

Transfer Pricing Country Summary

Azerbaijan

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1. Introduction

Azerbaijan is not a member of the Organization for Economic Cooperation and Development (OECD). However, as previously said, the widespread expectation is that Azerbaijan will embrace OECD-style norms and models.

The Ministry of Taxes has begun discussions with the Organisation for Economic Cooperation and Development (OECD) about the adoption of new, more thorough transfer pricing rules. The common expectation is that Azerbaijan will adopt OECD-style principles and models at some point in the future, although the government has not set a deadline.

2. Laws & Regulations

a) References to OECD/EU/Local Rules

The present transfer pricing provisions were first adopted in the existing tax legislation on January 1, 2001, and have since been changed multiple times. These rules primarily address the establishment of prices for the sale of goods, work, or services, and they establish the principle of arm's-length pricing for transactions involving related parties, as well as, in some cases, the method for adjusting transfer prices.

In practice, tax authorities have limited experience dealing with transfer pricing, primarily adjusting taxpayer profits by disallowing certain deductible costs or challenging interest rates or the mark-up on services that were not incurred or charged on an arm's-length basis, according to their judgment.

b) Definition of Related Party

Persons are considered 'related' in the following cases:

- If one person holds, directly or indirectly, 20% or more of the value or number of shares or voting rights in the other entity, or in an entity that actually controls both entities.
- If one individual is subordinate to the other with regard to official position.
- If persons are under the direct or indirect control of a third person.
- If persons have a direct or indirect control over a third person.

c) Nature of Transfer Pricing Documentation

Although there were some limited transfer pricing prohibitions in the pre-tax code legislation focused mostly on cases when products, work, or services were sold at or below cost or bartered/transferred without charge, the transfer pricing idea is relatively new to Azeri tax law.

The current transfer pricing requirements were first enacted into existing tax legislation on January 1, 2001, and have been modified several times since then.

In fact, tax authorities have limited experience with transfer pricing, adjusting taxpayer profits mostly by disallowing specific deductible costs or challenging interest rates or the mark-up on services that were not incurred or invoiced on an arm's-length basis, according to their view.

d) Tax Havens & Blacklists

The Azerbaijani government has made significant revisions to the tax system, which will take effect on January 1, 2022. New controlled foreign corporation (CFC) laws and transfer pricing modifications are among the improvements aimed at combating tax fraud and broadening the revenue base.

The new laws also provide for various tax benefits and exemptions for businesses and individuals, as well as better tax administration.

e) Advance Pricing Agreement (APA)

In Azerbaijan, there are currently no procedures for acquiring an APA. On transfer pricing issues, however, a formal opinion from the tax authorities is possible.

Opinions like this aren't legally binding.

f) Audit Practice

Currently, there are no defined procedures in the tax code for conducting independent transfer pricing audits by the tax authorities. Price control is generally accomplished during tax audits.

3. Transfer Pricing Documentation

a) Level of Documentation

Apart from a basic necessity for taxpayers to preserve and retain accounting and tax records and papers, there is no statutory requirement in Azeri law that mandates transfer pricing documentation to be generated. It is apparent, however, that taxpayers who do not take steps to establish documentation for their transfer pricing systems, either in general or for individual transactions, will run a higher chance of being subjected to a comprehensive transfer pricing audit.

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

e) Choice of Transfer Pricing Method

The tax code lists the following methods for determining the 'market price':

- Comparable uncontrolled price (CUP) method.
- Resale price method.
- Cost-plus method.

The tax code stipulates the priority of pricing methods that tax authorities should apply to ascertain market prices, with the CUP method taking precedence over all other methods.

If none of the procedures above can be used to estimate the market price, the market price should be determined by an 'expert'.

f) Economic Analysis – Benchmark Study

The tax authorities are expected to take into account common discounts or mark-ups to prices when assessing the market price. The tax code, in particular, specifies the circumstances under which discounts or mark-ups might occur, such as degradation in product quality or the end of a product's useful life.

Furthermore, the tax code establishes the widely acknowledged idea that only transactions carried out under comparable conditions should be considered when assessing the market price. The following factors should be considered in particular:

- Quantity (volume) of supply;
- Quality level of goods and other consumption indicators;
- Period within which liabilities should be fulfilled;
- Terms of payment;
- Change of demand for goods (works, services) and supply (including seasonal fluctuations of consumer demand);
- Country of origin of goods and place of purchase or procurement.

There is a separate set of comparability considerations in the Profits Tax part of the tax code that should be looked at to identify borrowings that can be classified as taking place under comparable circumstances. Borrowings, in particular, should be conducted in the same currency and under the same terms and circumstances.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

h) Financial Statements

Not applicable.

i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

| | Prepare or File? | Format | Deadline | Notification Deadline* | Threshold* (Yes/No) | Local Language (Yes/No)*(If "No", it can be filed in English) |
|--|------------------|------------|----------|------------------------|---------------------|---|
| Corporate Income Tax | File | Local GAAP | 31 March | N/A | Yes | Yes |
| Master File | N/A | N/A | N/A | N/A | N/A | Yes |
| Local File | File | Local GAAP | 31 March | N/A | N/A | Yes |
| CbCR | N/A | N/A | N/A | N/A | N/A | N/A |
| Local form X | File | Local GAAP | 31 March | | Yes | Yes |
| Local form Y | N/A | N/A | N/A | N/A | N/A | N/A |
| Local form Z | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual Accounts | N/A | N/A | 31 March | N/A | Yes | Azerbaijani |
| Segmented P&L | N/A | N/A | N/A | N/A | N/A | N/A |
| * Azerbaijan has signed the MCAA agreement for the filing of CBCR. | | | | | | |
| * Azerbaijan does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises. | | | | | | |

j) Mandatory Language

Documents in a foreign language must be translated into Azerbaijani by local tax officials.

The notification must be prepared in Azerbaijani.

k) Notification Requirement

The CbC notification must be submitted by June 30th of the year prior to the year for which it is intended.

The following information must be included in the CbC notification by the legal entity based in Azerbaijan:

- it must state whether the legal entity resident in Azerbaijan (the reporting entity) is the ultimate parent entity (UPE) or the surrogate parent entity (SPE);
- if the reporting entity is neither the UPE nor the SPE, the reporting entity must indicate the UPE or SPE of the MNE and its country of residence; and
- it must indicate the financial year of the MNE.

l) Record Keeping

“Accounting documents, including information in electronic and (or) paper format should be kept for at least 5 years in a readable form within the time prescribed by law.”

m) Penalties and Interest Charges

For not submitting the notification and presenting inaccurate information, a penalty of AZN 500 (approx. USD 200) applies.

in the Notification.

When an adjustment is sustained, a fine of 50% of the understated tax amount applies. For late payment, the interest is 0.1%.