

# Rules for determination and application of transfer prices<sup>1</sup>

## 1. General provisions

1.1. Application of the Law of the Republic of Azerbaijan dated December 16, 2016 No. 454-VQD "On Amendments to the Tax Code of the Republic of Azerbaijan" and the Law of the Republic of Azerbaijan "On Approval, Entry into Force of the Tax Code of the Republic of Azerbaijan and Related Legal Regulation Issues" and approval by this Law The purpose of ensuring the implementation of subsection 2.1.1 of the Decree No. 1171 of the President of the Republic of Azerbaijan dated December 23, 2016 "On making changes to the Decree No. 393 of the President of the Republic of Azerbaijan dated August 30, 2000" on the implementation of the Tax Code of the Republic of Azerbaijan and defines the rules for determining and applying transfer prices to ensure the application of Article 14-1 of the Tax Code of the Republic of Azerbaijan (hereinafter - the Tax Code) by the tax authorities of the Republic of Azerbaijan. [2]

1.2. The difference resulting from the application of transfer pricing is used for the purposes of profit (income) tax. [3]

1.3. Determining the profit (income) on the income of non-resident persons from the Azerbaijani source and calculating taxes in relation to the permanent representation of that non-resident in the Republic of Azerbaijan is determined according to Article 14-1 of the Tax Code and these Rules.

## 2. Key concepts

2.0. *Concepts used in the field of application of transfer pricing in these Rules, if no other meaning is provided in these Rules, are defined in the Tax Code, in the "Transfer Valuation Rules for Transnational Companies and Tax Authorities" of the Organization for Economic Cooperation and Development (the text of those Rules translated into the Azerbaijani language by the Ministry of Economy of the Republic of Azerbaijan is provided on the official website of the State Tax Service) is applied in the accepted sense. The main concepts used in these Regulations have the following meanings: [4]*

2.0.1. Controlled transaction – transactions carried out between the following persons:

2.0.1.1. between a resident of the Republic of Azerbaijan and non-residents who are mutually dependent on that resident, as well as any representative office, branch and other division of that resident located in other states (territories); [5]

2.0.1.2. Between the permanent establishment of a non-resident in the Republic of Azerbaijan and that non-resident himself or any of its representative offices, branches and other divisions located in other states, and any other person who is mutually dependent with that non-resident and located in another state; [6]

2.0.1.3 between a resident of the Republic of Azerbaijan and (or) a non-resident's permanent representation in the Republic of Azerbaijan and entities established (registered) in countries subject to preferential taxation;

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<sup>1</sup> This document is the translation of Rules for Determination and Application of Rransfer Prices (Transfer qiymətlərinin müəyyən edilməsi və tətbiqi qaydaları). The translation is provided by the Stat Tax Service. The official authentic Azerbaijani text of the Rules may be found below:

2.0.1.4. Except for the cases specified in subsections 2.0.1.1 - 2.0.1.3 of these Rules, between a resident of the Republic of Azerbaijan or a permanent establishment of a non-resident in the Republic of Azerbaijan and non-resident persons, provided that: [7]

2.0.1.4. Except for the cases specified in subsections 2.0.1.1 - 2.0.1.3 of these Rules, between a resident of the Republic of Azerbaijan or a permanent establishment of a non-resident in the Republic of Azerbaijan and non-resident persons, provided that: [7]

1. individuals have conducted transactions on products traded on international commodity exchanges and (or);

2. The total income of the permanent establishment of a resident of the Republic of Azerbaijan or a non-resident in the Republic of Azerbaijan during the tax year is more than 30 million manats, and the specific weight of the volume of transactions with each non-resident person in the total income (expenses) is more than 30 percent.

2.0.2. Uncontrolled transaction – transaction that is not included in the scope of subsection 2.0.1 of these Rules;

2.0.3. Comparable transaction - a transaction carried out between independent parties under the same or similar conditions as the controlled transaction and selected as a result of comparative analysis;

2.0.4. Transfer price - the price of goods (works, services) for controlled operations determined in accordance with the Tax Code of the Republic of Azerbaijan and these Rules; [8]

2.0.5. Benchmarking – the process of selecting an uncontrolled transaction that is comparable to a controlled transaction;

2.0.6. Resale margin – the difference between the purchase price paid to the consignors and the subsequent (re)sale price (including applied surcharges);

2.0.7. Profit margin - the profit margin added by the manufacturer to the actual costs incurred in connection with the production of goods (works, services);

2.0.8. Special weight:

2.0.8.1. the specific weight of the profit obtained in the total income, total expenses or the total value of assets;

2.0.8.2. the specific weight of the profit obtained by each party from the transaction between enterprises that are members of the same enterprise group in the total profit of the group;

2.0.8.3. Except for the cases specified in subsections 2.0.8.1 and 2.0.8.2 of these Rules, the specific weight is determined in an agreed and justified manner between the tax authority and the taxpayer. [9]

2.0.9. Acceptable interquartile range is the interval between the median of the lower quartile and the median of the upper quartile of the relevant indicators (price, margin or specific weight) selected from all compared transactions. If the transfer price is outside the acceptable interquartile range, then the tax is calculated using the median of that range;

2.0.9-1. Lower quartile - the median of the lower half of the database;

2.0.9-2. Upper quartile - the median of the upper half of the database; [10]

2.0.10. Enterprise group - the head office of an enterprise, the totality of its branches, representative offices, subsidiary or dependent enterprises and other units, regardless of the state in which it is located;

2.0.11. Intra-group financing - debts and loans that lead to interest payments between persons belonging to the same enterprise group, including bank guarantees;

2.0.12. Tested party (entity) - the party to which the transfer pricing method can most reliably be applied and the most reliable data for comparison will be obtained, that is, the party that performs the simplest functions in terms of complexity in the controlled transaction. [11]

### **3. General principles**

If the prices of the goods (works, services) provided or received by the taxpayer within the controlled transactions do not correspond to the prices of comparable non-controlled transactions, the taxpayer and the tax authority shall recalculate the tax from that transaction based on the transfer prices.

#### **4. Selection of comparable transactions for determination of transfer price**

4.1. For the purpose of determining the transfer price, the selection of non-controlled transactions compared with the controlled transaction is carried out on the basis of comparative analysis.

4.2. As a comparable non-controlled transaction, both similar transactions conducted by the party to the controlled transaction with independent persons and similar transactions conducted between independent persons can be used.

4.3. When selecting comparable transactions, it should be taken as a basis that they are implemented in the same period as the controlled transaction and that the following indicators are the same or similar:

4.3.1. Type, country of origin, quality and other consumer indicators, etc., of the goods (works, services) that are the subject of the operation;

4.3.2. Contract terms, including the amount of goods provided, scope of work, services, terms of execution of obligations under the contract, delivery terms, payment terms;

4.3.3. The functions performed by each of the parties to the transaction and the risks they bear;

4.3.4. Tangible and intangible assets and rights owned or involved by the taxpayer used during the transaction;

4.3.5. The economic conditions in which the parties to the transaction operate, including the geographic location of the markets, the presence of the same or similar goods (works, services) in the market;

4.3.6. Launching new goods (works, services) to the market, launching existing goods (works, services) to new markets, launching improved versions of existing types of goods and other similar cases in connection with the implementation of marketing policy.

4.4. When the controlled transaction is related to the transfer of ownership or concession of rights to intangible assets, when a comparative analysis is carried out to select a transaction comparable to it, in addition to those provided for in clause 4.3 of these Rules, the following indicators are compared: [12]

4.4.1. the advantage that the acquisition of a proprietary or concessional patent, trademark, license or other intangible asset will give to the acquirer in the market; [13]

4.4.2. any geographic restrictions or prohibitions on the use, re-submission of the rights to the intangible asset granted or granted; [14]

4.4.3. whether the right to use an intangible asset is an exclusive or non-exclusive right; [15]

4.4.4. that the person acquiring the right to use the intangible asset has the power to improve or change it.

4.5. When the controlled transaction is related to intra-group financing, when a comparative analysis is carried out to select a comparable transaction, in addition to those stipulated in clause 4.3 of these Rules, the following indicators are compared:

4.5.1. If there are debt or credit transactions, the credit history and solvency of the borrowing party or the party whose obligations are guaranteed; [16]

4.5.2. Type of collateral and market value; [17]

4.5.3. Credit or debt issuance period;

4.5.4. The currency of the loan or debt;

4.5.5. Interest rate and its determination procedure; [18]

4.5.6. Other factors affecting the determination of the interest rate.

## **5. Methods for determining transfer prices**

5.1. The following methods are used to determine transfer prices:

5.1.1. The price comparison method is the determination of the transfer price by comparing the price of the goods (work, service) provided or received within the controlled transaction with the price formed within the uncontrolled transaction. (Example 1 attached) [19]

5.1.2. The subsequent (re)sale price method is determined by deducting the applied surcharges from the subsequent sale price (Example 2 is attached). [20]

5.1.3. The method of value accumulation is the determination of the transfer price by comparing the profit margin of the price of goods (works, services) provided within the framework of controlled operations to the actual costs incurred in connection with their production with the profit margin of uncontrolled operations. (Example 3 is attached) [21]

5.1.4. The method of profitability is the determination of the transfer price by comparing the specific weight of the profit obtained by the person who is a party to the transaction within the framework of controlled transactions in its total costs, revenues or the total value of its assets with the specific weight applied within the framework of a comparable uncontrolled transaction (Example 4 is attached) ).

5.1.5. Profit distribution method - when transactions are carried out between the persons specified in Article 14-1.2 of the Tax Code, the profit obtained by each of the parties from those transactions is distributed among those persons according to Article 14-1 of the Tax Code and these Rules (Example 5 is attached).

5.2. To determine the transfer price, in all cases where it is possible, the price comparison method provided for in subsection 5.1.1 of these Rules should be applied.

5.3. If it is not possible to determine the transfer price by the price comparison method, as well as if there are no comparable transactions or information about the prices of those transactions whose source is known for the application of this method, other methods are used. [24]

5.4. When choosing other methods, based on the nature of the controlled transaction, characteristics of persons who are parties to the transaction and other indicators, the information about the identified comparable uncontrolled transaction is used, which method is more applicable. If the obtained information allows the application of one of the methods provided for in subsections 5.1.2 or 5.1.3 of these Rules, as well as one of the methods in subsections 5.1.4 or 5.1.5 of these Rules, the transfer price during determination, one of the methods in subsections 5.1.2 or 5.1.3 of these Rules should be chosen. [25]

## **6. Recalculation of taxes by applying transfer prices**

6.1. To determine the transfer price, a comparative analysis should be carried out based on the information contained in the sources specified in section 8, as well as similar transactions specified in clause 4.2 of these Rules. [26]

6.2. If only one comparable transaction is found as a result of the comparative analysis, the transfer price is calculated based on the relevant indicators of that transaction.

6.3. If there are several comparable transactions, the transfer price is calculated by finding an acceptable interquartile range of selected relevant indicators (price, margin or specific weight) of all comparable transactions (Example 1-5 attached). [27]

6.4. If the price (margin or specific weight) for controlled transactions corresponds to the transfer price (margin or specific weight) for uncontrolled transactions, or is within a specified range, taxes are calculated based on the actual price.

6.5. During controlled operations:

6.5.1. If the controlled transaction is related to the provision of goods (works, services) by the taxpayer and the price determined during the transaction is lower than the specified transfer price or interval, taxes are calculated on the transfer price, and if it is higher, on the actual sale price.

6.5.2. If the controlled transaction is related to the purchase of goods (works, services) by the taxpayer, and if the price determined during the transaction is lower than the specified transfer price or interval, taxes are calculated on the actual purchase price, and if it is higher, the transfer price is calculated.

6.6. The relevant indicators of the enterprise in the audited period are compared with the average indicators of the audited period and the previous two years of the enterprises selected for non-controlled operations. In this case, during the comparison, it is not allowed to differentiate the companies selected for non-controlled transactions by year. [28]

## **7. Documentation**

7.1 If the total value of the controlled transactions conducted by the taxpayer during the tax year exceeds the limit determined under Article 16.1.4 of the Tax Code, information on the transactions conducted by that taxpayer shall be submitted to the Board of the Ministry of Taxes of the Republic of Azerbaijan on 27th of 2017 "Statement on Controlled Transactions" and its appendix must be duly completed and submitted to the tax authority in the form determined by Resolution No. 1717050000006200 dated January. [29]

7.2 The total value of the controlled operations carried out by the taxpayer during the tax year, in the event that the Reference is not submitted due to the absence of the circumstances provided for in Article 16.1.4 of the Tax Code, during the tax control measures implemented by the tax authorities, the controlled operations carried out in the reporting periods covered by those measures prices shall be determined according to these Rules. [30]

7.3. In cases where the taxpayer determines the transfer price himself, the documents provided for in clause 7.4 of these Rules are submitted to the tax authority. [31]

7.4. According to Article 16.1.4-1 of the Tax Code, the taxpayer must submit the following information to the tax authority at the request of the tax authority: [32]

7.4.1. About the enterprise group:

7.4.1.1. Composition of the enterprise group;

7.4.1.2. Activities of the enterprise group, geographical area covered and main sources of income;

7.4.1.3. The list of intangible assets of the enterprise group, agreements on the distribution of costs within the group related to intangible assets, and the transfer pricing policy of the group in the relevant field;

7.4.1.4. financial statements of enterprises included in the enterprise group of the enterprise being audited in the Republic of Azerbaijan and conducting controlled operations for the audited period and two years prior to that;

7.4.1.5. A brief functional analysis of each of the enterprises included in the enterprise group (the functions it performs, the risks it carries and the assets it uses);

7.4.1.6. Transfer pricing policy related to financial agreements concluded between enterprises included in the enterprise group;

7.4.1.7. Business strategy for the field in which the enterprise group operates;

- 7.4.1.8. Documents related to the distribution of costs within the enterprise group.
- 7.4.2. About the inspected enterprise:
  - 7.4.2.1. Financial statements of the enterprise for the audited period and two years prior to the audited period;
  - 7.4.2.2. Information on the structural changes made by the head office of the enterprise during the audited period or in the last two years, the impact of this change on the enterprise, presentation of intangible assets and the effects of these operations on the audited enterprise;
  - 7.4.2.3. The structure of the enterprise and the number of employees per structure;
  - 7.4.2.4. The enterprise's main competitors in the local market;
  - 7.4.2.5. Documents related to business restructuring.
- 7.4.3. About controlled transactions:
  - 7.4.3.1. information on controlled operations (business activity, financial activities of the enterprise group, cost sharing agreements and other information affecting the determination of the transfer price);
  - 7.4.3.2. expenses for each category of controlled transactions;
  - 7.4.3.3. a detailed functional analysis of the taxpayer in relation to each category of controlled operations, i.e. functions performed, assets used (including intangible assets) and risks incurred, including the changes that occurred compared to the audited period and the two years preceding the audited period reference;
  - 7.4.3.4. identification of other controlled transactions of the taxpayer that directly or indirectly affect the price of the documented controlled transaction and their description;
  - 7.4.3.5. stating that it is the most appropriate transfer pricing method for the transaction category and justifying the selection of this method;
  - 7.4.3.6. a mention of the related enterprise selected as the tested party (entity) and an explanation of this choice;
  - 7.4.3.7. a list and description of the selected comparable non-controlling transactions, where possible, information on financial indicators related to the independent enterprises referred to in the comparative analysis of transfer pricing, including a comparable search methodology;
  - 7.4.3.8. an indication of the adjustments made for the purpose of comparability and whether these adjustments are made with respect to tested parties (entities), comparable, non-controlled transactions, or both;
  - 7.4.3.9. a description of cases confirming that controlled transactions are conducted in accordance with the arm's length principle based on the selected transfer pricing method;
  - 7.4.3.10. an overview of the financial data used in applying the transfer pricing methodology.

## **8. Data sources used to find comparable transactions**

- 8.1. When determining transfer prices, the following databases are used:
  - 8.1.1. domestic and international stock market quotations;
  - 8.1.2. foreign trade statistics conducted by the customs authority;
  - 8.1.3. report information placed in information sources whose source is known;
  - 8.1.4. databases of specialized international agencies to which the tax authority is affiliated; [33]
  - 8.1.5. other sources of information with a known source on goods, works and services, as well as their prices established in local and international markets. [34]

8.2. In order to determine the transfer prices of various goods, works or services by the tax authorities and the taxpayer, in addition to the databases provided for in clause 8.1 of these Regulations, comparative analysis of financial and statistical data on public and private companies of different countries, market analysis and financial analysis of those countries and other reliable information bases that enable the selection of comparable operations in the field can be used.

8.3. When tax authorities join the databases of specialized international agencies for the purpose of finding comparable transactions for transfer pricing, they take the necessary measures to inform taxpayers about it. [35]

## **9. Pre-determination of transfer pricing methods**

9.1. Before conducting any controlled transaction, the taxpayer may apply to the tax authority with an application determined by the State Tax Service under the Ministry of Economy of the Republic of Azerbaijan, providing information on all the details of the transaction along with the relevant contract for pre-agreed transfer pricing method. [36]

9.2. The application provided for in clause 9.1 of these Rules must be submitted at least three (3) months before the start of the controlled operation to be carried out. [37]

9.3. An application for pre-agreed transfer pricing methods is reviewed by the tax authority within 30 days. If additional time is required for the investigation of the received application, the tax authority has the right to extend the application review period twice, each time by 30 days, with justification. In this case, the applicant should be informed no later than the date of extension of the execution period. A letter is sent to the taxpayer on prior agreement of the methods of transfer pricing in the absence of grounds specified in paragraph 9.3-4 of these Rules for refusal. The validity period of the tax authority's letter on pre-approval of transfer pricing methods is 3 years. [38]

9.3-1. The letter on advance agreement of transfer pricing methods issued by the tax authority can also be applied in relation to the same transactions carried out by the taxpayer in previous periods and not covered by the tax audit. [39]

9.3-2. The method of transfer pricing agreed with the tax authority cannot be applied to the same transactions carried out in previous periods covered by an ongoing tax audit initiated by the tax authority.

9.3-3. The application of the transfer pricing method agreed with the tax authority is not mandatory for the taxpayer. The price (margin, special weight) determined as a result of applying the transfer pricing method agreed with the tax authority should not differ from the prices (margins, special weight) of comparable uncontrolled transactions.

9.3-4. In the following cases, the tax authority refuses to pre-negotiate transfer pricing methods:

9.3-4.1. if there is distorted information in the application and the documents attached to it;

9.3-4.2. if there is a letter from the tax authority on the prior agreement of transfer pricing methods in accordance with these Rules for the transaction mentioned in the application;

9.3-4.3. if the operation mentioned in the application has already taken place or there is a court dispute between the parties regarding the relevant operations;

9.3-4.4. when it is determined that the taxpayer intends to obtain a tax advantage by creating a tax evasion scheme for the transaction applied for acceptance by the tax authority.

9.4. The transfer price determined by the taxpayer using the method of transfer pricing agreed with the tax authority is used only in the determination of income and expenses for taxation purposes, and the tax on the controlled transaction is calculated based on that price when submitting the relevant declaration (profit, income or simplified). The actual price of the transaction can be independently agreed between the transaction parties. [40]

9.5. According to Clause 9.4 of these Rules, if the taxpayer submits the relevant declaration applying transfer prices, the "Statement on Controlled Transactions" in the form determined by the Decision of the Board of the Ministry of Taxes of the Republic of Azerbaijan dated January 27, 2017 No. 1717050000006200, when submitting that Statement to the tax authority The "Information on transfer assessment applied to controlled transactions" section must also be filled out and submitted to the tax authority electronically.

At the same time, the change should be taken into account in the corresponding line of the declaration. [41]

9.6. As part of the pre-negotiation of transfer pricing methods by the tax authority, the formulas and indicators used in the distribution of income are also agreed depending on the nature of the transaction. [42]

## **10. Independent determination of the transfer price by the taxpayer**

10.1. A taxpayer may calculate, declare and pay tax on transactions where the actual contract price is applied based on the transfer price determined independently under these Regulations. In this case, the requirements stipulated in clauses 5.2-5.4 of these Rules should be followed when choosing the appropriate method for determining the transfer price. [43]

10.2. In the event that the taxpayer determines the transfer prices independently, all the documents required for the verification of the compliance of that price with the requirements of these Regulations, including all the details and conditions of the controlled transaction, calculation data, the transactions selected for comparison, the reason for choosing those transactions and the applied method, and must also submit information and supporting documents to the tax authority. [44]

10.3. If the taxpayer calculates the tax based on the transfer price according to clauses 10.1 and 10.2 of these Regulations, section 3 of the "Information on Controlled Transactions" entitled "Information on transfer assessment applied to controlled transactions" must also be filled out. If the taxpayer declares the tax from the controlled transaction by calculating it without adjusting the actual contract price, that section is not filled.

10.4. If the tax authority agrees with the transfer price determined independently by the taxpayer, the tax on the controlled transaction is calculated based on that price. [45]

10.5. If the tax authority concludes that the transfer price should be calculated using another method or other comparable transactions due to insufficient evidence provided by the taxpayer, it shall calculate the tax based on the transfer price determined on the basis of its own investigations. [46]

## **11. Dispute resolution**



11.1. If the taxpayer does not agree with the transfer price determined by the tax authority, he can submit evidence to the tax authority that the transfer price should be determined differently.

11.2. If the tax authority makes a justified conclusion that the evidence provided by the taxpayer is insufficient to change the determined transfer price, taxes are calculated and paid based on the transfer price determined by the tax authority.

11.3. The provisions of Clause 11.2 of these Regulations do not limit the rights of the taxpayer to appeal and apply to court in the administrative procedure provided for in the legislation.

## **12. Elimination of double taxation**

12.1. If the taxpayer's taxation base is subject to changes as a result of the determination and application of the transfer price in the controlled transaction, and as a result of this, a situation of double taxation may arise both in the Republic of Azerbaijan and in the state of the person who is the other party to the transaction in relation to the profit from that transaction, the taxpayer or another person who is a party to the transaction on the basis of his application, the tax authority can provide the applicant with explanatory information about the taxes paid as a result of the transaction in the Republic of Azerbaijan for the purpose of consideration in another state.

12.2. If the competent body of the other state does not agree with the conclusion and taxes calculated by the tax authority of the Republic of Azerbaijan, the mutual agreement procedure is carried out on the basis of the provisions of the international agreement on elimination of double taxation in force between that state and the Republic of Azerbaijan.

12.3. In the absence of an international agreement on the elimination of double taxation in force between another state and the Republic of Azerbaijan, the position of the tax authority of that other state regarding the transfer price determined by applying the legislation of the Republic of Azerbaijan and the calculated tax is not taken into account.