

# **Succeeding in Azerbaijan**

## The Dentons Guide for Businesses

2018 Edition

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2018 Edition

**Dentons' Baku Office**

Hyatt International Center  
Hyatt Tower 2, 8 Izmir Street  
Baku AZ1065, Azerbaijan  
Telephone: +994 12 490 75 65  
Telefax: +994 12 497 10 57  
[James.Hogan@dentons.com](mailto:James.Hogan@dentons.com)  
[Kamal.Mammadzada@dentons.com](mailto:Kamal.Mammadzada@dentons.com)

**Dedication**

This book is dedicated to the beautiful country  
and the warm people of Azerbaijan.

The information given in this Guide is generally accurate as of 1 May 2018.

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## Abbreviations used in this guide

EPA – Export Pipeline Agreement

PSA – Exploration, Development and  
Production Sharing Agreement

# Preface

This booklet is the twelfth edition of our business guide, which represents the collective knowledge and experience of our Firm after many years advising clients in Azerbaijan. Dentons is the world's first polycentric global law firm. Driven to provide clients a competitive edge, and connected to the communities where its clients want to do business, Dentons knows that understanding local cultures is crucial to successfully completing a deal, resolving a dispute or solving a business challenge. Now the world's largest law firm, Dentons' global team builds agile, tailored solutions to meet the local, national and global needs of private and public clients of any size, with more than 8,800 lawyers in more than 159 locations, serving 67-plus countries across Africa, Asia Pacific, Canada, Central Asia, Europe, Latin America, the Middle East, Russia, CIS and the Caucasus, the UK and the US.

Active in this jurisdiction since 1990, and having opened our permanent Baku office in 1999, Dentons in Azerbaijan covers a full range of local and international business transactions in the private and public markets, including related corporate restructuring and financing. From initial strategy through the due diligence phase, all the way to post-transaction integration, our professionals deal with all corporate, competition, tax, commercial, banking, employment and real estate aspects of corporate and finance transactions.

The oil-rich economy of Azerbaijan, where the international petroleum industry began in the mid-19<sup>th</sup> century, experienced a prolonged second oil boom following independence in 1991. The opening of new export routes via the Baku-Tbilisi-Ceyhan oil pipeline and the South Caucasus Pipeline system for gas has led to public spending increases in infrastructure projects and Azerbaijan's modernization. At the same time, diversification of the economy and the development of new industries are a national priority, particularly in light of the recent drop in the price of hydrocarbons and resulting economic crisis. Openness to foreign investment has aided Azerbaijan's transition to a market economy, and wide-ranging reforms have improved its overall macroeconomic environment.

We have seen many legal developments in Azerbaijan during the years since its independence, including the enactment of a modern Civil Code, the streamlining of activities requiring licenses and permits, the establishment of centralized property and mortgage registries, the adoption of international financial reporting standards, the establishment of special economic zones and industrial parks and the introduction of a single window system for company registration, immigration/work permit formalities and customs processing, together with remarkable advancements in e-government.

In the World Economic Forum Global Competitiveness Index 2017-2018 Azerbaijan was ranked 35<sup>th</sup> (out of 137 countries). In the Doing Business 2018 report, published by the World Bank and the IFC, Azerbaijan received a respectable ranking of 57<sup>th</sup> (out of 190 countries) in an independent evaluation of the ease of doing business. Within the specific categories, Azerbaijan placed especially well in the areas of starting a business (18<sup>th</sup>), registering property (21<sup>st</sup>), protecting minority investors (10<sup>th</sup>), paying taxes (35<sup>th</sup>) and enforcing contracts (38<sup>th</sup>).

The Dentons Guide is general in nature, intending only to highlight some of the principal issues of interest to those present in this market. For companies and financial institutions considering an activity in Azerbaijan, we hope that it will serve as a good and practical introduction to the legal and business environment in the country.

This edition is very much a group effort on the part of Dentons' rapidly growing team in Baku.

We would also like to express our special appreciation to the management of the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan for the valuable contribution to the chapter on ASAN services.

We also appreciate the valuable feedback we have received from clients and friends of the Firm on the usefulness of the guide for their activities in Azerbaijan.

- Ophelia Abdullayeva
- Sabina Kerimova
- Sona Taghiyeva
- James E. Hogan
- Kamal Mammadzada
- Ulvia Zeynalova-Bockin
- Ruhiyya Isayeva
- Sabina Orujova
- Nargiz Kazimova
- Naida Sadigova



# Chapter 1



# Coming to Azerbaijan: Visas, work permits and police registrations

## Work and visitor visas

The law that governs the issuance of work and other types of visas, the Law “On Entry, Exit and Passports,” dated 14 June 1994 (Visa Law) does not specifically refer to work visas. There are, however, two types of entry visas provided: single entry-exit (valid from three days to three months) and multiple entry (valid from one to two years, although to date only one-year visas have generally been granted). Currently, with few exceptions, visitors must obtain visas from the country of departure prior to arrival in Azerbaijan. It is also a good idea to have an invitation letter from a business in Azerbaijan available for presentation.

In order to obtain a multiple-entry visa, an invitation letter from a business in Azerbaijan is required by the embassy granting the visa. Formalities for submitting invitation letters differ from one embassy to another—sometimes these may be delivered by fax from the enterprise (or even by hand by the applicant) directly to the embassy, but in other cases the embassy may require that the invitation letter be sent to the visa-issuing embassy via the Azerbaijani Ministry of Foreign Affairs. In still other cases, the Ministry of Foreign Affairs advises that the applicant must arrive in Azerbaijan using a single-entry visa and then apply personally to the Consular Department of the Ministry in Baku to be issued with a multiple-entry visa.

According to the Migration Code of the Republic of Azerbaijan, adopted on 2 July 2013, a foreign national hired by an employer must arrive in Azerbaijan with a work or labor visa. However, no detailed rules on work visas have been adopted to date, and under these circumstances the legal regime applicable to general multiple entry visas under the Visa Law also governs work visas.

All of the following documents must be filed with the Embassy of Azerbaijan in the employee's country of residence in order to obtain a multiple entry visa:

- A letter of invitation on the employer's letterhead
- A standard application form
- Two color photographs of the employee
- The employee's passport
- State duty (Normally, US\$250 for a one-year multiple entry visa; however, for nationals of countries which charge higher visa fees to citizens of the Republic of Azerbaijan, the amount of the state duty may be higher.)

A new ASAN visa procedure exists for tourist visas processed through ASAN Services. Now it is possible to obtain a tourist visa for 30 days online by providing a scanned copy of the foreigner's passport and information about arrival and departure dates.

### **Work permits**

Each foreign employee planning to work in Azerbaijan must obtain an individual work permit for such purposes. The decision on issuing a work permit is taken by the State Migration Service in accordance with a "single window" or "one stop shop" principle, considering the opinion of the Ministry of Labor and Social Protection of the Population. All of the documents required to obtain a work permit must be filed with the State Migration Service. The delivery of the work permits is also carried out by this body.

An employment contract with the foreign employee may not be concluded for a period exceeding the duration of the work permit, which itself may not exceed one year. An application for renewal (extension) of a work permit must be filed with the State Migration Service at least 22 days prior to expiration. The state duty payable for obtaining a work permit for a period of one year is AZN 1,000. The fee payable for the renewal of a permit for a period of one year is also AZN 1,000.

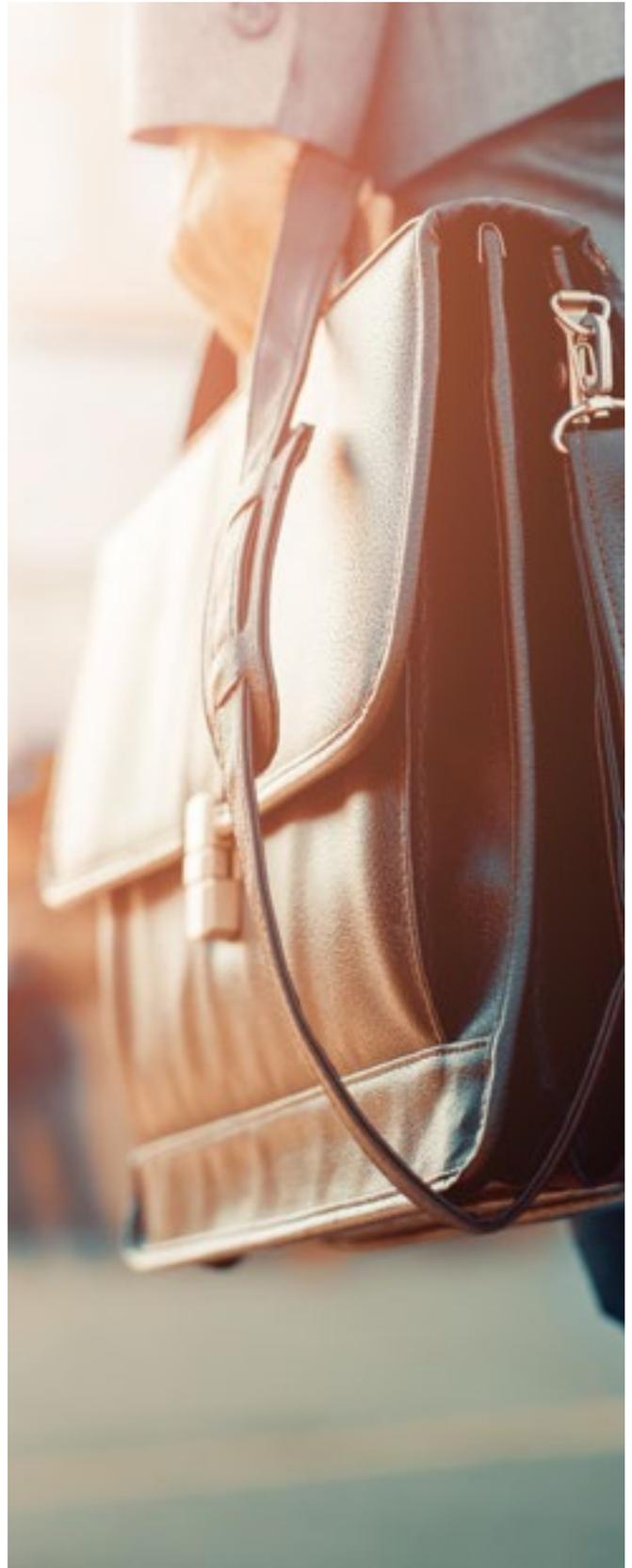
A work permit is not needed for the following:

- A person on a business trip for a period not exceeding 90 days per year carrying out types of activities determined by the relevant executive authority
- A person engaging in independent entrepreneurial activity
- A director and any deputy of a foreign legal entity or a representative office or branch of a foreign legal entity
- A director and any deputy director of a legal entity incorporated in the Republic of Azerbaijan and having a foreign legal entity or a foreign individual as at least one of its shareholders

The employer must file the following documents with the State Migration Service:

- An application for an individual work permit (stating the name, organizational-legal form and legal address of the employer, as well as the full name, citizenship, mailing address of the employee's permanent place of residence, date and place of birth, sex, specialization, details of employment within the last five years and the anticipated position and address of the place of work of the employee in Azerbaijan)
- Two photos on a red background (3 x 4)
- A notarized copy of the qualifications of the foreign employee for the position for which he or she is being hired (a copy of a diploma/degree; professional qualifications/certifications)
- Justification for employment of the foreign individual in the particular position
- A copy of the document authorizing the foreigner's stay in Azerbaijan if such person is present in Azerbaijan on other grounds (i.e., a copy of the visa); this condition presumably has effect only in respect of employees who are already legally in Azerbaijan but do not have a work permit.
- A copy of the foreigner's identification document
- A medical certificate on the foreigner's health condition issued by a medical institution approved by the State Migration Service
- Notarized registration documents of the employer
- Documents confirming the foreigner's address in Azerbaijan (e.g., notarized consent of the landlord, notarized copy of the landlord's national ID card; notarized copy of an extract from the Register of Immovable Property in respect of the premises)

A work permit becomes void if the employment contract concluded between the employer and foreign employee is terminated or revoked. In cases where an employment contract has been terminated, the employer must notify the State Migration Service within five days.



### **Registration at place of residence and stay**

Foreign nationals planning to remain in Azerbaijan for more than 10 days must be registered at their place of residence and stay in Azerbaijan.

For this purpose, within 10 days from the date of the arrival of the foreign national at a hotel, sanatorium, rest home, boarding house, campground, tourist base, apartment or other living space, the administration or owner of such living space (the receiving party) should submit to the State Migration Service an application on the registration of the foreign national at the place of residence and stay, together with a scanned copy of the foreign national's passport. No state duty is payable for the registration of foreign nationals at their place of residence and stay.

The application must be submitted by e-mail ([qeydiyyat@migration.gov.az](mailto:qeydiyyat@migration.gov.az)), and an electronic application form is available on the website of the State Migration Service ([www.migration.gov.az](http://www.migration.gov.az)). After receipt of the application form, the State Migration Service shall register the foreign national at the place of residence and stay and shall provide written notification to the receiving party within one working day.

Foreign nationals are registered for the following periods:

- Persons arriving under a visa—for the period indicated in the visa
- Persons arriving under a visa-free regime—for 90 days. However, the receiving party or the foreign national must inform the State Migration Service upon the foreign national's departure, whereupon the State Migration Service shall cancel the registration.

Whenever a foreign national changes his or her place of residence and stay he/she should be registered at the new place of residence and stay according to the procedure above.

#### **Useful websites:**

- Ministry of Foreign Affairs – [www.mfa.gov.az](http://www.mfa.gov.az) (English version available)
- State Migration Service – [www.migration.gov.az](http://www.migration.gov.az) (English version available)

#### **How Dentons can help**

Dentons has assisted many companies and individuals in obtaining visas, work permits and residence permits in Azerbaijan. Dentons can also advise on employment contracts, work visas and other issues related to immigration and residence in Azerbaijan. However, the application for obtaining a work permit must be submitted by the employer itself or by an employee of the company. A Power of Attorney for this purpose issued to a non-employee of the company will not be accepted by the State Migration Service.



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# Chapter 2



# Setting up and closing down operations

## Choosing a local presence

Azerbaijan currently permits essentially three types of corporate entity that are of greatest interest to those wishing to establish a local subsidiary:

- The limited liability company (LLC)
- The closed joint stock company (JSC-C)
- The open joint stock company (JSC-O)

The Civil Code (2000), unlike earlier legislation, does not provide for the state enterprise as an organizational legal form (nor is there any mention of the municipal enterprise). In theory, all state and municipal enterprises should be organized in one of

the forms specified by the Code—in most cases, in the form of limited liability companies or joint-stock companies, but this is not always the case in practice (see, e.g., SOCAR). Traditionally, JSCs and LLCs have been considered the most appropriate vehicles for establishing “joint ventures” with local partners.

The JSC and LLC forms are similar in many respects (e.g., both require at least one founder; shareholders/participants enjoy limited liability; the same tax treatment applies; pre-emptive rights exist). However, in certain respects the LLC form of legal entity offers more flexibility in structuring the internal operations of a company, and fewer registration and reporting requirements apply than in the case of a JSC

(e.g., JSCs require the registration of securities and the publication of financial statements).

The minimum charter capital requirements for JSCs have been established as follows:

- JSC-Cs – AZN 2,000
- JSC-Os – AZN 4,000

In each case the charter capital must be paid in full prior to State registration. Currently, there is no fixed minimum charter capital that is applicable to LLCs, subject to a general requirement that the charter capital must be sufficient to satisfy the claims of creditors.

The registration procedures and state registration fees, AZN 11, are the same for both types of entity. All entities (with the exception of non-commercial organizations, which continue to be registered by the Ministry of Justice) are to be registered with the Ministry of Taxes as part of a “single window” or “one stop shop” process. The Ministry of Taxes subsequently informs the State Statistics Committee, the State Social Protection Fund, the local tax authority and the State Employment Center about such registration. Furthermore, in the case of JSCs, shares must be registered with the Financial Market Supervisory Authority.

### **Representative offices and branches**

Many foreign companies operate in Azerbaijan through either representative offices or branches. Both of these forms may engage in some or all of the functions of the founder. Technically, representative offices should be limited to activities of a preparatory or auxiliary nature and, although in practice there is essentially little difference between the treatment of the two forms, it is recommended that activities requiring a license be conducted through a branch (or a locally incorporated company), rather than through a representative office. The state registration duty for both branches and representative offices is AZN 220.



The following is a non-exhaustive list of documents which must be provided to the Ministry of Taxes for the registration of a branch office (or a representative office):

- A board resolution approving the establishment of the local office
- Regulations of the local office
- A power of attorney in favor of Dentons’ personnel authorizing them to complete the registration formalities on behalf of the founder
- A power of attorney for the director of the local office
- A certificate of incorporation of the company establishing the local office
- The charter/bylaws of the company establishing the local office



All of the above documents should be notarized and legalized or, where applicable, apostilled. A list of countries which are party to The Hague Convention of 5 October 1961 *On Abolishing the Requirement of Legalisation for Foreign Public Documents*, by which an apostille may be substituted for the more cumbersome legalization procedure, can be viewed at [http://hcch.e-vision.nl/index\\_en.php?act=conventions.status&cid=41](http://hcch.e-vision.nl/index_en.php?act=conventions.status&cid=41). (Public documents originating in certain signatory countries, including Germany, also require full legalization; an apostille from such countries is not accepted).

In addition to the above documents, the company must also provide evidence of its legal address in Azerbaijan (e.g., a notarized office lease, or a notarized letter of consent from the landlord and a notarized copy of the extract from the Register of Immovable Property in respect of the premises) and a copy of the passport of the director. These requirements apply to both a branch office and a representative office.

#### **Additional formalities**

After registration with the Ministry of Taxes, a number of additional steps need to be taken before the local presence is operational. These include:

- Procuring the corporate/representative office/branch seal
- Obtaining permission from the Ministry of Taxes to open bank accounts
- Obtaining notarized signature samples on bank account signature cards from the selected bank in Azerbaijan
- Opening bank accounts

One should also budget for local translation/notarization expenses of at least US\$ 750+ (not including VAT) and possibly more if the documents are voluminous.

### Tax-only registrations

In some cases, a tax-only registration is possible. This is generally permitted for companies which do not have permanent establishments in Azerbaijan and are domiciled in countries with which Azerbaijan has a double-tax treaty.

### Liquidation and office closures

Legal entities, branches and representative offices must undergo a number of steps prior to de-registration.

- a. Approval of a formal statement (stating assets and liabilities) on the solvency of the legal entity and indicating a 12-month deadline for the settlement of claims with the creditors. (The statement must be approved at the request of the members of the executive body of the company not earlier than twenty (20) days prior to the liquidation resolution. If the company's executive body states the impossibility to adopt a formal declaration of solvency, the company's independent auditor, as then appointed by the General Meeting, may approve its own conclusion on the solvency of the legal entity. An audit report is considered an appropriate official statement)
- b. Adoption of a resolution on the liquidation and the appointment of a liquidation commission
- c. Not later than 10 days from the date of the adoption of the liquidation resolution, the publication of a notice of liquidation in the official press, specifying a period of at least two months for the submission of claims. Such notice must be published in the same manner two additional times: a second publication 15-20 days after the first publication and a third publication 15-20 days after the second publication
- d. Sending a notification on liquidation to all known creditors (if any)
- e. Submission of the formal statement (referred to in (a) above), the resolution on liquidation and the seal of the entity to the registration department within 15 days from the date of the adoption of the liquidation resolution
- f. Ordering a new seal for the entity with the notation "in the process of liquidation" for further use by the liquidation commission (liquidator)
- g. Notifications to the State Social Protection Fund, the Audit Department of the Ministry of Taxes and the State Customs Committee with requests for closing audits
- h. Completing various reports and documents requested by the tax authorities
- i. Preparing a preliminary liquidation balance within ten days of the expiration of the two-month period for filing claims
- j. Settlements with creditors (to be completed within 12 months)

Within five days of completing settlements with creditors, the liquidation balance and a statement of the plan for the allocation of the remaining assets to the owner of the representative office are compiled. These documents must be approved by the owner of the representative office within not later than 45 days. Such property is subject to transfer to the owner of the representative office within 10 days.

Submission of the required clearances from the necessary state bodies, the liquidation balance, the asset distribution plan, the document confirming the allocation of the remaining assets to the owner and other documents provided by legislation to the registration department of the Ministry of Taxes within 10 days from the date of the allocation of the assets.

Receipt of a document from the Ministry of Taxes confirming deregistration.

The total duration of the process for the liquidation of a legal entity shall not exceed one year from the date of submitting the documents to the registration department. Exceeding this period would entail the recommencement of the liquidation process.

#### **How Dentons can help**

Dentons has assisted many companies in establishing a presence in Azerbaijan, whether as a representative office, branch or local legal entity. Dentons provides a full registration service, including model documents, instructions on the procedures, fulfillment of all registration formalities and practical advice during the process.

Dentons also has considerable experience in the suspension of activity, closing and reorganization of local offices and subsidiaries.





# Chapter 3



# Corporate governance

## Introduction

The legislation dealing with JSCs and LLCs is found primarily within a few sections of the Civil Code. These provisions sometimes lack clarity and detail. The mandatory corporate governance principles that exist with respect to entities in these legal forms are subsumed within these sections of the Civil Code. There are other pieces of legislation which supply additional corporate governance rules that are applicable to companies engaged in certain types of activities, such as financial institutions, insurance companies, investment companies, investment funds, agricultural cooperatives, etc. This chapter is not intended to cover such entities, even though they may be mentioned occasionally.

In addition to the mandatory corporate governance principles, there is also a set of Azerbaijani Corporate Governance Standards prepared by a working group consisting of representatives of the Ministry of the Economic Development of the Republic of Azerbaijan and the International Finance Corporation. These standards were prepared based on the 2004 Edition of the OECD Principles of Corporate Governance and are of a voluntary nature.

One of the difficulties encountered in considering the corporate governance of LLCs and JSCs is that the rules are not uniform, and the concept of implicit repeal sometimes leaves it unclear as to whether an older provision is still in force. Furthermore, in general the law restricts the term “director” to members of the board of directors (supervisory board), which

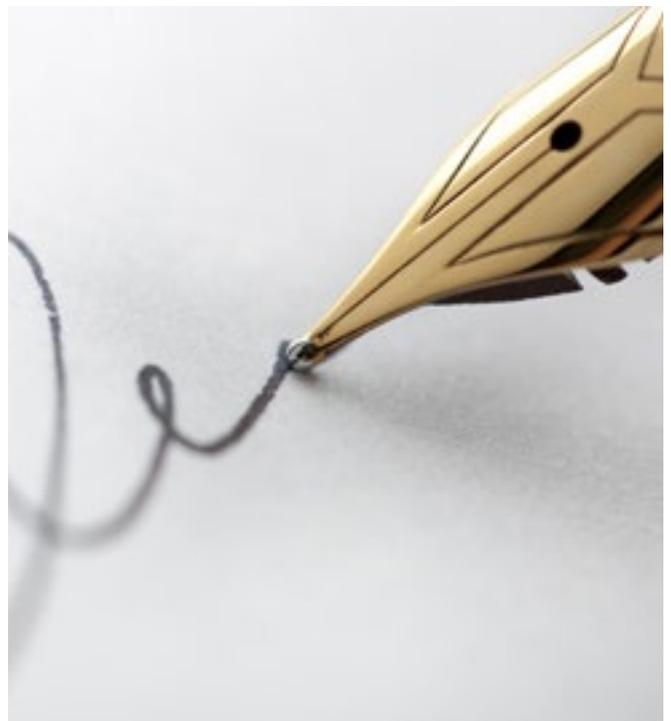
only a JSC-O is required to have in place. The broader term “officer” is used in various laws, and penalties for improper or inadequate performance of duties are imposed on “officers” though not “directors.” The term “officers,” however, is also not defined.

Good corporate governance ideally should involve:

- Independence from the State in decision-making
- Transparency of decision-making
- Financial transparency
- Responsibility and accountability
- Good internal controls
- Good record keeping (minutes of meetings, accounts, etc.)
- Effective flows of information

Transparency and avoiding conflicts of interest are fundamental principles of good governance, but extra care is required where there is one dominant shareholder. Although the law states that the general meeting of shareholders is the highest body of corporate governance (and it is this body which is exclusively responsible for making changes to the charter, approving the annual financial statements and similar actions of highest importance), it is the board of directors (sometimes referred to as the supervisory board) and the executive body (sometimes referred to as the management board) where the main aspects of governance are exercised.

In a JSC the power to appoint and terminate members of the executive management board may be vested by the charter in the supervisory board. Only a JSC is required to have a two-tier board structure (having both a supervisory board and a management board), and then only where it has more than 50 shareholders or where it qualifies as *an entity of public importance*.<sup>1</sup> An LLC is not required to have a two-tiered board structure but may optionally choose to have a supervisory board by so providing in its charter or where it qualifies as an entity of public importance.



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<sup>1</sup> Such as financial institutions, insurance companies, investment companies, investment funds, etc., as well as companies with an annual revenue of at least AZN 120 Million, having 1,500 employees and/or having assets valued at AZN 300 Million.

## The general meeting of shareholders

The Civil Code reserves to the general meeting of shareholders certain major matters, such as approving changes to the charter, increases in the charter capital, a reorganization or winding-up of the company, annual statements and the distribution of profits, and the election of the supervisory board and finance/audit committee.

Both LLCs and JSCs must hold a general meeting of participants/shareholders not less than once per annum. LLCs are required to hold an annual general meeting within four months of the end of the year, while a JSC must do so not later than within six months of the end of the financial year. An extraordinary general meeting of an LLC or a JSC may be convened by the directors, the management board (where no supervisory board exists), or the audit committee, or at the request of shareholders representing at least 10% of the votes.

The annual general meeting is convened by the directors (or, where there is no supervisory board, by the executive body). For a JSC-O, in addition to sending notices to all shareholders, at least 45-days' notice of an annual general meeting must be given by publication in the mass media. For an extraordinary general meeting of shareholders, the notice period is only 30 calendar days.<sup>2</sup> The notice must provide certain basic details, including an agenda and details on how shareholders may familiarize themselves with background materials to the agenda items. Closed JSCs are only required to notify shareholders in writing.

Resolutions of general meetings of JSCs must be notified to the shareholders within 15 days. The minutes must be signed by the chairman and secretary and must be sealed. The minutes must specify certain pieces of information, such as the time and place of the general meeting, its agenda, the number of shares represented at the meeting, the results of the voting in respect of each issue put to a vote, as well as the precise text of each resolution passed.

The law provides for methods of counting votes at general meetings in JSCs with more than 100 shareholders: A panel of at least three tellers is required. The members of, and candidates to, the supervisory and management boards and the audit committee may not be appointed as tellers. The tellers must add to the minutes of the meeting a record of the results of the vote.

In relation to a JSC-O a transaction which exceeds 25% of the net asset value of the company must be approved by the general meeting of shareholders, and the method of disclosing the details of such transactions should be specified in the charter.

Voting at a general meeting is usually carried out in person or by proxy, unless the charter expressly permits votes to be cast in writing. Resolutions of a general meeting of shareholders must be recorded in the form of minutes (in duplicate and prepared within three working days of the meeting), which must be signed by the chairman and secretary and sealed. This appears to be the only reference in the Civil Code to the functions of a secretary in the context of company administration. Generally, there is no requirement to have a formal company secretary position. Shareholders are entitled to review the minutes on demand.

The right to vote by preferred shareholders at shareholder meetings is strictly limited to issues concerning reorganization, liquidation and certain charter amendments (unless the charter grants them other rights).

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<sup>2</sup> JSCs which are banks may also convene a general meeting of shareholders without any notice at all, provided, however, that 100% of all shareholders are present in person or in proxy.

## **Directors and management: independence and qualifications**

In general, the laws of Azerbaijan do not require directors serving on the supervisory board or executive officers to possess any special qualification, nor does a prior criminal record normally disqualify a director or officer from such a position (unless such JSC is a bank, an insurance company, an investment company, or an investment fund, etc.)

Supervisory board members, who are elected by the general meeting of shareholders, are, at least in theory, independent from the management and from the audit committee. A supervisory board director may not also serve as a member of the management board, though he/she is allowed to serve as an audit committee member.

The State has the right to appoint board members in cases where it continues to own at least 25.5% of an enterprise following privatization. However, a shareholder holding more than 20% of the shares of a JSC may not be a member of the management board.

A member of the supervisory board of a JSC may be appointed for a period not exceeding three years, other than for banks.<sup>3</sup> There appear to be no statutorily established limits on the reappointment of members of the management board. The appointment of the management board is carried out by the participants/shareholders in a general meeting, except that in a JSC this authority may be delegated to the supervisory board. The head of the executive management should enter into an agreement with the LLC, which would normally be signed by the chairman of the general meeting of participants at which the head is appointed.

Management of both LLCs and JSCs may be collegial, in the form of an executive management board, or it may consist of one person, who may be independent of the owners or a representative of one or more owners.

Members of the supervisory and/or management board of both LLCs and JSCs may be removed from their position by the general meeting of shareholders for causing damages to the company.

## **Audit committee (or Auditor)**

JSCs are required to have an audit committee that is independent of its supervisory and management boards, if it has more than 50 shareholders (other companies may provide for audit committees in their charters), or where they qualify as an entity of public importance. A shareholder or a member of the management board may not be a member of the audit committee. Published financial statements must be audited by an independent external auditor. Audits of a JSC are carried out at the request of the audit committee (or by resolution of a general meeting, the directors or management or at the request of more than 10% of shareholders.)

An LLC may have an audit committee (or a sole auditor) but is not required to do so, unless the LLC has more than 50 participants or where it qualifies as an entity of public importance. Shareholders or management board members of an LLC may not be members of the audit committee, while supervisory board members may serve on the audit committee. An LLC is required to appoint an independent external auditor.

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<sup>3</sup> In a bank, the terms of both supervisory board and management board members may not exceed four years.



### **Related-party transactions**

Regulations on related party transactions now extend to all Azerbaijani legal entities (previously similar regulations existed only for issuers of investment securities and banks.) The regulations apply to any transaction or series of related transactions between a legal entity and a related party with respect to such legal entity.

In general, the term “related party” is defined quite broadly and includes the following:

1. The chairmen and members of the management and supervisory boards of a company
2. Heads of divisions, branches and departments of the company
3. Relatives of persons listed under items 1 and 2 above
4. Shareholders of the company (whether legal entities or individuals) holding (whether directly or indirectly) at least 10% of the shares in the company
5. Legal entities in which persons listed under items 1, 2 and 4 above (whether directly or indirectly) hold shares
6. Legal entities in which the company in question holds at least 20% of the shares
7. Persons (whether legal entities or individuals) holding (whether directly or indirectly) at least 20% of the shares in entities listed under items 4 and 6 above
8. Chairmen of the management and supervisory boards of legal entities listed under items 4 and 6 above

In the event that the value of a related party transaction is equal to or exceeds five (5) percent of the relevant company's assets, such transaction may be entered into based on the opinion of the independent auditor engaged by the company and a resolution of the general meeting of its shareholders adopted by a simple majority. A shareholder of the company who is a related party in relation to the transaction in question may not cast a vote during the general meeting of shareholders.

If the value of the related party transaction is less than five (5) percent of the company's assets, such transaction must be approved by either the general meeting of shareholders, the supervisory board or the management board of the company, in accordance with the charter of the company. For this purpose, a member of the supervisory board or the management board of the company or a shareholder of the company who is the related party in relation to the transaction in question may not cast a vote.

If the related party is the chairman of a management board which consists of one person or persons listed under items 3 and 5 above, such transaction must be approved by the supervisory board of the company, or by the general meeting of shareholders if no supervisory board is established.

The law also establishes liability for damage inflicted upon the company caused by the latter entering into a related party transaction in violation of relevant approval procedures. Such a transaction also can be rescinded by the company or any of its shareholders.

Finally, the law requires that the chairman and members of the supervisory board of a company must disclose to the shareholders of the company in writing the fact that they are related parties in relation to a transaction with the company, as well as the details of their interests in such transaction. A similar requirement applies to the chairman and members of the management board of a company and any other related party, except that the latter must address the disclosure to the supervisory board (or to the general meeting of shareholders if no supervisory board is established).

Shareholders of JSCs also have the right to require a review of relevant agreements, presumably, prior to approving these transactions.

### **Directors' and officers' duties**

The function of a supervisory board is to carry out control over the activity of the executive body (the management board). Because the term "director" is not defined in law, it is not possible to deduce clearly from the legislation the nature of a director's duties. Essentially, the Civil Code leaves it to the charter (the constitutive document) of each company to define and establish the duties of the directors. Penalties (administrative and criminal) are levied on officers who fail to fulfill their duties or who do so inadequately. In the vast majority of cases, these penalties are applied to the general director or, where the matter relates to an accounting or tax offense, the chief accountant.

The management board of a JSC must, in theory, provide background information relating to any general meeting agenda item within a prescribed period prior to the meeting. However, a shareholder must request the information and it is not clear whether the information must be provided to all shareholders or, as is the most likely interpretation, only to the shareholder requesting the information.

According to recent amendments to the law, shareholders of a JSC have the right to apply to a court or other competent authority for damages suffered by the JSC or its shareholders as a result of a concluded transaction.

Finally, there is administrative and criminal liability for the violation of related party transaction regulations.



## Fiduciary duties

Rudimentary indications of fiduciary duties were introduced into Azerbaijani corporate governance standards several years ago. Although not labeled as such, the language in the law suggests that the duties include the duty of good faith, the duty of care and the duty of loyalty.

Specifically, a person acting on behalf of a legal entity, including a member of the supervisory board or the management board, must discharge his/her duties (i) in good faith, (ii) in a professional/reasonable manner and with due care and (iii) must remain loyal to the interests of the company and its shareholders/participants and put the interests of the company before his/her own interests.

The law also provides that a fiduciary who fails to discharge his or her duties in accordance with the stated standards is liable for any damage suffered by the company of which he or she is a fiduciary as a result of such breach of duty. Recently, a list of specific actions and behaviors was introduced into the Civil Code, attempting to clarify what exactly duties of good faith, care and loyalty entail (e.g., payments of executive bonuses, when a company is operating at a loss or where bonus is disproportionate to company's profitability levels, etc.).

A shareholder or participant holding at least 5% of the company's charter capital may step into the shoes of a company that has suffered damage as a result of the actions or inaction of fiduciaries and may demand that the latter compensate such damages to the company. Recent amendments to the law require access to relevant information and documents, subject to complying with confidentiality requirements.

## Criminal liability for legal entities

Criminal liability—which previously was applicable only to physical persons, such as members of the management of a legal entity—will extend, once made effective through implementing regulations, to legal entities themselves as well. Based on amendments to the Criminal Code adopted in 2012, legal entities may be subject to criminal liability for actions of officers of a legal entity that benefited or were taken for the protection of such a legal entity.

Criminal liability may arise for legal entities in connection with, *inter alia*, human trafficking; involuntary servitude; the legalization, knowing possession, use and disposal of funds and other property obtained illegally; terrorism and the financing of terrorism; computer hacking; the creation, use and distribution of computer viruses; abuse of office; the receiving or giving of bribes; as well as corruption-related crimes.

The following are the punitive measures that may be taken against legal entities:

- Financial sanctions
- Confiscation of illegally obtained property
- Deprivation of the right to engage in certain activities
- Forced liquidation of a legal entity

While punitive measures in the form of the forced liquidation of a legal entity may only be a primary penalty, financial sanctions can be both primary and auxiliary penalties. Measures such as confiscation and deprivation of the right to engage in certain activities can only be auxiliary penalties.

Relevant amendments are also expected to be made to the Criminal Procedural Code and the Code of Implementation of Criminal Penalties.

## **Conclusion**

The existing rules of corporate governance that apply in Azerbaijan are mandatory, and therefore they must be followed. However, at present they are not fully adequate to ensure the protection of minority shareholders or the efficient operation of JSCs and LLCs. The current business environment in Azerbaijan, which includes a strong state sector, large industrial holdings with dominant market positions and close ties to the government, corruption and a rule of law that is still developing, makes the establishment of good corporate governance principles all the more important. Ideally, the shortcomings in the existing rules should be addressed in the constitutive documents and internal regulations of such entities.

## **How Dentons can help**

Dentons has considerable experience conducting due diligence of companies and establishing joint ventures in Azerbaijan, including through the use of complex offshore structures for investment. As corporate governance professionals, Dentons can advise on effective governance structures and procedures, to provide more reliable corporate governance principles, compensating by contract or through internal company rules for the existing inadequacies under laws of general application.



# Chapter 4



# Banking and finance

## Overview

The Azerbaijani banking system is characterized by a relatively small number of banks, and a concentrated market where the newly-constituted Financial Market Supervisory Authority (FIMSA) is now the central regulatory body.

FIMSA was established in accordance with the Presidential Decree *“On the Establishment of the Financial Market Supervisory Authority Public Legal Entity in Azerbaijan,”* dated 3 February 2016, for the purposes of the licensing, regulation and oversight of the securities market, investment funds, insurance companies, credit organizations (banks, non-banking organizations and the national postal operator) and payment systems, along with strengthening

oversight over the prevention of the legalization of criminally obtained funds or other property and the financing of terrorism.

FIMSA has replaced the State Securities Committee, the State Insurance Supervision Service under the auspices of the Ministry Finance and the Financial Monitoring Service under the auspices of the Central Bank. FIMSA was established in the form of a “public legal entity,” a quasi-state entity, for the purposes of engaging in activities of national significance. In accordance with the latest amendments to the Constitutional Law *“On Normative Legal Acts,”* decisions adopted by the Central Bank of Azerbaijan (the CBA) and FIMSA have been included in the list of enactments of a normative character.

Credit institutions are divided into banks and non-banking credit institutions. Banks are subject to the licensing terms prescribed by FIMSA and, in general, may carry out all types of banking operations stipulated by the existing legislation, while non-banking credit institutions are permitted to conduct only certain types of such activities (for example, only banks are allowed to accept deposits).

### **Size**

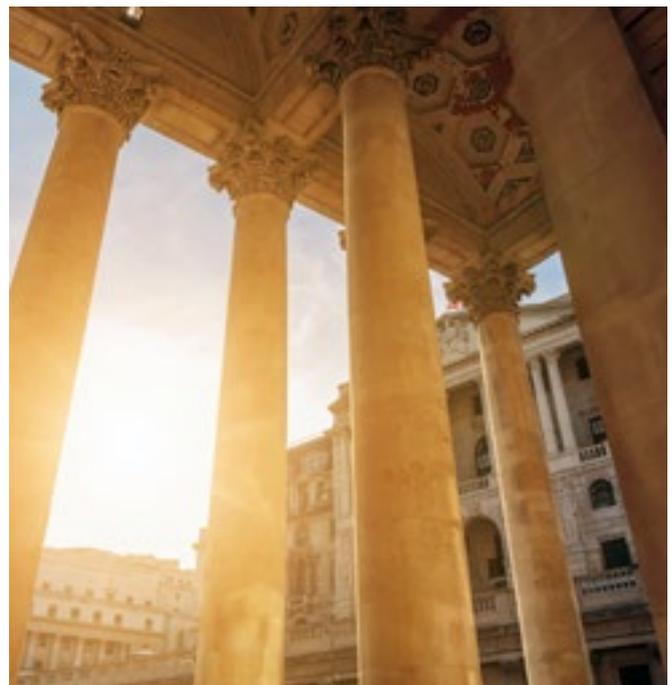
With only two banks still partially owned by the state, the remaining banks and two branches of foreign banks in Azerbaijan are now privately owned. According to statistics current as of January 2018, the total assets of Azerbaijani banks were approximately AZN 32.4 billion.

### **Legislation, supervision and transparency**

The banking legislation is fairly well developed in Azerbaijan, both at the level of primary laws and at the level of various implementing regulations.

Azerbaijani banks provide financial reports in accordance with international financial reporting standards. Mandatory external audits (i.e., by independent auditors) have also been introduced, making the system more transparent, which has encouraged and reassured domestic and foreign investors' confidence.

In addition, FIMSA is moving towards a broader application of the Basel III standards, including the application of leverage norms, the performance of preparatory work for the management of short term liquidity and the improvement of the internal institutional potential for the purpose of the sustainability of banks in light of financial risks.



# Regulatory framework, money laundering

## Banking and finance

The principal laws in the area of the establishment and operation of banks are the Law “On Banks” and the Law “On Non-Banking Credit Institutions”. The existing system of legislation also encompasses a large number of implementing regulations, dealing, *inter alia*, with issues of licensing, the establishment and acquisition of subsidiaries, participation in other legal entities, corporate governance and requirements for managerial personnel.

## Money laundering

According to the Azerbaijani Criminal Code the following activities are crimes associated with money laundering and terrorism financing:

1. Financing extremism and terrorist activity
2. Money laundering or laundering other unlawfully acquired property

The principal legal acts against money laundering in Azerbaijan are the following:

- Civil Law Convention on Corruption, dated 4 November 1999
- Criminal Law Convention on Corruption, dated 27 January 1999
- United Nations Convention against Corruption, dated 31 October 2003

- European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, ratified 1 March 2003
- The Criminal Code, dated 30 December 1999
- The Civil Code, dated 28 December 1999
- The Tax Code, dated 7 November 2000
- The Law On Combating Corruption, dated 13 January 2004
- The Law On Banks, dated 16 January 2000
- The Law On Credit Unions, dated 2 May 2000
- The Law On Currency Regulation, dated 21 October 1994
- The Law On Combating the Legalization of Illegally Obtained Funds and Other Property, dated 10 February 2009

The CBA also has adopted guidelines on “International Cooperation on Anti-Money Laundering issues and the Financing of Terrorism” with the participation of the FATF (Financial Action Task Force), an inter-governmental body, which develops and promotes policies to combat money laundering and terrorist financing.

FIMSA is charged with the implementation of State policy on prevention of the legalization of criminally-obtained funds and other property and the financing of terrorism, creating a system of supervision over, *inter alia*, financial institutions.

## Compliance supervision

Azerbaijani law authorizes FIMSA to review the financial statements, accounting books, documents and other records of banks and to demand explanations on matters relating to the accounts and financial statements of the bank.

## Deposit Insurance

According to the law “*On Deposit Insurance*” (2006) all licensed banks which accept deposits become members of the Deposit Insurance Fund and, as of now, 28 banks and two branches of foreign banks have become members of this Fund. The Deposit Insurance Fund insures deposits at each member bank for up to 100% of the eligible deposit balance. (A previously applicable insurance limit of AZN 30,000 was suspended by presidential decree until 4 March 2019).

According to the latest changes in the law, any matured obligations of the depositor vis-à-vis the banks in which eligible deposits were made will be set off for the purposes of calculating the final payout by the Azerbaijani Deposit Insurance Fund.

## Criminal liability

The conduct of financial operations and other transactions with monetary funds or other property which was unlawfully acquired, as well as the use of such funds or other property, can lead to criminal liability, including imprisonment for a period from three to 12 years, with the possibility of the confiscation of property for any person who has abused or exceeded the authority of his or her office.

## Mergers and acquisitions

The existing legislation of the Republic of Azerbaijan contains a number of provisions which envisage various notices, approvals and permissions that apply in Azerbaijan in connection with the proposed acquisition of a shareholding in an Azerbaijani bank.

As a general comment, we note that the existing legislation of Azerbaijan, when referring to a major shareholder, implies the ownership of at least 10% in the target legal entity, whether such ownership is direct or indirect. The legislation also provides a definition for a “bank holding,” which means a direct or indirect holding in an undertaking which represents 10% or more of the capital or the voting rights or which makes it possible to exercise significant influence over the management of the undertaking in which the holding subsists.

### 1. FIMSA Approval for the Purchase of Shares in a Bank

In accordance with the law “*On Banks*”, the prior written consent of FIMSA must be obtained in order for any person to become a major shareholder of a bank in Azerbaijan or to create a bank holding with respect to a bank in Azerbaijan. The consent of FIMSA would also be required each time any such purchase will cause the purchaser’s shareholding to equal or exceed the thresholds of 20%, 33%, 50% and more than 50% of the charter capital of a bank.

### 2. Consent of the Antimonopoly Authority

The consent of the State Service for Antimonopoly Policy and the Protection of Consumers’ Rights under the aegis of the Ministry of Economy must be obtained, *inter alia*, for the acquisition of more than 20% of the shares of a bank.

### 3. Registration with FIMSA and the Ministry of Taxes

In accordance with Azerbaijani law, all banks must be organized as open joint stock companies, and all newly-issued shares must be registered with FIMSA. The registration of any amendment to the charter of a bank with the Ministry of Taxes of the Republic of Azerbaijan is also required.

### 4. Name

Under Article 4 of the Law “*On Banks*” the name of a bank must contain the word “*bank*” or derivations of that word. We also note that under the existing legislation, the name of a subsidiary bank should contain a reference to the name of its parent bank.

# Prudential norms and disclosure

## Capital requirements

According to the Basel II capital methodology FIMSA requires the monthly reporting of capital ratios. Minimum capital ratios are 56.0% for Tier I capital and 10.0% for Total capital, which is a sum of the Tier I and Tier II capital. Tier II capital is allowed to equal, but may not exceed, 100% of Tier I capital.

Furthermore, for the leverage ratio, all banks must maintain the aforementioned indicator at a level not below 5.0%. The leverage ratio is calculated by dividing Tier I capital minus Tier I capital deductions by the sum of balance sheet assets and off-balance sheet liabilities.

The components of Tier I capital are as follows:

- Fully paid common stock (except treasury stock)
- Fully paid non-cumulative perpetual preferred stock
- Capital gains from placement of common or preferred stock

- Retained earnings from previous years
- Capital of minority shareholders in companies where a bank is a majority shareholder

The components of Tier II capital are as follows:

- Retained earnings from current year
- Total reserves (up to 1.25% of the risk weighted value of balance and off-balance sheet assets (after deductions), but in an amount not greater than the value of “normal” reserves)
- Hybrid elements of the capital, except for non-cumulative perpetual preferred stock

## Total capital requirements

The total capital of the banks may not be less than AZN 50 million. Banks established prior to 1 January 2015 must also comply with the new total capital requirement, while any new bank must have charter capital in the amount of AZN 50 million.



## Disclosure of information

### 1. Financial Disclosure and Transparency

Banks have a duty to disclose all material information, including their financial condition, operating results and information about ownership and management, to the *main users of information* in a timely manner. (The main users of information are defined as *existing and potential shareholders, market participants and other interested persons*.)

Banks in Azerbaijan are subject to several financial disclosure requirements set forth by FIMSA, the latter's regulations being applicable to banks since they are issuers of investment securities (stock). The FIMSA rules set forth minimum disclosure requirements for banks' annual reports, while the CBA's rules supplement those requirements, as well as establish a more frequent disclosure timeline for certain types of information.

In particular, a bank must provide the *main users of information* with the consolidated annual report of the bank that was prepared based on International Financial Reporting Standards and audited by the external auditor, along with its opinion, within no later than a five-month period after the end of the respective year. The annual financial reports of the bank must be published in the mass media or on the official website of the bank. Additionally, information related to the bank's activities and the risks that it faces must be disclosed at least once a year, unless this information has materially changed, in which case such changes must be disclosed no less frequently than once every six months. Information about the composition and adequacy of the bank's capital must be disclosed at least once per quarter (no later than within the first month of the next quarter).

Banks may opt to disclose their unaudited balance sheets, profit and loss statements and key financial ratios on a quarterly basis.

### 2. Disclosure to the Centralized Credit Registry

Pursuant to the law "On Banks" a Centralized Credit Registry (the CCR) has been established by the CBA. The CCR is charged with collecting the credit histories of borrowers and making them available to banks. Information on any loans to individuals and legal entities must be reported to the CCR. This information includes the amount of the loan, the purpose of the loan, the maturity date, any delays in the repayment of the loan or interest and the status of the loan.

### 3. Disclosure to the Financial Monitoring Service

Additionally, the law requires that information about certain transactions be disclosed to the Financial Monitoring Service under the aegis of FIMSA, including transactions with funds or other property associated with, as well as individuals or legal entities registered in, or having residency, a permanent business or a bank account in, banks registered in certain countries (territories). This requirement also applies to transactions with persons included on certain lists based on the relevant UN resolutions, as well as the legislation of the Republic of Azerbaijan and international agreements to which it is a signatory.

FIMSA periodically approves and publishes a list of high risk countries/jurisdictions likely participating in the legalization of illegal proceeds or other illegal property, financing terrorism, supporting transnational crimes, as well as armed separatism, extremism and mercenaries, the illegal circulation of narcotic drugs or psychotropic substances, as well as a list of designated persons.



## Corporate Governance

The Azerbaijani corporate governance regime applicable to banks consists primarily of several provisions in the Civil Code of the Republic of Azerbaijan (the Civil Code), the law “On Banks” and the Rules “On the Implementation of Corporate Governance Standards in Banks” (the CBA Corporate Governance Rules). The CBA also has promulgated a number of standards and instructions intended to guide banks in their preparation for and implementation of corporate governance standards.

The CBA Corporate Governance Rules are aimed at the implementation of high corporate governance standards and set forth the basis for the corporate/organizational structure of a local bank, its activities and corporate behavior.

The rules in question define corporate governance as a method of prudential governance that ensures the identification of the strategic responsibilities of the bank on the basis of its strategic outlook (vision), the precise allocation of responsibilities at all levels of the bank’s management, the suitability of the members of the bank’s management to the positions that they are holding, the implementation of detailed internal control systems for the purposes of effective risk management, as well as ensuring the effective use of internal and external audits for the purposes of achieving transparent governance.

Further, the CBA has identified those areas that are necessary to ensure the effective implementation of good corporate governance, as follows:

- Implementation of a strategic planning process
- Creating an effective organizational structure
- Determining the reporting system, implementing the budget planning process
- Ensuring that financial reporting is in compliance with the International Financial Reporting Standards
- Ensuring the availability of an effective system of internal controls and risk management systems
- Disclosing accurate, comprehensive and impartial information, reflecting the bank’s activities in a timely manner
- Ensuring the availability and development of reliable management information systems that provide a systematic flow of extensive and clear information about the current financial state of the bank and its operations
- Creating an internal auditing structure that constantly enhances the productivity of and improves and strengthens internal controls
- Determining internal auditing policies and strategies
- Ensuring full and timely disclosure of direct and indirect interests that may create conflicts of interest for the bank for the purposes of avoiding such conflicts
- Ensuring that administrators place the interests of the bank above their personal interests
- Taking measures to prevent any damage to the reputation of the bank or the deterioration of its financial position by virtue of persons related to the bank
- Ensuring the compliance of bank activities with the relevant legal acts



## Fiduciary duties

Each member of a bank's Management Board and Supervisory Board must discharge his/her duties: (i) in good faith and (ii) in a professional, reasonable manner and with due care and (iii) must remain loyal to the interests of the company and its shareholders/participants and place the interests of the company before his/her own interests.

Members of the Management Board or the Supervisory Board may not delegate their fiduciary duties to other administrators.

Additionally, each member of the Supervisory Board must:

- Be well informed about the financial affairs of the bank by regularly and independently analyzing the reports of the Management Board and other committees of the bank
  - Be up-to-date about the developments and trends in banking and other financial markets
  - Review all official correspondence between the internal and external auditors of the banks
  - Be logical, careful and conservative in his/her analysis and voting
  - Cast a vote only based on his/her personal judgment and beliefs for the purposes of defending the bank's interests
  - When casting their votes or adopting decisions, not uphold the interests of one shareholder/group of shareholders over the others, nor be influenced by them, as well as not adopt any decisions that are contrary to the bank's interests or undertake long-term risks for short-term gains
  - Defend the legitimate interests of the bank, not publicly criticize the other members of the Supervisory Board or members of the Management Board
  - Not let his/her business activities affect the bank
- Keep confidential any information related to the bank, persons related to the bank, bank customers and other people with whom the bank has business dealings that are obtained in his/her capacity as a member of the Supervisory Board, except where disclosure is mandated by the law
  - Discuss problems related to the internal controls, financial results and the implementation of the strategic plan of the bank with the relevant officers of the bank
  - Ensure the independence of the Audit Committee
  - Not interfere with the activities of the internal auditors, but rather provide a recommendation to the Audit Committee in relation to the main directions of the internal audit plan and make sure that the internal audit department is subordinated to the Audit Committee
  - Ensure that the necessary information and documents related to the bank and persons related to the bank are provided to the internal auditor to be reviewed and that the latter has an opportunity to meet relevant employees
  - Assess at least once a year the professional skills of each member of the Management Board and their contributions toward the profitability of the bank, that it is in a stable financial state, the timely achievement of the strategic goals, as well as the suitability of the Management Board members to their positions

The responsibilities of the members of the Supervisory Board go beyond the mere acceptance of reports on progress, opinions and/or recommendations from the members of the Management Board or other administrators of the bank. They should be ready to question and object to these for the benefit of the bank and the depositors, despite positions taken by the shareholders and other members of the Supervisory Board.

### Conflicts of interest

Each member of the Supervisory Board, the Audit Committee and the Management Board, as well as the members of their families, must disclose any significant commercial interests that they might have to the Supervisory Board and the Management Board upon becoming a member of a bank's management body and afterwards in accordance with the internal procedures of the bank.

In cases where a matter related to interests of the members of the Supervisory Board, the Audit Committee, the Management Board or a member of any other committee or working group of the bank, as well as to employees of the internal audit department, is up for discussion, such member or employee must disclose his/her interests before the discussions begin, he/she must also withdraw from such discussions and not participate in decision-making. The presence of such member or employee may not be counted towards establishing the applicable quorum.

### Potential liability of bank administrators

Further to latest amendments to the Law "On Banks", the liquidator now has the authority to investigate the circumstances that led to the bank's liquidation and to inform the relevant authorities of the results of its investigation, including the names of any potential suspects, as well as to apply to courts on behalf of the bank, presumably for the purposes of seeking compensation for damages suffered by the bank.

The language of the relevant provisions of the law is rather broad and could be interpreted to include bank administrators (members of the management and supervisory boards of the bank, heads of its branches, etc.) and possibly even shareholders of the bank.



### Disposition of an Insolvent Bank

A new section was introduced to the Law "On Banks", entitled "Disposition of an Insolvent Bank", which deals with various matters related to the appointment of a temporary administrator by FIMSA for an initial period of nine months, which could be extended for a further three months. This section sets forth in detail events that would warrant the appointment of a temporary administrator by FIMSA, the principles under which the temporary administrator would manage the insolvent bank and the powers of the administrator, as well as the possible outcomes for troubled banks. These include the following:

- Merger of an insolvent bank into a healthy bank
- Transfer of assets and liabilities of an insolvent bank (fully or partially) to an acquiring bank
- Establishment of a bridge bank, the transfer of healthy assets and liabilities of an insolvent bank (fully or partially) to the bridge bank, and the sale of the bridge bank to investors
- Sale of an insolvent bank to investors
- Liquidation of an insolvent bank



### Financial Rehabilitation

Another new legal development is the so-called process of resolution of a distressed bank, which deals with various matters related to the financial rehabilitation and the conduct for temporary administrators appointed by FIMSA.

FIMSA may appoint a temporary administrator to a distressed bank in the following cases:

- If the aggregate capital of the bank falls to 25% or less of the minimum aggregate capital established for banks, or its adequacy ratio falls to 3% or less
- If the bank cannot perform its payment obligations as they become due or does not have sufficient liquidity at the moment of performance of obligations
- If the bank's license is revoked on the grounds specified in the Banking Law

The temporary administrator is to manage the distressed bank for an initial period of nine months, which could be extended for a further three months, and should achieve the following:

- Merger of an insolvent bank into a healthy bank
- Transfer of assets and liabilities of an insolvent bank (fully or partially) to an acquiring bank
- Establishment of a bridge bank, the transfer of healthy assets and liabilities of an insolvent bank (fully or partially) to the bridge bank and the sale of the bridge bank to investors
- Sale of an insolvent bank to investors
- Liquidation of an insolvent bank

(Different financial rehabilitation rules apply to banks of systemic importance.)

The temporary administrator is also granted broad powers, including removal of the management of the bank and assumption of their powers, as well as approval of all transactions with or on behalf of the bank during the temporary administration.

During the period when a bank is under a temporary administration, a court may be requested by FIMSA to order a complete or partial moratorium on payments on deposits of legal entities and individuals, as well as payments under other obligations of the bank. The stated purpose of such measures is to allow for the valuation of assets and assessment of financial standing of the bank during the period of temporary administration, as well as to prevent a reduction in asset value.

### **Voluntary debt restructuring of bank obligations**

Another important novelty is a previously unavailable framework that would allow banks to force a voluntary debt restructuring of the bank's obligations vis-à-vis its creditors, except for claims of depositors that are eligible for deposit insurance.

According to the latest amendments, the process of voluntary debt restructuring begins with a resolution of the Supervisory Board of the bank if the bank is unable to comply, or there is a risk of the inability on the part of the bank to comply, with the demands of its creditors due to the absence or lack of funds or the impossibility to use funds for other reasons. FIMSA will then have up to 20 calendar days to review the resolution of the Supervisory Board and to enter into a written agreement with the bank.

The bank then would prepare a draft restructuring plan to be submitted to FIMSA for its approval, after which the bank would file an application with a court asking for approval of the commencement of the voluntary restructuring of the bank's obligations. The bank would be required to publish notices in the local and international press about the court decision, as well as inform its creditors of the obligations which are subject to restructuring.

From the effective date of the court decision on the voluntary restructuring of the bank's obligations, the bank would be entitled to:

- Suspend the performance of sale and purchase agreements, exchange and gift agreements, or any other agreements providing for the disposal of any assets of the bank, and to suspend the conclusion of agreements creating any risks for the bank, including, loan, credit and guarantee agreements or agreements providing any kind of financing
- Suspend, in full or in part, the performance of the obligations that are subject to restructuring

The above-mentioned restrictions would apply for 180 calendar days, a term that could be extended for up to 90 calendar days upon application of the bank, as acknowledged by FIMSA.

The bank would be able to introduce changes to the draft restructuring plan in the course of the voluntary debt restructuring of the bank's obligations, in which case such amendments must be submitted to the Regulator for approval 30 calendar days prior to the creditors' meeting. Once approved by the Regulator, the final draft of the restructuring plan would be presented for the creditors' approval during a creditors' meeting. The restructuring plan would be approved by creditors holding at least two-thirds of the total bank obligations which are subject to restructuring, and will be binding for all creditors, claims of which have been included into the restructuring plan. Once approved by the creditors, the restructuring plan would be presented to the court for final approval. Members of the Supervisory Board, the Audit Committee and the Management Board must disclose any transaction with shares of the bank to which they are a party in the mass media.

### **How Dentons can help**

In the banking and finance sector, Dentons combines its long experience and in-depth knowledge of domestic legislation with international banking and financial sector experience in London, Frankfurt, Paris, New York and Hong Kong, among other jurisdictions. This enables the Firm to devise appropriate solutions for clients, selecting from local law financial structures and the most suitable offshore law mechanisms, in addition to issuing legal opinions under English, New York, German and French law, as well as under Azerbaijani law.

Dentons is an acknowledged leader in Azerbaijan in the provision of banking and finance advice. We have acted as general counsel for the major foreign banks operating in Azerbaijan, as well as micro-finance banks and other financial institutions. Our office is experienced in trade finance, project finance and lease finance, as well as Islamic finance and capital markets work, including the first successful Eurobond listing by an Azerbaijani financial institution.

In addition to our vast knowledge and experience in the field of conventional banking, we are also well situated to advise clients on matters related to Islamic banking and finance, including a review and comment on contractual documents and advice on specific products.



# Chapter 5

# Investment funds

## **Introduction**

Except for activities conducted by the State Oil Fund of Azerbaijan (SOFAZ), investment fund activity has been almost non-existent in Azerbaijan, even though the previous Law “On Investment Funds,” dated 30 November 1999, had been in force for many years.

## **Investment funds law**

The cornerstone of the legislation on regulating the activities of investment funds is the current law “On Investment Funds,” dated 22 October 2010 (the Investment Funds Law). This law repealed the previous 1999 law.

The Investment Funds Law is fairly detailed and sets forth provisions regulating a wide array of subjects, such as the establishment, licensing and management of investment funds; the issuance, placement and redemption of shares in investment funds; the composition and value of the assets of investment funds; the requirements for fund managers; the procedure that applies to the acquisition of a major shareholding; marketing activities for investment funds; the reorganization, liquidation and bankruptcy of investment funds; and state supervision over the activities of investment funds.

The Investment Funds Law does not apply to legal entities created by the State for the purposes of the fulfillment of state investment policy or to entities created by such legal entities. It appears from this section of the law that SOFAZ, which was arguably created for the purposes of the fulfillment of State investment policy, is expressly exempted from the scope of this law, contributing to an increasingly confusing status of SOFAZ, its assets and its activities.

The law also provides for the promulgation of a number of rules and regulations primarily by FIMSA, some of which have been adopted already by the previous regulator, the former State Securities Committee.

### Investment funds defined

An investment fund is defined as a financial institution established in the form of (i) a joint stock investment fund or (ii) a mutual investment fund, created for the purpose of generating profit by making investments using the capital it has raised in accordance with an investment declaration.

**(i) Joint Stock Investment Fund.** A Joint Stock Investment Fund (JSIF) is an open joint stock company having a license to engage in the activities of a JSIF, and the **sole** activity of which consists of investing funds raised by the placement of its common stock in securities and other property, including real estate, for the purposes of gaining profit and in accordance with an investment declaration.

A JSIF may not engage in any other business activity or establish any subsidiaries, nor may it issue any securities other than common bearer stock. A JSIF must obtain the relevant license for such activity from the FIMSA and must register with the Registry of the Investment Funds and the Investment Fund Managers maintained by the FIMSA (the Registry).

**(a) JSIF Management:** The Investment Funds Law sets forth a number of deviations from the general provisions related to the management of joint stock companies contained in the Civil Code. For instance, a JSIF must have a supervisory board consisting of at least three directors, regardless of the number of its shareholders. Also, the law requires that at least one of the JSIF directors be an independent director.

There is also an additional notification requirement regarding the convocation of a forthcoming general meeting of shareholders of the JSIF.

Other matters related to JSIF management are governed by the relevant provisions contained in the Civil Code, to the extent not amended by, or in contradiction to, the Investment Funds Law.

**(b) Issuance of Shares.** In addition to adhering to the general list prescribed by the joint stock company provisions of the Civil Code, any issuance of shares by a JSIF must be accompanied by two additional categories of documents (i) copies of the agreements with the manager and the depository of the fund, and (ii) both full and summary versions of the investment declaration. The JSIF may issue shares of common stock only after it has obtained the relevant license from FIMSA. The shareholders' registry of the JSIF is maintained by a central depository, while transactions in relation to them are concluded via investment companies.

**(ii) Mutual Investment Fund.** A Mutual Investment Fund (MIF) is a professionally managed pool of funds which is owned by the participants in the MIF under a right of common property. MIFs do not have the status of legal entity; thus, they avoid the Azerbaijani corporate profit tax. MIFs are created by a decision of the investment fund manager. An MIF is considered formed when it has raised the minimum capital required by FIMSA or set forth in the management rules, whichever is higher.



MIFs must be registered with the Registry, which takes place upon the registration of the Management Rules of the MIF with FIMSA.

There can be three forms of MIFs: (a) open-ended, (b) interval and (c) closed-ended:

- (a) Open-ended Mutual Investment Fund.** An *Open-ended Mutual Investment Fund* (OMIF) is a mutual investment fund which sells and redeems its shares at least once per week, and the assets of which consist of money and securities.
- (b) Interval Mutual Investment Fund.** An *Interval Mutual Investment Fund* (IMIF) is a mutual investment fund which sells and redeems its shares at least once per year and the assets of which consist of money and securities.
- (c) Closed-ended Mutual Investment Fund.** A *Closed-ended Mutual Investment Fund* (CMIF) is a mutual investment fund which sells and redeems its shares upon the expiration of the term for which such CMIF was created. The assets of a CMIF may consist of money, securities and real estate.

*Shares in an MIF* are denominated in Azerbaijani Manats (AZN), must be paid for in cash and have no nominal value. The calculation of their value must be in accordance with the relevant rules. Shares in MIFs may not serve as an asset base for the issuance of derivatives, and they may be offered to potential participants only after the Management Rules of the MIF have been duly registered and published in accordance with the law.

An investment fund manager may issue an unlimited number of shares in OMIFs and IMIFs, while the number of shares in a CMIF is limited to the figure set forth in its Management Rules. The sale and redemption of the placed IMIF and CMIF shares must be concluded through the stock exchange, while shares in OMIFs are placed by the investment fund manager for not less than their value as of the date of the sale.

All participants in an MIF enjoy equal rights, and no single participant may own more than 50% of the shares in an MIF. MIF participants are not liable for the obligations of the MIF, and losses incurred as a result of a change in the market value of the MIF's assets are limited by their respective contributions to the MIF. Likewise, MIFs are not liable for the obligations of their participants, the creditors of which may direct their claims only against the shares actually owned by such participants in the MIF.

### Investment fund manager

Only a legal entity organized under the laws of Azerbaijan with asset management provided as the sole category of activity stated in its charter, holding the relevant license and having a minimum charter capital may be an Investment Fund Manager. An investment fund may have only one investment fund manager at a time, unless some assets of such an investment fund are located outside of Azerbaijan. A foreign investment fund manager may be appointed only with the consent of FIMSA.

Investment fund managers manage investment funds (JSIFs and MIFs) for the benefit of the shareholders/ participants of such funds, based on a management contract and in accordance with the Management Rules. There are also a number of requirements set forth in the law, which the officials of investment fund managers must satisfy (e.g., the absence of a conviction involving a crime against property, economic crimes or especially grave crimes).

### Licensing

The review of an application for the issue of the applicable license to JSIFs or MIFs is conducted in two stages – initial and final. Upon completion of an initial review, FIMSA issues a document, which, together with other documents, must be submitted to the Ministry of Taxes for the state registration of a JSIF or an MIF. The licenses are not limited by time.

Foreign investment funds' or fund managers' representative offices may conduct their *activities* upon receipt of the written consent of FIMSA. The law defines a representative office as a subdivision of an investment fund or fund manager located somewhere other than at the location of the investment fund or fund manager, the activities of which are limited to representing the interests of the investment fund or fund manager and protecting such interests.

### JSIF acquisitions

Along with the general requirements contained in various other acts of legislation (e.g., antimonopoly consent), the prior written consent of FIMSA must be obtained for the acquisition (whether directly or indirectly) of a major shareholding in a JSIF (i.e., 10%). Further, such consent would also be required each time a purchase will cause the purchaser's shareholding to equal or exceed the thresholds of 20%, 33% or 50%, subject to the condition that that no person may own more than 50% of the charter capital of a JSIF.

Unlike the acquisition of a major shareholding in a bank or an insurance company, where the relevant regulator is deemed to have consented to such acquisition if it fails to object within a certain period of time, no such provision is provided regarding the FIMSA consent, which may potentially cause significant delays in closing acquisitions of JSIFs.

Additionally, there are restrictions related to legal entities and/or their founders, the major shareholders or beneficiaries of which are incorporated in certain offshore jurisdictions (the list is to be determined by FIMSA).



### **Reporting, disclosure and marketing**

Investment funds must prepare financial reports in accordance with international financial reporting standards (IFRS), and an independent auditor must approve such reports. Such independent auditor must comply with the standards set forth by the regulator of the auditor's profession, as well as those of the FIMSA.

JSIFs and MIFs must disclose certain information to investors in the offices where such JSIF or MIF accepts orders for the sale and redemption of their shares. The minimum scope of such information is set forth in the law. The law also requires that the Management Rules be posted on the official website of the investment fund manager.

The law requires that the advertising of the investment fund manager and of JSIF's must not be inaccurate, misleading, or in contradiction to the investment declaration. Importantly, the law introduces the concept of "material information," which is necessary for making a decision by an investor and requires the disclosure of such material information together with the risks associated with the investment.

All advertising and sales materials must be submitted to FIMSA, which, upon discovery of any illegal content, shall order that the dissemination of such materials cease.

Additionally, the law goes so far as to require that the investment fund manager or professional participants in the securities market provide investors with a separate risk statement and have them countersign the statement. If the investment fund manager or the underwriter fail to do so, they may be liable to the investors for any losses from such investment.

### **Bankruptcy**

Unlike the law "On Banks," which sets out its own bankruptcy rules, the Investment Funds Law refers to the provisions of the law "On Insolvency and Bankruptcy" for issues pertaining to the bankruptcy of a JSIF to the extent not covered by, or in contradiction to, those of the law.

### **How Dentons can help**

Dentons is well equipped to advise on any transactions related to the establishment and marketing of investment funds, as well as investments and other operations involving such funds.





# Chapter 6

# Secured transactions

## Overview

Generally, a secured transaction is a loan or a credit transaction in which the lender acquires a security interest in collateral owned by the obligor or a third-party security provider, entitling it to foreclose on the collateral in the event of the obligor's default. The terms of the relationship are governed by a security agreement.

Secured transactions in post-independent Azerbaijan have become an important part of the law and the economy of the country, as the State housing fund was privatized and the overall volume of lending has dramatically increased. Allowing lenders to create a security interest in collateral owned by an obligor or a third-party security provider, coupled with a centralized registry of rights over immovable property

and relatively effective enforcement mechanisms, have provided lenders with greater remedies in case of a default by the obligor.

Secured transactions law entered a new era in mid-2017, when the new law "On Secured Transactions with Movable Property" was adopted by the Parliament. The new law follows the so-called Functional Approach developed by UNICITRAL, i.e., it relies on a concept of "security interest" that includes all types of rights in movable property (except for movable property that is registered in an official registry and securities that are subject to state registration) created by agreement to secure the payment or other performance of an obligation, regardless of the form of the transaction or the terminology used by the parties, as well as on a public registry that provides notice of a security right to

third parties. As such, the new law applies to usufructs, secured transactions, retention-of-title sales, landlord's, tenant's, warehouse owner's liens, the leasing of certain movable property, the right of retention, factoring, etc.

### **Security agreements**

Azerbaijani law regards security agreements as legal devices by which a pledgor (borrower) pledges to a pledgee (lender) assets and/or rights that it owns in order to secure the performance of an obligation. In Azerbaijan, a security agreement is a written document which is an accessory to a loan agreement (or any other agreement, the obligations under which are secured by such security agreement.) Agreements creating a security interest over certain assets and/or rights are required to be notarized and/or publicly registered. As a rule, the pledgor retains the legal title to, and is entitled to occupy and/or use, the assets and/or rights, unless and until the pledgor fails to perform the secured obligations.

Prior to the adoption of the law "On Secured Transactions with Movable Property", any security interest in Azerbaijan could be enforced by means of a public auction, except in the event that the collateral was money or a monetary value. This requirement was arguably premised on the perception that a public auction was a transparent procedure that provided greater assurance of obtaining the best market price for the collateral, by requiring that the highest bidder win the auction. However, the fact that, in practice, auction prices in Azerbaijan rarely exceed the established starting price supports the view that participation in public auctions is dominated by interested parties and property speculators, who are unlikely to bid higher than the total amount of secured obligations, plus related expenses.

As detailed later in this Chapter, the law "On Secured Transactions with Movable Property" adopts a different approach to enforcement, though it only applies to existing or future movable property and related rights and claims, except for movable property that is registered in an official registry (e.g., vehicles, tractors, etc.) and securities that are subject to state registration.

### **The law of secured transactions**

The legislation on secured transactions in Azerbaijan consists mainly of one chapter in the Civil Code (2000), the law "On Mortgages" (2005), the law "On Secured Transactions with Movable Property" (2017) and numerous rules on the perfection of various types of security interest.

In Azerbaijan, in principle, laws and codes are of equal legal force. Previously, in the event of conflicts between two laws of equal status, the law adopted later in time prevailed. However, the current Constitutional Law "On Normative Legal Acts," dated 21 December 2010, has changed the analysis. The current law applies a different test to determine which provision prevails in the event of contradictory enactments and is much more complex than the respective provisions of the old law. It states that in the event of conflicts between the provisions of the Civil Code and the provisions of other codes and laws which contain civil law provisions, the provisions of the Civil Code prevail. Therefore, in the event of a conflict between the two, the Civil Code will prevail with respect to relations arising on or after 17 January 2011, the effective date of the current Law "On Normative Legal Acts."

A similar situation can be described for the interaction of various provisions of the Civil Code and the law "On Secured Transactions with Movable Property" related to the creation and enforcement of security interests. The local business community expected that amendments would be introduced to the Civil Code to provide more clarity in implementation, but it would appear that the law "On Secured Transactions with Movable Property" will be fully effective before such amendments are made.

The foregoing, coupled with the pace with which new laws, regulations and legal structures were introduced, creates a rather inconsistent and complex body of the law of secured transactions in Azerbaijan.

## Types of security interest

There are five major types of proprietary security interests in Azerbaijan: (i) the pledge of assets (including movable property and goods in a pawnshop); (ii) the pledge of rights; (iii) the pledge of cash; (iv) the pledge over assets in circulation (a floating charge); and (v) the mortgage (hypothec).

### (i) Pledge of assets

A pledge of assets is one of the most widely provided security interests in Azerbaijan. This may be explained by the fact that the creation of this type of security requires fewer formalities. Depending on the agreement between the parties, a pledge of assets may or may not be possessory. In Azerbaijan, only non-registrable assets can be subject to a pledge of assets (for registrable assets please see below the section related to mortgages (hypothec)). This pledge is perfected by entering into a written security agreement signed by both parties and the delivery of the pledged asset into the possession of the pledgee, if so provided by the security agreement.

### Pledge of goods in a pawnshop

A pledge of goods in a pawnshop is a form of possessory security, and accordingly, the pledged goods (usually personal property) must be physically delivered to the custody of the beneficiary of the pledge (the pledgee). In Azerbaijan, such a pledgee must be a licensed organization professionally engaged in this type of business. This pledge is perfected by the pledgor providing the pledgee with the pledge receipt (ticket).

The pledgee has no power of sale in the event of a default on the secured obligations. Instead, the pledgee must enforce the security interest through an open auction of the pledged good. The difference in this type of security is that the security interest is terminated upon such sale of the pledged good, even if the proceeds of the sale are insufficient to satisfy the secured obligations. To mitigate this risk, pawnshops usually require a greater loan-to-collateral ratio.



### **(ii) Pledge of rights**

A pledge of rights is generally a form of non-possessory security. In other words, the pledgor retains the title to, and may exercise, the rights so pledged. An exception is when the pledged rights are evidenced by a documented security, in which case such security must be delivered into the pledgor's possession or deposited with a bank or a notary public, unless the parties agree otherwise.

In Azerbaijan, only alienable rights may be pledged, i.e., rights that are attached to the person of the pledgor may not be pledged (e.g., bodily injury claims, alimony). The pledge of rights is perfected by notifying the obligor under the pledged rights. Registration of the pledge of rights is also required in cases where the pledged rights are themselves registrable.

### **(iii) Pledge of cash**

Under a pledge of cash agreement, a pledgor must deposit cash into a deposit account with a bank or a notary. Although the pledgor retains the title to the cash, the pledgor is not entitled to use it. Unless agreed otherwise, any interest accrued on such cash deposited with a bank is owned by the pledgor. Such pledge is perfected by entering into a written pledge of cash agreement, to which the bank where the cash is deposited must be a party.

### **(iv) Pledge of assets in circulation (floating charge)**

A pledge over assets in circulation (a floating charge) is a non-possessory security interest over a certain category of the pledgor's assets without attaching to any asset in particular, and, thus, allowing the charge to float until an event of default occurs. This provides the pledgor the freedom to deal with or dispose of the assets, and any subsequent holder of such assets takes them free of any security interest. Only non-registrable movable property may be the subject of a floating charge (e.g., goods, raw materials, etc.)

The floating charge is perfected by entering into a written pledge agreement.

### **Provisions applicable to subsections (i)–(iv) above**

As mentioned above, the law "On Secured Transactions with Movable Property" applies to the pledge of assets, the pledge of rights, the pledge of cash and the pledge over assets in circulation (floating charge), as well as a security interest created further to certain provisions of the Civil Code listed in the new law, in relation to any existing or future movable property, and related rights and claims, except for movable property that is registered in an official registry (e.g., vehicles, tractors, etc.) and securities that are subject to state registration.

A security interest created in relation to movable property under the law will apply to fixtures, proceeds (whether in cash or in kind), any compensation received by the security provider from the forced sale, requisition or nationalization of the collateral, as well as to any insurance proceeds in relation to the collateral.

### **Types of security interest**

There are two types of security interest provided for in the new law – the state and municipality security interest (hereinafter, State Security Interest) and the Private Security Interest.

A State Security Interest is created by operation of various provisions of the law and must be publicized in accordance with the law.

A Private Security Interest is created by entering into a contract or by operation of certain provisions of the Civil Code listed in the new law. Publicity in relation to a private security interest is optional, though publicity will affect the priority ranking of a particular private security interest.

## Publicity

The new law provides for three ways of publicizing the security interest:

- Registering the security interest with the registry
- Acquiring actual possession over the collateral
- Exercising control over the collateral

A security interest holder may apply one or more publicity methods listed above or may change the publicity method any time during the validity period of the security interest. The priority ranking will not change, so long as the security interest has not lapsed.

## Priority

The priority rules in relation to collateral are as follows:

- Claims of a security interest holder that has disclosed its interest using one of the methods described above
- Claims of a security interest holder that has not disclosed its interest using one of the methods described above
- All other claims

Notwithstanding anything stated in the law, claims of security interest holders in relation to cash in a bank account will be discharged in the order prescribed in the Civil Code.

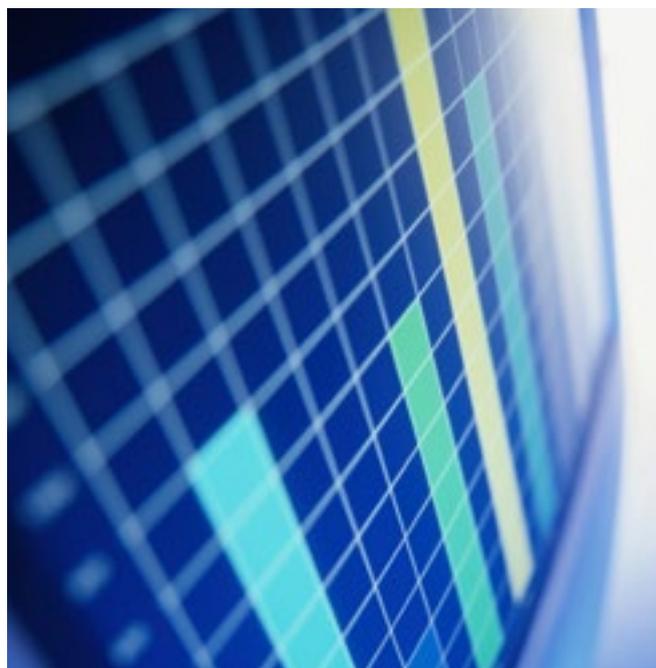
Where there are several security interest holders that have disclosed their interests in relation to the same collateral, the general rule in priority ranking is “first in time, first in right.” There are several exceptions to this rule listed in the new law, including purchase money (acquisition finance), proceeds, purchase in the ordinary course of business, rules for the right of retention, fixtures, accessions and commingled goods.

## Enforcement

Depending on the type of collateral or the methods of publicizing, there are several ways set forth in the new law to enforce a security interest. For instance, among other methods, where collateral is:

- Cash (receivables), the security interest holder may demand the payment of cash (receivables) to it
- In the possession of the security provider, the security interest holder may foreclose on the collateral (subject to an agreement with the security provider) or may apply to the court or a notary to demand foreclosure
- In possession of a security interest holder, the latter may foreclose upon and sell the collateral

The security interest holder must satisfy the claims of all security interest holders having a higher priority ranking.



## Registry

The new registry has been created by for the purposes of implementation of the new law to be operated by FIMSA, which can be accessed at <https://mpcr.fimsa.az>.

## (v) Mortgage (Hypothec)

In Azerbaijan, a security interest over immovable property, as well as over registrable movable property, is called a mortgage (or hypothec); a mortgage is created by entering into a notarized and publicly registered agreement or by issuing a security (a mortgage certificate). A person mortgaging an asset in favor of the beneficiary of the mortgage retains the legal title to, and is entitled to occupy and use, the mortgaged asset.

There are three possible ways to enforce a mortgage – enforcement through a court proceeding (judicial enforcement), by a notary writ (extrajudicial enforcement) or through an open market sale.

The purchaser of the collateral takes it free of the mortgage, and in the event there is any unsatisfied secured obligation, the mortgagor must compensate the difference.

## Judicial enforcement

Judicial enforcement is available for a mortgagee, irrespective of the specific method of enforcement that the parties have agreed in the mortgage agreement. It is also the only manner by which to enforce a mortgage in cases where the residence of a mortgagor is unknown.

Judicial enforcement entails numerous statutory steps and formalities, each of which has its own content, filing and timing requirements. Its main disadvantages are: (i) it is a lengthy and costly process (taking up to two years); (ii) it involves a sale by public auction under the supervision of bailiffs; and (iii) it requires a statutory distribution of the proceeds. Despite the foregoing, judicial enforcement is the only approach which ensures completion of the enforcement without interruption.

## Extrajudicial enforcement

If the mortgage agreement contains an extrajudicial enforcement clause, or if the mortgage was formalized by the issuance of a mortgage certificate, the mortgagee may also proceed with an extrajudicial enforcement of the mortgage.

Extrajudicial enforcement also requires compliance with the prescribed statutory steps, including a possible appeal of the extrajudicial enforcement by the mortgagor in court. Therefore, the most important advantage of this method, i.e., avoidance of the involvement of local courts, can easily be eliminated by such appeal. In Azerbaijan, extrajudicial enforcement requires a sale by public auction and the statutory distribution of the proceeds.

## Open Market Sale

Azerbaijani law provides for party autonomy with regard to the method of sale, e.g., in a manner other than a sale by public auction. However, in this case, the mortgagee is allowed to participate in the sale and acquire the collateral only after the initial sale is unsuccessful.

An obvious advantage of an open market sale over a forced sale is its expediency, which allows both parties to save time and money on legal costs, auction fees and accrued interest. Additionally, a sale through a property broker and with the cooperation of the mortgagor may potentially yield a higher price for the property, thereby serving the best interests of both parties. Given that this option is largely premised on cooperation from the mortgagor, it is reasonable to expect that the mortgagor will vacate the premises of the foreclosed property voluntarily, eliminating the need for a forced eviction. Finally, an open market sale avoids the involvement of local courts and bailiffs, and, thus, avoids the costs associated with court proceedings and enforcement.

## How Dentons can help

Dentons is very experienced in all aspects of secured lending and the enforcement of pledges and mortgages in Azerbaijan, including the drafting and negotiation of security documentation, the registration of mortgages, the enforcement of security interests and court proceedings in respect of secured transactions.





# Chapter 7



# Taxation and social security

## (Outside the oil and gas sector)

### Introduction – Taxes in Azerbaijan

The Tax Code (2000) prohibits the imposition of taxes that are not specified by the Code. The following taxes are specified:

- Personal income tax
- Corporate (profits) tax
- Value Added Tax (VAT)
- Excise tax
- Assets tax
- Land tax
- Road tax
- Mineral resources tax
- Simplified tax

Social security contributions and unemployment insurance are not defined as a “tax” but, for convenience, are also dealt with briefly below.

### Income tax and social security

Both resident and non-resident physical persons may be payers of income tax. A person is “resident” in any calendar year (which is also the tax year) if he or she is in Azerbaijan for an aggregate of more than 182 days during that year. Residents are subject to income tax on worldwide income, whether or not received in Azerbaijan (there are certain exceptions for

foreign workers in the oil industry). Foreign employees working for non-governmental organizations engaged in implementing US assistance programs are generally exempt from Azerbaijani income tax (and social security contributions). The taxable income of a non-resident is limited to income from sources in Azerbaijan.

Certain types of income are not subject to income tax, e.g., reimbursement of business trip expenses, housing and food benefits. Income tax is assessed on a progressive basis with two tax bands, 14% and 25% (the top rate applying to monthly income over AZN 2,500). In addition, the employee is also subject to a 3% social security contribution (the employer pays 22%) and 0.5% unemployment insurance (the employer also pays 0.5%). Most foreign employees working in Azerbaijan in the non-oil sector will be subject to social security payments, but they should check to see whether a social security treaty exists with their home countries, as such treaties might provide an exemption.

Income taxes are withheld by employers and must be paid by the 20<sup>th</sup> of the month following the month of payment.

### **Corporate profits tax**

A resident enterprise pays corporate profits tax on worldwide income. A non-resident enterprise carrying on business in Azerbaijan through a permanent establishment is liable for tax on profit gained from such activity. In addition to profits tax, the permanent establishment will pay a 10% branch withholding tax on all remittances of net profit made abroad. The rate of profits tax is 20%.

### **Deductible expenses**

All expenses connected with the earning of income are deductible for tax purposes unless otherwise specifically stated. Non-deductible expenses include business trip expenses exceeding the norms established by the Cabinet of Ministers, costs (including transport costs) incurred in obtaining and installing fixed assets and other costs of a capital nature, benefits provided to employees that are not taxable as income of the employee, etc.

### **Loss relief**

Losses may be carried forward for five years.



## Depreciation and amortization

Certain categories of assets are not depreciable for tax purposes. These include land; fine art; buildings or structures of historical or architectural value; stud animals; libraries, film stock and fixed assets kept in a warehouse that have not been put into operation.

Short-life assets (i.e., assets with a life of less than one year) are written off and not depreciated.

Depreciable fixed assets (i.e., assets with a useful life of more than one year) are divided into seven classes or pools, including:

- Buildings and structures – up to 7% p.a. on a reducing balance basis
- Machinery and equipment – up to 20% p.a. on a reducing balance basis
- Computing devices which is a product of high technologies – up to 25% p.a. on a reducing balance basis
- [Motor] vehicles – up to 25% p.a. on a reducing balance basis
- Geological exploration costs and development costs preparatory to the extraction of natural

resources (including the cost of acquiring the right to explore, develop or exploit natural resources) – up to 25% p.a. on a reducing balance basis

- Intangible assets with a life of more than one year – depreciated over the useful life of the asset or, where the useful life cannot be determined, at up to 10% p.a. on a reducing balance basis

Depreciation is calculated in respect of each class of assets, although each building/structure is regarded as a separate class. However, if the asset is sold at a profit over its residual value, the difference is added to taxable income and if sold at less than residual value, the difference is deducted from income (i.e., the difference does not reduce or increase the pooled category). Where the residual value of a fixed asset at the end of the year is less than 500 AZN or less than 5% of the initial value, the residual value is deducted from income.

The taxpayer may choose not to take all the depreciation to which he or she is entitled. The taxpayer may apply a lower rate of depreciation and carry forward to the next or later years the amount of forgone depreciation.

## Taxes on capital gains

No special regime exists for the taxation of capital gains, the gains of enterprises being taxed at the ordinary profits tax rate. No gain or loss arises if:

- a. Assets are transferred between spouses
- b. Assets are transferred between former spouses as part of a divorce settlement
- c. Assets are unintentionally or involuntarily destroyed, liquidated or sold and the proceeds are reinvested in an asset of the same or similar nature before the end of the second year following the year in which the liquidation or sale took place



## Withholding taxes

Dividends paid by an Azerbaijan resident enterprise are subject to a 10% withholding tax at the source. This is a final tax (i.e., individuals and Azerbaijan legal entities are not subject to further tax on dividend income).

Interest paid by an Azerbaijan resident or the permanent establishment of a non-resident is subject to a withholding tax at the source of 10%. Withholding tax is not applied to interest paid to Azerbaijan banks or financial leasing organizations or to the Azerbaijan permanent establishments of non-resident banks or financial leasing organizations. The withholding tax is a final tax for individuals. In the case of companies, the tax withheld is creditable against the final profits tax liability.

A three-year tax holiday (starting from 1 February 2016) applies to annual interest income of physical persons from deposits in Azerbaijani banks and Azerbaijani branches of foreign banks operating in Azerbaijan. The same tax relief applies to dividends payable by issuers in respect of investment securities, discounts (differences resulting from the placement of bonds at prices lower than the nominal amount) and interest income.

In general, income from the lease of movable or immovable property paid by an Azerbaijan-resident company to an individual is subject to a final withholding tax of 14%. No tax is withheld from payments to Azerbaijani companies.

Royalties paid to an individual by an Azerbaijan-resident company or the permanent establishment in Azerbaijan of a non-resident is subject to a withholding tax at source of 14%. A "royalty" is basically defined as a payment received for the right to use (or assignment of) literary, artistic or scientific works, software, cinematographic films and other non-material assets, patents, trademarks, designs or models, plans, know-how and processes, information concerning industrial, commercial or scientific experience; or the right to use (or assignment of) industrial, commercial or scientific equipment.

See the Appendix for the withholding tax rates on payments to residents and non-residents.



## Profits tax returns

The following businesses must file tax returns by 31 March following the end of the calendar (i.e., fiscal) year:

- Resident enterprises
- Non-residents with Azerbaijan source income who have not been taxed at the source
- Non-resident enterprises with permanent establishments in Azerbaijan and tax agents appointed by such non-resident entities
- Private notaries, individuals who have received income not taxed at the source of payment, or resident individuals receiving income outside the borders of the Republic of Azerbaijan, including income from royalties

The cessation of business or closure of a permanent establishment of a non-resident, or the liquidation of an Azerbaijan enterprise, requires the liquidation commission to file a final tax return within 30 days of the date determined for closure, covering the period from the beginning of the year up to the date of closure/cessation.

The taxpayer may apply for a three-month extension of the date for filing a profits tax return, if the application is made before the due date and all taxes due have been paid. If these conditions are fulfilled, the extension is automatically given though, for the purposes of calculating late payment interest etc., the extension will have no effect.

## Tax accounting

The taxpayer is at liberty to choose the accounting method appropriate to the form of business, making adjustments to taxable profit in accordance with the provisions of the Tax Code. Accounting may be on a cash or accruals basis, provided that the same basis is used throughout the fiscal year. Any change of accounting method must be accompanied by appropriate adjustments to accounting entries to ensure no income falls out of tax or is taxed twice. Where the cash basis has been chosen, rent and interest expenses are, nevertheless, accounted for on an accruals basis.

Where accounting records, etc., are either not available or not sufficient to permit the tax authorities to establish income, the tax authorities may resort to information relating to analogous taxpayers.

In some cases (e.g., certain related-party transactions,) market value may be substituted by the tax authorities for the actual price.

## Payment of corporate profits tax

Companies must pay in advance, within 15 days of the end of each calendar quarter, 25% of the tax paid in the previous year. As an alternative, the taxpayer may opt to apply to the current quarter's gross income the ratio of tax to gross income in the previous year.

Advance profits tax payments for taxpayers without activity in the previous year are calculated on a cumulative quarterly basis in accordance with the tax rate for the year. Advance tax payments must not be less than 75% of the profits tax due. The tax authorities must be advised of the payment within 15 days of the end of the relevant quarter.

Taxpayers must pay over any balance of taxes before the due date for filing the tax return (for legal entities and permanent establishments, 31 March of the year following the relevant fiscal year). Upon request, profits tax returns may be deferred by up to three months if taxes due have been paid.

Profits tax (and other taxes) which has been overpaid may be netted off against other taxes due. Although in theory taxes overpaid may be refunded, this is highly unlikely in practice.

## Value Added Tax

VAT is generally charged on businesses operating in Azerbaijan. The Tax Code refers to three specific categories of transaction (or supply): exempt (e.g., financial services), taxable but zero-rated (e.g., exports), and taxable at the full rate. For ease, a reference in this chapter to "input" VAT is a reference to VAT on "purchases" while a reference to "output" VAT is a reference to VAT on "sales."

Imported goods are taxable supplies unless specifically exempted. The contribution of assets (except for imported assets) to the share capital of an enterprise is an exempt supply.

Imported services are generally subject to a VAT reverse charge. The buyer of the service is treated as a tax agent and will calculate and pay VAT on the payment to the non-resident service provider. The payment order confirming the transfer of the VAT due to the tax authorities is treated as a VAT invoice, giving the tax agent the right to a VAT credit.

The obligatory VAT registration threshold is turnover exceeding AZN 200,000 in any 12-month period. Output VAT is accounted for using the accrual method, but input VAT is accounted on a cash basis.

Input VAT is generally creditable against output VAT. Input VAT is only creditable where payment is made other than in cash and tax is paid using a VAT 'deposit' account. In addition to some VAT exemptions (e.g., the provision of financial services) the supply of certain services and goods may be VAT zero-rated, e.g., the export of goods and services. No input VAT is available for VAT incurred in connection with expenses which are not tax deductible for corporate profits tax purposes.

A taxpayer carrying out both transactions subject to VAT and exempt transactions will be entitled to take a credit for input VAT on an apportioned basis having regard to turnover subject to VAT as a proportion of total turnover.

VAT returns must be filed on a monthly basis by the 20<sup>th</sup> of the following month.

### **Simplified tax**

Small businesses and sole traders not liable for VAT registration and certain other categories of taxpayers (e.g., persons involved in construction activities or persons involved in trading and/or catering activity with a turnover during consecutive 12 months exceeding AZN 200,000) **may** become payers of simplified tax. Payers of simplified tax do not pay VAT or profits tax (or, in the case of sole traders, income tax on income from entrepreneurial activity).

Certain businesses, e.g., persons involved in the transportation of cargo and passengers (except for international transportation), operators and sellers of sports betting games, and owners of residential or non-residential areas selling their properties (with certain exceptions) are payers of simplified tax irrespective of their turnover.

### **Oil and gas industry**

Various exploration, development and production sharing agreements and pipeline agreements provide a special tax regime for companies operating in the oil and gas sector. These are covered in a separate chapter.

#### **Useful websites:**

- Ministry of Taxes – [www.taxes.gov.az](http://www.taxes.gov.az) (English version available)
- State Social Protection Fund – [www.sspf.gov.az](http://www.sspf.gov.az) (English version available)

### **How Dentons can help**

Dentons is an acknowledged leader in Azerbaijan in the provision of tax services. Dentons has assisted companies in all aspects relating to tax matters, including:

- Defending taxpayers in the courts – Dentons has successfully defended taxpayers against claims made by the tax authorities
- Operating payrolls, filing tax and social security reports
- Planning tax strategies
- Conducting comprehensive tax reviews to ensure taxes are being properly accounted for
- Preparing calendars of tax payments due
- Assisting with tax-only registration
- Interviewing prospective accounting staff; choosing the right people is important to any organization; however, special factors in Azerbaijan (including the sale of jobs, the forging of certificates etc.) mean that careful selection, especially for positions of trust, is critical. An independent review can give an unbiased assessment



## Tax rates – at a glance

Effective at 1 May 2017

Tax	Rate	Notes
Profits tax	20%	
Value added tax	18%	Exempt and zero-rate categories exist
Assets Tax	1%	For enterprises, different rates will apply to individuals
Land Tax	Various rates, according to size, location and use	E.g., in Baku, the rate is AZN 10 per 100m <sup>2</sup> of land for commercial, construction or industrial use for a land plot up to 10,000 m <sup>2</sup>
Road Tax	Various rates applicable to non-resident owners of vehicles entering the territory of Azerbaijan and using the respective territory for the transportation of passengers and cargo, according to the period of stay in Azerbaijan, number of seats, load, distance etc.; persons involved in the production in or import to Azerbaijan of petrol, diesel fuel and liquid gas	E.g., US\$ 15 for vehicles in transit with up to 2,000 cm <sup>3</sup> engine capacity and duration of up to one month  AZN 0.02 added to the wholesale price (including VAT and excise) of a liter of petrol, diesel fuel or liquid gas produced for local consumption or to the customs value (including VAT and excise) determined in accordance with the Customs Code not less than market value of the wholesale price of a liter of imported petrol, diesel fuel or liquid gas in Azerbaijan
Minerals Resources Tax	According to type and volume of mineral extracted	E.g. tax on extraction of iodine/bromine waters is AZN 0.04 per m <sup>3</sup> .
Excise Tax	Various rates	On beer, spirits, tobacco, vehicles, yachts and petroleum products, imported platinum, gold and jewelry made from them, imported fur and leather products, e.g., excise duty rates for vehicles with up to 2,000 cm <sup>3</sup> engine capacity is AZN 0.2 per each sm <sup>3</sup> .
Simplified tax	4%	Different rates apply to persons operating outside Baku and those in transportation, operators and sellers of sports betting games, trading, catering and construction activity

## Income tax

Taxable monthly amount (AZN)	Income Tax
Up to 2,500	14%
Above 2,500	350 AZN + 25% of the excess

Taxable annual amount (AZN)	Income Tax
Up to 30,000	14%
Above 30,000	4,200 AZN + 25% of the excess

## Social protection fund contributions

Contributions	Rates
Employer's contributions	22% of employee earnings
Employee's contributions	3% of earnings

## NON-RESIDENT Withholding tax

Azerbaijan source income of non-residents (not attributable to a permanent establishment)	Withholding Tax Rates
Dividends	10%
Interest	10%
Lease of movable and immovable property (other than that paid by a lessee being a physical person)	14%
Royalties	14%
Insurance or reinsurance premiums	4%
Payments for international communication services	6%
Payments for international transportation services	6%
Winnings from lotteries and sports games less participation expenses	10%
Payments to entities established in countries with beneficial taxation	10%
Payments to electronic money wallets belonging to non-residents	10%
Other income from an Azerbaijan source for the supply of immovable property or performance of works or services (excluding employment income)	10%

## List of countries with which azerbaijan has concluded a treaty on the avoidance of double taxation

Effective at 1 MAY 2018

	Country	Date of signing	Date of entry into force
1	Austria	4 July 2000	23 February 2001
2	Belarus	8 August 2001	29 April 2002
3	Belgium	18 May 2004	12 August 2006
4	Bosnia and Herzegovina	18 October 2012	26 December 2013
5	Bulgaria	12 November 2007	25 November 2008
6	Canada	7 September 2004	23 January 2006
7	China	17 March 2005	17 August 2005
8	Croatia	12 March 2012	18 March 2013
9	Czech Republic	24 November 2005	16 June 2006
10	Denmark	17 February 2017	31 December 2017
11	Estonia	30 October 2007	27 November 2008
12	Finland	29 September 2005	29 November 2006
13	France	20 December 2001	1 October 2005
14	Georgia	18 February 1997	1 December 1997
15	Germany	25 August 2004	28 December 2005
16	Greece	16 February 2009	11 March 2010
17	Hungary	18 February 2008	15 December 2008
18	Iran	10 March 2009	25 January 2010
19	Israel	13 December 2016	28 December 2017
20	Italy	21 July 2004	28 April 2010
21	Japan	30 May 2005	11 April 2008
22	Jordan	5 May 2008	NOT YET IN FORCE
23	Kazakhstan	16 September 1996	7 May 1997
24	Korea	19 May 2008	25 November 2008
25	Kuwait	10 February 2009	18 April 2012
26	Latvia	3 October 2005	19 April 2006
27	Lithuania	2 April 2004	13 November 2004
28	Luxembourg	16 June 2006	2 July 2009
29	Macedonia	19 April 2013	12 August 2013
30	Malta	29 April 2016	30 September 2016
31	Moldova	27 November 1997	28 January 1999
32	Montenegro	12 March 2013	4 November 2013
33	Netherlands	22 September 2008	18 December 2009
34	Norway	24 April 1996	19 September 1996

	Country	Date of signing	Date of entry into force
35	Pakistan	10 April 1996	1 July 1997
36	Poland	26 August 1997	20 January 2005
37	Qatar	28 August 2007	11 March 2008
38	Romania	29 October 2002	29 January 2004
39	Russian Federation	3 July 1997	3 July 1998
40	San Marino	8 September 2015	2 May 2016
41	Saudi Arabia	13 May 2014	1 May 2015
42	Serbia	13 May 2010	1 December 2010
43	Slovenia	9 June 2011	10 September 2012
44	Spain	23 April 2014	NOT YET IN FORCE
45	Sweden	10 February 2016	30 September 2016
46	Switzerland	23 February 2006	13 July 2007
47	Tajikistan	13 August 2007	11 February 2008
48	Turkey	9 February 1994	1 September 1997
49	UAE	20 November 2006	25 July 2007
50	UK	23 February 1994	29 September 1995
51	Ukraine	30 July 1999	3 July 2000
52	Uzbekistan	27 May 1996	2 November 1996
53	Vietnam	19 May 2014	11 November 2014



# Chapter 8



# Oil and gas taxation

## Introduction

The taxation of oil and gas activities in Azerbaijan is largely regulated by a series of exploration, development and production sharing agreements (PSAs) dealing with specific deposits (mostly offshore, though some agreements also deal with on-shore deposits) and inter-governmental pipeline agreements relating to export pipelines (EPAs).

Although PSAs originated as ordinary commercial agreements, most have been enacted into law. In addition, the Tax Code (the Code) applies to the extent that the specific PSAs and EPAs permit. This chapter gives an overview of the general principles of taxation set out in the two types of agreements

and looks at some of the difficulties that may arise for taxpayers in operating under more than one such agreement. The following summary is a general outline only; no attempt is made to deal with the details and nuances of specific PSAs/EPAs or the Code.

The Code states that, in the event of conflict, whether or not adopted prior to the entry into force of the Code, the provisions, of PSAs, EPAs or the oil and gas law,<sup>4</sup> take precedence over the Code and normative legal acts enacted pursuant to the Code. Leaving aside issues of the legality or effectiveness of attempting to bind the legislature in this way, it might be expected that persons operating under

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<sup>4</sup> No such law exists at the time of writing.

the umbrella of PSAs, and – in some respects – EPAs, could function without reference to the contents of the Code. However, this will not always be the case, in particular where a taxpayer has a combination of both PSA (or EPA) and non-PSA (or EPA) income. Indeed, in respect of employees who are Azerbaijani nationals, domestic tax legislation has always applied, even to those working within the framework of a PSA or EPA.

Furthermore, it may well be that, in some circumstances taxpayers to which the Code alone applies may be in a better position than those subject to PSA/EPA tax provisions.

### PSAs and EPAs – introduction

Azerbaijan has concluded some 30 or so PSAs with various Contractor Parties (i.e., field participants), though not all of them are fully operational at present. The first PSA, and to date the most important by large measure, was entered into on 20 September 1994 (*Agreement on the Joint Development and Production Sharing for the Azeri and Chirag Fields and the Deep-Water Portion of the Gunashli Field in the Azerbaijan Sector of the Caspian Sea* (the ACG PSA).)

There are two host government agreements with participants which deal with export pipelines: the first relating to the export of oil (commonly known as the Baku-Tbilisi-Ceyhan – or BTC – pipeline) and the other relating to natural gas (the South Caucasus Pipeline System – the SCP System).

Both PSAs and EPAs have one thing in common: the participants or contractor parties themselves (excluding the State Oil Company of the Azerbaijan Republic – SOCAR) are taxed in accordance with the detailed provisions of those agreements. Those agreements set out less detailed provisions (often supplemented by separate tax protocols agreed with the tax authorities) relating to foreign employees, value-added tax, import/export duties and suppliers of goods and services. Although there is much duplication in the agreements, there are occasionally some very significant differences (e.g., the rate of tax), and it is not possible to detail all the differences here.

### Export pipeline agreements

Taking the EPAs first, each participant is, in principle, made liable for profits tax. In the BTC agreement, it applies, ostensibly, the law in force on 1 January 1999, and the rate of profits tax is set at 27%, i.e. the rate applicable on 1 January 2000. The SCP System agreement also sets 27% as the rate of profits tax but applies the law in force on 1 January 2001.

Having stated that the profits tax law (albeit the law in effect at differing times) is to be applied, in fact the EPAs set out a detailed regime for the calculation of taxable income. This regime essentially makes tax



deductible all expenses relating directly or indirectly to the pipeline projects and establishes special depreciation rates. It also sets out administrative procedures relating to filing tax returns, etc. Furthermore, no taxes (including taxes on interest, royalties and dividends) are imposed with respect to payments made "in connection with" main export pipeline activities to "Entities" (a broadly defined term) established outside Azerbaijan.

In addition to dealing with the participants, the EPAs also deal with suppliers of goods or services to the pipeline participants or their affiliates in connection with the pipeline projects. In general, no taxes are imposed or withheld with respect to payments to suppliers. Suppliers also have no tax compliance or filing obligations arising from or related, directly or indirectly, to the main export pipeline activities.

Foreign employees involved in the main export pipeline projects are liable for income tax in Azerbaijan but only if present in the country for more than 182 days in a calendar year. Such foreign employees are taxable only on that part of their income earned as a direct result of employment in Azerbaijan. Taxes are payable by the employer by withholding. No social insurance contributions are payable in respect of such employees. Azerbaijani citizens are taxed according to Azerbaijani legislation in force from time-to-time, and social security contributions are payable in respect of them.

Basically, the assignment of any rights or obligations of a pipeline participant is free of tax.

Goods (works, services, technology) supplied to pipeline participants are subject to value added tax at the rate of zero percent, as are the import and export of petroleum/gas through the pipelines and the import (export) of goods, etc., in connection with the pipeline activities. Entitled persons must obtain certificates from the tax authorities declaring their special status, and these are presented to suppliers in order to ensure the right VAT treatment.

Imports and exports are free of duties and taxes to the extent that the supplies are for use in connection with the pipeline project.

### **Production sharing agreements**

PSAs have similar but more complex tax provisions than those of EPAs. The differences are largely in the manner in which suppliers and foreign employees are taxed.

In PSAs, basically, each participant is referred to as a Contractor and suppliers are referred to as Sub-contractors. Suppliers incorporated overseas are known as Foreign Sub-contractors (FSCs). The Contractors are, in principle, made liable for profit tax. In the ACG PSA, it applies, ostensibly, the law in force on 1 January 1993 and the rate of profit tax is set at 25%.

However, as with EPAs, PSAs set out detailed regimes for the calculation of taxable income. These regimes essentially make tax deductible all expenses incurred in carrying out Hydrocarbon Activities in Azerbaijan or elsewhere. Special depreciation rates are applicable. PSAs also set out administrative procedures relating to filing tax returns, making advance payments of tax, etc. Although in the ACG PSA, the Contractors are directly liable for their own taxes, in other PSAs this obligation is often borne by SOCAR.

In addition to dealing with the Contractors, PSAs provide a special tax regime for companies operating in the oil and gas sector. This, in relation to Sub-contractors, may be summarized as follows:

- FSCs are normally subject to withholding tax on payments made to them with regard to work and services (though there are some PSAs where FSCs pay profits tax and file profits tax returns, e.g., the Muradhanli, Jafarli and Zardab PSA). With certain exceptions, the sale of goods is not subject to withholding taxes other than on any mark-up in respect of sales in Azerbaijan. The rate of withholding tax varies from 5% to 5.5%, 6%, 6.25%, 6.75%, 7.5% and 8%, depending on the particular PSA

- In some PSAs, the withholding tax provisions for FSCs apply only prior to the commencement of the development and production periods. Once that period has commenced, normal profits tax provisions may apply (except that those provisions and the rate of tax may be historic, fixed at the time of entering into the PSA)
- Only tax resident foreign employees of FSCs are payers of income tax, and the concept of “residency” is defined differently from EPAs and non-PSA related tax legislation. Such foreign employees are taxable only on that part of their income earned as a direct result of employment in Azerbaijan. Taxes are payable by the employer by withholding. Social insurance contributions are not payable in respect of foreign employees under certain PSAs (e.g. ACG PSA) but under other PSAs the situation may be different, and the relevant PSA should be consulted separately. Residence is, basically, defined as being present in Azerbaijan for more than 182 days in the year, or being present for more than 30 consecutive days or 90 cumulative days in the year (in which case tax is payable in respect of income earned after the 30<sup>th</sup>/90<sup>th</sup> day). However, “rotators” and other foreign employees who are routinely in Azerbaijan for more than 90 days in the year, and who perform their primary employment in Azerbaijan, will be tax resident *ab initio*
- Subcontractors are exempt with credit (zero percent rate) from VAT in connection with Hydrocarbon Activities
- Subcontractors have the right to import into, and re-export from, the Republic of Azerbaijan free of any taxes and restrictions in their own name the following: all equipment, materials, machinery and tools, vehicles, spare parts, goods and supplies (excluding foodstuffs, alcohol and tobacco products)
- An FSC is not normally obliged to file any tax return with the Ministry of Taxes in respect of any income or profit which it earns from its business activities in the Republic of Azerbaijan in connection with Hydrocarbon Activities, nor does it have any other tax compliance or filing obligation (other than filing returns for withholding tax and VAT and providing information, which may be required, relating to the FSC’s employees) in connection with Hydrocarbon Activities

Azerbaijani citizens are taxed according to Azerbaijan legislation in force from time-to-time and social security contributions are payable in respect of them.

### Multi-PSA/EPA operations

The EPA/PSA regimes have, in general, been beneficial to taxpayers by setting out a more or less certain method of calculating, paying and reporting taxes. However, in particular for FSCs operating under more than one PSA, the benefit of simplicity can transform itself into a cumbersome and complex web of reporting requirements, tax rates and so on.

There are currently eight withholding tax rates in operation: 5% (applying to Azeri-Chirag and deep water Gunashli fields, Shafag-Asiman); 5.5% (Kurovdaq, Absheron); 6% (Zigh Hovsan), 6.25% (Shah Deniz); 6.75% (Pirshaat) 7.5% (Mishovdag-Kelameddin, Padar); 8% (Kursangi-Karabagli and certain other PSAs), and 10% (Muradhanli, Jafarli and Zardab – for Foreign Sub-contractors which are not registered for tax purposes in Azerbaijan). The rates are set by assuming a deemed profit, usually 25%,<sup>5</sup> and applying a fixed rate of corporate profits tax (varying rates ranging from 20% to 32%). The withholding tax rates are fixed (i.e., they are unaffected by any changes in general rate of profits tax.)

<sup>5</sup> However, under the ACG PSA, the profitability rate is 20%.

The first issue that an FSC might face when operating under more than one PSA, either simultaneously or sequentially, will be that of reporting. Each of the PSAs has its own reporting regime. In principle, these are very similar but there are differences in detail, a variety of formats for tax returns, etc. Although, as certain PSAs have been terminated, the rules applying to some of those remaining have been brought into conformity with one another, some differences still exist.

The next contentious issue might be which rate of withholding tax is to apply to a particular transaction. This problem could arise in two situations: first, where providing general or global services to related parties which may be operating under different PSAs but which share certain services (e.g., office space). In this situation, the recipient of the service will normally provide a copy of its VAT certificate entitling it to zero-rating for VAT purposes and will determine which rate of withholding to apply. The certificate will normally make clear for whom the service is being provided. The second, and more difficult area, is where there is a chain of FSCs, one (FSC1) providing general long-term services (e.g. housing, office space) to the other, where the service user (FSC2) is operating under more than one PSA. In this case FSC2 has to decide which rate of withholding to apply. One solution might be to apply the highest rate of withholding tax (currently, 8%), which may not be technically correct but may satisfy the tax authorities.

Any FSC providing non-PSA services will face additional difficulties. It will have expenses, but part of its income will already have been taxed. The tax authorities will expect a portion of the expenses, therefore, to be disallowed in computing tax on the non-PSA income. The simplest method of doing this is to apportion the expenses amongst PSA and non-PSA income in the same ratio.

### Example

FSC has PSA income of 500 (before tax at 5% under the Azeri-Chirag PSA) and non-PSA income of 400 (before tax). FSC's expenses are 600. FSC's non-PSA taxable income after expenses will be calculated as follows:

$$\frac{\text{Non-PSA income}}{\text{Total income}} \times \text{Expenses} = \text{Allowable expenses}$$

$$\frac{400}{900} \times 600 = 266$$

Taxable income will be 400-266 = 134

However, where it is possible to establish with some accuracy which expenses relate to PSA income, only those expenses should be disallowed.

### Some other PSA issues

- Under most PSAs, the supply of goods by an FSC for Hydrocarbon Activities is exempt from tax altogether. The FSC must ensure that it can clearly document the cost of goods or it risks being subject to profits tax (though not necessarily at the current rate) on the full amount received
- In some PSAs, the withholding tax provisions for FSCs apply only prior to the commencement of development and production periods. Once that period has commenced, normal profits tax provisions apply (except that those provisions and the rate of tax may be historic, fixed at the time of entering into the PSA). However, a further complication is that the PSA may provide that, even after the commencement of the development and production period, for short-term contracts or contracts below a certain value, the withholding tax regime will continue to apply<sup>6</sup>

<sup>6</sup> See, for example, the Agreement on the Exploration, Development and Production Sharing for the Araz, Alov and Sharg Prospective Areas in the Azerbaijan Sector of the Caspian Sea, 20 July 1998.

- Under the tax protocols of some PSAs, a sub-contractor is under an obligation to inform its sub-contractors, in the prescribed way that services are being provided under that particular PSA.<sup>7</sup> This is often overlooked
- VAT: The PSAs and tax protocols apply a zero-rate of VAT to goods and services provided in connection with Hydrocarbon Activities. Sometimes, however, a taxpayer may have to bear the VAT and apply for a refund or make an offset against other taxes. Under the Code, as VAT is payable on an accruals basis, it may be that more situations will arise of VAT suffered and re-claims/offsets made as suppliers will no longer be able to delay issuing invoices until the client has obtained its certificate showing that it is entitled to VAT zero-rating

### Export Law

The law *On the Implementation of a Special Economic Regime for Oil and Gas Activity for Export Purposes*, 2009 (the Export Activity Law) provides for a special taxation, customs, and currency regime which is very similar to PSA and EPA regimes (though the law explicitly states that it does not apply to PSA or EPA operations or to other oil and gas operations carried out in the territory of Azerbaijan).

The Export Activity Law applies to local contractors (with or without foreign investment) and to their local or foreign sub-contractors involved in oil and gas activities (including the exploration for and the sale and purchase of oil and natural gas) oriented towards exports (e.g., the supply of goods, works and services in connection with oil and gas operations conducted *outside* of Azerbaijan). The Export Activity Law will be in force for 15 years, unless further extended.

The taxation regime under the Export Activity Law allows the contractor to choose between taxation under the Tax Code and the payment of profits tax by the withholding mechanism at the rate of 5% of the total payment due. Foreign subcontractors will pay profits tax only by the withholding mechanism. Among other noticeable tax advantages under the Export Activity Law are the following:

- No dividend or interest tax for contractors and foreign subcontractors
- No net profit remittance tax for foreign subcontractors
- Exemption from the assets and land taxes

### Conclusion

Dealing with oil and gas taxation in Azerbaijan is a complex affair. There is no one set of rules which is applicable to all such activities. This chapter has touched briefly upon some of the issues which foreign investors might meet in dealing with upstream and mid-stream operations, but each PSA/EPA must be reviewed independently. Special care must be taken when working under more than one such regime. While these agreements are generally designed to lift some of the tax burden from participants and their suppliers, the traps can be all the more unexpected.

### Useful website:

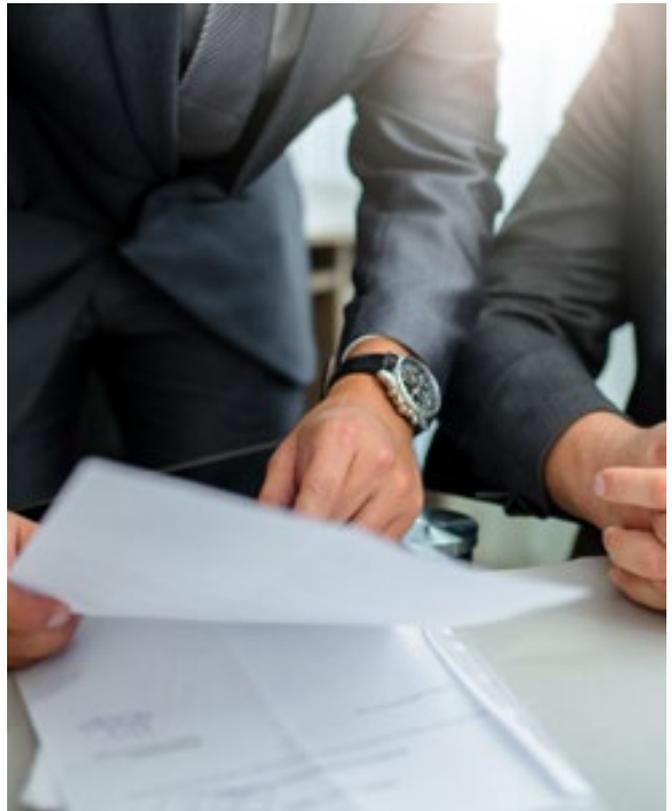
Ministry of Taxes – [www.taxes.gov.az](http://www.taxes.gov.az)  
(English version available)

<sup>7</sup> See, for instance, the Protocol Concerning Taxation of Foreign Sub-contractors, Art. 2.5, made under the Agreement on the Exploration, Development and Production Sharing for the Shah Deniz Prospective Area in the Azerbaijan Sector of the Caspian Sea, 4 June 1996 (the Shah Deniz PSA).

### How Dentons can help

Dentons has represented clients in the oil and gas sector of Azerbaijan for many years. Our services have included:

- Defending taxpayers in the courts
- Operating payrolls, filing tax and social security reports
- Analyzing tax protocols
- Planning tax strategies
- Conducting comprehensive tax reviews to ensure taxes are being properly accounted for
- Interviewing prospective staff – choosing the right people is important to any organization, but special factors in Azerbaijan (including the sale of jobs and qualifications, the forging of educational certificates etc.) mean that careful selection, especially for positions of trust, is critical. An independent review can give an unbiased assessment





# Chapter 9



# Trade: imports and exports

## Introduction

Since the break-up of the Soviet Union, Azerbaijan has significantly liberalized its trade regulations. Resolutions and decrees on the liberalization of trade were issued as far back as 1992.

Nonetheless, significant restrictions on the export of “strategic goods” or “goods of strategic importance” existed until 1994. The list of strategic goods used to be quite extensive and included, *inter alia*, oil and oil products, electricity, ferrous metals and products made of ferrous metals, non-ferrous metals, aluminum and products made of aluminum, cotton,

glass, tobacco, handmade carpets, etc. Since that time, the restrictions in respect of strategic goods have largely been lifted. Presently, with some exceptions (see below), physical persons and legal entities are theoretically free to conduct their export-import business as they see fit. However, licensing or certification requirements in a number of cases continue to impose obstacles and impede trade. Furthermore, statutory contradictions and uncertainties remain in relation to the procedures for the licensing and certification of import-export transactions.

## Restricted export-import business

A limited group of products requiring some form of approval, certification, licensing or positive opinion for the purpose of export or import activity remains.

- For different purposes, the following group of goods, work, services and products of intellectual activities (Controlled Goods) are subject to export controls by the Azerbaijani authorities:
  - Goods and technologies subject to export controls in accordance with the international treaties to which the Republic of Azerbaijan is a party
  - Military goods, including weapons of mass destruction and their means of delivery
  - Dual purpose goods which can be used in the creation and preparation of the weapons of mass destruction, weapons, military equipment and supplies
  - Explosives and radioactive substances, materials and equipment having radioactive origin, sources and installations of ionizable rays
  - Other goods determined by the President of the Republic of Azerbaijan, including those subject to export controls due to the ultimate purpose for utilization or the ultimate user

Control is carried out by the relevant state authorities through the examination of export transactions and the issuance of special permits. Exporting legal entities or individual entrepreneurs must obtain a special permit from these authorities for the export of Controlled Goods. Before the issuance of a special permit, these authorities must examine the export transaction in order to verify the information provided concerning the exporter, the exported goods, their ultimate users and the final destination. Export transactions with certain Controlled Goods are also subject to post-export examination for compliance with the terms and conditions stipulated in the issued special permit.

- The export or import of the following goods is carried out exclusively on the basis of a decree of the Cabinet of Ministers:

- Weapons, military equipment (including spare parts required for their production)
- Explosives
- Nuclear and radioactive materials and technologies (including radioactive wastes), special non-nuclear materials and sources of radioactive radiation
- Narcotic and psychotropic elements and materials restricted for free circulation
- Special types of scientific or technical information and technology necessary for the production of weapons
- Blood and blood components and preparations made from them
- The export of unprocessed diamonds

Such goods may not be exported on credit or on consignment.

- The export or import of the following goods and services is carried out based upon the issuance of an opinion by certain state authorities.

Export:	State Authority
Wild animals and plants	The Ministry of Ecology and Natural Resources
Raw materials extracted from wild animals and plants for the production of medicines (including snake and scorpion venom)	The Ministry of Ecology and Natural Resources; The Ministry of Health
Information on the location of natural resources and thermal energy fields	The Ministry of Ecology and Natural Resources
Works of art and antiques	The Ministry of Culture and Tourism
Controlled psychotropic substances	The Ministry of Health
Cultural wealth included in the State List of national cultural property in relation to exhibitions, guest performances, presentations, international cultural events and restoration work	The Ministry of Culture and Tourism

Import:	State Authority
Insecticides	The Ministry of Agriculture
Medicines and medical equipment, including controlled psychotropic substances	The Ministry of Health
Veterinary drugs and substances	The State Veterinary Control
Construction activity (engineering-survey, design, construction and betterment works)	The State Municipal Planning and Architectural Committee, the Ministry of Emergency Situations, the Ministry of Ecology and Natural Resources
Freight and passenger transportation, forwarding services	The "Azerbaijan Railways" CJSC, the State Maritime Administration, the State Civil Aviation Administration, the Ministry of Transport, Communications and Information Technologies
Communication services (international, intercity, city, village, cellular, trunk radio, cable TV installation and use, speeded post services)	The Ministry of Transport, Communications and Information Technologies
Legal services	The Ministry of Justice

These goods may not be exported on credit or consignment (Rules of Regulation of Import-Export Transactions in the Republic of Azerbaijan, approved by Presidential Decree No. 609, dated 24 June 1997.)

### Prohibition of the export of scrap metal

The export of ferrous and non-ferrous scrap metal has been temporarily suspended (since 2001) by presidential decree.

### Restriction on the export and import of ozone-depleting substances

The import from and export of ozone-depleting substances to countries which are not signatories to the Montreal Protocol of the Vienna Convention on Substances that Deplete the Ozone Layer is prohibited.

### Export of foodstuffs to the EU countries

The export of foodstuffs from the Republic of Azerbaijan to EU countries is possible only based upon the issuance of a quality certificate by the Ministry of the Economy.

### Export-import of goods by PSA contractors

Under certain PSAs (for example, the ACG PSA), contractors, their agents and sub-contractors, have the right to import into, and re-export from, the Republic of Azerbaijan in their own name, free of any taxes and restrictions, the following: all equipment, materials, machinery and tools, vehicles, spare parts, foodstuffs (subject to compliance with applicable regulations pertaining to the import of foodstuffs), goods and supplies necessary in the Contractor's reasonable opinion for the proper conduct and achievement of petroleum operations as defined under the specific PSA. It should be noted that a number of PSAs exclude foodstuffs, alcohol and tobacco from this list.

PSA contractors and their sub-contractors working under a PSA are typically exempt from the provisions of Azerbaijan foreign trade regulations concerning the prohibition, limitation and restriction of the import and export and country of origin restrictions on those items indicated in the paragraph above.

### Goods imported into free economic zones

The Resolution of the Cabinet of Ministers No 29 dated 27 February 2013 "On approving the Rules for the customs bodies to approve the internal-goods status of goods imported into a free economic zone, processed in a free economic zone and in free turnover within a free economic zone," provides that goods imported into a free economic zone shall be granted internal-goods status. In this connection, the importer is entitled to obtain a special certificate issued by the customs authorities based on the relevant paper or electronic application of the importer. Such certificate is valid for 12 months.

### **Goods imported by the holders of an investment promotion certificate**

The Decree of the President of the Republic of Azerbaijan, "On Additional Measures to Promote Investment" dated 18 January 2016, provides that holders of an investment certificate will be able to obtain tax and customs privileges for export of certain goods.

### **Sanctions for the violation of import-export regulations**

The violation of import-export regulations is punishable according to Azerbaijani laws. The Criminal Code and the Code of Administrative Violations of the Republic of Azerbaijan envisage a number of sanctions for such violations.

#### **Useful websites:**

Ministry of the Economy– [www.economy.gov.az](http://www.economy.gov.az)  
(English version available)

### **How Dentons can help**

Dentons has provided clients with trade-related advice during many years. Dentons has assisted companies in all aspects relating to the import and export of goods, including customs duties, labeling, compliance with local and international standards, certification, changes of customs regimes, pre-payment for goods and customs disputes.



# Chapter 10



# Customs duties and regimes

## Introduction

Almost everyone doing business in Azerbaijan will have encountered difficulties from time to time with the customs authorities. Most of these are resolved without recourse to law, but the occasional lack of transparency and inconsistent application of the customs legislation by customs officers sometimes demands the involvement of lawyers. Even the oil industry, which has special privileges in respect of the importation of goods, encounters regular problems. However, there are also instances when the cooperation of customs officers is required (e.g., in the seizure of counterfeit goods), and customs officials can be accommodating and very helpful. More than with most government agencies, the relationship with the customs authorities is a difficult one.

## Customs legislation

The principal laws and regulations governing the payment of customs duties in Azerbaijan are as follows:

- Customs Code, which took effect on 1 January 2012
- Law On Customs Tariffs of 13 June 2013 (the Tariffs Law)
- Law On the Implementation of a Special Economic Regime for Oil and Gas Activity for Export Purposes of 2 February 2009
- Resolution of the Cabinet of Ministers No. 91 of 22 April 1998, On Import – Export Duty Rates (the 1998 Resolution)

- Resolution of the Cabinet of Ministers, No. 500 of 17 November 2017, On Commodity Nomenclature of Foreign Economic Activity, Rates of Import and Export Customs Duties (the 2017 Resolution)

Following the accession of Azerbaijan to the International Convention on the Simplification and Harmonization of Customs Procedures, as revised in 1999 (the Kyoto Convention), a new Customs Code was adopted, which was intended to take into consideration the main principles of the Kyoto Convention, such as transparency, the use of information technologies, the standardization and simplification of documentation, the minimization of customs control, etc.

The Customs Code distinguishes among the following types of payments to the customs authorities:

- Customs duties
- VAT
- Excise tax
- Road tax
- Customs dues
- Fees (auction)
- State duties<sup>8</sup>

### Customs duties

Customs duties are divided into three classes:

- Ad valorem duties (i.e., duties calculated in percentage terms upon the declared value of goods).
- Specific duties (i.e., duties based on a specific number of units of goods).
- Composite duties (i.e., duties calculated through a combination of the other two methods).<sup>9</sup>

The rates of import and export duties are currently regulated by the provisions of the 2017 Resolution. The 2017 Resolution is based on the Nomenclature governed by the Convention on the Harmonized Commodity Description and Coding System. Ad valorem import duties are set at rates ranging from 0 to 15%. Some examples follow: 0% – certain types of oil products, natural gas condensate, 0% – airplanes, helicopters, US\$ 15 per 1,000kg – non-processed aluminum, 5% – various types of stainless steel, 15% – cement, 0% – petroleum coke, petroleum bitumen.

For certain types of goods, the 2017 Resolution prescribes variable rates of duty depending upon, for example, the season of the year.

Under the Tariffs Law, certain imports are exempt from customs duties, some of which are:<sup>10</sup>

- Goods carried across the border for representative offices of foreign states and their employees
- Food products and transportation means, as well as personal equipment, spare parts, personal items intended for traveling personnel imported as aid and distributed as such in zones of natural disaster
- Goods which are in transit and intended for third countries
- Personal and household items, as well as items necessary for the employment activity of foreign migrant workers in Azerbaijan
- Certain instances of goods imported in, produced or processed in and exported from special economic zones
- Imports of technological equipment and structures based on a so called “investment promotion certificate” including for the infrastructure of industrial parks

<sup>8</sup> Article 224 of the Customs Code

<sup>9</sup> Article 226 of the Customs Code

<sup>10</sup> Article 20, the Tariffs Law

- Imports of machinery, technological equipment and plants by legal entities and individuals engaged in entrepreneurial activities without forming a legal entity that are residents of industrial and technological parks established according to a decision of the relevant executive authorities, on the basis of a confirming document of the relevant executive authority for the construction of production facilities of industrial or technological parks, research and development work, established in accordance with the decision of the relevant executive authority – within seven years from the date of registration of the resident in the industrial or technological park
- Imports of all kinds of goods for the purposes of those activities on the basis of the approval of the relevant executive authority by an industrial park resident involved in activities defined by the relevant executive authority in the industrial park established according to the decision of the executive authority – for a period of five years from 1 May 2016

Under the 1998 Resolution, certain imports are exempt from import duties and these include:

- Goods imported for petroleum operations in connection with certain exploration, development and production-sharing agreements and transportation agreements relating to hydrocarbons
- Goods imported on the basis of financial aid, loans and technical grants of international organizations, foreign governments and foreign persons in accordance with inter-governmental and international treaties of Azerbaijan
- Goods imported by individuals for distribution free of charge
- Goods imported on the basis of a document reflecting equipment used in the prevention of force majeure situations and the mitigation of its consequences, confirmed by the Ministry of Emergency Situations

856.2	454.549.374,59	54.60
3	139.685.374,59	78.369.92
00	571.454.211,00	49.123.77
00	157.678.786,00	10.945.4
1,23	162.354.466,82	16.354
77,88	856.214.378,21	65.46
	454.549.327,81	16.3
	139.685.374,59	65
	454.549.327,81	54
	139.685.374,59	
	571.454.211,00	

- Operations relating to the transfer of fixed assets, movable or other property to the State Oil Fund pursuant to agreements of the Republic of Azerbaijan and legal entities representing it, in accordance with the exploration, development and production sharing of hydrocarbons, export pipelines and other agreements resulting therefrom
- Equipment, data, accessories and materials for the creation and operation of systems of passport control, equipment, data, accessories and materials imported for the purposes of police services, goods imported (in the absence of local provisions) for the purposes of the implementation of tourism investment projects in mountainous areas, 1,300 meters above sea level
- Certain movable property which is the subject of a leasing agreement
- Equipment in connection with oil and gas operations for the purpose of exports (based on the list approved by SOCAR)
- Technologies, equipment and accessory parts imported by the Ministry of the Defense Industry and its subsidiaries for the purpose of the creation and production of defense products

- Goods imported into a special economic zone (excluding excise goods)
- Sports equipment, technology and goods imported for training of a national team
- Grain and grain products imported for the purpose of supplying the State Grain Reserve
- Certain scientific devices and equipment imported on the basis of confirming document of the Azerbaijani National Academy
- Registration certificates, driving licenses, registration plates and certain equipment imported at the expense of budget funds
- Gold imported for placing as assets of the State Oil Fund
- When supported by the relevant documentation issued by the State Agency for Alternative and Renewable Energy, structures used for the purpose of renewable energy, as well as equipment, parts and accessories necessary to manufacture such structures
- The list of structures, parts and equipment which can be imported free of customs dues on the basis of a confirming document from the Ministry of Communications and High Technologies by legal entities and individual entrepreneurs which are residents and of Mingchevir Technological Park has been approved.
- Mazut imported for the production of electrical energy by Azerenerji Joint Stock Company on the basis of documents issued by the Ministry of Energy.

### **VAT on imports and exports**

Currently, the standard rate of value-added tax (VAT) in Azerbaijan is 18%. Under the Tax Code the following imports are among those exempt from VAT:

- Imports of the national and foreign currency, as well as securities (except for numismatic purposes)
- Imports of gold to be deposited with the Central Bank of the Republic of Azerbaijan and the State Oil Fund of the Republic of Azerbaijan, as well the import of currency valuables of the Central Bank of the Republic of Azerbaijan, monetary resources, commemorative coins and other similar valuables of the Republic of Azerbaijan manufactured abroad
- Imports of goods, the provision of works and services by the Central Bank of the Republic of Azerbaijan and the State Oil Fund of the Republic of Azerbaijan, connected with obligations stipulated by the legislation
- Imports of machinery, technological equipment and plants by managing organizations or operators of industrial and technological parks on the basis of a confirming document of the relevant executive authority for the establishment and construction of infrastructure, production areas of industrial or technological parks, established in accordance with the decision of the relevant executive authority, as well as for research and development activities
- Imports of machinery, technological equipment and plants by legal entities and individuals engaged in entrepreneurial activities without forming a legal entity that are residents of industrial and technological parks established according to the decision of the relevant executive authorities, on the basis of a confirming document of the relevant executive authority for the construction of production facilities of industrial or technological parks, the research and development work,



established in accordance with the decision of the relevant executive authority – within 7 years from the date of registration of the resident in the industrial or technological parks

- Imports of technical equipment and tools of all types, spare parts, weapons and ammunition used for military purposes by the relevant executive authority, imports of technology, equipment and component parts for the purpose of defense-oriented development and production
- Commodities imported by humanitarian organizations duly registered in the Republic of Azerbaijan, as well as imports by other legal entities and individuals, subject to receipt of a consent from the organization, established by the relevant executive authority, for humanitarian aid purposes
- Commodities imported in connection with grant assistance, including technical assistance, and for charitable purposes of countries, governments and international organizations
- Commodities imported by individuals not for production or commercial purposes, through the customs border in cases and in the manner prescribed by the relevant executive authority
- Equipment and materials imported in connection with export-oriented oil and gas activities (subject to provision of the list of equipment and materials, imported into the Republic of Azerbaijan in connection with export-oriented oil and gas activities, approved by the relevant executive authority to the customs authorities)
- Goods (except for excisable goods), imported into a special economic zone
- Imports of technology, technical equipment and facilities by legal entities and individual entrepreneurs on the basis of an approval document given by the relevant executive authority – for 7 years from the date of receipt of an investment promotion certificate
- Imports of all kinds of goods for the purposes of those activities on the basis of the approval of the relevant executive authority by an industrial park resident that is involved in activities defined by the relevant executive authority in the industrial park established according to the decision of the executive authority – for a period of 5 years from 1 May 2016
- Aircraft, their spare parts, engines and power plants imported for civil aviation purposes

Additionally, under the Tax Code, the provision of financial and other services is exempt from VAT.

The Tax Code also treats certain imports and exports as subject to VAT but at a zero percent rate.<sup>11</sup> These include:

- The export of goods and certain services
- With the exception of international postal services, international and transit carriage of passengers and freight; services and work directly related to international and transit flights
- The import of goods, works or services on the basis of overseas grants
- Goods and services designed for official use by diplomatic and similar establishments accredited in Azerbaijan, as well as for the needs of diplomatic, administrative and technical staff and their family members having relevant status and who are not nationals of the Republic of Azerbaijan; however, other services obtained from overseas will generally be subject to a VAT reverse charge
- The sending of gold and other valuables to the Central Bank of Azerbaijan

### Customs clearance payments

The general rates for customs clearance depending on the cost of goods are the following (per declaration or customs credit order):

- Goods with a value up to AZN 1,000 – the fee is AZN 10
- Goods with a value from AZN 1,001 to AZN 10,000 – the fee is AZN 50
- Goods with a value from AZN 10,001 to AZN 100,000 – the fee is AZN 100
- Goods with a value more than AZN 100,001 – the fee is AZN 275

However, certain exclusions apply and these are as follows:

- No customs clearance fees are payable for the goods exempted from custom duties according to the Resolution of the Cabinet of Ministers No. 305 of 14 October 2013.
- No customs clearance fees are payable for imports under grant aid agreements, humanitarian aid and technical assistance.

Clearance fees at double the basic rate are applied where clearance is performed outside of normal working hours or at locations other than those specified for carrying out customs clearance operations.

### Excise tax

Under the Tax Code 2000 only consumable alcohol, beer and other alcoholic beverages, tobacco products, automobiles (with the exception of special purpose vehicles equipped with special marks and equipment), yachts for sport and recreation, and other floating vessels for these purposes, petroleum products, imported platinum, gold, jewelry and other household goods prepared therefrom; processed, sorted, framed and mounted diamonds and imported fur products are subject to excise tax in Azerbaijan.<sup>12</sup>

The rates of excise tax applicable on imports (with the exception of automobiles, leisure and sports yachts and other floating transport designated for such purposes, as well as platinum, gold, jewelry and other domestic items made therefrom; processed, sorted, framed and fixed diamonds) are regulated by the Resolution of the Cabinet of Ministers No. 20 of 19 January 2001 (as amended by Cabinet of Ministers' Resolution No 574, dated 21 December 2017), On Approval of the Rates of Excise Tax Applicable to Goods Imported into the Republic of Azerbaijan.

<sup>11</sup> Tax Code, Article 165

<sup>12</sup> Tax Code, Article 190.1

Some examples include:

- Malt beer – AZN 1.7 per liter
- Wines – AZN 3.5 per liter
- Cigars, cut-end cigars and cigarillos containing tobacco – AZN 20 per 1000
- Cigarettes containing tobacco – AZN 12 per 1000

### **Production sharing and transportation agreements**

Under various exploration, development and production sharing agreements and export pipeline agreements in relation to hydrocarbons, the importation of goods is free of import duties and VAT (though it is subject to a customs service/documentation fee), as long as the goods (and services) are used in connection with petroleum operations. This exemption also applies to the sale of goods by contractors and subcontractors to related parties imported into the Republic of Azerbaijan for export purposes under various exploration, development and production sharing agreements and export pipeline agreements in relation to hydrocarbons.

### **Customs procedures**

There are five types of customs procedures:<sup>13</sup>

- Transit (international and national)
- Warehouse (temporary storage and customs warehouse)
- Free zone
- Special use (temporary import and end use)
- Processing (internally and abroad)

Care should be taken to ensure that the correct procedure has been applied to the relevant import.

Presidential Decree No 12, dated 11 November 2008, On the Application of a “Single Window” in the Inspection of Goods and Transportation Means Passing through the State Border Check-Points of the Republic of Azerbaijan, provides that the inspection of veterinary, sanitary, phytosanitary, hygienic and other certification is carried out by the customs authorities at the border.

### **Warehouses**

Warehouses are used for the temporary storage of imported goods where, during the term of storage, no customs duties or relevant taxes are paid. In general, customs warehouses may be of an open type or of a closed type (the latter being restricted in use to specified persons). The warehouse procedure includes temporary storage and the use of a customs (bonded) warehouse. The maximum term for temporary storage is four months and, for a customs warehouse, it is three years. At the expiration of the temporary storage period, goods should either be declared under a different customs procedure or placed in a customs warehouse. Upon expiration of the customs warehouse period, the goods must be placed under a different customs procedure.<sup>14</sup>

### **Temporary imports**

Goods may be imported into Azerbaijan for temporary purposes. In general, a temporary import period for goods should not exceed 24 months. Where the purpose of the temporary import has not been achieved, the temporary import period can be extended to 12 months.<sup>15</sup> A temporary importation of goods generally involves the payment on importation of only part of the applicable customs duties and taxes (3% per month of the total which would be payable for goods imported for free circulation) or full exemption from payment until the expiration of the temporary importation period.

### **Useful website:**

State Customs Committee – [www.customs.gov.az](http://www.customs.gov.az) (English version available), <http://www.rusum.az/>

### **How Dentons can help**

Dentons is an acknowledged leader in Azerbaijan in the provision of customs advice. We have assisted companies and individuals in defending demands for excessive duties and dealing with the customs authorities in enforcing prohibitions against the importation of counterfeit and gray market goods.

<sup>13</sup> Customs Code 2012, Article 166

<sup>14</sup> Customs Code, Chapter 30

<sup>15</sup> Customs Code, Article 193



# Chapter 11



# Handling audits

## Introduction

In many ways, the strategy for handling tax and other audits by official bodies in Azerbaijan is the same as in any other country. However, Azerbaijan, in this as in many areas, has its own peculiarities which need to be taken into account.

Audits should not be seen as something of which to be afraid. They are a normal part of doing business, and it is important that everyone is aware of this. And, of course, it is important to stress that no attempt should be made to hide documents or provide misleading information to an auditor.

To verify that the audit is a legitimate one, the company should check whether the audit is included in the Register of audits of entrepreneurial activity maintained by the Ministry of Justice.

At the same time, any audit can be time-consuming and disruptive to business and, as such, it is important that the auditors are directed towards what is relevant.

## Tax audits

The tax authorities have broad powers in the conduct of an on-site audit. They are, however, required to give at least 15 days' written notice before the commencement of a routine audit. A routine on-site tax audit may not be carried out more than once a year and should not exceed 30 days in length. Exceptionally, an extension by up to 90 days is possible. The audit may also be suspended for up to nine months in certain cases, including, *inter alia*, where documents required for "conducting objective and complete" off-site tax audits are to be received from abroad.

A routine on-site tax audit, in respect of corporate profits tax, income tax, property, road and land taxes, cannot exceed the last three calendar years (i.e., three years, excluding the year in which the audit is carried out). In respect of other taxes (e.g., VAT), it cannot exceed the latest three years (i.e., three years, including the year in which this audit is carried out.)

An extraordinary tax audit is possible in certain circumstances, including where an application is made for a refund of taxes.

A taxpayer who is asked by the tax authorities to submit documents must submit certified copies within five days of the request.

### Other audits

Other bodies also have the rights of audit or the right to perform statutory checks. For instance, these include the health authorities (in respect of restaurants, hotels, etc.), environmental control (use of water, waste disposal, etc.), the fire department (compliance with fire safety regulations), migration authorities (compliance with migration issues), etc. In such circumstances, the company should ensure that the auditors sign the enterprise's audit control book.

### Some do's and don'ts

In order to ensure that the audit progresses smoothly, a few simple rules should be followed:

- Ensure a room is provided for the auditors to carry out their work. The room should ideally be near facilities e.g. washroom, photocopier etc. and away from others' work areas
- Ensure that one person is designated as the principal contact with the auditors. This person will normally be someone with direct knowledge of the matters being audited. Consideration should be given to the person acting as liaison with the auditors
- Be cooperative but businesslike
- Before releasing documents, ensure that they are relevant to the audit and that the auditors are entitled to request them

- Keep copies or a record of all documents released
- If the auditors wish to interview any person, ensure that a management representative is also present and that notes of the meeting are taken
- Although, outside of criminal proceedings, there are no formal rules of legal privilege, nevertheless, some documents may be subject to protection on the grounds of confidentiality
- Don't panic – to minimize the potential for staff to spread rumors, ensure that everyone is aware that an audit is underway, and that it is a normal part of business

### Audit holidays

At present, until 1 January 2021, a temporary moratorium on audits is in force. The moratorium does not apply to tax audits and, in accordance with a list approved by the President, it also does not apply to audits of the quality of medicine, audits related to verification of compliance with safety rules and control over the safety of foodstuffs, audits related to cases which may create significant danger to the lives and health of the public, state security and economic interests, as well as to audits of the General Prosecutor's Office in connection with the investigation of corruption-related crimes. The list of permitted audits includes audits by the Ministry of Health of compliance with safety and sanitary-hygienic rules; and audits by FIMSA of insurers and re-insurers.

### How Dentons can help

Dentons is an acknowledged leader in Azerbaijan in the provision of tax services. We have assisted companies in all aspects relating to tax matters, including:

- Preparing for, dealing with and responding to audits, including employment and environmental audits
- Advising taxpayers and other clients of their rights
- Defending taxpayers in the courts – Dentons has successfully defended taxpayers against claims made by the tax authorities
- Planning audit strategies





# Chapter 12



# Real estate and property ownership

## Ownership rights

An owner of property has the right to possess, use and dispose of such property freely.

Persons other than owners may also have the right to possess, use and dispose of property belonging to another person. For example, a lessee of an apartment has the right to possess and use the apartment for residential purposes and, where the lease agreement permits, to sublet it. However, the difference between the rights of the owner and the rights of the lessee is that the lessee's rights can be limited by an agreement with the owner.

This being said, the rights of an owner to possess, use and dispose of property freely may also be limited by legislation and "other means," e.g., by agreement.

Furthermore, the exercise by an owner of ownership rights should not violate the rights of neighbors and third parties and, as such, the owner should not abuse its rights.

The Civil Code allows for a transfer of property to "trust management." A trustee must manage the property for the benefit of the owner or third parties indicated by the owner. The Code does not provide any details on such trust relationships. The Statute "On the Management of State Enterprises (Facilities)

under Agreements”<sup>16</sup> elaborates upon the rules for the management of property by non-owners (outside the personal sphere.)

Presently, the situation with regard to the nature of the ownership rights to the property of state/municipal enterprises remains somewhat unclear. The State Committee of the Republic of Azerbaijan on Property Issues is in charge of the disposition of state property and exercises control over the management and efficient use of such state property by State enterprises.

The Law “On Public Legal Entities,” dated 29 December 2015 regulates issues on the establishment, operation and organization of public legal entities. The charter capital of public legal entities is formed on the basis of assets contributed to by its founder(s). State and municipal property granted to public legal entities shall be used only in accordance with the purposes reflected in its charters.

### Types of property

The Code provides for tangible and intangible property and for movable and immovable property.

Immovable property includes plots of land, subsurface areas, forests, plantations, buildings, structures and other objects firmly associated with the land, i.e., objects which cannot be removed without causing significant damage (presumably, this also includes pipelines, cables, etc.). Movable property is defined as anything that is not immovable.

### Ownership

The Land Code 1999 provides that foreign persons, (including physical persons, legal entities, international organizations and foreign states) cannot own land, though they do have the right to lease land. Azerbaijani persons and entities, including entities with foreign participation, can freely own, use or lease land.

“Use” in general may be permanent or temporary, the latter being short-term (up to 15 years) or long-term, which is divided into two categories: private (from 15 to 99 years), and land owned by the state and municipality (from 15 to 49 years), and in such cases only land tax is payable. Under a “lease” of land, rent is payable (land tax being paid by the owner.)

Certain land falls within the exclusive jurisdiction of the State (e.g., land situated from 20 to 50 meters from the shore of the Caspian Sea or land granted to state enterprises, institutions and organizations for permanent use, etc.).

Furthermore, as a general rule, subsurface and mineral resources are owned by the state. However, land owners may extract certain mineral resources – e.g., the extraction of “widely available mineral resources” (including, in general, drilling for and exploitation of underground water) for their own needs, where the extraction is carried out without the use of explosives and from a depth of not more than five meters.

Historical and cultural monuments<sup>17</sup> under private ownership are subject to registration, and the Ministry of Culture and Tourism must be notified of a proposed sale, as the State has a pre-emptive right to purchase such monuments.

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<sup>16</sup> Approved by Presidential Decree No. 437, dated 9 February 1996

<sup>17</sup> According to the Law “On the Protection of Historical and Cultural Monuments,” dated 10 April 1998, the list of monuments is approved by the Cabinet of Ministers.

## Acquisition of ownership rights over immovable property

Ownership and other rights with regard to immovable property must be State registered. A right to possess and use immovable property arises as soon as its sale and purchase agreement is notarized (with the exception of rights, which are created on the basis of a court order or other resolution in legal force and not subject to appeal). A right of disposal, however, does not arise until the property is state registered. Currently, the registration is carried out by the State Registry Service of Immovable Property attached to the State Committee on Property Matters (the Registry Service). The Registry Service is charged with recording the ownership and other rights to immovable property in the state register and the compilation and maintenance of a unified register of immovable property.

Some of the services provided by the Registry Service are also performed by the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan (ASAN), which was established by the Decree of the President of the Republic of Azerbaijan, No.685, dated 13 July 2012. According to this decree ASAN service centers will perform, *inter alia*, the following services:

- Primary state registration and re-registration of ownership of apartments and the issuance of statements and technical certificates
- State re-registration of ownership of individual houses and the issuance of statements and technical certificates

- Reference note of state registration on restrictions (encumbrances) on rights over immovable property

The recent changes to the Civil Code and the Law on Notary Mo 762-IQ dated 26 November 1999 make it possible to exchange information and documents between the notaries and the Registry Service, including the direct electronic access of notaries to the State Registry, in order to verify the disposal rights and obligations of the owner of immovable property, as well as the existence of encumbrances over property in the Registry Service, including electronic access to information.

The registration of the ownership rights with the Registry Service was streamlined by allowing a notary to immediately send the notarized agreement on the alienation of immovable property to the Registry Service via registered electronic mail information systems and by registered mail.

In case of the alienation of real estate on the basis of extracts from the Registry Service stored on the e-government portal, at the request of the owner, the extract shall be made by a notary public or other officials authorized to make such notarial actions in the Registry Service through the electronic information system in real time. The Registry Services and the notaries are still working on the full implementation of this system which is currently unavailable.

## Land

The situation with respect to land is complicated by the fact that, before the Civil Code came into force in 2000, several bodies were responsible for issuing various land tenure documents, and they were often inefficient in registering rights. The rapid change of the bodies in charge of land allocation decrees and land tenure documents has further aggravated the problem – there have been at least four regimes established since independence: The first was established under the old Land Code 1991; a new regime was established in a package of legislative acts passed after the adoption of the law “On Land Reform,” 1996 and the privatization legislation; the third regime arose under the Land Code 1999, which is currently in force; finally, there were a few additional provisions introduced on property rights following the introduction of the Civil Code 2000.

The Cabinet of Ministers, the Ministry of Ecology and Natural Resources or local executive authorities act as lessors in respect of leases of state-owned land. The same State authorities are authorized to make decisions on the allocation of state-owned land for use.

Pursuant to Article 9 of the Law “On the Management of Municipal Land,” No. 160-IIIQD, dated 29 June 2001, the ownership and lease rights over municipal land must be obtained only through land auctions or tenders with the exception of cases related to an allocation of land for the construction of an individual housing unit, subject to the restriction established by Article 9.8 of the Law, applicable to citizens of the Republic of Azerbaijan permanently residing and at the same time having a registration address for at least five years in the territory of the same municipality, as well as the transfer of land to state ownership or lease for the purpose of fulfilling obligations arising out of international agreements to which the Republic of Azerbaijan is a party. Further amendments to the Land Code and to the Law “On the Land Market,” which came into force on 12 December 2008, accorded a priority right in the course of land auctions/tenders for municipal land to certain categories of individuals.

Presidential Decree No.972, dated 23 October 2003, which approved the Rules “On the Holding of Land Tenders and Auctions for the Transfer of State and Municipal Land into Ownership or Lease,” sets out the rules on the transfer of State or municipal owned land into ownership or lease on the basis of land auctions or tenders.

All rights in respect of land owned by private persons are transferred to other persons on the basis of a notarized agreement. In practice, typically, a notary in Azerbaijan will insist on the use of his or her template land sale and purchase agreement, although negotiated terms between the parties can often be inserted into such template agreements.

## Movable property

The Civil Code requires that the sale and purchase of certain movable property be recorded in official registers and that the transfer of such movable property must follow the rules for the sale and purchase of immovable property (Article 650, Civil Code), i.e., sale and purchase agreements must be notarized and registered with the State.

On 11 April 2007, a Presidential Decree approved the Rules “On the Official Registers of Movable Property, the Compilation and Maintenance of such Registers.” According to these Rules, the following are among the registrable items of movable property: weapons, motor vehicles, tractors and certain mechanical transportation vehicles, ships, aircraft, trains, films, rare publications, documents of the national archive and moveable historic and cultural monuments.

The Code confirms the rights of a bona fide purchaser to movable property. However, (other than in relation to money, documentary securities or items acquired at auction) a person is not considered a bona fide purchaser if the true owner of the property has lost such property, through theft or otherwise, contrary to his will, or if the acquirer has given no valuable consideration.

### Termination of ownership rights

Ownership rights in immovable property terminate upon cancellation of the registration by the Registry Service or the complete destruction of the immovable property.

Ownership of movable property will be terminated where the owner surrenders his ownership right, the property is destroyed or another person acquires ownership rights in the property.

The Constitution declares that no person may be dispossessed of property without a decision of the court.

The law does, however, provide for compulsory state purchase or confiscation in certain circumstances, for example, for State needs. If such a decision is made by the relevant State authorities and is registered in relation to the acquisition of land plot where a residential building is located, the owners

of apartments in such residential building must be notified about the decision in written form. The relevant compensation to the owners of apartments shall be made based on an agreement between the State authority and the owner of the apartment or on a decision of the court.

Rights over land (other than ownership rights) may be terminated, *inter alia*, if: land tax payable by users of land, or rent payable by lessees, is not paid for one year without a valid reason; the land is purchased by the State in a compulsory manner; the ownership over the constructions and installations which are located on the land plot and owned by the owner of such land plot is transferred to other individual or legal entity; the land is not used for the granted purpose; without a valid reason, the land is not put to use where granted for agricultural purposes within two years (or within one year where the land has been given for non-agricultural purposes).



### **Ownership jointly with others**

Property may be under common ownership of two or more persons, i.e., the share of each owner can be held severally (an independent share of each being determined) or jointly (i.e. without determining a separate share for each). The former is the more usual case.

The Civil Code deals ambiguously with ownership rights in residential apartment blocks and enclosed areas with separate entrances. The ownership right to an apartment, as an integral part of an apartment block, is declared in the Code to be in common (though this is probably not what was intended) with the registered owner of the apartment having the right of possession, use and disposal in respect of the apartment belonging to him or her.

Furthermore, apartment-owners have shared ownership of common structures outside or inside their apartments which service more than one apartment in a residential building, as well as the main (load-bearing) constructions, mechanical, electrical, sanitary and technical and other equipment and adjacent land. Owners of apartments cannot independently alienate their shares in the ownership rights over such common property.

Owners of apartments must bear certain common management and other expenses, e.g., expenses incurred with regard to a commonly held piece of land or for the maintenance of common parts.

Where the owner of an apartment fails to pay his/her share of common expenses for three years, the meeting of owners will have the following rights:

- To register a charge over his share in the common parts
- To take a pledge over moveable property located in the apartment of the defaulting owner

In practice, these steps are rarely, if ever, taken and would be almost impossible to achieve.

It is noteworthy that a separate code, the Apartment Code, which has been in force since 1 October 2009, also contains provisions in respect of rights in residential apartments. The Apartment Code provides for special rules on the acquisition of residential buildings in emergency situations.

### **Mandatory insurance of property**

On 18 September 2011, the Law “On Compulsory Insurance” (the Compulsory Insurance Law) was adopted by the Milli Majlis of the Republic of Azerbaijan. The Compulsory Insurance Law sets forth the general principles of four compulsory types of insurance – (i) compulsory insurance of immovable property, (ii) compulsory insurance of civil liability in connection with the use of immovable property, (iii) compulsory civil liability insurance of owners of motor vehicles and (iv) passengers’ personal accident insurance. The Compulsory Insurance Law is said to be aimed at protecting the property interests of individuals and legal entities by ensuring that the losses they suffer are compensated, while it expressly excludes the loss of profit.

Two types of compulsory insurance related to the immovable property are defined as follows:

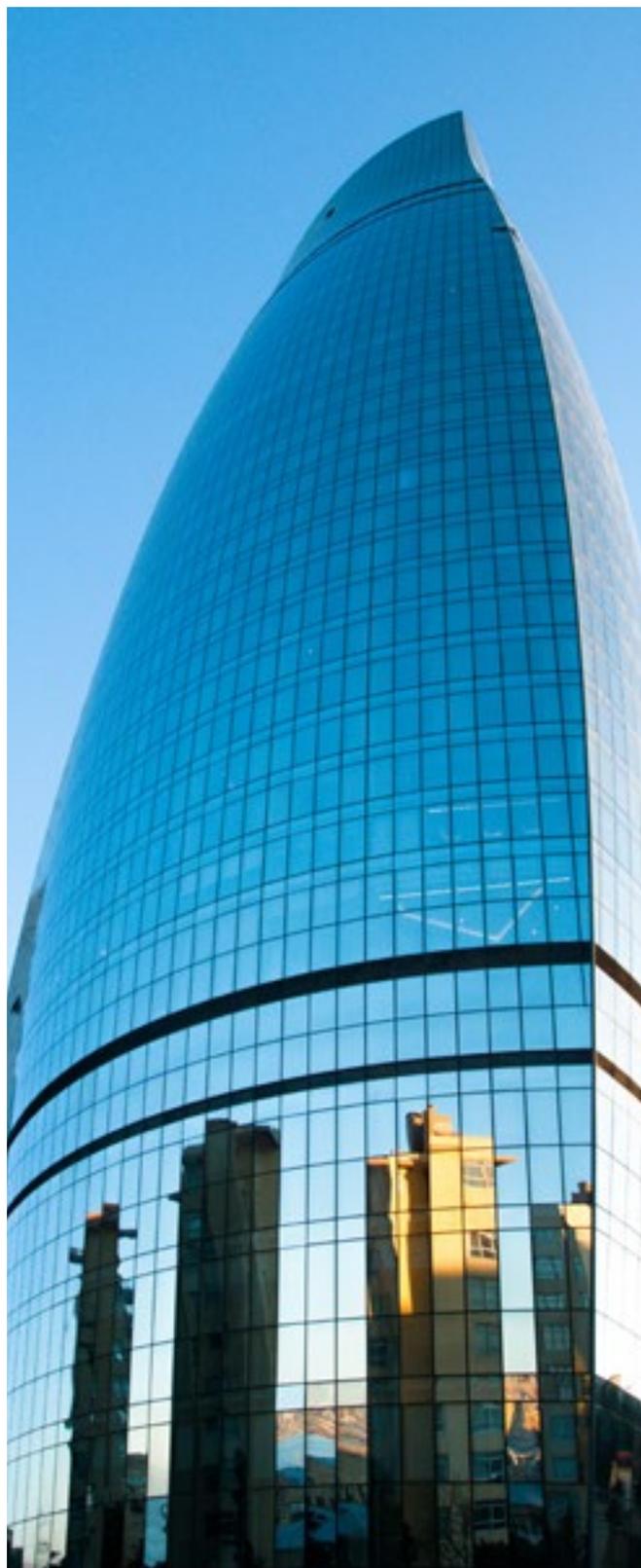
- Compulsory insurance of immovable property – The Compulsory Insurance Law makes it obligatory for the owners or holders of immovable property, whether individuals or legal entities, to obtain loss or damage insurance coverage, with the exception of certain types of immovable property. Among covered insurance events are: fire, lightning strikes, natural disasters, natural gas explosions, floods, third party actions, etc.
- Compulsory insurance of civil liability in connection with the use of immovable property has been introduced to insure against damage to health and property of third parties in connection with the use of immovable property, as well as with construction, renovation and other similar works being carried out within the boundaries of such immovable property. The use of immovable property is limited to that by legal entities or individual entrepreneurs for the purposes of their respective entrepreneurial activities. The introduction of this type of insurance is, in our view, particularly important in the light of the high level of construction activity that is going on in the country

### **Compulsory Insurance Bureau**

The Compulsory Insurance Law mandates creation of a Compulsory Insurance Bureau and its registration as a public association for the non-commercial purpose of, *inter alia*, protecting the interests of insured and other injured third parties and ensuring the stability and development of the compulsory insurance system. In order to obtain permission to underwrite compulsory insurance, an insurer must become a member of the Bureau and pay a security deposit.

### **Useful website**

- Registry Service: <http://www.emdkdedrx.gov.az/>
- State Committee on Property Matters: <http://www.stateproperty.gov.az/>



## How Dentons can help

Dentons has acted for owners, vendors and purchasers, financial institutions, investment funds, real estate developers and construction companies, as well as individual and institutional mortgagees. Dentons has assisted companies, financial institutions and diplomatic missions in all aspects relating to the sale, purchase and mortgage of property, including:

- Structuring commercial and residential real estate projects, including the preparation of project and financial documents
- Reviewing title documents and performing title searches
- Advising on real property law, construction licenses and permits, taxation issues
- Drafting or reviewing sale and purchase agreements
- Successful defense of the rights of property owners in the courts
- Carrying out comprehensive conveyance services
- Advising banks and lenders on taking and registering security

Frequently asked questions with respect to land and immovable property

### Can a non-Azerbaijani citizen or foreign legal entity (e.g., a registered branch of a foreign legal entity) own land in Azerbaijan?

No.

### Can a non-Azerbaijani citizen own real estate property other than land in Azerbaijan?

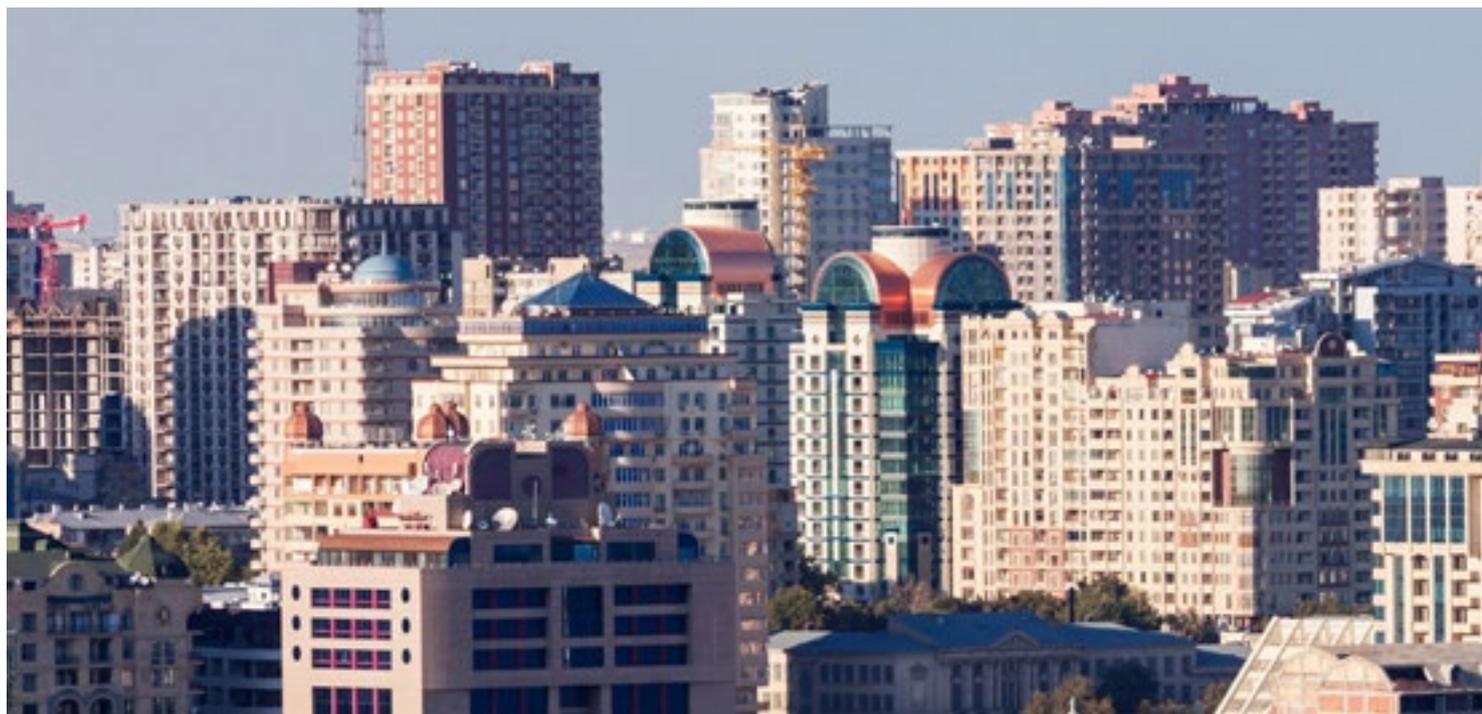
Yes.

### Can I build on someone else's land?

An owner of land may, subject to observing the applicable construction standards and regulations, but also in compliance with the conditions in respect of the designation of the land, construct or demolish buildings on its land or allow other persons to construct upon it.

### If I build on someone else's land, who owns the building?

You will own the building, as long as all necessary permissions were obtained from the land owner prior to construction.



**If I own a building on someone else’s land, can I use the land?**

An owner of a building situated on land which belongs to another person has the right to use that part of land on which the building is situated, i.e., it is important to ensure proper access to rights of way to and from the property and rights to the laying on of services.

**What rights does a purchaser of a building get to the land beneath it?**

The purchaser of a building usually acquires the right to use the relevant part of land under the same conditions and to the same extent as the seller.

**If I own a building on another person’s land, what happens if the land is sold?**

The transfer of ownership of land to another person is not in itself a ground for the termination or change in the right to use the land by the owner of a building constructed on it.

**Can a building owner dispose of or demolish a building situated on land owned by another person?**

Yes.

**What happens to buildings constructed on another’s land when the right to use the land ceases?**

According to the Civil Code, unless otherwise specified by an agreement with the owner of the land, the right of ownership to buildings, structures and other immovable property constructed on the land will transfer to the landowner. However, the Land Code 1999 provides that, unless otherwise envisioned by an agreement with the owner of the land, any temporary constructions must be demolished at the expense of the land user or lessee. The rule under the Law “On Leases” is that any building constructed by the lessee without the permission of the lessor (i.e., the landowner) is the property of the lessor.

**If I buy an apartment, who owns the yard and other ancillary land adjoining the apartment block?**

Plots of land adjoining residential buildings owned by the State or a municipality (or which are partly privatized) will remain under the ownership of the state and municipality but will be given for permanent use to the relevant organizations managing such blocks. However, plots of land of completely privatized residential buildings and non-residential buildings attached to them should in theory be given to permanent use of the independent management organizations established by the residents.





# Chapter 13

# Leases

In Azerbaijan, the lease of land and other immovable property is primarily governed by the following laws:

- The Law “On Leases,” dated 30 April 1992 (the Law on Leases)
- The Law “On Land Leases,” dated 11 December 1998
- The Land Code, effective as of 8 August 1999
- The Civil Code, effective as of 1 September 2000

In addition to the concept of “lease” there also exists in Azerbaijani law the concept of “use,” which is most commonly encountered where State land is granted for a particular purpose (e.g. for construction purposes). The Civil Code provisions for the rental of property also apply to lease agreements, unless the law stipulates otherwise.

## **Parties to lease agreements**

Since foreign nationals/companies may not own land under Azerbaijani law, they also may not be lessors of land. The Azerbaijani State, municipalities and Azerbaijani persons (physical persons and legal entities—including legal entities with foreign participation) can act as lessors as well as lessees of land.

Foreign nationals/companies can, however, be owners and lessors of immovable property other than land, such as apartments.

## **Notarization and registration of leases**

The Civil Code requires that a lease agreement involving immovable property must be notarized. However, notarization is not required for an agreement to lease land from the state or a municipality.

The Law “On the State Register of Immovable Property” requires that any lease of immovable property for a term exceeding eleven (11) months must be registered. The state does not guarantee the protection and immunity of land rights which have not been registered.

### **Title documents**

Normally, the availability of the following documents confirms the right of a lessor to grant a lease of land or other immovable property:

An extract issued by the Registry Service (or other documents issued by the predecessors of the Registry Service). The extract should confirm the right of use, lease or ownership (as the case may be) of the leased property. Recent changes to the legislation allow notaries to check the existence of such document in a real time regime but such practice has not yet been implemented.

A technical passport which contains information about the technical parameters of the immovable property.

A document confirming that the property is not encumbered. This document can be obtained from the Registry Service or requested to be checked at the notary office before the notarization of the relevant agreement.

The foregoing documents would also routinely be requested for inspection by a notary engaged to notarize a lease agreement.

### **Contents of lease agreements**

The law requires that a land lease agreement contain at least a description of the land (including its size, designation, boundaries and use), the term of the lease, a statement of condition, the rent and payment terms, conditions of use and terms relating to the exploitation, protection and improvement of the land. The agreement should also contain the names and legal addresses of the parties and provisions on renewal (or amendment), early termination, force majeure, consequences of breach and dispute settlement.

The law also binds the parties to the lease agreement to requirements which may not be mentioned in the lease. For example, a lessee is not responsible for wear and tear on a leased property used for its designated contractual purposes. Also, the costs of maintaining and cleaning leased property are not recoverable from the lessor.

Moreover, the leased property must be suitable for the uses outlined in the lease agreement, and the lessor must continue to maintain the property in that condition throughout the entire term of the lease. The lessor is also responsible for ensuring that the property has the characteristics specified in the lease agreement. It is an implied term of a lease agreement of residential property that it is safe, with no evident danger to life or health of the lessee.

A lease agreement which is not in conformity with the mandatory requirements of the law is void.

### **Subleases and assignment of leases**

Under the Civil Code, the lessee of premises cannot sublet such property without the consent of the lessor. The Civil Code suggests that consent to sublet to a third party may be withheld on objective grounds relating to the identity of the third party. In any case, it is advisable to include in a lease agreement a provision obliging the lessor not to “unreasonably withhold” consent to sublet. Alternatively, the lease can be negotiated to include the specific conditions for sub-letting.

In general, the Civil Code suggests that the assignment of leases of land or other immovable property is only possible with the consent of the owner or lessor of such land.

### **Termination of lease agreements**

According to the Civil Code, a fixed-term lease agreement terminates upon the expiration of its term. But under certain conditions a fixed-term lease agreement can be terminated prior to the expiration of its term. For example, a lessee can terminate a lease agreement with immediate effect if the property substantially deteriorates and the lessor fails to remedy such breach. A lessor can terminate with immediate effect if the lessee fails to pay rent or a substantial portion thereof for two consecutive months or if the lessee uses the property in such a way which substantially violates the rights of the lessor.

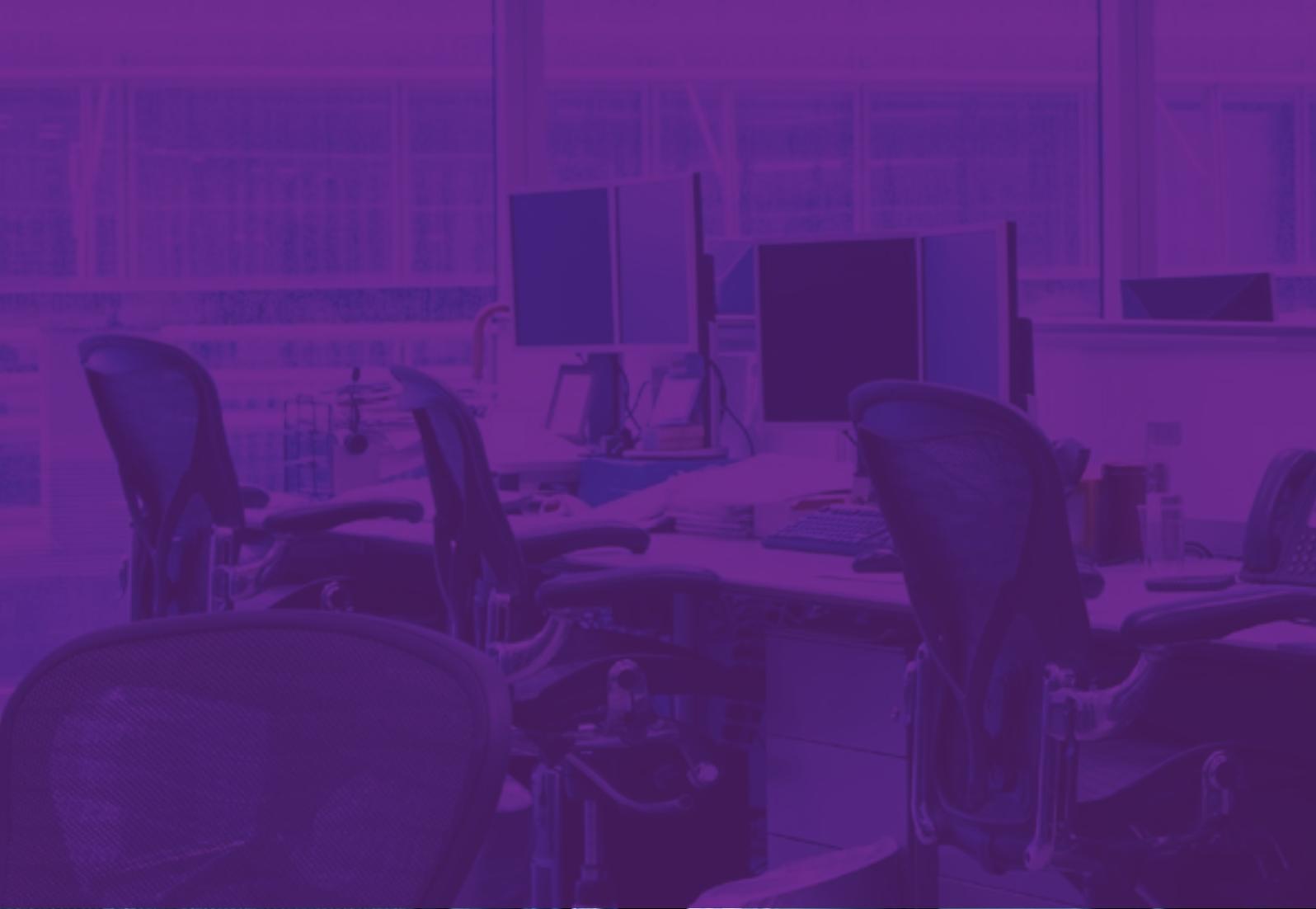
Under the Civil Code (Article 691), an agreement to rent premises, for which the rent is paid on a monthly basis, can be terminated by three months’ notice, provided the notice to terminate is submitted on the first day of the first month (e.g., the notice is submitted on 1 August to terminate a lease agreement as of 1 November). However, Article 704 of the Civil Code only gives this right to the lessor.

The Law on Leases appears to allow a lease agreement to be terminated in accordance with the agreement of the parties concerned. However, given the content of Article 2.5 of the new Law on Normative and Legal Acts (2010), the Civil Code should take precedence over the Law on Leases in the event of any conflict between the two legal acts. It appears, as a consequence, that the lessee could terminate upon three months’ notice only if this was acceptable to the lessor, but not otherwise.

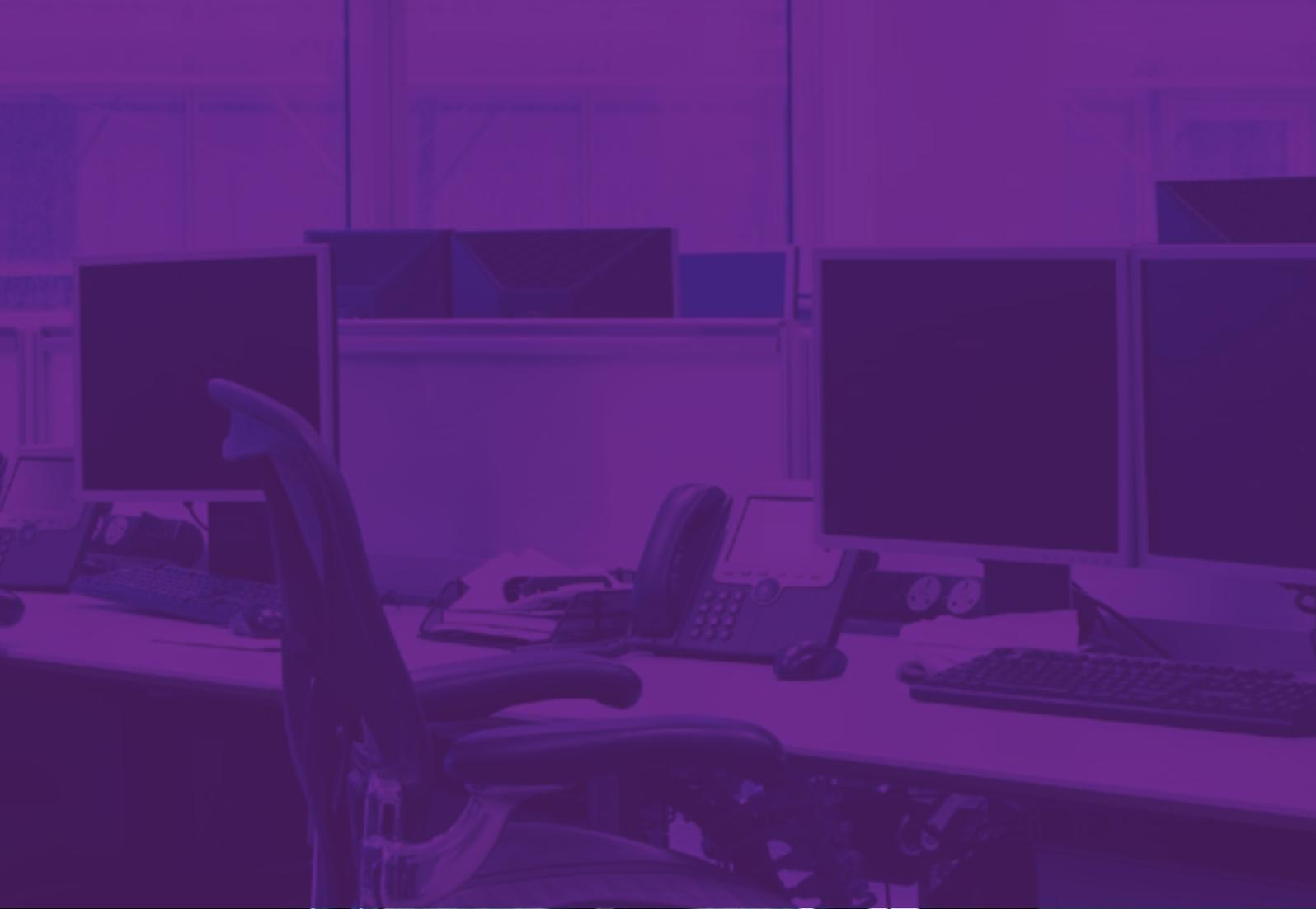
### **How Dentons can help**

Dentons has acted for both lessors and lessees and has assisted many companies, international finance institutions and diplomatic missions in all aspects relating to leasing, including:

- Drafting or reviewing leases
- Reviewing title documents and performing title searches
- Advising on real property law, construction permits and taxation issues
- Providing model lease agreements
- Successfully defending owners, lessors or lessees in the courts



# Chapter 14



# Employment

## Introduction

The Labor Code (1999) (as amended) is the principal legal act regulating employment relations in Azerbaijan. The Code prescribes minimum rights and obligations which must be observed in employment relationships.

## Employment Relations

Entry into employment contracts, amendments to employment contracts and information on the termination of employment contracts become effective upon registration with the electronic database maintained by the Ministry of Labor and Social Protection of the Population.

The State authority should issue to the employer an electronic confirmation of the registration of the employment contract (amendments, termination)

within one business day following the submission of the relevant notification.

The employer may be subject to administrative liability and, subject to certain conditions, criminal liability, for engaging individuals for any work without an effective employment contract.

## Fixed-term contracts

An individual employment contract may be concluded for either an indefinite period or a fixed period of up to five years. If the term of the fixed-term contract lasts continuously for more than five years, it will be deemed to be an indefinite term contract. However, generally, if the employment functions to be fulfilled are permanent in nature, an employment contract must be concluded for an indefinite period. Temporary work, on the other hand, would justify the

conclusion of a fixed-term contract. The Labor Code lists various instances where a fixed-term employment contract is permitted.

### **Content of employment contracts**

Although the parties to an individual employment contract may determine its structure and content, certain mandatory provisions must be included. These include terms and conditions relating to an employee's position, employment functions (i.e., job description) and the duration of employment.

The Labor Code does provide a model form of employment contract. Although originally intended to be mandatory, later drafts of the Labor Code were amended to permit freedom of contract.

### **Hiring a new employee**

The Labor Code requires that an employer collect and keep at the work place certain documents which evidence the existence of employment relationships. Such documents include the employee's labor book, copies of the employee's identification documents, state social insurance certificate, certificates evidencing his/her education and training and medical certificates in special cases. The employer, in practice, usually issues an internal order on hiring new staff. Contracts must be recorded in a special book or computer record.

With the exception of certain specifically exempted categories, an employee entering into an individual employment contract must produce a labor book. As the document confirming length of service of the employee for specific purposes, the labor book should contain information on the date of the commencement of employment, the employee's position, and the grounds for and date of employment termination. The employer also signs an entry in the labor book on the termination of employment.



### **Probationary periods**

An individual may be employed subject to a probationary or trial period. The probationary period cannot exceed three months and, for certain protected categories of employees (those aged under 18; persons hired by competition, pregnant women and women having children under three years of age, as well as men raising children under age three alone; persons hired in accordance with their profession (specialization) for the first time in the year of graduation from an educational organization for the profession, persons elected for paid elected positions, persons with whom the labor contract was concluded for up to two months), it cannot be applied at all. Either party may terminate the employment contract during the probationary period by giving three days' notice but, if the termination is to be carried out at the initiative of the employer, the contract must specify the grounds on which it may be terminated during the probationary period.

### **Compensation**

Employees must be paid in Azerbaijani Manats. Normally, salaries must be paid by way of a non-cash settlement.

Under the Labor Code, salaries should, as a rule, be paid in two installments per month. However, where salaries are calculated on an annual basis, payment is permitted once a month.

## Working Hours

Under a normal work regime, an employee must not work more than eight hours per day or more than 40 hours per week.

Depending on the category of the job, the age of the employee, working conditions, etc. the legislation also provides for a reduced working week for certain groups of employees:

- Those up to the age of 16: not more than 24 hours per week
- Those between the ages of 16 and 18, as well as category I and II invalids, pregnant employees and employees having a child under the age of 18 months: not more than 36 hours per week

As a rule, a five-day working week is the norm. At companies where a five-day working week is not convenient for production purposes, a six-day working week may be applied. In a six-day working week, the normal working day should not exceed seven hours where the working week is 40 hours. Working hours on the eve of holidays are reduced by one hour in both five-day and six-day regimes.

Part-time work may be agreed between the employer and the employee; however, the employee will be entitled to the full protection of Azerbaijani labor laws.

Work may, if desired, be based on a regime of the cumulative recording of working time. This method is usually adopted when work is carried out far from the place of residence of the employee and the possibility to return home every day is impractical. The recording unit under the regime of cumulative recording of working time can be any calendar unit (e.g., one month, three months, etc.) but it may not be longer than one year. The duration of daily work during such regime may not exceed 12 hours. The number of working hours during the recording unit should not exceed the number of normal working hours prescribed by the authorities for the same period.

Overtime is permissible only in exceptional circumstances, for very limited periods and subject to strict compliance with, and additional compensation prescribed by, the Labor Code. Statutory references to "overtime" do not include work during weekends or on holidays, as these are provided for separately. Overtime may not be required of certain categories of employees, e.g., those who work in extremely hazardous work conditions.

## Vacation and holidays

An employee is entitled to four different types of leave: employment-related leave/vacation (basic and supplementary), social leave (which includes maternity leave), study leave and unpaid leave. While the duration of basic employment-related leave is 21 calendar days, certain positions (e.g., specialists, managerial staff) are entitled to 30 calendar days. Depending on work conditions, experience and other prescribed factors, an employee may be entitled to one or more supplementary vacations.

An employee may, in general, take leave only after having worked for the employer for at least six months but certain categories of employees, e.g., employees under 18, are not subject to this restriction. At least one period of leave in each year should be for not less than two calendar weeks.

During the second and subsequent years, leave is given at a time agreed in accordance with the order of priority approved by the local trade union, if any, or in its absence, by the employer after discussion with the employee. In order not to upset the normal production and working process, a schedule of priority in giving leave may be drawn up for the year by the end of January.

An employee may be required to work on a holiday only in prescribed exceptional circumstances.

## Safety at Work

An employee has the right to work under safe and healthy work conditions. The safety rules applicable to work places are aimed at improving employment conditions and preventing industrial accidents, injuries and occupational hazards at the work place. For example, an employer must ensure that buildings, equipment and facilities are safe and that sanitary and hygienic requirements are observed at the work place. Each enterprise must have fire extinguishers and fire safety guidelines which, among other things, allocate smoking areas, describe evacuation rules and set forth duties regarding inspection of premises at the end of the work day. There are also detailed safety rules in respect of the use of computers and other equipment emitting electromagnetic rays.

## Employment termination

An employment contract may be terminated on the following general grounds:

- Termination by one of the parties to an employment relationship
- Expiration of an employment contract's fixed term
- Change of employment conditions
- Change of owner (applies to certain senior managerial personnel only)
- Circumstances beyond the control of the parties
- Other additional grounds stipulated in an employment contract

Termination of an employment contract must be justified on one of the grounds available for employment termination under the Labor Code. The Labor Code prohibits reference to more than one ground or reference to grounds other than those specified in the Labor Code.

The Labor Code also provides six specific grounds under which an employer may terminate an employment contract:

- Employer's liquidation or closure
- Staff reduction or downsizing
- Decision of a special commission of the employer that the employee is unqualified or incompetent for the position
- Employee's failure to fulfill employment obligations
- Failure to pass the probationary period
- Reaching pensionable age (applies to employees of enterprises financed from the state budget)

The termination of an employment relationship must be appropriately documented.

## Redundancies

Certain types of employees (e.g., mothers with children under the age of three) cannot be made redundant and certain other categories (e.g., war veterans) can be terminated only if certain strict conditions apply.

In any event, an employee whose job is redundant must be given notice, depending on the employee's experience with the specific employer, from two calendar weeks to nine calendar weeks (or be paid in lieu of notice from 0.5 monthly salaries to two monthly salaries, at the employee's option) and severance from one month's salary to two months' salary, depending on the employee's experience with the specific employer.

Any termination of employment needs to be carefully, lawfully and sensitively handled. Failure to do so can lead to expensive and disruptive litigation. An employer who has breached the employment rights of an employee is liable to compensate the employee for the damage done or loss caused. An employee who has a grievance may file a case in the district court.

“Damage” can extend to what is known as “moral” damage—defamation of character, insult (verbally or by action), humiliation of the employee, etc. The Labor Code, 1999, does not impose any limit on the amount of moral damage which may be claimed by the employee—this is at the discretion of the court hearing the case as long as the quantum of moral damage has been pleaded by the employee in his or her claim.

### Oil industry

A large number of PSAs have been entered into by the various oil consortia with the Government of Azerbaijan, and most of these have been passed into law. Consequently, they are important in determining the law applicable to employment contracts of employees engaged in the oil industry. The PSAs,<sup>18</sup> in summary, state that the employer is free to implement practices relating to:

- Recruitment
- Dismissal
- Performance review
- Incentives

These are customary in international petroleum operations and—in the experience and judgment of the employer—are best able to promote an efficient and motivated workforce.

This appears to give great scope to the employer (though what is customary in international petroleum operations is rather vague) but it makes no reference to common and important provisions contained in most contracts, e.g., leave entitlement, maternity benefits, etc. It can be concluded, therefore, that an employer falling under the umbrella of a PSA is reasonably free (within the confines of what is customary in international petroleum operations) to set such policies as it sees fit in respect of the matters listed above, but that other matters will fall under the consideration of the general labor law of Azerbaijan in the normal way.

### Social insurance and taxation

Employees are taxed through a withholding mechanism. The employer is required to withhold income tax and the employee’s social security obligations from the employee’s salary and to pay over the withheld amount to the appropriate authorities.

Unless there has been an arithmetical error or the employee consents to this, excess payments made to an employee as a result of failure to enforce the law (e.g., failure to withhold taxes) cannot be recovered by the employer by deduction from later payments. The top rate of income tax is 25% on monthly income over AZN 2,500.

Taxable income will generally include all bonuses, non-arms’ length transactions and benefits-in-kind other than those of a social nature. There are, however, certain exceptions.

An employee’s social security contributions are three percent of employee remuneration. The contribution is paid to the Social Protection Fund (SPF). The employer’s social security contributions are 22% of total remuneration. In general, the base for calculating income taxes is the same for calculating social security contributions, but there are some important differences. For instance, sick leave allowances are subject to tax but are not subject to social security contributions.

### Unemployment insurance

Employees are subject to unemployment insurance which should be deducted monthly by employer from the employee’s salary in the amount of 0.5%. The employer is also required to pay 0.5% of unemployment insurance which is paid to the SPF.

Employees may benefit from such unemployment insurance if their employment is terminated on the ground of redundancy or liquidation of an enterprise.

<sup>18</sup> E.g., the *Agreement On the Joint Development and Production Sharing for the Azeri and Chirag Fields and the Deep-Water Portion of the Gunashli Field*, dated 20 September 1994. Cf. Art. 6.7(c) which states that “All Azerbaijani citizens hired by any Sub-contractors shall be hired pursuant to a written employment contract which shall specify the hours of work required of the employee, the compensation or benefits to be paid or furnished by the employer and all other terms of employment. Such employees may be located wherever the Sub-contractors deem appropriate in connection with the Petroleum Operations Sub-contractors shall be free to implement recruitment, dismissal, performance review and incentive compensation programs and practices that are customary in international Petroleum operations and in Sub-contractor’s experience and judgment are best able to promote an efficient and motivated workforce.”

## Employment of foreigners

With the exception of certain categories of foreign employees (including permanent residents of Azerbaijan, individual entrepreneurs, heads and deputy heads of branches or representative offices of foreign legal entities operating in Azerbaijan and the heads and deputy heads of legal entities established in Azerbaijan where at least one of the shareholders is a foreign individual or a foreign legal entity), a foreign national may not work in Azerbaijan without a work permit.

## Employee or contractor?

In many countries, employees are given a special status, governed by special laws aimed to protect them and provide them with benefits that are considered socially desirable (e.g., maternity leave, sick leave, paid vacations, job security, etc.). In this respect, Azerbaijan is no different.

Individuals providing services other than as employees (referred to here as “contractors” to differentiate them from the recipients of services, which we shall refer to as “clients”), do not receive the protection offered to employees other than through the normal contractual relationship (i.e., the contract may, in general, be terminated in accordance with its provisions without other statutory obligations being imposed.) In addition, clients may have certain tax and social security advantages in establishing this form of relationship.

Employment contracts are governed by the Labor Code (as amended). Contractor arrangements are governed by the Civil Code (as amended), by provisions which apply to what are generally known as civil-law agreements. The latter might include the provision of one-off services such as translating or interpreting or more regular work (e.g., driving, cleaning.)

Employers worldwide have often sought to avoid the sometimes onerous consequences of entering into employment relationships by re-defining the relationship as one for the provision of services. Whether such re-definition is successful in avoiding the potential burdens imposed by an employer-employee relationship is very often a question of fact and intention, which sometimes must be proved to the satisfaction of the court. Dentons is experienced in drafting both employment contracts and contracts for services.

## How Dentons can help

Dentons is the acknowledged leader in Azerbaijan in the provision of employment services. Dentons has assisted companies in all aspects relating to employment matters, including:

- Providing advice regarding prospective staff – choosing the right people is important to any organization but special factors in Azerbaijan mean that careful selection, especially for positions of trust, is critical
- Carrying out employment audits – to ensure that contracts, internal procedures, records and regulations conform to the law, Dentons can carry out employment audits
- Drafting employment and contractor agreements. Dentons does not normally recommend the use of the model employment contract provided in the Labor Code, other than in very rare instances. Dentons is able to draft employment contracts in accordance with Azerbaijani law, but which give much greater protection to the employer than those provided for in the model
- Providing a model agreement that is specifically designed to assist the employer in understanding employment legislation in Azerbaijan
- Defending employers in the courts in unfair dismissal cases
- Assisting with obtaining work permits and employee work books
- Operating payrolls, file tax and social security reports
- Undertaking income tax and social security reviews to ensure the correct amounts are being paid and the right documentation available
- Planning redundancy strategies
- Drafting grievance procedures, staff manuals and disciplinary rules





# Chapter 15

# Currency regulation

## Introduction

Currency operations are regulated mainly by the Financial Market Supervisory Authority, the Central Bank of Azerbaijan and the State Customs Committee of Azerbaijan. Separate rules are specified for residents (generally, legal entities registered in Azerbaijan and Azerbaijani citizens) and non-residents (generally, legal entities registered outside Azerbaijan, their branches and representative offices in Azerbaijan).

## Remittances

Residents and non-residents may, on the provision of evidence of an import or inward remittance, remit outside of Azerbaijan whatever funds have been previously brought into or remitted to the country. The repatriation of income earned by non-residents from investment activity is allowed after

providing a certificate of payment of “relevant taxes and duties” or providing the relevant tax exemption documents. Similarly, the payment of dividends to shareholders is generally permitted. The banking system is responsible for ensuring compliance with these rules, and investors should be careful to obtain and keep certificates from their banks concerning inward remittances.

A special regime applies to the remittance of funds that were previously brought into Azerbaijan in cash form or transferred from overseas to a local bank account, including those transferred from overseas via a payment system without opening a bank account. The regime includes the submission of relevant documents (e.g. an original customs declaration, a document evidencing the transfer of funds from

overseas to a local bank account or a bank document confirming the transfer of funds via a payment system without opening a bank account).

Non-resident individuals may repatriate salaries, dividends and interest after providing evidence for the payment of taxes in respect of such income/ payments. In the case of dividends or interest, such evidence will normally be the order to the bank making the remittance to pay the appropriate withholding taxes to the tax authorities. In case of salaries, an employment agreement showing salary payment terms must be presented to the bank.

Resident and non-resident individuals may make transfers freely from their Azerbaijani accounts to overseas bank accounts of up to US\$1,000 per banking day, but not exceeding US\$10,000 per calendar month, by indicating the purpose of the transfer. Resident individuals may make transfers, but not exceeding US\$10,000 per calendar month, to their immediate family members living or temporarily residing abroad.

Both resident and non-resident individuals may also transfer foreign currency in the amount of up to US\$1,000 overseas per banking day, but not exceeding US\$10,000 per month, without opening bank accounts via local licensed banks.

### Customs control of cross-border movements of cash

The following customs rules apply to foreign currency brought into/taken out of Azerbaijan in cash:

Cross-border transfers in cash	Documents and conditions of transfer
Bringing in foreign currency in any amount	No restriction, subject to complying with the relevant customs formalities
Taking out foreign currency not exceeding the equivalent of US\$10,000	Verbal declaration to customs authorities
Taking out foreign currency exceeding the equivalent of US\$10,000, but less than the equivalent of US\$50,000	Presenting documents confirming that funds have been previously brought into Azerbaijan in cash form and completion of a written customs declaration
Taking out foreign currency exceeding the equivalent of US\$50,000	Prohibited

### Foreign currency bank accounts

Basically, all banking or cash transactions made within Azerbaijan must be in Azerbaijani Manats; but, subject to legal entities and entrepreneurs obtaining a “duplicate certificate” from the tax and social insurance authorities, there is no restriction on maintaining foreign currency accounts in Azerbaijan. Such accounts may, however, generally only be used to receive foreign currency from overseas.

An Azerbaijani entity may generally open bank accounts in banks located abroad, though new rules are expected for entities that are subject to regulation in financial markets (e.g., entities engaged in licensable activities in the securities market, credit organizations, professional participants in the insurance market, investment funds and investment funds managers). All Azerbaijan taxpayers must obtain a “duplicate certificate” and submit a reporting form for the opening of accounts in non-resident banks for business purposes. Failure to do so could result in a financial sanction of 100% of the amount deposited into the account.

### **Finance of trade and investments**

Advance payments are made subject to the presentation of supporting documents for a particular transaction (i.e., contract, invoice, order, etc.). Only the importer/purchaser of goods, works and services may pay to the seller, unless the import agreement was concluded in favor of a third person, in which case the importer/purchaser of goods, works and services and/or the person that is a party to the import agreement would pay for the imported goods, works or services. A new deadline has been introduced requiring the submission to the bank of a customs declaration or a document confirming the provision of imported services within 270 days from the date of the advance payment. Failure to return from abroad funds paid in advance where goods, works or services for which an advance payment was made were not imported, performed or provided within the specified periods of time may lead to the imposition of an administrative fine from 10 to 30% of the amount in question.

### **Repatriation of foreign currency earning**

Resident enterprises and organizations are required to repatriate their foreign currency earnings into accounts with resident banks.





# Chapter 16



## Licensing and permits

Before lawfully engaging in business in Azerbaijan, physical persons and legal entities having certain activities must satisfy applicable administrative requirements, including the obtaining of licenses or authorizations/permits.

The licensing regime in Azerbaijan is regulated by several legal acts, the most significant of which are the following:

- Law “On Licenses and Permits,” No 176-VQ, dated 15 March 2016, which is in force from 1 June 2016 (“Law on Licenses and Permits”)
- Decree of the Cabinet of Ministers No. 174, dated 7 November 2002, “On Additional Conditions for Granting Special Permissions (Licenses) for Certain Types of Activities” (with further amendments, the latest of which were introduced 15 January 2016)

- Decree of the President No. 713, dated 21 December 2015, “On Certain Actions in the Area of Licensing”
- Decree of the Cabinet of Ministers No. 347, dated 16 September 2016 approving Rules on the Maintenance of a Single Register for Licenses and Permits

In an effort to improve the investment climate, the Government of Azerbaijan has implemented a number of positive actions, among the most important of which was Law on Licenses and Permits, which has reduced the number of licensable activities to 24 (plus five activities related to national security).

The Law on Licenses and Permits sets out criteria for types of activities requiring licenses and permits (except within the financial markets) and

an exhaustive list of licenses and permits. While different ministries or state agencies are involved in the licensing sector, the Ministry of the Economy and ASAN provide general control and administration over licensing procedures, including the preparation of the main regulatory directions and draft legislation, the supervision of implementation by other government agencies and the maintenance of a unified register.

According to the Law on Licenses and Permits, the issuance of licenses and permits, duplicates of such licenses and permits and amendments thereto, and the re-issuance, suspension, resumption and cancellation of licenses and permits shall be made through an Electronic Licenses and Permits Portal. Licenses now will be issued within 10 days from the date of application (the previous regulations provided for a 15-day period), and permits will be issued within seven days. The Law on Licenses and Permits sets out a procedure for the notification of the applicant by the relevant authority within five days of the need to eliminate defects in the application and attached documents, as well as the right of the applicant to eliminate such defects within 10 days.

The Law is applicable to all legal entities, including branches and representative offices of foreign legal entities, and to private entrepreneurs (except in financial markets), as well as to the authorities granting license and permits.

The Law on Licenses and Permits also refers to an Electronic Licenses and Permits Portal, as well as to a Single Register for Licenses and Permits. It contains a list of information which shall be included on the portal and in the register. Licenses and permits are to be issued for limited and unlimited periods of time depending on requirements of relevant legislation.

The specific procedure for the issuance of licenses is set out in the 2002 Decree of the Cabinet of Ministers No. 174, which defines the list of documents required to obtain a license, depending on the type of licensable activity.

Licenses are divided into general and special licenses. A general license is a license granting the right to be engaged in a licensable activity for each of the listed sub-groups of licensable activities without a special license. A special license is a license granting the right to be engaged in one or more sub-groups of licensable activities. The license holder alone shall be entitled to use the license granted, which cannot be transferred to another person.

The Law on Licenses and Permits has three annexes: 1) a List of activities which require a license (except for cases related to national security); 2) a List of activities related to cases of national security which require a license; and 3) a List of permits to be issued for entrepreneurial activity.



We have provided below the list of licensable activities reflected in the Law on Licenses and Permits):

### List of activities which requires license (except for cases related to national security)

1. Toxic industrial waste:
  - 1.1 Utilization
  - 1.2 Neutralization
2. Private medical activities
3. Pharmaceutical activities:
  - 3.1 Production of drugs
  - 3.2 Gross sale of drugs
  - 3.3 Retail sale of drugs
4. Precursors:
  - 4.1 Production
  - 4.2 Import
  - 4.3 Export
  - 4.4 Transit transportation
5. Educational activities:
  - 5.1 Pre-school education organizations
  - 5.2 General educational organizations (including lyceums and gymnasiums)
  - 5.3 Elementary vocation educational organizations (vocational schools and vocational lyceums)
  - 5.4 Mid-vocational educational organizations
  - 5.5 Higher education institutions
  - 5.6 Additional educational organizations
  - 5.7 Mid-vocational religious education institutions
  - 5.8 High school religious education
6. Communication services:
  - 6.1 Telephone (wire)
  - 6.2 Radio-trunk and wireless
  - 6.3 IP-telephony (internet-telephony)
  - 6.4 Arranging of internal telecommunication channels
  - 6.5 Arranging of international telecommunication channels
  - 6.6 Transfer of information (data)
  - 6.7 Express postal service
7. Storage of radioactive and ionized radiation waste
8. Transportation of hazardous cargo by transport facilities
9. Liquid and natural gas plants:
  - 9.1 Installation
  - 9.2 Exploitation
10. Mining-extractive works, mining and well excavation works
11. Installation and repair of elevators
12. Exploitation of side-shows
13. Installation and repair of lifting facilities, metallurgical equipment, boilers, vessels, operating under pressure
14. Diagnostics and other maintenance inspection of equipment and technical facilities exploited in the potentially hazardous facilities
15. Fire protection activity:
  - 15.1 Fire protection on the basis of an agreement with entities and settlements
  - 15.2 Production and purchase of fire extinguishing equipment, conducting of tests
  - 15.3 Installation of fire protection systems and facilities, technical service and repair
  - 15.4 Repair and servicing of fire protection equipment, primary firefighting equipment, quality of restoration of firefighting equipment
16. Engineering-survey works concerning buildings and structures which require construction permit
17. Construction-assembly works concerning buildings and structures which require construction permit
18. Designing of buildings and structures which require construction license subject to applicability of information execution
19. Private veterinary medical activity
20. Veterinary medications:
  - 20.1 Production
  - 20.2 Sale
21. Plant protection means and agrochemical substances:
  - 21.1 production
  - 21.2 import
22. Establishment of private hunting plants
23. Procurement of wild raw plant drugs for production
24. Preparation of different types of stamps and seals

## List of activities related to cases of national security which requires license.

1. Private security activity
2. Activity in the sphere of designing and producing information protection means
3. Establishment of biometric technologies and provision of services to such technologies
4. Formation of personal data information resources and establishment of information systems and provision of services for such systems and resources
  - 4.1 Cellular (mobile) communication services (with reference to the name of technological standard)
5. Television and Radio Broadcasting activity:
  - 5.1 Television broadcasting to the entire Republic
  - 5.2 Television broadcasting to Baku city
  - 5.3 Regional television broadcasting
  - 5.4 Radio broadcasting to the entire Republic
  - 5.5 Radio broadcasting to Baku city
  - 5.6 Regional radio broadcasting
  - 5.7 Additional information broadcasting
  - 5.8 Cable network broadcasting with the number of subscribers up to 5000
  - 5.9 Cable network broadcasting with the number of subscribers over 5000
  - 5.10 Satellite broadcasting
  - 5.11 Activity on ensuring the satellite broadcasting of foreign radio and television channels by means of encoding devices

The Law “On the State Duty,” dated 4 December 2001, specifies the appropriate state duty for each category of activity granted by relevant license or permit.

## List of permits to be issued for entrepreneurial activity

According to the Law on Licenses and Permits, a “permit” is an official document (permit, approval, certification, certificate, accreditation) granted by the authority responsible for issuing the permit for the purpose of the fulfillment of the relevant entrepreneurial activities or certain actions in connection with the implementation of entrepreneurial activities. The list of permits includes 86 types of commercial activities.

Azerbaijani legislation in the field of licensing is constantly evolving. Presidential Decree No 509, dated 26 October 2011, emphasized the notion of the purposes of licensing, which might serve as a means of liberalizing the licensing legislation. These purposes can be divided into two categories: those aimed at the protection of state interests and those aimed at the protection of the personal rights and interests of individuals and legal entities.

Presidential Decree No. 509 also ordered the establishment of a web portal that would collect data provided by the central and local executive bodies with respect to the name of the permit, the legal basis, the list of required documents, the issuing body, etc. The web portal [www.icazeler.gov.az](http://www.icazeler.gov.az) was created and officially launched on 15 March 2012.

### How Dentons can help

Dentons has advised many companies and financial institutions on the legal requirements for licensed activities and has assisted in the procurement and renewal of the relevant licenses and permits necessary for our clients’ activities in many sectors of the economy.





# Chapter 17



# Intellectual property

## Introduction

Along with most newly-independent states, the infringement of intellectual property rights is not uncommon in Azerbaijan. Nevertheless, Azerbaijan has acceded to a number of conventions designed to protect intellectual property rights, and the successful enforcement of rights is often possible.

## Legislation

The basic laws regulating intellectual property in Azerbaijan are:

- On Copyright and Related Rights, 1996
- On Patents, 1997
- On Trademarks and Geographical Indicators, 1998

- On the Legal Protection of the Layout of Integrated Circuits, 2002
- On Protection of Expressions of Folklore, 2003
- On the Legal Protection of Compilations, 2004
- On Ensuring Intellectual Property Rights and Combatting Piracy, 2012

Azerbaijan has ratified a number of important international conventions in this area, including:

- The Berne Convention for the Protection of Literary and Artistic Works, 1886
- The Paris Convention for the Protection of Industrial Property, 1883 (the Paris Convention, which, inter alia, provides priority for a local registration.)

- The Madrid Agreement Concerning the International Registration of Marks, 1892 (which essentially allows an international registration to extend to all countries that are parties to the Agreement.)
- The Protocol to the Madrid Agreement Concerning the International Registration of Marks, 1989 (which contains basically the same provisions as the Madrid Agreement itself, but with some important differences, e.g. under the Protocol one can ask for international registration based on only the application of a trademark, rather than the registration.)
- The Patent Cooperation Treaty, 1970 (which makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing a single “international” patent application.)
- The Eurasian Patent Convention, 1995 (which allows the filing of a single patent application in the Russian language with an automatic extension to member states.)
- A number of classification-related treaties – the Locarno Agreement Establishing an International Classification for Industrial Designs, 1968; the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, 1957; the Strasbourg Convention on the International Classification of Patents, 1971; and the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure, 1977

Azerbaijan has the status of observer in respect of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights signed in Marrakech on 15 April 1994, which establishes minimum standards for the protection of various objects of intellectual property rights.

### Registration of intellectual property rights

Before independence in 1991, there was a centralized system of registration of intellectual property rights based in Moscow. Subsequently, however, Azerbaijan established its own registration center. The relevant state authorities are responsible for registering intellectual property rights.

Disputes related to industrial property rights are considered by the relevant state authority. Decisions of the relevant state authority can be challenged in Azerbaijani courts.

### Enforcement mechanisms

The Resolution of the Cabinet of Ministers No. 195, dated 7 December 2011, ordered the establishment of an Intellectual Property Enforcement Center under the National Copyright Agency. The Enforcement Center is expected to deal with the enforcement of copyright protection and the training of specialists in the field.

The Law “On Ensuring Intellectual Property Rights and Combatting Piracy” (2012) is designed to complement the existing laws with the mandate to achieve better protection objectives. This controversial piece of legislation spurred debate



over its lack of clarity. Initially intended for copyright protection, its scope was extended shortly before adoption. Though the law was expected to offer more effective measures of legal protection, it has introduced a number of far-reaching judicial and other mechanisms for addressing the infringement of intellectual property rights.

For instance, the Law elaborated on temporary judicial measures that are available. The law makes it possible to require—through a court action—that a person allowing an infringement of intellectual property rights provide information on the directly or indirectly infringing third party and that the respondent provide information on the distribution channels for the infringing goods. It also makes possible a judicial award of damages from the person that allowed the infringement, even where such person was not aware of the unlawfulness of such actions with regard to the use of the intellectual property object, or where there were insufficient grounds for such person to know. The law has also introduced a number of non-judicial protection mechanisms, such as the use of unique digital codes to enable identification and the use of ISBN, ISMN, ISSN, ISAN and ISRC to be assigned to objects of copyright and related rights.



### **Registration of trademarks – some pitfalls**

A major problem with the registration of trademarks is the absence of computerization, which makes the efficient search of trademarks impossible. This sometimes results in the double registration of the same trademark in the name of different trademark claimants, with the natural consequences being disputes over ownership. It appears that, as searches have to be performed manually, the relevant state authority has temporarily halted official searches of trademarks. Searches are performed on an unofficial basis.

The Law “On State Duties” (2001) has been revised recently to eliminate the state duties for registering a trademark. State duties for other actions, such as filing opposition, registering a license agreement, trademark renewal, etc., remain unchanged. The respective fees for trademark registration are now determined by the relevant state authority.

As a general rule, foreign legal entities must file a trademark application through a recognized patent attorney. However, the registration of a mark with the relevant state authority does not necessarily mean that the mark will be protected during the validity period: There are a number of circumstances where a registration may be cancelled or annulled. One such instance is the non-use of the mark in Azerbaijan for five consecutive years. Where there is a license agreement for the use of a mark by a person in Azerbaijan, the agreement must be registered with the relevant state authority. Otherwise, if a registered mark has not been used for five years by the owner or a registered licensee, the registration of the mark in Azerbaijan may be cancelled.

## Well-known marks

By reference to Article 6bis of the Paris Convention, protection is accorded to marks which have been recognized as well-known by the competent authority of the country of registration or use. In Azerbaijani recognition as a well-known mark will prevent the use of the mark in respect of any types of goods and services where such use causes damage to the holder. When recognizing a mark as well-known, the relevant state authority will take into account such factors as the extent to which the goods and services in connection with which the trademark is used, are known in Azerbaijan; the distribution channels of such goods/services, the distinctiveness of the trademark, including those obtained through use; the territory within which trademark is used, the length and scope of use, etc.<sup>19</sup> To date there appear to be no marks that have been formally recognized as well-known.

## Known marks

The concept of use-based protection is slowly expanding. The most recent legislative changes have expanded the grounds based on which a trademark application can be refused, by introducing the notion of marks that have earlier acquired distinctiveness among consumers and manufacturers through use (known marks).

## Parallel imports

Though the Law on Trademarks and Geographical Indicators provides for the national exhaustion of trademark holders' exclusive rights, the theoretical and practical debate on the issue of parallel imports remains far from settled. However, as the prevention of parallel imports becomes important for businesses—and with gradual improvements in enforcement legislation—the issue should soon find solid ground.

## Customs register

Azerbaijani law allows for the possibility to record an object of intellectual property, such as a registered trademark right, with a register maintained by the customs authorities. However, the register is not yet operational due to a number of reasons, including the amount and nature of the warranty to be provided by the applicant in case goods the entry of which is suspended upon the applicant's request turn out to be legally imported.

## Legal protection of registered marks

The following measures for legal protection are available to owners of registered marks:

- Applying to the Ministry of Economy, which is charged with enforcing the legislation on the protection of trademark rights, as well as on unfair competition, including the unauthorized use of trademarks
- Obtaining an injunction and claiming: termination of the use of an infringing trademark; compensation for damage caused by the illegal use of a mark or compensation for damage caused by counterfeit goods (from AZN 1,000 to AZN 50,000); confiscation or destruction of the goods infringing a trademark (as well as materials and equipment used in the production of counterfeit goods)
- Requesting the arrest of goods imported into Azerbaijan bearing an infringing mark (except for transit goods and goods acquired abroad from sale by owner or upon the owner's consent). These goods can be impounded for 10 business days (with the possibility of extension) based on a court order
- Applying to the customs authorities, upon reasonable grounds, to seize goods bearing a mark infringing the owner's or the licensee's rights and obtaining information about the sender and quantity of goods
- Recording registered trademarks with the Customs Committee Register of Intellectual Property for the purpose of preventing the importation of illegal goods
- Protecting holders of exclusive trademark rights against parallel import

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<sup>19</sup> Law on Trademarks and Geographical Indicators 1998, Article 7

### **Legal protection of copyrights**

When considering the infringement of copyrights and related rights, along with the general means of defending a right, the court may also apply one of the following: (a) withhold the income obtained by the infringer as a result of the infringement, in lieu of compensation for damages, (b) decide on compensation in the amount from AZN 110 to AZN 55,000, in lieu of the payment of damages or the withholding of income.

### **How Dentons can help**

Dentons is a leader in Azerbaijan in aiding companies to protect their intellectual property rights. We have assisted companies in all aspects, including:

- Enforcement – Dentons has successfully assisted companies in persuading infringers to cease their infringing acts both before and after application to government agencies
- Defending trademarks in the courts and before the state authorities – Dentons has successfully prosecuted cases against infringers
- Advising on, and giving legal opinions on, whether a particular slogan or name will contravene the law or the intellectual property rights of others
- Advising on measures to protect against parallel imports
- Organizing official raids by the Ministry of the Economy on markets trading in suspected counterfeit goods



# Chapter 18



# Language: The use of Azerbaijani

## Introduction

Since independence, the use of the Azerbaijani language has become more and more common. Inevitably, this has given rise to issues concerning the use of foreign languages (in particular, Russian) and the Cyrillic alphabet. Laws have been in place from an early date regarding the state language, but since the late 1990s pressure has been growing to enforce the universal use of Azerbaijani written in the Latin script. A presidential decree issued in June 2001 created a great deal of confusion, but essentially it instructed the drafting of a new law and the introduction of certain other actions. Even today, finding fluent speakers and translators of both Azerbaijani and English is not easy. The laws themselves are often imperfectly drafted, because of the drafters'

inadequate grasp of legal Azerbaijani terminology. This chapter examines some of the issues involved.

## State language

The Constitution states that the state language of Azerbaijan shall be "Azerbaijani."

It appears that, in certain areas, the use of the Azerbaijani is obligatory. These include the following:

- Court and notary proceedings
- Replies by state authorities to proposals, applications and complaints of Azerbaijani citizens
- Clerical work at enterprises, institutions and organizations

- Letterhead, seals, stamps and nameplates of enterprises, institutions, organizations, etc.
- Accounting ledgers
- Labels and instructions for use on all goods sold on the domestic market

In registration proceedings, the Ministry of Taxes is now regularly requiring corporate names to be transliterated into Azerbaijani.

### Penalty for Resisting the Use of Azerbaijani

An administrative penalty in the amount of AZN 1,000-1,500 for individuals, AZN 2,500 – 4000 for officials and AZN 12,000 – 16,000 for legal entities may be imposed for the following:<sup>20</sup>

- Propaganda against the use of Azerbaijani
- Resisting the use and development of Azerbaijani
- Attempts to limit the sphere of use of Azerbaijani
- Obstructing the use of the Latin alphabet for Azerbaijani

Failure to provide information to consumers (which may include the absence of a translation into Azerbaijani) may result in a penalty in the amount of AZN 200.<sup>21</sup>

Failure to translate labels and instructions for use into Azerbaijani may result in the temporary withholding of the goods from circulation until the non-compliance is rectified.

### Use of other languages

In accordance with the Constitution, Azerbaijan provides for the free use and development of other languages spoken by the people of Azerbaijan. The Constitution also guarantees the equality of rights and liberties of each person irrespective of language and prohibits discrimination between people based on language. Similar provisions are contained in other legislative acts.

The use of other languages, in addition to the state language of Azerbaijan, is allowed, *inter alia*, in the following cases:<sup>22</sup>

- Service enterprises (trade, health care, transportation, consumer services, intercity communication, etc.) which provide services to foreigners may use Azerbaijani and a foreign language.
- Written announcements, information, advertisements and other visual information must be in Azerbaijani and, where necessary, may also be accompanied by other appropriate international languages. However, the foreign language should follow the Azerbaijani text and should not occupy a larger area.
- Labels and other inscriptions on goods produced in Azerbaijan, as well as exported, must be in Azerbaijani, along with appropriate foreign languages.
- Labels, names of goods imported into Azerbaijan and instructions applicable to them, along with foreign languages must be accompanied by translation into Azerbaijani.

Despite the fact that provisions of the Law “On Public Television and Radio Broadcasting and Special Rules On Ensuring the Use of the Azerbaijani Language in the Field of Television Broadcasting in the Territory of the Republic of Azerbaijan” have required for some time that all media outlets broadcast their programs and films in the State language, universal compliance with this requirement has occurred only since 1 January 2008.

A Presidential Order of 9 April 2013 approved a State Program on the Use of the Azerbaijani Language in Accordance with the Needs of the Times and the Development of Linguistics. Some of the measures of the State program include the improvement of current laws regulating the use and application of the state language in educational and scientific institutions.

### How Dentons can help

Dentons has advised several major multinational corporations in respect of advertising, labeling, accounting and record-keeping with regard to the proper use of Azerbaijani.

<sup>20</sup> Code on Administrative Violations, Article 533

<sup>21</sup> Code on Administrative Violations, Article 453

<sup>22</sup> Law on the State Language, Article 7





# Chapter 19



# ASAN Service

## Introduction to “ASAN Service”

“ASAN Service” is run by the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan.

“ASAN Service” has created an innovative model of public service delivery in Azerbaijan. More than 280 services are rendered by 10 government agencies in ASAN service centers.

The following **public services** are offered at ASAN service centers by 10 state agencies (Ministry of Internal Affairs, Ministry of Justice, Ministry of Taxes, State Migration Service, Ministry of the Economy, State Customs Committee, State Committee on Property Issues, State Social Protection Fund, National Archive Department, State Service on Mobilization and Conscription):

- Issuance and renewal of identity cards
- Issuance and renewal of passport of citizen
- Notary services
- Issuance of licenses
- Issuance of the reference about the registration on residence
- Issuance of reference notes about conviction
- State registration of civil status acts
- Renewal of driving licenses
- Documents required for determination occupational pensions
- Registration of operations concerning the real estate

- Migration services
- Registration of commercial legal entities and taxpayers
- Providing information on all services rendered by the state entities
- Customs services
- Issuance of archival documents
- Military registration

In addition, private services are delivered by more than 30 private companies:

- Banking and insurance services
- Professional translation services
- Payments of public utilities
- Mobile operator customer services
- TV and internet services providers customer services
- Consulting on e-services
- Ticket sales office of "iTickets"
- Tourism services
- Legal consulting services
- Tax consulting services
- Documents delivery service
- Sales of SOCAR bonds
- Customer services representatives of different private companies

This list is not exhaustive; every company willing to cooperate with ASAN may easily join the ASAN family.

Currently 13 ASAN service centers operate in the country – five in the capital Baku and eight in the regions (Sumgait, Ganja, Quba, Masally, Mingechevir, Sabirabad, Gabala, Barda). Sheki and Imishli ASAN service centers are planned to be opened soon.

Each "ASAN Service" center serves more than 2,500 users daily. The customer satisfaction rate is almost 98%.

The centers operate seven days a week from 10 a.m. until 8 p.m. and on weekends from 10 a.m. until 5 p.m. without a lunch break.

Citizens can find information on the centers and available services from the official web site ([www.asan.gov.az](http://www.asan.gov.az)), the 108 Call Center, and social networks (Facebook, Twitter and Instagram). Appointments can be made before coming to the centers, via the website or 108 Call Center.

In addition to the aforementioned public and private services, businesses may also benefit from the following innovative "ASAN projects":

#### **Mobile "ASAN Service":**

The State Agency has developed a mobile service, which involves well-equipped large buses that travel to the regions to deliver services in rural and remote areas that do not host "ASAN Service" Centers. This type of service is unique in Azerbaijan and beyond. The main objectives of this service are to ensure the universal accessibility of state services for all and to increase public satisfaction.

By paying an additional fee, intra-city mobile services enable citizens to receive services at work or home address, or any other location they wish. An extra payment for service-in-place and/or document-handover is complementary to state fees.

In order to promote social cohesion and solidarity, intra-city mobile services are available free of charge to all persons with disabilities and to children with limited health conditions.

### **ASAN Communal (Utility) centers**

“ASAN Communal” centers have been created to optimize the unified management and transparency of public services. “ASAN Communal” centers will provide services to individuals and legal entities on the basis of existing standards of “ASAN Service”.

In ASAN Communal centers, 45 types of services are rendered by three entities – “Azersu,” “Azerishiq” and “Azerigas.” In addition, the center provides banking and insurance services as well.

### **ASAN Call Center – 108**

ASAN Call Center was created in order to respond operatively to questions about services rendered by “ASAN Service” and “ASAN Communal” centers, without wasting time going to centers or service centers, and to receive complaints related to offenses.

### **ASAN Visa**

The “ASAN Visa,” implemented since January 2017, is designed to simplify the procedure for issuing visas to foreigners and stateless persons who intend to come to Azerbaijan. Today foreigners from 94 countries may obtain a single entry e-visa to Azerbaijan within three hours (urgent visa) or three working days (standard visa). A list of eligible countries may be found by following this link <https://evisa.gov.az/en/countries>.

Foreigners intending to receive a visa personally can apply to “ASAN Visa” service without applying directly to Azerbaijan Embassies and without using the services of intermediary companies. This means overcoming bureaucratic impediments in visa issuance.

Beginning from 15 May, 2018 visas for citizens of qualifying countries that may be issued upon arrival at the international airports of Azerbaijan will be issued through “ASAN Visa” system.

### **E-license portal**

Almost all licenses given for some entrepreneurial activities are done electronically via an E-license portal. The aim of the E-license portal is to support entrepreneurship activities and to strengthen the G2B connection, that provides electronic registrations of licenses and permits, and retrieval of information from integrated information systems.

The electronic license portal performs the following functions required for the implementation of entrepreneurial activity:

- Issuance required licenses or permits
- Issuance of their duplicate and annex
- Re-formalization
- Suspension, restoration and cancellation

### **ASAN Pay**

The multifunctional “ASAN payment” system provides possibilities to make the payment of fines, public utilities, cable TV, mobile operators, Internet and other payments in a short time, in a safe and convenient mode. Both citizens and companies may easily pay their fines or any other payments with these terminals that are located throughout the country.

Covering a large area within the country, “ASAN payment” terminals are available for 24/7 payment, as well as through [www.asanpay.az](http://www.asanpay.az) portal and “ASAN Pay” mobile application on any service, with no limitations.

The advantages of “ASAN payment” system:

- Access to completely secure payment
- Payment possibilities without registration
- Payment possibilities through bank cards with no commission
- Portal and terminals with convenient use
- Reception of 24/7 payments
- The terminals cover a large area within the country

### **“Innovations Center” LLC**

The Innovations Center has been established to enable social innovation in Azerbaijan, and to work closely with state authorities, academia and international business community in order to introduce innovative solutions within the public services and beyond.

The Innovations Center provides technical support, developing and introducing new solutions that contribute to increasing efficiency and quality of public services at the ASAN Centers around the country. We also work with other public institutions in Azerbaijan providing innovative solutions within the sphere of information technology and public service.

We believe that Azerbaijan has a lot of potential in running successful public private partnerships, and the Center is open to developing new models of cooperation that can bring innovative solutions to the country. The Innovations Center is making every effort to bring the state and the businesses closer to each other in order to establish better public services and improve the life of citizens.

The Innovations Center is a government owned entity and reports to the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan.

### **AZINNEX**

Azerbaijan Innovation Export Consortium – AZINNEX is a unique platform offering innovative solutions to the global marketplace.

The Consortium has been established collaboratively by Azerbaijan’s 10 leading internationally recognized companies specializing in innovations with the aim of becoming a trusted and flexible global partner. We are committed to go global by moving locally applied advanced innovation products and services to the international market, enhancing the availability and reliability of the business environment, and supporting entrepreneurial activities. We present our insightful experience to make more informed and strategic business decisions along with the quality products and services. We have laid the foundations for cooperation with a number of countries from different continents, and we have implemented the intellectual products of Azerbaijan.

### **E-Gov portal**

The “E-Government” portal is used by government entities to provide information and e-services to all citizens, legal persons and individuals, foreign citizens and stateless persons living in the territory of the Republic of Azerbaijan through the use of modern information technologies.

The portal has integrated 91 institutions (including 41 central executive bodies, 31 bank credit organizations, 1 local executive body and 18 other institutions) and provides 442 services, and more than 60 million applications have been registered/recorded during seven years. 94 information resources for 42 institutions have been registered in the state information resources registry.

Business may enjoy all electronic public services and receive information about all public services from one single platform. The aim of the E-Gov portal is to create a single electronic platform for citizens and businesses to have access to information about all public services and use electronic services.

Businesses may register their company, pay taxes and receive references and other documents from one single platform.

E-Gov reduces the ‘distance’ between civil servants and citizens in provision of social services, as well as simplifying and making these relations transparent. The widespread use of electronic services by public authorities, increasing their number, improving their quality and enhancing citizens’ satisfaction with the services are means of achieving this goal.

### **Electronic Registry of Public Services**

The Electronic Registry of Public Services was created and commissioned according to the Decree of the President of the Republic of Azerbaijan “On Measures for the Establishment of an Electronic Registry of Public Services” for the collection and systematization of information on public services, elimination of repetition in service delivery and provision of flexibility management in this area through the creation of new types of services, in order to increase the capacity of analysis and forecasting for services. At present, all information on 673 public services, provided by 113 public bodies, is reflected in the registry.

### **Idea Bank**

The primary purpose of the “Idea Bank” is to collect ideas from citizens to improve the activities of the State Agency, including the ASAN service centers. It is a powerful tool, not only for understanding customers’ experience, views and feedback with public services, but also for developing strategies to improve those services.

In addition, different types of people, including students, researchers, etc. send their ideas to Idea Bank to seek support for their implementation. Businesses may use this platform to inquire solutions to their needs and problems, and interested people will offer their solutions.

The platform implements different contests with different public and private partners to increase the awareness and involvement into the project.

### **ASAN Radio**

ASAN Radio, established in 2015 as the first-ever and unique radio specialized in the field of public services, is broadcasted via 100 MHz frequency to 70% of Azerbaijan.

The mission of ASAN Radio is to serve public with information on public sector and enhance citizens’ awareness on public services, as well as their rights and obligations. ASAN Radio is a primary source of information for citizens on the activities of “ASAN Service” centers and projects that it implements. It also provides news and information on public sector, social and economic life of people and prepares cultural programs that inform, educate, enlighten and enrich the public.

ASAN Radio is an online radio that you can connect to from practically anywhere as long as you have an internet connection; you can even broadcast live radio from your smartphone and tablet.

It is the most popular and the most listened to radio broadcaster in the country. Businesses enjoy their ads broadcasted via ASAN Radio throughout the entire country.

### **ASAN WiFi**

ASAN Wi-Fi is a platform designed to provide free internet access to the public. People benefit from free high-speed internet in all ASAN Service centers in exchange for ad watching. Companies use this platform to promote their products and services.

The platform is also a source of information on the activities of ASAN Service centers and shares news on the most important dates, historical events and other useful information about the public services.

ASAN WiFi is currently used in Haydar Aliyev International Airport, Bravo Supermarket, etc.

### **ASAN Volunteers**

Volunteering in “ASAN Service” is a great opportunity for young and enthusiastic people between 17–25 years who are eager to have their first work experience. To date more than 14,000 volunteers have been involved in the work of the “ASAN Service” Centers, and close to 1,000 have been employed subsequently by “ASAN Service” and relevant ministries.

Young people take part in the trainings of the “ASAN School” volunteering program, gain theoretical knowledge and use this knowledge through internship experience in ASAN Service centers.

Once volunteers complete their service, they are awarded with a certificate and a reference.

Many partner organizations and companies cooperate with ASAN volunteers, and most of them have internships or jobs in those companies.

### ASAN Kadr Career Center

In order to enhance employment opportunities for its volunteers and supply the labor market with qualified and experienced young professionals, in March 2015 “ASAN Service” launched “ASAN Kadr” Career Center – a web portal ([www.asankadr.az](http://www.asankadr.az)), where the CVs of all ASAN Volunteers are uploaded.

Partners of “ASAN Service” in the public and private sector can easily access this database and find proper candidates to fill their vacancies. Meanwhile, they can also post vacancy notices on the portal. This mechanism creates a bridge between youth with distinctive work experience seeking to start a successful career and their potential employers.

Approximately 3,749 CV’s have been uploaded to the portal, and 938 public and private entities have registered therewith.

Each volunteer who goes through these stages can place his/her CV on [www.asankadr.az](http://www.asankadr.az) at the same time employers are able to announce vacancies on a regular basis. Thus, the [www.asankadr.az](http://www.asankadr.az) portal is a technological bridge between young people, public and private organizations.

### ASAN Training Center

Civil servants, volunteers and other employees of ASAN are regularly trained in ASAN Training Center with the purpose of creating customer service culture, mindset and improving their skills and knowledge in the field of public service delivery.

Other state agencies and private companies also enjoy trainings in the field of “Customer management,” “Public management,” “Stress management,” “Time management,” “Conflict management,” “Effective communication,” “Protocol and ethics,” etc.

Within the framework of international cooperation, ASAN Training Center organizes training courses for employees of Afghanistan “ASAN khedmat,” Indonesia’s Ministry of Administrative and Bureaucratic Reform, etc.



### ASAN Letter

ASAN Letter (<http://asanmektub.az>) is a platform where the State Agency within its social corporate responsibility collects wishes and desires of children from different regions and shares them on its website so that people and companies may pick and buy whatever they wish. The slogan of the projects is “Love for children ASAN.”

For the implementation of these projects, ASAN cooperates with different companies. You may see the children’s dream tree in Bravo supermarkets.

### Labor Relationships Monitoring Center

In 2017 the Center for Labor Relations Monitoring was established under the supervision of the State Agency to ensure protection of labor rights of workers in the construction sector, strengthen control over labor relations and, by using modern innovations, monitor illegal activities of the labor force.

The core activity of the Monitoring Center is to create an electronic registry of persons engaged in the field of construction. The registry is being updated and verified with field monitoring done in the construction areas. The purpose of the monitoring is to protect the labor rights of the citizens in the field of construction, ensure the enjoyment of social security and strengthen control over labor relations in order to prevent informal labor relations.

The Monitoring Center has created a database of service contracts where companies may easily upload the service contracts of their employees.

## ABAD

ABAD “Easy Support to Family Business” established in September 2016 acts as a social innovation concept with the purpose of promoting and empowering small-sized family enterprises that are willing to participate in agro-processing and artisanal manufacturing and is unique in (i) supporting families through the whole business cycle “from A to Z” and (ii) carrying out all business relations with public and private institutions regarding the production and sales of the products.

ABAD centers established under the project aim to assist families with manufacturing facilities and equipment, as well as provide a variety of free consulting services throughout the entire business process. It employs a value chain approach in supporting family businesses “from the idea to the shelf.” In particular, ABAD centers offer:

- Business consulting, such as elaboration of business plans
- Promotion of families and their products, branding and design
- Financial and accounting services
- Legal assistance across the entire business process
- Supply chain management

## International and public relations

“ASAN Service” has achieved numerous awards and international standard certificates in recognition of its high-quality work and achievements in the delivery of public services.

First and foremost, “ASAN Service” is the winner of the 2015 United Nations Public Service Award.

In the competition that lasted from November 2014 until May 2015, and applied by several hundred initiatives from around the world, the United Nations, through its Committee of Experts on Public Administration, selected “ASAN Service” for its outstanding achievements as the First Place Winner of the 2015 United Nations Public Service Award in the category of “Improving the Delivery of Public Services.”

The United Nations Public Service Award is the most prestigious international recognition of excellence in public service. Through an annual competition, the UN Public Service Awards promotes the role, professionalism and visibility of public service.

“ASAN Service” is a holder of the quality management system certificate ISO 9001:2008, the international certificate on occupational health and safety management system OHSAS 18001:2007, as well as the International Safety Award by the British Safety Council.

Winning first place in the United Nations Public Service Award, ASAN Service enjoys worldwide recognition and has become a brand through which Azerbaijan promotes the principles of efficiency, transparency, accessibility and citizens’ comfort in public service delivery based on innovation and modernization and building solid partnerships with like-minded countries. Following the adoption of the United Nations Agenda 2030 for Sustainable Development, the importance of international cooperation in replicating best practice by other countries has risen greatly. In pursuit of this goal, the Azerbaijan State Agency is constantly establishing new ties with like-minded nations and is ready to transfer its expertise and know-how in the field of public service delivery to partner countries. ASAN service is already being studied and applied by different countries. In this regard The State Agency has several MOUs with Italy, France, Korea, Indonesia, Afghanistan, Montenegro, etc.

The State Agency also organizes study tours for delegations from various countries such as Afghanistan, Egypt, Djibouti, Iran, Kazakhstan, Morocco, Sudan, Turkey and Uzbekistan to introduce them to Azerbaijani best practice in the sphere of public service delivery and to discuss opportunities to deepen relations. The Agency is convinced that cooperation in the improvement of public service delivery will contribute the capacity to enjoy a more transparent, efficient and citizen-friendly service delivery mechanism to the people of those countries.



# Chapter 20

# Legislative system

## Introduction

To be legally enforceable, legislation in Azerbaijan must be adopted in accordance with certain procedures and thereafter published.<sup>23</sup> Legal acts can be adopted in the form of normative legal acts, non-normative legal acts or acts of a normative nature.<sup>24</sup>

Normative legal acts are official written documents:

- Adopted on issues the regulation of which is within the competence of an authorized state body, as provided by the Constitution of the Republic of Azerbaijan, laws and decrees or acts passed by referendum
- Containing a compulsory code of conduct
- Are for general applicability and multiple use

Normative legal acts include *local normative legal acts*, the force of which is limited to one or more specific State bodies, and *technical normative legal acts*, which are approved in the manner established by the legislation of the Republic of Azerbaijan, such as technical bylaws, state standards, technical requirements, aviation rules, sanitary norms, fire safety rules, norms for the safe transportation of dangerous shipments, etc.<sup>25</sup>

<sup>23</sup> Amendments to Article 149 of the Constitution of the Republic of Azerbaijan adopted by Constitutional Referendum, dated 18 March 2009.

<sup>24</sup> Article 1.0.1, Constitutional Law on Normative Legal Acts (No 21-IVKQ), dated 21 December 2010 (the "Constitutional Law on Normative Legal Acts"), with legal force from 17 February 2011.

<sup>25</sup> Articles 1.0.21 and 1.0.22, Constitutional Law on Normative Legal Acts.

There is a hierarchy of normative legal acts:

1. The Constitution
2. Acts passed by referendum
3. Laws
4. Decrees of the President
5. Resolutions of the Cabinet of Ministers
6. Normative acts of central executive authorities

In the event of a conflict between different types of normative legal acts, acts of higher stature shall prevail. A normative legal act adopted by a state body concerning a public relationship on which this relevant body has the *specific* authority to regulate has superior legal force over normative legal acts adopted by another State body of the same level.<sup>26</sup>

In the event of conflicts between the provisions of the Civil Code and the provisions of other codes and laws which contain civil law provisions, the provisions of the Civil Code prevail.<sup>27</sup> In relation to all other spheres of law, in the event that two legal acts of equal force contain conflicting provisions, then the *specific legal act* shall apply to the particular relations, provided that the relations are in the same field as the legal acts applied.<sup>28</sup> If there is a conflict between general and specific norms set out within the same normative legal act, the specific norms shall apply.<sup>29</sup> A new normative legal act has a higher legal force over a normative legal act adopted previously by the same State authority regarding the same issue.<sup>30</sup>

Legal acts that are adopted for the implementation of specific (one-time) organizational, supervisory or directive matters or considered for other one-time implementation are considered non-normative legal acts. They include the following:<sup>31</sup>

- Decisions of the Milli Majlis of the Republic of Azerbaijan
- Orders of the President of the Republic of Azerbaijan
- Orders of the Cabinet of Ministers of the Republic of Azerbaijan
- Acts of bodies implementing civil registration
- Other acts which fall under the definition of non-normative legal acts

In addition, there are acts of a normative nature which are also enforceable. These are decisions of the Constitutional Court; decisions, regulations and explanations of the Central Election Commission; decisions of financial market regulator;<sup>32</sup> decisions of local executive authorities and municipalities; decisions of the National Television and Radio Council, and decisions of the Judicial Legal Council. Acts of a normative nature, with the exception of decisions of the Constitutional Court, must not contradict normative legal acts.

26 Article 10.2, Constitutional Law on Normative Legal Acts.

27 Article 2.5, Constitutional Law on Normative Legal Acts.

28 Article 10.3, Constitutional Law on Normative Legal Acts.

29 Article 10.4, Constitutional Law on Normative Legal Acts.

30 Article 10.5, Constitutional Law on Normative Legal Acts.

31 Article 3, Constitutional Law on Normative Legal Acts.

32 Amendment to the Law on Normative Legal Acts on 30 September 2016 (effective since 20 October 2016).

The Ministry of Justice is the State registration body entrusted with entering all normative legal acts, acts of normative character, decisions of the Milli Majlis, Orders of the President and the Cabinet of Ministers, as well as acts of the Central Bank of Azerbaijan, the Financial Markets Supervision Authority of the Republic of Azerbaijan and municipalities, into the State Registry of Legal Acts of the Republic of Azerbaijan.<sup>33</sup> All normative legal acts shall be officially published in the state language. The official publication of normative legal acts means bringing them to the attention of the general public by means of publishing their texts in official periodicals and by reporting them on public television and radio channels; however, the latter is not a substitute for their publication in official periodicals.<sup>34</sup>

If a normative legal act is published in several official sources at various times, the date of the official publication of the legal act and its entry into force shall be determined according to the date of its first publication.<sup>35</sup> Normative legal acts shall be published in a manner which indicates certain compulsory details: the type of the act, the date of its adoption, its number and its title.<sup>36</sup> Laws and decrees shall be officially published within 72 hours of the moment of their signing by the President. Similarly, resolutions of the Cabinet of Ministers must be published within 72 hours from their adoption. Other normative legal acts, after being entered into the State Registry of Legal Acts, are published as a collection every three months.<sup>37</sup> Pursuant to Article 149 of the Constitution, no one may be forced to abide by a regulation that was not published or held liable for failing to abide by such a regulation.

Although the Constitutional Law on Normative Legal Acts is silent on which sources shall be considered as official periodicals, there is a Presidential Decree No.384, dated 16 February 2011, on the “Application of the Constitutional Law on ‘Normative Legal Acts’,” which provides a list of periodicals where normative legal acts shall be officially published as follows:

- The Constitution, Acts passed by Referendum, Constitutional Laws, as well as Presidential Decrees and Orders related to their application—in the newspaper “Azerbaijan” and “Khalg”
- Laws and the Presidential Decrees and Orders related to their application—in the newspaper “Azerbaijan”
- Other Presidential Decrees and Orders not considered above, as well as Resolutions of the Cabinet of Ministers—in the newspaper “Khalg”

However, there is also a separate Resolution of the Cabinet of Ministers, No. 80, dated 11 April 2012, on “Approval of the Rule on the Official Publication of Acts of the Cabinet of Ministers,” which provides slightly different periodicals where the acts of the Cabinet of Ministers shall be officially published including in the newspaper “Azerbaijan,” as well as the “Collection of Legislation of the Republic of Azerbaijan.” In addition, after the acts of the Cabinet of Ministers are officially published, they shall also be published in the electronic version of the State Registry of Legal Acts available at <http://www.huquqiaktlar.gov.az/>.

33 Presidential Decree No.463, dated 1 July 2011 on “Approval of the Rules on the Entry of Legal Acts into the State Registry of Legal Acts of the Republic of Azerbaijan”.

34 Article 82.2, Constitutional Law on Normative Legal Acts.

35 Article 82.6, Constitutional Law on Normative Legal Acts.

36 Article 83, Constitutional Law on Normative Legal Acts.

37 Article 81, Constitutional Law on Normative Legal Acts.

Other legal acts are published as follows:

- Decisions of the Milli Majlis—in the newspaper Azerbaijan and the Bulletin of the Milli Majlis
- Normative legal acts of central executive authorities, acts of a normative nature of local executive authorities, the Central Bank of Azerbaijan and the National Television and Radio Council—in the Bulletin of Normative Acts of the Republic of Azerbaijan
- Acts of a normative nature of municipalities—in the Bulletin of Acts of Local Municipalities
- Decisions of the Constitutional Court—in the newspaper Azerbaijan and the Bulletin of the Constitutional Court
- Acts of the Central Election Commission—in the newspaper Azerbaijan

The date on which legislation comes into force depends upon the nature of the act. The following rules apply:

- Laws, presidential decrees and resolutions of the Cabinet of Ministers—from the date of publication, unless a later date is specified in such acts
- Other normative legal acts—from the date of publication in electronic form in the State Registry of Legal Acts, unless a later date is specified in such acts.<sup>38</sup>

If there is not a different period stipulated in an intergovernmental agreement to which the Republic of Azerbaijan is a party, a normative legal act regulating foreign trade activity shall state in its implementing act that it shall enter into legal force 30 days from the date of its publication.<sup>39</sup>

In the event of uncertainties and differences, as well as obvious contradictions, in the practical application of a normative legal act, the legislative body which adopted such act, or the Constitutional Court, shall provide an official interpretation thereof. The law, however, is silent as to which body may officially interpret legal acts which are not normative legal acts (e.g., rules of the Central Bank of Azerbaijan, etc.)

### **How Dentons can help**

Dentons can, and has, advised companies and has provided legal opinions on the legal enforceability of provisions of Azerbaijani law and other legal acts, helping our clients navigate the maze of complex, sometimes contradictory provisions comprising the current state of the legislation of Azerbaijan.

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<sup>38</sup> Article 85, Constitutional Law on Normative Legal Acts.

<sup>39</sup> Article 85, Constitutional Law on Normative Legal Acts.





# Chapter 21

# Dispute resolution—the courts and arbitration

## Introduction

Few people enjoy having to resort to the courts to enforce their rights. In addition to the usual problems associated with this process (legal costs, time, difficulties in enforcement, etc.), the judiciary and the legal system in general have a reputation for variable standards, leading to unpredictable results. However, in some cases initiating legal proceedings to defend one's rights is unavoidable or important for various reasons, for instance, to avoid setting precedents (e.g., in employee dismissal cases) or damage to reputation (e.g., charges of causing environmental damage) or to recover debts.

It also should be noted that during the past few years, certain reforms were introduced for the modernization of the judicial system. New courts have been established, including regional appellate courts. The method for selecting judges has been revised, through the introduction of requiring multi-phase exams for new judges and long-term training courses. Moreover, the number of judges has doubled with the addition of 235 new judges during the last several years (according to [http://www.judicialcouncil.gov.az/mehkeme\\_ve\\_huquq.php](http://www.judicialcouncil.gov.az/mehkeme_ve_huquq.php)), and more judges are expected to join in the coming years, as currently 124 candidates are

pursuing long-term training courses;<sup>40</sup> new positions for judges' assistants have been created; the number of court administration staff has increased by up to 60%; and the access of parties to the courts has significantly improved.

Under the auspices of a World Bank project for the modernization of the judicial infrastructure and the use of up-to-date technologies by the courts, the work and structure of administrative body of courts also has improved, with the construction and renovation of court facilities.

In 2011, as part of a judicial reform, the Local Economic Courts were abolished and seven Administrative-Economic Courts were established, of which two are located in Baku and the others in Ganja, Sumgait, Shirvan, Sheki and the Nakhchivan Autonomous Republic, as well as six appellate courts in the same regions as well as in Baku. Now the appellate courts have the following four (4) Court Boards—the Civil Board, the Criminal Board, the Military Board and the Administrative-Economic Board, which operate further to territorial jurisdiction. The judicial reform has also entailed the decentralization of the Serious Crimes Court of the Republic of Azerbaijan by establishing regional Serious Crimes Courts in Baku, Ganja, Sheki, Lankaran and the Nakhchivan Autonomous Republic. This development has released judges from the district/city courts from their review of multiple administrative cases and has led to a further reduction in the time required to resolve a case.

A crucial reform in the judicial system started following the Order of the President of the Republic of Azerbaijan "On the Establishment of an "Electronic Court" Information System in Azerbaijan," dated 13 February 2014, which aims to ensure transparency in the justice system, to increase the effectiveness of the protection of human rights and freedoms and to speed up the process for the application of modern information technologies. Within the framework of the new Electronic Court Information System, it is possible to submit applications, complaints and other documents electronically; to lead proceedings in civil, economic, administrative and criminal cases and to carry out exchanges of documents electronically; to receive notifications on court proceedings and relevant procedural deadlines through e-mail, SMS and other electronic means; and to follow up on court proceedings, decisions issued and their enforcement and complaints or protests of the parties via a "private cabinet," essentially a restricted online web space. In this regard relevant amendments to the Civil Procedure Code were made allowing the submission of documents (statements of claim, applications, complaints and other documents), as well as the receipt of court summons in cases related to economic disputes, to be carried out electronically. Additionally, further to these amendments, the court hearings on economic disputes are now subject to continuous video and audio recording.<sup>41</sup>

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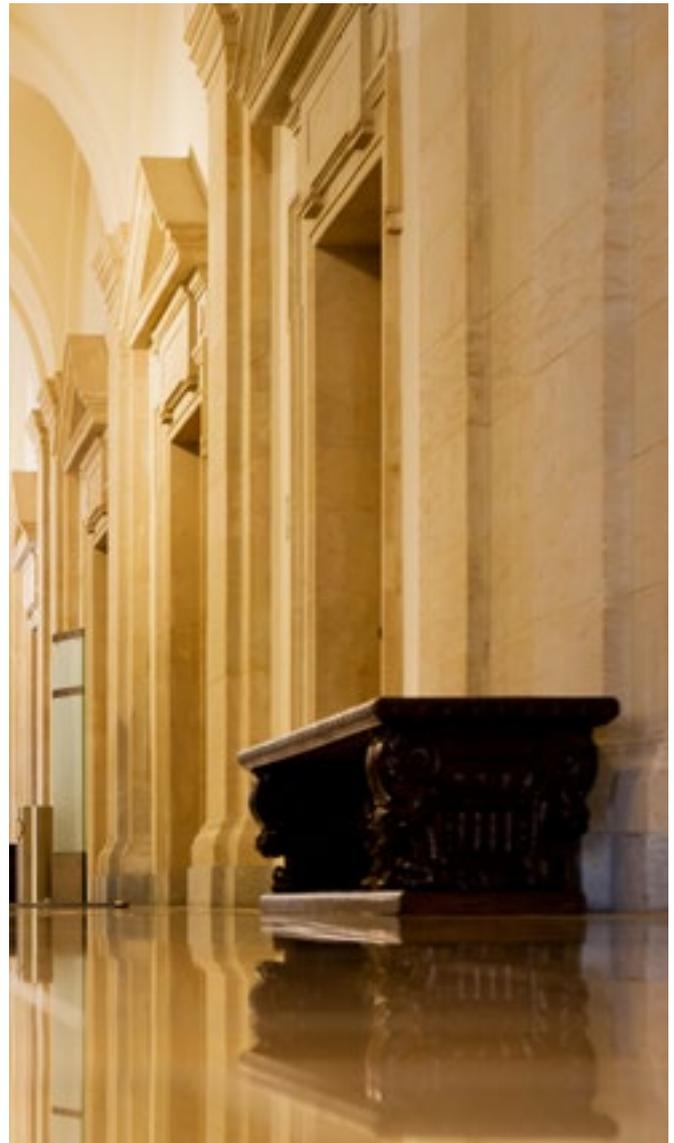
40 Further to the Presidential Decree No.310 dated 09 August 2010 the total number of the judges in the Republic of Azerbaijan shall be 600. There are currently 75 vacant judge positions (source: <http://www.judicialcouncil.gov.az/shtatjlc.php>)

41 Law of the Republic of Azerbaijan, No.330-VQD, dated 30 September 2016

During the past several years, several changes were made to the Law “On Courts and Judges” and the Law “On the Judicial Legal Council,” which included an increase in the powers of the Judicial Legal Council, certain incentives for judges in recognition of efficiency in promoting justice (e.g., gifts, honorary diplomas or honorary badges), some measures for improving safeguards for judges, as professional as well as financial and social (for example, now the law prohibits judges’ salaries from being decreased during their tenure; in addition certain age limits were established for judges of the Supreme Court (68 years) and other courts (66 years).)

According to the Doing Business 2018 Report of the IFC/World Bank, Azerbaijan stands at 38 in the ranking of 190 economies on the ease of enforcing contracts. The ranking of Azerbaijan is improved in comparison to previous years due in part to the introduction of electronic court systems, which also allows users to pay court fees electronically.

The recently implemented and expected judicial and legal reforms, as well as reforms implemented in the Collegium of Advocates of the Republic of Azerbaijan (increase of the number of advocates, ban on non-advocates representing clients in the courts, etc.) could improve the reputation of the courts, the transparency of court hearings, the effectiveness of justice and the access of physical persons and legal entities to qualified legal aid and to the courts for the protection of their rights, freedoms and interests.



## The Courts

The court system consists of the following:

First instance courts

- District (City) Courts
- The Serious Crimes Courts
- The Serious Crimes Court of the Nakhchivan Autonomous Republic
- Military Courts
- Administrative-Economic Courts

Appellate instance courts:

- Courts of Appeal
- Supreme Court of the Nakhchivan Autonomous Republic

Cassational instance court:

- Supreme Court of the Republic of Azerbaijan

Proceedings on additional cassational review and newly revealed circumstances:

- The Plenary Board of the Supreme Court of the Republic of Azerbaijan

The Constitutional Court

The Constitutional Court is the highest judicial body in the country, the basic objectives of which are ensuring the supremacy of the Constitution of the Republic of Azerbaijan and the protection of the individual's fundamental rights and freedoms.

The Constitutional Court is an independent state body, and it does not depend in its organizational, financial or any other form of activity on any legislative, executive and other judicial bodies, local self-government bodies or on legal entities and physical persons.

Decisions of the Constitutional Court are final and cannot be cancelled, changed or officially interpreted by any person or official. It may consider, *inter alia*, the following matters:

- Contradictions between the laws of Azerbaijan, decrees and instructions of the President, resolutions of the Milli Majlis, resolutions and instructions of the Cabinet of Ministers, and the normative legal acts of central executive authorities to the Constitution
- Contradictions between subordinate legislation and legislation of higher authority
- Contradictions between judgments of the Supreme Court and the Constitution and the laws of Azerbaijan
- Contradictions between interstate treaties of the Republic of Azerbaijan which have not yet come into force and the Constitution
- Disputes relating to the respective authorities of the legislature, executive and judiciary

Any person may apply to the Constitutional Court for the restoration of his/her rights and freedoms breached by acts of the legislature, executive bodies, municipalities or courts.

In recent years, the Constitutional Court has played a tremendous role in establishing the case law of Azerbaijan with its authority to issue decisions providing official interpretations of the Constitution and the Laws of the Republic of Azerbaijan further to Article 130 (VI) of the Constitution. The Constitutional Court issued 21 decisions in 2017 related to the interpretation of certain norms and articles of Laws and Codes, whereby the Constitutional Court creates new rules or norms which are binding throughout the entire territory of the Republic of Azerbaijan and may be considered as an additional source of law.

## Jurisdiction

*The District (City) Courts*, being courts of general jurisdiction, may hear civil, criminal, administrative offenses and other matters where at least one of the parties to the dispute is a physical person not having the status of an entrepreneur or, if he has such status, the dispute has not arisen in connection with his entrepreneurial activity.

*The Administrative-Economic Courts* have jurisdiction to resolve administrative and economic disputes where the parties involved are legal entities or physical persons engaged in entrepreneurial activities.

Further to most recent changes in the authorities of the district (city) courts administrative matters, which may arise out of relations with any administrative body regarding tax, real property related matters, the use of natural resources, protection of environment, etc. are now heard by the Administrative-Economic Courts.

## Initiating proceedings

In general, an action may be commenced in the appropriate court for the district in which the defendant has his or her registered residential address or, if the defendant is a legal entity, the district in which such legal entity has its registered address.

The court before which proceedings are brought may also be determined by written agreement of the parties. However, certain claims must be brought before specific courts:

- Claims concerning the recognition of the ownership of, or the repossession of, a building, structure or land. Such claims must be brought before the relevant court where the building, structure or land is located
- Claims of creditors of persons inheriting certain property filed prior to acceptance of the legacy by heirs. Such claims must be brought in courts located at the place of the location of the inherited property or a main portion thereof
- Claims against common carriers arising out of agreements for the carriage of passengers or freight. Such claims must be brought before the relevant court for the place of the location of the carrier

In the courts of first instance, a civil case or an economic dispute is considered by a single judge. Appeals are considered by a panel of three judges, with one of them acting as presiding judge, though cassational appeals may be considered by a panel of more than three judges.

## Evidence

In practice the submission and consideration by the courts of evidence is, at best, a haphazard affair. In theory, each party must provide evidence to support its claims and objections, and the following may be accepted as evidence in civil proceedings if received in accordance with the Law:

- Written and material evidence
- Expert opinions
- On-site examinations
- Audio and video recordings
- Testimony of witnesses
- Explanations of persons participating in the case

## Costs

Court costs include a state duty for various matters, including filing an action with the court. Subject to certain exceptions, State duty is paid when:

- Filing an application
- Filing an application for joinder of third parties
- Filing an application to determine legally significant facts
- Lodging an appeal (to the appellate or cassational courts)

State duty is calculated based on the amount of the claim. In general, state duties vary from AZN 10 to approx. AZN 40.

When lodging appeals and cassational complaints, the amount of state duty payable is up to 50% of the State duty established for the application to the court of first instance.

## Enforcement

The enforcement of judgments and other orders is generally carried out by enforcement officers.<sup>42</sup>

As a general rule, in contested matters, the court must issue an execution writ before the enforcement may proceed.

Banks are required to enforce attachment orders issued by courts and other authorities (e.g., tax authorities, social protection fund). A bank has seven days within which to execute a bailiff's order.

Execution may be suspended in certain cases, for example, where the bailiff has asked the court to explain its decision, the debtor has a valid reason for being absent when the execution is to take place, or where a complaint has been filed in respect of the bailiff's actions.

An execution order that cannot be wholly or partly satisfied, because, among other reasons, it has not been possible to trace the debtor or his/her assets, must be returned to the court (or other body) that issued it.

A legal successor (for example, a successor of a legal entity following a corporate reorganization) continues to be liable for the debts of the original debtor.

Failure by a debtor to voluntarily execute an execution order in respect of a property claim may give rise to a penalty of 7% of the amount claimed. In respect of non-property claims (e.g. reinstatement at work), the penalty is AZN 11 for physical persons and AZN 55 for legal entities.

## Arbitration

A dispute under the jurisdiction of a court of law may, by written consent of the parties, be referred to an arbitral tribunal. However, the Azerbaijani courts have exclusive jurisdiction in certain matters which cannot, therefore, be arbitrated. These include:

- Actions concerning property rights over immovable property, including the lease or pledge of such property, if the property in question is located in Azerbaijan
- Actions regarding the recognition of a patent, trademark or other right, if such right is registered, or application for registration has been filed, in Azerbaijan
- Actions against carriers arising out of contracts for the carriage of goods

In 1999 Azerbaijan acceded to the New York Convention on the enforcement of foreign arbitral awards. Azerbaijan also passed a Law "On International Arbitration." Accession to the New York Convention has greatly increased the utility of overseas arbitrations, while the Law "On International Arbitration" provides for international arbitrations with the place of arbitration in Baku. It is essentially useful in those instances where it is impractical or inadvisable to arbitrate abroad (for example, for reasons of cost, language or law) and so the prospect of arbitration in Baku is a welcome alternative to the Azerbaijani courts. However, as no procedural mechanism has been established in Azerbaijan for the enforcement of a local arbitral award, arbitration proceedings inside Azerbaijan are fraught with difficulties.

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<sup>42</sup> Further to amendments made on 18 June 2010 to the Law "On Court Supervisors and Court Executors" the term "court supervisor and court executor" was replaced with "enforcement officer," and the name of the Law "On the Execution of Court Decisions" was amended to be the Law "On Enforcement."

Furthermore, though both the Law “On International Arbitration” and the New York Convention have been in force in Azerbaijan for several years, foreign arbitration is not necessarily effective and attempts to enforce foreign arbitral awards have been largely untested.

There are two local arbitration bodies in existence “The Baku International Arbitration Court” under the aegis of the Azerbaijan Chamber of Commerce and Industry and “The International Commercial Arbitration Court of Azerbaijan” (though neither body has yet been tested in a significant way), but both local and foreign arbitrations suffer from their dependence on normal domestic enforcement procedures.

Because of the cost of international arbitrations and associated enforcement, international arbitration involving Azerbaijani parties is generally only recommended where the potential sums involved are great and where both parties have overseas assets that can be attached.

### **Mediation**

For smaller disputes, such as basic landlord and tenant matters, companies may wish to consider mediation mechanisms.

### **How Dentons can help**

Dentons is a recognized leader in Eastern Europe and the former Soviet Union in the practice of international arbitration, both in representing clients and acting as arbitrators or mediators. Also, as one of the few foreign firms with experience of litigation as well as arbitration in Azerbaijan (including commercial, contract, banking, tax, employment, real property, product liability, debt recovery and intellectual property matters), Dentons can prepare claims/defenses and represent clients in court and arbitration proceedings.



# Contributing authors

## **Ophelia Abdullayeva, Of Counsel, Dentons' Baku office**

Ophelia graduated from the Azerbaijan Teacher Training Institute of Foreign Languages (Dipl., 1985), Bilkent University, Turkey (MA, 1993), Moscow Academy of Economy & Law (BA, 1998), and the London School of Economics, UK (LLM, with merit, 2001). She is experienced in tax, employment, corporate, and property matters and has also advised extensively on foreign investment and intellectual property matters, as well as various corporate and related matters in Azerbaijan.

During 2000-2001 Ms. Abdullayeva worked part-time in the Firm's London office. Ophelia has been recognized as a leading business lawyer (Corporate Tax, Construction) by *Who's Who Legal*. She has also been recommended in Banking & Finance, Corporate and M&A, Litigation and Tax by *Best Lawyers* in Azerbaijan and was named "Lawyer of the Year" in Tax Law. She is endorsed as "Highly regarded" for Azerbaijan in Banking, Capital markets and M&A by the 2018 edition of *IFLR 1000: Guide to the World's Leading Financial Law Firms*.

Ophelia is also recognized as one of the most highly acclaimed legal experts in Azerbaijan in General Corporate Practice by *Asia law Leading Lawyers*. Ms. Abdullayeva has also been ranked in *General Business Law* by *Chambers Global* and *Chambers Asia Pacific 2018*.

Ophelia speaks Russian, Azerbaijani, English and basic German.

## **James E. Hogan, Managing Partner, Dentons' Baku office**

Active in international practice since 1984, James has concentrated exclusively on corporate, commercial and natural resource matters relating to the CIS and Eastern Europe since 1988. He is particularly active in the structuring, negotiation and implementation of petroleum, mining and other natural resource projects in Azerbaijan, Kazakhstan, the Russian Federation, Ukraine and elsewhere in the CIS. His experience has included PSAs, service agreements, concessions, oil-field service and drilling contracts, licensing and pipeline and marine transportation issues, including the sale and transportation of LNG.

His experience also includes advising major international companies on investment strategies, the establishment of joint ventures and cooperation structures, banking and finance, project finance, infrastructure development, privatization, licensing and related tax, currency, customs, environmental, governance and other matters. He also frequently advises financial institutions, development banks and investment funds on investment and secured lending.

Mr. Hogan graduated from the University of Michigan (AB with distinction, in Russian and East European Studies, 1979), the Pushkin Institute, Moscow (1980, 1981) and the University of Texas (JD, with honors, 1984). He was admitted to the District of Columbia bar in 1984, qualified to practice in France as a conseil juridique in 1991 and as an avocat with the Paris bar in 1992. He speaks English, French and Russian.

He is a member of the American Bar Association and the International Bar Association, as well as the Boards of the International Tax & Investment Center (ITIC) and La Chambre de commerce France-Azerbaïdjan (CCFAz). Highly recommended for Azerbaijan by *Chambers Global*, *Chambers Asia-Pacific*, *Chambers Energy*, *The Legal 500*, *IFLR1000* and *Who's Who Legal – Energy* 2016. James is also recognized by *The Legal 500* 2018 as one of the elite leading lawyers for seven consecutive years and included in *The Legal 500* Hall of Fame.

### **Ruhiyya Isayeva, Senior Associate, Dentons' Baku office**

Ruhiyya graduated from the School of Law and Social Sciences of Khazar University (BSc, 1998) and Azerbaijan University (LLM, 2004). A member of the Collegium of Advocates of the Republic of Azerbaijan, and a practicing advocate, she has extensive experience in litigation and dispute resolution of civil, economic and administrative matters (including contract law, commercial law, tax law, banking, corporate, employment, real estate, product liability, telecommunications and IP law in all court instances of Azerbaijan, including the Supreme Court and the Constitutional Court.

In 2013 Ruhiyya was awarded with a Certificate of Appreciation for long-term efficient legal practice by the Presidium of the Collegium of Advocates. Ruhiyya has been teaching courses in English on International Law to students of Special Talented Groups at Azerbaijan State Economic University and on European Private Law in the LLM in the European Law program of Baku State University in 2013.

Ruhiyya continues teaching in English on the Impact of EU Law on the National Law of Member States in the LLM in European Law program of Baku State University since September 2013. Ruhiyya also serves as the Chair of the Board of Directors of local NGO "Legal Resource and Information Center" Public Association, which she founded in 2005 with the aim to assist in the development of lawyers and the legal education of the population. Ruhiyya speaks Azerbaijani, Russian, English, Turkish and some French and German.

### **Nargiz Kazimova, Associate, Dentons' Baku office**

Nargiz is experienced in corporate law, contract law, corporate compliance, commercial and business law, tax, employment law and migration law. She has also advised extensively on the construction and engineering sector and has experience with constitutional issues in Azerbaijan. Nargiz holds an LLM degree in International Commercial Law from the University of Edinburgh, in addition to her bachelor and master degrees in Law from Baku State University. She has completed a number of courses on legal topics organized by the American Bar Association. Nargiz has also taught courses on International Private Law, Translation of Legal Documents and Legal Commercial English at Baku Eurasian University during 2008-2009. Nargiz speaks Azerbaijani, English, Russian and Turkish.

**Sabina Kerimova, Associate, Dentons' Baku office**

Sabina has experience in corporate, environmental, employment, migration, administrative and registration law. She specializes in assisting clients in the establishment of branches and local subsidiaries, the procurement of licenses and consents, registration with various state regulatory and tax authorities, obtaining work and residence permits, trademark registrations, and intellectual property law, and various other matters. Sabina is also a member of the Creditors Committee of the Bank Standard (currently in bankruptcy). She graduated from the law faculty of Nakhchivan State University, 2011. Sabina is fluent in Russian, Azerbaijani and English. She also has certain knowledge of French.

**Kamal Mammadzada, Partner, Dentons' Baku office**

Kamal graduated from Khazar University's Faculty of Law and Social Sciences (BSc. 1996, LLM, 1999), attended George Mason University, Virginia, USA, and graduated from Manchester University, UK (LLM with merit, 2001). He is experienced in banking and finance law, secured lending, mergers and acquisitions and corporate law. He has extensive experience in the structuring of transactions, foreign investment, oil & gas and other matters. He shares his time between the Firm's offices in Baku and Almaty.

Kamal Mammadzada has been ranked in Band 1 in General Business Law by *Chambers Global* 2018 and *Chambers Asia Pacific* 2018. He has also been highly recommended by *The Legal 500* and by *Best Lawyers* in Banking & Finance, Corporate and M&A in Azerbaijan. Kamal was named a leading lawyer in the 2018 edition of *IFLR 1000: Guide to the World's Leading Financial Law Firms*, and he was recently recognized as one of the most highly acclaimed legal experts in Azerbaijan in General Corporate Practice by *Asialaw Leading Lawyers*. Kamal speaks Azerbaijani, Russian and English.

**Sabina Orujova, Associate, Dentons' Baku office**

Sabina graduated from the law faculty of Odlar Yurdu University, 2001. She has experience in corporate, environmental, employment, competition, IP and administrative law. Sabina speaks Azerbaijani, Russian and English.

**Naida Sadigova, Associate, Dentons' Baku office**

Naida graduated from Khazar University (BA English/Arabic, 2000; Master of Laws, 2006) and the University of New Hampshire School of Law (formerly Franklin Pierce Law Center), Concord, New Hampshire, USA (LLM, 2008). She has experience in corporate, banking and finance and trademark and intellectual property matters. She was Khazar University team captain for the Philip C. Jessup International Law Moot Court Competition in 2004 and 2005, also winning best Oralist (2004) and best memorial awards (2004 and 2005). Naida speaks Azerbaijani, Russian and English.

### **Sona Taghiyeva, Counsel, Dentons' Baku office**

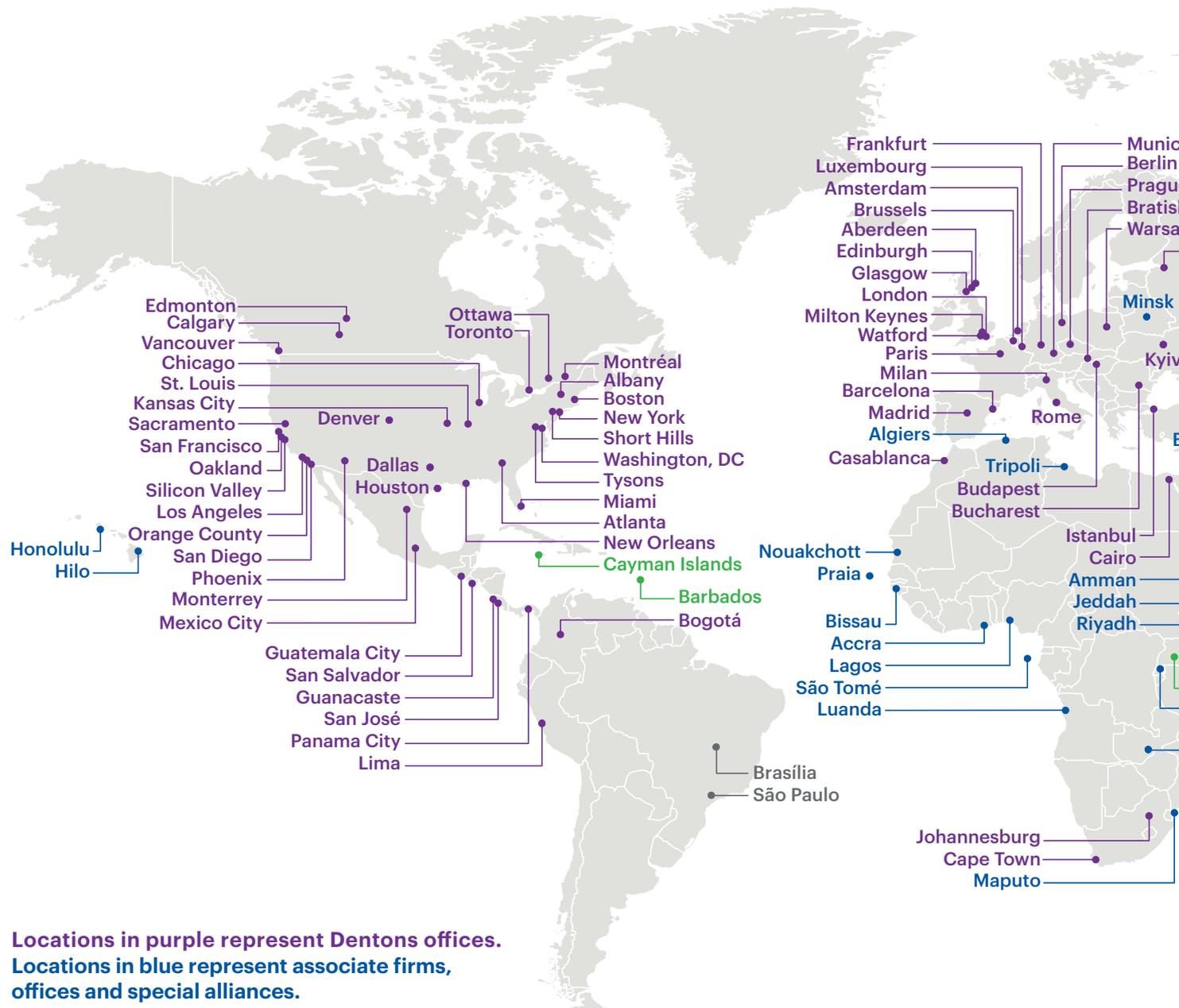
Sona graduated from Baku State University (BA in International Law, 2005), Baku State University (LLM International Law, 2007 *cum laude*) and the University of San Diego, USA (LLM in Comparative Law, specializing in Corporate and Business Law, 2010), and she was admitted to the New York Bar (2011). She has been a member of the American Bar Association since January 2011. While working in the Washington DC office of Dentons in 2015, Sona advised clients on energy, corporate, trade compliance and other matters. Sona has experience in corporate and commercial law, as well as banking and finance, real estate, hospitality, tax and dispute resolution. Working in the New York office of legacy Salans in 2010, Sona assisted on various corporate, mergers and acquisitions, real estate, estate and probate matters. She has been teaching courses on "Corporations" at the LLM Commercial Law Faculty of Baku State University since November 2012 and "General Energy Law" at the LLM Energy and Maritime Law Faculty of Baku State University since September 2013. Sona has been independently recommended as a Rising Star in Azerbaijan by the *IFLR Energy and Infrastructure Guide*, since 2016 and in "Financial and Corporate" by the *IFLR1000* (since 2016) – The Guide to the World's Leading Financial Law Firms. She speaks Azerbaijani, Russian and English.

### **Ulvia Zeynalova-Bockin, Counsel, Dentons' Baku office**

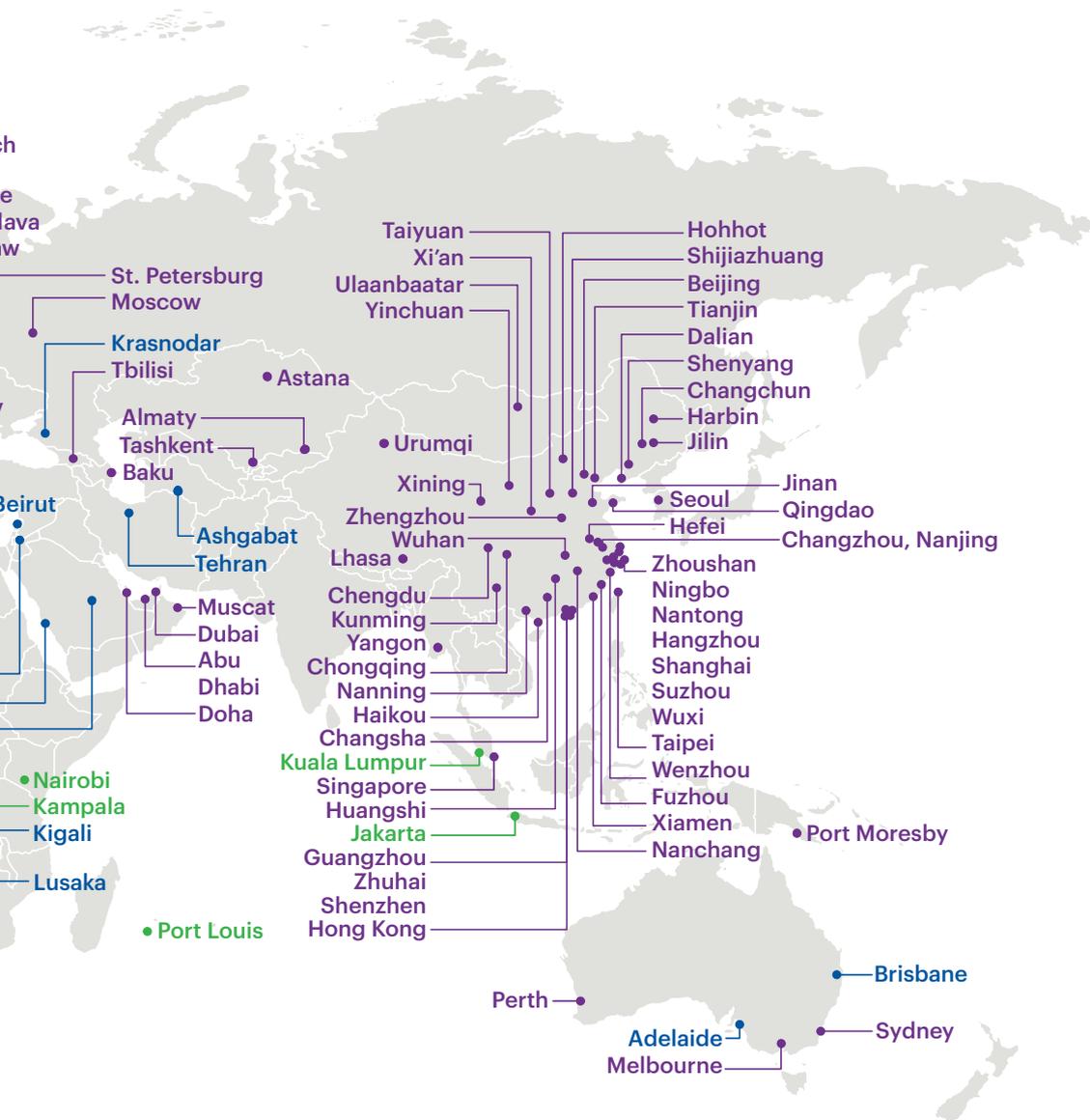
Ulvia graduated from Khazar University School of Law, Baku, *cum laude*, (LLB, 2006) and Georgetown University Law Center, USA (LLM, with a concentration in Securities and Financial Regulation, 2009). She is admitted to the New York Bar as of January 2010 and completed a short-term assignment in the Firm's New York office in October-November 2011. Her practice includes banking law, Islamic finance, real estate finance, mergers and acquisitions, as well as corporate law and finance, with special expertise in securities and financial regulation, including work with the Corporation Finance Division of the U.S. Securities & Exchange Commission in Washington, D.C. and advising clients with business interests in the CIS countries while working in the Firm's New York office.

Ulvia has provided legal support to local and international clientele in high-profile matters, including the first IPO to be listed on the Baku Stock Exchange, and advising major investment banks on the enforceability of ISDA Master Agreements, Global Master Repurchase Agreements and Global Master Securities Lending Agreements and participating in the privatization of the largest bank in Azerbaijan. Ulvia also successfully represented local and foreign banks in various derivatives and lending transactions, assisted in shareholding restructuring, conducted legal due diligence, drafted agreements and other transaction documents and assisted with regulatory approvals and other business concerns. She has been recognized as the Next Generation Lawyer by *The Legal 500 EMEA 2017 & 2018* rankings and as the Recognized Practitioner in Azerbaijan by *Chambers and Partners Asia-Pacific 2018*. She speaks Azerbaijani, Russian, English and Turkish.

# Global presence



Locations in purple represent Dentons offices.  
 Locations in blue represent associate firms, offices and special alliances.  
 Locations in green represent proposed combinations that have not yet been formalized.  
 Locations in gray represent Brazil Strategic Alliance.



# What the Press Says

- ***The Legal 500 EMEA, 2018***  
Top tier in Azerbaijan based on client and peer feedback in *Legal Market Overview*
- ***The Legal 500 Hall of Fame***  
James Hogan is recognized by *The Legal 500* as one of the elite leading lawyers for seven consecutive years and included in *The Legal 500 Hall of Fame*
- ***Chambers Global & Chambers Asia-Pacific, 2018***  
Dentons Azerbaijan ranked Band 1 in General Business Law
- ***IFLR1000, 2018, Oil and Gas***  
Dentons Azerbaijan ranked Tier 1 in “Oil and Gas” by the *IFLR1000* (2018 edition) – The Guide to the World’s Leading Financial Law Firms
- ***IFLR1000, 2018, Financial and Corporate***  
Dentons Azerbaijan ranked Tier 2 in “Financial and Corporate” by the *IFLR1000* (2018 edition) – The Guide to the World’s Leading Financial Law Firms
- ***Chambers Global & Chambers Asia-Pacific, 2018***  
“They’re very active, friendly and positive, with a fast and flexible approach. We appreciate their attention to customisation and understanding of our industry segment, and value their emphasis on building and maintaining a long-term relationship.”  
  
“They’re very flexible and they get back to us quickly. They work every day we need them; I really value how they understand the situation.”  
  
“The firm has an extensive international reach, and it provides a one-stop shop for Azerbaijan branch management and administrative services required.”
- ***IFLR1000, 2018, Financial and Corporate***  
“As part of the largest international network in the world, the Azerbaijani office of Dentons is able to leverage that position into significant mandates in the domestic market.”
- ***The Legal 500, 2017***  
“Dentons has outstanding knowledge of Azerbaijan and its laws and government and finds workable solutions to business problems.”
- ***Chambers Global, 2017***  
“I enjoy working with them because of their high level of professionalism, client-oriented approach and timeliness,” “always helpful and available” “comprehensive and practical” advice.
- ***IFLR1000, 2017, Energy and infrastructure***  
“Dentons in Baku has developed substantial legal expertise in oil and gas throughout the years.”
- ***IFLR1000, 2017, Financial and corporate***  
“They gave us legal opinion and analysis on making joint ventures and advised on which form of venture would be better,” “They are cost effective, negotiable and Kamal [Mammadzada] is very good and always has time.”



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