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International Double Taxation

CONTRACT NO. AFP-1-00-04-0002-00 TO:03

14 July 2008

This publication was produced for review by the United States Agency for International Development and the Government of Georgia. It was prepared by USAID Business Climate Reform, managed by Chemonics International Inc. The author is Steve Vasak, Senior Tax Policy Attorney.

The views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

July 14, 2008

INTERNATIONAL DOUBLE TAXATION

By: Stephen Vasak, Senior Tax Policy Attorney

I. CURRENT SITUATION

International double taxation represents the imposition of comparable income taxes by two or more sovereign countries on the same income items on the same taxpayer for the same tax period. Bilateral tax treaties often provide solutions to this problem. Most are based on one of three models--the United States Model Income Tax Convention of September 20, 1996 (the U.S. Model), the United Nations Model Double Taxation Convention Between Developed and Developing Countries (the U.N. Model) and the OECD Model.

No tax conflicts should normally arise if all States followed a territorial tax system and restricted their taxing rights to income arising in their own fiscal jurisdiction.

On 14 March 2008 the Georgian Parliament passed amendments to the Tax Code. Some of those many amendments regard International Double Taxation issues:

1. A significant amendment toward eliminating, double taxation is the imposition of territorial taxation regarding a natural person's exclusion of foreign source income, Article 168.1(v). This provision, however, does not apply to legal persons.
2. The creation of International Financial Companies, Article 26, as defined in Article 19, eliminating double taxation issues on profits from financial service activities, sale of securities issued by the IFC, profits from sale of public debt, profits from issuance of risk based insurance and re-issuance, interest on Government debt securities, sale of Government debt securities, profits from warehouse operations in industrial free zone, Article 172.
3. Dividends received from shares of IFC Article 195.
4. Interest received from financial institutions, Article 196.
5. Interest received from public debt securities, Article 196.
6. Foreign Tax Credit against Georgian profit tax, Article 192.

Despite these sweeping amendments, there remain double taxation issues that need to be addressed. While outbound transactions of Georgian natural persons eliminate double taxation issues, both outbound transactions of Georgian legal persons and inbound transactions of foreign legal and natural persons require corrective action.

II. SUMMARY OF RECOMMENDATIONS

1. Delete Article 12.8 since its definition of related family members is incorrect.
2. Amend Article 12.11 to include new definition of dividend.
3. Amend Article 12.13 to redefine royalties.
4. Amend Article 12 to include definition of lease.
5. Amend Article 22 to permit both or either the host or resident country to initiate and treat as source income the effect of transfer pricing violations.
6. Amend Article 22.10 to include calculation of difference in pricing based on market price not actual price.
7. Amend Article 23.2 broadening the definition of natural persons related to legal persons, and legal persons related to other legal persons.
8. Amend Article 23.3 to include new definition of related natural persons.
9. Amend Article 24.1a to limit taxation of employment income, except for Director fees, only if the person was employed for a period greater than 183 days.
10. Amend Article 24.1n to include as source income earned from reserves of an insurance company.
11. Amend Article 24 to add dividends between subsidiary and foreign parent not subject to withholdings.
12. Amend Article 24 to add interest payments by permanent establishment and subsidiary to foreign not subject to withholding if PE or subsidiary did not deduct payment to arrive at tax base.
13. Amend Article 24.li so that royalty payments by a permanent establishment and subsidiary to foreign parent not subject to withholding
14. Amend Article 24.1p to include only communication and transportation services conducted strictly in Georgia.
15. Amend Article 24 to include withholding on income earned by foreign entertainer and sportsperson.
16. Amend Article 24 to include taxation provision for professors,, teachers, researchers and students.
17. Amend Article 24 to add income received by a foreign joint owner or joint venture participant.
18. Amend Article 29.2 to establish minimum time period prior to construction or natural resource payments are subject to withholding.
19. Delete Article 29.4 since it conflicts with Article 29.5.
20. Amend Article 29 to regarding fees paid for independent personal services.

21. Delete the amendment Article 192.1 placing foreign tax credit provisions in Article 192, which regards Net Operation Loss.
22. Reinstate Article 193 and include language of Article 192.1.
23. Amend Article 192 by including part 3 disallowing foreign permanent establishment losses of a domestic legal person.
24. Amend Article 192 to include part 4 net operating losses of two or permanent establishments of the same foreign parent.
25. Amend Article 192 to include part 5 to add use of net operating loss by acquirer of loss company on condition that losses limited to prior year profits.
26. Amend the replaced Article 193 to include carry forward of excess foreign tax credit.
27. Amend the replaced Article 193 to include a savings clause.
28. Amend Article 206.1 to include joint ventures.
29. Amend Article 215 to include cross border reorganizations provisions.
30. Amend Article 215 to change 50% to 51% interest.
31. Amend Article 213 to change liquidation threshold from 50% to 51%.
32. Amend Article 217 to permit consolidated returns,
33. Amend Article 218 procedure for withholding of tax at source.

CURRENT LEGISLATION

The following Tax Code Articles were considered regarding the issue of double taxation:

1. Article 12.8 defines a family as those related parties residing with the taxpayer.
2. Article 12.11 defines dividends as distribution of profits to partners.
3. Article 22.10 determining transfer pricing violations as the difference between price paid and actual price as opposed to market price.
4. Article 23, definition of Interrelated persons does not include all forms of interrelations.
5. Article 24, Source rules.
6. Article 29.2 determining permanent establishment by of construction and drilling without time factors for activities.
7. Article 29.4 determining permanent establishment based upon use of independent agent for period exceeding 3 months.
8. Article 166.5 taxing sale of stock by non-resident foreign natural person.
9. Article 170.6 profits earned from sale of stock.

10. Article 192. Net Operating Loss not applied among foreign permanent establishments or subsidiaries.
11. Article 192.1. Foreign tax credit has no provision for carry forward of unused credit.
12. Article 197, taxation of international transportation.
13. Article 206 not including joint ventures between resident and non-resident natural and legal persons.
14. Article 218, procedure for withholding taxes on income paid to foreign person.
15. Article 217 filing of tax returns does not permit consolidated returns.

IV. DISCUSSION OF RECOMMENDATIONS (all references to Articles pertain to the Tax Code)

Related Parties (Article 12.8 and Article 23.2 and .3)

Related party definitions are intended to control the association, control and influence among taxpayers to determine transfer pricing and other forms of tax avoidance. For purposes of double taxation, an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. Enterprises are also related if the same persons participate directly or indirectly in the enterprise's management, control, or capital

Article 12.8 of the Tax Code defines family members, but of concern is the phrase "...For the purposes of this Code, the taxpayer concerned unconditionally specifies the persons (out of the above mentioned persons) permanently residing with him/her and jointly running the household". This provision implies that control and influence among family members exists only in cases where family members reside in the same household. This is clearly not the case. As a result, I recommend that this Article 12.8 be deleted from the Tax Code. The relations of natural persons are already defined in Article 23.3 and there is no need to have Article 12.8 to negate the effect of Article 23.3.

Article 23.2 defines Interrelated Persons among natural persons and a natural person's relation to a legal person, but the Article does not adequately define interrelations between legal persons. The Article does not include:

- The relationship between two related natural persons who are managerial heads of two separate companies while each company transacts business with the other.
- Stock attribution rules meaning the shares owned by one related natural person such as a spouse are considered as owned by another related party such as the other spouse. This rule is crucial to determine stock ownership in a legal person.
- Two legal persons being members of the same group of legal persons as defined in the rules for consolidated returns.
- Joint venture relations between two separate legal persons.

Article 2.3 defines the relationship between natural persons, but the list of interrelated natural persons is incomplete and ambiguous.

I recommend that Article 12.8 be deleted from the Tax Code. I also recommend in the Appendix that Article 23.2 and Article 23.3 be amended to list each form of interrelation. The language used to define interrelation among businesses, Article 23.2, is the relationship recommended January 2008 by the International Accounting Standards Tax Committee representing the most recent definition of related legal persons. The related natural person definition, Article 23.3 is the generally accepted OECD and US treaty definition.

2. Definition of Dividend (Article 12.11)

Article 12.11 defines dividends as “...part of the profit being distributed by a legal person among the partners considering the results of the tax year(s),...” and then the definition makes reference to return of capital, which is standard to partnership taxation as opposed to legal persons.

This definition does not conform to double taxation Treaty provisions and International Accounting Standards, which is significant in determining double taxation issues. The current definition implies that partnership distributions are dividends, which is clearly not accepted under International Best Practice.

The generally accepted treaty definition of a dividend is “any distribution of property made by a corporation (legal person) to its shareholders from current or accumulated earnings and profits.

In the Appendix I have expanded the definition of a dividend and recommend that Article 12.11 be deleted and replaced with the recommended language.

3. Transfer Pricing (Article 22)

The Transfer pricing provisions of Article 22 are correct. However, Article 22.10 computes the price between related parties as the difference between the price charged and the “actual” price. Actual price is not the correct determination and contradicts the usage of the term “market price” in parts 1 through 9 of Article 22. Actual Price also is contradictory to the transfer pricing regulations of Article 9.2 of the OECD Model Convention and the 1995 OECD transfer pricing guidelines, which require an “arms length” standard. Therefore, I recommend that the word “actual” be deleted and replaced with the words “open market price”.

In the case of transactions between related enterprises, if conditions are made or imposed between two enterprises in their commercial or financial relations that differ from those that would be made between independent enterprises, there exist the potential for transfer pricing. In such a case, a country may allocate to such an enterprise the profits that it would have accrued but for the conditions so imposed. This treatment is consistent with the U.S. Model treaty. For the purpose of transfer pricing, an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. Enterprises are also related if the same persons participate directly or indirectly in the enterprises’ management, control, or capital.

I, therefore, recommend Article 22.11 permitting either countries to evaluate the transfer pricing rules in the event the host and resident country companies are interrelated.

4. Georgia Source Income (Article 24)

Article 24.1 a-Employment

This article subjects employment income within Georgia to be subject to withholding. Model OECD and US Tax treaty provide employment taxation remains the right of the resident

country, unless the natural person has been employed in the host country for a period exceeding 183 in a 12 month period, except that income paid for Director fees for the management of a permanent establishment or subsidiary of a foreign parent to a foreign natural person may be taxed by the host county without reference to the 183 day rule.

I would amend Article 24.1a to require the 183 rule to the taxation of employment income.

Article 24.1e- **Dividend.**

Since the Tax Code has been amended to delete dividends from taxation, this report will not comment on the double taxation issue of dividends. Except that the Tax Code should delete

those parts in other Articles that conflict with the new amendment exempting dividends from both domestic and foreign withholding, such as Article 24.1e, Article 175 and Article 195. It is also recommended that until the exemption of dividends comes into effect, both the EU directives 2003/123/EC and 90/435/EEC, and most tax treaties exempt dividend withholding between a subsidiary and its foreign parent on the basis that such dividends are subject to single taxation in the resident country of the parent (US Treaty Model).

Article 24.1f- **Interest Income from Institutions**

Since the amendments to the Tax Code exempt from both domestic taxation and foreign withholding interest received from banks and other financial entities and Government securities, there is no need to comment on the double taxation issue of interest income. Except that the Tax Code should delete reference to interest taxation in Article 24.1f, Article 175 and Article 196.

Article 24.1h –**Interest Income from Loans**

This Article taxes interest income paid by a permanent establishment to a non-resident person. Pursuant to EU Directives 2003/123/EC and 90/435/EEC, EU Commission Recommendation and EU and US Model Treaty cross-border treaties, interest paid by a permanent establishment or controlled subsidiary (10% or more stock interest) of a foreign parent to the foreign parent is considered as arising in the resident state of the foreign parent, if the permanent establishment or subsidiary has not deducted the interest expense in its calculation of tax base. As a result, I have amended Article 24.1h in the Appendix.

Article 24.1i- **Royalties**

The OECD Model Treaty grants full exemption from taxation in the source State for royalties paid to non-residents and especially if the intellectual property will be used outside of Georgia. In addition, pursuant to EU Directives ((2003/123/EC and 90/435/EEC, EU Commission Recommendation) on cross border transactions between associated, related permanent establishments or controlled subsidiaries, there is no withholding for royalties paid by a permanent establishment or subsidiary to its foreign parent, if the permanent establishment or subsidiary did not deduct the royalty payment as an expense in calculating tax base. I therefore, recommend the proposed amendment to Article 24.1i in the Appendix.

In addition to the amendment of Article 24.1i, I recommend amending the definition of a Royalty in Article 12.13, since the current definition does not follow the recommendations of model treaty provisions.

Article 24.1j Income from Movable Property

This Article taxes or provides foreign withholding upon income earned from leasing movable property within Georgia. However, it is noted this Article is qualified by the amendments to Article 168(s) and Article 172(l), which correctly exempts leasing income on movable property, which was not received by a permanent establishment of a foreign person.

As will be subsequently discussed under the heading of permanent establishment, the current Article 29 must be amended, otherwise the beneficial and correct applications of Article 168(s) and Article 172(l) will be nullified.

Income from the sale of movable property by the country where the property is located is a primary right of the source country, Articles 166.5 and 170.6

Article 24.1k Income from Immovable Property

This Article taxes income from immovable property located in Georgia. Unlike income from movable property in Article 24.1j, which clearly refers to leasing income, this Article 24.1k makes no reference to leasing income from immovable property, although it appears the Article would include leasing income from immovable property. This Article also creates a conflict of terminology between jurisdictions defining the term “leasing”. The legal dictionary definition of a lease applies to both movable and immovable property and considers the terms rental, letting and leasing as the same. Whereas a financial lease is not a definition, it is a form of structure resulting in certain tax affects.

The Tax Code has no specific definition of the term lease, although the term is applied in Article 21 pertaining to financial leases, which applies to movable property. However, Article 21.2 uses the term rent, but uses the term in application to standard financial leasing transactions. Therefore, it is unclear whether the exemptions from source income granted under Article 168(s) and Article 172(l) apply to leasing income of immovable property.

The standard form of double taxation regarding immovable property permits the country where the property is located to tax income from property. The issue is how will the income be taxed. If the owner is a permanent establishment, then the general provisions of the Profit Tax Law apply regarding computing tax base. However, if the owner is a non-permanent establishment then the owner may elect to be taxed subject to foreign withholding, which in the case of Georgia is 10% of gross income, or be taxed under the tax base computation of the Profit Tax Law.

In the case of Georgia, it is necessary to determine the definition of the term “Lease”. Does it include income from both movable and immovable property as is generally recognized by International Accounting Standards and the standard legal dictionary definition, or is the term “lease” only to apply to movable property? If applied only to movable property restricted exclusively to Article 21, Financial Lease, than what is the definition of a transfer of use of property in exchange for money, which does not qualify as a financial lease? If the term “lease” is exclusively applied to financial leases of movable property, then the exemptions of Articles 168 and 172 would not apply, which I do believe is this the result intended by the amendments to Articles 168 and 172?

I recommend there be an amendment to Article 12 defining the term lease to apply to the use of both movable and immovable property in exchange for money. As a result, Articles 168 and 172 would be applied to all leases and not just financial leases pursuant to Article 21.

The state where the property is situated has the primary right to tax the sale of immovable property, Articles 166.5 and 170.6.

Article 24.1n **Income from Insurance Activities**

This article should also include any income earned on reserves for risk based insurance for insurance companies that do not qualify under the 14 March 2008 amendments to Article 26, International Financial Companies, and the proposed amendment to Article 19 under the report entitled “International Financial Center”.

Article 24.1p **Income earned from International Transportation**

This Article considers international transportation and communications between Georgia and other countries as Georgian source income. This approach contradicts standard model treaty provisions. Income derived from a cross-border international transportation and communication operation is taxed in the country in which the company performing such cross border operations has its place of business. Transportation and communication income, however, is sourced in the country of performance, if the foreign provider’s operations are limited to the source country.

I recommend that Article 24.1p be amended.

Article 24.1 Add additional part “r”-**Income from Sporting and Entertainment**

Add amendment, see Appendix, income from the performance of entertainment and sporting activities carried out in Georgia regardless if paid directly to the person or to another person or legal person on behalf of the entertainer or sportsperson. This is a standard provision of tax treaties, but absent in the Georgia Tax Code.

Article 24.1 add as part “t” **Income earned by Professors, Researchers and Students**

Both the OECD and US Model Treaty condition taxation of temporary work of professors, researchers and students upon whether the work is performed for a university, college or research institution as opposed to private companies. If the work is performed for private companies, the rule pertaining to employment income apply. If the work is performed for a university, college or research center, than the income should be excluded in the country of performance and taxed only the resident country. In Ireland for example, the exclusion of income is for a period of one year.

Article 24.1 add as part “v” **income earned by partner or joint venture participant.**

The host country reserves the right to withhold taxes upon the distribution of profit to foreign partners or joint venture participants that the host country considers taxable income, even if the resident country does not treat the distribution as taxable income.

5. Article 29. Permanent Establishment

Article 29.2 establishes PE status on construction and natural resource services without regard to time periods. Standard Treaty provisions distinguish between minor and major activities. In regard to construction activities, the standard to establishing PE status is activities in excess of six (6) months or nine (9) months during a 12 month period. In regard to natural resources, the standard is in excess of six (6) months over a period of 24 months (Ireland). I recommend amending Article 29.2 to include time periods to determine PE status.

Article 29.4 is incorrect and should be deleted. The finding of a permanent establishment in regard to a non-resident natural person or a non-registered business of a foreign person is based upon the agency relationship between a domestic agent and a foreign principal, OECD Model treaty Article 5. If the agent is dependent, the foreign principal is considered a permanent establishment, if independent, the principal is not considered a permanent establishment. The test is the degree of participation of the agent regarding contractual obligation authority. Article 29.5 of the Tax Code correctly recognizes this distinction by stating an agent having no authority to negotiate for or sign agreements for the foreign principal does not result in the foreign principal becoming a permanent establishment in Georgia. However, while this part 5 of Article 29, correctly recognizes the agency rule, Article 29.4 negates the terms of Article 29.5. Article 29.4 states even if the agent is considered an independent the use of the agent for a period more than 3 months establishes a permanent establishment.

While it is true in some circumstances that a long-term use of the same independent agent may imply dependency, the need for changing an independent agents every three months is a deterrent and the test should be applied on a case by case basis. Article 29.4 adds nothing to the Tax Code and only confuses the treaty rules regarding independent agents as correctly stated in Article 29.5. I, therefore, recommend that Article 29.4 be deleted from the Tax Code.

Article 29 add Article 29.13 Independent Personal Service

The definition of Permanent establishment does not address the situation where a domestic person hires the personal services of a foreign independent consultant or advisor, such as an attorney, accountant, advertising firm, construction expert, etc. The standard rule is that the source State of the income may only tax payments to a foreign independent service provider if the independent service provider maintains a fixed base of operations in the source State. I have, therefore, added this amendment, since the Tax Code does not refer to Independent Personal Service.

6. Sale of Securities Articles 166.5 and 170.6

The source country has the right to tax proceeds from the sale of securities. This is the position of Articles 166.5 and 170.6. However, the profit received by natural persons selling securities in foreign markets is exempt under the amendment crating territorial taxation.

7. Net Operating Loss Article 192 and Foreign Tax Credit Article 193

Article 192 permits a deduction for net operating losses with carry forward provisions up to 5 subsequent years. However, Article 192.1 amends Article 192 by adding tax credits for foreign income tax paid. At the same time, Article 193, which separately addressed the foreign tax credit was deleted.

Net operating loss and a credit for foreign taxes paid are two separate and distinct subjects. The provisions for a foreign tax credit should not be included in the Article providing provisions for a net operating loss. Rather, there should be two separate Articles.

I recommend deleting Article 192.1 regarding foreign tax credit in Article 192 and reinstating Article 193, Foreign Tax Credit, with the same language as in the amended Article 192.1.

I recommend adding to the original Article 192 part 3, to include the disallowance of foreign permanent establishment losses of a domestic legal person to be used in the computation of the domestic tax base.

I recommend adding part 4 to the original Article 192 stating that the net operating losses of two or more permanent establishes of the same foreign parent may consolidate their net operating losses, this encourages foreign persons to expand their operations within Georgia.

I also recommend that the reinstated Article 193 provide that any excess foreign tax credit applied against the Georgian tax can be carried forward for 5 successive years and include a savings clause. A savings clause is a clause standard to all treaties that allows the country of residence to tax income otherwise exempt from taxation in the host country. The foreign person receiving income from the host country may credit the host country's tax against the resident's country tax as if the host country was actually paid a tax on such income.

It is noted that Article 216. Limitation of the Carrying Forward of a Loss, Deduction and Credits in the Case of Change of Ownership of Shares of a Legal Person has been deleted by the amendments of 14 March 2008. Deleting Article 216 opens the door to tax avoidance by allowing companies to buy tax loss companies to avoid taxation when the acquiring company expects substantial profits in subsequent years. The original 216 disallowed an acquirer's carry forward losses, unless the acquirer continued the loss company's business for three years, but this would require filing three amended tax returns in the fourth year. The best way to stop avoidance but at the same time financially assist legal persons with losses, prevent insolvency and loss of employment is to reinstate the concept of the deleted Article 216 by including a new Article 192.4, which permits the purchase of legal persons with losses, but conditions the acquirer's use of the carry forward losses to the acquirer's profits prior to the year of acquisition. The Appendix provides the language for Article 192.5.

7. Article 206 Joint Ownership

It is not uncommon for foreign persons to enter into legal business relations with a domestic person for the joint activity of performing a service or activity, producing a product or distributing a product. In this situation, each person maintains its single identity, but for the sharing of profits from the joint activity.

Article 206 applies pass-through taxation in the situation of joint ownership. However, a joint venture is not a joint ownership, since co-ownership of property is not the issue, it is joint activity. As a result, since Article 206 does not refer to joint activities, I recommend that there be an amendment to 206 by adding the term joint venture.

8. Article 215 Reorganization

This Article defines reorganization as an acquirer acquiring 50% control of a target company. Pursuant to EU Directive on Mergers, EU 90/434/EEC and the model Treaty provisions on cross border reorganizations, tax-free reorganizations are afforded the acquirer and the target if only 10% of the target is acquired. I therefore recommended that Article 215 be amended to address reorganizations of cross border transactions.

It should also be noted, that Article 215 and Article 213, Liquidations, define control as acquiring a 50% or more interest. I recommend that the 50% interest be changed to 51%, or more, since control is not established by a 50% interest.

9. Article 217 Submission of Tax Return

Although the filing of consolidated returns is not an issue of double taxation, it is an issue regarding foreign direct investment, since consolidated returns is a standard procedure in developed countries. Therefore, I have drafted an amendment to Article 217 permitting consolidated returns among legal persons and two or more permanent establishments of a foreign parent.

10. Article 218, Procedure for Withholding Tax at Source of Payment

Article 218 describes the procedure for the withholding and reporting of payments to foreign persons. The procedures, however, do not adequately describe the information required of a foreign person and does not define the term revenue upon which the calculation of withholding is made. As a result I have amended this Article to include parts 6 through 9 to avoid any confusion.

V. CONCLUSION

This Report recommends 33 amendments to the Tax Code. The 14 March 2008 amendments legislated into Law and the amendments recommended in the Report on International Financial Center include another 30 amendments for a total of 60 or more total amendments.

It is recommended that the Income and Profit Tax sections of the Tax Code be rewritten to include the new amendments and delete provisions contradictory to the amendments. The basic principle of a good Tax Law is that it must be simple, clear and consistent. The inclusion of so many amendments results in a very complicated and unclear Law.

I also recommend that the new draft of the Income and Profit Tax sections include provisions for Micro (small), and Medium enterprises. This is standard Best Practice Taxation in developed countries and should be a standard in Georgia to attract Foreign Direct Investment. The implementation of enterprise categories will also reduce the shadow economy, promote economic expansion and increase Government tax revenue.

The USAID Business Climate Reform Projects looks forward to assisting the Government in its establishment of a clear, internationally accepted tax law.

Appendix

Amendments for Double Taxation

Amendment 1.

Delete the definition of family Article 12.8

Amendment 2.

Delete Article 12.11 and replace with new definition of Dividend

Article 12.11 **Dividend** – A dividend means any distribution out of the profit in money or in kind by a legal person to a stockholder of the legal person that is made by reason of the ownership of stocks in such legal person, except for the following:

- (i) any distribution of additional stock that does not change the percentage ownership of the stock of any stockholder of the legal person;
- (ii) any distribution in money or in kind made in connection with the redemption of stock of the legal person, other than a redemption of stock that is part of a plan of redemption that does not change the percentage ownership of the stock of any stockholder of the legal person; or
- (iii) any distribution in money or in kind made in connection with the liquidation of a legal person.

Amendment 3

Delete definition of royalties in Article 12.13 and replace with:

Article 12.13. **Royalty.** Royalty means any amount required to be paid in money or in kind for the use of, or the right to use, any of the following:

- a) any copyright of a literary, artistic or scientific work, including films or tapes for radio or television broadcasts or other transmissions to the public, and audio or video recordings;
- b) any patent, invention, innovation, license, trademark, trade name, franchise, design, drawing, model, plan, sketch, secret formula or production process, or software;
- c) any direct or indirect cable transmission, relay transmission, or satellite transmission;
- d) any information or knowledge concerning industrial, commercial or scientific experience;
- e) the name or image of any physical person or other similar rights with respect to a physical person;
- f) the right to record or broadcast a performance, show, sporting event or other similar activity.

Amendment 4

Add Article 12.48, Definition of Lease

Article 12.48 **LEASE** - A lease is a contractual agreement by which one party gives the right of usage in property to another party, for a limited period, subject to various conditions, in exchange for something of value, but still retains ownership. A lease contract can involve any property that is not illegal to own. Leases include agreements for leasing real estate and apartments, manufacturing and farming equipment, and consumer goods such as automobiles, televisions, stereos, and appliances.

Amendment 5

Add 22.10 c)

c) In those cases where the related parties consist of a domestic person and a foreign person, each jurisdiction shall cooperate with each other and jointly agree upon the proper allocation of transfer pricing respective to their jurisdiction.

Amendment 6

Article 22.10 b) delete word “actual price” and replace with word “market price”.

Amendment 7

Delete Article 23.2 and replace with:

2). Natural Person related to Legal Person and Legal Person related to another Legal Person.

(a) A physical person or a close member of the family, defined in part 3 herein, of that person is related to a reporting company, if either physical person:

(i) is a member of the key management personnel of the reporting company or a parent of the reporting company or another company doing business with the reporting company;

(ii) has control over the reporting company, meaning owning directly or indirectly 25% or more of the stock of the reporting company, for this purpose, a physical person is considered to indirectly own stock that is owned by his or her spouse, parents, grandparents, children, stepchildren brothers and sisters.

(iii) has joint control or significant influence over the reporting company.

(b) A company is related to a reporting company if:

(i) the company and the reporting company are members of the same group, which means that each parent, subsidiary and fellow subsidiary, and brother-sister relationship are related to the others;

(ii) the reporting company is a group member or joint venture of the company (or of a member of a group of which the company is a member);

(iii) the company is a group member or joint venture of the reporting company (or of a member of a group of which the reporting company is a member);

(iv) the company is controlled by a person identified in (a);

(v) the company is one in which a person identified in (a)(i) or (a)(ii) owns 25% or more of the stock of the reporting company or has joint control or significant influence over the reporting company; or

(vi) a member of the key management personnel of the company, or a parent of the company, has control, joint control or significant influence over, or 25% or more of the stock in the reporting company

Amendment 8

Delete Article 23.3 and replace definition of related natural persons with:

3). Related physical persons, means a husband and wife and family members as follows:

1. Lineal descendant: child, grandchild, great-grandchild, step-lineal descendants such as stepchildren.
2. Brother and sister, including stepbrothers, stepsisters and half-brothers and half sisters.
3. Lineal ancestor, which means parent, grandparent, great-grandparent, and on up the lineal trunk of the family tree; step-lineal ancestors are included.
4. Niece, nephew, aunt, or uncle (not including relations by marriage).
5. In-law, which means father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, and sister-in-law.
6. Anyone else who is not related to the physical person, but who lived in the physical person's home for the entire year and which is not the physical person's spouse.

Amendment 9

Amend Article 24.1 a) by adding:

- a) income earned from employment in accordance with Article 16 of this Code and Article 34.2 of this Code, except that income paid to foreign Directors by the domestic permanent establishment or subsidiary is considered source income ;

Amendment 10

Amend Article 24.1 n). to include the following language:

- n). income earned from management, financial and/or insurance (including reinsurance) services of a Georgian enterprise or a permanent establishment of non-resident in Georgia to include income earned from reserves held in Georgia;

Amendment 11

Amend Article 24.1 e) to include the following language:

- e).income earned in the form of dividends from resident legal person and sale of the partner's share in such legal person, except for dividends paid by a subsidiary or profits by a permanent establishment to its foreign parent owning a 10% or more equity interest;

Amendment 12

Amend Article 24.1 h) to include the following language:

- h). income earned in the form of interest from non-resident having permanent establishment in Georgia or having a property located on the territory of Georgia if outstanding liabilities of such person are related to its permanent establishment or property, except for loan interest payments

paid by a subsidiary or by a permanent establishment to its foreign parent owning a 10% or more equity interest, if the subsidiary or permanent establish did not deduct the interest payment in the computation of its Tax Base;

Amendment 13

Amend Article 24.1 i) to include the following language:

i) income earned in the form of royalties related to rights or property used in Georgia; income as defined by the part 13 of the article 12 earned through sale or transfer of the property used or existing in Georgia, except for payments paid by a subsidiary or by a permanent establishment to its foreign parent owning a 10% or more equity interest, if the subsidiary or permanent establish did not deduct the royalty payment in the computation of its Tax Base;

Amendment 14

Amend Article 24.1 p) to limit source to services performed exclusively within the territorial boundaries of Georgia.

p) income earned from telecommunications or transportation services in course of international communications or transportation conducted exclusively within the territory of the Republic of Georgia by a foreign person, as opposed to cross-border services.

Amendment 15

Add Article 24.1 r) Sports and Entertainment Income

r) income from entertainment or sporting activities carried out in the Republic of Georgia regardless whether the income is received by the entertainer or sportsman or by another person or legal person in behalf of the entertainer or sportsman;

Amendment 16

Add Article 24.1 s) Income of Professors, Teachers, Researchers and Students

s) income paid to professors, teachers, researchers and students employed by a private legal person pursuant to Articles 16 and 34.2 of the Tax Code, if, however such persons exceed the conditions of Article 34.2, then source income only applies for a period of 12 months over a two year period if such income is paid for services performed for a public institution, college, university or charitable institution.

Amendment 17

Add Article 24.1 t) income of joint ventures and joint ownership

t) income or profits paid to a joint venture participant or partner in a domestic joint venture or partnership.

Amendment 18.

Amend Article 29.2 a) and b) by providing time period qualification:

2.The following are equivalent to a permanent establishment:

- a) construction sites, assembly or building facilities as well as the implementation of controlling activities connected with such facilities if such activity exceeds a period of 6 months within a 12 month period of time;
- b) installations or sites, drilling equipment or ships used for surveying of natural resources, as well as the implementation of controlling activities connected with such facilities, if such activity exceeds a period of 6 months within a 24 month period of time;

Amendment 19

Delete Article 29.4

Amendment 20

Add Article 29.13 Independent Personal Services

13. Services performed by foreign person providing independent consulting or advise, shall not be considered a permanent establishment if the foreign independent consultant or advisor does not maintain a fixed base of operations within the Republic of Georgia.

Amendment 21

Delete Article amendment 192.1 and move the amendment to the deleted Article 193.

Amendment 22

Reinstate Article 193 and include as part 1 the language of amendment 192.1. The new Article 193 would be as follows:

Article 193. Foreign Tax Credit

1. Sums of profit tax paid outside Georgia will be credited at the moment of tax paying in Georgia for income, which has not been generated from the source in Georgia
2. According to part 1 of the present code, the amount of sums credited should not exceed the sums of the tax, which would have been accrued according to the rule and rates on this income and profit effective in Georgia.

Amendment 23

Add to Article 192 part 3

3. In the case of a foreign permanent establishment of a Republic of Georgia legal person produces a loss, such loss is not available against the Republic of Georgia's legal person's domestic tax base.

Amendment 24

Amend Article 192 to include part 4, consolidating losses of two or more permanent establishments

4. In the event a foreign parent operates two or more permanent establishments within the Republic of Georgia, the net operating losses of each permanent establishment may be consolidated for the purpose of filing a single annual tax return.

Amendment 25

Amend Article 192 to include part 5 regarding the application of net operating losses by an acquirer of a loss company.

5. If more than 51% of the stock in a legal person are acquired by another legal person, than any unused fiscal loss of the acquired legal person on the date of the acquisition may be used only to reduce the profit that is attributable to an economic activity that was carried out by the acquiring legal person prior to the date of acquisition.

Amendment 26

After reinstating Article 193 with the language of Article 192 amendment 192.1 I would add as part 3:

3. In the event of any excess foreign tax the excess may be carried over for up to 5 fiscal years subject to the same limitations stated in part 2 for such fiscal years.

Amendment 27

Amend reinstated Article 193 by providing a savings clause as part 4.

4. In the event the Republic of Georgia exempts a tax on income, the tax that would have been paid but for the exemption, may be credited against a foreign person's resident tax as if the tax was paid to the Republic of Georgia.

Amendment 28

Article 206 should be amended to include pass-through taxation of joint ventures

Article 206. Joint Ownership

In the case of joint ownership (co-ownership) that involves ownership by more than one person but without establishment of a legal person or a joint venture that does not involve co-ownership but rather a joint activity by more than one person that does not establish a legal person, the taxable income shall be attributed to the joint owners and joint venture participants pro rata their shared and included in their joint income.

Amendment 29

Amend Article 215 to add part 12 regarding cross-border reorganizations.

12. In case of cross border reorganizations between a Republic of Georgia legal person and foreign legal person, the same rules stated in parts 1 to 11 apply except that control is reduced from 51% or more to 10% or more.

Amendment 30

Amend Article 215 by deleting control as “50% or more” to “51% or more”.

Amendment 31

Amend Article 213, Liquidations, to delete the term “50% or more” and change to “51% or more”.

Amendment 32

Amend Article 217 by including part 14 permitting consolidated returns.

14. Republic of Georgia legal persons may file a Consolidated Annual Tax Return if the legal persons meet the following conditions:

(1) An affiliated group of legal persons all located within Georgia may elect to file a Consolidated Annual Tax Return in accordance with the Regulations to this Law.

(2) For purposes of this Article an affiliated group of legal persons is a group of one or more Georgia legal persons that are connected through the ownership of stock with a common parent provided that:

(i) The common parent owns at least 80% of the stock in at least one other legal person that is included in the affiliated group; and

(ii) If the common parent does not own at least 80% of the stock in a legal person that is included in the affiliated group, then the parent may file a consolidated return if one or more other legal persons that are included in the affiliated group own at least 80% of the stock in such legal person;

(3) If a foreign legal person has two or more permanent establishments performing economic activity within Georgia, the foreign legal person may aggregate the economic activity of each permanent establishment for the purpose of determining tax base and filing a consolidated Annual Tax Return.

Amendment 33

Amend Article 218 by adding parts 6 to 9.

6. The tax to be withheld from income payments to a foreign legal person is based upon the total income paid. The total income paid means the income that would have been paid to the foreign legal person if tax had not been withheld from the payment of the income.

7. If the beneficiary of income to which the withholding of tax applies is a resident of a foreign state that has entered into a Treaty with the Republic of Georgia regarding taxes on income,

then for purposes of part 6 above the tax rate applicable to each such source of income is not to exceed the tax rate applicable to such source of income that is specified in the Treaty.

8. An exemption from tax or a lower rate of tax specified in a Treaty with a foreign state is to apply to income to which the withholding of tax applies only if the foreign person beneficiary of the income provides to the payer of the revenue a certificate of establishment or residence issued by the Government of the foreign state or other evidence of residence specified by the Tax Administration of Georgia.

9. Any person that is required to withhold tax in accordance with the provisions of this Article from income paid to a non-resident person is to submit an annual withholding return to the Tax Administration Office on or before the 30th day of January of the year that follows the year the tax withholding is required. The withholding return for a year is to include the following information for each foreign person on whose behalf tax has been withheld for such year:

- a. The name of the person and the country of its establishment or residency;
- b. The type and the total amount of income to which the withholding of tax applies;
- c. The amount of tax required to be withheld;
- d. The amount of tax withheld and remitted to the Government.