**ON BEHALF OF THE REPUBLIC OF AZERBAIJAN**

**DECISION**

##### OF THE PLENUM OF CONSTITUTIONAL COURT

##### OF THE REPUBLIC OF AZERBAIJAN

*On interpretation of Article 14 of the Tax Code of the Republic of Azerbaijan and Article 390 of the Civil Code of the Republic of Azerbaijan*

# 12 March 2012 Baku city

The Plenum of the Constitutional Court of the Republic of Azerbaijan composed of Farhad Abdullayev (Chairman), Sona Salmanova, SudabaHasanova, Rovshan Ismaylov (Reporter-Judge), Jeyhun Garajayev, Rafael Gvaladze, Isa Najafov and Kamran Shafiyev;

attended by the Court Clerk Ismail Ismaylov,

the legal representatives of the subjects interested in special constitutional proceedings: Ilgar Suleymanov, Deputy head of Legal Department of Ministry of Tax of the Republic of Azerbaijan, Rasim Gasimzade, Head of Department on work with courts of Legal Department of Ministry of Tax of the Republic of Azerbaijan, Rovshan Muradov, Head of Sector of Legislation on financial and budgetary issues of the department of Economy Department of the Milli Mejlis of the Republic of Azerbaijan;

experts: Phd. Afat Mirzoyeva, Docent of Chair of Civil Procedure and Commercial Law of Baku State University, Rufat Geyushev, senior teacher of Civil Law Chair;

specialists: Ilgar Dadashev, Judge of Supreme Court of the Republic of Azerbaijan, Hilal Halilov, Judge of Court of Appeal of Baku city, Jamil Alizadeh, Head of Department of Tax Policy and Incomings of Ministry of Finance of the Republic of Azerbaijan, Anar Asadov, senior adviser of legal department of the Ministry of Finance of the Republic of Azerbaijan, Ayhan Asadov, lawyer specialized on relevant sphere;

in accordance with the Article 130.4 of the Constitution of the Republic of Azerbaijan examined in open judicial session via special constitutional proceedings the case on request of the Cabinet of Ministers of the Republic of Azerbaijan concerning the Article 14 of the Tax Code of the Republic of Azerbaijan and the Article 390 of the Civil Code of the Republic of Azerbaijan.

having heard the report of Judge Rovshan Ismaylov, the reports of legal representatives of the subjects interested in special constitutional proceedings, specialists and experts, and having examined the materials of the case the Plenum of Constitutional Court of the Republic of Azerbaijan

**DETERMINED AS FOLLOWS:**

The Cabinet of Ministers of the Republic of Azerbaijan having applied to the Constitutional Court of the Republic of Azerbaijan (hereinafter referred to as the Constitutional Court) referring to the Articles 96.1, 99.3.3, 124.1, 150.1.6 and 150.2 of the Tax Code of the Republic of Azerbaijan (hereinafter referred to as the Tax Code) specified that tax law defining an income from leasing of property as an object of taxation fixes collection of a tax with respect to this income from a payment source. But complexity in this area is generally connected with establishment of sum of rents.

Thus, unlike disciplined taxpayers, in practice sometimes there occur cases when for purpose of evasion of taxation sum of leases of rent is specified in much less of real and even the property is leased on the basis of the power of attorney. In that case, tax authorities estimate taxes according to the Article 14 of the Tax Code on the basis of market prices or on similar data according to the Article 67 of this Code.

The acts of tax authorities adopted about it in many cases are challenged in a judicial proceeding and in the created jurisprudence such requirements, as a rule, are met on the basis of freedom of the parties in definition of contractual conditions, including, a rent, that is freedom of the contract according to the Articles 152.1, 390.1, 390.5 and 390.6 of the Civil Code of the Republic of Azerbaijan (hereinafter referred to as the Civil Code).

The applied body which differently think concerning the matter, considers that according to the Articles 14.6.1.8 and 14.6.4 of the Tax Code, the tax authority has the right to apply market price, and in cases when it is impossible, to estimate the tax sum with use of similar data according to Article 67.1 of this Code.

Whether in this regard for elimination of noted contradictions the Cabinet of Ministers the Republic of Azerbaijan asks to interpret whether it possible the application of market price to the lease according to Articles 14, 67 and 124 of the Tax Code and Articles 152.1, 390.1, 390.5 and 390.6 of the Civil Code.

In connection with the request, the Plenum of the Constitutional Court considers necessary to note the following.

In the Article 29.3 of the Constitution of the Republic of Azerbaijan (hereinafter referred to as the Constitution) which affirmed the property right and in Article 152.1 of the Civil Code it is specified that this right consists of the right of the owner for possession, use and order of property independently or together with others. In the Article 59 of the Constitution right of everyone according to existing legislation, individually or together with other citizens, to carry out business activity or other kinds of economic activity is not prohibited by law.

In this sense, it should be noted that the Article 1 of the Law of the Republic of Azerbaijan “On Lease” (hereinafter referred to as the Law “On Lease”) establishes that rent represents an urgent paid ownership based on a contract and using property. According to the Article 8.1 of this Law, the size of a rent and order of payment should be stipulated in contract.

Nevertheless, according to the Article 2.5 of the Civil Code, extending also on the Law “On Lease” being the civil normative legal act, the civil law and other legal acts do not apply to property relationships based upon administrative or any other power-based subordination of one party to another, as well as tax, financial and administrative relationships, except as otherwise provided stipulated by law. Besides, Article 2.3 of the Tax Code establishes that in cases of tax legislation contradict any legislation in other areas, with the exception of provision stipulated by Article 2.7 of this Code, the provisions of tax legislation are applied.

The income from leasing of property by natural persons refers according to the Article 99.3.3 of the Tax Code to the income from non-business activity; by the Articles 124.1, 150.1.6 and 150.2 of this Code it is established that tax from this income makes up to 14 percent and is subject to collection from a payment source. The Article 124.4 of the Code provides that relevant executive authority should establish the minimum amount of monthly leasing payment for the purposes of taxation of immovable property (with exception of resident housing fund) in the Republic of Azerbaijan. However, such limit for real estate that is in a private property that can be accepted as a certain starting point for taxation now is not established.

At the same time, the Article 14 of this Code provides application of market price for taxation, including definitions of tax which is subject to collection from the rent sum. Thus, in the Article 13.2.11 of this Code, “service” is specified as activity that does not involve provision of any commodities and has financial value, and the Article 14 of the Code including in the concept “services” the rent, made possible the application of market price to this sphere (the Article 14.6.1.8).

Defined market prices are used only for the purpose of taxation of goods (works, services) registered at actual sale price in order provided by legislation (Article 14.6.4 of the Tax Code). Despite it, calculation of taxes taking into account market price is required by Article 14.3 of the Tax Code. This norm as the basis of application of market price establishes some concrete circumstances, including, implementation of deals between interrelated persons, or at price deviation for more than 30 percent (either side) within 30 days from the pricing level applied by taxpayers on analogue or similar goods (works, services).

Thus, the bases noted in the recent article give to tax authority the grounds for suspicions concerning commission by the taxpayer of the actions directed on reduction of the tax that is subject to payment and by that calculation of a tax concerning of it according to market price. In that case, all subsequent calculations and the consequences following from it depend on exact definition of market price. In this sense, experience of the European experts in the sphere of definition of market price is also interesting. Thus, on the concept created by this experience, the rent makes an annual financial equivalent that can be received in the market of use of real estate within the lease contract. Therefore, it has to correspond to the market value of rent of real estate that can be acquired in the conditions of usual rent for the corresponding property located in this territory. The market value of rent decides on a deduction of the expenses connected with the right of rent or the VAT, and any other expenses connected with rent or assigned for rent (point 1 of the section “Market prices” of the Charter “On expert examination of real estate”, devoted to “The principles of an assessment”).

In this sense it is necessary to emphasize that the Article 73.1 of the Constitution expressing common interests provides a duty of everyone to pay the taxes and other government levy established by the law in full and in due time. Plenum of the Constitutional Court noted that application of certain restrictions in implementation of the state coercive measures is directed on protection of such constitutional values, as stability and definiteness of public legal relations, ensuring stability of conditions of management, preservation of balance between interests of the state and personal interests of subjects of legal relations (decision “On Interpretation of Articles 78.3, 85.4, 90.3 and 93.1.1 of the Tax Code of the Republic of Azerbaijan” of January 12, 2011).

Such approach found the reflection and in international law. Thus, point 2 of Article 29 “Universal Declaration on Human Rights”, subparagraph 1 “a” of the Article 8 of the International Covenant “On Economic, Social and Cultural Rights” and Article 1 of the Protocol No. 1 to the Convention for Protection of Human Rights and Fundamental Freedoms do possible the restriction of freedom of the contract with the purpose of satisfaction of the general requirements of welfare, protection of the rights and freedoms of others, and also the public interest. In connection with the last provision the European Court of Human Rights (hereinafter referred to as the European Court) declared that the notion of “public interest” is necessarily extensive and that the States have a certain margin of appreciation to frame and organize their fiscal policies and make arrangements - such as the right of pre-emption - to ensure that taxes are paid (case on Hentrich v.France, N. 136146/88, September 22, 1994, § 39).

But, considering that market value is the factor influencing on property rights of the taxpayer, Plenum of the Constitutional Court considers noteworthy the position which is available in foreign practice of the constitutional procedure on a similar issue“…possible limitations imposed by the federal legislation on the right to possess, use, and dispose of property and the freedom of entrepreneurial activities and freedom of contract shall be – as follows from the general principles of law – fair, adequate, proportional, balanced, and necessary to protect constitutionally significant values, including private and public rights and other persons’ lawful interests; they shall be general and abstract, shall not be retrospective, shall not affect the essence of the constitutional right, i.e. shall not restrict the scope and application of the core contents of the respective constitutional norms” (the fifth paragraph of point 2 and point 6 of motivation part of the decision of Plenum of the Constitutional Court of the Russian Federation of April 01, 2003).

In this regard it should be noted that freedom of the contract established in Article 390 of the Civil Code acts as one of elements of the realization of the property right provided in Article 29 of the Constitution and Article 152.1 of the Civil Code and also the right for freedom of business activity affirmed in Article 59 of the Constitution. The called provision is guarantees the free conclusion of contracts by natural and legal entities and definition of the contents of these contracts. Among the elements forming the content of freedom of contracts it is possible to note freedom of the conclusion (or not the conclusions) contracts with the chosen contractor, definitions of its kind and a form, and also conditions of the signed contract, including, the corresponding prices.

Providing to participants of a civil turn these freedoms, the legislation acted from the assumption of their integrity according to the general principle of the right. The integrity presumption providing that actions of everyone are considered honest, until proved otherwise (quivispraesumitur bonus donesprobeturcontrarium), is one of fundamental legal presumptions. Proceeding from this presumption, Article 14.2 of the Tax Code establishes that unless otherwise stipulated by this article, for the purposes of taxation the price of goods (works, services) fixed for operation (deal) should be used.

To proof the contrary, that is, abuses of civil law and by that the denial of the called presumption is assigned to tax authority. The European Court, connecting the proofing of such circumstance with existence of the serious bases for suspicion of evasion from taxes specified that State has other suitable methods at its disposal for discouraging tax evasion where it has serious grounds for suspecting that this is taking place; it can, for instance, take legal proceedings to recover unpaid tax and, if necessary, impose tax fines. Systematic use of these procedures, combined with the threat of criminal proceedings (above-noted decision on case of Hentrich vs.France, § 47). As evident from a legal position of the European Court, application of market price for collection of a tax on income gained from the rent relations demands existence of the serious bases concerning approach from a tax.

In connection with instrument of evidence that can confirm the existence of such serious bases, the tax authority, first of all, has to treat each concrete case individually taking into account its special physical, legal and economic circumstances. For this purpose the tax authority has to proceed from the circumstances specified in Article 8.1 of the Law “On Lease”, that is, the standard limits of the sum of a rent set taking into account cost and a condition of the fixed rented assets, prospects of development of the enterprise and other factors, including, the minimum income which has to be received from operation of leased property, and also fixed for the state or municipal property which is in a similar state. As a result, legality of the decisions made by tax authority is caused by strict observance of the following provisions of the Tax Code and Law of the Republic of Azerbaijan “On Administrative Procedure” (hereinafter referred to as the Law “On Administrative Procedure”), in particular requirements of Article 14.4 of the Tax Code which fixed the general rule for definition of market price.

According to this norm, market price is determined until the good (work, service) is sold, but not later than 30 days from the moment the good (work, service) is sold at the price established on the closest date (before or after) at appropriate deals on identical (analogue) goods (works, services during determination and recognition of goods (works, services) market value the official sources of information on market values of goods (works, services) and exchange rates, databases of state and local authorities, information submitted by taxpayers to state tax authorities, information of advertisement sources and other appropriate information is used (Article 14.9 of the Tax Code).

These provisions first of all lay the foundation of comparative identification of market price. This method, based on consideration of conditions of the lease contracts with a similar subject signed earlier under equivalent circumstances consists of establishment of the most real possible price of property with use of the relevant state sources, official or public data. But as identification of the price when using this method not in all cases and is not always productive, the tax authority for the purpose of definition of market price can proceed to the following stage.

Thus, according to Article 14.6 of the Tax Code if provisions of Articles 14.4. and 14.5 of this Code are not applicable, the market value of good (work, service) is determined in accordance with requirements of this Article. The regular costs on production and/or marketing (purchase price and residual value) of good (work, service), transportation, storing, insurance and other similar costs are considered as well as added values and discounts practiced during deals between non-interrelated persons, that will consider the factor of demand and supply. Specified costs shall be considered also when the good losses its quality or other consumer characteristics or expiration (close expiration) date as well as other similar cases.

In case of application of this article does not yield results, as the following stage Article 14.6.3 of the Tax Code establishes that if on relevant goods (works, services) market with similar or same kinds of goods (works, services) no operations are conducted, and it is not possible to collect the information on market prices of these goods (works, services) from official or open sources, following evaluation methods can be applied:

- on the basis of subsequent (secondary) selling price Market prices of goods (works, services) are determined on the basis of subsequent (secondary) selling price of these goods (works, services). The market price is determined with deduction of applied raise from subsequent selling price (Article 14.6.3.1);

- on the basis of value accumulation method Market prices are calculated with accumulation of costs and profits, motivated by the party providing goods (works, services) (Article 14.6.3.2);

- if market prices of goods (works, services) can not be determined by one of the methods established in this Article, market prices are determined by contractor expert (Article 14.6.3.3).

As for the involvement of the expert, in Article 44 of the Tax Code and Article 41 of the Law “On Administrative Procedure” the order of carrying out of inspection and a number of providing in this regard, including, involvement of the expert on the basis of the contract, possibility of pre-discretion is fixed in the contract of responsibility of the expert for making wrong or obviously false conclusion, purpose of inspection according to the petition of interested persons or on own initiative on the basis of the decision of the body which is directly carrying out tax audit and also providedthe obligation of the tax authority which passed the decision on carrying out inspection to acquaint the taxpayer which inspection is carried out, with given decision, and to explain to this person about his rights provided in Article 44.7 of the Tax Code including the address of this person about appointment of the expert from among the persons specified by it, participation in carrying out of inspection directly or through the representative, in advance having notified the official of the tax authority which is carrying out tax audit when carrying out inspection and acquaintance with the expert opinion.

According to the Article 14.8 of the called Code which is extending on all stages of the above process and being one of display of active participation of the taxpayer in definition of the tax which is subject to collection, the taxpayer holds the right to submit to state tax authority the evidences that market values for goods (works, services) are determined in certain deals in accordance with the procedure that differs from one stated in this article.

It is also necessary to note that the raised issue is resolved in a similar order also in other member states of the Council of Europe and in this area the jurisprudence of the respective countries was already created. For example, Court of Cassation of the Republic of France in the decision of December 19, 2000, having expressed the legal position, specified that if the appointed sum or an assessment is lower than market price, Article L.17 of the Tax Procedural Code which allow the repeated calculation of the sum or an assessment which became the basis for establishment of the corresponding collection is a sufficient legal ground for the refer by tax authorities only to market price for the purpose of a repeated assessment.

On the other hand, if the taxpayer makes the actions which are not directed on cooperation with tax authority or even interfering calculation of a tax specified in Article 67.1 of the Tax Code, tax authorities have the right to estimate the tax sum which is subject to payment, using the tax declarations presented by the taxpayer to tax authority for the previous reporting periods and other similar data noted in this article. Thus, application of this provision, as opposed to the Article 14 of the Tax Code, does not concern cases of the indication of the underestimated sum of rent and is the independent means that is carried out at non-fulfillment of legal requirements for the purpose of establishment of object of the taxation.

But, anyway, it is necessary to consider a legal position of the European Court according to that Article 1 of Protocol No. 1 also requires that any interference be reasonably proportionate to the aim sought to be. Consequently, interference must achieve a “fair balance” between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights. The requisite fair balance will not be struck where the person concerned bears an individual and excessive burden(case of Iwaszkiewicz vs. Poland, no. 30614/06, 26 of July, 2011, § 44).

Proceeding from it, Plenum of the Constitutional Court considers that legality of application of market price by tax authority requires acceptance of this administrative action with observance of the above mentioned requirements of the tax law, including, the indication of the documents proving that the rent sum in the contract is reduced, and also justification of the applied market price with an explanation of the elements of comparison corresponding to features of property taking into account provisions of Article 49.2 of the Tax Code and Article 61 of the Law “On Administrative Procedure”.

In case if inspected person disagrees with given administrative action, including demanding to carry out new inspection and claims that market price is estimated incorrectly, or agreeing with applied market price claims that deviated it for special and private reasons, according to the Articles 62, 63 of the Tax Code and the Article 72 of the Law “On Administrative Procedure” can use appellate procedures in higher tax authority or court. Within a lawsuit, these rights of inspected person cannot exempt tax authority from a duty of proof of correctness of applied market price.

Not coincidentally that according to requirements of Article 53.3 of the Tax Code, every taxpayer is considered innocent in a violation of tax legislation until his guilt is proved in the order provided by the present Code or the verdict of court entered into force. The taxpayer is not obliged to prove the innocence in a violation of the tax legislation. The obligation for proof of circumstances testifying to the fact of violation of tax legislation and guilt of taxpayer in its commission is assigned to tax authorities. Ineradicable doubts in guilt of taxpayer in violation of law shall be interpreted in favor of a taxpayer.

Thus, solution of issue, on the one hand, in the above order serves for ensuring of unconditional execution of obligation to pay taxes established by law, and to creation of conditions for calculation of cost of contracts signed by taxpayers according to market price as that is demanded by Article 73 of the Constitution, and, on the other hand, gives to taxpayer opportunity to prove illegality and groundlessness of actions of tax authorities in this direction in a judicial proceeding according to the Article 60 of the Constitution.

According to stated, the Plenum of the Constitutional Court comes to conclusion that application of the market price provided in Article 14 of the Tax Code for the purpose of calculation of a tax on income gained from leasing of property does not violate the property right and freedom of the contract enshrined in Articles 152.1 and 390 of the Civil Code.

According to Article 14 of the Tax Code, market price is determined by tax authority on observance of the requirements and stages fixed in this article including by means of examination.

In case of non-fulfillment by the taxpayer of legal requirements specified in Article 67.1 of the Tax Code, for the purpose of establishment of object of the taxation the sum of a tax is estimated with use of similar data according to this article.

Taking into consideration that the jurisprudence created in courts of the Republic of Azerbaijan differs from the above mentioned interpretation of Article 14 of the Tax Code and Articles 152.1 and 390 of the Civil Code, Plenum of the Constitutional Court considers that for the purpose of protection of rights and freedoms of participants of the rent relations, the market price provided in the Article 14 of the Tax Code can be used for the purpose of collection of taxes from income gained from rent relations after the date of entry into force of the present Decision.

Being guided by Article 130.4 of the Constitution of the Republic of Azerbaijan and Articles 60, 62, 63, 65-67 and 69 of the Law of the Republic of Azerbaijan “On Constitutional Court”, Plenum of the Constitutional Court of the Republic of Azerbaijan

**DECIDED:**

1. Application of the market price provided in the Article 14 of the Tax Code for the purpose of calculation of a tax on income gained from leasing of property does not violate the property right and freedom of the contract enshrined in the Articles 152.1 and 390 of the Civil Code.

According to the Article 14 of the Tax Code, market price is determined by tax authority with observance of requirements and stages specified in this article (including by means of examination).

2. The market price provided in the Article 14 of the Tax Code can be used for the purpose of collection of taxes from income gained from the rent relations after the date of entry into force of the present Decision.

3. The decision shall come into force from the date of its publication.

4. The decision shall be published in “Azerbaijan”, “Respublika”, “Xalq Qazeti” and “Bakinskiy Rabochiy” newspapers, and “Bulletin of the Constitutional Court of the Republic of Azerbaijan”.

5. The decision is final, and may not be cancelled, changed or officially interpreted by any institution or official.