion-dollar value in 25 years.

So far, this is the biggest natural gas contract signed in the Caspian region. SOCAR and Shah Deniz partners have also agreed on terms for extending the Shah Deniz Production Sharing Agreement up to 2048. This project plans to expand the SCP through Azerbaijan and Georgia, to construct the Trans Anatolian Gas Pipeline (TANAP) across Turkey and the Trans Adriatic Pipeline (TAP) across Greece, Albania into Italy. The TANAP shareholders are SOCAR (58.0%), BOTAS (30.0%) and BP (12.0%)<sup>5</sup>. The TAP shareholders are: SOCAR (20%), BP (20%), Snam S.p.A (20%), Fluxys (19%), Enagas (16%), Axpo (5%).

Oil prices are trading at their highest level since 2014, with Brent crude hovering at close to \$85 on September 2018, having passed the \$80 mark for the first time since November 2014 last week.

## State Oil Company of the Azerbaijan Republic (SOCAR)

SOCAR is the main player in the Oil and Gas market of Azerbaijan.

It is involved in exploring oil and gas fields, producing, processing, and transporting oil, gas, gas condensate, marketing petroleum, and petrochemical products in domestic and international markets. SOCAR is also supplying natural gas to industry and the public in Azerbaijan. SOCAR has trading companies in Switzerland, Singapore, and United Arab Emirates.

## State Oil Fund of the Republic of Azerbaijan (SOFAZ)

Established in December 2000, SOFAZ is an extra-budgetary fund designed to ensure macroeconomic stability for the future and promote investment in non-oil sectors of the economy. Another key reason for the establishment of SOFAZ was boosting the transparency of oil revenue management.

Currently, oil revenue profits from the development of new offshore oil fields flow directly into SOFAZ. The assets of SOFAZ as of April 1, 2018 have increased by 5.1% compared to the beginning of 2018 (USD 35 806.5 mln.) and stood at USD 37 631.7 mln. The increase was mainly due to SOFAZ budget revenues, asset management activity and exchange rate effect of investment portfolio currencies.

By withholding a large share of total oil revenues from the country's immediate income, SOFAZ helps to counter inflation as well as produces other positive effects on the local economy.



## Non-Oil Sector

Azerbaijan's economy is still dependent on oil and gas exports, which causes a significant devaluation of the national currency in line with dropping oil prices.

Diversification of the economy is one of the main priorities in the country's politics.

A number of significant steps have been taken for the development non-oil industry and reducing its dependence on the production and export of oil and gas.

## Banking

In 1991 Azerbaijan introduced the institutional framework for the national banking system and the National Bank of the Republic of Azerbaijan was established in 1992 and renamed into its current title as the Central Bank of the Republic of Azerbaijan (the "CBAR") in 1992. Currently, there are 30 banks in Azerbaijan including two state-owned banks.

Regulatory structure of financial system consists of 3 main bodies: CBAR, Financial Market Supervisory Authority (FIMSA) and the Council of Financial Stability.

CBAR is the regulator of monetary policy in the country and regulation of banking and payment systems.

In the first half of 2016, Azerbaijan established a new supervisory authority, the FIMSA that took over most of the CBAR's former responsibilities. FIMSA was established with the goal of improving licensing, regulation and supervision of securities market, investment funds, insurance, credit organizations (banks, non-bank credit organizations and postal operator) and payment systems operations. After the establishment of the FIMSA, the regulatory functions have been taken away from the CBAR, although the CBAR still perform its traditional functions in the economy such as a lender of last resort, money supply control, inflation control, maintenance and improvement of payment systems.

Council of Financial Stability was established by President Ilham Aliyev in 2016. The aim of the Council was to strengthen macroeconomic stability and financial sustainability, coordinate policy in this field and achieve effective practice of legal application.

If the year of 2016 was a real test for Azerbaijani banks, 2017 became a year of banking reforms, adaptation to new economic realities and preparations for further growth. Namely, the Financial Literacy Council and the Azerbaijan Credit Bureau limited liability companies were established. It must be specifically noted that one of the landmark moments of 2017 was the establishment of the Institution of Banking Ombudsman. One of the main functions of the latter is to provide practical assistance in overcoming differences, as well as to simplify, speed up the procedure for considering the issues that have arisen on mortgages between the bank and the borrower and so far the Banking Ombudsman reviewed more than 160 cases in favor of bank customers.

At the same time, after the difficult period of 2015-2016, the banking sector began to recover gradually – this trend became evident late 2017; although licenses of some banks were revoked throughout 2017. Firstly, the banking sector has regained its profitability; early November 2017, net profit of banks amounted to 549.6 million Manats (approximately, US\$ 934.48 million) as compared to the loss of 1.7 billion Manats (approximately, US\$ 2.8 billion) in 2016. The aggregate capitalization of banks has grown from 1.9 billion Manats (approximately, US\$ 3.2 billion) to 3.1 billion Manats (approximately, US\$ 5.3 billion). The number of bank employees has also increased.

Unfortunately, the banks are yet to overcome one of the banking sector's main problem which is continuing growth in overdue loans. Certain measures taken by banks have not yielded particular results. However, the fact that the government takes comprehensive measures to fight against the growth of problem loans gives some hopes that the condition of banks and their customers will improve in 2018-2019.

The Ministry of Taxes, the Financial Market Supervisory Authority (FIMSA) and the banks themselves implemented various measures to encourage non-cash payments in 2017. Entrepreneurs' cash operations have been restricted since 2017. For example, entrepreneurs involved in the areas of trade and public catering with the monthly turnover of more than 200,000 Manats within 12 consecutive months have been restricted to withdraw no more than 30,000 Manats (approximately, US\$ 17,000) per month. In particular, credits, payment of administrative fines, financial sanctions, taxes, customs duties, insurance payments, issuance of loans and payment of debts for leasing operations, pensions, and others have been transferred to non-cash form since 2017.

To withdraw cash from their bank accounts entrepreneurs must pay tax at a rate of one percent of the withdrawal amount. All these measures resulted in an increase in funds in bank accounts of, primarily, entrepreneurs and banks received additional funds for the issuance of loans.

Negotiations about the need to merge the banks that have continued for many years finally produced some results in 2017. The number of merged banks, taking into account the active negotiations that took place last year, in practice, it did not go further than talking. Nevertheless, there was only one merger last year - the merger of Ata Bank and Caspian Development Bank was completed in 2017. As a result, Caspian Development Bank was liquidated and its assets were transferred to Ata Bank.

Non-bank credit organization PARA appeared in Azerbaijan in March 2017. In fact, this is an important event of the past year, since this is the first bank (i.e. PARA Bank) in the history of the Azerbaijani banking sector that turned into a non-bank credit organization.

The International Bank of Azerbaijan is in the process of recovery since 2015. The country's biggest bank successfully completed the restructuring of foreign liabilities worth \$3 billion in 2017. The previous year became a preparatory one for the bank before being put up for privatization. It is expected that in 2019 the IBA, the majority of shares of which is owned by the government represented by the Ministry of Finance, will be sold wholly or partly.



The banking sector of Azerbaijan still has problems – banks have to take measures to resume growth in crediting, attracting deposits. Over the past few years, much has been done to improve the situation in the sector: new laws have been adopted, and old ones have been modernized and supplemented.

Simultaneously, CBAR has been relaxing capital-adequacy requirement in banking from 12% to 10% and introducing 100% deposit insurance coverage to bolster public confidence in the financial sector and to reduce dollarization of the national economy.

### Telecoms and IT

After the oil sector, the telecommunications industry is the largest sector in Azerbaijan and a major contributor to the country's economy. Fixed-line broadband market penetration has grown moderately over the last five years, with penetration increasing from a relatively small base. Over the next five years to 2022 growth is expected to continue to grow moderately. By January 2018 Baktelecom expanded its GPON fibre-optic network in the capital city Baku and surrounding areas.

BuddeComm's "Asian Telecoms Maturity Index", is an index (on a scale between 0 and 100) that measures and ranks the relative maturity of the telecoms industry in all of the 34 countries in Asia. Azerbaijan is ranked 13th out of 34 with a Telecoms Maturity Index score of 43. This ranks Azerbaijan sixth in the "Market Challengers" category.

Mobile subscriber growth is expected to grow slowly over the next five years to 2022.

Currently, there are four generations of mobile communication in the world. It is believed that the fifth generation of mobile communications will appear by 2020 or later.

These networks will achieve a mobile data transfer rate of up to 10 gigabits per second, that is, 100 times more than the speeds offered by today's 4G networks. And the current generation (4G) networks, built using LTE technology, allow today to reach speeds of 100 megabits per second.

At the moment, programs are underway to develop the basic outlines of the fifth generation standard. That is why it is yet impossible to give an exact definition of 5G, we can only guess what the networks will become after 2020.

However, there is no doubt that the new standard will be quickly integrated into with the ICT sphere of Azerbaijan, as it is considered to be one of the crucial spheres for the further.

Today, a significant part of the population enjoys mobile access to the Internet in Azerbaijan. About 91 percent of citizens check smartphone updates in their mailbox, 75 percent of the population uses mobile devices to communicate in social networks.

Currently, three companies operate in the mobile Internet and communications market of Azerbaijan: Azercell, Bakcell, Nar (Azerfon).

### Construction

The construction business has evolved into a very competitive sector in Azerbaijan, with a number of strong local companies providing high-quality services for diverse projects, including the development of residential areas, business offices, hotels, etc.

Remarkable performance of this sector can be explained by low base effect and government's anti-crisis measures. As a result of the global financial crisis, construction had contracted by 8.2% in 2009. However, measures directed to increase liquidity in the local market, slow recovery of mortgage system and Government's investments into the sector helped to rebound construction by 20.3 %.

Approximately USD\$ 1,73 billion was used for the implementation of construction works in the country in January – February 2014, a 7.9 % year on year rise compared to the corresponding period in 2013.

On 1 January 2013, the new Urban Planning and Construction Code of the Azerbaijan Republic (the "Code") came into effect. Before the Code, the construction rules were set in separate laws.

Recently, due to the fall in oil prices there is an observable slowdown in the construction sector in Azerbaijan.

### Agriculture

Azerbaijan has been one of the region's strongest agricultural centres since pre- Soviet times. The country's climatic and ecological diversity allows for differentiation in crop cultivation.

Following the break-up of the Soviet Union in 1991 and the dissolution of collectivized property, Azerbaijan has adopted a policy of deregulation and allowed up to 99% of its agricultural sector to be privatized.

Following the privatization of farm properties, the focus of Azerbaijani agriculture has shifted to producing profit-yielding crops and increasing self- sufficiency. For instance, rice fields were replaced by grain fields in the 1990s, resulting in a rise in grain production up to 1.5 mln tonnes per year. According to State Statistic Committee, in 2017 3,065,100 tonnes of grain, 902,400 tonnes of potato, 1,269,300 tonnes of vegetable, 883,700 tonnes of fruit and berry, 464,600 tonnes of water-melon and melons, 134,500 tonnes of grape, 3598 tonnes of tobacco, 321,300 tonnes of sugar beet, 1015.7 tonnes of green tea leaf were gathered in Azerbaijan.

Azerbaijan continue to be strong in the cultivation of specialized, often rare, crops. Aside from cotton, tea, tobacco and vegetable production, the country produces

other potentially valuable crops, including indigenous pink grapes, persimmon, and other rare crops.

The actual value of agricultural output in Azerbaijan amounted to AZN 3369,6 mln in 2016. Though agriculture employed over 37% of the economically active population of Azerbaijan in 2016, it accounted for only 5.6% of the country's GDP.

## Tourism

The uniqueness of Azerbaijan as a touristic attraction is its natural location which creates different landscapes with own climate, flora, and fauna.

The cultural diversity of Azerbaijan, caused by centuries of foreign intervention by different nations, formed the country's image of the "European charm of the Orient", which implicates a mix of Islam, ancient Caucasian culture and elements of European culture.

Business people currently account for the majority of foreign visitors to Azerbaijan. In 2016, local hotels greeted a huge flow of tourists coming from various countries like Russia, Georgia, Iran, UAE, etc. Azerbaijan offers substantial opportunities in tourism, with a number of international hotel chains, such as Four Seasons, Fairmont, Marriott, Sheraton, Hilton, Holiday Inn, Park Inn, Hyatt.

Azerbaijan has a number of attractive historical sites, such as Shirvanshah's palace, the Walled City of Old Baku, Sheki Khan Residence, while its eco-diversity accounts for many natural resorts. The country's climatic zones offer the potential for developing mountain ski resorts, beach resorts, mineral baths, and special unique medical health spas, like the resort in Naftalan, which offers treatments using indigenous therapeutic oil.

In January-March 2018, Azerbaijan received from 151 countries of the world 629.4 thousand or 12.4% more foreigners and stateless persons compared to the same period of last year. 27.4% of the arrivals were from the Russian Federation, 22.1% - Georgia, 15.8% - Iran, 11.6% - Turkey, 4.7% - the United Arab Emirates, 1.9% - Ukraine, 1.8% - Iraq, 14.6% were citizens of other countries, and 0.1 percent were stateless people.

There has been a significant increase in the number of visitors from the Gulf countries (except Iran) in January-March 2018. The total number of arrivals from the Gulf countries has increased by 35.2% and amounted to 32.9 thousand persons.

The Economic Study Impact is a comprehensive research carried out by PwC analyzing the holistic regional effect of

an event such as Formula 1 Grand Prix, the overall economic impact of Formula 1 in Azerbaijan in two years has been approximately USD 280 million.

## Foreign trade relations

According to State Customs Committee in January-March 2018, legal and natural entities of the Republic of Azerbaijan realized trade operations with their partners in 146 countries of the world; goods were exported to 92 countries and imported from 136 countries.

Taking into account value of statistically estimated exported crude oil and natural gas registered in the customs agencies but customs formalities of which not completed the foreign trade turnover on January-March 2018 made 6894.6 million USD, including export value - 4703.5 million USD, import value - 2191.1 million USD and consequently positive trade balance reached to 2512.4 million USD. In comparison with January-March, 2017 foreign trade turnover increased in actual price by 34.9%, in real by 6.3%, including export - by 5.3% and import - 8.7%.

On January-March 2018 non-oil products in the amount of 356.4 million USD have been exported and that is more in actual prices for 34.8% and in real terms for 29.6% relatively to January-March 2017.

Most non-oil products were exported to the Russian Federation (\$ 36.8 million), Turkey (23 million), Switzerland (17.9 million), Georgia (11.3 million) and China (4.4 million US dollars) during the first month of the year. Among the non-oil sector products exported in January 2018, gold (not used but in other rough forms) ranks first (\$ 17 million) as gold bullions, but in other rough forms) ranks first (\$ 17 million). The second place in this list is persimmon (\$ 13 million), and the third one is the initial polyethylene (\$ 9.7 million), with a specific mass of less than 0.94.

It will be interesting to note, that according to PwC Azerbaijan 2<sup>nd</sup> Annual Survey, looking through the perspective of the geographic markets, Russia again tops the chart - 76% of local CEOs consider it one of the three most important countries for growth, followed by Turkey with 71%. China closes the top three, with one in four CEOs considering it an important growth market.

The USA remains at its previous place with 24% of votes (19% in 2015). Furthermore, Germany bumps Georgia as the fifth most attractive market in 2017. Interestingly, this year Iran lost dramatically the interest of local CEOs as the market for growth (decrease from 22% in 2015 to 3% in 2017).

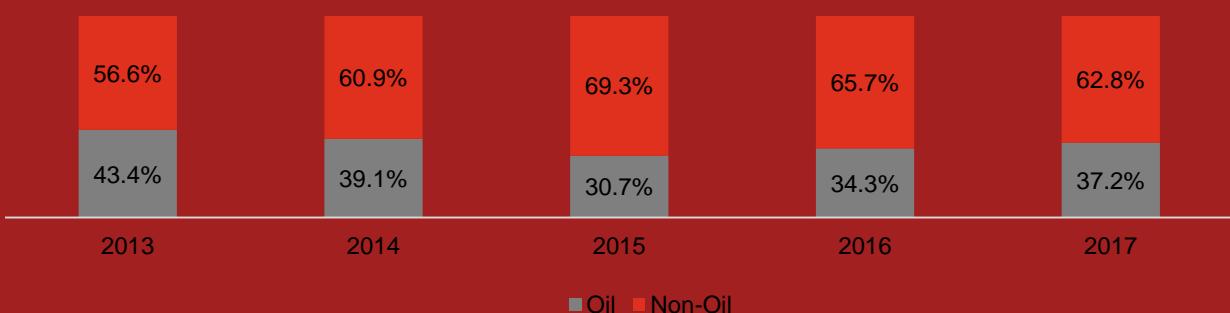


# Main macroeconomic indicators

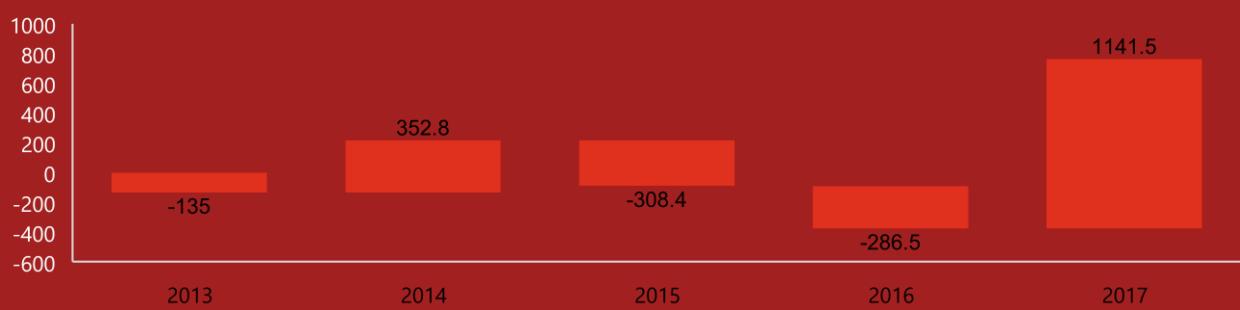
## Main macroeconomic indicators

Macroeconomic indicators	2016	2017	1Q 2018
GDP (US\$ bln)	34.7	39.2	13.5
GDP per capita (current US\$)	3597.5	4097.6	1380.0
Inflation	12.6%	13%	7%
Unemployment rate	5%	4.9%	n/a
Imports of goods and services (US\$ bln)	7.7	7.8	2.2
Exports of goods and services (US\$ bln)	11.9	14.0	4.7
Agriculture, value added (% of GDP)	5.6%	5.6%	5.2%

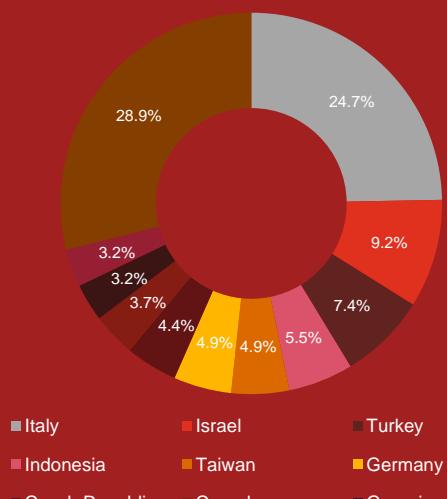
## Breakdown of oil and non-oil GDP



## State budget (million manats)



## Main export countries



## Main import countries





## *Foreign investment*



## Investment climate

Azerbaijan's average annual economic growth rate was about 10% over the past few years. In 2009, despite the global financial crisis, Azerbaijan's rapidly developing economy grew by 9.4% and has continued its rapid expansion.

As of 2014, almost 80% of the economy had been privatized. In 2015, the stock of foreign direct investment (FDI) in the Azerbaijani economy amounted from \$7-7.5 billion with investment in the oil and natural gas sector constituting 88.5% of the total amount. The World Bank reports on per capita FDI inflows rank Azerbaijan near the top among CIS and Eastern European countries. According to the WB, in 2004, private sector investments were accounting for 90.7% of total investments, and foreign investment accounted for 73.1%. However, since 2005 domestic public investments have gained pace, while private and foreign investments have been decreasing.

## Foreign investment

### Definition of a foreign investor

According to the Law on Protection of Foreign Investment, the following entities and individuals are considered as foreign investors in Azerbaijan:

- Foreign legal persons;
- Foreign citizens, stateless persons, and citizens of Azerbaijan with a permanent residence abroad subject to registration in their country of residence for engaging in economic activity;
- Foreign states;
- International organizations.

### The General regime for foreign investments

Foreign investments are generally defined as all types of tangible and intangible rights, including intellectual property rights, contributed by foreign investors to entrepreneurial and other types of activities for the purpose of making a profit. They include, among other things, participation interest and shareholding in Azerbaijani companies, acquisition of immovable property (except land plot), acquisition of securities and other assets liable for purchase by foreign investors under Azerbaijani law, and contractual agreements with Azerbaijani individuals and legal entities that provide for other forms of foreign investments.

Azerbaijani law is evolving in accordance with the government's strategic goal of creating a welcoming environment for foreign businesses. Foreign investments are thus protected by guarantees provided under law. These include:

- Guarantee against deterioration of legislation: a foreign investor is assured that the laws governing its investment will remain in force for a period of 10 years from the initial investment.
- Guarantee against nationalization and requisition: foreign investors are guaranteed immediate, adequate and effective compensation in a case of nationalization and requisition. Compensation should be commensurate to the amount of the investment at the time of nationalization or requisition, payable in foreign currency and freely transferable abroad.
- Guarantee of compensation of damages: foreign investors are entitled to compensation for damages, including compensations for lost profits resulting from illegal acts of state authorities;

- Guarantee of profit repatriation: foreign investors are entitled to repatriate profits derived from foreign investments subject to applicable taxes and duties.

In the light of above, the President signed an order dated 18.01.2018 on promoting investment activities and protection of rights of foreign investors in Azerbaijan. The very point of the order is to pass a new law on investment activity covering state guarantee to investor's rights, rules on alternative dispute resolution and indemnifying damage.

The government is expected to continue its policy of supporting privately held enterprises, including those with foreign capital and owned or operated by foreign nationals.

There are no general trade barriers or embargos for the import of goods to Azerbaijan. Exports are not subject to customs duties or restrictions. Regulations exist only for the export of strategic commodities such as electricity, petrol, cotton and non-ferrous metals.

### Registration of foreign investors in Azerbaijan

All companies operating in Azerbaijan are required to be registered. Without formal registration, a company may not do business in Azerbaijan (e.g., maintain a bank account, clear goods through customs, etc.). As a part of the ongoing business law reforms, a "One Stop Shop" principle was introduced effective 1 January 2008. The registration procedures involving several governmental bodies (Ministry of Justice, Ministry of Taxes, Social Insurance Fund and Statistics Committee) have been eliminated, obligating businesses to register only with the Ministry of Taxes. The established period for state registration with the Ministry is officially set at not later than two days for commercial legal entities. Registration of non-commercial legal organizations (e.g. public associations) is conducted by the Ministry of Justice.

### Legal forms of doing business by foreign investors

The law stipulates that any company with foreign investment operating in Azerbaijan must be organized as a joint-stock company, limited or additional liability company, partnership, or any other structure that is consistent with Azerbaijani law.

### Business entities

#### Subsidiary

A subsidiary is an Azerbaijani legal entity with foreign ownership, which can be registered as a limited liability company or joint-stock company. Although such an enterprise may be owned by foreign nationals, it is considered as an Azerbaijani legal entity for tax, currency accounting, reporting and other requirements.

#### Representative Office (RO)

A RO is the locally registered presence of a foreign legal entity (represents and defends interests of the entity) and has the "non-resident" status in regard to Azerbaijani tax, legal and currency regulations. If RO's activities are strictly limited to providing representative services to its head office, it is not subject to any profit taxes. A RO is responsible for the timely payment of all other applicable taxes to the tax authorities, such as personal income tax and social fund payments from employees.



## Branch

A Branch carries out functions of Head Office totally or partially along with functions of RO. Branch and RO are broadly subject to the same legal, tax, currency and reporting requirements. Branches are free of the requirement to have a charter fund and are able to channel income into overseas accounts, provided these accounts are duly registered with authorities in Azerbaijan. State duty for both Branch and RO registration is AZN 220 (approximately US\$ 129).

## Types of commercial legal entities

The Azerbaijani Civil Code stipulates the following legal forms for doing business in the country:

### General Partnership (GP)

An enterprise established by two or more physical and/or legal persons. The owners of a GP have “unlimited” liability for the obligations of the GP.

### Limited Partnership (LP)

An LP may be established by two or more physical and/or legal persons, with at least one of the participants bearing unlimited liability for the obligations of the LP and not participating in the entrepreneurial activity.

### Limited Liability Company (LLC)

An LLC is an enterprise which is established by one or more physical and/or legal persons. The legal fund of an LLC is divided into authorized shares as specified in its charter. The shareholders of an LLC have limited liability commensurate with their shares in the LLC.

### Additional Liability Company (ALC)

The legal status of an ALC is similar to that of an LLC, with the exception that the participants of an ALC may assume liability in excess of their contributions.

### Joint-Stock Company (JSC)

A JSC's structure is similar to that of an LLC. JSCs may be established either as “open” or “closed” business entities. An “open” JSC is able to offer its shares to investors, while a “closed” JSC can only redistribute its shares among its founder shareholders and other predetermined persons.

Under the Privatization Law, foreign investors may participate in Azerbaijan's mass privatization program by the acquisition of the state privatization options.

## Types of non-commercial legal entities

### Public Association

Public Association is a non-profit organization established by individuals or legal entities to engage in activities of their common interest. Members of public association do not have any ownership rights over property or membership contributions allocated to an association. Public association does not carry any responsibility for its members, and so do its members.

### Foundation

Foundation is a non-membership organization established by individuals and/or legal entities on the basis of their voluntary material contributions and aimed at social, charitable, cultural, educational and other socially useful purposes.

Foundation's establishers are not its members.

Thus, they do not participate in its management and all managerial decisions are made through governing bodies determined by its charter.

### Union of legal entities

The Union can be established by commercial or non-commercial entities to promote their business and non-business activities. The Union is not responsible for its members, however, members are responsible for union's obligations at the amount of their contributions to the union's charter.

### Public Legal Entities

Recently established law on Public Legal Entities governs procedures on the establishment, operation, and organization of public legal entities. According to the law, public legal entity, being not a state or a municipal body, may be established only either by the state, or by a municipality for the purposes of carrying common state or publicly important activities in Azerbaijan. A public legal entity has its own charter, property and charter capital formed by property contributed thereto by its founder(s). State and municipal property contributed to the public legal entity may be used only for the purposes indicated in its charter. Neither the state nor municipalities are responsible for obligations of the public legal entity; they carry the risk for the damages caused in accordance with activity of the public legal entity to the extent of the value of the property contributed by them to the charter capital of the public legal entity. Incorporation, re-organization, and liquidation of the public legal entity are regulated by the Civil Code of the Republic of Azerbaijan and its respective charter.

### Licensing

The new Law on Licenses and Permits is aimed to create a favorable environment for the development of business by simplifying the process of license and permits obtainment. Law shed lights to previously obscure aspects of license obtaining by setting out criteria for activities requiring license or permits; list of authorities granting licenses and permits and their powers and functions; rules of obtaining, renewal and termination of license; validity periods of licenses or permits, as well as amounts of state duties payable for that. Law introduced the notion of Electronic Portal on Licenses and Permits and a Single Registry for Licenses and Permits.

Law brought new principles of state control over licenses and permits such as:

- a “One Stop Shop” principle;
- notion of silent consent in regard to issuance, renewal, suspension, resumption and cancellation of licenses and permits (in case if license issuing body does not respond to license or permit application within time frame established by the Law, such application will be treated as consented, and information regarding new license or permit shall automatically be added to the Single Registry for Licenses and Permits);
- proportionality of interests of entrepreneurs, society and state when issuing licenses and permits (for the elimination of misconduct addressed to competition restrictions in the market); and



- analysis of regulatory body influence (analysis is made by the body issuing licenses and covers evaluation of impact of new laws on licensing and permits on entrepreneurship; evaluation of achievement of the goals set by the new laws).

Law defines “permit” as an official document granted by the authority issuing permits to exercise certain business activities or actions. Law contains an explicit list of 87 types of activities requiring obtainment of permits. Applications for license obtainment shall be made via Electronic Portal on License and Permits, which will enable to conduct all operations related to licensing (e.g. obtainment of licenses, their duplicates, and amendments thereto, renewal, suspension, resumption and termination thereof). Period of issuance of licenses and permits has been decreased to ten working days for license obtainment and seven working days for permit obtainment.

### **Privatization**

Under the Privatization Law, the following are considered to be foreign investors:

- Foreign legal entities and their subsidiaries;
- Azerbaijani legal entities with participation of foreign investment in excess of 50% charter capital share;
- Foreign nationals;
- Stateless persons.

Privatization of state property began with the First Privatization Programme (1995- 1998). Since 2002, the privatization of large enterprises has been underway, with approximately 2,000 medium to large enterprises having been privatized. The International Bank of Azerbaijan (IBA), the largest bank in the country, has been in the process of privatization since 1998, but 50.2% of the shares still remain in state hands. In December 2011, it was officially reported that PwC was a part of the consulting consortium which finalized the first preparatory stage of the project of privatization of the state share in the authorized capital of IBA. The second phase would involve the final preparation of necessary documentation for the privatization of the bank and final determination of a list of potential buyers.

### **State Migration policy**

Adoption of the Migration Code on 1 August 2013 was one of the measures aimed to implement the state policy in the sphere of migration.

The new Migration Code clarified grounds, terms and procedure of obtaining work permits, residence permits, visas. A number of restrictions regarding of extension of these permits are removed.

Heads and deputy heads of legal entities, founded in Azerbaijan by a foreign legal entity or a foreign individual, professionals of certain categories, invited to work into the country by legal entities established in Azerbaijan, or individuals – citizens of Azerbaijan have been included to the list of foreign persons exempted from applying for a work permit.

### **Taxation**

#### **Tax regimes**

The Tax Code of the Republic of Azerbaijan adopted in 2001, currently has 221 articles

and a number of old tax laws were abolished from it.

Briefly speaking, Azerbaijan currently has three different tax regimes: 1) the statutory tax regime; 2) Production Sharing Agreements (PSA) and 3) Host Government Agreements (HGA), which are exclusively for the BTC and South Caucasus pipelines.

The statutory tax regime applies to all legal entities (both local and foreign) with the exception of those that are governed by a PSA or HGA, each of which has its own tax rules. The PSA/ HGA tax regimes also generally apply to relevant oil operating companies, foreign investors serving as contractor parties and all foreign service companies working with such parties.

Azerbaijan has up to date signed and ratified over 30 PSAs and HGAs for oil and gas production and transportation. Some of them have been terminated or remain dormant. Each PSA and HGA is subject to its own exclusive tax and accounting regime. PSAs and HGAs provide more favorable legal and tax regime (e.g., simpler reporting regime, deductibility of expenses, fixed rate of Profits Tax, exemption from certain taxes and duties, etc.) for its participants, contracting parties and subcontractors.

The following sections outline the statutory and PSA/HGA tax regimes in detail.

#### **Statutory tax regime**

By law, foreign legal entities must register their representative or branch offices before conducting activities in Azerbaijan.

If a representative office or a branch halts its commercial activities, such representative office or branch should file a notification to the tax office no later than the date of cessation of the operations. The major taxes applicable under the statutory tax regime are outlined below.

#### **Corporate income taxation (“CIT”)**

CIT taxpayer might be either legal entities or representative or branch offices of foreign legal entities.

CIT is computed on the basis of an entity's taxable profit. Taxable profit is generally equal to gross realization (receipts), minus deductible expenses, which are defined as any costs incurred in generating of income. The entity tax currently is 20%. CIT should be reported on an annual basis, although current tax payments shall be made quarterly.

In addition to CIT paid by the non-resident entity's permanent establishment, each amount repatriated by such permanent establishment from its net profit is subject to branch profit tax at the rate of 10%.

From 1 January 2013 profit of the residents of the industrial and technological parks is exempt of profit tax for the period of 7 years since registration as a resident of the industrial and technological park.

From 1 January 2019 the revenue generated by the SME Cluster Participant from the supply of goods /work/ services under the contract with the SME Cluster Company which is directed to the CAPEX are exempt from income and profit taxes for 7 years.

At the same time, the “Start-ups” engaged in micro and small entrepreneurial activity are exempt from profit taxes for 3 years from the date of obtaining the start-up certificate.



Following are also exempt from profit tax from 1 January 2019:

- Profits of education institutions and special education centers established for disabled persons (except for portion of profit distributed as dividends);
- Non-cash payments (up to 10% of the profit) made by the legal entity to the education, health, sports and cultural organizations that match certain criteria, for 10 years;
- 50% of taxpayers income from the disposal of shares/participation interest that is owned for more than 3 years;
- 75% of profit generated by Micro Entrepreneurs/Enterprises;
- Dividend income of shareholders of a resident legal entity not registered as VAT payer and with a turnover is below AZN 200,000 (approximately USD 117,878) in any consecutive 12 month-period.

#### Simplified tax

From 1 January 2016, persons with annual turnover of up to AZN 200,000 are eligible to be registered as Simplified Taxpayers.

Persons rendering catering services (e.g. restaurants, coffee shops, etc.) with annual turnover exceeding AZN 200,000 may choose to be a simplified taxpayers. Simplified tax rate is 8% for catering services.

From 1 January 2019, Simplified tax rate is determined as 2% for throughout the territory of Azerbaijan (except for the persons engaged in certain activities).

A special rate of simplified tax is set:

- for the persons involved in residential and non-residential housing construction at a fixed amount of AZN 45 per square meter multiplied by an applied coefficient;
- for the persons selling residential and non-residential premises (except for premises of individuals where he/she has been residing for at least 5 years) at a fixed amount of AZN 15 per square meter multiplied by an applied co-efficient; the applied co-efficient being determined by the regional executive authorities.

A special rate of simplified tax is set for operators of gambling games at a rate of 6% from gross receipts from game participants and for the sellers of such games at a rate of 4% from gross commission paid to the sellers by the operators.

The following persons will not be eligible to be classified as simplified taxpayer effective from 1 January 2019:

- Persons engaged in wholesale trade;
- Companies with headcount over 10 employees engaged in production;
- Professional participants of insurance market (except for insurance agents providing services under mandatory insurance agreement);
- Persons providing services to the tax registered persons/entities;
- Persons engaged in license-required activities (other than construction activities).

#### Dividend withholding tax

A 10% Dividend Withholding Tax applies to both domestic and foreign shareholders and is levied in the currency in which the dividend is paid. Double taxation treaties (DTT) may reduce the rate at which dividend tax applies.

Effective from 1 January 2019, definition of dividend was broadened and should include the following:

- During the liquidation of the legal entity, distribution of the property (assets) formed out of the retained earnings;
- Payments for redemption of shares at portion of nominal value of shares increased based on retained earnings.

Transfer of assets to the shareholder for other beyond the business purposes as well as the set-off of the shareholder's debts is treated as dividend payment and will be subject to withholding tax at a rate of 10%.

#### Other withholding taxes

Foreign legal entities without a permanent presence in Azerbaijan are subject to Withholding Tax on income, which is derived from the following sources:

From 1 January 2016 annual interest income of individuals on bank deposits placed in all banks in Azerbaijan, as well as dividends, discounts and interest income on investment securities paid by the issuer, are exempt from withholding taxes for 7 years.

<b>Interest</b>	<b>10%</b>
<b>Rent and royalty</b>	<b>14%</b>
<b>Freight income</b>	<b>6%</b>
<b>Telecommunications services</b>	<b>6%</b>
<b>Financial leasing and insurance payment</b>	<b>4%</b>
<b>Payments to an electronic wallet</b>	<b>10%</b>
<b>Payments to parties registered in countries with favorable tax regime</b>	<b>10%</b>
<b>Other income</b>	<b>10%</b>

#### Transfer pricing

The transfer price must be in accordance with prices determined by comparable transactions between independent persons under the same conditions.

Taxes may be computed based on the transfer price for transactions concluded between the following persons:

- Azerbaijani resident and non-resident in a related party relationship;
- A permanent establishment of a non-resident in Azerbaijan and that non-resident, or any other representation, affiliate or other division of that non-resident in the other country, affiliated with that non-resident, or any other person in another country;
- Azerbaijan resident and (or) Azerbaijani permanent establishment of non-resident person or persons established (registered) in a country with a favorable tax regime.



The transfer price is determined based on the following methodologies:

- Resale price method;
- Cost plus method;
- Comparable profit method;
- Profit split method.

The method is used only if it is established that no comparable information on different transactions exists or it is not possible to obtain information on price of the goods in transactions between other persons.

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

Generally, VAT is charged at the rate of 18% for each taxable operation and for the value of each taxable import. There are detailed requirements for registration and accounting for VAT, with penalties for non-compliance.

Legal entities and individuals with taxable transactions exceeding an annual threshold of AZN 200,000 (approximately US\$ 117,878) must register as VAT payers.

Other companies carrying out business activity in Azerbaijan may register voluntarily. Only registered VAT payers may charge VAT and claim credit for input VAT. VAT is also applied to goods imported into Azerbaijan at customs unless exempt or 0% rated.

There is also the self-assessment of VAT (reverse-charge) for the services rendered by unregistered non-residents in Azerbaijan. In general, VAT paid on purchases (i.e., input VAT), is recoverable against the output VAT that is charged on the sale of manufactured goods or the provision of services in Azerbaijan.

From 1 January 2013, equipment, imported by residents of industrial and technology is exempt from VAT for the period of 7 years. The VAT exemption is also applicable to goods imported into special economic zones (excluding those that are subject to an excise tax). Additionally, certain categories of imported goods are exempt from VAT as defined by the Cabinet of Ministers.

Starting 1 May 2016, all types of goods imported based on relevant supporting documents by the residents of the industrial parks shall be exempted from VAT for the period of 5 years.

From 1 January 2019, machinery, technological equipment and devices imported for the purpose of production and processing by SME Cluster Companies are exempted from VAT for 7 years from the date of their registration as a SME.

All registered VAT taxpayers must pay the value of the goods (work, services) excluding VAT, to a normal bank account of the vendor, and the VAT amount (input VAT) must be remitted to the VAT deposit account, single treasury account created for the allocation of VAT.

Taxpayers will not be able to recover input VAT paid into any other account (i.e., not the VAT deposit account).

Failure to remit VAT into the VAT deposit account is subject to the 50% penalty of the unpaid VAT amount. All VAT-registered taxpayers must issue electronic VAT invoices in AVIS (Automated Tax Information System) instead of paper ones.

Effective from 1 January 2019, supply of goods without issuing an electronic VAT invoice is subject to penalty in

amount of 10% of sale price of the supplied goods (for the first time), 20% (for the second time) and 40% (for the third time and more).

### **Limitation of the cash settlements**

Settlements over the below limits must be carried only cashless:

#### *VAT payers:*

- Over AZN 30,000 per calendar month (effective from 1 January 2017).

#### *Other taxpayers:*

- Over AZN 15,000 per calendar month.

#### *Cash withdrawals:*

- 1% Simplified tax is calculated for cash withdrawals by legal entities and sole traders from their bank account.

### **Interest and penalties**

Interest and penalties are applicable for failure to comply with tax legislation.

Interest on outstanding tax liabilities is currently being accrued at a rate of 0.1% per day. Penalties vary from 50% up to 100% of the amount of tax due.

Administrative penalties may be applied for failure to file declarations, register a taxpayer with the authorities, notify the authorities of a change of address, etc. Tax law violations have a three-year statute of limitation.

### **Thin capitalization**

Accrual interests on foreign borrowings exceeding 2 times of equity were not deductible for CIT purposes (it is not applicable to banks and credit institutions).

Above limitation is not applicable to debt on bonds received from foreign banks and loan institutions, and securities traded in foreign stock exchanges.

### **Mining tax**

Legal entities and individuals involved in the recovery of minerals in Azerbaijan are obliged to pay the Mining Tax. The rate depends on the type of mineral extracted and varies from 3% to 26% of its total wholesale price.

### **Excise tax**

Excise goods produced in or imported to Azerbaijan are subject to Excise Tax, unless said goods are specifically exempt. The following goods are considered excisable goods:

- Spirits, beer and all types of alcoholic beverages;
- Tobacco products;
- Petroleum products;
- Light vehicles (with the exception of motor transport means for special purposes, with special markings and equipment);
- Leisure and sports yachts, as well as other boats vehicles, stipulated for the aforementioned purposes

### **Property tax**

Companies operating in Azerbaijan are required to pay property tax at the rate of 1% of the fixed assets' average annual residual value.



## Land tax

Land Tax is levied as a fixed payment. Individuals and/or entities who own or use land within Azerbaijan are subject to Land Tax. Except for agricultural lands, the land tax rate per 100 square meters of a land plot varies between 0.1-20 AZN depending on the purpose of the land - e.g., industry, construction, transportation, etc. - and its location.

The economic activity level of the land's tenant/owner does not influence the Land Tax payment.

From 1 April 2016, land tax rate for agricultural land is 10 AZN for every 100 square meters and must be paid to state budget except, agricultural lands which are used for purposes or other agricultural lands which are not used for its intended purpose because of irrigation, land reclamation and other agro-technical reasons.

## Road tax

Since the 1 January 2015, all individuals engaged in the production or import of vehicle gasoline, diesel fuel and liquefied gas to Azerbaijan are road taxpayers. Vehicle owners (excluding the road tax on transit) are expected to indirectly pay the road tax within the price of fuel.

The Road Tax rate varies depending on vehicle engine volume, number of axles, weight carried, and how long the vehicle will be in Azerbaijan (for foreign vehicles).

**Wholesalers** - road tax rate for vehicle gasoline, diesel fuel and liquefied gas manufactured in Azerbaijan and directed to the national consumption (wholesale) is AZN 0.02 on wholesale price (including VAT and excise) for each liter of these mentioned items.

**Importers** - for vehicle gasoline, diesel fuel and liquefied gas imported into Azerbaijan, road tax is calculated at AZN 0.02 on the customs value, but not lower than wholesale market price (including VAT and excise), of each litre of the mentioned items.

## Employment taxes and contributions

### Income tax

Effective from 01 January 2019, the monthly income of employees in other than oil and gas and government sector is taxed as follows for 7 years period:

Taxable monthly income	Tax rate
up to AZN 8000	0 %
over AZN 8000	14% of the amount exceeding AZN 8000

Monthly income of employees in oil and gas and government sector is taxed as follows:

Taxable monthly income	Tax rate
up to AZN 200	0 %
From AZN 200 to AZN 2500	14%
Over AZN 2500	25% of the amount exceeding AZN 2500

Taxable income of individuals engaging in entrepreneurial activity is subject to tax at 20%.

## Social insurance fund

Employers and employees must make payments into the Social Insurance Fund. The employer pays the equivalent of 22% of an employee's gross salary, and employees pay 3% of their gross salary (withheld from their salary by the employer). Foreign citizens, except from foreign employees working under the PSA/ HGA tax regime, are also subject to social insurance contributions.

Effective from 01 January 2019, the mandatory SIC rates for employment income (other than oil and gas and government sector) are considered as follows for 7 years period:

Amount of income	Employee portion of SIC	Employer portion of SIC
up to AZN 200	3 %	22 %
more than AZN 200	AZN 6 + 10% for the amount exceeding AZN 200	AZN 44 + 15% for the amount exceeding AZN 200

## Unemployment insurance contributions (“UIC”)

Starting from 1 January 2018, the law “On Unemployment” has been enacted as a result of which each of employers and employee will bear 0.5% UIC assessed on the gross monthly salary.

The amount of unemployment insurance payments depends on the length of insurance record and the amount of past average monthly salary.

## Double tax treaties

Azerbaijan has ratified treaties to avoid double taxation with 51 countries. In the meantime, due to administrative barriers imposed by the Azerbaijani tax authorities, the benefits of double tax treaties have not been fully utilized. The tax authorities require that the majority of types of taxes due be paid before the taxpayer lays a treaty claim. Following the submission of the full payment, a non-resident enterprise may file a refund/offset claim for overpaid taxes. As the process of gaining a refund or an offset is tedious, lengthy, requires filing a great deal of paperwork and involves the risk of a tax audit, few taxpayers have chosen to file a treaty claim. From 12 June 2017, the non-residents have entitled a right of submission of DTA forms electronically via online tax cabinet for all types of income independently or via tax agent.

## Production Sharing Agreement (PSA) tax regime

Foreign companies operating as PSA subcontractors in Azerbaijan are referred to as foreign subcontractors (FSC), and are subject to a simplified tax regime (withholding of tax in place of Profits Tax - 5% to 8%). This simplified corporate income tax regime does not apply to Azerbaijani legal entity subcontractors.

VAT (both input & output) and customs duties for activities conducted under the PSA regime are charged at a rate of 0%.



## Customs regime

Goods imported into Azerbaijan are subject to imports duties (ranging from 0% to 15% per metric unit).

Azerbaijani law recognizes several customs regimes pertinent to goods imported into Azerbaijan. Such procedures as transit, customs storage, bonded warehouse, temporary import, and processing in/outside of customs territories may be of interest to foreign investors. If the import is temporary, no customs duties may be applied to it, and it must be exported from Azerbaijan within a certain period of time. The deadline for exporting a temporary import is established by the customs authorities.

Goods brought into Azerbaijan under the temporary import regime should be exported without substantial changes to their form/structure. According to the destination VAT principle, VAT in Azerbaijan is payable (subject to an applicable customs regime) on the declared value of the goods (including assessed import duties and Excise Tax). Certain categories and types of goods are exempt from import duties and are subject to 0% VAT.

A customs clearance fee up to AZN 550 (approximately US\$ 324) is applicable to nearly all imports/exports. Exports are exempt from customs duties, except for certain types of metals and metal products. Under a PSA regime, contractors, their agents and subcontractors are entitled to import and re-export goods used in hydrocarbon activities free from import duties. Imports under a PSA regime are subject to 0% VAT. A similar regime applies under HGAs.

## Labour and social relations

### Labour law

Labour relations in Azerbaijan are covered extensively by the 1999 Labour Code, which comprises legislation different from the early 90s with a number of later lower-tier regulatory acts expanding the general code's provisions.

A standard working week is 40 hours. Overtime and work performed on days off (Saturdays, Sundays, public holidays and one mourning day) must be compensated at double daily rate. Employment relations are established by the employment contract, which, in most cases, does not necessarily indicate a fixed term of employment. An employer must give an employee two months' notice of termination in the event the employee is made redundant. However, certain exceptions to this rule are available (e.g., in the case of a gross violation of the employee's duties). An employee can terminate their employment contract at any time but must give one month's notice.

## Accounting

Accounting regulations are set out in the Law of the Azerbaijan Republic "On Accounting" (March 1995). In 2004, the Azerbaijani government took steps to improve the transparency of financial reporting and accelerate the economy's integration into the global financial system, as well as modernize the national accounting system and reporting with respect to the international standards by implementing the International Financial Reporting Standards (IFRS) in organizations involved in commercial activities.

According to the amendments, the main goal of state regulation in the area of accounting in the Republic of

Azerbaijan is to ensure the preparation of financial statements on the basis of International Financial Reporting Standards, International Financial Reporting Standards for Small and Medium Enterprises, International Accounting Standards for Public Sector and accounting rules and maintenance of accounting records in the country. At the same time, with these amendments, the National Accounting Standards and the simplified accounting rules for small entrepreneurs were removed from the Law.

In accordance with amendments, chief accountants of the following entities should be professional accountants:

1. Legal entities that which controlling interest (stocks) of shares belong to the state;
2. Other public interest entities, except the legal entities with securities traded at the stock exchange;
3. Large Enterprises (an entrepreneur with AZN 1.250k and more annual income, or 125 or more employees);
4. Public legal entities publishing their annual or consolidated financial statements and state-funded organizations.

The legal entity rendering accounting services to the above-mentioned persons on contractual basis should have an employment contract with at least two professional accountants and the individual engaged with an entrepreneurial activity without the establishment of a legal entity shall have an employment contract with at least one professional accountant.

The professional accountant is the person who successfully passes an exam organized by the State Examination Center, obtains a professional accountant certificate and is a member of the professional accounting organization. The relevant certificate is provided to persons those who successfully passed professional accounting examination and registered by the Ministry of Finance. Professional accounting organization is a non-commercial organization consisting of professional accountants and accredited by the Ministry of Finance.

*We build trust in society  
and solve important problems*



*PwC Azerbaijan*



PricewaterhouseCoopers Global (PwC) is one of the world's most extensive networks of professional services firms. In its current form, the network of firms was established in 1998 through the merger of Price Waterhouse and Coopers & Lybrand, both of which were headquartered in London. PwC posted revenues of US\$ 41.3 billion for fiscal year 2018. PwC Global employs 250,930 people in 158 countries.

PwC is dominating Vault Accounting 50 rankings for the fifth year in a row. Online career resource Vault published its sixth annual "Accounting 50" on Tuesday, ranking the 50 best accounting firms to work for in 2019. Utilizing the feedback of more than 8,800 professionals, firms were ranked according to a number of factors, such as firm reputation, culture, and overall job satisfaction.

PricewaterhouseCoopers (PwC) Azerbaijan, established in 1995, is one of the country's first international professional services firms. The Firm has made significant investments in the local economy and community and will continue to do so.

In addition to the quality of the services, we provide to our clients, we are fully committed to the development of our people. In the past 23 years, we have trained and developed a large number of high-quality professionals, many of whom are still with us, and some of whom have moved on to increase the level of expertise in the business community here in Azerbaijan.

PwC Azerbaijan employs 140 people, including a select group of international and local professionals from 6 countries led by three partners.

PwC Azerbaijan's wide range of skills and experience, along with local and international expertise, allow us to offer our clients the highest level of service and professional excellence. We provide the full spectrum of client services, developed to be commensurate with evolving client expectations. This comprehensive service line has enabled us to accept and successfully complete some of the largest, most technically-challenging projects undertaken in Azerbaijan up to date. Our firm is widely recognized as a leader in its sector, and stakeholders regard PwC as the firm that sets the professional standard. Our opinions on matters of public policy are sought-after and highly regarded.

PwC Azerbaijan has the vast experience in the oil and gas industries, banking and financial services, telecommunications and consumer products sectors. We help organizations and individuals create the value they are looking for by delivering quality in assurance, tax, legal and advisory services. PwC's clients range from the world's leading multinational companies to new and growing enterprises, from large family businesses and governments to NGOs, and private individuals. We aim to create trust in society and solve important problems.

#### **Assurance services**

We have a team of around 50 strong specialists in Assurance, 5 out of them holding ACCA qualifications and local statutory auditing certification. We also have a local

A team of 4 risk management specialists, whom we supplement, if needed, with international experts to meet our clients' project needs.

Our clients number oil and gas upstream and downstream, insurance, construction, manufacturing and service companies, banks as well as Government entities. We provide tailored assurance solutions to fit the clients' individual business requirements and adapt our audit approach to address the needs of small and large, private and state-owned, start-ups and mature, local and international businesses. Our audits draw on the full breadth and width of our global network in virtually any industry.

We audit under the International Standards of Auditing (ISA) providing an internationally required opinion which helps our clients both access international financing and expand the global horizons. With us, our clients can improve their external and internal financial reporting to match the information requirements of any stakeholders: owners, banks, financiers, debtors, creditors, employees, Government and society. We also help our clients to make a successful transition to comply with new regulatory requirements and strengthen corporate governance procedures.

#### **Advisory services**

We have a team over 25 individuals providing IT-related, management consulting and deals services to the public and private sectors in Azerbaijan. With a range of experience and expertise, this team can deliver projects locally and, where it will add value to our clients, in collaboration with other specialists from the PwC global network.

We thereby deliver the best solutions to our clients from strategy and market advice and business and IT improvement through to execution, including deals support and ERP system implementation.

#### **Tax and Legal services**

Consisting of 40 tax specialists and lawyers at the top of their profession, our Tax and Legal practice is the largest team in Azerbaijan.

We are organized around different aspects of tax and law, reflecting the need for in-depth specialist knowledge in each key area. We recognize that, in many cases, knowledge of tax and law must be embedded in a thorough understanding of the industry. We have therefore developed specialized teams along industry lines, allowing us quickly assemble a team with the required tax and legal skills, as well as the relevant industry knowledge. This year The Legal500 has again confirmed Tier 2 position for PwC Azerbaijan for the year 2018.

The Legal 500 assesses the strengths of law firms in over 100 jurisdictions, the results of which can be viewed free of charge using the "Rankings" tab at the top of the page.

Highlights included advising on the merger of AtaBank and CDB Bank, which involved conducting due diligence on both parties, and handling post-merger matters.

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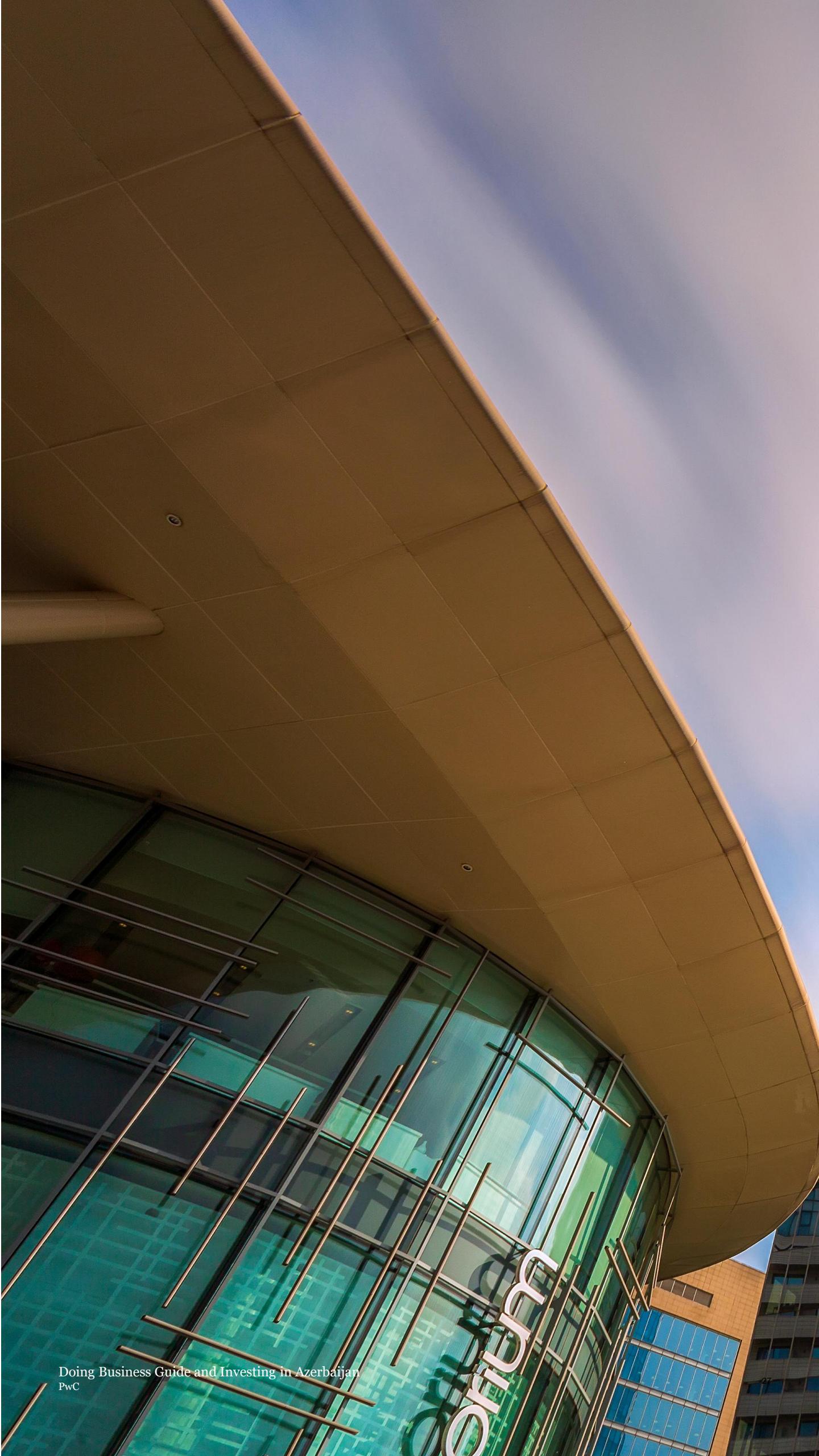
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# *Any questions?*

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