

Doing Business and Investing in Azerbaijan

2014 Edition

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Why invest in Azerbaijan?

Azerbaijan has substantial hydrocarbon reserves

Azerbaijan boasts a highly educated and skillful workforce

Azerbaijan has significant agricultural potential due to its fertile climate, which spans nine of the eleven existing climatic zones

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

Azerbaijan enjoys favored trade status under an EU Partnership and Cooperation Agreement

Doing Business and Investing in Azerbaijan

Our Doing Business Guide is intended to provide timely information about Azerbaijan's business environment.

For more in-depth information on doing business in Azerbaijan, please contact us directly at PwC Azerbaijan in Baku.

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Foreword

It is my great pleasure to present the 2014 PwC Guide on Doing Business and Investing in Azerbaijan, which 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 commentary on the latest legal developments, audit and accounting changes, major tax and investment incentives, and general economic and business conditions.

This publication is sure to be an invaluable tool for both domestic and foreign investors, regardless of the type, size and character of the investment.

We hope this publication will make interesting reading for you and we welcome you to explore Azerbaijan business opportunities together with PwC Azerbaijan!

From our office in Baku, PwC Azerbaijan has been serving clients in Azerbaijan since 1995. We currently have a staff of over 100 dedicated professionals working with our clients across three main lines of service: Assurance, Tax and Legal, and Advisory.

PwC Azerbaijan in Baku offers the full spectrum of services which have been developed to meet the ever-growing expectations of our clients. This full service line has allowed us to take on and successfully complete some of the largest and most technically challenging projects in Azerbaijan to date.

Good luck!

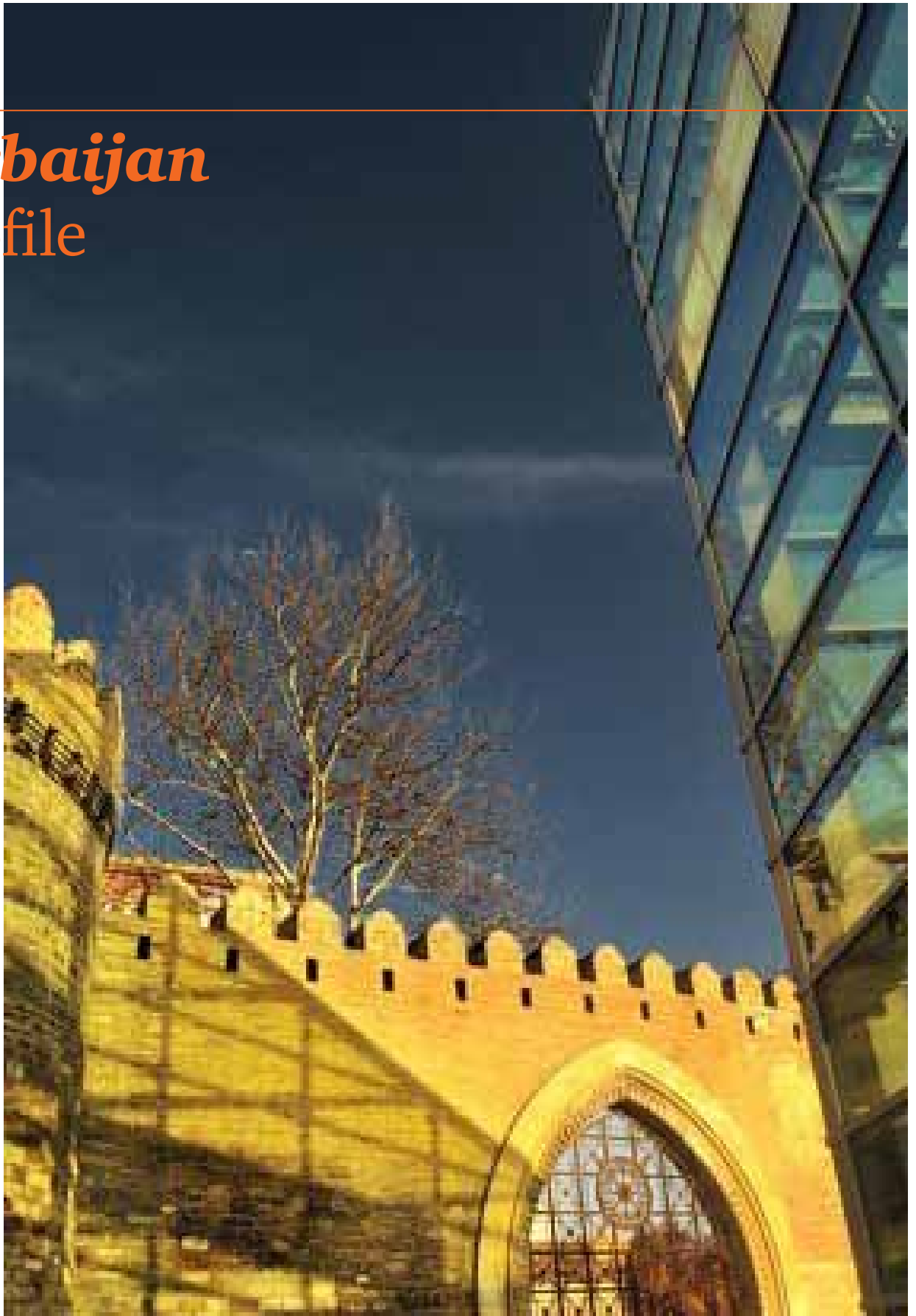
Movlan Pashayev

Managing Partner



Azerbaijan

A profile



Introduction

Modern-day Azerbaijan is a paradox. Although it has relatively sophisticated communication and transportation infrastructure, as well as industrial, agricultural, educational, housing and healthcare sectors, the oil and gas industry still accounts for the bulk of its exports. Azerbaijan is continuing to develop its market infrastructure, including legal, tax and banking systems and links to the international business community. This paradox 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.

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

Investors, whether they are multinational oil companies or small trading companies, continue to weigh the risks associated with investments in Azerbaijan and are mindful of the impact that fluctuating commodity prices, particularly for gas, can have on this emerging economy that is heavily dependent on natural resources.

This Doing Business guide outlines the various 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, this guide strives to cover a spectrum of key issues that investors would include in their "mission checklist" when going to Azerbaijan.

We hope you will enjoy the guide and find the content informative. We issue

regular updates of this guide as time unveils new changes in legal, tax and business issues in Azerbaijan. Please contact us if you would like to obtain these updates.

Geography and climate

Azerbaijan is located on the shore of the Caspian Sea in Southwestern Asia, between Iran and Russia, with a small European portion north of the Caucasus range. The Republic of Azerbaijan (including its non-contiguous exclave of Nakhchivan) shares common borders with the following countries: Armenia – 787km (566km with Azerbaijan proper and 221km with Nakhchivan); Iran – 611km (432km with Azerbaijan proper and 179km with Nakhchivan); Georgia – 322km; Russia – 284km; and Turkey – 9km (with Nakhchivan).

Baku is the capital of Azerbaijan. It is located on the Absheron peninsula at the easternmost point of Azerbaijan, on the shore of the Caspian Sea. Azerbaijan falls within the Central European Time zone (GMT+4).

The country covers an area of 86,600 sq km and falls within nine climatic zones.

The large flat Kura-Araz Lowland forms the approximate center of the country, with the Caucasus Mountains to the north and Karabakh Upland to the west.

The most populous cities in Azerbaijan are:

Cities	Population ¹
Baku	2,122
Ganja	321
Sumgayit	318
Mingacevir	98
Shirvan	80

¹ Source: Azerbaijan State Statistical Committee, 01.01.2012

History

The roots of Azerbaijan stretch back to approximately the fourth century BC and Caucasian Albania, intermittently governed by the ancient Median and Persian empires. Inhabitants of ancient 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 Seljuq Empire and the Persian Safavid Empire, the population of Azerbaijan underwent a mass conversion to Islam. Turkish conquest led to the Turkification of the nation and the creation of the Azerbaijani language, a close cousin of Turkish.

Later, Azerbaijan was integrated into the Russian Empire during 1813-1918, until the fall of Romanov Tsarist rule. Azerbaijan enjoyed a brief spell of independence until 1920, when it was overwhelmed by the Soviet forces and incorporated into the USSR.

Azerbaijan proclaimed its independence on 18 October 1991. On 12 November 1995, the Constitution of independent Azerbaijan was adopted and received nationwide support in a referendum.

While ethnic Azerbaijanis are in the majority, the country is home to many other nationalities. All minorities in Azerbaijan have the constitutional right to education, media and cultural activities in their own language. Minorities include Russians, Talysh, Lezgins, Kurds, Mountain Jews, Georgians and Udines.

People

According to the Government of Azerbaijan statistics, the population of Azerbaijan was estimated at 9,356 million as of 01.01.2013

Ethnic composition

Azerbaijanis	90.6%
Lezgins	2.2%
Russians	1.8%
Armenians	1.5%
Talysh	1.0%
Turks	0.5%
Others	2.3%

Languages

Azerbaijani	92.3%
Lezgi	2.2%
Russian	1.8%
Other	3.7%

Religion

Islam	93.4%
Russian Orthodox	2.5%
Georgian Orthodox	0.18%
Judaism	0.11%
Other	3.8%

Government structure

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

Under the 1995 Constitution, the executive, legislative and judicial branches of government in the Republic of 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)

The National Assembly (Milli Majlis) is the legislative branch of the government in Azerbaijan. The unicameral assembly currently consists of 125 deputies elected for five-year term from single seat constituencies.

The most recent legislative election was held in November 2010. The New Azerbaijan Party (YAP) currently holds the majority of seats in Milli Majlis.

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

Legal system

The legal system of Azerbaijan is broadly based on the 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 Supreme Court, the Appellate Court, the Economic Courts and the General Jurisdiction Courts are subordinate to the Constitutional Court and hear only those cases that are within their jurisdiction.

The Constitutional Court also considers international treaties to which Azerbaijan is a signatory as a source of law.

Thus, international agreements take precedence over national law in case they contradict.

International time

Azerbaijan operates within a single time zone. It is four hours (+4) ahead of GMT. International time in Azerbaijan is also subject to Daylight Savings Time alterations during the summer.

Business hours

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

Economy

Major industrial products

- Oil and natural gas petroleum products
- Oilfield equipment
- Steel
- Iron ore
- Chemicals/petrochemicals
- Cement
- Textiles
- Metal
- Rubber and plastic products

Major agricultural products

- Cotton
- Grain
- Rice
- Tea
- Tobacco
- Livestock
- Fruit
- Wine
- Grape
- Sheep

Overview

Throughout the Soviet period, Azerbaijan's economy had always been more industrially developed than neighboring Armenia and Georgia, but was also less diversified as a result of low levels of investment in non-oil sectors. Having a history of industrial development with more than 100 years, Azerbaijan has proven to be an economic powerhouse in the Southern Caucasus region through the tumultuous aftermath of the Soviet collapse in the early 1990s up until the present days.

After Azerbaijan regained its independence in 1991, the country underwent a lengthy period of transition from a Soviet-style command economy toward a modern, market-driven economy, concentrated on the production and export of its hydrocarbon resources.

Hydrocarbons currently form the economic lifeblood of Azerbaijan's economic future – the country possesses an estimated 7 billion barrels of proven oil reserves and 1 trillion cu m of proven natural gas reserves. This makes Azerbaijan a leading exporter of oil and natural gas, which accounted for about 95% of its exports in 2012². In 2012 revenues of Oil exceeded \$ 22.6 billion. More than US\$ 60 billion was invested in Azerbaijan's oil industry by global oil majors operating in the BP-led Azerbaijan International Operating Company(AIOC) consortium. Oil production under the first Production Sharing Agreements (PSAs) with AIOC began in November 1997. Currently, Azerbaijan exports over 700,000 barrels (bbl) per day.

Azerbaijan's prospects for boosting its oil exports brightened considerably in May 2006, when the US\$ 4 billion Baku-Tbilisi-Ceyhan (BTC) pipeline pumped its first oil from Baku to the Turkish port of Ceyhan on the Mediterranean. The BTC pipeline was designed to transport 1 million barrels per day (bpd) at maximum discharge, with inflow from both Azerbaijani-produced

oil and Kazakhstani oil, which is shipped across the Caspian to Baku.

The country's non-energy economy posted double-digit growth in 2008, spurred by growth in the construction, banking and real estate sectors. However, the current global economic slowdown presents some challenges for the Azerbaijani economy as oil prices have plummeted since mid-2008 and local banks face a more uncertain global financial environment. In October 2013 direct investments in the oil sector of Azerbaijan increased by 29.5% against September 2013 and reached 40% of all investments, though investments in other sectors collapsed by 28.3%. For January-October 2013 oil investments made up 30.1% of all investments and non-oil investments 69.9%. For comparison, in 2012 the oil sector raised 23.8% of all investments in country's economy against 23.2% in 2011, 30.3% in 2010, 27% in 2009 and 30.9% in 2008.

Azerbaijan still faces a number of challenges for its further development. Among those are the need taking into consideration the existing opportunities and resources to achieve sustainable economic growth and social prosperity in Azerbaijan, ensure effective state governance and rule of law. The ongoing conflict with Armenia over the Nagorno-Karabakh region, still poses risk to economical stability of the country, and the potential for a sharp downturn in the construction and real estate sectors.

Trade with Russia and the other former Soviet republics is declining in importance, as Europe and Turkey increasingly become key trading partners. The EU, Russia and the U.S. are key trade partners of Azerbaijan for 2012³.

Azerbaijan's long-term prospects will depend on world oil and gas prices, the discovery of new oil reserves and the development of gas pipelines in the region, as well as Azerbaijan's ability to manage its energy wealth to promote sustainable growth in non-energy sectors of the economy and spur

employment.

Visa regime

The Consular Department of the Azerbaijani Ministry of Foreign Affairs (MFA) issues single, double and multiple entry visas for individuals wishing to visit Azerbaijan. Single or double entry visas can be valid for periods from three days up to three months. Multiple-entry visas are valid for up to one year.

Foreign nationals travelling to Azerbaijan must have an Azerbaijani entry visa, regardless of the purpose of the trip. Foreign nationals must obtain their visas abroad through the nearest Azerbaijani embassy.

If they wish to extend their entry visas, foreign nationals must inform the MFA in advance before the visa expiry date. A letter of invitation, or an equivalent hotel reservation, may be required for foreign nationals entering Azerbaijan for business, tourism or other purposes.

Public holidays 2014

1-6 Jan	New Year's Holidays
20 Jan	Day of the Martyrs
8 Mar	Women's Day
20-24 Mar	Novruz Bayram
9 May	Victory Day over Fascism
28 May	Republic Day
15 Jun	Day of National Salvation
26 Jun	Armed Forces Day
28-29 Jul	Ramazan Bayram
18 Oct	National Independence Day
12 Nov	Constitution Day
15-16 Oct	Gurban Bayram
9 Nov	Flag Day
17 Nov	National Restoration Day
31 Dec	Solidarity Day

² Source: Central Bank of Azerbaijan

³ Source: The State Statistic Committee
<http://abc.az/eng/news/71087.html>



Weights and measures

Azerbaijan uses the metric International System.

Foreign 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 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 and the Organization of Islamic Cooperation.

Settling the Nagorno-Karabakh conflict is the priority of Azerbaijan's foreign policy. Since the early 1990s, 16% of Azerbaijani territory has been occupied by Armenian troops. Azerbaijan and Armenia are still officially at war, although a ceasefire has been in place since May 1994. As a result of hostilities, 800,000 ethnic Azerbaijanis have been displaced from their homes.

Azerbaijan has longstanding cultural and historical links with Turkey, which accounts for approximately 13.35% (2011) of Azerbaijan imports. Through its national oil company (TPAO), Turkey has a 6.7% share in the AIOC, and hosts a major portion of the BTC oil as well as gas export pipeline.

Azerbaijan maintains good relations with the United States and the European Union, reflecting its desire for stronger trade and strategic ties with both political entities. A bilateral investment treaty (BIT) between the US and Azerbaijan has been in effect since 2001. Azerbaijan has also signed a Partnership and Cooperation Agreement with the EU, which is designed to harmonize Azerbaijani and European law. Azerbaijan became a member of the Council of Europe in 2001.

Economy



Economic forecast

Azerbaijan's projected growth rate is expected to be driven by oil industry-related construction and especially by the oil export revenues as large fields come on-stream and new pipelines boost oil exports to Western markets.

In response to increased dependency on oil revenues, the government is trying to ensure that Azerbaijan develops a diverse economy. Large amounts of foreign investment in the oil sector have precipitated rapid growth in others, particularly in the trade, construction and service sectors. The agricultural and non-oil manufacturing had 6% and 8% increase rate in 2012 accordingly. According to the State Statistical Committee, Azerbaijan's foreign trade turnover amounted around US\$ 39,5 billion, while GDP has steadily increased by 25% each year during the peak growth period between 2005 and 2007⁴. GDP growth rate was 2.2% in 2012.

Oil & gas

Azerbaijan's proven crude oil reserves were estimated at 7 billion barrels in January 2013, according to the Oil and Gas Journal (OGJ). In 2012, Azerbaijan produced approximately 930,000 barrels per day (bbl/d) of total oil and consumed about 85,000 bbl/d. The country was among the 20 largest exporters of oil in the world in 2012.

Azerbaijan is one of the world's oldest producing countries and has played a significant role in the development of today's oil industry. The world's first paraffin factory was opened there in 1823 and the first oil field was drilled in 1846. Azerbaijan was the site of the first offshore oil field, the Neft Dashlary, in the shallow water of the Caspian Sea, which still produces oil today.

With the well-developed Azeri-Chirag-Guneshli oilfield serving as the country's key oil production platform, Azerbaijan pumps up to 1 million bbl per day. The BTC pipeline, which can handle up to 1 million bbl per day, is the region's Main Export Pipeline and transports Azerbaijani oil to Western

markets via Turkey.

In 1999 former Azerbaijani President Heydar Aliyev issued a decree creating the State Oil Fund of Azerbaijan (SOFAZ), which accumulates energy-related windfalls and serves as the country's macroeconomic stability fund.

Oil export issues

Prior to completion of the BTC pipeline in 2006, Azerbaijan suffered from inadequate oil export routes. The existing pipeline infrastructure in the Caspian region could not efficiently handle exports of AIOC/Azerbaijan produced oil, as the daily discharge capacity was too low, while the network itself was designed to link the Soviet Union internally and route through Russia. AIOC has been exporting its oil via the Northern and Western routes since the end of 1997.

Since the BTC launch, the problem of limited export capacity has largely been alleviated, while spare pipeline capacity is reserved for cross-Caspian oil transport from Kazakhstan.

Oil export routes: The Northern route

The Northern route pipeline, more commonly known as the Baku-Novorossiysk pipeline, runs from the Sangachal terminal south of Baku to the Russian Black Sea port Novorossiysk. Oil transportation via the Northern route pipeline began in 1997, when the State Oil Company of Azerbaijan (SOCAR), AIOC and Russia's Transneft reached a trilateral agreement. The maximum discharge of the pipeline is 5 million tons of oil per year - from January to September 2013 State Oil Company of Azerbaijan (SOCAR) shipped 1,327,517 tons of oil from the Novorossiysk port via the Baku-Novorossiysk oil pipeline, down 7.5% against the same period last year, reported SOCAR. In September 2013 SOCAR shipped 162,821 tons of Azerbaijani oil from the Novorossiysk port.

There are, however, a number of limitations to exporting oil via the "Northern" route. On 6 December 2006, after dispute over natural gas supplies

from Russia, Azerbaijan announced that it will stop the exports of Azeri oil through the Baku-Novorossiysk pipeline starting from 1 January 2007. Although SOCAR continued decreased oil supplies through the Baku-Novorossiysk Pipeline, the Azerbaijan International Operating Company stopped using the pipeline starting from 1 April 2007 and SOCAR became the new operator of the Azerbaijani section. SOCAR temporarily stopped oil supplies through the pipeline in February 2008 due to a pricing disagreement with Transneft. Later that year, the disagreement has been resolved and SOCAR resumed pumping oil on old agreement terms. In August 2008, the transport of oil along the Baku-Novorossiysk pipeline was radically increased due to sabotage in Turkey and the conflict in Georgia forcing a temporary shutdown of the rival Baku-Ceyhan and Baku-Supsa pipelines. As of 2013, the Baku-Novorossiysk pipeline remains operational, although the volume of oil pumped through it is relatively low. Essentially, the pipeline is heavily reliant on Russian participation, once again tying European energy security to Russian transit. AIOC has also voiced concerns over political instability in nearby Chechnya and Dagestan, which provide transit routes for the pipeline. Lastly, exporting oil via Novorossiysk involves tankers traversing the crowded and environmentally sensitive Bosphorus strait, making transit into the Mediterranean expensive and inefficient.

Oil export routes: The Western route

The Western route, more commonly known as the Baku-Supsa pipeline, runs from the Sangachal terminal south of Baku to the Supsa terminal on Georgia's Black Sea coast. The 145,000 barrels per day (at maximum discharge) pipeline is operated by BP and was commissioned in 1999. Currently, 150,000 barrels of oil is transported through Baku-Supsa Early Oil Pipeline.

The pipeline recently underwent a series of large-scale upgrades, which were finished in April 2008 following a

4 Source: U.S. Energy Information Administration <http://www.eia.gov/countries/cab.cfm?fips=AJ>

two-year hiatus in oil exports to Supsa. With some old sections of the pipeline replaced, the Baku-Supsa route is now fully operational and may see an increase in capacity up to 300.000-600,000 bpd after further upgrades. In 2009 the Baku-Supsa pipeline exported 407,101.7 tons of SOCAR oil and 250,774.8 tons of oil of the Azerbaijan International Operating Company⁵.

Oil export routes: The Main Export Pipeline (MEP)

The Main Export Pipeline (MEP), or as of May 2006 the Baku-Tbilisi-Ceyhan (BTC) pipeline, was designed to be the key route for exporting Azerbaijani oil to European markets. The decision to build a pipeline with a maximum discharge of 1 million bpd was primarily driven by AIOC's estimates that the limited capacity of existing export routes would have prevented the consortium from reaping the maximum benefit from increased oil production. With AIOC estimating annual production of 40 million bbl after 2010, BTC has proved to be the only export route with enough capacity to handle Azerbaijan's daily oil output.

Of three initial route options for the MEP, the Baku-Ceyhan route gained strong political support from the West, which was keen to build a pipeline bypassing Russian and Iranian territory, thus boosting European energy security. Moreover, BTC solved the so-called "Bosphorus problem", so Azerbaijani oil exports were routed directly to the Mediterranean and bypassed the crowded Dardanelles.

Currently, ownership stakes in BTC are held by: BP (30.1%), AzBTC (25.00%), Chevron (8.90%), Statoil (8.71%), TPAO (6.53%), ENI (5.00%), Total (5.00%), Itochu (3.40%), INPEX (2.50%), ConocoPhillips (2.50%) and ONGC (2.36%).

The total cost of the pipeline was estimated at about US \$4 billion⁵, making BTC a major investment in expanding oil exports to global markets. In comparison, the Baku-Supsa pipeline

cost only about US \$ 1.8 billion. Azerbaijan, Georgia and Turkey have signed and ratified the Host Government Agreements, granting considerable legal, tax and currency benefits to foreign investors.

The legal status of the Caspian Sea

The precise legal status of the still Caspian Sea, and particularly the territorial rights of the littoral states, is subject to dispute. A fundamental disagreement over the demarcation of territorial waters in the southern Caspian between Iran, Azerbaijan and Turkmenistan continues to pose a strategic threat to the development of offshore oil and gas fields.

Prior to the collapse of the Soviet Union, the Caspian Sea was bordered by only two states – the USSR and Iran. Under the Soviet-Iranian bilateral treaties of 1921 and 1940, Iran agreed to divide the sea along the Astara-Hasankuli line, a straight median between the relevant cities in modern-day Azerbaijan and Turkmenistan. However, with the emergence of Azerbaijan, Turkmenistan, Kazakhstan and Russia as independent political entities, the territorial ownership of the Caspian Sea has become subject to disagreement.

The situation is further complicated by uncertainty over whether the Caspian is legally considered a sea or a lake. Iran, having consistently insisted that the Caspian is a lake, claims to possess an equal share (20%) of the seabed, well beyond the Astara-Hasankuli line.

And while the division of the northern Caspian seabed has been agreed by Azerbaijan, Russia and Kazakhstan, the status of the southern Caspian remains uncertain. Although both Turkmenistan and Iran have claims to 20% shares of the seabed, these states remain in direct conflict with each other as well as with Azerbaijan.

Currently, Azerbaijan and Iran are locked into a dispute regarding the Alov field in the southern Caspian, just above

the Astara-Hasankuli line. Azerbaijan and Turkmenistan have not signed the intergovernmental agreement on the Caspian Sea bottom division yet.

Natural gas

With the startup of the Shah Deniz natural gas and condensate field in late 2006, Azerbaijan became a natural gas net exporter. Gas production amounted to 17.9 billion cubic meters of tank gas in 2013 compared to 17.24 billion cubic meters in 2012⁶. Although historically an oil producer, Azerbaijan's importance as a gas producer and exporter is growing. Most of the natural gas production comes from the Shah Deniz field, although some volumes of natural gas are produced alongside oil in the ACG field. Natural gas plays a central role domestically, and it likely will gain importance in the future, particularly in the electric power sector⁷. There should be noted that it is estimated to reach the pick of oil production by 2014 when its annual production level will be around 60 mln ton. This suggests that the growth in oil GDP will be lower.

In the absence of new oil and gas discoveries, non-oil sector seems to be taking the role of the main driver of growth in the next few years. As opposed to oil sector, the growth rate in the non-oil sector has reached 8% in 2012 which was main driving force of GDP.

However, there are several downside risks to non-oil sectors, reflected in the dynamics of investment. The main factor of concern is the trend in investments. The growth in the previous years was mainly driven by foreign private investments, albeit to oil sector. 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. As a

5 Source: BP
<http://www.bp.com/sectiongenericarticle.do?categoryId=9019153&contentId=7034855>

6 Source: U.S. Energy Information Administration
<http://www.eia.gov/countries/cab.cfm?fips=AJ>

7 Source: SOCAR, Department of Marketing and Economic Operations
<http://www.news.az/articles/6035>

result, private sector's share in the total investments decreased to 29.6 % and foreign sourced investment's share decline to 24.8 % by 2009 accordingly. These declining trends in the foreign and private investments pose serious downside risks to growth rates in the next few years. While it is reasonable for the public investments to increase in order to compensate for the falling private investments during crisis years, especially given the fiscal capacity to do so, it is imperative to attract more foreign and private investments in order to achieve sustainable and strong economic growth.

Shah Deniz

Discovered in 1999 off the coast of the southern Caspian Sea, the Shah Deniz field is the largest accumulation of offshore gas in Azerbaijan. The gas field covers an area of about 860 sq km and is estimated to hold 1.5-3 billion bbl of oil and 50-100 billion cu m of gas for extraction. Shah Deniz is expected to be one of the primary sources for Europe's future natural gas supplies, either via the planned Nabucco pipeline or alternative routes.

The Shah Deniz project is operated by BP (25.5% stake). Other partners in the PSA include Statoil (25.5%); SOCAR (10%); Total (10%); LukAgip (an Eni-LUKoil joint venture, 10%); Naftiran Intertrade Co. (10%); and TPAO (9%).

The South Caucasus Pipeline (SCP) was completed in 2006 and operates to transfer Shah Deniz reserves from Baku to Erzurum, Turkey, via Tbilisi. The maximum discharge of the pipeline is 20 bcm per year as of 2012.

Shahdeniz 2:

The Shah Deniz Consortium - Azerbaijan's state energy company SOCAR, British BP and France's Total - has made the final investment decision (FID) on the second phase of offshore gas condensate field development.

A final investment document on a project to supply European buyers with gas from Azerbaijan's Shah Deniz-2 field was

signed in Baku on December 17, 2013. This long-awaited decision becomes a major milestone for the diversification of Europe's energy supplies, opened a strategic door for stronger European energy security and turned Azerbaijan into a strong player in the world gas market.⁸

State Oil Fund of Azerbaijan (SOFAZ)

Created in December 2000, Azerbaijan's State Oil Fund (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 is to boost 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 January 1, 2014 has grown by 5.1% compared to the beginning of 2013 (\$ 34,129.4 million) and stood at \$ 35,877.5 million.⁹

SOFAZ is also believed to be critical in dampening the negative effects of substantial flows of oil revenue into the country's economy. By withholding a large share of total oil revenues from the country's immediate income flow, SOFAZ helps to counter inflation as well as produces other positive effects on local economy.

Banking

Azerbaijan's financial sector has grown rapidly and consolidated over the past few years. The Central Bank of Azerbaijan (CBAR), serves as the banking sector regulator, monetary policymaker and key facilitator of price stability. In 2009, the government introduced a three-year tax exemption on capitalised profit which helped to strengthen the banking sector. Although the CBAR has been advocating consolidation in the banking sector for many years, the number of banks at the end of 2012 stood at 43 (compared with 44 in 2011). In recent years, limits on foreign participation in Azerbaijan's banking sector were reduced. Foreign investors may now

own stakes of up to 50% in Azerbaijani banks. All restrictions on withdrawing foreign currency in Azerbaijan were largely lifted in 2002. Since the global economic crisis of 2008-2009, Azerbaijan's monetary policy has expanded, with the refinancing rate cut from 15% to 2% and the reserve requirement ratio reduced sharply from 12% to 0.5%. The CBAR continues to pursue exchange rate stability by pegging the Azerbaijani currency, the Manat (AZN), to the US Dollar.

Annual average inflation rate% (Azerbaijan State Statistical Committee)	
2006	8.3%
2007	16.7%
2008	20.8%
2009	1.5%
2010	5.7%
2011	7.90%
2012	1.10%
2013	2.4 %

GDP per capita, US\$ (Azerbaijan State Statistical Committee)	
2006	2,471.6
2007	3,841.70
2008	5,603.3
2009	5,018.2
2010	5,922.0
2011	7,003.4
2012	7,490.5
2013	7,912.5

Telecoms and IT

Coming into 2013 Azerbaijan's mobile subscriber numbers had passed the 10 million milestone (107% penetration). After more than a decade of very strong growth, the rate of expansion had moderated to around 10% per annum by 2011 and continuing in this mode in 2012/2013. Operator Azercell continues to lead the market, but its earlier dominance was being slowly eroded and market share had fallen to 43%,

⁸ Source: Azemews http://www.azemews.az/oil_and_gas/62613.html

⁹ Source: Trend <http://en.trend.az/capital/energy/2110535.html>

down from the more than 50% it held in years past. The second and third ranked operators, Bakcell (33%) and relative newcomer Azerfon (24%) were both throwing out a challenge to Azercell's number one ranking.

Azerbaijan currently has 25 television stations and 15 radio stations. Almost 70% in the country are Internet users. Azerbaijan's Internet country code domain name is ".az."

In early 2013 Azerbaijan put its first telecommunications satellite into orbit. The Azerspace-1 satellite was set to provide communications coverage for Azerbaijan, Central Asia, Europe and Africa over a designed mission life of 15 years. It was designed to provide digital broadcasting, internet access and data transmission, among other services. The government subsequently announced that Azerspace-2, the country's second telecommunications satellite, would be launched in 2018¹⁰.

Construction

Azerbaijan has a booming construction market. Driven by extensive revenues from oil and natural gas exports, as well as the increased demand for new homes, Azerbaijan has become fertile ground for the construction of new infrastructure, residential buildings, etc.

The World Bank reported the growth in 2010 after decline the year before. Remarkable performance of the construction sector can be explained by low base effect and government's anticrisis 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%. The volume of construction work in Azerbaijan increased by 30.9% as of early November 2012 compared to the same period of last year, reported the State Statistics Committee¹¹.

The construction business has evolved into a very competitive sector in Azer

baijan, with a number of strong local companies providing high-quality services for diverse projects, including the development of residential areas, business offices, hotels, etc.

On 9 September 2012 the new Urban Planning and Construction Code of the Azerbaijan Republic (the "Code") was adopted and the new Code came into effect on 1 January 2013. Before the Code, the construction rules were set in separate laws. The codification of the construction legislation has helped to bring together separate legal acts, make the rules and requirements more precise and clearer. The Code comprises of 3 parts and 106 sections.

Agriculture

Azerbaijan has been one of the region's strongest agricultural centers 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. In 2011, agriculture accounted for 6% 5.5% of the country's GDP, and employed 39% 37.9% of labor force¹².

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 million tonnes per year. In 2012, 2,800,400 tonnes of grain, 968,300 tonnes of potato, 1,190,400 tonnes of vegetable, 665,100 tonnes of fruit and berry, 427,700 tonnes of water-melon and melons, 124,700 tonnes of grape, 4,200 tonnes of tobacco, 98,400 tonnes of sugar beet, 550,300 tonnes of green tea leaf were gathered in Azerbaijan. Grain rose 14%, cotton –16.8%, tobacco – 19.7%, potato – 3.3%, fruit and berry – 8%, grape – 8.4%, green tea leaf – 7.1%, vegetable – 0.5%, watermelon and melon slipped

10.5%, sugar beet – 48.4%¹³.

Azerbaijan continues 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.

Tourism

Business people currently account for the majority of foreign visitors to Azerbaijan. However, Azerbaijan offers substantial opportunities in tourism, with a number of international hotel businesses, such as Hyatt, Excelsior, Four Seasons, Hilton, Jumeirah, JW Marriott, Sheraton, Kempinski and Fairmont.

Azerbaijan has a number of attractive historical sites, such as Shirvanshakh's palace, the Walled City of Old Baku or Sheki Khan Residence, while its ecodiversity accounts for many natural resorts. The country's nine climatic zones offer the potential for developing mountain ski resorts, beach resorts, and mineral baths and medicinal health spas. A resort in Naphtalan offers treatments using unique indigenous therapeutic oil.

10 Source: Budde Comm
<http://www.budde.com.au/Research/Azerbaijan-Telecoms-Mobile-Broadband-and-Forecasts.html>

11 Source: State Statistics Committee
<http://www.azernews.az/business/46656.html>

12 Source: Azstat.org 2011 – State Statistical Committee

13 Source: State Statistics Committee
http://en.apa.az/news_azerbaijan_increases_producer_prices_of__182795.html

Foreign investment



Investment climate

In 2012, the stock of foreign direct investment (FDI) in the Azerbaijani economy exceeded US\$ 8.3 billion with investment in the oil and natural gas sector constituting more than 80% 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. As a result private sectors share in total investments have decreased to 29.6 % by 2009 and foreign sourced investment's share decline to 24.8 %. 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. In 2007, at the peak of economic growth, the country's GDP rose by an unprecedented 25%. GDP growth rate was 2.2% in 2012¹⁴.

Foreign reform

There are no restrictive licensing regulations for foreign businesses in Azerbaijan, although exceptions for certain businesses (primarily telecom munications, construction, etc.) do exist.

As of 2011, 82% of the economy has been privatized. However, while the privatization of Azerbaijan's largest "blue chip" state enterprises began back in 2002, the process is still incomplete.

Foreign investment

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:** According to the general rule, a foreign investment is subject to the legislation in effect at the time it is made. Thus, the 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 investments are not subject to nationalization (except in cases of harm to the population and the state) and requisition (except in cases of natural disaster, epidemics, accidents, emergencies). Foreign investors are guaranteed immediate, adequate and effective compensation in case of nationalization and requisition. Compensation should be commensurate to the amount of the investment at time of nationalization or requisition, payable in foreign currency and freely transferrable abroad;
- **Guarantee of compensation of damages:** foreign investors are entitled to compensation for damages, including compensations for lost profits resulting from the 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.

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 into 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.

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, 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.

Definition of a foreign investor

The following entities and individuals may be 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;

14 Source: IMF and World Bank

- International organizations.

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 Window” principle was introduced from 1 January, 2008. The registration procedures involving several governmental bodies (Ministry of Justice, tax authorities, Social Insurance Fund and Statistics Committee) have been eliminated, obligating businesses to register only with the Ministry of Taxes.

A considerable number of documents are required to register a company with the Ministry of Taxes. Some must bear an apostil (or other form of legalization) from the investor’s country of incorporation.

The established period for state registration with the Ministry of Taxes is officially set at three days for commercial organizations.

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, or 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)

An RO is the locally registered presence of a foreign legal entity and has the “non-resident” status in regard to Azerbaijani tax, legal and currency regulations. If an RO’s activities are strictly limited to providing representative services to its head office, it is not subject to any profit taxes. An 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

The relevant legislation does not distinguish between an RO and a Branch. They are both 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.

Oil Production Sharing Agreements (PSA) and Host Government Agreements (HGA)

Azerbaijan has 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 for a 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, contractor parties and subcontractors.

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 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 acquisition of the state privatization options.

Currency regulations

Foreign exchange transactions are governed by the Law on Currency Regulation of 21 October 1994. The Central Bank of Azerbaijan set foreign exchange policy and issues regulations relating to foreign exchange controls.

The Azerbaijani Manat is the legal tender of the Republic of Azerbaijan. Payment for all goods, work and services sold in Azerbaijan must be made in Manats, except where the payee holds a special license issued by the CBA.

Foreign exchange regulations allow residents and non-residents to transfer foreign currency from Azerbaijan in certain situations (e.g. re-payment of loans, royalties, franchising fees, etc.).

In January 2006, Azerbaijan denominated its currency into the New Azerbaijani Manat (AZN), which is pegged to the US Dollar by the CBA’s monetary policy. Currently, the exchange rate against the US Dollar is maximally 1 USD = 0.78 AZN

Licensing

Banking activities, including the acceptance of deposits, maintenance of correspondent accounts, cash operations, money transfers and lending, are subject to licensing. The CBA has the exclusive right to grant banking licenses.

Licenses are still required for banking, insurance, auditing, transportation, securities dealing and other types of activity. Foreign individuals, legal entities and their branches and representative offices engaged in licensable activities in Azerbaijan, must be licensed according to the legally prescribed procedure. A license’s term of validity is usually five years with the right to extend it.

State duties for licenses come up to AZN 22,000 (about US\$ 28,000).

Privatisation

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). Four methods of privatization were then authorized: privatization of small enterprises; privatization of medium and large-scale enterprises; privatization of banks; and sale of specialized investment fund shares. In this first stage, 167 JSCs were founded.

In 2000, the second phase of the privatization programme was approved by the president to allow privatization of the country's remaining large-scale enterprises, as well as strategic holdings in the oil and gas, chemical, petrochemical, infrastructure and metallurgy sectors.

After experiencing a lengthy crisis in agriculture, Azerbaijan launched the Farm Privatization Project (FPP) in 1997. Originally conceived as a pilot project to improve land use, the FPP was aimed at restructuring selected former collective and state farms, and transferring their assets to the local population. The scheme is expected to reduce poverty through private sector growth, off-farm job creation, and the provision of community-based services.

Since 1998, the privatization process in Azerbaijan has slowed down, and sales of medium and large-scale firms have dwindled. Based on the reports of the World Bank, IMF and EBRD, structural reforms, good governance, modernization of infrastructure, and adequate access to financing are necessary to boost private sector development.

Currently, agricultural land is largely privatized (almost 99%) with landowners gaining the right to grant land shares and receive land titles. The State Committee of Land and Mapping was established to supervise the development of a market in land.

According to the State Statistics Committee, approximately 82% of all Azerbaijani enterprises had been privatized as of 2010. The private sector continues to expand its share of the Azerbaijani economy.

Since 2002, the privatization of large enterprises has been under way, 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 the consulting consortium PwC and Dentons finalized the first preparatory stage of the project of privatization of the state share in the authorized capital of IBA. The second phase will involve the final preparation of necessary documentation for the privatization of the bank and final determination of a list of potential buyers¹⁵.

2012-2013	
GDP	US\$ 68.7 billion, growth rate 2.2%
GDP per capita (PPP)	US\$ 74905
GDP composition by sector	Industry 50.5% (Jan-Nov) Construction 9.9%(Jan – Nov) Agriculture 5.7%(Jan – Nov) trade and service fields on maintenance of transport means 6.7 % (Jan-Nov) transport and warehouse 4.8%(Jan – Nov) services on information and communication 1.8% (Jan – Nov) accommodation of tourists and in the field of catering services 1.5%(Jan – Nov) in the field of social and other types of service 12.7 % (Jan – Nov)
Labor force	Potential workforce 4.688 million, actual workforce 4.445 million
Labor force by occupation	Production (production, industry, construction) – 51.9% Services – 48.1%
Unemployment rate	5.20%
Population below poverty line	6%
Household income distribution	Highest 10% Lowest 10%
Budget(Jan-Nov)	Revenues - US\$22 billion Expenditures - US\$21.77 billion
External debt	US\$ 4,817 billion for 2012
Inflation rate	2.2%
CBA refinancing rate	4.75%
Reserves of foreign exchange	US\$ 14.219 billion
Current account balance	US\$ 9.3 billion profit
Exports	US\$ 23.8 billion
Stock of FDI at home	US\$ 13.3 billion
Stock of FDI abroad	US\$ 8.8 million
Population	US\$ 9477100 million
Literacy rate	98,80%
Life expectancy at birth	73.9 years

15 Source: State Committee on Property
<http://www.contact.az/docs/2012/Economics&Finance/090300009723en.htm#.USXGd6VBPTQ>

Taxation

Tax regimes

Broadly 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 rule. 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.

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

Statutory tax regime

Azerbaijan adopted a new Tax Code in 2001, which introduced 220 new articles and abolished a number of old tax laws.

All foreign legal entities doing business in Azerbaijan through a “permanent establishment” must register with the tax authorities regardless of whether its activities are subject to profits taxation. Tax registration of a Representative Office or a Branch should take place within one month from the start of operations. Termination of an RO’s or a Branch’s activities should be reported to the authorities one month before the cessation of operations. The major taxes applicable under the statutory tax regime are outlined below.

Corporate taxation

Profits Tax

The Tax Code applies the same tax rate and principles of taxation to all types of legal entities with a registered presence in Azerbaijan. All those who pay profit tax are legal entities (including foreign legal entities) engaged in business activity in Azerbaijan.

Profit tax is computed on the basis of an enterprise’s taxable profit.

Taxable profit is generally determined on the basis of gross realization (receipts), minus deductible expenses, which are defined as any costs related to generating profits.

From 1 January 2010 the tax rate on enterprise profit was reduced from 22% to 20%.

An enterprise’s Profit Tax should be reported on annual basis, although current payments shall be made quarterly.

In addition to Profit Tax paid by the non-resident’s permanent establishment, each amount transferred from the net profit of the permanent establishment is taxed 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 resident of the industrial and technological park.

Simplified tax

This tax is intended to ease the tax burden for small enterprises and is levied in the place of general Profits Tax. Simplified Tax is charged at the following rates on the taxpayer’s gross revenue:

- Operation in Baku 4%
- Operation outside Baku 2%

From 1 January 2013, legal entities and individuals with annual turnover of up to AZN 120,000 (approximately US\$ 152,000) are eligible to be registered as Simplified Tax payers. Those paying Simplified Tax are also exempt from VAT, Profits Tax and Property Tax. Simplified tax is levied on a quarterly basis.

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.

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:

Interest	10%
Rent and royalty	14%
Freight income	6%
Telecommunication services	6%
Financial leasing and insurance payments	4%
Other income	10%

Exemption of individuals from personal income tax on interest from bank deposits and dividends was extended till the end of 2013.

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.

From 1 January 2013, legal entities and individuals with taxable transactions exceeding an annual threshold of AZN 120,000 (approximately US\$ 152,000) 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 exempt from VAT for the period of 7 year. 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.

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, a 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 a 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.

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.

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 mineral extracted and varies from 3% to 26% of its total wholesale price.

Excise tax

Excise goods produced in or imported into 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 floating transportation 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. The economic activity level of the land's tenant/owner does not influence the Land Tax payment.

Individuals and/or entities who own or use land within Azerbaijan are subject to Land Tax.

The Land Tax rate is between AZN 0.1 and AZN 10 per 100 sq m of a plot. The rate varies depending on what the land is used for – e.g., industry, construction, transportation, etc.

Road tax

Legal entities and foreign nationals are subject to Road Tax. 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).

Employment taxes and contributions

Income tax

From 1 January 2013, the maximum rate of Personal Income Tax is reduced to 25% starting from AZN 2,500 per month. Income Tax in Azerbaijan is hence charged at progressive rates of 14% or 25% of gross income.

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).

All payroll taxes and withholdings should be paid to the relevant state budget bank accounts. This should be done no later than the 20th day of the month following the net (take-home) salary month.

Foreign citizens, except from foreign employees working under the PSA/HGA tax regime, are also subject to social insurance contributions.

Double tax treaties

Azerbaijan has ratified treaties to cease double taxation with 42 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.

Production Sharing Agreement (PSA) tax regime

There are currently 22 ratified PSAs and 2 ratified HGAs, with an exclusive tax regime for each one. The PSA tax regimes are applicable to each contractor party (signatory to the PSA), the operating company, and the subcontractors (in particular, foreign subcontractors). Additionally, tax protocols that provide guidance on paying taxes and filing reports are negotiated with the Azerbaijani government.

The PSAs ratified by the Milli Majlis and granted the force of law have their own separate tax regime in Azerbaijan.

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). This simplified corporate income tax regime does not apply to Azerbaijani legal entity subcontractors.

Value Added Tax (VAT) and customs duties

VAT (both input & output) and customs duties for activities conducted under the PSA regime are charged at a rate of 0%. Exemption certificates must be obtained from the tax authorities and the State Customs Committee to confirm this tax relief.

Foreign subcontractor tax

Generally foreign subcontractors are subject to Withholding Tax (from 5% to 8%, depending on the PSA regime) on the gross payments received for goods and services supplied within Azerbaijan. Withholding Tax satisfies all FSC tax obligations. The only exception is Personal Income Tax for FSC employees. Personal Income Tax for FSC employees may be subject to the tax residency and tax deduction benefits.

Some PSAs envisage the application of the statutory profit tax regime for FSCs during the PSA's development and production period.

Customs regimes

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 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.

Goods imported into Azerbaijan are subject to imports duties (ranging from 0% to 15% per metric unit). Excise Tax applies to certain types of goods (e.g., tobacco and alcohol products). 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 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.

Labor and social relations

Labor law

Labor relations in Azerbaijan are covered extensively by the 1999 Labor 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 the 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.

Termination of employment contracts with certain categories of employees (e.g. pregnant women, women with children under three years of age) is prohibited.

Upon making employees redundant, or upon the company's liquidation, the employer must provide the affected employees with severance pay, which must be a total of up to three months of the employees' regular salary.

The Azerbaijani Labor Code's procedures for employment and employment termination should be followed very closely, as employees tend to be favored in legal disputes with their employers.

Obligatory social insurance

Employers and employees are required to make payments into the social insurance fund. Employers must ensure that social insurance contributions are paid into the relevant state bank accounts on time. Thus, employers are required to withhold employee contributions (3% of an employee's gross salary), along with employee income tax, and transfer these amounts to the state. This must be done on the behalf of employees.

Employers are also required to make monthly social insurance contributions in the amount of 22% of its employees' salary fund.

Registered individual entrepreneurs are required to pay social insurance contributions at a rate of 4% of the minimum monthly wage (AZN 30 or approximately US\$ 33).

Azerbaijani law also provides for obligatory medical insurance. However,

the applicable rates and procedures have not been established to date. Holes in the current legislation make the Law "On Medical Insurance" practically non-operational.

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.

The Law "On Accounting", adopted in June 2004, stipulates the implementation of the International Financial Reporting Standards (IFRS) in organizations involved in commercial activities within Azerbaijan. The Law defines the types of organizations liable to various accounting standards.

Public interest entities are defined as credit organizations, insurance companies, private pension funds and legal entities with stock market share listings. Entities that meet at least two of the following criteria are also considered as public interest entities: 1) revenue of AZN 30 million (approximately US\$ 24 million); 2) an average of 1,200 employees, and 3) a total balance sheet of AZN 100 million (approximately US\$ 80million). All public interest entities in Azerbaijan must adhere to IFRS. Commercial organizations must either follow IFRS or the National Accounting Standards for Commercial Organizations (NASCO). Small businesses are allowed to follow simplified accounting rules approved by the Ministry of Finance. Alternatively, they may choose to follow NASCO.

Small businesses are defined as such with respect to the size of the business in the exclusive sphere of their operations. For instance, for industry and construction, an entity with fewer than 40 employees and an annual turnover of less than AZN 200,000 is considered a small business.

NASCO regulations are largely based on IFRS (2006 release). However, their intention is not to duplicate IFRS, but to simplify the principles for implementation.

The use of IFRS and NASCO standards became compulsory for commercial entities and public interest entities on 1 January, 2008. These standards have also been in force for non-commercial organizations since January 2009.

The transition period is specified as one year for small businesses, two years for Public Interest Entities, and three years for non-commercial and non-governmental entities. The Civil Code contains general provisions on financial reporting and audit requirements for legal entities. JSCs and limited liability companies are required to use an independent auditor to audit their annual financials (JSCs must also publish their annual accounting reports and balance sheets). Depending on the value of the assets on the balance sheet or annual revenues, companies are required to have their balance sheet audited.

PwC Azerbaijan



PricewaterhouseCoopers Global (PwC) is one of the world's most extensive networks of professional services firms, and the largest of the Big Four. 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\$ 26.2 billion for fiscal year 2012 (year ended June 2010) US\$31.5 billion. 2011 (June 2012). PwC Global employs over 180,500 people in 158 countries.

PricewaterhouseCoopers (PwC) Azerbaijan, established in 1995, is one of the country's first international professional services firms. Over the past 19 years, the Firm has made significant investments in the local economy and community and will continue to do so. Having started with just 10 staff, PwC Azerbaijan now has more than 100 partners and staff, including a select group of international specialists, all committed to the goal of excellence in serving our clients.

Our firm is key part of Eurasia region of PwC Central and Eastern Europe (CEE), PwC CEE is a fully integrated organization comprised of nearly 7500 professionals in 29 countries with 53 offices that in turn is an integral part of the global PwC network.

PwC Azerbaijan's wide range of skills and experience, along with local and international expertise, allow us to offer our clients the highest levels 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 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, and telecommunications and consumer products sectors. We are thus ideally positioned to service all elements of the evolving Azerbaijani business environment, with clients including leading foreign companies and important indigenous businesses.

Assurance services

PwC Azerbaijan's Assurance group provides assurance on the financial performance and operations of your business. We can also help your business improve its external financial reporting and adapt to new regulatory requirements. Our services include:

- Financial statements audit and/or review
- IFRS transition
- Financial accounting
- Corporate reporting improvement
- Risk assurance services
- Internal audit
- Client training

Advisory services

We help organizations to work smarter and grow faster. We consult our clients to build effective organizations, innovate & grow, reduce costs, manage risk & regulation and leverage talent. Our aim is to support you in designing, managing and executing lasting beneficial change. Our services include:

- Strategy and operations
- Financial effectiveness
- Managing performance
- Governance, risk and compliance
- Liquidity management
- IT effectiveness
- Creating a sustainable business
- Strategic cost reduction
- Transaction services
- Valuations
- Mergers and acquisitions

- ERP implementations

Tax and Legal services

We are organized around different aspects of tax and law, reflecting the need for in-depth specialist knowledge in each key area.

However, in many cases, knowledge of tax and law must be embedded in a thorough understanding of industry. This is why we have developed specialized teams along industry lines, allowing us to quickly assemble a team with the required tax and legal skills, as well as the relevant industry knowledge. Our services include:

- Tax treaty relief
- Special tax regimes, Production Sharing Contracts and Tax Protocols
- Indirect taxes and customs
- International tax structuring
- Tax management and accounting services
- IFRS transition and tax adjustments
- Tax aspects of M&A
- Tax advice on inbound and outbound assignments
- Developing an efficient tax function and a tax strategy
- Tax risk management
- Company establishments and dissolutions
- M&As: due diligence, legal opinions, pre- and post-transactional advice
- Drafting investment and shareholders' agreements
- Corporate finance, assets and real estate acquisitions
- Security agreements
- Contracts, loan/credit agreements, guarantee deeds
- Dispute settlement, arbitration and mediation
- Drafting employment agreements, labour law advice

Be with the best

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