



Transfer Pricing Rules and Documentation in Azerbaijan



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Transfer Pricing Rules and Documentation in Azerbaijan

1. Background

The concept of “transfer prices” is newly introduced into Azerbaijani tax law. The transfer pricing rules of Azerbaijan have been effective since 2017. The Tax Code (Article 14-1) provides for the general definitions and rules of controlled transactions and applicable transfer pricing methods.

Azerbaijan’s transfer pricing regulations are in line with OECD transfer pricing guidelines and recommendations. Detailed rules regulating transfer pricing in Azerbaijan are prescribed by the Transfer Pricing and Application Rules, approved by the Resolution No. 171705000006200 of the Board of the Ministry of Taxes of the Republic of Azerbaijan dated January 27, 2017.

State Tax Service of Azerbaijan has an agreement with Thomson Reuters for accessing international database in order to find comparable transactions for transfer pricing purposes.



2. Application of transfer pricing rules

Under the general principle of the transfer pricing, if the prices of goods (works, services) supplied or received within controlled transactions by the taxpayer do not correspond to the prices of comparable uncontrolled transactions, the taxpayer and the tax authority recalculate the tax on the transaction based on transfer pricing principles. Therefore, in such cases the application of the transfer pricing rules is a duty of the taxpayer, not a right. The same position applies to the tax authority, it is a duty of the tax authority to apply transfer pricing rules in Azerbaijan and re-assess the tax obligations based on transfer pricing methods.

Under the Tax Code, the transfer pricing rules are applied to the transactions between the following persons and entities:

1. Between a resident of the Republic of Azerbaijan and non-resident persons which are associated enterprises, as well as between any representative office, branch, or other division of the resident located in other countries (territories);
2. Between the permanent establishment of a non-resident in the Republic of Azerbaijan and that non-resident themselves, or any of their representative offices, branches, or other divisions located in other countries, or any other person located in another country which is an associated enterprise to that non-resident;
3. Between a resident of the Republic of Azerbaijan and/or the permanent establishment of a non-resident in the Republic of Azerbaijan and entities established (registered) in low-tax jurisdictions;
4. Except for the cases mentioned in Articles 14-1.2.1 to 14-1.2.3 of the Tax Code, between a resident of the Republic of Azerbaijan or the permanent establishment of a non-resident in the Republic of Azerbaijan and non-resident persons, provided that:
 - The persons conduct transactions involving goods traded on international commodity exchanges; and/or
 - The total income of the resident of the Republic of Azerbaijan or the permanent establishment of a non-resident in the Republic of Azerbaijan exceeds 30 million manats during the tax year, and the

volume of transactions with each non-resident person constitutes more than 30% of their total income (expenses).

3. Transfer pricing methods

Following the established international practice and OECD guidelines, the following 5 transfer pricing methods are used in Azerbaijan:

1. Comparable Uncontrolled Price Method (“*Qiymətlərin müqayisəsi üsulu*”)

2. Resale Price Method (“*Sonrakı (təkrar) satış qiyməti üsulu*”)

3. Cost Plus Method (“*Dəyərin toplanması üsulu*”)

4. Transactional Net Margin Method (“*Rentabellilik üsulu*”)

5. Profit Split Method (“*Mənfəətin bölgüsü üsulu*”)

Whenever possible, Comparable Uncontrolled Price Method must be applied to determine the transfer price.

Only when it is not possible to determine the transfer price through direct price comparison, or when there is no information on comparable transactions or prices for such transactions, may other methods be used.

However, while methods other than Comparable Uncontrolled Price Method, if the obtained information allows the application of Resale Price Method or Cost Plus Method, as well as other methods (Transactional Net Margin Method or Profit Split Method), preference must be given to Resale Price Method or Cost Plus Method. For this Purpose, the method that is best supported by the information obtained about the identified comparable uncontrolled transaction shall be taken as priority.

The concept, use and calculations while applying relevant transfer pricing methods are in line with OECD guidelines.

The taxpayer may independently calculate, declare, and pay taxes on transactions conducted based on the actual contractual price, using the transfer price determined independently in accordance with the laws and regulations.

If the taxpayer independently determines the transfer prices, they must provide all required documentation to the tax authority to verify compliance with the laws and regulations. This includes, but is not limited to:

- All details and conditions of the controlled transaction;
- All conditions of the calculations;
- The transactions selected for comparison;
- The reasons for and justification of the selected transactions and the applied method; and
- Supporting documentation.

If the tax authority concludes that the justifications provided by the taxpayer are incorrect (or insufficient) and that the transfer price should be calculated using a different method or other comparable transactions, the tax authority will calculate the tax based on the transfer price determined through its own calculations.

4. Advance pricing agreement

To mitigate potential risks arising from discrepancies and disputes between taxpayers and tax authorities regarding the selection of transfer pricing methods, data, or calculations, the Transfer Pricing and Application Rules provide for the possibility of entering into an advance agreement on transfer pricing, commonly referred to as an Advance Pricing Arrangement or Advance Pricing Agreement (APA).

A taxpayer is entitled to submit a formal letter to the tax authority at least three (3) months before conducting any controlled transaction. The letter should provide details of the transaction, along with the relevant agreement, and request the prior selection of the transfer pricing method.

If the tax authority reviews the taxpayer's request and provides a written response recommending a specific transfer pricing method to be applied for the transaction, the method recommended will be considered valid for the given transaction.

The transfer price determined by the taxpayer using the method recommended through formal correspondence with the tax authority will be used solely for tax purposes to determine income and expenses. Taxes on the controlled transaction will be calculated based on this price when filing the relevant tax return (profit, income, or simplified tax). The actual price of the transaction may still be independently agreed upon between the parties to the transaction.

5. Reporting requirements and deadlines

Where the transfer pricing rules apply, in cases such transactions occur between associated enterprises in cases 1-3 above, a transfer pricing report must be submitted only where the annual value of the transactions between associated enterprises based on transfer pricing rules exceed 500 000 AZN.

Where a transaction between a resident and non-resident either i) includes transactions involving goods traded on international commodity exchanges, and/or ii) income of Azerbaijani resident (or PE in Azerbaijan) exceeds 30 million manats during tax year and the volume of transactions with each non-resident constitutes more than 30% of the total income, the transfer pricing report shall be submitted.

In both circumstances above, the transfer pricing filing deadline to submit relevant report is 31 March for the previous tax year. This report must be submitted alongside with the annual corporate income tax returns.

This Report form is called Information on Controlled Transactions and Appendix to such Report. These forms are attached to the Transfer Pricing and Application Rules, and detailed instructions on filling the forms are provided therein. Appendix to the Report form is not required to be submitted only when the transfer pricing report is submitted due to controlled transactions between a resident of the Republic of Azerbaijan and/or the permanent establishment of a non-resident in the Republic of Azerbaijan and entities established (registered) in low-tax jurisdictions (case 3 above).

If the taxpayer independently determines transfer prices, they must submit all required documents to the tax authority to verify compliance with these Rules. This includes details and terms of the controlled transaction, calculation data, selected comparable transactions, reasons and justification for the selection of those transactions and the applied method, as well as supporting documentation.

In such cases, the third section of the "Information on Controlled Transactions" form, titled "Information on Transfer Pricing Applied to Controlled Transactions," must also be completed. However, if the taxpayer calculates and declares tax on the controlled transaction based on the actual contractual price without making any adjustments, this section does not need to be completed.

6. Transfer Pricing documentation: Master file and Local File requirements

Where the transfer pricing rules apply, tax authorities have a right to claim further information about the multinational enterprise and its resident entity in Azerbaijan. This would be applicable where the taxpayer determines its transfer prices independently. These are Master file and Domestic File requirements.

In line with OECD standards, Master File provides high-level information about the multinational enterprise and requires the include of the following information: (Article 7.4 of the Transfer Pricing and Application Rules, effective since 05 August 2022):

The following information about the group entity:

- The composition of the group;
- The group's areas of activity, geographic scope, and main sources of income;
- A list of the group's intangible assets, agreements within the group for the allocation of costs related to intangible assets, and the transfer pricing policy for this area;
- Financial statements for the audited entity in Azerbaijan, as well as for the entities within the enterprise group with which it conducts controlled transactions, covering the audited period and the two preceding years;
- A brief functional analysis of each entity within the group (functions performed, risks assumed, and assets used);
- The transfer pricing policy regarding financial agreements between entities within the group;
- The business strategy of the group in its operating sector;
- Documentation related to cost-sharing arrangements within the group.

For this purpose, Master File covering the above information shall be available upon submission of the transfer pricing reports, since tax authority is entitled to require such information where transfer-pricing cases arise.

In addition to the Master file, Local File shall be submitted upon the request of the tax authority. Local file focuses on resident entity and its transactions related to the country of jurisdiction, and shall include the following information about the audited entity and transactions (Article 7.4 of the Transfer Pricing and Application Rules, effective since 05 August 2022):

The following information about the audited entity:

- Financial statements of the entity for the audited period and the two preceding years;
- Information on structural changes implemented by the headquarters during the audited period or the past two years, their impact on the entity, the transfer of intangible assets, and the effects of these operations on the audited entity;
- The structure of the entity and the number of employees in each structure;
- The entity's main competitors in the local market;
- Documents related to business restructuring.

□ The following information about Controlled Transactions;

- Information on controlled transactions, including business activities, financial operations within the enterprise group, cost-sharing agreements, and other information influencing the determination of transfer pricing;
- Costs associated with each category of controlled transactions;
- A detailed functional analysis of the taxpayer regarding each category of controlled transactions, including functions performed, assets used (including intangible assets), and risks assumed, along with a comparison of changes over the audited period and the two preceding years;
- The identification and description of other controlled transactions that directly or indirectly affect the documented price of the controlled transaction;
- The indication of the most appropriate transfer pricing method for each transaction category and justification for its selection;
- The identification of the related entity selected as the tested party (entity) and an explanation of this selection;
- A list and description of selected comparable uncontrolled transactions, and, where possible, financial indicators related to independent entities referenced in the comparative analysis of transfer pricing, including the methodology used for identifying comparables;
- Adjustments made for comparability purposes and their application to the tested parties, comparable uncontrolled transactions, or both;
- The description of the circumstances confirming that the controlled transactions were conducted in accordance with the arm's length principle based on the selected transfer pricing method;
- A summary of financial data used in applying the transfer pricing methodology.

In order to achieve the purposes of the OECD's transfer pricing standards, a three-tiered approach is completed by requiring the submission of the Country by Country Report in addition to Master File and Local File.

7. Country by Country (CbC) Reporting requirements in Azerbaijan

Effective since 2020, Azerbaijan applies Country by Country Reporting as well. Where the total revenue of a multinational enterprise (MNE) group exceeds the manat equivalent of **750 million euros** during the financial year, an enterprise that is part of the MNE group and a resident of the Republic of Azerbaijan must, within the timeframe, format, and procedure established by the relevant executive authority, provide information for automated data exchange with the competent authorities of other states under international agreements to which the Republic of Azerbaijan is a party.

A special Regulation "On the timeframe, format, and procedure for submitting the report of an enterprise that is a resident of the Republic of Azerbaijan and part of a multinational enterprise group to the tax authority" has been effective since 28 April 2020.

Where the multinational enterprise has a total income of more than 750 million euros in the financial year in manat equivalence, Azerbaijani resident enterprise which is a member of the multinational enterprise (group) shall submit Country by Country Report in the following cases:

- there is no main entity (group parent company) or authorized entity in Azerbaijan; or
- main entity (group parent company) or authorized entity of a multinational enterprise group is not obliged to submit the Country-by-Country report in its country of residence; or

- when the country of residence of the main entity (group parent company) or authorized entity, despite being a party to an international agreement to which the Republic of Azerbaijan is also a signatory, does not have an agreement with the tax authorities of the Republic of Azerbaijan for the submission of the Country-by-Country report until the submission date of the Report; or
- when the Azerbaijani tax authorities notify the group entity resident in Azerbaijan about the non-fulfillment of obligations by the country of residence of the main entity (group parent company) or authorized entity.

8. Country by Country (CbC) notification and reporting deadlines

A resident of the Republic of Azerbaijan that is part of a multinational enterprise group and serves as the main entity (group parent company) or authorized entity or another group entity must submit the notification (Annex 2 of Rules on CbC Reporting) electronically to the tax authorities of the Republic of Azerbaijan by June 30 of the reporting year, specifying the following information:

- Whether it is the main entity (group parent company) or authorized entity;
- If it is not the main entity (group parent company) or authorized entity, the identification and residency of the entity responsible for submitting the relevant report;
- The financial year of the multinational enterprise group.

The Country-by-Country report must be submitted to the tax authority by the end of the reporting year, i.e. 31 December of the relevant year.

In cases where adjustments are necessary for previous reporting periods, the revised report must be submitted before the commencement of a field tax audit.

9. About us



Caspian Legal Center is a Baku based consulting company ranked by IFLR 1000, Legal 500 and Chambers & Partners. The majority of our clients are foreign multinational enterprises, including several FORTUNE 500 companies operating in Azerbaijan.

Our Tax Practice has been recognized by World Tax and World TP as recognized firm, and we have won Tax Firm of the Year Award and Transfer Pricing Firm of the Year Award in the CIS region by International Tax Review (2023-2024).



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Mr Nabili has over 16 years of practical legal and tax experience. He received his legal education at Baku State University (LL.B, 2007) and Central European University (LL.M, 2008).

Before joining CLC, he has led Tax Law Reforms Unit at the Ministry of Taxes, where he initiated and participated in the introduction of a number of international taxation concepts and methods into the current Tax Code (in particular, transfer pricing, Tax Free regime, advance rulings, general rule against tax evasion).

Mr Nabili is a member of the Azerbaijan Bar Association and the International Bar Association. He has published in the annual reports of the International Bar Association's Tax Committee where he acted as Tax Reporter from Azerbaijan (2019-2022), as well as in Bloomberg Tax and other international publications. Being author of the "Tax Law" textbook (Istanbul, Bilnet, 2023), he has been teaching law at a number of local universities since 2012, including tax law and international tax law courses at Baku State University.

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Ms Heydarova is responsible for Tax and Accounting team at CLC. She supervises and advises on domestic tax, international and double taxation, PSA and tax filing issues. Having accounting degree from UNEC (Azerbaijan), she is PAC certified, and has masters degree in Finance and Tax from the Lund University (Sweden).

Ms Heydarova has extended experience in tax filing supervision, Transfer Pricing Report and documentation, CbC Report filings in Azerbaijan.

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Ms Karimli oversees accounting work of our accounting team for full compliance with IFRS and tax purposes. She has finance and accounting degree from UNEC and possesses Professional Accountant Certificate provided by the State Tax Service.

Ms Karimli is well experienced in IFRS and tax accounting, as well as tax and statutory filing in various industries, including application of double tax treaties, transfer pricing documentation and calculation.

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