

Georgian Tax News Georgian Profit Tax Reform



Amendments to the Tax Code of Georgia

After almost half a year of discussions and hearings the Georgian Parliament has formulated amendments to the Tax Code of Georgia. In May 2016, the Parliament adopted and the President signed into law the amendments and addendum to the Tax Code of Georgia. The mentioned amendments will change the existing profit tax regulations to the so-called “tax on distributed profits” model, very similar to Estonian one.

The new profit tax rules will be effective as of 1 January 2017, however these rules will not apply to commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops until January 2019. This new system of profit tax will only apply to Georgian resident companies and permanent establishments of non-resident companies and the object of taxation will be:

- Distributed profit;
- Expenses incurred or other payments not related to economic activities;
- Free of charge supply of goods/services and/or transfer of funds;
- Representative expenses that exceed the maximum amount defined in the Tax Code of Georgia.

Profit generated through transactions related to oil and gas, under the current Agreements, were concluded in line with Georgian Laws (if and when such agreements were concluded prior to 1 January 1998) and taxed according to the provisions and tax norms effective before January 1 2017.

The profit tax rate will remain unchanged at 15%, however, to receive a taxable amount, the object of taxation must be divided by 0.85. In the case of free of charge supply of goods/services a taxable transaction will be determined at the market value of the goods/services.

Tax returns will be filed and tax will be paid no later than the 15th day of the month following the reporting calendar month (the tax reporting period will be a calendar month).

The tax depreciation charges, thin capitalization or tax loss carry-forward will not be applicable for a resident entity or non-resident's permanent establishment as of January 2017.

Distributed profit

According to the law, the profit distributed to shareholders in a monetary or non-monetary form as a dividend is a taxable distributed profit. However, the allocation of received dividends from foreign enterprises (with the exception of entities registered in a low tax jurisdiction) shall not be considered to be a distributed profit.

Herewith, a payment made to a non-resident enterprise in a monetary or non-monetary form of profit earned by a permanent establishment's activities shall be treated as a distributed profit of a permanent establishment. Attributable profit for a permanent establishment is profit, which would be possible to generate as an independent enterprise engaged in the same or similar activities, operating under the same or similar conditions.

According to the law, the following shall also be treated as the distribution of profit:

- a) A transaction made by an enterprise with a related party (who are not a subject to profit tax according to the article 97(1.3) of the Georgian Tax Code) - if the value of the transaction agreed between them is different from market value and their interdependence has an impact on the result of the transaction;
- b) Cross-border transactions with related parties - if the established conditions of such transactions do not comply with the arm's length principles;
- c) A transaction made by an enterprise with a party exempt from income/profit tax (except for budgetary organization) - if the transaction value is different from market value.

Herewith, if resident enterprises have distributed dividends from net profit during the time period between 1 January 2008 and 1 January 2017, they have the right to offset the profit tax paid in said reporting period. The credit profit tax should not exceed the tax paid on the profit distribution as envisaged in the Tax Code of Georgia. The offset amount is calculated according to the following formula: $A \times B / (C - D)$, whereby:

A – The amount of dividend subject to distribution;

B – The profit tax accrued and paid during a reporting period from 1 January 2008 to 1 January 2017;

C – The net profit earned within a reporting period from 1 January 2008 to 1 January 2017;

D – The value of shares/stakes of the enterprise transferred to its partner in exchange for dividends from the net profit earned by such enterprise during the time from 1 January 2008 to 1 January 2017.

Expenses incurred or other payments not related to economic activities

The law provides a list of expenses that should not be considered to be related to economic activities and the key categories of such expenses are:

- Undocumented expenses;

- Expenses that are not incurred for the purpose of receiving profit, income or compensation;
- Interest payments on loans higher than the annual threshold rate defined by the Georgian Minister of Finance;

New profit tax rules also define other payments that are subject to profit tax and the key categories of such payments are:

- Payments made for the acquisition of a debt security issued by a person registered in a low tax jurisdiction or by a person exempted from profit tax according to the Tax Code of Georgia;
- Payment of penalties/fines arising from contractual relations or advance payments to a person registered in a low tax jurisdiction or to a person exempted from profit tax according to the Tax Code of Georgia (except the budgetary organization);
- Issuance of a loan or payments made for the acquisition of a claim towards a person registered in a low tax jurisdiction or by a person exempted from profit tax according to the Tax Code of Georgia. However, this does not apply to commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops;
- Capital contributions or payments for the right to participate in the equity of nonresident or a person exempted from profit tax according to the Tax Code of Georgia;
- Issuance of loans to an individual or non-resident, also deposit the security of a loan taken by such entities from third parties, whereby the amount of tax base is defined by the amount of such loans. However, this does not apply to commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops.

However, when actual payments are made for the acquired debt security, equity participation or claim transfer and in the case of loans/advance payments, the abolishment of ensuring a loan with a deposit or delivery of goods/services in exchange for advance payments entity are entitled to seek offsetting and refund of the profit tax in the reporting period of such a transaction.

The list of countries, for which the purpose of the Tax Code of Georgia shall be deemed the low tax jurisdiction, shall be defined by a decree of the Government of Georgia.

Free of charge supply of goods/services and/or transfer of funds

According to the law, the supply of goods/services that are not for the purpose of receiving profit, income or compensation, shall be considered to be a gratuitous supply. Also the shortage of inventory or fixed assets is deemed to be free of charge in the supply of such goods at the moment where these shortages are identified.

The following are major exceptions in the free of charge supply of goods/services that will not be subject to profit tax:

- a) Donations made to a charity organization during a calendar year, which do not exceed 10% of the net profit received during the previous calendar year;
- b) Gratuitous transfer of goods or funds, which is already taxed at the source in line with Article 154 of the Tax Code of Georgia.
- c) Free of charge supply of goods/services or transfer of financial resources to the Government, municipalities or legal entity of public law.

Representative expenses that exceed the maximum amount defined by the Tax Code of Georgia

According to the law, for the purpose of taxation, the maximum amount of representation costs incurred during the calendar year shall be 1% of the income received during the previous year (1% of incurred expenses if the expenses exceed this income). The maximum amount of representation costs incurred in the year of incorporation shall be 1% of expenses incurred by the end of the current calendar year.

Deloitte's Role and Contribution in the Tax Profit Reform

Deloitte Estonia, represented by the senior tax manager Ivo Vanasaun who is also an international expert on the USAID project "Governing for Growth (G4G)" in Georgia and Co-Founder of the Estonian Corporate Income Tax model, was actively engaged during creation of the new profit tax model with the Georgian Government.

During the course of the tax reform, Mr. Vanasaun was involved in holding industry workshops for the parties concerned, including the Ministry of Finance, Revenue Services, the Parliament/ Government of Georgia, tax service line leaders, Georgian B4 and other main auditing/advisory firms, with the purpose of giving a neutral overview including advantages and potential disadvantages of the "Estonian model". Mr. Vanasaun participated in public events held for businesses to help introduce the "Estonian model", gave people insight about the new profit tax model through his experience/knowledge and assisted in the examining of drafts for proposed Georgian law.

Mr. Vanasaun was actively involved not only in reviewing the Georgian law drafts, making comments, holding discussions and meetings for the parties concerned, but also in the analysis and suggestion process of changes, that were needed based on the "old" Georgian law for implementing the "Estonian model".

Deloitte possesses a unique knowledge with regards to the new profit tax model being introduced in Georgia.

If you have any questions regarding the information provided in this newsletter, please contact one of the Tax & Legal professionals at our Deloitte offices:

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