



ნოდია, ურუმაშვილი და პარტნიორები NODIA, URUMASHVILI & PARTNERS

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Brief overview of the changes in tax legislation of Georgia

VAT Reform

With the amendments to the Tax Code of Georgia in July 2020 a significant VAT reform was implemented, that introduced completely renewed regulatory norms and made alteration to the fundamental principles of the VAT application.

Reform echoes obligations arisen from the EU-Georgia Association Agreement that among others envisages to harmonize Georgian Tax Legislation with the VAT Directive (2006/112/EC).

The amendments have a positive impact on the tax burden of taxpayers as it eliminates number of shortcomings and ambiguities in the tax legislation. Given the scale and complexity of changes, VAT reform will take effect from January 1, 2021, allowing taxpayers to analyze the impact of amendments on their operations.

• **New definition of economic activities**

Amendments concern a definition of an economic activity for VAT purposes. Economic activity only includes:

- Entrepreneurial activity (also activities defined by the Law of Entrepreneurs of Georgia Article 1.3.);
- Utilizing property to generate income on a regular basis;
- Ordinary activities of persons supplying goods and services on a regular basis;
- Disposal of the non-residential building regardless of the constancy and recurring nature of the activity.

From 2021 non-entrepreneurial activities conducted on non-regular basis once, except for the disposal of the non-residential building, will not fall under economic activity definition. Therefore, from 2021 these activities will not be subject to tax given the fact that the VAT taxation only applies to the supply of goods/services on the territory of Georgia within the framework of economic activity.

• **VAT taxation of the Advance Payment**

VAT taxation of the amount received in advance has been introduced in the tax legislation of Georgia since January 1, 2017, although it did not apply to:

- The advance payment received within the framework of regular or continuous services;
- The advance payment received within the framework of regularly or continuously supplying goods (guaranteed capacity electricity or heat, gas or water).

From January 1, 2021, the scope of VAT application on the advance payment is expanding. Accordingly, the advances received within the framework of regular or continuous operation will also subject to VAT payment.

Exceptions from the general principles of applying VAT to advance payment are as follows:

- Providing telecommunication/communication services regularly or continuously;
- Supplying goods (guaranteed capacity electricity, gas, water, heat, cooling system or other similar goods) regularly or continuously.
- Hence, from 2021, the advance received within the framework of rental, consulting, legal and other similar services will be subject to VAT if these services are provided regularly or continuously.

• **Taxation of free delivery of goods or services**

According to the current tax legislation supply of goods and services is a transaction subject to VAT if it is carried out within the framework of economic activity. Moreover, free of charge transaction carried out by the enterprise shall also be considered as an economic activity and, therefore, VAT taxable transaction.

As of January 1, 2021, VAT taxable transaction is defined as the supply of goods and services carried out within the framework of (1) economic activity and (2) in exchange for remuneration. This does not mean that free of charge transactions are not be subject to VAT as according to the Article 160 and 160¹ of the Tax Code of Georgia free of charge transactions may still be regarded to be completed for remuneration for tax purposes in the following circumstances:

- Delivery of goods free of charge, if the supplier has fully or partially included VAT on these goods or the expenses incurred on them;
- Providing services free of charge to an employee for personal use or for a purpose other than the purpose of their own ordinary activity.

It is also noteworthy that from 2021 the amount of VAT for free of charge transactions subject to VAT shall be calculated corresponding to the cost of goods / services provided.

- **Place of supply of services**

From January 1, 2020 place of supply of services is fundamentally changing and shall be determined according to the following principles:

1. Place of supplying services in B2B transactions is the place of incorporation of the person receiving services;
2. In B2C transaction place of supplying services is the place of incorporation of the supplier.

However, these principles have exceptions:

- Place of supply of services associated with immovable property shall be the place where the property is located;
- Place of supply of transport shall be the place where the transportation takes place, proportionately in terms of distances covered;
- Place of restaurant and food services is the place where the service factually takes place, etc.

The Tax Code reform from 2021 introduces new concept to determine the place of service, namely, *Criterion of Effective Use and Enjoyment*. The criterion was first set forth in 1997 in the Tax Code of Georgia; as long as its application was disputable, it was removed in 2010. Nevertheless, from 2021, this criterion will still be added under following derogations:

- It shall not be used to determine the place of supply of service for B2B and B2C transactions in situations set by the Minister of Finance in Georgia, and
- Georgia will be considered to be the place of rendering the service, if the factual use or use of the service takes place in Georgia.

Evidently, these principles will shape same side effects as before, however, the overcoming the difficulties will be at ease as long as:

- Guidance on application of the mentioned criterion will be regulated by the Ordinance of the Minister of Finance of Georgia;
- A similar criterion is introduced in the European VAT Directive followed by the fortified practice the European Court of Justice on its application.

- **The assignment of intangible property is regarded as a supply of services**

According to the current Tax Code the term "supply of goods" is defined as a "... transfer of ownership of goods ...", and goods include both tangible and intangible property.

As of 2021 the reform sets forth a definition of supply of services for VAT purposes, more specifically:

- 'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner.
- 'Supply of services' shall mean any transaction which does not constitute a supply of goods.

Therefore, from 2021 assignment of intangible property will be regarded as a supply of good. Although, this novelty does not make any modification to the VAT taxation, the change amends a flaw in the current Tax Code.

Taxation of free of charge transactions with corporate income tax

With the amendment to the Tax Code of Georgia in July 2020 pursuant to the "Estonian model", the taxation of profit tax paying enterprises has been liberalized. It is established that free of charge supply of goods, services or transfer of funds by a Georgian enterprise to the enterprise that pays profit tax according to the Estonian Model shall not be subject to the corporate income tax.

Herewith it should be noted that this principle is not used with respect to other taxes (e.g. VAT). Those operations are still subject to the basic taxation principles.

Providing housing and food services to the employees

According to the amendments of May 13, 2016 and the add-ons to the Article 101 (3) (c) it was established that from January 2017 providing transportation services to the employees could not be regarded as a benefit received in the form of salary. With this change the rule of taxation of providing an employee with transportation service has been added, however, providing food or housing services to the employees remained unregulated. This raised number of questions and resulted in the different approaches.

With the amendments of July 2020 in the Tax Code, providing housing or food services to the employee by the employer or the reimbursement of expenses related to these services will not be considered as salary and will not be subject to income tax if the following conditions are met:

First Condition:

- Providing housing or food services or reimbursement of expenses related to these services is not part of the remuneration in the employment contract between the employer and the employee.

Second Condition:

- Providing housing or food services to the employee is based on the peculiarities of the employer's activities and is a necessary condition for the ordinary performance under the employment contract.
- Providing housing or food services to the employee without being provided by the employer requires unreasonable expenses by the employee.
- Providing housing or food services to the employee without being provided by the employer requires unreasonable time spent by the employee.

Meeting even one requirement of the second condition is sufficient.

For instance, company pursues its activity and sets up a communication line far from the populated area. There is no food facility near the workplace.

The company provides its employees with food services that is not a part of remuneration under the employment agreement.

In this case, apart from the first condition, the second condition is also met – to move to a populated area and then returning back requires an unreasonable time. As long as both conditions are fulfilled providing an employee with food services will not be subject to VAT.

Expanding the scope of the Property Tax

With the amendments to the Tax Code of Georgia, scope of property taxes on a resident enterprise/organization has been expanded. Namely, within the property taxable objects the following are added:

- Real estate, yachts (cutters), helicopters, airplanes and other transport vehicles acquired as the lien to ensure the performance on the contractual obligation.
- Real estate, yachts (cutters), helicopters, airplanes and other transport vehicles acquired within the performance of a pecuniary obligation by auctions, direct selling or other means of acquisition.

Regardless of the form of registration of the property owned by the enterprise (even if the owned property is registered as a commodity-material supply), it will still be subject to property tax.

It shall be noted that the amendment has the legal effect on the legal relationships arisen from 2020.

Liberalization of fines

The existing fines on issuing invoices have been liberalized. In particular, transportation of goods for business purposes without a consignment note, not issuing a consignment note at the request of the buyer or refusing to accept a

consignment note while purchasing goods, regardless of the value of the goods, will result in a fine of 500 GEL.

Prior to this change, if the value of the goods exceeded GEL 10,000, a fine of GEL 10,000 had been determined.



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