

PwC Azerbaijan Times

Issue №20

Overview of this Issue:

- **Personal income tax**
- **Tax incentives for small and medium enterprises and entrepreneurs**
- **Simplified tax**
- **Exemptions envisaged in Profit Tax**
- **Dividend**
- **Sale of participation shares**
- **Thin capitalisation**
- **Financial sanctions**
- **The Other Important Changes**



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The draft Law on "Amendments to the Tax Code of the Republic of Azerbaijan" ("Draft Law") was accepted by the Parliament of Azerbaijan. The President of the Republic of Azerbaijan has not approved the Law yet.

Nevertheless, we would like to share the most important changes in the Draft Law together with some changes to the "Law on Social Insurance".

Personal income tax

Personal income tax rates

According to the recent draft amendments to the Tax Code, which is planned to be effective from 01 January 2019, the monthly income of employees in other than oil and gas and government sector will be 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

The criteria of oil-gas and government sector will be defined by the respective executive authority. The rules have not been announced yet.

In addition, if the monthly income of individuals is up to AZN 2500, gross income of AZN 200 will be exempt from personal income tax. As the monthly income in amount up to AZN 8,000 of individuals employed by private businesses other than in the oil and gas and government sector is exempt from PIT, this exemption is only applicable for employees of oil-gas and government sector.

Mandatory social insurance contribution (SIC) rates

According to the changes to the Law on Social Insurance which will be 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

PwC Azerbaijan Times

Issue № 20

SIC for Individual Entrepreneurs

According to the amendments to the Tax Code, individual entrepreneurs carrying out operations in trade and construction shall pay social insurance fee of 50% of the minimum monthly salary and for the other sectors – 25%.

Endowment Life Insurance

The personal income tax exemption for insurance premiums paid under the endowment life insurance policies concluded for not less than three years will be applicable to only insurance premiums paid in the amount up to 50% of taxable income of insured persons.

According to the amendments to the Law on Social Insurance, social insurance exemption for insurance premiums paid by both employer and employee under the endowment life insurance policies concluded for not less than three years will be applicable to only insurance premiums paid in the amount up to 50% of taxable income of insured persons.

Other Personal Income Tax Exemptions

- ✓ Dividend income of shareholders of the resident legal entity, not registered as a VAT payer and the revenue not exceeding AZN 200,000 in any consecutive 12-month period;
- ✓ Income from writing-off tax debts to the state budget;
- ✓ 50% of taxpayer's income from disposal of shares and participating interests owned at least for three years;
- ✓ Up to AZN 10 of winnings received from lotteries registered in the relevant executive authority;
- ✓ Income generated from the compensation of debts of the borrowers for the guaranteed loan by the relevant executive authority;
- ✓ Profit tax determined by the portion of payments made through the POS-terminal on total revenue in retail business and catering will be reduced by 25%;

Income on non-commercial activity

According to changes made to the Tax Code, income driven from non-commercial activity is subject to 14% income tax.

Tax incentives for small and medium enterprises and entrepreneurs

Tax incentives for Small and Medium Entrepreneurship ("SME") Cluster Companies, participants of SME Cluster and Start-ups are introduced to the Tax Code:

- "SME Cluster Companies" are exempt from profit tax, property tax and land tax for 7 years from the date of their registration as a SME;
- 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;
- The portion of revenue generated by the SME Cluster Participant from the supply of goods (work and services) under the concluded contract with the SME Cluster Company which is directed to the CAPEX (capital expenditure) are exempt from income and profit taxes for 7 years;
- "Start-ups" engaged in micro and small entrepreneurial activity are exempt from income and profit taxes for 3 years upon obtainment date of start-up certificate.

Simplified tax

Taxpayers

The following persons will not be eligible to be classified as simplified taxpayer effective from 01 January 2019:

- Persons engaged in wholesale trade;
- Persons engaged in retail trade activities with turnover exceeding AZN 200,000 over consecutive 12 months period;
- Companies with headcount over 5 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 ;
- Persons engaged in license-required activities (other than construction activities).

PwC Azerbaijan Times

Issue № 20

Tax rate

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

In addition, monthly fixed simplified tax amount was determined for individuals engaged in tailoring, hairdressing and some other activities.

Exemptions envisaged in Profit Tax

List of exemptions for corporate income tax ("CIT") purposes in recent amendment to Tax Code is identified below:

- 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 organisations 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 from entrepreneurial activity;
- Dividend income of shareholders of a resident legal entity not registered as VAT payer and its turnover is less than AZN 200,000 in any consecutive 12 month-period.

Dividend

The definition of dividend shall 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%.

Sale of participation shares

Income from sale of participation shares or stocks shall be determined as follows:

- If actual sales price is exceeding proportionate value of net assets - the difference between actual sales price and nominal value (if shares or participation interest are purchased for higher price – actual purchase price).
- If actual sales price is less than proportionate value of net assets - the difference between value of net asset at the date of disposal and nominal value of shares (if shares or participation interest are purchased for higher price – actual purchase price).

Thin capitalisation

Accrual interests on foreign borrowings exceeding 2 times of equity will not be 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.

Financial sanctions

According to the amendments, in order to enhance tax compliance, the amount of sanctions has been increased significantly. Below we have outlined some important changes:

- For hiding or not registering cash in amount of more than AZN 1,000, 10% (previously 5%) for the portion exceeding AZN 1,000, 20% (previously 10%) for the amount exceeding AZN 1,000 if such event reoccur during a year;
- Failure to submit FATCA, CRS and other similar reports by the financial institution in the prescribed form and period - AZN 10,000 (previously AZN 1,000);
- For violation of cash settlement rules – if such event happens the first time during the calendar year - AZN 1,000, second time - AZN 3,000 and if such violation occurred for the third time or more - AZN 6,000;
- For engaging of individuals to any work (services) without concluding Employment Contract by the Employer - AZN 2,000 (for the first time), AZN 4,000 (for the second time) and AZN 6,000 (for the third time or more);

PwC Azerbaijan Times

Issue № 20

- Understatement or evasion of tax (including withholding tax) by the persons obliged to e-accounting – 25% (previously 50%) of understated or evaded tax to these taxpayers (except for the amount additionally calculated as a result of off-site tax inspection).
- Excise tax introduced for imported buses (other than operating on compressed gas) in amount of 2-10 AZN per each cubic centimetre.

In addition, the following new financial sanctions are envisaged to be added to the Tax Code:

- Supply of goods without issuing electronic invoice or electronic tax invoice – 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);
- If the records of income and expenses are not kept in the prescribed manner – 10% of expenses not supported by documentation (if such case happens for the first time during the year), 20% (for the second time) and 40% (for the third time and more);
- For non-declaration or understatement of non-taxable income - 6 % of unreported or reduced income (without expense deductions).

The Other Important Changes

- It is envisaged that only legal entities and individuals engaged in entrepreneurial activities can be treated as a lessee under the financial leasing transaction;
- Physical consumers will be returned VAT cashback - 15% of VAT for cashless payments through POS terminal and 10% of VAT for cash payments in retail and catering;
- Excise tax has been increased for cigarettes and cigars produced in Azerbaijan;
- New excise taxes are introduced for alcohol and non-alcohol energy drinks as well as liquid for electronic cigarettes;
- Excise tax on imported cars in Azerbaijan increased more than 1.5 times;