



# Doing Business in Azerbaijan



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# Contents

<b>Country overview</b> .....	<b>2</b>
<b>Economy</b> .....	<b>4</b>
<b>Business overview</b> .....	<b>6</b>
Licensing of business activity .....	7
Labor licensing requirements .....	7
Profit repatriation .....	8
Currency regulations .....	8
Land ownership .....	8
Establishing a business .....	8
Types of business presence .....	9
<b>Taxation</b> .....	<b>10</b>
Introduction .....	11
Statutory tax regime .....	11
Corporate taxation .....	11
Individual tax .....	15
Value added tax (VAT) .....	17
Other taxes and fees .....	18
Withholding tax .....	22
<b>Accounting and reporting</b> .....	<b>24</b>
Investment Incentive Certificates .....	25
<b>EY Azerbaijan</b> .....	<b>26</b>
Introduction .....	27
Services .....	27
Assurance .....	27
Tax & Law .....	27
Consulting .....	28
Strategy and Transactions .....	28
<b>Contacts</b> .....	<b>29</b>



# 1 Country overview



According to the Constitution adopted on 12 November 1995, Azerbaijan is a democratic, secular, unitary republic based on the rule of law. The country is governed by the president, who is directly elected for a seven-year term by popular vote.

Currently, the President of Azerbaijan is Ilham Aliyev. The First Vice-President of Azerbaijan is appointed by and subordinate to the President. This position is currently held by Mehriban Aliyeva. The Government (Cabinet of Ministers) is subordinate to the President, who appoints the Prime Minister (subject to the approval of the legislature) and other ministers. The highest legislative body is the 125-member single-chamber parliament, known as Milli Majlis, which is elected for a five-year term by popular vote. Milli Majlis may be dissolved by the President in cases prescribed by the Constitution. In addition, the President is able to veto its decisions.

The Republic of Azerbaijan gained its independence from the Soviet Union in 1991. It joined 11 other former Soviet republics to form the Commonwealth of Independent States (CIS) in 1993.

### General statistics\*

Population	Approx. 10 million
Territory	86,600 square kilometers (approx. 33,400 sq. miles)
Neighboring countries	Russia, Iran, Armenia, Georgia, Turkmenistan, Kazakhstan, Turkey
Main ethnic group	Azerbaijani (91.6%)
Ethnic minorities	Russian, Lezghi, Talysh, Tatar
Capital	Baku (pop. 2,300,500)
Other populous cities	Sumgait (pop. 346,100) Gandja (pop. 335,800)
Autonomous Republic	Nakhchivan Autonomous Republic (pop. 461,500)

\*Source: <https://www.stat.gov.az/>





# 2 Economy





Azerbaijan's vast oil reserves attract foreign investment into the country's economy. Several major oil contracts have been signed since 1994.

According to a 2019 report issued by the Azerbaijani State Statistics Committee, foreign investments in the oil & gas sector made up 54% (US\$ 4,900.8 mln) of all foreign investments. The Ministry of the Economy of the Republic of Azerbaijan has reported that the oil & gas sector accounted for 79% of capital expenditure in 2021.

Following the success of oil & gas projects, the Government declared a policy calling for the development of the non-oil sector. Rapid progress in this area has seen the share of total foreign investment going to oil & gas gradually fall compared with earlier years. The Ministry of the Economy of the Republic of Azerbaijan reported that 64.2% of investments went to the non-oil sector.

On 26 May 2000, the President of Azerbaijan signed the Law on the Main Export Pipeline ("MEP"). The MEP, which connects Baku with the Turkish oil terminal in Ceyhan via Georgia, is the main route for the transportation of Azerbaijani crude to the world oil market. On 26 October 2001, Milli Majlis also passed a law ratifying the Agreement on the South Caucasus Pipeline ("SCP"). The SCP is the main route for the transportation of Azerbaijani gas to the world market. In particular, the SCP pipeline is used to ship natural gas from the offshore Shah-Deniz gas field to Turkey.

The country has one state-owned oil refinery. Large petrochemical and metallurgical plants are located in Sumgait, 28 kilometers from Baku.

In addition, there are 5 so-called industrial parks and 3 high-tech parks in Azerbaijan. These provide a 10-year tax holiday for entrepreneurs operating as residents of the parks.

The President of Azerbaijan signed a decree on additional measures to improve the business environment and strengthen the country's position in international rankings on 13 July 2016.

That decree set up a special body (Commission) tasked with generating proposals for the establishment of a favorable business environment, developing an appropriate legal and institutional framework and preparing an action plan to achieve the goals set.



# 3 Business overview





## Licensing of business activity

The Law on Licenses and Permits, adopted on 15 March 2016, establishes a “one-stop-shop” principle for issuing licenses. The Ministry of the Economy of Azerbaijan maintains the Register of Licenses and Permits.

It should also be noted that licenses to conduct business activity are normally granted for an indefinite term, save for specific exceptions.

## Labor licensing requirements

Foreign employees are required to have individual work permits issued by the State Migration Service of Azerbaijan. Severe penalties are prescribed for employers that fail to obtain a work permit: AZN 3,000 to AZN 4,000 for executive officers and AZN 15,000 to AZN 20,000 for legal entities. The penalty rises to AZN 35,000 if the violation is committed in relation to three or more foreign employees. Heads and deputy heads of branches/representative offices of foreign companies and foreign entrepreneurs are exempt from the requirement to obtain work permits. The same rule applies to heads and deputy heads of legal entities established in Azerbaijan that have at least one foreign (corporate or individual) founder.

Furthermore, a foreigner or stateless person has the right to work in the Republic of Azerbaijan without obtaining a work permit provided that he/she is

on a business trip in an area of business specifically permitted by the Cabinet of Ministers of Azerbaijan and the period of the business trip does not exceed a cumulative total of 90 days in a year.

Foreign citizens coming to Azerbaijan for more than fifteen days must register with the State Migration Service within fifteen days, based on an application made by the landlord (owner) of the premises where the visitor is residing.

Foreign citizens wishing to live in Azerbaijan are required to obtain a temporary residence permit before their visas or visa-free stay expire. Temporary

residence and work permits are issued under the one-stop-shop principle. State duty for a temporary residence permit or for a work permit varies depending on the period of validity (e.g., AZN 120-160 for a one-year temporary residence permit and AZN 1,000-1,400 for a one-year work permit).

The employer must register the conclusion, amendment and termination of employment contracts electronically in the E-government web-based information system using an enhanced electronic signature to authenticate entries made.





## Profit repatriation

Under the Law on the Protection of Foreign Investment (adopted on 15 January 1992) and the Law on Investment Activity (adopted on 13 January 1995) (collectively the “Foreign Investment Laws”), foreign investors are entitled to repatriate profit in convertible currency after the payment of all taxes and other fees that are due.

## Currency regulations

The official currency of Azerbaijan is the Manat (AZN). Foreign companies and individuals may have both AZN and foreign currency accounts at local banks. All settlements within Azerbaijan, including the payment of salaries, must be made in AZN, save for certain specific exceptions.

## Land ownership

Land ownership in Azerbaijan is governed by a set of legal acts, including the Law on Land Reform, the Law on the Land Market, the Civil Code of Azerbaijan and the Land Code. Azerbaijani citizens and legal entities are permitted to own land.

Foreign individuals and legal entities cannot acquire land in Azerbaijan, but they have the right to lease land. Foreign individuals and legal entities may purchase dwellings. In such instances, the land on which the acquired dwellings are situated is rented to those foreign individuals and legal entities.

## Establishing a business

The Foreign Investment Laws provide the legal framework for foreign investment in Azerbaijan. They stipulate the types of entity foreign companies can invest in, the rules governing the repatriation of profit, and the general rights and guarantees provided to foreign investors. Foreigners can invest in a business venture in Azerbaijan in a number of ways, such as:

- ▶ Establishing a fully owned subsidiary
- ▶ Acquiring shares in an existing company
- ▶ Establishing a joint venture with Azerbaijani companies and individuals
- ▶ Entering into other acceptable forms of investment agreement



Various registration requirements apply to foreign companies establishing a business presence in Azerbaijan. A special license to conduct business is required for companies operating in telecommunications, sea and air transportation, insurance and other regulated industries. The State Tax Service is charged with registering the business presence of commercial legal entities based on a one-stop-shop principle.

## Types of business presence

The following forms of commercial legal entity exist in Azerbaijan:

- ▶ Open and closed joint-stock companies
- ▶ Additional and limited liability companies
- ▶ General and limited partnerships

Foreign investors wishing to establish a presence in Azerbaijan may opt for any of the above forms. Foreign entities may also operate in Azerbaijan through a branch or a representative office.

### **Joint-stock companies (JSCs)**

A JSC is governed by the Civil Code. A JSC is established by at least one legal entity or individual. The liability of a JSC shareholder is limited to the value of his shares. JSCs fall into two categories – “closed” and “open” JSCs. The shares of closed JSCs are not freely transferable and the company must have a minimum capital of AZN 2,000. The shares of open JSCs are freely transferable, but the company must have a minimum capital of AZN 4,000.

### **Limited liability companies (LLCs)**

LLCs may be founded by one or more legal entities and/or individuals with the founding members having a participating interest in the LLC proportional to the amount paid into the charter capital. Each owner’s liability is limited to the amount invested in the LLC. LLCs do not issue shares.

A participating interest in an LLC is freely transferable to third parties.

### **Partnerships**

General and limited partnerships are governed by the Civil Code. A general partnership is established by at least two legal entities or individual entrepreneurs with all partners having unlimited liability. A limited partnership is established by at least two legal entities and/or individual entrepreneurs with at least one partner having unlimited liability.

### **Branch or Representative Office**

Foreign companies may operate in Azerbaijan without establishing a local legal entity if they register a branch or representative office with the State Tax Service instead. Branches and representative offices are allowed to conduct commercial activities in Azerbaijan. The state duty for the registration of a branch or representative office is AZN 220.

### **Other forms of legal entity**

Apart from commercial entities, Azerbaijani legislation also provides for non-commercial legal entities and public legal entities.

A non-commercial legal entity is an entity that neither generates profit as its main purpose nor distributes profit among its members. Non-commercial legal entities may be created in the form of public associations, funds, or unions of legal entities.

Public legal entities engage in activities of state and public significance. They may be founded by executive authorities designated by the President of Azerbaijan on behalf of the government or by municipal bodies on behalf of municipalities. They may also be founded by other public legal entities if the charters of the latter authorize this.

# 4 Taxation





## Introduction

There are currently two separate and distinct tax regimes in operation in Azerbaijan. These are the statutory profit tax regime and the special tax regime. The latter is applicable in limited cases, in particular to oil & gas and mining companies operating under Production Sharing Agreements (“PSAs”) and/or Host Government Agreements (“HGAs”), as well as companies operating in special areas (e.g., ports and high-tech parks). The statutory (general) profit tax regime is applicable to all other entities operating in Azerbaijan.

Foreign companies that are deemed to have a permanent establishment (“PE”) in Azerbaijan are taxed on income derived from the commercial activities of the PE in the country. Foreign companies receiving income from Azerbaijani sources other than a PE are subject to withholding tax on the amount of such income.

The PSA regime is a set of rules covering 20+ production-sharing agreements that have been ratified by the Milli Majlis. The PSA regime generally applies to all contractor parties under the PSAs and their direct and indirect foreign subcontractors. The HGA tax regime applies to entities working on the Baku-Tbilisi-Ceyhan oil export pipeline and the South Caucasus Pipeline. For a complete summary of the PSA and HGA regimes mentioned in this paragraph, please refer to our separate Azerbaijan oil & gas tax guide.

## Statutory tax regime

The tax regime outlined below is based on the Tax Code enacted on 1 January 2001, as amended up to 2022. The main taxes and payments affecting foreign investors operating under the statutory regime are as follows:

- ▶ Corporate profit tax
- ▶ Personal income tax
- ▶ Value added tax

In addition to the above, the legislation envisages social fund contributions and other taxes and charges (e.g., excise tax, property tax, road tax and land tax).

## Corporate taxation

### Profit tax

The following entities are subject to profit tax in Azerbaijan:

- ▶ Azerbaijani legal entities, with or without foreign ownership
- ▶ Permanent establishments of foreign legal entities
- ▶ Representative offices of foreign legal entities engaged in commercial activities in Azerbaijan
- ▶ Non-commercial organizations deriving income from commercial activities

Taxable profit includes trading profit, capital gains, profit from financial activities and other profit sources. Residents, including entities with foreign investments, are taxed on worldwide profit. Non-residents are taxed only on profit from business carried on in Azerbaijan.

## Permanent Establishments (PEs)

The Tax Code defines a PE as a non-resident foreign legal entity or natural person that carries on commercial activities for no less than 90 cumulative days in any twelve-month period.

Where activities associated with a building or repair site or an installation or assembly project and related supervisory activities are carried out by a non-resident general contractor, time spent on those projects by subcontractors engaged by the general contractor which are related entities of the general contractor and/or whose work it oversees is added to the period of activity of the general contractor itself. This applies only where subcontractors' activities last for more than 30 days.

However, the Tax Code also provides that entities that carry on exclusively any or any combination of the following activities do not create a PE in Azerbaijan:

- ▶ The storage and display of goods
- ▶ The storage of goods for processing by another entity and subsequent export from Azerbaijan
- ▶ The purchase of goods for proprietary use and the collection of information
- ▶ Any other preparatory or auxiliary activities for proprietary purposes

If a non-resident and entities related to it carry on joint activities involving any of the activities listed above in the Republic of Azerbaijan for business purposes or if the results of such joint activities

are not of a preparatory or auxiliary nature and/or the activities carried on by the persons concerned are mutually complementary as part of a single business process, the activities of those entities will be deemed to create a PE in Azerbaijan.

Foreign companies that operate in Azerbaijan without establishing a PE are subject to withholding tax (see below) on any taxable income received from Azerbaijani sources.

It should be noted that the provisions of double tax treaties (see the list of effective double tax treaties below) prevail over those in the Tax Code.

### Tax rates

The general profit tax rate is 20%. An additional branch remittance tax of 10% applies to profit remittances from the branch to the head office. The taxable base is net profit after taxes.

### Determination of taxable profit

Annual income disclosed in a company's Azerbaijani statutory accounts is reduced by all business expenses except for those specifically disallowed by the Tax Code. The most significant items of non-deductible expenditures for tax purposes are:

- ▶ Depreciation and repair expenses in excess of the established limits (to be capitalized and expensed through depreciation)
- ▶ Entertainment, accommodation and meal expenses (except for meal expenses for the provision of "therapeutic nourishment", milk and

similar foodstuffs to employees, which are deductible up to certain limits)

- ▶ Losses arising from spoilage and other damage in excess of natural loss limits set by the relevant executive authority are deductible for profit tax purposes
- ▶ Business travel expenses in excess of the statutory limits

### Capital gains

There is no separate capital gains tax in Azerbaijan. Capital gains are subject to profit tax in Azerbaijan only when an asset is alienated. Gains arising from the disposal of assets are calculated as the difference between the sale price and the net book value of an asset (excluding VAT).

Gains arising from the alienation of shares or other participating interests in resident enterprises are also subject to general profit tax. Such gains are calculated as the difference between the actual sale price and the nominal value of sold shares if the shares/participating interests are sold for a price exceeding the proportional value of net assets of the company corresponding to the alienated shares/participating interest. If the sale price is lower than the proportional value of net assets, the gain is calculated as the difference between the proportional value of net assets as at the date of sale and the nominal value of the alienated shares.

50% of a taxpayer's income from the sale of shares/participating interests owned by the taxpayer for at least 3 (three) years is exempt from profit tax.

### Interest and dividends

Interest (except for interest on loans paid to local banks or non-resident banks with PEs in Azerbaijan) and dividend income received from Azerbaijani companies and PEs of foreign companies are subject to 10% withholding tax.

### Depreciation charges

All assets with a net book value of more than AZN 500 and a useful life of more than one year must be capitalized and expensed through depreciation. The applicable depreciation rates depend on the category to which the assets belong. The following are the maximum depreciation rates by category for the most common groups of assets:

Type of assets	Rate of depreciation (%)
Capitalized land improvements and buildings	up to 7
Machinery and equipment	up to 20
High technology equipment	up to 25
Means of transport	up to 25
Livestock	up to 20
Intangibles	10 (for those with an indeterminate period of use)
All other assets	up to 20

Micro-enterprises are entitled to make depreciation deductions for fixed assets used in their entrepreneurial activities at 2x the depreciation rates shown above, while small enterprises may make deductions at 1.5x the rates shown above.



Depreciation rates are applied to the net book value of assets. Depreciation may be applied at a lower rate than the maximum rate. The balance resulting from using the lower rate may be claimed in future periods.

### Losses and bad debts

Entities that have deductible expenses in excess of their annual income may carry the resulting losses forward for a period of up to five years and offset them against profits for those years without any limitation. Bad debts may be deducted from taxable income only if they are recognized as having no value in the company's accounts and were reflected as income in previous periods. Losses and bad debts recovered in future periods are recognized as income in the period of their recovery.

### Transfer pricing rules

The Regulations on the Calculation and Application of Transfer Prices ("Regulations") were adopted by the Ministry of Taxes in 2017. They are used for profit tax purposes. Transfer prices calculated under the Regulations may be used to recalculate profit tax in respect of controlled transactions between the following persons:

- ▶ A resident of Azerbaijan and a non-resident related entity, and between the same resident and any of its establishments, branches or other subsidiaries located in another country (territory)
- ▶ A PE of a non-resident in Azerbaijan and the non-resident itself or any of

its representative offices, branches or divisions located in other countries or any other person located in another country that is a related entity of the non-resident

- ▶ A resident of Azerbaijan and/or a PE of a non-resident in Azerbaijan and entities incorporated (registered) in jurisdictions identified as having preferential tax regimes
- ▶ A resident of Azerbaijan or a PE of a non-resident in Azerbaijan and non-residents in the following cases:
  - If the transactions involve goods traded on international commodities exchanges
  - If the total income of the resident or the PE of a non-resident in Azerbaijan exceeds AZN 30 mln or transactions with a single non-resident account for more than 30 per cent of total income (expense) during the tax year

As a rule, where the prices or margins in controlled transactions involving supplies of goods (works, services) are not consistent with those in comparable transactions carried out between unrelated parties under the same or similar conditions at arm's length, the tax base of the transaction may be recalculated based on transfer prices.

The Regulations also lay down certain contingent methods for determining transfer prices if no information is available on comparable transactions.



Taxpayers must submit a notification to the tax authorities in respect of controlled transactions exceeding AZN 500,000 during a reporting period. As an exception, controlled transactions between a resident of Azerbaijan or a PE of a non-resident in Azerbaijan and non-residents are subject to a notification requirement irrespective of the transaction value in the following cases:

- ▶ If the transactions involve goods traded on international commodities exchanges
- ▶ If the total income of the resident or the PE of a non-resident in Azerbaijan exceeds AZN 30 mln or transactions with a single non-resident account for more than 30 per cent of total income (expense) during the tax year

The deadline for submitting the notification is 31 March of the year following the reporting year. In addition, taxpayers must submit transfer pricing documentation to the tax authorities upon their request.

### **Controlled Foreign Companies**

Controlled foreign company rules were incorporated into the Tax Code with effect from 2022. A non-resident enterprise registered in a state (territory) with a preferential tax regime is subject to taxation in Azerbaijan in the following cases:

- ▶ If a resident entity directly or indirectly owns more than 50% of the voting shares or more than 50% of the charter capital of the foreign entity or has a right to receive more than 50% of the profits of that foreign entity and

- ▶ If tax actually paid on profit of the controlled foreign company is at least two times less than profit tax payable under the tax legislation of Azerbaijan and
- ▶ If more than 30% of the annual income of the foreign entity is made up of the following:
  - Interest on financial assets
  - Royalties on intellectual property
  - Income from the sale of shares and equity interests
  - Income from financial leasing
  - Income from insurance, banking and other financial activities
  - Income from companies generating income from goods and services that do not create economic value

Where profit of a controlled foreign company is taxed in Azerbaijan, an allowance is made for tax already paid on that profit.

However, the following types of income received from a controlled foreign company are exempt from tax in Azerbaijan:

- ▶ Dividends received from a controlled foreign company
- ▶ Where a resident entity is a subsidiary of a controlled foreign company - taxable profit attributable to that resident entity
- ▶ Income generated through a permanent establishment of a controlled foreign company in Azerbaijan, and income received from a company established in Azerbaijan that is taxable in Azerbaijan

### **Market prices**

In the case of import and export operations, barter transactions, transactions between related parties and transactions in which the price differs by more than 10% in the case of wholesale trade, 20% in the case of construction and manufacturing and 30% in the case of other economic activities from prices in transactions for the same (similar) goods (works, services) on the market during the preceding 30 days, or where property is insured for amounts exceeding its net book value, or where the minimum amount of monthly rent for real estate (other than housing) is required to be established for tax purposes, taxes may be recalculated based on the market price.

### **Declarations and payments**

Profit tax is calculated on a calendar year basis. All taxpayers must submit their profit tax returns no later than 31 March of the year following the reporting year. The deadline may be extended by three months provided that tax is paid in full by the original due date. Tax installments are due quarterly by the 15th of the month following each quarter. Tax installments are estimated as one quarter of the tax payable for the previous calendar year or may be calculated by multiplying income for the latest quarter by the ratio of tax to annual income for the previous year.

The final payment of the balance due must be made no later than 31 March of the following year. Failure to comply may result in penalties (for details of these, see the Interest and penalties section below).



## Individual tax

### Residency rules/scope

A resident is defined as an individual who is physically present in the Republic of Azerbaijan for a period of 183 days or more in a calendar year. Individuals not meeting this requirement are considered to be non-residents unless otherwise determined by the application of tie-breaker rules.

Residents are taxed on their worldwide income, while non-residents are taxed only on their Azerbaijani source income. Tax on Azerbaijani source income is normally paid by withholding tax at source at progressive rates. Income from overseas sources is assessed on a current year basis for residents. An Azerbaijani source of income is defined as any income from commercial activities and sources in Azerbaijan, and specifically includes dividends received from Azerbaijani companies, income from the sale of shares and participating interests in Azerbaijani companies, income from employment in Azerbaijan, etc. The place of payment is irrelevant in determining the source of income.

### Rates

Income earned from employment in the oil and gas or public sectors is subject to the following tax rates:

Monthly taxable income	Tax rates
Up to AZN 2,500	14%
Over AZN 2,500	AZN 350 + 25% of the amount exceeding AZN 2,500

Starting from 1 January 2019, individuals whose monthly income is less than AZN 2,500 are exempt from tax on the first AZN 200 of their income. Annual income of individuals engaged in non-entrepreneurial activity is taxed at the rate of 14%. Individuals whose annual income is less than AZN 30,000 are exempt from tax on the first AZN 2,400 of their income. Individuals who derive income from business activities without forming a legal entity are liable to personal income tax at the rate of 20%.

Effective from 1 January 2019, employees not working in the oil and gas and public sectors are eligible for reduced PIT rates as follows for a period of 7 years:

Monthly taxable income	Tax rates
Up to AZN 8,000	0%
Over AZN 8,000	14% of the amount exceeding AZN 8,000

### Determination of taxable income

Virtually all forms of compensation to an employee are taxable, including hardship and cost of living allowances, payments by an employer for the education of an employee's child and payment of taxes on behalf of an employee, unless they are specifically exempted. One such exemption is accommodation and meal expenses incurred by an employer on behalf of employees, provided that no tax deduction is made for these expenses on the profit tax return.

### Social Insurance Fund contributions payable by employees

Subject to the exception below, both Azerbaijani and foreign nationals earning employment income in Azerbaijan must contribute 3% of their gross salary to the Social Insurance Fund of Azerbaijan ("Fund").

For individuals engaged in employment activities in neither the oil and gas sector nor the public sector, the following amounts must be withheld from the employee for a period of 7 years starting from 1 January 2019:

Gross taxable monthly income of:

- ▶ below AZN 200 – 3% of the amount;
- ▶ above AZN 200– 10% of the amount exceeding AZN 200 plus AZN 6.

Contributions are to be withheld at source and remitted to the Fund by the employer. Fund contributions are not applicable to foreign employees who are employed under PSA-related contracts.

In addition, effective from 1 January 2018, employers must withhold 0.5% from the employee's monthly wage and contribute it to the Unemployment Fund as an unemployment insurance premium.

### Mandatory medical insurance

Under the Law of the Republic of Azerbaijan "On Medical Insurance," compulsory medical insurance was introduced from 1 January 2021.

However, the Government is implementing the compulsory medical



insurance system gradually across the country. The implementation process will be completed in 2021.

The collection of compulsory medical insurance contributions started from 1 January 2021.

Compulsory medical insurance contributions are determined based on taxable monthly income:

- ▶ below AZN 8000 - 2% at the expense of the employee and 2% at the expense of the employer
- ▶ above AZN 8000 - 0.5% of the amount exceeding AZN 8000 plus AZN 160 at the expense of the employee and the same amount at the expense of the employer

Contributions are to be withheld at source and remitted to the State Agency for Compulsory Medical Insurance by the employer.

### **Capital gains and investment income**

Sales of movable assets are not generally subject to income tax unless the disposal relates to business or other entrepreneurial activities. The sale of an immovable asset is not subject to tax if it has been the place of residence of the seller for at least five years. Except for these two exemptions, all other gains resulting from the sale of property are taxable based on the annual income tax rates for individuals and the profit tax rate for legal entities.

Gains arising from the alienation of shares or other participating interests in resident enterprises are also subject to general income tax. Such gains must be calculated as the difference between the actual sale price and the nominal value of the sold shares if the shares/participating interest are sold for a price exceeding the proportional value of net assets of the company corresponding

to the alienated shares/participating interest. If the sale price is lower than the proportional value of net assets, the gain is calculated as the difference between the proportional value of net assets as at the date of sale and the nominal value of the alienated shares.

Half of a taxpayer's income from the sale of shares/participating interest owned by the taxpayer for at least three years is exempt from income tax.

Interest on deposits of individuals and dividends received by individual shareholders of JSCs are exempt from taxes until 1 February 2023.

### **Declarations and payments**

Both residents and non-residents must complete and file their income tax declarations no later than 31 March of the following tax year. Tax must be paid before the filing deadline. Where



a taxpayer only has Azerbaijani source income, which is subject to withholding tax at source, the individual is not required to submit an income tax declaration.

The deadline for filing declarations may be extended by three months provided that tax is paid in full by the original due date. Failure to comply may result in penalties (for details of these, see the Interest and penalties section below).

## Value added tax (VAT)

### Scope

All companies that do business and/or import goods and services into Azerbaijan are subject to VAT. Effective from 1 January 2017, the trade-markup applied to retail sales of agricultural produce is also subject to VAT.

### Rate

The standard VAT rate is 18%.

### VAT registration

There are detailed requirements for VAT registration and accounting, with set penalties for non-compliance. Legal entities and individuals with taxable turnover exceeding AZN 200,000 over twelve consecutive months, excluding those involved in trade and public catering services, must register as VAT payers.

Other companies doing business in Azerbaijan may register voluntarily. Only registered VAT payers may charge VAT or claim credit for input VAT that they pay.

### Determination of the taxable base

VAT is levied on turnover from supplies of all goods and services, including imports, unless they are zero rated or specifically exempt. Barter and free supplies of goods and services are specifically included in the taxable base. All excise taxes and customs duties paid are also included in the taxable base for VAT purposes.

Zero-rated goods and services include exports, transit and international transportation, purchases of goods and services for projects funded by international loans, and imports paid for with foreign financial donations. Exempted goods and services include:

- ▶ Financial services
- ▶ Currency and securities transactions
- ▶ Publications

Generally, goods are deemed to be imported or exported if they undergo customs clearance.

There are detailed place of supply rules for determining the treatment of exported and imported services. Azerbaijani tax legislation generally allows credit for input VAT on commercial goods or services.

However, credit is allowed only if VAT is paid to suppliers through a designated VAT deposit account (see below for additional information). Credit is not allowed for input VAT in relation to VAT exempt goods or services (such input VAT can only be claimed as a deduction for profit tax purposes). If input VAT exceeds output VAT, the excess input VAT may be carried forward or offset

against certain VAT or other tax liabilities. Taxpayers may also apply to the tax authorities for a refund of excess input VAT. VAT on purchases of fixed and intangible assets is not capitalized as part of the asset's cost, but offset against output VAT.

### Reverse charge of VAT

Foreign companies that provide services in Azerbaijan without establishing a PE must pay VAT on taxable sales in Azerbaijan. In such cases, VAT is applied through the reverse charge mechanism. In other words, it is self-assessed by the recipient of the services and remitted to the state budget.

### VAT deposit accounts

All VAT payers are required to remit VAT amounts through designated bank accounts known as VAT deposit accounts. Only VAT payments made through these accounts may be credited against output VAT. The VAT is then claimed by the payer.

### Declarations and payments

Declarations must be filed and VAT must be remitted monthly by the 20th of the following month. Whereas before 1 January 2020, output VAT was generally accounted for on both accrual and cash bases and input VAT was accounted for on a cash basis, starting from 1 January 2020 both output and input VAT is accounted for on a cash basis. VAT on imported goods is paid separately at the point of customs clearance.

## **Timing of transactions for VAT purposes**

In accordance with amendments made to the Tax Code effective from 1 January 2020, for VAT purposes transactions are recognized based on the date of payment. "Payment" in this context means the receipt of the principal amount due (exclusive of VAT) for goods (works, services) supplied.

Provisions have been introduced to clarify the concept of payment in specific cases. Specifically, the date of payment is defined as:

- ▶ The date on which money is received by the taxpayer in cash or as a transfer to an account held by or otherwise at the disposal of the taxpayer
- ▶ In the case of mutual settlements - the date of the discharge or settlement of an obligation
- ▶ In the case of accounts receivable - the date of the expiration of the recovery period
- ▶ In the case of in-kind and barter transactions - the date of the alienation of assets
- ▶ In the case of alienation without consideration - the actual date of such alienation
- ▶ In the case of the assignment of a claim - the actual date of such assignment.

Where a purchaser does not pay for goods or services received from a supplier, but grants a loan to the supplier, a taxable transaction is deemed to have occurred:

- ▶ On the date of the supply if the loan was granted before the supply was made
- ▶ On the date of the loan if the loan was granted after the supply was made

Where payment for goods or services supplied is made in installments, each installment is considered as a separate taxable transaction.

### **Electronic Delivery Notes**

Effective from 1 January 2017, an electronic delivery note is defined as a primary accounting document prepared in electronic format that is issued by a person supplying goods, services or works to individual entrepreneurs and legal entities. As from 1 January 2020, electronic VAT invoices have been abolished and electronic delivery notes are the only documents required to be issued by suppliers to their customers when selling goods or providing services or works. Electronic delivery notes issued by the supplier suffice for a transaction to be recognized and for input VAT to be reclaimed.

Electronic delivery notes for supplies of goods (services, work) must be provided to legal entities and individuals engaged in entrepreneurial activities within 5 days, while electronic delivery notes for returns of goods (services, work) must be provided within 3 days. Movements of goods include movements between a principal and an agent.

The general format and content of electronic delivery notes and the procedures for their issue, amendment

and cancellation are laid down in the Regulations on Electronic Delivery Notes approved by a Resolution of the Cabinet of Ministers.

## **Other taxes and fees**

### **Excise tax**

Excise taxes range from 3% to 72% for domestically produced hydrocarbon products and from AZN 0.2 to AZN 4 per liter for alcoholic beverages and non-alcoholic energy drinks. The rate for tobacco products is AZN 38.5 - 43 per 1,000 units. Excise tax and VAT are not included in the taxable base. Imported automobiles, yachts, platinum, gold, and diamonds are also subject to excise taxes.

Excise tax for platinum is AZN 4 per gram; for gold it varies from AZN 1.5 to AZN 6 per gram depending on the amount of gold in a thousand weight units; for diamonds it is AZN 400 per carat, but the calculation may differ depending on the diamond's size. Where excisable goods are produced from excisable supplies, any excise tax paid on the supplies may be deducted from the excise tax due on the finished product.

Declarations must be filed and payment must be made monthly by the 20th of the following month. Excise tax is deductible for profit tax purposes.

### **Property tax**

Property tax is levied at the rate of 1% of the average annual net book value of fixed assets, including



buildings, machinery and equipment. The taxable base is calculated as the average of the values at the beginning and end of the year. If property of an enterprise is insured for an amount exceeding its residual value, property tax is calculated at the rate of 1% of its market price. Property tax is deductible for profit tax purposes. The following are exempt from property tax:

- ▶ Facilities that are used for environmental protection, fire safety or civil defense purposes
- ▶ Product pipelines, railways and motorways, communication and power transmission lines, irrigation facilities, satellite and other aerospace assets
- ▶ Property of educational, health, sport and cultural institutions used only for officially designated purposes

Taxpayers are expected to submit their declarations no later than 31 March of the following year. Tax due is payable in quarterly installments by the 15th of the second month of the calendar quarter in the amount of 20% of the property tax due for the previous year.

### **Road tax**

Non-resident owners of vehicles entering the territory of Azerbaijan to transport passengers or cargo must pay road tax. The road tax payable by such non-resident owners is collected by the customs authorities at rates depending on the engine volume and weight of the vehicle, the period of stay in Azerbaijan, the number of seats, the axle load and the nature of imported products.

Tax is also indirectly applicable to vehicles used locally through the taxation of automobile gasoline, diesel fuel and liquid gas producers and importers. Specifically, AZN 0.02 is added to the wholesale price per liter of automobile gasoline, diesel fuel and liquid gas produced for local consumption or imported into Azerbaijan.

### **Land tax**

Companies using land are generally subject to land tax calculated at AZN 2 to AZN 20 per 100 square meters, depending on location. Land tax is deductible for profit tax purposes.

Taxpayers are required to submit their declarations annually by 15 May. The tax is payable twice a year, no later than 15 August and 15 November.

### **Social Insurance Fund employer contributions**

Employers in the oil and gas sector and the public sector are required to make contributions to the Fund amounting to 22% of the gross payroll for both local and foreign employees.

Effective from 1 January 2019, employers other than those operating in the oil and gas and public sectors are required to make Fund contributions amounting to 22% of the gross taxable monthly income of both local and foreign employees if their gross taxable monthly income is below AZN 200, and 15% of the amount exceeding AZN 200 plus AZN 44 if their gross taxable monthly income is above AZN 200, for a period of 7 years.

These contributions are made at the expense of the employer and are deductible for profit tax purposes. Relevant reports must be filed quarterly by the 20th of the following month. Fund contributions do not have to be made in relation to foreign employees employed under PSA-related contracts.

In addition, effective from 1 January 2018, employers contribute 0.5% to the Unemployment Fund as an unemployment insurance premium.

### **Mining tax**

All companies and individuals engaged in extracting mineral resources are subject to mining tax at the appropriate rate in addition to any land tax due. Mining tax is deductible for profit tax purposes. The tax is applied to the wholesale price of oil, natural gas and all types of metals at rates ranging from 3% to 26%. For all other taxable mineral resources, the rates range from AZN 1 to AZN 10 per cubic meter. Taxpayers are required to submit their declarations monthly by the 20th of the following month. The tax is payable monthly by the 20th of the following month.

### **Simplified taxation system**

- ▶ Legal entities and individual entrepreneurs that are not required to register for VAT purposes in Azerbaijan are eligible to be registered as payers of simplified tax, which is generally levied at 2%. The taxable base is gross income received from sales of goods, works and services, except for income subject to withholding tax.

- ▶ Persons engaged in public catering activities with a taxable turnover exceeding AZN 200,000 in any month(s) over a period of 12 consecutive months are also entitled to register as payers of simplified tax. The tax rate in such cases is 8%.
- ▶ Special simplified tax rates are established for taxpayers engaged in certain activities (the list below is non-exhaustive):
- ▶ Persons engaged in the provision of their own residential and non-residential premises – AZN 15 multiplied by the location zone rate, varying from 1.2 to 4.0 per square meter
- ▶ Alienation of land – taxation depends on the location and purpose of use. Agricultural land is subject to tax calculated at AZN 0.5 per square meter, while for other types of land tax is calculated at AZN 0.5 per square meter and multiplied by the appropriate location coefficient specified in the Tax Code

Legal entities operating under the simplified tax regime do not pay VAT or profit tax.

Any taxpayer whose business is transporting passengers or cargo (except for international transportation) is liable to pay a fixed amount of simplified tax and is required to obtain what is referred to as a “distinguishing license plate”. Taxpayers who are not involved in a local transportation business and own vehicles for the transportation of

their own cargo and employees must obtain a “special distinguishing license plate” to differentiate themselves from simplified taxpayers. Both distinguishing license plates and special distinguishing license plates are issued by the State Road Transport Service attached to the Ministry of Digital Development and Transport of the Republic of Azerbaijan at no cost within two and five days respectively.

Taxpayers under the simplified tax regime must submit their declarations quarterly by the 20th of the following month. The tax is payable quarterly by the 20th of the following month.

Persons who do not have the right to become simplified taxpayers include:

- ▶ Persons engaged in trading activities for whom the volume of taxable transactions in any month (months) during a period of 12 consecutive months exceeds AZN 200,000
- ▶ Persons who provide services other than services rendered to persons not registered as taxpayers (except for persons who pay fixed amounts of simplified tax)
- ▶ Persons engaged in the production of goods that are excisable and subject to mandatory labeling
- ▶ Persons engaged in production activities that have more than 10 employees
- ▶ Persons engaged in activities requiring a license, except for persons providing services under compulsory insurance contracts

- ▶ Persons engaged in wholesale activities
- ▶ Credit organizations, professional participants in the insurance market (other than insurance agents providing services relating to compulsory insurance agreements), investment funds and managers of such funds, persons licensed in the securities market, and pawnshops

### **Import tax**

The maximum rate of import tax is currently 15%. There are certain import tax exemptions.

Customs processing fees are payable on imported goods in amounts ranging from AZN 10 to AZN 550 (depending on the value of the goods declared and whether customs clearance takes place within or outside regular working hours and within or outside the customs territory).

### **Export tax**

Most goods are exempt from export tax.

### **Interest and penalties**

Interest and penalties are applied for non-compliance with tax legislation. For example, interest is charged on outstanding tax liabilities at the rate of 0.1% per day.



The following is a non-exhaustive list of penalties that may be applied for non-compliance with tax legislation:

Offence	Penalty
Failure to file declarations	AZN 40
Understatement of tax liability	50% of understated tax
Payments from petty cash while bank accounts are under tax sanctions or penalties imposed by the tax authorities	50% of expenses paid from petty cash
Failure to register a foreign bank account with the tax authorities	100% of the revenue collected on such accounts
Delay in paying VAT on supplier/service provider invoices in accordance with the rules on the payment of VAT using a designated bank account	50% of VAT paid in violation of the special rules
Failure to submit financial statements at the request of the tax authority (only medium-sized and large businesses)	AZN 1,000
Failure to provide or provision of misstated information on imported goods to the tax authorities (except for taxpayers in the public and oil and gas sectors)	2% of the value of the imported goods or the misstated portion thereof for micro-enterprises 5% of the value of the imported goods or the misstated portion thereof for other persons
Failure to provide information on payables and receivables to the tax authorities	AZN 100
Failure to register a business entity (facility) with a tax authority in accordance with the prescribed rules or submission of misstated information on an entity (facility)	AZN 40 – for micro-enterprises, non-profit organizations and persons engaged in non-entrepreneurial activities AZN 400 – for other persons
Failure to provide or misstatement of information in a payment order	AZN 100 for each such payment order
Failure to record income and expenses in the manner prescribed by the Tax Code	20% of unrecorded expenses
Carrying out cash settlements in violation of the rules on cases where cash settlements are prohibited	1st time in a calendar year - 10% of the total transaction amount 2nd time - 20% 3rd time or more - 40%
Purchasing goods without receiving a delivery note or electronic delivery note	1st time in a calendar year - 10% of the value of the goods purchased 2nd time - 20% 3rd time or more - 40%
Supplying goods without issuing an electronic delivery note required to be issued under the Tax Code	1st time in a calendar year - 10% of the value of the goods supplied 2nd time - 20% 3rd time or more - 40%

The statute of limitations for a tax violation is three years.



## Withholding tax

### Scope

Withholding tax is applicable to the repatriation of profit and other cross-border payments to foreign companies not related to a PE in Azerbaijan. The tax is payable at the following rates:

Nature of payment	Rate of withholding tax (%)
Insurance premiums	4%
Fees for international communication and freight services	6%
Dividends and interest, including the interest element of financial lease payments	10%
Management fees and fees for other services performed or deemed to be performed in the territory of Azerbaijan but not connected with an Azerbaijani PE	10%
Rents and royalties	14%
Licenses	14%
Branch remittance tax - for the remittance of profit derived from a permanent establishment in Azerbaijan to the head office	10%
Payments to countries with a favorable tax regime*	10%

\* The list of countries with preferential tax regimes is approved by the President of the Republic of Azerbaijan. In addition, there is a list of cases where payments to a country or territory with a preferential tax regime are not treated as income from an Azerbaijani source. These include:

- repayment of the principal amount of a debt (excluding interest)
- transfers made by resident banks to correspondent accounts of those banks
- payments made by individuals not registered with the tax authorities for the purchase of goods (work, services) for personal consumption from countries and territories with preferential tax regimes, or for the purchase of movable and immovable property
- payments for the acquisition of bonds
- payments of dividends derived from investments in Azerbaijan and interest on deposits held in Azerbaijani financial institutions
- payments of salaries and pensions to residents of countries and territories with preferential tax regimes
- payments of duties and other fees to competent authorities, and payments made in order to receive permits and certificates
- the return of a payment made to a country or territory with a preferential tax regime back to the payer's

## Double tax treaties

The rate of withholding tax under existing double tax treaties varies depending on the content of a particular treaty. The maximum rates of withholding tax under current double tax treaties are shown in the table below.

Payee resident in	Dividends (%)	Interest (%)	Royalties (%)
Austria	5/10/15	0/10	5/10
Belarus	15	0/10	10
Belgium	5/10/15	0/10	5/10
Bosnia and Herzegovina	10	0/10	10
Bulgaria	8	0/7	5/10
Canada	10/15	0/10	5/10
China	10	0/10	10
Croatia	5/10	0/10	10
Czech Republic	8	0/5/10	10
Denmark	5/15	0/8	5/10
Estonia	5/10	0/10	10
Finland	5/10	0/10	5/10
France	10	0/10	5/10
Georgia	10	0/10	10
Germany	5/15	0/10	5/10
Greece	8	0/8	8
Hungary	8	0/8	8
Iran	10	0/10	10
Israel	15	0/10	5/10
Italy	10	0/10	5/10
Japan	15	0/10	10
Jordan	8	0/8	10
Kazakhstan	10	0/10	10
Kuwait	5/10	0/7	10
Latvia	5/10	0/10	5/10
Lithuania	5/10	0/10	10
Luxembourg	5/10	0/10	5/10
Macedonia	8	0/8	8
Malta	8	0/8	8
Moldova	8/15	0/10	10
Montenegro	10	0/10	10
Netherlands	5/10	0/10	5/10
Norway	10/15	0/10	10
Pakistan	10	10	10
Poland	10	0/10	10
Qatar	7	0/7	5
Romania	5/10	0/8	10
Russian Federation	10	0/10	10
San Marino	5/10	0/10	5/10
Saudi Arabia	5/7	0/7	10
Serbia	10	0/10	10
Slovenia	8	0/8	5/10
Spain	5/10	0/8	5/10
South Korea	7	0/10	5/10
Sweden	5/15	0/8	5/10
Switzerland	5/15	0/5/10	5/10
Tajikistan	10	0/10	10
Turkey	12	0/10	10
Turkmenistan	10	0/10	10
UAE	5/10	0/7	5/10
Ukraine	10	0/10	10
United Kingdom	10/15	0/10	5/10
Uzbekistan	10	0/10	10
Vietnam	10	0/10	10
No treaty country	10	10	14



# 5 Accounting and reporting



All entities registered in Azerbaijan (Azerbaijani legal entities, representative offices and branches) are required to maintain their books and records in the territory of Azerbaijan in accordance with the appropriate standards.

The Law on Accounting stipulates that all public interest entities, including credit institutions, insurance companies, investment funds and managers of such funds, non-public (private) social funds, licensed participants in the securities market, listed entities, commercial organizations meeting certain criteria and, subject to certain exceptions, public legal entities, must maintain their records in accordance with International Financial Reporting Standards ("IFRS"). At the same time, large and medium-sized enterprises and medical and educational institutions must follow IFRS for Small and Medium-Sized Entities ("IFRS for SME") if their charters allow them to engage in entrepreneurial activities. All other large and medium-sized enterprises may also use IFRS. Micro and small enterprises may either use the bookkeeping rules for micro and small enterprises set by the Ministry of Finance of Azerbaijan, or follow IFRS for SME.

## Investment Incentive Certificates

An investment incentive certificate ("Certificate") entitles its holder to tax and customs benefits. The Certificate is granted by the Ministry of Economy of Azerbaijan to entrepreneurs who have submitted investment projects that meet criteria approved by the Cabinet of Ministers regarding the field of economic activity, the minimum investment amount and the region in which the investment project is to be carried out. Accordingly, the Tax Code and the Law on Customs Tariffs set out the applicable tax and customs duty exemptions for entrepreneurs. The following exemptions from taxes apply

for a period of 7 years from the date the Certificate is obtained:

- ▶ Personal income tax – 50% of an individual entrepreneur's income
- ▶ Profit tax – 50% of a legal entity's income
- ▶ VAT – full exemption for the import of machinery, production equipment and devices by individual entrepreneurs and legal entities
- ▶ Property tax – full exemption for relevant property of individual entrepreneurs and legal entities
- ▶ Land tax – full exemption for relevant land parcels owned or used by individual entrepreneurs and legal entities





# EY Azerbaijan





## Introduction

EY has led projects in Azerbaijan continuously since 1993. We were the first international accounting and tax consulting network to establish a member firm in Azerbaijan. Our office in Baku opened in 1994. Currently we have a team of over 200 professionals, led by Assurance Partner Ilgar Veliyev, a member of the American Institute of CPAs.

## Services

EY Azerbaijan, in conjunction with partners and staff in other EY offices, provides Assurance, Tax & Law, Advisory and Transaction Advisory Services to both international and local clients.

We have undertaken a number of major assignments in the country relating to inbound investment, enterprise and sector restructuring, and public policy.

## Assurance

EY has been licensed to conduct audits in Azerbaijan since 1994. We have gained unprecedented experience in that time.

Many of the auditors at our Baku office are certified public accountants (US) and/or ACCA members.

We provide audit services to numerous companies operating in Azerbaijan under PSAs. We audit the cost recovery reports and profit tax returns of all PSAs and perform profit tax return audits for numerous contracting parties owning interests in various PSAs.

We also provide accounting advice and other Assurance services to foreign and Azerbaijani companies preparing accounts in accordance with IFRS, US GAAP and UK GAAP.

## Tax & Law

EY is recognized as the leading tax and legal advisor in Azerbaijan. The Tax and Law service line is headed by Partner Arzu Hajiyeva. Through its team of tax and legal consultants, EY advises on all aspects of corporate and personal tax planning and compliance and licensing, corporate, insurance,

business, migration, contract and labor law. We have provided advice on local and international tax and legal issues to numerous international entities that have already made or are considering making investments in Azerbaijan. Our areas of expertise include international tax planning, transaction structuring, expatriate tax affairs, local tax compliance, currency and foreign exchange planning and legal advisory and due diligence, as well as litigation support, representing clients in disputes, including in proceedings before courts and other adjudicatory bodies.



Our impressive client base speaks for itself. The firm has established good working relationships with key state bodies and government agencies and is in a position to facilitate negotiations between potential investors and the authorities.

This continues to be a key service in a legislative environment that is constantly evolving and open to interpretation.

The firm's tax practice receives technical support and a wider perspective on tax affairs in the CIS through its links with the rest of the EY network.

## Consulting

EY's Business Consulting practice comprises professionals with extensive experience in addressing a broad spectrum of business goals. We are experts in delivering performance improvements and business value to our clients, reducing costs, managing risks, operating efficient IT systems, and successfully accomplishing operational and strategic objectives.

A dedicated team develops each project based on the specific features of the industry and the client.

Our clients in Baku are major private holdings and state-owned entities. As part of a global network, we are able to team up with professionals from all over the world to help our clients overcome market challenges and address unique business risks.

We combine our international perspective and experience with knowledge of the local market and realities to provide unsurpassed consulting services, ensuring our clients' businesses grow.

Our major services include:

- ▶ Performance Improvement
- ▶ Finance Consulting Services

## Strategy and Transactions

EY's Strategy and Transactions team provides assistance in finance raising (including project finance, infrastructure financing and public-private partnerships), mergers and acquisitions, infrastructure and real estate transactions. We are experienced independent financial advisors who have participated in numerous transactions regionally and locally.

We provide a full range of hands-on, operationally focused support and advice across the transaction life cycle, on both buy-side and sell-side. We also put together the most effective restructuring plans, improving transactions to achieve clients' strategic goals.

Our services include assistance in valuing clients' businesses, financial interests, assets and liabilities, utilizing our proven experience in legal taxation and financial due diligence to provide clients with valuation advice for a multitude of purposes. With more than 10 years of local expertise, we provide the following Transaction Advisory Services:

- ▶ Lead Advisory
- ▶ Operational Transaction Services
- ▶ Real Estate Advisory Services
- ▶ Restructuring
- ▶ Transaction Support
- ▶ Transaction Tax
- ▶ Valuation & Business Modeling



# Ernst & Young Holdings (CIS) B.V. Baku office

## Assurance Services



**Ilgar Veliyev**  
Country Managing Partner  
+994 12 490 70 20  
Ilgar.Veliyev@az.ey.com

## Tax & Law Services



**Arzu Hajiyeva**  
Partner, Head of Tax and Law  
+994 12 490 70 20  
Arzu.Hajiyeva@az.ey.com

## Strategy and Transactions



**Azer Babayev**  
Partner  
+994 12 490 70 20  
Azer.Babayev@az.ey.com



**Ruslan Rzayev**  
Head of SaT  
+994 12 490 70 20  
Ruslan.Rzayev@az.ey.com

## Consulting



**Turgay Teymurov**  
Partner  
+994 12 490 70 20  
Turgay.Teymurov@az.ey.com



**Nargiz Karimova**  
Head of Advisory Services,  
Assurance Partner  
+994 12 490 70 20  
Nargiz.Karimova@az.ey.com

## Address

Port Baku Towers  
Business Centre,  
South Tower 9<sup>th</sup> floor  
153 Neftchilar avenue  
Baku, AZ1010, Azerbaijan

## Communications

**Inara Akhundova**  
Head of Brand, Marketing  
and Communications  
Tel.: +994 12 490 70 20  
Inara.Akhundova@az.ey.com





## **EY | Building a better working world**

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