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Reforming the Taxation of Agrarian Entrepreneurship (Case Study of Azerbaijan)

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Abstract. The relevance of the stated topic of study is determined by the fact that the bulk of tax revenue in transition economies comes from agrarian entrepreneurship. The purpose of the study was to develop practical recommendations that would resolve most of the issues in the agribusiness sector in transition economies. The key research methods are a qualitative combination of modelling, analogy, deduction, and induction, which allowed for a comparative characterisation and identification of the most effective options for reforms in the agricultural sector. It was determined that the creation of a favorable tax environment would contribute to increasing the efficiency of agrarian business, which in turn would lead to the improvement of basic economic indicators. It was established that over the past ten years, many positive changes have taken place in the tax sector of Azerbaijan, which have improved the overall efficiency of the country's tax system. This made it possible to increase the amount of income to the state budget of the country. Having analysed the experience of other countries and studied in more detail the advantages and disadvantages of the tax system in Azerbaijan, it became possible to provide key recommendations to improve performance in the area. The results of the study present reforms to improve the agricultural taxation system, which account for the socio-economic characteristics of Azerbaijan and can be used as recommendations in further studies aimed at improving the taxation of agribusiness. The impact of various reforms on the functioning of the tax system in light of the proposed changes was estimated. The results of this investigation have practical value for employees of the tax authorities of Azerbaijan and scientists who will continue studies in this regard

Keywords: agro-industrial complex, taxes, tax reform, agriculture, Azerbaijan, CIS



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INTRODUCTION

Taxation is one of the most important instruments of state policy. The tax system cannot effectively perform its functions for decades without any changes. Azerbaijan's tax system today is not perfect and requires global reform and a change in the key principles that underpin its operation. Therefore, at this stage, it is necessary to continue searching for new approaches that will improve the situation.

To facilitate this task, both positive and negative experiences of other countries were studied. This would provide new insights into the current issues and possible perspectives if certain tax policy instruments were to be applied. Since Azerbaijan became independent, the government has prioritised the agriculture sector. In particular, most of the small government loans that are issued through the National Entrepreneurship Support Fund were issued to agribusiness (Sadygov *et al.*, 2020).

However, today the agrarian business has certain problems, especially with regard to taxation. As a result of the unfavourable tax regime in Azerbaijan, the agricultural sector is mainly engaged in production for domestic consumption, while at the same time reducing production for sale on the market. Thus, farms reduce their tax deductions (Aliislam, 2021).

Being the largest country in the South Caucasus, Azerbaijan is making some progress both in the economy and in the national legal framework (Doing Business in Azerbaijan, 2022). These developments range from significant changes in legislation, the creation of centralised real estate and movable property registries, the creation of e-government, the adoption of international financial reporting and accounting standards, the creation of special economic zones and industrial and technology parks along with the introduction of a one-stop shop for business registration, including the introduction of simplified procedures in obtaining work permits.

Today, the tax system, which is the basis for the country's economic and social development, is in a state of change. The main efforts are aimed at supporting small and medium-sized businesses, reducing parts of the "shadow economy", increasing tax revenues to the national budget, and improving the tax administration system. Already at this stage, the Azerbaijani government is taking progressive steps in the sphere of optimising the taxation system: non-residents working in Azerbaijan without obtaining a permanent establishment can apply for a provisional exemption or tax reduction for all types of income, including business profits, dividends, interest, and royalties (Taxation and investment in Azerbaijan, 2022).

The main issue with the previously conducted studies in the stated subject area was the lack of comprehensiveness of the investigation and provision of tangible solutions to remedy current issues. Scientific figures of the researchers M. Sadygov *et al.* (2020) have studied a wide list of issues related to the basic principles

of the tax system, while also conducting an analysis of the origin and historical development of the taxation system.

The study by E. Kekchabaeva and G. Zhakupova (2008) has analysed whether agribusinesses can count on state support and investment programs. Using the Azerbaijani Tax Code (2000), the key positions on which Azerbaijan's current tax policy is based have been derived. The study of N. Nizamzadet (2017) was analysed and the key recommendations in this area were highlighted. The thesis of Z. Guseinov (2016), which aims to study the current system of taxation in Azerbaijan, considered the functioning of modern tax policy and the tax system of the country and reviewed the tax system as a factor in improving the efficiency of the economy of the country under study. However, none of the aforementioned studies has provided a comprehensive analysis of possible reforms to Azerbaijan's tax policy and suggested options for addressing problematic aspects.

The main objective of this study is to identify modern mechanisms to optimise the taxation of agrarian entrepreneurs, using the experience of Azerbaijan. The results of the study can then be adapted and used to develop materials for further studies on other countries with similar levels of economic development.

MATERIALS AND METHODS

The methodological basis of the study is the fundamental provisions of the agricultural business taxation system. The qualitative combination of modern methods of system analysis in the investigation of agrarian business taxation with the analytical study of the legal basis for the functioning of agrarian structures allowed to identify the most promising solutions to the key problems of the agrarian sector. The methods used in this study were abstract to concrete, a combination of analysis and synthesis, the structural-systems approach, and the cause-effect method. Using the abstract to the concrete method, the key features of the taxation system were highlighted, and the key anchor points of the system were analysed. The system-structural approach made it possible to consider the functioning of the agricultural tax system in terms of the functioning of the state's economic system. The theory itself was built using historical and logical methods that are interdependent on each other. The historical method has been used to identify the basic principles of the tax sphere, which have been gradually shaped in these lands over the course of evolution. The logical method enabled parallels to be drawn with other countries that have emerged under similar conditions, while the method of structural relationships provided conclusions and concrete steps for improving the agricultural taxation system in Azerbaijan.

This study was conducted on the basis of a previously established theoretical and legal framework that

acts as a qualitative basis for all further investigations. The theoretical basis for this study consists of the results of studies carried out by a number of Azerbaijani and largely international academics focusing on a number of problematic issues related to the main challenges for agriculture and the key imperfections of the tax system.

The study of the theoretical framework is critical to all investigative efforts, regardless of whether quantitative, qualitative, or mixed methods are used. The presented study was carried out in three main stages.

The first stage of the research involved the preparation of a theoretical framework, which was subsequently used as the basic foundation for further investigations, and the examination of the documentary base. Additionally, contributions by researchers who have undisputed professional expertise in this matter have been employed. A conceptual framework was developed to narrow down the theoretical base and operationalise it. Thus, the theoretical framework sets the direction, and the conceptual framework outlines the path to be pursued to achieve the objectives set. The conceptual framework contributed to the development of hypotheses for investigation based on the theoretical basis and variables.

The second stage was an analytical study of the application of the key recommendations for improving the taxation system for agribusinesses. This stage included an analytical comparison of the findings with the results and conclusions of other academics engaged in the practical development of improvements in the taxation

system. This contributes to expanding the perspective of studies on the tax laws of different countries.

The final stage of the study resulted in the formulation of the conclusions that summarise the findings and generally identify the main trends in tax legislation.

RESULTS AND DISCUSSION

In most countries, benefits for agricultural enterprises are provided in profit taxation. This practice is popular in Azerbaijan and Poland. In these countries, income received from agricultural activities is not subject to taxation. In Belarus, a preferential rate of 10% is applied to agricultural enterprises that receive profits from production and technical services (the general rate is 30%), while agricultural enterprises that sell their own production of crops, livestock, fishery, and apiculture do not have to pay certain categories of taxes. In Kyrgyzstan, the income tax is not paid by enterprises for which land is the main means of production and the only source of income. In Canada, however, it is possible to pay tax on the average profit for five years and apply a reduced rate of 12% (total – 29%) provided for small businesses and farms, while in France and Germany a number of reductions and exemptions are available, which reduce the amount of tax actually paid to 17% and in the Netherlands to 21.4% (Meshcheryakova, 1995). The main approaches to the design of the taxation system in different countries around the world are shown in Figure 1.

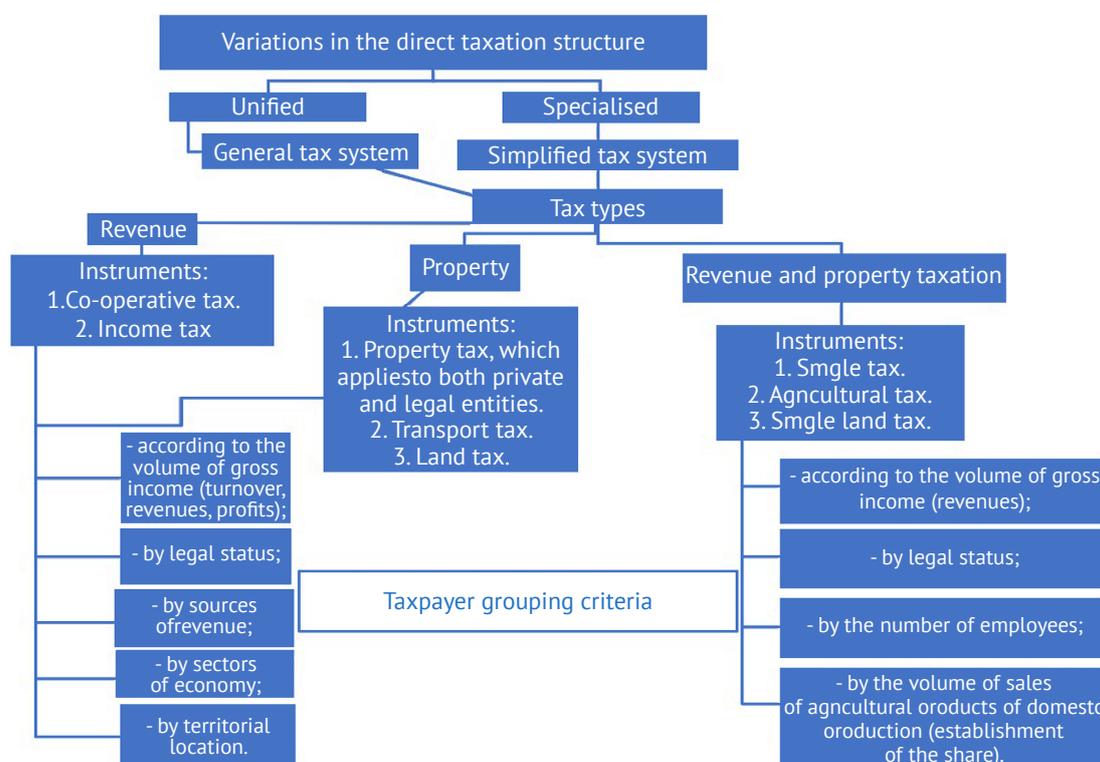


Figure 1. The Key Concepts of the Agricultural Tax System Worldwide

In the United States, the most important tax benefits for agriculture under the federal income tax are the averaging of income and the deduction of certain capital expenditures, and the accounting of certain gains from the sale of assets as capital gains. However, the greatest advantage of the US tax system can be considered a reduced farm tax. Most of the tax revenue comes from the provision of public services, including educational. This may account for the reduced tax rates per unit of land. All states have adopted a special assessment programme designed to reduce the amount that farmers are required to pay to the state. The most common type of programme is known as the “use-value assessment” whereby property taxes are based on some version of the hypothetical value of the land if it were to remain in agricultural use in perpetuity. This can provide significant property tax relief, lowering farm operating expenses. In 2021, with this valuation system, entrepreneurs were able to save around USD \$59.7 million (Global food security index, 2021).

Under the current US tax structure, farm businesses can be taxed under federal individual income tax or corporate income tax. State-level tax treatment is the same as federal. According to research, in the US, instead of the average effective income tax rate of 17.2%, farms pay 13.9%, and medium-sized farms (those with gross cash farm income of between USD 350,000 and USD 1 million) benefit the most.

It is believed that in agriculture, land use taxes should be primary and only supplemented by profit tax. This situation is common in countries where agricultural production is borderline unprofitable. However, the experience of developed countries shows a reverse correlation – the main type of taxation in the agricultural sector is profit tax (corporate and personal), while land value tax within property taxes only complements tax on profit and serves the function of levelling the business environment for enterprises. Agriculture is a strategic sector for Azerbaijan. In 2021, 37% of the population was employed in this sector (Taxation and investment in Azerbaijan, 2022).

Currently, the total income tax rate in Azerbaijan is 20%. An additional 10% branch transfer tax applies to

transfers of profits from the branch to the head office. The taxable base is net profit after taxation (Taxation and investment in Azerbaijan, 2022).

Land tax in Azerbaijan is USD 0.035 per unit of agricultural land used for intended or unintended purposes for irrigation, melioration, and other agricultural purposes, based on conditional units per hectare (Taxation in Agriculture in Azerbaijan, 2020).

The Global Food Security Index (GFSI) considers food affordability, availability, quality, and safety, along with natural resources and resilience, across 113 countries. In 2021, Azerbaijan ranked 56th on this list (Global food security index, 2021). A more efficient agricultural system would allow Azerbaijan to climb up to approximately the 30th position. The establishment of such a system cannot be achieved without an appropriate and motivating regional-specific tax policy. It is also important to recognise that agriculture generates the largest share of the profits of the country under review.

Value Added Tax (VAT) is only levied on surcharges applied to retail sales of agricultural products produced in Azerbaijan. From 1 January 2022, for 3 years, VAT is charged on the mark-up applied to the wholesale and retail sale of agricultural products (local and foreign origin). According to the latest amendments to the Tax Code, the following transactions are not subject to VAT:

1. Wheat import, flour, and bread production (for 7 years from January 1, 2017).
2. Sale of animal and poultry meat (for 4 years from January 1, 2020).
3. Sale of feed additives used in poultry farms (for 4 years from January 1, 2020), (Ivashchenko, 2007).

During the 2020 pandemic, the Azerbaijani government abolished the mandatory requirement to pay land and property taxes for a period of one year, and also reduced the level of income tax and insurance payments of companies, especially for those who suffered the most from the restrictions imposed as a result of the coronavirus pandemic (General overview of tax system in Azerbaijan, 2022). According to the data provided by the World Bank, the value added in agriculture (% of GDP) in Azerbaijan in 2021 amounted to 5.87% (Fig. 2).

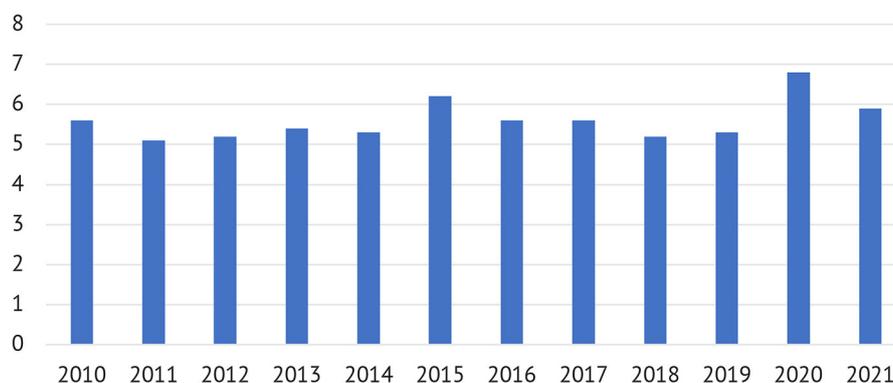


Figure 2. Value added in agriculture (% of GDP) in Azerbaijan, 2010-2021

In 2021, more than 45,000 farmers in Azerbaijan received seasonal or annual subsidies. These subsidies apply, according to the Agrarian Credit and Development Agency (AKIA), to an area of more than 82,000 hectares (Marketing research..., 2021). In addition to the above incentives, entrepreneurs can obtain an Investment Incentive Certificate, under which they will be exempt from paying taxes such as VAT (imports of production equipment by individuals and companies), property tax and land tax for 7 years (Doing Business in Azerbaijan, 2022).

However, despite various tax benefits, more than 52% of Azerbaijan's business continues to operate underground. Overall, direct subsidies have a negative impact on agricultural enterprises, as demonstrated in other countries (Bahl & Bird, 2008). Enterprises with and without subsidies are not on an equal footing. In the long term, this will preclude the creation of an efficient

agribusiness sector that operates on free market principles. Direct subsidies include the actual cash flow to a particular enterprise. According to the author, it is much more effective to use an indirect subsidy tool. For example, investments in technology, infrastructure, education. This will improve the qualitative performance of agricultural enterprises. A negative aspect of the tax exemption is that some entrepreneurs, not wanting to pay the four per cent simplified tax, registered their business in regions where the simplified tax was half as much, complicating the accounting.

Azerbaijan's most promising sector is oil. However, when looking at other areas, according to the Doing business survey, companies consider agriculture (36%) and manufacturing (22%) to be the two most promising sectors in Azerbaijan in the next 5 years (Figure 3) (Doing Business in Azerbaijan, 2022).

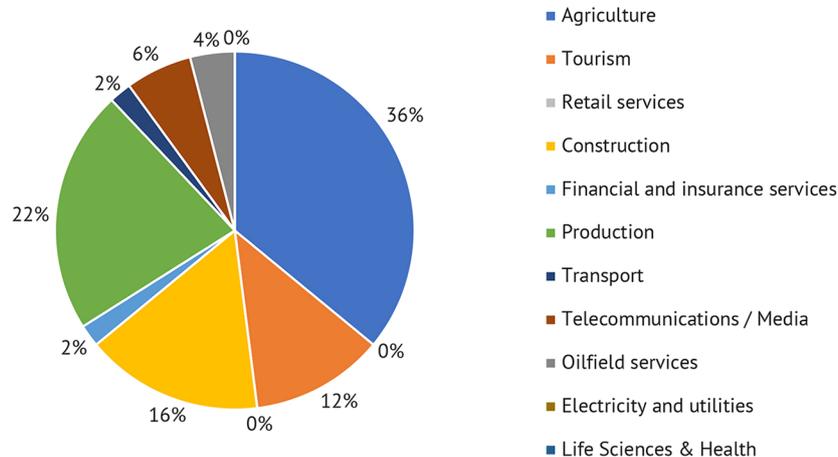


Figure 3. The most promising investment sectors for entrepreneurs in Azerbaijan

Source: Doing Business in Azerbaijan (2022)

According to reports from government agencies in Azerbaijan, the issue of abuse of tax exemptions is becoming more and more acute. Thus, over 90% of taxpayers are payers of the simplified tax (State Tax Service, 2022). The most productive reforms of Azerbaijan's agricultural sector would be:

1. Optimisation of the national system of direct taxation by applying a differentiated approach to the subject composition of taxpayers. Various factors should be accounted for when constructing a taxation system, especially the dynamically changing market and the entrepreneurs who follow it. Linear or preferential taxation systems are becoming obsolete.

2. Establishment of a non-taxable minimum in the taxation of income from agricultural activities.

3. Granting the land tax the status of local.

4. Creation of a fiscal cadastre to record the value of real-estate and land sold. This will avoid using different schemes.

5. Introduction of a tax on the misuse of agricultural land. This will motivate agricultural entrepreneurs to develop their businesses in this particular area.

6. Maintaining a simplified taxation system for small agricultural firms. It is very important to provide the greatest number of benefits to small businesses and allow them to get the start-up base they need.

7. Establishment of time limits on the duration of tax exemptions. This will allow agribusinesses to make efforts to develop with further increases in tax deductions.

8. Establishment of control over the use of benefits by agricultural enterprises to avoid fraudulent use at the expense of the state.

Applying the proposals provided will contribute to an even distribution of the tax burden and encourage the further development of agricultural enterprises.

The tax system is a complex ecosystem, the effective operation of which depends on a large number of variables. In developing countries, the agro-industrial complex is a key sector of the economy. Tax policy affects the competitiveness of agriculture by influencing the level of farm income, investment in development and technology, the use of labour and other inputs, and the adoption of the latest agricultural practices. For example, tax

systems can encourage investment in farms by reducing taxable income through depreciation allowances. Revenue levels for income, property and land can affect structural change, while differential tax rates for specific agricultural activities can affect the whole agribusiness system.

Tax policy is often used as a lever to influence entrepreneurial behaviour in the agricultural sector, affecting producer income, investment, and innovation. The success of agribusiness in the long term depends on how effective the tax policy will be built. An analysis of the Tax Code of the Republic of Azerbaijan (2000) showed a lack of a comprehensive approach to the regulation of agricultural taxation. Moreover, it has not been updated timely to reflect new realities and new government bills, unlike Russia, where a flat tax has been in place since 2002.

M. Sadygov *et al.* (2020) consider in detail the history of the formation and development of the tax system of Azerbaijan, along with the key concepts and principles of its functioning. However, they do not address the problems and do not propose concrete solutions to them, recognising the influence of socio-political factors.

Studies by global consultancy and auditing companies, as well as internationally recognised indices that report on the functioning of the agricultural sector, do not analyse in detail the issue of tax efficiency, or provide options to address the problems at hand. These companies do not delve in detail into the historical and economic specifics of the agricultural sector in each individual country. For example, Deloitte provides a general overview of the analysis of the tax environment in the country and assesses the reforms adopted in this area but does not give specific answers regarding the effectiveness of the tax system specifically in the agricultural sector (Taxation and investment in Azerbaijan, 2022). These reports are aimed more at foreign counterparties who are considering the prospect of engaging in agribusiness.

The World Bank Group's annual Doing Business (2022) report also examines different taxes in all areas of the country individually. Information on land tax is not considered comprehensively in the context of agricultural taxation. The varying approaches of legislators in different countries to the application of special tax regimes allow academics to opine on the appropriateness and legality of legislative regulation. N.S. Ivashchenko (2007) believes that the single tax (paid under the simplified system) and the single tax on agriculture are federal taxes. And as for the single tax on presumptive income, such a special tax regime is not actually required, as it can be part of local taxes. From a scientific point of view, it is a question of defining special tax regimes.

The analysis revealed that almost all the erasers share income tax (personal income tax) and corporate tax (corporate income tax) belonged to national taxes. Other taxes can be applied at both national and local levels. It depends on historical factors, the traditions of the country in question, the level of local budgets, and

the legislative initiative of local authorities. Similar taxes exist in the United States and Canada, but local rates are significantly lower compared to federal tax rates. In the USA and Canada, VAT is the equivalent of sales tax and refers to local taxes (Kubakh, 2021). The level of income tax in Europe is determined at the national level. The basis for calculating income tax is the net income received by the taxable entity during a certain period of time. The tax is indexed, i.e., the taxable minimum and maximum are periodically revised.

According to T. Zyryanova (2018), states can be categorised according to the directions of tax policy. There are three main types: the policy of maximum taxes (mainly applied to high-margin businesses), the policy of tax neutrality, and the policy of tax favourability. Agriculture falls into the latter category. It is very important to adhere to a policy of reasonable protectionism, to support the Azerbaijan agricultural producer through the application of customs tariffs. A favourable tax policy implies that the taxation of agricultural enterprises is regulated in accordance with the current tax legislation, which provides for various benefits and special tax regimes.

E. Kekchabaeva and G. Zhakupuva (2008) believe that according to the "Kazakhstan 2050" strategy in the agro-industrial complex, the main directions of development in this sphere were the improvement of food security, the formation of a favourable taxation climate in the country, increasing the competitiveness of agricultural enterprises, increasing Azerbaijani production and export, reducing food imports in the domestic and foreign markets, the introduction of an effective system of state support.

A. Allahveranov and E. Huseynov (2013) examine tax reforms that focus on "structural" administrative interventions, such as the shift from income tax to sales tax. However, in this case, income can be accounted for without reducing aggregate profits, despite the inefficiencies in production. The main responsibility for compliance with the tax system, however, lies with the taxpayers, as they can be influenced psychologically. The implementation of such methods may bring tangible results, but only in the long term. The study by N. Nizamzadet (2017) analysed in detail the land tax legislation, including the land tax. The scientist suggests setting up a research and design institute for land relations and land management, which would focus on developing land reforms, investigating the current market situation and assessing the results of the reforms.

Z. Guseinov (2016) believes that in developed countries, one of the ways to improve tax policy is to improve the quality of service (it means servicing taxpayers as users of the services of the tax system). In Azerbaijan, however, the taxation system has been built on the basis of state objectives, without regard to changes in the agricultural business structure. The scholar also recommends to separate the processes of tax policy development and implementation from one another; to implement strategic management using

planning and control cycles; to fundamentally change relationship between tax authorities and taxpayers; and to develop a market-oriented tax structure. Each area of tax policy is unique. There are general principles for building tax policy in each state, but it is important to take into account the specifics of a particular area of regulation (Karpan, 2019; The Economic Cooperation Organisation, 2022).

The main obstacle identified in the process of studying the theoretical framework prior to conducting the present investigation, is that there is no single scientific study that compiles and analyses the key principles of the operation of the tax mechanism for agrarian entrepreneurship in Azerbaijan. Further developments in this area will enable a more comprehensive approach to the study and analysis of this research topic in the future.

CONCLUSIONS

A study of the possibilities for agricultural reform has resulted in the following conclusions. As an analysis of global agricultural experience showed, the effective functioning of the agricultural sector could not be achieved without appropriate regulation of tax mechanisms. In each country, the taxation system has its own specific features, which reflect the current state and trends in agricultural development. Primarily, the income tax system is applied, while land taxation has the function of levelling the conditions of agricultural activity.

Each country adapts its agricultural taxation system according to the current economic situation and specific historical background of the state. There are two

main approaches to setting up a taxation system for agricultural producers: unified and specialised. In Azerbaijan, the tax legislation classifies the simplified tax as a state tax, although in terms of content and essence it can be considered a special tax regime. The government provides a large number of benefits for enterprises that are involved in the agricultural sector. Yet, the incentive mechanisms must be used rationally, as poor management will not only fail to achieve the long-term goals but will also deteriorate the overall situation in a particular area.

Based on a system-structural approach, a system of definite steps that would optimise the agricultural taxation system in Azerbaijan has been developed. These can be divided into two key areas: the design of a coherent and transparent system of taxation of agribusinesses and the establishment of a system to monitor the effectiveness of enterprises in utilising the various tax incentives.

The modernisation and efficiency of the tax system and the use of new approaches to taxation have always been and will be of great interest to entrepreneurs and ordinary citizens alike. Efforts towards the improvement of the tax system must be sustained at all times. This issue should always be on the national government's agenda. In summary, the findings of this investigation and the conclusions drawn from it can be used as an effective scientific basis for further studies on the prospects for amending the Tax Code in the agricultural sector. This study may prompt other researchers to approach the issue from a new perspective.

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Реформування оподаткування аграрного підприємництва (на прикладі Азербайджану)

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Анотація. Актуальність заявленої теми дослідження визначається тим, що основна частина податкових надходжень у країнах з перехідною економікою надходить від аграрного підприємництва. Метою дослідження є розробка практичних рекомендацій, які б дозволили вирішити більшість проблем в аграрному підприємстві в країнах з перехідною економікою. Основними методами дослідження є якісне поєднання моделювання, аналогії, дедукції та індукції, що дозволило провести порівняльну характеристику та визначити найбільш ефективні варіанти реформування аграрного сектору. Визначено, що створення сприятливого податкового середовища сприятиме підвищенню ефективності аграрного бізнесу, що призведе до покращення основних економічних показників. Встановлено, що за останні десять років у податковому секторі Азербайджану відбулося багато позитивних змін, які підвищили загальну ефективність податкової системи країни. Це дозволило збільшити обсяг надходжень до державного бюджету країни. Проаналізувавши досвід інших країн та більш детально вивчивши переваги та недоліки податкової системи Азербайджану, стало можливим надати ключові рекомендації щодо покращення показників у цій сфері. За результатами дослідження представлено реформи щодо вдосконалення системи оподаткування сільського господарства, які враховують соціально-економічні особливості Азербайджану та можуть бути використані як рекомендації в подальших дослідженнях, спрямованих на вдосконалення оподаткування агробізнесу. Автором оцінено вплив різних реформ на функціонування податкової системи з урахуванням запропонованих змін. Результати дослідження мають практичну цінність для працівників податкових органів Азербайджану та науковців, які продовжать дослідження в цьому напрямі

Ключові слова: агропромисловий комплекс, податки, податкова реформа, сільське господарство, Азербайджан, СНД
