



OVERVIEW OF THE GEORGIAN TRANSFER PRICING DISPUTE PRACTICE

Introduction

On 24 April and 28 May 2019, PwC Georgia organized transfer pricing ("TP") seminars for business organizations with the purpose of highlighting the recent developments in the Georgian TP dispute practice.

These seminars specifically focused on recent TP examinations by Georgian Revenue Service ("GRS"), explaining what the issues raised by the tax authority were, the arguments made by the companies, any counter arguments that was made as well as a more general analysis of the actual cases.

The sessions also focused and highlighting the newest developments and trends followed by GRS during TP examinations. Considering the rapidly increasing interest of this topic for both the GRS as well as companies in Georgia, we have summarized some of the key points which were identified in this article.

Overview of the Georgian TP dispute practice

Since the inclusion of the TP rules into Georgian regulations, GRS has carried out several TP examinations with growing frequency on a yearly basis.

Generally, such inquiries by the GRS can either be as part of the general tax examination, or a separate audit solely focused on TP, i.e. the intercompany transactions of the company. This option allows the GRS TP audit team to efficiently allocate the administrative resources for key inspections. Recently, we have seen both types of inspective methods actively being used by the tax authority.

According to the GRS's official yearly report for 2018, the challenged and assessed amount, specifically in relation to intercompany controlled transactions, increased drastically. For 2018, the assessed amount was approximately 135 million Georgian Lari ("GEL"), compared to approximately 3-4 million GEL in the previous two years.

Out of this increase in the numbers, the following trends can be outlined:

1. There has been an increased focus by the GRS on high value transactions. Based on observations, the GRS is more likely to assess higher value transactions and specifically focus on a company's material transactions.



Even though the local Georgian regulations do not include any transactional materiality threshold, using the value of a company's intercompany transactions and the materiality of these transactions is a logical and widely used risk analysis tool, pursued by various tax authorities.

2. Overall, a focus on the intercompany transactions by the GRS has increased significantly. This is also supported by the observation that the GRS transfer pricing team has increased in number. This reflects the current global trend of an increase in the scrutiny of intercompany transactions to prevent potential mispricing of transactions and other abusive practices within multinational groups.

The most common intercompany transactions challenged by the GRS include, but are not limited to: buying and selling of goods, manufacturing activities, receiving and/or provision of various intra-group services, (e.g. management services, legal, human resources and accounting services, information technology services), use of a group's brand or tradename, intercompany loans, etc. [Transfer Pricing Newsletter #2](#) (February, 2019), includes more detailed information on the general features for each of these transactions.

When analysing the details of the various assessments which the GRS have made public, there is one fact that most of the assessments have in common, the companies involved have not prepared detailed TP documentation and hence were not able to provide the documentation when requested by the GRS. According to Georgian TP regulations, a taxpayer is required to submit its TP documentation within 30 calendar days after receiving an official request from the GRS. Notably, preparation of the proper TP documentation in 30 days is in most cases very difficult, if even possible.

In accordance with the local TP regulations, and as seen in several of the assessments, once a company fails to present the TP documentation when requested, the onus of proof moves to the company. This means that when examining the intercompany transactions, the initial assessments of the auditors are usually based on the facts and information available to them at that stage. When the company fails to provide the TP documentation, the information available to the GRS is factually incomplete and does not provide a full picture on the activities of the company. As a result, in case of insufficient information available to them, the GRS often adopts an extremely conservative approach, challenging the transactions as a whole and for example deeming the entire costs attributed to an intercompany service transaction as being non-deductible costs. Under the Estonian tax model, this means that the local company's entire expenses related to intercompany services received from a foreign related service provider may be treated as costs incurred for non-economic activities. As a result, the expenses is likely to be subject to taxes in Georgia.

Such strict assessments by the GRS often become the subject of appeal, lodged by the company. In some instances the company is allowed to prepare and submit TP documentation, including counter arguments supporting its intercompany transactions. However, preparing comprehensive TP documentation at the dispute stage is usually associated with stringent time limits as well as increased difficulty related to disproving the position taken by the GRS. It also results in increased costs related to defending the position during the disputes. In the recent practice, we have seen companies engaging in extended disputes with the GRS, at various stages of the tax appeals, including litigation. It should be noted that even though most tax appeals do get resolved, in some instances it might take 2-3 years, or even longer.



Therefore, it is to the benefit of the companies to adopt a rigid approach and have TP documentation prepared in advance, not waiting for the notice from the tax authority. To reduce the risks of the aforementioned issues and the business ambiguity coming from the lengthy disputes, the robust TP policy supported by a detailed TP document is essential. Although, having a TP documentation ready by no means guarantee the taxpayer that no challenges will be raised, in most cases it significantly reduces the TP risks. When all intercompany transactions are properly covered and explained in detail from a TP perspective, the burden of proof moves from a taxpayer to the tax authority, which means that the GRS is required to disprove a backed position taken by the company, which in practice is related to establishing higher standard of proof which is much harder to do.

How we can help?

To raise general awareness on TP, together with issuing newsletter series, PwC Georgia will keep organizing open seminars for the business organizations in Georgia. In addition, these events can be used as a platform to assist the companies in clarifying some of the vague issues of TP that they might be exposed to during pricing their intercompany transactions.

PwC Georgia has one of the best TP teams in Georgia which consists of a local director and two managers. Having an extensive experience in Georgian and international markets, our team offers a full scale of TP consulting services to multinational enterprises operating in Georgia. We can help you in identifying and mitigating the TP risks, preparing the proper TP documentation for all types of controlled transactions and assisting you in position defence during the TP disputes.

In case of interest, the PwC Georgia Team is ready to answer your questions:

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