

Your Tax Dispute InfoGuide

A monthly newsletter by PwC Georgia Tax & Legal Team

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Your Tax Dispute InfoGuide is prepared by PricewaterhouseCoopers (PwC) Georgia, based on decisions undertaken by Georgian Revenue Service (GRS) and the Council of Dispute Resolution (CDR) at the Ministry of Finance. We provide a brief review of the facts on selected cases, including arguments of the parties and the relevant decisions made by the dispute resolution authorities. This publication is prepared for general guidance on matters of interest only, and does not constitute a professional advice.

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Case #1: Issue of taxation of services rendered by non-resident individuals

Facts

The company had the labor contracts with a few non-resident individuals. During the period when these individuals were in Georgia, the company taxed salary incomes earned by mentioned non-residents with 20% rate at source.

After a certain period, the abovementioned individuals left Georgia and changed the working territory, after which the company terminated the labor contracts with them and instead conducted the service agreements. Within the scope of the service agreements, the company considered rendered services as services provided by non-resident individuals and imposed 10% tax rate on the paid amounts.

Position of Audit Department

The tax inspection revealed the following circumstances:

- The service agreements were not essentially different from the labor contracts. Consequently, the contents of abovementioned contracts were not consistent with the service agreements;
- According to the terms of the contracts, these individuals were actually performing the officials' duties of the company;
- According to the agreements the fee amounts for rendered services were fixed on monthly basis;
- The parties had not been putting in place primary accounting documents proving the provision of services;
- The inspection detected business trip expenses in the company's "accounting" program (even though the company considered mentioned expenses as payments for rendered services);

Based on the revealed circumstances and the fact that the relation between individuals and the company has not changed (changes applied only to working territory), the inspection considered paid amounts as earned salary income by individuals and imposed 20% tax rate.

Arguments of the Company

According to the company's position, there was nothing unlawful with the individual to work under the labor contract for certain period and then continue to work with the same company under the service agreement, even if the individual performs the same activity. The labor contract itself is already a different legal relationship form from the service agreement.

The company explained that the reimbursement of the business trip expenses does not constitute the basis for changing the content of the operation. By the service agreement, the service receiver party almost always covers travel, hotel and other overhead expenses that may be related to the rendered services. Also, there is not any legal restriction about the fixed remuneration of the service.

By the company's argument, even if the company changed agreements in order to avoid taxes, tax reduction would not have happened - the additional amounts accrued in the respect to Personal Income Tax (hereafter PIT) would have been deducted for CIT purposes (In 2015 and 2016).

Decisions of dispute resolution authorities

At the initial stage, GRS discussed the case and considered that the Audit Department's position was legitimate and did not satisfy the appeal.

The dispute continued at the CDR at the Ministry of Finance. The council decided that GRS had not properly studied and evaluated the dispute case. In particular, the following circumstances must have been studied:

- Issue of residency of individuals according to the Article 34 of the GTC;
- Whether the income of individuals constituted the income from Georgian source, according to the Article 104 of GTC;

Based on the abovementioned, the council canceled the decision of GRS and returned it to the later for re-examination.

Source: Decision of the Dispute Resolution Board of the Ministry of Finance #7441/2/2019

Case #2: Considering provided discounts as scholarships

Facts

The company carries out educational activities. The company has signed individual agreements with the students. The mentioned agreements define the cost of services and contain information about the benefits granted by the company. The benefits are granted according to academic performance (high academic ratings and attendance) and based on taking into consideration the economic conditions of the families of students.

Position of Audit Department

The tax inspection considered provided benefits as scholarships. Only the scholarships issued by state are exempt from PIT. Consequently, the gross income increased with the amount of scholarships and these amounts became subject to PIT. At the same time, mentioned amounts were deducted from gross income as expenses related to the economic activity of the company. Also, the tax inspection accrued tax fines as well.

Arguments of the Company

The company explained that offering different price from basic one should not be considered as scholarship appointment. Such assessment contradicts the legislation of Georgia (Georgian legislation does not precise the exact definition of scholarship).

The approach of company intended to provide high quality education for talented students, regardless of their financial ability. The company's brochure, website, the internal regulation rules of the students and educational contracts prove the abovementioned practice. Also, company never had and does not plan to give any monetary scholarships.

According to the company's argument, the price different from the basic price is unacceptable to be

regarded as scholarship, due to the following circumstances:

- The student, on its own initiative, asks the company to reduce the cost of education and only after reviewing the statement, the bilateral agreement is reached on the new price. While the academic institutions appoint scholarships based on only one-sided decisions;
- The company essentially envisages the financial condition of a student's family during negotiating with the student on the reduction of the price. While usually the scholarships are awarded to the students with high academic performances and the students' financial conditions are neglected during the appointment of the scholarships;
- Reduction of the educational cost alleviates significant financial difficulties for students, while the amounts of scholarships mostly are symbolic and significantly less than the discounts provided by the company;

It worth to mention that by the year 2014 tax authority had inspected the company. The company had similar contracts before too, however, then discounts were not qualified as scholarships. Consequently, the company had a legitimate expectation that the company's practice was in accordance with the requirements of GTC.

Furthermore, even if the tax authority illegally may consider the company's contract on the new price as financial benefit, the obligation to apply PIT will not arise because the Article 154 of GTC does not provide the obligation to withhold financial benefit at source.

Decisions of dispute resolution authorities

At the initial stage, GRS discussed the dispute and considered that the audit department legitimately qualified operations as scholarships. Consequently, did not satisfy the appeal.

At the second stage, CDR at the Ministry of Finance discussed the case. The council emphasized the following circumstances:

- It is not only the company's decision to establish the different amount of the tuition fees. For this purpose it is necessary the student to express the initiative and go through a number of procedures to agree on the acceptable price for both parties;
- When agreeing to the different fee the student's financial capabilities are the first priority and not only the academic achievements;
- The company grants the benefit to the students by reducing the amount of the tuition fees and not by making the monetary payments;

The Council considered that the tax authority did not have sufficient grounds to change the qualification for mentioned operation.

Consequently, the council abolished the assessed amounts. It has held that the tax authority must use other methods to determine the company's tax liabilities and study each cases on its merits.

According to the decision, the council returned the dispute case to GRS for further studies.

Source: Decision of the Dispute Resolution Board of the Ministry of Finance #5621/2/2018

Case #3: The issue of taxation of fuel expenses without documentary support

Facts

The company executes transportation of its inventory by self-owned vehicles. The company also provides transportation services to other persons.

Position of Audit Department

The inspection analyzed the information presented by the company and the information of the waybills issued in the unified data basis of GRS. Specifically, the distance from the start to the end of transportation, by contrasting the fuel consumption rate to the provided information by the company in accordance with the waybills, in which it was indicated that the company incurred the transportation expenses. In 2014-2015, the inspection revealed the difference between the amounts of spent fuel and amounts stated by the company.

Since the company provides transportation services as well, the inspection considered the identified difference as spent in the transportation services it renders. As a result, the cost of consumed fuel with an additional 100% mark-up was considered as deemed income of the company (the inspection defined the mark-up according to explanation provided by the company).

Consequently, it increased taxable income of the company and VAT turnover resulting in the assessment of the relevant taxes and sanctions.

Arguments of the Company

The company sells goods to the registered taxpayers, as well as to the final consumers. According to the company's statement, in the cases of transportation to the final consumers, in most cases the company had not issued the waybills.

Abovementioned is based on the following assumption that buyers who do not represent entrepreneurial entities or who are the ultimate consumers are actually interested in acquiring goods at the lower prices, in contrast with the VAT taxpayers who have the right to deduct the input VAT of the purchased goods. Therefore, it is impossible to sell the goods to the final consumers without certain commercial offers. That is why the company often proposes the supply of goods to the final consumers with transportation in order to maintain healthy competition conditions.

According to the company's position, based on presented documentation on fuel consumption and the order of the Minister of Finance of Georgia dated by 18 April 2011, the fuel expenses are related to the company's economic activity. In particular, the receipts are issued for the goods supplied with a condition of transportation and the appropriate amounts are included in the gross income. Consequently, there is not relevant grounds to include fuel expenses in gross income.

Decisions of dispute resolution authorities

Originally, GRS discussed the case and considered that the legal grounds to satisfy the appeal did not exist.

The dispute continued at the CDR at the Ministry of Finance. The Council emphasized the following:

- It is illegitimate to consider the difference, between the amounts provided by the company and the amounts detected by the inspection, as the amounts spent on transportation services and to increase the taxable base of VAT. Consequently, the funds accrued on this basis shall be abolished.
- The company does not have the expense documents for fuel, which the inspection observed as over-spent and accordingly, the fact of using mentioned expenses in economic activities cannot be determined. Respectively, the consumed amounts should not be included in the deductible expenses and input VAT credit for purchased goods should be cancelled.

According to the decision of the Council: i) the Audit Department must correct the tax liabilities of the company, due to the abovementioned grounds; ii) considering the amendments to GTC adopted by the Law N4225 of December 27, 2018 concerning the reduction of the tax sanctions, the Audit Department also must take into consideration the mentioned changes in the calculation process.

Source: Decision of the Dispute Resolution Board of the Ministry of Finance #5410/2/2018

PwC Georgia offers clients integrated **audit, tax, legal and consulting services**. The PwC network comprises 255,000 professionals worldwide, employing 756 offices in 158 countries.

We provide effective, innovative and practical tax advice tailored to your specific business needs, whether simple or more complex. Using our knowledge of Georgian tax legislation and in conjunction with international laws and treaties we are able to solve your problems and bring you certainty. We can also help you with the everyday tasks of complying with tax law, cost-effectively preparing your annual and monthly tax returns.

PwC Georgia **Tax Services** includes tax advisory services, tax reviews and tax compliance, transfer pricing compliance, representation during tax disputes, tax structuring, double tax treaty advice, tax due diligence support, customs matters and others.

PwC Georgia's **Tax Dispute Resolution** practice comprises leading international and Georgian tax specialists proficient in all areas of pre-trial and judicial tax dispute resolution and draws on the expert knowledge of the world's leading tax consultants. We are ready to assist companies at all stages of an inspection by state authorities, as well as during the appeal process, which includes:

- Diagnostics of tax risks and preparation for a potential inspection by state authorities;
- Supporting during a tax inspection;
- Appeal of an inspection results;
- Tax refunds

PwC Georgia Tax & Legal team would be delighted to provide you with any additional information regarding to what impact the above-mentioned dispute resolutions might have on your business.



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