Tax Reforms Carried Out in Georgia

Ministry of Finance and Economy of Ajara A.R.

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The "Old System" and The Mission of The New Government

- New Government since 2003;
- By that time the entire system was extremely ineffective and based on soviet era principles;
- Corruption was a daily threat for Georgian taxpayers;
- The main goal on the new Government was:

  - to change the political mentality as well as the political practices;

  - build new institutions and work to build lasting public trust.

Economic and Structural Reforms

- In 2004, there were 22 different taxes in Georgia and many ineffective and in most cases unnecessary bureaucratic barriers.
- **First steps towards simplification of business environment started in 2005, when Georgia adopted new Tax Code**
- Number of taxes and tax rates have been gradually decreased:
  - Since 2005 only 7 taxes left out of 22;
  - **Since 2008 only 6 taxes left in Georgia:**
    - VAT – 0% and 18%
    - Personal income tax – 20% flat
    - Corporate income tax – 15%
    - Customs tax – 5% and 12% *(only on agricultural products and construction materials)*
    - Excise – depends on the type of good
    - Property tax – up to 1%

Economic and Structural Reforms

- A new **Customs Code** in harmonization with EU standards, entered into force from January 1, 2007;
- Time and number of documents for exports and imports procedures has been significantly reduced;
- In 2006 Georgia adopted new liberal **Labor Code**, which:
    - Eliminates soviet-era burdens on the freedom of contract;
    - Makes cost for hiring and firing workers very low;
    - No mandatory minimum wage requirements;
    - No obligatory overtime costs.

Today, Georgia's Labor Code is one of the most flexible labor regulations in the world!

General Plan of Tax Reforms

Reforms of tax system can be divided into several phases:

Phase I (2003-2005)

- Drafting a principally new and progressive tax legislation;
- Removing all unnecessary and in many cases ineffective intervention from the Government into private businesses (tax legislation was an important part of the Government's "General plan");
- Adoption of simple and fair rules of play and warranty its follow up from every single entity.

Phase II (2005-2009)

"Implementation Period"

- Taking into account practical needs of taxpayers;
- Periodic amendments of the Tax legislation;
- Institutional transformation;
- Upgraded infrastructure;
- Financial effectiveness;
- Lightening administrative burden and costs for taxpayers (e-declaration etc).

Phase III (2009-2010)

- Drafting a new tax code in line with EU standards;
- Introduction of internationally accepted methods and practices;
- Introduction of different taxation regimes for taxpayers according to their needs;
- Further elimination of bureaucratic barriers;
- Further lightening of administrative burden of taxpayers.

Tax Reform – 1st Steps

- 22 different taxes before 2005;
- Complexity of tax legislation;
- Inadequate administrative tools;
- High level of corruption in the tax agencies;
- New tax code reduced both number of taxes from 22 to 7 (and later on only to 6) and tax rates (tax burden 7% of GDP was removed from businesses);
- Reduction of tax rates coupled with improved administration resulted rapid increase of tax revenues (by 2.6 times only from 2003 to 2006).

Further Reduction of Tax Burden

- In 2008 corporate profit tax reduced from 20% to 15%;
- Payroll taxes (PIT and social tax) merged into one and W.A. tax rate reduced from 27% to 25%;
- In 2009 reforms carried out towards reduction of tax burden:
  - Income Tax rate reduced from 25% to 20%;
  - Tax rates for dividends and interest payments reduced from 10% to 7.5%.

Institutional Changes

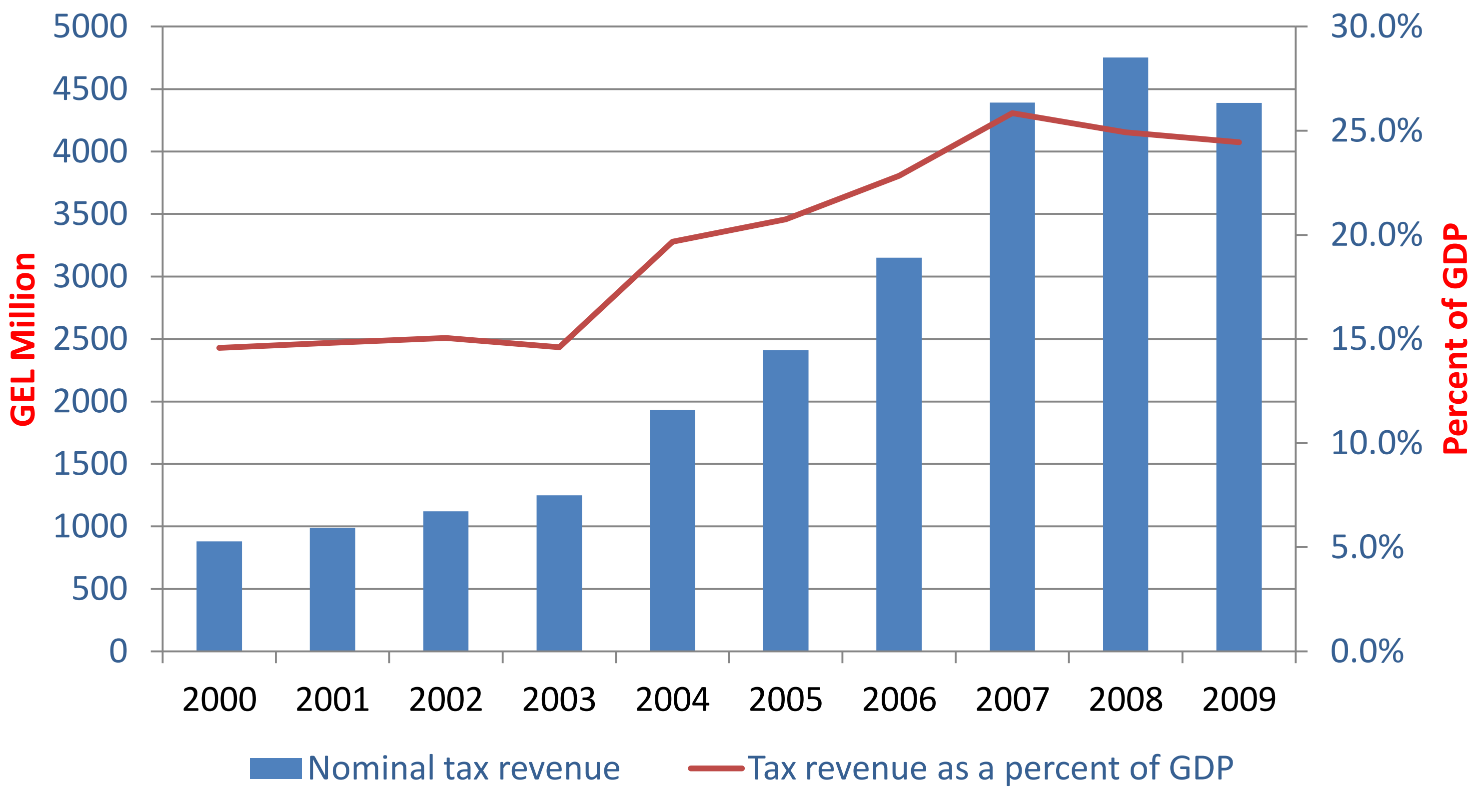
- In 2007 an unified Revenue Service of Georgia was established in Georgia;
- Revenue Service merged into one tax, customs and financial police agencies;
- Since than taxpayer has only one single governmental agency to declare about its business activities;
- Effectively functioning public institutions and rule of law led to dramatic reduction of informal activities.

	Before Tax Reform	After Tax Reform
Number of taxes	22	7-6
Potential tax revenue as a percent of GDP	40-45%	30-35%
Actual tax revenue as a percent of GDP	14.6%	25.8%
Compliance Rate	32%	75-80%

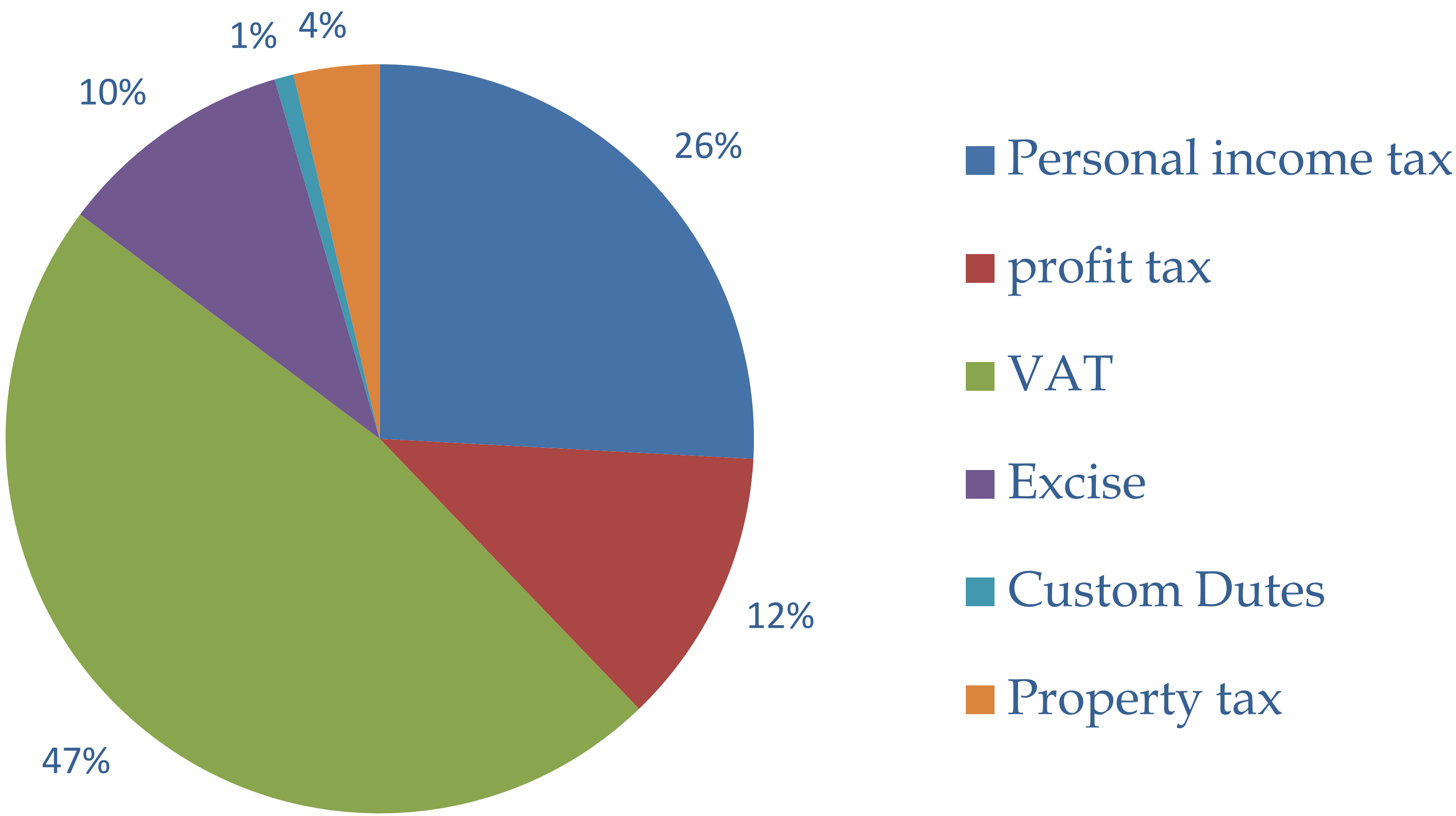
Effective Management and Improved Administration

BATUMI invest

- Better administration and simplified business regulations provoked rapid growth of tax revenues.



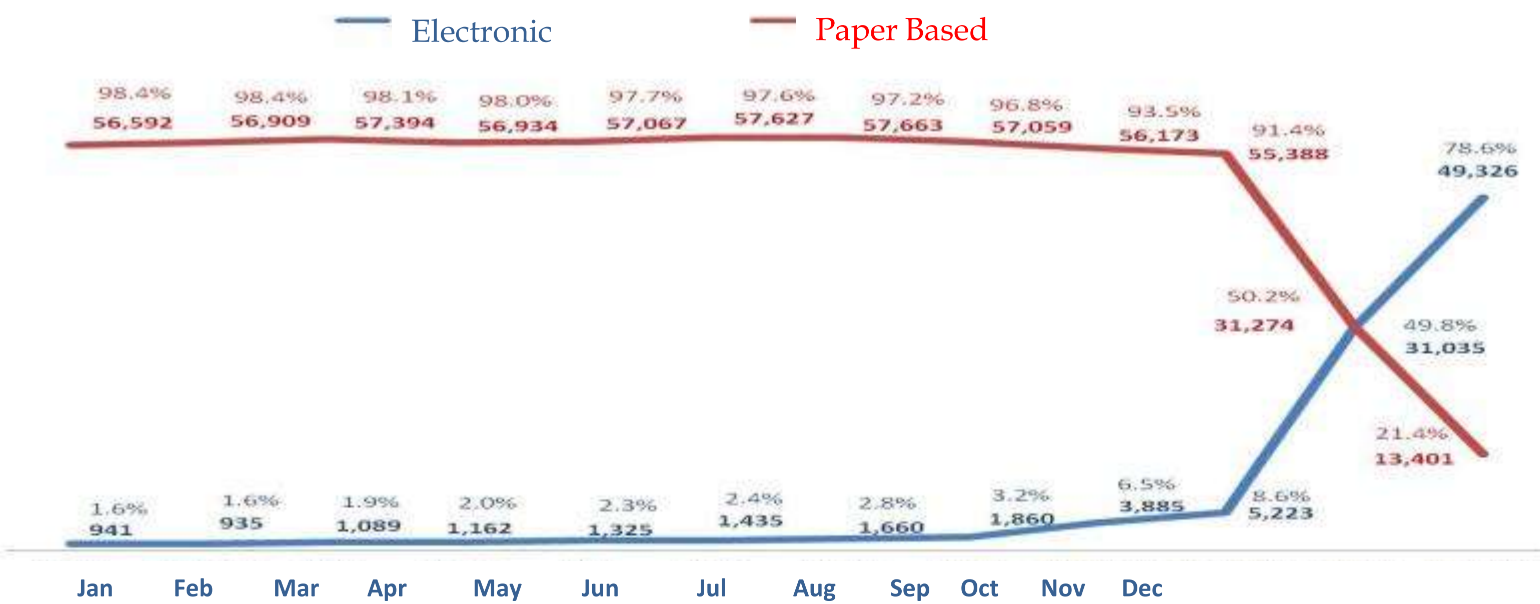
Composition of Tax Revenues (2009)



Recent Innovations for Taxpayers

- Electronic Filing System implemented in 2008 and significantly improved in 2009;
- All declarations are available in electronic form;
- Registration in the system is based on taxpayer's request;
- Automated refund to those taxpayers who submitted declarations electronically;
- No request to submit hardcopies of VAT invoices, for the taxpayers using e-filling.

NUMBER OF DECLARATIONS, SUBMITTED DURING 2009
BY MONTHS



Need for New Changes!

- Georgia reached the point to make another step forward towards more simplification of tax legislation and be more in line with the best international practices!
- The updated and radically progressive tax code will enter into force in 2011 .
- **The new tax legislation will simplify Doing Business in a following ways:**
    - Increase trust towards Tax System, Reasonable Administration;
    - Formation of Stable and Sustainable Tax environment;
    - Ensuring an increased culture of taxpaying through simplified administrative mechanisms and improved taxpayer support;
    - Encouraging business legalization;
    - Simplification of legal Provisions – Removing ambiguities;
    - Reduction of Tax Compliance burden – Simplification of Tax Administration;
    - Evenly distribution of tax burden;
    - Using the best international tax practices, EU directives.

Introduction of New Tax Regimes

Micro Business

- Entity with less than GEL 30,000 turnover.
- EXEMPT FROM TAXES, which will encourage:
  - Employment;
  - reduction of poverty through self-employment;
  - full legalization of business.

Small Business

- An individual/sole entrepreneur with less than GEL 100,000 turnover.
- Small Business Taxation:
  - will be taxed with one single tax;
  - tax rate of 3% or 5% of turnover;
  - removing requirements of book keeping in conformity with international standards.
- In case of 5% tax rate:
  - small business is obliged to run only simple "purchases and sales journal" and cash registers.
- In case of 3% tax rate:
  - Any small business can choose to be taxed at this rate if it provides standard accounting documentation for at least 60% of their turnover.

Special Trade Zone (STZ)

Further simplification of procedures for small businesses which are involved in trading at public places:

- organizer/administrator of special trade zones is acting as a tax agent;
- organizer/administrator is in charge of tax liabilities and accounting of "zone participants“;
- tax authorities control an STZ organizer/administrator, instead of "zone participants".

Advance Rulings

Tax authority issues 2 types of advance rulings:

Advance Private Rulings:

- An advance tax ruling is a written statement given by the
by Tax authority to a taxpayer stating how it will interpret and apply specific provisions of tax law to a definite transactions the taxpayer is contemplating;

- An advance tax ruling is binding upon the Tax Authority. This means that if the transaction was carried out substantially as set out in the request, taxpayer will not be subject to any additional tax or sanctions.

Public Tax Rulings:

- In case of decision of tax appeals council and other relevant administrative body which changes and/or establishes tax practice different from existing one, the Ministry of Finance is obliged to issue relevant legislator interpretation act – Public Tax Ruling.

Supreme Board of Auditors

- The supreme board of auditors is to be established (consisting of 5 members including the Minister of finance/the head of the board);
- The mission of the board is encourage stable and sustainable tax environment;
- consequently:
  - any form of tax treatment of transactions not practiced in the past 2 years can be used by tax authority during tax audits only after the consent of the board of auditors.

Reduced Number of Payments – 2 months interest free loan

- From 2011 we shift to quarterly tax reporting
  - quarterly payment of taxes (except for income tax, where tax is withheld and paid to budget simultaneously)
  - quarterly tax reporting instead of monthly reporting (some of them only once in a year)

Taxpayer Rights

- Special chapter dedicated to taxpayer rights in the new tax code;
- Tax Ombudsman institute is established to secure protection of taxpayer rights;
- New principle - "Good Faith" is defined according to which tax appeals council prefers substance of tax offence over its form, if it can be proved that taxpayer acted in good faith and it really believed that facts and circumstances are as he thinks and he did not intend to avoid taxes;
- In case of ambiguity in legislation, council of tax appeals is obliged to make a decision in favor of taxpayer.

Unification of Tax & Customs Codes

- Tax and Customs legislations are merged into one single code.
- New tax legislation:
  - Unifies taxpayers tax and customs assets/liabilities, by which companies can transfer excess amount available on tax card to cover customs liability and contrary.
- Excess payments will be automatically returned to taxpayers by tax authority :
  - To entities who report their income electronically;
  - Companies will have a chance to withdraw from this regime and return to the existing one.

Reasonable Administration

- Profit Tax:
  - allowance of deductions – if taxpayer cannot prove its expenses with documents, but the fact of expenses are proved practically.
  - disallowing deductions - tax authorities are prohibited from disallowing deductions on which taxpayers have a "document", but with only one non-essential mistake.

- Taxpayers will have right to write off outdated and defective goods.

Inventory and Spot Checking

- During Inventory market price of goods in the last 2 years will not be applied to the current price as a result of an Tax Inventory;
- Penalty for spot checking will be reduced from 50 to 20 times. Room for deviation (currently minimum 10%) will be defined by the Government of Georgia taking into account industry specific characteristics;
- Spot checking is not allowed to be conducted to persons which use accounting server at the Ministry of Finance of Georgia in their business transactions;
- Before spot checking period video recording will be conducted.

In Line with World's BEST Practices

- Terminology used fully in line with OECD standards;
- Transfer Pricing;
- International cargo;
- Associated entities.

Evenly Distribution of Tax Burden

- Expansion of tax base (profit, property, VAT) simultaneously keeping traditional exemptions (press, agriculture, income less 40000 etc);

- Shifting tax burden from small businesses to excise goods, speculative transactions, etc.

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