

# 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.

Within the Infoguide the following issues of one case will be discussed:

**Issue 1: Considering the foreign enterprise and its branch office as one entity;**

**Issue 2: Taxation of catering to employees under VAT**

**Issue 3: Considering catering service as employee's benefit.**

## **Issue 1: Considering the foreign enterprise and its branch office as one entity**

### **Facts**

The branch of a foreign enterprise (BO) has signed a lease agreement with the head office on construction equipment, with the monthly payment condition. BO imported equipment under temporary admissions customs procedure. Company pays lease fees to the head office in advance. Moreover, the head office is issuing invoice on the provided service on a monthly basis.

BO considers the lease service as a subject to reverse charge VAT and credits it.

BO considers lease payments as expenses and reduces CIT taxable base.

Under inspection, the above-mentioned technique was registered on the balance of BO with calculated value according to the tariff value indicated in customs declaration and was deducted through depreciation. In CIT declaration taxable income reduced with depreciation amount. Paid reverse charge VAT was

reduced as well.

### Position of the Audit Department

- Tax legislation does not consider the BO of the foreign enterprise as separate entity, rather it only represents the permanent establishment (PE) of the non-resident enterprise, through which the enterprise wholly or partially carries on the economic activity in Georgia.
- Civil Code of Georgia establishes that, in order to conclude agreement, existence of more than one party is required, which is not present in BO's case.
- Therefore, the relationship between the BO and head office must not be considered as rendering of services based on the service agreement, which, according to tax legislation, does not constitute the basis for increasing expenditure.
- The relationship between BO and head office must not be considered as rendering services based on the service agreement, which, according to tax legislation, does not constitute the operation subject to taxation under VAT.

### Position of the Company

- According to the Article 8(18) of Georgian Tax Code (GTC), a person is a natural or legal person under the Civil Code of Georgia, an enterprise, or an organization under the GTC.
- According to Article 21 (1.b), PE of a foreign enterprise is regarded as enterprise.
- According to the Articles 5 (1) and 5 (2) of Convention between Georgian Government and Government of Republic of Azerbaijan on "Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to the Taxes on Income and on Capital", the term "Permanent Establishment" includes, inter alia, branch office (department).
- According to the Article 29 (2.d) of GTC, branch office constitutes a PE.
- According to the above-mentioned tax norms: a BO of a non-resident is a PE of non-resident: a PE of a foreign enterprise is considered as an enterprise; and an enterprise represents an entity under legislation.
- According to the Article 21 (1.b) corporations, companies, firms and similar entities established under the legislation of a foreign country, irrespective of whether they have legal entity status, are considered as enterprises.
- Therefore, Georgian legislation considers foreign enterprise and its branch office as two separate entities and relationships between them must be regarded as business relationship between different parties.
- The lease relationship between the head office and the

BO must be considered as rendering services based on the agreement and, therefore, subject to taxation under reverse VAT and be deducted from income with the invoicing amount, rather than with the depreciation amount.

### Decisions of dispute resolution authorities

- Georgian Revenue Service (GRS) shared Audit Department's opinion and refused to satisfy the appeal. GRS considered that lease payments do not represent the deductible expenses according to the tax legislation.
- The dispute continued at Council of Dispute Resolution (CDR) of Ministry of Finance. Under the decision of CDR, the appeal was not satisfied. CDR shared GRS's argumentation:
  - According to the Article 16 (2) of GTC an action that is not a supply of goods and that is performed voluntarily, for consideration or free of charge by a person for another person is deemed as rendering of services.
  - According to Article 8 (18) of GTC, a person is a natural or legal person under the Civil Code of Georgia, an enterprise, or an organization under the Tax Code of Georgia.
  - According to the Article 66 (3) of GTC, a branch of a foreign enterprise that is subject to registration in the Register of Entrepreneurs and Non-entrepreneurial (Non-commercial) Legal Entities, is registered for tax purposes and issued an identification number by the National Agency of Public Registry at the moment of the registration of the branch.
  - If the said foreign enterprise was registered for tax purposes before the registration of the branch and was issued an identification number by a tax authority or if two or more branches have been registered, the identification number first issued shall remain intact.
  - As rendering services is considered as action, other than supply of goods, and the BO of the foreign enterprise does not constitute a person, determining BO's tax liability under inspection without taking into consideration the service agreement with the head office was legitimate.

### Issue 2: Taxation of catering to employees under VAT

#### Facts

BO has supplied to the hired employees with products, as well as with food via subcontractors.

BO did not consider the supply of products/food as

subject to taxation under VAT.

BO has deducted subcontractor payments in expenses.

Tax invoices has been issued, which BO partially credited.

Under inspection, taxable base for VAT was increased and relevant tax was imposed to the BO.

### Position of the Audit Department

- Amount paid for products/food represents employee's benefit, therefore product/food payment amount including VAT is considered as salary income (benefit).
- Due to the fact, that VAT amount is a part of benefits, VAT credit is also subject to annulment.

### Position of the Company

According to GTC, use of goods/services purchased with VAT for non-economic activity, if the payer has credited VAT with respect to the goods/services, represents the transaction subject to VAT. Therefore, providing service to the employees free of charge, for which, when purchased, VAT was not credited by BO, does not represent the transaction subject to VAT.

### Decisions of dispute resolution authorities

GRS partially satisfied the appeal regarding the issue.

- GRS referred to the Article 96 of General Administrative Code of Georgia, according to which an administrative body is obliged to investigate all significant circumstances of the case and to make a decision based on evaluating and comparing the circumstances.
- The issuance of an individual administrative act must not be based on the circumstance, which is not investigated by the administrative body in the manner determined by law.
- For the full investigation of the circumstances, according to Article 49 of GTC, tax authorities are entitled to: examine production, storage, sales and other facilities of enterprises, organisations and entrepreneur natural persons, perform tax monitoring, take inventory of stock of goods, conduct observations by time-study or any other method and determine the number of taxable objects, conduct tax audits, monitor taxpayer observance of the rules for use of cash registers and, in the case of non-compliance with this rule, determine and impose appropriate liabilities under the legislation of Georgia with respect to those persons.
- GRS referred to Article 174 of GTC, according to which creditable VAT amount is the amount of VAT that has been paid or is payable in accordance with credit

documents in the event of the purchase of goods and services, import of goods and/or temporary admission of goods, including on the balance of inventory holdings available at the moment of entry into force of VAT registration.

- VAT is not credited based on tax invoices not reflected by the payer (buyer/recipient of deduction) in at least one of the VAT returns filed within the respective time frame;
- GRS ordered the Audit Department to study/analyze the subject matter with the participation of the taxpayer and in case of the existence of the corresponding grounds, to correct the imposed amount (reduce).
- Company appealed GRS's decision to CDR, which shared GRS's opinion regarding the issue.
- CDR highlighted Article 161 of GTC, according to which transaction subject to VAT is use of goods/services purchased with VAT for non-economic activity, if the payer has credited VAT with respect to the goods/services, where:
  - the amount of a taxable transaction is the market price of the goods/services (including taxes, duties and other payments) exclusive of VAT;
  - the time of the execution of a taxable transaction shall be the moment of the commencement of the use of the goods/services.
- CDR pointed out, that: as the company states that VAT was not credited when free of charge service was purchased and therefore, providing services free of charge should not have been taxed with VAT and under the GRS decision the Audit Department was ordered to study/analyze the arguments stated in the appeal, there is no ground to annul the decision of GRS regarding to this issue.

### Issue 3: Considering catering service as employee's benefit.

#### Facts

BO has supplied to the hired employees with products, as well as with food via subcontractors.

BO did not consider the catering payments as employee benefits and did not tax it under private income tax (PIT).

BO has deducted subcontractor payments in expenses. BO has issued tax invoices on the mentioned service and has credited some of them.

### Position of the Audit Department

- Amount paid for products/food represents employee's benefit, therefore product/food payment amount including VAT is considered as salary income (benefit), due to which taxable base for the purposes of PIT was increased.

### Position of the Company

- Workers have to work hard (railway construction) in field conditions, on a desolate, barren territory: they work at different construction sites, which are 5-10 kilometres apart from each other.
- The workers have to spend a night at the site- without availability of basic living conditions.
- It is impossible to access the food independently for the simple reason that the field is barren and there is no food service facilities; Due to the long distance, it is impossible to "bring it from home" (workers sleep at the site).
- Under such conditions, according to the Article 35 of Labour Code of Georgia employer obliged to provide employees with a working environment that is maximally safe for the life and health of the employees, to which one of the essential parts is food.
- In the working conditions mentioned above, providing catering, due to the interests of the company, is directly related to earning income.
- Providing catering to the employees is nothing, but the imminent condition for the recovery of physical ability and fulfilment of the production necessities, rather than their benefit.
- Providing employees with food on the field during the railway construction period, represents employer's expenses related to economic activity/earning income and considering it as an employee benefits, is inappropriate.

### Decisions of dispute resolution authorities

GRS satisfied the appeal regarding the issue.

- GRS referred to the Article 16 of GTC, according to which an action that is not a supply of goods and that is performed voluntarily, for consideration or free of charge by a person for another person is deemed as rendering services.
- GRS also referred to Article 102 (2) of GTC, according to which when supplying of goods/services free of charge, the market price of such goods/services is included in gross income.

- Article 101 (1) was mentioned as well, according to which salary income represents any compensation or benefit received by a natural person as a result of employment, including income earned as a pension or in any other form from the previous employment, or income from future employment.
- GRS considered that providing employees with food by the company does not represent employee benefits, because mentioned service derives from business activity of the enterprise and is an imminent condition for fulfillment working requirements.
- GRS ordered the Audit Department to reduce amount imposed based on the consideration of food supply as employee benefit.
- Company appealed GRS decision to CDR.
- CDR shared GRS's opinion regarding the issue and referred to the GRS's decision, according to which supply of food to the employees was not regarded as employee benefits and the Audit Department was ordered to reduce imposed amount.
- As a result, CDR stated that there was no ground to annul the decision of GRS regarding to this issue.

*Source: Decision #1748/2/2016 of Dispute Resolution Council of the Ministry of Finance dated 3 April, 2019.*

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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