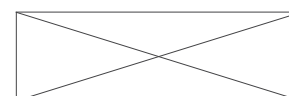


REVIEW: Legal

The Set Up



► BHM Lansky Ganzger & Partner LLC provides an overview of the rules and regulations for establishing and running a business with foreign capital in Azerbaijan.

With its substantial oil and gas reserves and strategic geographical location Azerbaijan has been and continues to be a target destination for astute foreign investors. Since the country's independence, considerable efforts have been made to attract foreign investors to the domestic oil and gas industry. With this sector now firmly established, attention is being turned to the development of the non-oil sectors. Azerbaijan is receiving increased interest from around the world, with the potential for investment in financial services, infrastructure, consumer goods, construction, telecommunications, IT, tourism, and the education sector.

The legal system of Azerbaijan is based on civil law and the highest judicial authority is the Constitutional Court, which is ultimately overseen by the European Courts. In contrast with the common law-based judicial systems of the US and the UK, the civil law system of Azerbaijan does not rely on case law or judicial precedent. The 1995 constitutional acts adopted via referendum and legislation passed by the Milli Majlis, or national parliament, are the primary sources of law.

Foreign investors are in general subject to standard Azeri legislation, save for those working in the oil and gas industry who are affected by the numerous Production Sharing Agreements (PSA) and Host Gov-

ernment Agreements (HGA). At present there are 31 ratified PSAs and HGAs, and each agreement is subject to its own exclusive tax and accountancy regime, with these generally offering more favorable legal and tax regulations for participants, contractors, and sub-contractor parties.

Reforms to setting up a business

In the last decade a number of practical reforms have been made to the legal system to ease the process of doing business. The World Bank Doing Business report for 2009 listed Azerbaijan as a top reformer, with improvements made in seven out of 10 indicators of regulatory reform. In 2004 starting a business involved the application of 13 separate pieces of legislation, registration with six different bodies, following 15 procedures and the completion of over 33 documents; the entire process of which took 106 days.

In 2006 the President declared the situation as "unacceptable" and over the following two years a consultation and research program was initiated with the aim of overhauling the entire process. In 2008 a "one-stop shop" for business registration was implemented, simplifying the procedure and enabling all documents to be filed at a single state body—the Ministry of Taxes. As a result, the entire start-up process of a business can now be completed within 40 days. The results of the implementation of the one-stop shop were immediately visible, with the following six months seeing an increase in business registration of 40%.

In the beginning of 2011 a new act on Administrative Proceedings and Administrative Procedural Code came into force and new specialized administrative courts have begun operation. The aim of the new act is to improve the regulation

of administrative procedures and enhance human rights in the country. New courts have been established in a number of regions and judges are receiving training on the new procedures. The legislation will improve the access to affective resolution of disputes between citizens and public officials.

A significant amount of documents are required to register a company, however, and some documents must bear an apostille from the investor's country of incorporation. Azerbaijan is party to the Hague Convention on Abolishing the Requirement of Legalization for Foreign Public Documents, and as a consequence documents originating from Hague Convention signatory countries do not require legalization (with the exception of a handful of countries).

Conditions for foreign investors

The Government has an active policy of supporting privately held enterprises including those owned by foreign companies. Incentives may be available to foreign investors in certain sectors, granted by legislative acts and by agreements directly between the state and investors. The Law on Protection of Foreign Investments January 15 1992 sets out the forms foreign investment may take. There are no exclusive rules for the incorporation of companies by foreign investors with the exception of the standard translation and notarization requirements. Foreign investors may acquire domestic enterprises; establish joint venture operations; create enterprises wholly owned by foreign persons/legal entities; and open representative/branch offices. The legislation stipulates that foreign companies may be engaged in any type of economic activity provided it is not prohibited under Azeri law.

Custom regulations

Azerbaijan is not currently a member of the WTO, although it is in discussions to join. The country recognizes a number of custom regimes for imported goods, in particular transit, customs storage, bonded warehouse, temporary import and processing in and outside customs territories. Goods imported into Azerbaijan are subject to import duties ranging from 0% to 15% per metric unit. Excise tax applies to certain goods, notably tobacco and alcohol products. VAT is payable on the declared value of the goods although certain categories are exempt from import duties and VAT. Exports are in general exempt from customs duties, save for certain types of metal products. A customs clearance fee of AZN550 is payable on most imports/exports.

Labor Law regulations

Labor matters are regulated by the Labor Code 1999 as amended, together with a number of other laws and regulations issued pursuant to the Labor Code. The working week is 40 hours and the minimum amount of paid annual leave is 21 days, with certain senior professionals entitled to 30 days. In addition, there are 18 non-working days. An employer must give an employee two month's notice if it wishes to terminate the employment contract and the employee must give one month's notice. Termination of certain categories of employees is prohibited, including pregnant women and women with children under three years of age. The retirement age for women is 58 and for men is 63.

Foreign nationals wishing to work in Azerbaijan must obtain a work permit, which requires being registered at a place of residence. Work permits can be issued for up to one year and may be renewed up to four times. Heads of representative and branch offices are not required to obtain a work permit. ●

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

They would like to thank BHM Lansky Gernzger & Partner LLC for compiling this analysis.



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for a term of five years. State duties for licenses can be up to AZN22,000. Penalties for operating without a required license are severe and will be imposed pursuant to the Code on Administrative Offences and the Criminal Code.

Taxation

The statutory tax regime applies to all legal entities in Azerbaijan with the exception of those that are governed by a PSA or HGA. Taxation regulations are governed by the Tax Code, a new incarnation of which was adopted in 2001, abolishing numerous old tax laws and introducing 220 new articles. All Azerbaijan and foreign legal entities having a "Permanent Establishment" (PE) in the country must register with the tax authorities irrespective of whether the activities of the company are subject to profit tax. Representative and branch offices must register within one month of commencing activities in Azerbaijan and give one month's notice of an intention to cease operations.

Profit Tax is payable quarterly in advance on all taxable profits, which are determined by subtracting allowable deductible expenses from gross receipts. The tax rate is currently 20%, having been reduced on January 1, 2010 from 22%. Foreign legal entities are subject to income tax withheld on dividends and interest at a rate of 10%, whether or not such income was obtained through a PE. Azerbaijan has entered into bilateral treaties for the avoidance of double taxation with 33 countries and certain treaties may reduce the rate at which dividend tax applies.

Entities with an annual turnover of less than AZN150,000 and individuals with annual turnover less than 90,000 may register as Simplified Taxpayers. Simplified Tax is charged in place of Profit Tax at a rate of 4% of gross revenue.

Requirements for registration and accounting for VAT are detailed and subject to penalties for non-compliance. VAT is in large charge at a rate of 18%, for each taxable operation and for the value of each taxable import. Companies whose taxable transactions exceed AZN150,000 and individuals with an annual turnover of more than AZN90,000 must register as VAT payers. Other companies may register voluntarily, but only VAT registered entities may charge VAT or reclaim input VAT.

Personal income tax is levied at a progressive rate of 14% to 30% of gross income. Social insurance fund contributions of 25% must be made from gross salary (22% contributed from the employer and 3% from the employee).

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year. The establishment of a Supervisory Board of Directors is optional, but if one exists its directors cannot be on the executive management body.

The structure of an ALC is similar to that of an LLC with the distinction that participants in an ALC may assume liability for the company in excess of their contributions.

Partnerships

There are two types of partnership operations in Azerbaijan: a General Partnership and a Limited Partnership. A General Partnership must be made up of at least two sole proprietors and/or legal entities and the partners may only be participants in one partnership, either general or limited. A Limited Partnership comprises of at least one or more General Partner and one or more Limited Partners (who may be either individuals or legal entities) and as in a General Partnership, partners cannot participate in more than one partnership. General Partners are jointly and severally liable for the partnership's liabilities and the partners are personally liable for such obligations that the partnership has insufficient assets to fulfill. In a Limited Partnership, a Limited Partner is liable only to the extent of their contributions, while a General Partner is personally liable for the partnership obligations.

Partners may withdraw from a partnership by giving six months notice to the other partners and are entitled to retrieve the value of their participatory interest. General Partners remain liable for the debts acquired by their partnership before their departure for a period of two years.

Non-commercial Organizations

Whilst not-for-profit organizations must be established for social and economic activities not related to the generation of profit, they are treated as legal entities in Azerbaijan and have most of the corresponding rights and obligations. Non-commercial organizations are registered with the Ministry of Justice, and a recent change to the legislation now requires applicants to enter into an "agreement" with the Ministry, setting out the conditions under which the organization must agree to operate. The main conditions are that the organization must not engage in any illegal acts or political propaganda.

Branch / Representative Offices & Subsidiaries

Branch and representative offices of foreign companies are not considered legal entities under Azerbaijani legislation. Both branch and representative offices have "non-res-

the obligations of the JSC only to the extent of their capital contribution. Shares of a closed JSC are distributed among the shareholders and may be transferred to third parties only upon the shareholders' right of first refusal being exercised or upon the JSC's failure to purchase the shares. A shareholder has one month to decline to exercise the right to purchase the shares. The General Meeting of Shareholders (GMS) has exclusive competence in decision-making activities relating to the JSC and must be held not less than once a year. Open JSCs must publish notice of both annual and extraordinary General Meetings of Shareholders in the official press at least 45 days before a meeting.

An open JSC must establish a Supervisory Board of Directors to monitor the activity of the company's executive body. The supervisory board may be made up of shareholders or external persons and its directors may not be members of the companies executive management body. An open JSC must also appoint an internal auditor to monitor the company's financial operations, and an audit must be conducted at the end of each financial year. The executive management body of a JSC may be made up of a board of managers or by a sole manager and is responsible for day-to-day management duties.

Limited Liability Company (LLC) & Additional Liability Company (ALC)
An LLC can be created by one or more individuals and/or legal entities contributing their participatory interest to the charter capital. If the LLC is made up of only one legal entity, then that legal entity may not be a company having only one participant/shareholder. The participants in an LLC are normally liable only to the extent of their contributions and are not liable for the LLC's obligations. In turn, the LLC is not responsible for the obligations of its participants to third parties. A participant may sell an interest to a third party, but the other participants have the right of first refusal, unless the charter provides for otherwise.

There is no specified minimum capital requirement, although the Civil Code states that the minimum capital is to be set by the relevant executive authorities. The charter capital contributions of the participants must be paid in full prior to state registration. Capital contributions in kind must be valued by an independent auditor. The General Meeting of Partners (GMP) must be held a minimum of once annually and a GMP dealing with the results of an annual activity must be held no later than four months after the end of the reporting

There are a number of guarantees that protect foreign investment. Foreign investors enjoy a "not-less favored" regime, and therefore have the same rights as local investors. There is a guarantee against nationalization, which is only permitted in cases of emergency and in such cases foreign investors are entitled to prompt and effective compensation. The right exists to repatriate profits, revenues, and other amounts received through investments, provided that all taxes have been paid. If an amendment is made to legislation that adversely affects a foreign investment, that change is subject to a 10-year moratorium. Pursuant to the Azerbaijan Land Code only Azeri citizens and legal entities can own land; however, foreign individuals and entities can lease land and own immovable property, such as apartments and houses. Azerbaijan has entered into 39 bilateral investment treaties on the mutual protection of investments, with several more treaties being negotiated, and is also party to a number of multilateral treaties concerning foreign investment.

Establishing a legal presence

The Azerbaijan Civil Code and the Law on State Registration and the State Register of Legal Entities set out the regulations for establishing a legal presence in Azerbaijan. Joint Stock Company (JSC)
A JSC may be founded by either an individual or legal entity and may be either open or closed, with the closed JSC being limited to a maximum number of 50 shareholders. The charter capital of a JSC is made up of a fixed number of shares and the minimum amount of charter capital is AZN2,000 for a closed JSC and AZN4,000 for an open JSC. Capital contributions made "in kind" (e.g. property or supplies) must be independently valued and resolved at the founders meeting.

The foundation agreement and charter of the JSC are adopted at the founders meeting. The charter capital must be paid in full prior to state registration. Following that the JSC and the issued shares must be registered, the issued shares must be placed, and a report on the results of the placement must be registered. Issued shares are investment securities and must be registered at the State Securities Committee. The shares of an open JSC must be made publicly offered and this may be conducted by the JSC itself or through a stock exchange.

JSC shareholders/participants cannot be held to be personally liable for the liabilities of the company and are liable for

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