

Your Tax Dispute InfoGuide

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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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Facts

A company (hereafter: the Company) carries out production and realization of concrete on local market and concurrently is engaged in construction services. For the purposes of its activities, the Company was acquiring service (transportation, expertise and road construction) from individuals having the status of a small business.

It should be noted that since January 1, 2018 the individuals registered as small entrepreneurs (Small Entrepreneurs) shall be taxed at 1% rate on their gross income and are not subject to taxation at the source.

Position of the Audit Department

The tax inspection found that declared income of some Small Entrepreneurs are received from provision of service for the Company (which is also revealed by declared Personal Income Tax (PIT) returns by them and also by their written explanations), the rest of the Small Entrepreneurs additionally have another income generated from different sources.

According to the position of the Audit Department, form of the operation did not correspond to its substance. The tax inspection applied substance over form approach and reclassified the operation and paid amounts were considered as salary payments to the Small Entrepreneurs. Respectively, those amounts became subject to PIT and taxed with 20% rate at source. As a result, the tax inspection imposed principal tax along with appropriate sanctions on the Company.

Arguments of the Company

According to the Company's argument, paid amounts for provided services should not be considered as salary due to the following circumstances:

- The Company permanently hires employees, also concludes one-off service contracts with non-employed individuals within the scope of separate service agreement or state orders. These individuals provide service to the company at their own risks defined by the specific service contract and receive remuneration in accordance with the performed works. On each operation, act of acceptance is put in place and abovementioned persons have no other labour relations and / or rights-obligations toward the Company. Thus, considering mentioned factual circumstances, the service contracts are in line with the requirements of Georgian legislation.
- The Small Entrepreneurs have fulfilled their own tax liabilities on remuneration received from the company - they have declared and paid PIT. The tax inspection considered that received taxable income is received net salaries. Consequently, tax inspection grossed latter amounts and further imposed 20% tax rate. Overall tax burden on received amount was in the amount of 30%.

The Company also noted that during mediation process tax auditors mentioned the following factors led to applying substance over form approach: Individuals who do not have a small business status and want to be employed, the Company encourages them to obtain small business status and only after receiving the status, contracts them. Some of these persons' income are received only from the Company.

Based on the abovementioned circumstances the tax inspection considered that individuals are the employees of the Company and they receive relevant remunerations. According to the Company's position:

- The Georgian Tax Code (GTC) provides special taxation regimes for micro and small businesses. The aim of establishing these regimes of taxation is to foster micro and small business development in the country. The subordinate acts also determine the list of activities, which is prohibited to be carried out by individuals under the small business status. None of the services are listed in the subordinate acts which were provided by individuals to the Company.
- To apply a substance over form approach, it does not matter when these persons have been granted a small business status and whether they were providing services to another customer under the status. The main and decisive fact is that the Company concludes one-off service contracts with Small Entrepreneurs and no any other form of relations (including being employed at any "position") exists with them, except of the work defined by the contract.
- As regards the fact that some of the abovementioned persons undergone status obtaining and registration procedures before the service contract were concluded, the cost of the provided services are determined by their net amount remunerations (without taxes). Consequently, during negotiations process about payments, the Company states that it is more favorable to have business relations with the individuals having mentioned status and after this, the individuals decide to make decisions about obtaining the status, which is not restricted by any applicable legislation or norm.
- At the same time, when participating in tenders announced by the state, the cost of work that should be executed is determined by the value of services received from the persons with this status.

Based on aforesaid facts, there are not any legal grounds to consider Small Entrepreneurs as hired employees. The parties act within the contractual obligations and they have no connection with labor contracts, which excludes the fact of considering them as employees of the Company.

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 has concluded that from the reading of act of inspection and decision of GRS, it is not clear and there is no ground for applying substance over form approach for the operation. The argument of the tax inspection only indicates the fact that the Small Entrepreneurs provide services to the Company. The council decided that GRS had not properly investigated and assessed the dispute case. In particular, the following circumstances must have been scrutinized:

- What was the factual and legal circumstances when the tax inspection considered that provided services by Small Entrepreneurs had been performed as under employment of the Company;
- Whether or not exist the contracts signed between the parties, which confirm that individuals are hired employees of the Company.

- Whether or not Small Entrepreneurs use the fixed assets of the Company, or use the Company's inventories (consumable materials);

Based on all the abovementioned, the council cancelled the decision of GRS and returned the case to be examined and discussed again.

Source: Decision of the Dispute Resolution Board of the Ministry of Finance #7248/2/2019

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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