



Project Proposal for

AZERBAIJAN

June 2026

Component: Revenue and Spending

Module: RM-I: Tax Policy

SM-II: Public Financial Management



PROJECT SUMMARY

COUNTRY: Azerbaijan

LEAD DEPARTMENT: FAD

REGION: MCD

PLANNED DATES: FY27-28

PROJECT MANAGERS: Jean-Francois Wen (Tax Policy, FADT1, Lead)
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ESTIMATED BUDGET US\$ 556,400

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ACRONYMS

CD	Capacity development
FAD	IMF's Fiscal Affairs Department
MoF	Ministry of Finance, Azerbaijan
PFM	Public financial management
SOE	State-owned enterprises

I. PROJECT PURPOSE

Country request and relevance/importance

FAD has delivered capacity development (CD) in Azerbaijan during the past five years across several workstreams to mobilize and manage revenues, including improving tax policy and administration, and strengthening frameworks for managing public finances. The authorities have expressed interest in new CD activities to support the country's published medium-term budget framework 2027-2030, which prioritizes fiscal sustainability, transparency in public financial management (PFM), digital transformation, and broadening the tax base while fostering a favorable business climate. Key directions for revenue policy stated in the framework include improving tax policy efficiency through a review of tax expenditures and incentives and strengthening tax administration and compliance. This proposal addresses specific CD requests in the areas of tax policy and PFM. The CD program will take a country-centric approach by cooperating across workstreams to strengthen the macro-fiscal framework and mobilize revenues by curtailing tax expenditures and reducing tax distortions.

Description of Modules

The purpose of the Tax Policy module (RM I) is to support the Ministry of Finance of Azerbaijan (MoF) in estimating and evaluating tax expenditures, forecasting tax revenues, and taxing corporate groups on a consolidated basis. These activities will contribute to rationalizing tax expenditures by identifying cost-ineffective tax incentives for elimination; improving the accuracy and credibility of revenue forecasts for strengthening adherence to fiscal rules, including use of artificial intelligence applications; and enhancing tax neutrality and base protection through legislation on intra-group taxation.

On the PFM side (SM II), the focus will be on strengthening the medium-term budget framework, including integrating fiscal risks analysis; and advancing digitalization of fiscal operations.

Institutionalization of the rules-based fiscal framework in medium term budgets and fiscal strategies will support the MoF in reducing dependence on the oil sector and achieving structural diversification.

Enhanced monitoring of state-owned enterprises (SOEs) financial performance and fiscal implications will lead to tightened fiscal risk management, aiding fiscal consolidation, while implementing an integrated, digital government resource platform will provide policymakers a consolidated and timely view of government resources for greater spending efficiency.

The estimated budget for this project is US\$ 556,400, and endorsement is requested for the full amount through FY28.

II. BACKGROUND

Macro-fiscal situation

Azerbaijan's tax-to-nonoil GDP stands at about 31 percent in 2025, with nontax revenue—almost entirely Oil Fund revenues—adding another 18 percentage points. Existing oil and gas reserves are expected to be depleted in approximately 25 years and 40 years, respectively, at current extraction rates. Fiscal consolidation is needed to ensure that future generations benefit from the country's hydrocarbon wealth and to safeguard long-term fiscal sustainability. The authorities have broadly adhered to the fiscal rule since its introduction in 2022 and are committed to boosting non-oil revenue mobilization and maintaining expenditure discipline. However, achieving these objectives will require reinforcing policy frameworks and institutions to identify and implement a range of revenue and expenditure measures. This CD program will assist the authorities with gradually reducing tax expenditures and addressing base erosion risks, while strengthening the fiscal framework to achieve the medium-term fiscal consolidation.

Elevated energy prices stemming from the Gulf conflict may provide a temporary boost to Azerbaijan as an oil exporter, but they also heighten macroeconomic risks and may complicate efforts to rationalize tax expenditures supporting the non-oil sector.

Country engagement and alignment to reform priorities

Azerbaijan's tax system is complex and fragmented, characterized by numerous tax exemptions and rate reductions, as well as special regimes, for selected sectors and activities. Azerbaijan terminated a seven-year personal income tax holiday for nonoil, non-public sector employees at the end of 2025. With declining reliance on oil sector revenues, further rationalization of tax expenditures can mobilize revenues and reduce base erosion risks. A tax diagnostic mission conducted by the IMF's Fiscal Affairs Department (FAD) in 2021 covered all major tax policy areas—including personal and business income taxation, social insurance contributions, tax incentives, international taxation, indirect taxes, digital-economy tax issues, and property taxation—and recommended reforms aimed at broadening tax bases and improving economic efficiency, notably by reducing opportunities for tax arbitrage. The authorities followed the mission's advice not to renew the personal income tax holiday; however, profit tax exemptions were subsequently extended to IT companies in 2023. The mission discussed the implications of membership in global initiatives on BEPS and reviewed Azerbaijan's tax incentives in the

context of the OECD Forum on Harmful Tax Practices and the Code of Conduct Group of the European Union. Azerbaijan joined the OECD/G20 Inclusive Framework on BEPS in December 2022 and it signed the Multilateral Instrument on 20 November 2023. The authorities requested assistance in 2024 on questions of tax expenditure methodology and on the classification of revenue streams into oil versus nonoil, an issue relevant for the application of the fiscal rule. CD was delivered on these two topics through online sessions.

In 2026, the government requested assistance on its tax reform priorities of selecting cost-ineffective tax incentives for elimination, supporting nonoil revenue sustainability by improving revenue forecasts, and promoting neutrality and base protection by adopting rules for taxing corporate groups. Azerbaijan has also received considerable FAD support through the IMF's Caucasus, Central Asia, and Mongolia Regional Capacity Development Center (CCAMTAC) to improve tax administration, including TADAT training and CD on establishing an internal audit function. A Framework for International Tax Administration Strengthening (FITAS) assessment is planned for September 2026 regarding the country's capacity to effectively manage international tax risks.

The previous CD program on PFM - during the period 2019-2025 focused on implementing fiscal rules and managing fiscal risks, as well as establishing a medium-term expenditure framework and the PFM legal framework. Azerbaijan prioritizes further strengthening of the rules based fiscal framework and strategies to support medium-term fiscal consolidation and help maintain fiscal sustainability. It introduced revised fiscal rules, enhanced the macro-fiscal framework, and built MoF staff capacity in assessing fiscal risks, notably risks stemming from macroeconomic projections, SOEs and climate change. To strengthen the financial oversight of SOEs with the aim to reduce their fiscal burden, Azerbaijan established the SOE Monitoring Agency at the MoF and launched quarterly monitoring of SOEs financial performance. The authorities have launched pilot phase of developing medium-term expenditure framework in three sectors, which is expected to roll out to cover the entire budget. The key focus areas of the authorities medium-term plans include building the MoF's capacity in systematically assessing various risks to the fiscal framework, with the major focus on SOEs to inform medium term fiscal strategies; enhance integration of medium term budget plans in the annual budget process; and adopt advanced digital system as a key tool to improve public spending control and efficiency.

IMF priority areas / cross-cutting themes

GovTech. The project will advance PFM digitalization by supporting the implementation of an integrated, digital government resource platform that consolidates budgetary, fiscal risk, and SOE financial information. Tax policy support will also support the improvement of revenue forecasting accuracy and credibility through the use of AI.

III. PROJECT MODULES - DESCRIPTION

This proposal will provide CD support to Azerbaijan in tax policy and managing public finances. FAD CD will support improvements within the strategic objectives presented in Table 1.

Table 1. Summary of Objectives covered by the Proposal

Component	Module	Objective
Revenue	RM I / Tax Policy	- Strengthen Policy Monitoring, Evaluation, and Institutions - Improve Tax Policy Design
Spending	SM II / Managing Public Finances	- Strengthen budget management; - Strengthen macro fiscal frameworks; - Build sustainable fiscal institutions;

A. RM I – Tax Policy

Scope

As dependence on oil revenues diminishes, further rationalization of tax expenditures and mitigation of base erosion risks, along with improvements in tax administration, are critical to mobilize revenues. In this context, the authorities have requested CD support to assess the costs and benefits of tax expenditures to inform decisions on their retention or elimination, as well as on the taxation of corporate groups. In addition, they have requested CD on revenue forecasting methods, including the adoption of AI tools, which will support adherence to the fiscal rule.

The scope of this module will include developing institutional capacities on tax expenditures, base erosion risks, and revenue forecasting. CD will be delivered through a combination of topic-specific discussions with the technical staff and training workshops for both the MoF and the Ministry of Economy, as part of a comprehensive in-field mission in FY27. The first set of workshops will cover tax expenditure methodology, including establishing the reference tax system, and will discuss methods for assessing the impacts of tax incentive programs. The authorities will be encouraged to regularly produce and publish tax expenditure estimates and to periodically evaluate program impacts. The revenue

forecasting workshops will address methods used for different tax bases and will include the use of AI tools to improve forecasts. These tools enable the analysis of historical data, market trends, and taxpayer behavior, enhancing accuracy while allowing for real-time responsiveness. As part of this module, the CD team will assess the current forecasting models used by the authorities and their integration of AI techniques.

Program Objectives

The objectives of this module are to ameliorate tax policy design and strengthen policy-making institutions. To achieve this, the analytical capacity of the tax policy unit at the MoF to assess tax expenditures will be increased, enabling it to rationalize tax expenditures based on estimates of costs and benefits of different tax incentives; and its revenue forecasting techniques will be modernized. The planned CD activities will improve tax analytics, including estimating, evaluating, and reporting tax expenditures by the MoF, and using AI for revenue forecasting.

Expected Results (outcomes)

The expected results are tax reforms that mobilize revenues by broadening and protecting the tax base or improve economic efficiency. Milestones include the establishment of a reference tax system for tax expenditure evaluations, development of methods to identify cost-ineffective incentives, rationalization of tax expenditures, and annual publication of a tax expenditure report. A milestone for CD success on group taxation is the adoption of new legislation on the taxation of corporate groups. In addition, updating revenue forecasting techniques will produce more accurate forecasts, contributing to adherence to the fiscal rule. Milestones for revenue forecasting include the adoption of AI tools and systematic, material reductions in revenue forecast errors.

B. SM II – Managing Public Finances

Scope

The authorities acknowledge the importance of strong institutional and technical capacity for fiscal analysis, planning and implementation, and have extensive CD needs. The scope of this program is to improve the designing of medium-term budget and operationalizing them in annual budgets. In addition, monitoring the fiscal performance of SOEs to identify early warning signals for a potential fiscal impact and other risks to the fiscal framework is another key objective. Advancing the digitalization and adoption

of the integrated government resource platform for a consolidated view of public finance, including the priority SOEs.

Program Objectives

The objectives of this module are to enable authorities to achieve their public finance goals through better medium-term budgeting, stronger assessment, monitoring and management of fiscal risks, and the capacity to leverage the advantages of digitalization of public finance. The program will have the following objectives:

- Strengthen budget management, including medium-term budget framework.
- Strengthen macro fiscal frameworks by assessing, monitoring and managing fiscal risks.
- Support the foundations for more sustainable fiscal institutions by greater capacity for implementing digitalization of public finance.

Expected Results (outcomes)

Authorities will roll out medium-term budgeting in two more sectors and advance their integration in the annual budget cycle by 2028. Support on monitoring SOEs will allow authorities to strengthen the MoF's financial oversight function and capacity to translate the monitoring efforts into actionable insights about how mitigate the risks exposure to the budget. With CD support, authorities will modernize the core PFM digital solutions to make the integrated government resource platform an efficient control tool for efficient spending.

Project proposals typically cover only one to two years of CD activities, which are expected to contribute to the achievement of the objectives outlined in the sections above. The objectives of this GPFP project may require extended and ongoing support to be fully and sustainably realized. Therefore, progress reports will serve to monitor advancement towards these objectives, and it may be necessary to adjust or broaden project workplans to better facilitate the achievement of these goals.

IV. ORGANIZATIONAL ARRANGEMENTS

A. Country Engagement

This is the first program funded with Global Public Finance Partnership (GPFP) resources for Azerbaijan. Previous CD included a comprehensive tax policy mission in 2021 and online CD delivery on tax expenditure methodology and revenue stream classifications in 2024. The request for new CD on tax expenditures in 2026 is broader in scope and will cover tax expenditure estimation and impact

assessments. Azerbaijan has also been heavily engaged with CCAMTAC and FAD revenue administration topics since 2024. The MoF has worked closely with FAD in the PFM workstream on budget management and strengthening the macro-fiscal framework.

B. Delivery Modalities

CD will comprise of in-person activities. The following CD activities will be delivered as a package:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, ensure short-term expert (STX) work is aligned to plans, coordinate with other CD providers, and adjust reform implementation plans.
- **STX visits** to help implement the recommendations delivered by the HQ missions; a limited number of STXs will be assigned to provide specialized assistance in specific areas of revenue administration and public financial management.
- **Workshops**, during the HQ missions, staff visits, or STX visits, to share experiences, provide stakeholders with a view of progress achieved and challenges faced, and discuss with the managers and staff their views on the reforms and particular technical subjects.

C. Coordination / Cooperation

Partner	Coordination Type	Coordination Area	Frequency
MCD country team, including resident representative	Sharing information, insights, and recommendations	Tax policy – priorities, recommendations, and status of reforms	Regular
CCAMTAC	Sharing information, insights, and recommendations	Tax policy/tax administration nexus	Regular
World Bank, EU	Information and experience sharing, coordination of activities	Identification of complementarities in CD provision, implementation of FAD advice, avoiding duplication and leveraging other donors' capacity to support improving tax policy, strengthening revenue collection, climate change and disaster risk, and PFM reforms	Quarterly

V. RISK ASSESSMENT AND MITIGATION

Category/Module	Description	Risk Assessment	Mitigation Measures
EXTERNAL CLIMATE/CONDITIONS			
RM I - Tax Policy	Oil price fluctuations can delay tax reform initiatives.	Medium	Strengthen capacity for tax reform analysis.
SM II - Managing Public Finance	High dependence on hydrocarbon revenues poses risks to fiscal sustainability. Recent geopolitical crisis in Middle East and the oil shock have uncertain impact on the economy and fiscus.	High	Continue supporting the MoF in institutionalizing fiscal rules to anchor fiscal policy in non-oil aggregates.
POLITICAL SUPPORT			
RM I - Tax Policy	Responsibility for tax policy is shared between Ministry of Finance and the Ministry of Economy, potentially leading to coordination problems.	High	Provide joint workshops with staff from both ministries.
SM II - Managing Public Finance	There is strong political support to advancing PFM institutions for greater efficiency of spending to aid fiscal consolidation and private sector led economic diversification, likely to be maintained. However, these reforms require interdepartmental and intergovernmental coordination which proved to be difficult in Azerbaijan.	Medium	Quick wins and tangible results will help maintaining the reform momentum and political support. Emphasize the importance of setting formal coordination platforms and mechanisms during the CD engagement.
MANAGEMENT AND TECHNICAL STAFF SUPPORT AND COMMITMENT			
RM I - Tax Policy	Technical staff capacity can be compromised by turnover. At the institutional level, the silo approach can create bottlenecks on tax reforms.	Medium	Coordinate with other DPs (WB, EU) to undertake comprehensive capacity building program.
SM II - Managing Public Finance	Multiplicity of PFM priority areas and frequent turnover in the MoF poses risks to reform implementation	Medium	In conjunction with CCAMTAC and the regional PFM advisors, enhance the strategic CD delivery with hands on support and practical trainings of the MoF teams and new recruits
RESOURCE ADEQUACY			
RM I - Tax Policy	Lack of technical expertise to implement new forecasting techniques.	Medium	Coordinate with other DPs (WB, EU) on CD for the tax policy unit.
SM II - Managing Public Finance	While the commitment is evident and the human capacities seem adequate, with the large scale and the scope of PFM reforms foreseen in the near term, the risk may arise that the resources will be spread thin across reforms.	Low	Continuity of CD and coordination with other CD providers, as well as, prioritization of reforms, will be important to maintain the adequacy of available resources

VI. CD DELIVERY PLAN

Table 2. Summary of Indicative CD Delivery

CD Modalities (Remote or Field-based CD)	FY27	FY28	Grand Total
RM I – Tax Policy			
HQ led CD mission	1	-	1
STX visits	-	-	-
Staff visits	-	-	-
Workshops (inc. during HQ and remote CD)	1	-	1
Subtotal	2	-	2
SM II – Managing Public Finances			
HQ led CD mission	1	1	2
STX visits	1	1	2
Staff visits	-	-	-
Workshops (inc. during HQ and remote CD)	-	-	-
Subtotal	2	2	4
Total	4	2	6

Note: In-person delivery was chosen in most instances because of the hands-on nature of the workshops and the need to obtain sensitive data.

Table 3. First year workplan

Timing	CD Modality	Proposed Topics of CD
RM I – Tax Policy		
Q2/FY27	Field-Based work - FB	Revenue forecasting, tax expenditures and group taxation
SM II – Managing Public Finances		
Q3/FY27	Field-Based work - FB	MoF: PFM Digitalization (HQ)
Q2/FY27	Field-Based work - FB	MoF: SOE Monitoring – a follow up (STX)
Q1/FY28	Field-Based work - FB	MoF: Budget structure and classifications
Q3/FY28	Field-Based work - FB	MoF: SOE Monitoring – a follow up (STX)

VII. PROGRAM FINANCIALS

Module	FY27	FY28	TOTAL (USD)
Direct Delivery			
RM I - Tax Policy	200,000	-	200,000
SM II - Managing Public Finance	160,000	160,000	320,000
Subtotal	360,000	160,000	520,000
Trust Fund Management Fee (7%)	25,200	11,200	36,400
TOTAL	385,200	171,200	556,400

Note: The estimated budget for this project is US\$ 556,400 and endorsement is requested for the full amount through FY28. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

VIII. TARGETED LOGICAL FRAMEWORK

A. RM I – Tax Policy

Objective: Strengthen Policy Monitoring, Evaluation, and Institutions - TPM	
Outcome(s)	Indicator(s)
Improved structures (e.g., tax policy units) or capacity (e.g., models and tools) related to tax policy advice and analysis.	Revenue forecasts are implemented or improved.

Objective: Improve Tax Policy Design - TPD	
Outcome(s)	Indicator(s)
Increased economic efficiency by minimizing economic distortions or addressing externalities or market failures	Adopt legislation that reduces economic distortions.

B. SM II – Managing Public Finances

Objective: Strengthen Budget Management - SBM	
Outcome(s)	Indicator(s)
Strengthened medium-term budget frameworks	Developed medium-term budget framework, and/or expenditure framework

Objective: Strengthen Macroeconomic Frameworks - SMF	
Outcome(s)	Indicator(s)
Strengthened identification, monitoring, and management of fiscal risks	Strengthened effectiveness of management and reporting public corporation's fiscal risks including quasi-fiscal activities

Objective: Build sustainable Fiscal Institutions - SFI	
Outcome(s)	Indicator(s)
Strengthened capacity to plan, implement and sustain digitalization	Strengthened functionality and/or IT architecture of PFM digital solutions