



Georgian Legal News

Refer to the Law

Amendments to the Tax Code of Georgia

The Amendments to the Tax Code of Georgia, enacted in May 2016, entered into force as of 1 January 2017. These amendments are aimed at changing the existing profit tax regulations to the so-called "tax on distributed profits" model, which is very similar to the Estonian one.

This new system of profit tax only applies to Georgian resident companies and the permanent establishments of non-resident companies. According to the changes, the profit tax rate remains unchanged at 15 percent.

Pursuant to the amendment, the object of taxation is:

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

Profit gained as a result of oil and gas operations based on the "existing agreements" under the Law of Georgia on Oil and Gas shall be profit taxed according to the tax provisions in force before 1 January 2017.



Notably, these rules do not apply to commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops until January 2019.

➤ **Distributed profit**

Profit distributed to shareholders in a monetary or non-monetary form as a dividend is a taxable distributed profit. Under the Tax Code of Georgia, 'dividend' is defined as any income (including interest from preference shares) earned by a shareholder/interest-holder from shares or rights (interests) as a result of a distribution of profits made by a legal person to its shareholders/interest-holders in proportion, or not in proportion, to their shares/rights in the capital.

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 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 (that is not subject to profit tax according to Article 97 of the Tax Code of Georgia)—if the value of the transaction agreed between them is different from the 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 a budgetary organization)—if the transaction value is different from the 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.

➤ **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. 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 Georgia Minister of Finance

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

1. 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
2. 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 for a budgetary organization)

3. Issuance of a loan or payments made for the acquisition of a claim toward a person registered in a low tax jurisdiction or a person exempted from profit tax according to the Tax Code of Georgia

This does not apply to commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops.

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

The new profit tax is applied to capital contributions or payments for the right to participate in the equity of a nonresident or a person exempted from profit tax according to the Tax Code of Georgia. Additionally, this new regulation is applied to the 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.

➤ **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 from which these shortages are identified.

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

- a) Donations made to a charity organization during a calendar year, which do not exceed 10 percent 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 State, 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 one percent of the income received during the previous year (one percent of incurred expenses if the expenses exceed this income). The maximum amount of representation costs incurred in the year of incorporation shall be one percent of expenses incurred by the end of the current calendar year.



Important Amendment to the Tax Code of Georgia

As of January of 2017, important changes to the Tax Code of Georgia came into force, including, but not limited to:

- VAT of a taxable transaction additionally defined at the moment of payment of the amount/part of the amount of compensation for the goods to be supplied/services to be delivered if the payment is made before the supply of goods/delivery of services;
- At the moment of supplying immovable property, unless an advance is paid before the delivery of the immovable property, the time of the execution of a taxable transaction shall be the date of drafting a title deed to be filed with a registration authority for the registration of the title, and if the registration (transfer) of the title depends on the fulfilment by the party (parties) to such document of a certain obligation and/or the existence of a certain provision, the date of fulfilment of such obligation and/or existence of such provision shall be the time of the execution of the taxable transaction;
- Vehicles were added to property tax objects for natural individuals;
- The excise range on tobacco and vehicles was changed.

Possible changes to Order No. 996 on the Tax Administration of the Minister of Finance of Georgia issued on 31 December 2010

Possible changes to Order No. 996 are being considered by the Ministry of Finance of Georgia that will determine the taxation instructions of advances paid before the supply of goods/rendering of services.

The Order: N2/04, N4/04, N5/04 of the President of the National Bank of Georgia

In January 2017, the president of the National Bank issued Orders N4/04 and N5/04 to enable commercial banks to issue loans and bank loans to natural individuals in the amount of Lari 100,000 (hundred thousand) in a foreign currency in case the borrower is not a citizen of Georgia.

For the purposes of Article 625 of the Civil Code of Georgia, Order N2/04 defines the effective interest rate and the financial expenses of borrowers.





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