



LEASING DEVELOPMENT IN GEORGIA

REPORT

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REPORT

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ABSTRACT

The purpose of this report is to provide recommended actions that the Government of Georgia and the private sector can undertake with the support of international donors and agencies to grow capital formation and access to financing by furthering the use of financial leasing. These actions are recommended as three steps, including:

- Amendments to Civil, Tax and Banking Laws in Georgia to address current shortcomings while enacting a comprehensive Leasing Law, based on international best practices;
- Capacity building by providing expertise and applied knowledge to private sector players and government officials to apply the law and practices in order to achieve the objectives of sustainable capital formation and access to financing, within a framework of furthering foreign investment in Georgia; and
- Business development, by bringing relevant international players, such as equipment vendors and international financial institutions to provide equipment and funding to Georgia through their interaction and undertakings with Georgian leasing players.

ABBREVIATIONS

EPI	USAID Economic Prosperity Initiative
GDP	Gross Domestic Product
GEL	Georgian Lari (currency)
IAA REPORT	Report prepared by International Advisory Associates
IAS 17	International Accounting Standard No.17 issued by the International Accounting Standard Board: Accounting for Leases
LEASEEUROPE	European Federation of Leasing Company Associations
ROA	Return on Assets (Net profits/total assets)
ROE	Return on Equity (Net profits/total equity)
TBC LEASING	Subsidiary of the T'bilisi Banking Corporation (TBC Bank)
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
USAID	United States Agency for International Development
VAT	Value Added Tax

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EXECUTIVE SUMMARY

Georgia is an outstanding country with a very strong history, tradition, and a hard working population based. The country is currently positioning itself to attract capital to increase economic growth. One highly effective tool to achieve this objective is leasing.

Within the last decade, Georgia intended to create a valid framework to encourage the growth of leasing activity. Unfortunately, well-intended policy steps failed to address the right issues and as a result, the Georgian leasing industry faced one of the most hostile and negative legal frameworks in the world. While Civil and Commercial Law issues demonstrated overall progress, these laws created an environment that punished and prevented more players to invest in the leasing industry. For example, Civil Law imposed on lessors the obligation to refund to delinquent lessees any potential excess of proceeds of sale value over the outstanding balance of the lease, disregarding the right of lessors to claim damages and to compensate the risk taken in transactions.

An even worse issue, however, came from the Tax Code. Leasing companies were required to pay confiscatory effective tax rates due to the combination of several issues including the application of legal presumptions, misunderstandings about the economic reality of the business, and the importation of foreign accounting standards into the Tax Policy.

The leasing industry in Georgia has financed no more than GEL 40 million to date, which represents 0.2% of the Georgian GDP. The leasing industry has no more than three active players in the market place and a potential of hidden non-specialized players, who may or may not be applying best practices in leasing. The market penetration of leasing is too low, due to the legal reasons listed above.

The following report provides a gap analysis between the existing legal framework of leasing companies and best practices of the industry. Subsequently, it includes suggested changes to the existing laws, by means of a unique and systematic Leasing Law, which is intended to fully regulate the subject matter, while at the same time being able to be embedded into the existing Codifications and Statutes in force in Georgia.

However, this report also suggests going beyond changing the law. Recommendations are also provided for follow-up activities to

- Build the capacity of Georgian stakeholders, both in the private and the public sector.
- Increase support of leasing.
- Encourage global suppliers of both capital goods and funding to enter the Georgian market and participate in its efforts for economic development.

This report is the result of a collaborate process including the Business Association of Georgia, the Association of Georgian Leasing Companies, their consultants and the work of USAID's Economic Prosperity Initiative (EPI) experts.

INTRODUCTION

Georgia is a country with a rich history that predates most developed countries in the world. This history reaches as far back as when the region of present day Georgia included the ancient kingdoms of Colchis and Kartli-Iberia. The area came under Roman influence in the first centuries A.D. and Christianity became the state religion in the 330's. Domination by Persians, Arabs, and Turks was followed by a Georgian golden age (11th-13th centuries) that was cut short by the Mongol invasion of 1236. Subsequently, the Ottoman and Persian empires competed for influence in the region. Georgia was absorbed into the Russian Empire in the 19th century. Independent for three years (1918-1921) following the Russian revolution, it was forcibly incorporated into the USSR until the Soviet Union dissolved in 1991.

On April 9, 1991, Georgia regained its independence.

Very little has been written about Georgian legal history. However, under the presumption that the law is very closely connected to the "volkgeist", i.e. the "soul of the people", it can be asserted that the legal system and attitudes of Georgians toward the law demonstrates that the Roman Law system prevails (as we understand, with a large influence of the German Civil Code of 1900), but that in terms of its application there is still some heritage of the culture of prohibition that prevailed during the Soviet era.

Unfortunately, the quality of life in Georgia has not achieved the level it should have achieved after transforming into a free market economy. One could wonder whether the stakeholders responsible for application of the law view free market institutions with suspicion. This is one of the concerns associated with the challenging mission to write a sustainable leasing law for Georgia.

As the German jurist Hans Kelsen observed¹, the life of the law has three basic moments:

- The moment of its creation,
- The moment of its implementation, when the concerned parties (both private and public parties) put the law in motion to regulate their respective businesses,
- Moreover, the moment when the authorities need to define the law ("jurisdiction") either to solve conflicts or to gauge the taxes that the parties must pay to contribute to the public welfare.

Therefore, it is simply not enough to write a "good" leasing law. It is also necessary to ensure that the appropriate stakeholders embrace and implement such a law, and exercise the empowerment that this law would bring to them. Furthermore, it is necessary that the authorities understand the rationale and values inspiring the law, so that they apply the law with justice, certainty, and clarity.

Georgia is currently considered one of the best places to do business in the world according to the World Bank's rating of "Doing Business." At present, Georgia ranks

¹Kelsen, Hans. Pure Theory of Law, The Lawbook Exchange, Ltd. (June 30, 2009) ,ISBN-10: 1584775785 , ISBN-13: 978-1584775782

12th in the world, which is outstanding compared to all other Eastern European countries². This ranking is highly influenced by what is considered the ease of starting a business and registering property in Georgia. However, the country still lags behind a large number of countries in terms of “getting credit,” “protecting investors,” “paying taxes,” and “enforcing contracts.” All these issues will be addressed by the new leasing law, which will contribute to bring Georgia up in the global ranking.

The Georgian economy, while growing (in 2010, GDP growth was 6.3%), is still weak. Georgia’s main exports are scrap metal, wine, mineral water, ferro-alloys, nuts, aircraft, copper, ammonium nitrate, and gold (mostly commodities). Georgia’s main export markets include the countries of the former Soviet Union, the EU, Turkey, and the United States.

Georgia imports mainly petroleum products and natural gas, motor cars, medicines, sugar, turbines for power generation, aircraft, wheat, and electric power. After years of declining domestic industry, most consumer goods are imported from abroad as well. Turkey, Russia, Ukraine, Germany, and Azerbaijan are Georgia’s main sources of imported goods. Oil and gas imports dominate the range of goods imported from Azerbaijan.

It appears very clear that the country requires both import substitution and export diversification and growth. This is particularly challenging facing the Russian embargo for Georgian goods.

In this context, a sound leasing law would empower Georgian stakeholders to:

- Generate more production of goods and services substituting imports within a competitive supply chain,
- Expand and diversify the export of goods and services (wine production and tourism are good examples of fields where the leasing industry must focus), and
- Fuel the upgrade of infrastructure for business and daily life, including but not limited to investments in transportation infrastructure (such as ports, airports, rail projects and roads), energy, and information technology and communications.

Therefore, the purpose of this report and its inserted draft law is to serve as a basis for such empowerment and to ensure that this law is embraced in order to extract the best benefits of leasing.

² World Bank. Doing Business. In: <http://www.doingbusiness.org/data/exploreeconomies/georgia>. Last visited:5 March 2011

GENERAL LEGAL POLICY CONCEPT ON THE GEORGIAN LEASING SECTOR

GENERAL POLICY CONCEPT

Leasing is an effective tool for catalyzing sustainable economic development. By means of leasing, certain specialized companies (leasing companies) funnel investments directly into capital goods (in particular equipment) to grant their use to entrepreneurs. This in turn generates increased revenues, jobs, profits, and taxes all of which benefit the economy.

The contribution of leasing to economic development is so obvious that most multilateral organizations such as the World Bank consider leasing one of their top priorities to generate the sustainable development. Furthermore, empirical studies conducted both in the United States and Europe prove that there is a close and clear connection between a developed leasing industry and the growth and welfare of a national economy. In the United States, the Equipment Leasing and Finance Association conducts surveys about the State of the Industry on an annual basis and correlates the behavior of the leasing industry with the behavior of the economy³. In Europe, Leaseurope undertakes similar empirical studies⁴.

As leasing markets mature, they require the coexistence of three types of leasing companies:

- Bank affiliated leasing companies,
- Vendor related leasing companies or “Captives,” and
- Independent leasing companies.

Once a leasing environment is perceived as “friendly,” foreign investment will be driven, mainly by banks and equipment vendors increases. The coexistence of these three groups of players enhances competition and innovation, which have proven to be critical for the sustainable growth of economies.

As such, a legal policy for leasing must address at least the following goals:

- Attract investment (both domestic and foreign) into the leasing business. Private persons, companies and corporations must be attracted by the leasing business on the grounds that the law shall provide the goals indicated below;
- Provide certainty in the rules that govern leasing, so that investors can anticipate, manage, and prevent associated risks, including credit risks, asset risks, residual

³ Equipment Leasing and Finance Association. 2010 State of the Equipment Finance Industry Report, Financial Institutions Consulting, Inc. available at: <http://www.store.leasefoundation.org/cgi-bin/msascart.dll/ProductInfo?productcd=SEFI2010>

⁴ See Leaseurope Report, March 3, 2011 at www.leaseurope.org, and European Commission, DG Ecofin, Autumn Economic Forecast. The Commission services' autumn 2010 forecast is based on available data up to November 15 2010

risks, funding risks such as market risks impacting cost of funds, liquidity risks, country risks, and regulatory risks;

- Provide conditions for leasing companies to deliver competitive returns after taxes to investors. Therefore, the tax system must be dynamic, fair, equitable, predictable and simple, while encouraging investors to trust in tax rules;
- Create a short cash-to-cash cycle for lessors even in extreme cases of delinquency, by setting the conditions for quick turnarounds in repossession and disposition of leased assets in case of material defaults;
- Provide the conditions necessary to encourage leasing companies to support the recovery of distressed businesses, in particular those affected by extraordinary events, such as the war, the Russian embargo, the global financial crisis and other;
- Encourage the creation of sustainable secondary markets for equipment; and
- Offer a framework that permits the expansion of domestic and global capital markets to funnel resources into the leasing business, eliminating unnecessary obstacles that otherwise are imposed for funding mechanisms widely used by leasing companies.

THE GEORGIAN LEASING INDUSTRY

A study prepared by TBC Leasing describes the size and features of the leasing industry in Georgia⁵. In essence, this is a market with three relevant players, with the following market share:

Market Share

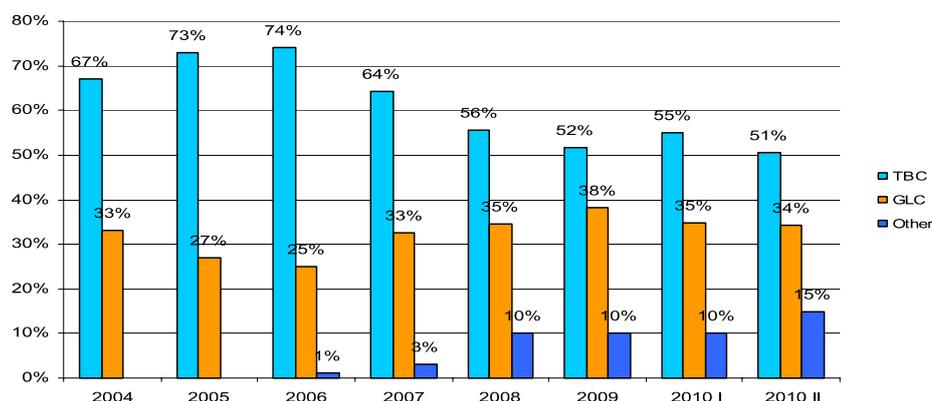


Figure 1: Georgian Leasing Industry Market Share

⁵ Georgia, TBC Leasing, Info Memo FY 2010

The estimated size of the leasing market is also indicated in the aforementioned study. This shows that the portfolio of the Leasing Industry in Georgia may be around the number of GEL 42,000,000 or approx. US\$ 25 million, a number that represents around 0.2% of the GDP of the Georgian economy. This is, of course, a very low figure and it clearly represents the large potential that the Georgian leasing industry has for growth:

GENERAL MARKET ASSUMPTIONS

	2004	2005	2006	2007	2008	2009	2010
MARKET FORECAST							Forecast
-	-	-	-				
Nominal GDP, mGEL	9,824,000,000	11,620,000,000	13,783,000,000	16,234,320,000	21,342,720,000	18,038,060,000	20,340,000,000
TBC Lease Portfolio	\$ 2,152,712	\$ 6,440,119	\$ 9,816,940	\$18,126,000	\$16,952,807	\$8,908,919	\$14,000,000
TBC Lease Portfolio in GEL	3,928,698.50	11,543,912.68	16,821,326.39	29,364,120	28,267,110	15,018,655	25,200,000
Market Share	67%	73%	74%	60%	60%	60%	60%
Market Estimate in Gel	5,863,729.10	15,813,579.01	22,731,522.15	48,940,200.00	47,111,850.20	14,848,197.94	42,000,000
Lease Market / GDP	0.06%	0.14%	0.16%	0.30%	0.22%	0.08%	0.21%
Market Demand Estimate	49,120,000	58,100,000	68,915,000	81,171,600	106,713,600	90,190,300	
as a % of GDP	0.5%	0.5%	0.5%	0.50%	0.50%	0.50%	

Figure 2: Estimated Size of Georgian Leasing Industry

It is clear that the current size of the Georgian leasing industry is very small. The country has unlocked opportunities in agriculture, food processing, oil and gas-related industries, power generation and distribution, tourism facilities, rail and road transportation, ports and airports, mining, information technology, and telecommunications. All these sectors can be stimulated with more access to leasing.

The following figure demonstrates the basis to calculate the potential of the leasing industry:

	2008	2009	2010	2011	2012	2013	2014	2015
	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
National accounts								
Nominal GDP (in million lari)	19,075	17,986	20,490	23,018	25,619	28,514	31,737	35,323
Real GDP growth	2.3	-3.8	6.3	4.5	5.0	5.0	5.0	5.0
Population (in million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
GDP deflator, period average	9.7	-2.0	7.2	7.5	6.0	6.0	6.0	6.0
Consumer price index, period average	10.0	1.7	7.0	8.8	6.0	6.0	6.0	6.0
Consumer price index, end-of-period	5.5	3.0	10.5	6.0	6.0	6.0	6.0	6.0
GDP per capita (in US\$)	2,937	2,455	2,618	2,880	3,089	3,338	3,607	3,898
Unemployment rate (in percent)	16.5	16.9
	(In percent of GDP)							
Investment and saving								
Investment 2/	21.5	14.4	15.0	17.2	18.9	20.3	21.2	21.3
Public	4.3	6.9	7.2	6.4	6.1	5.8	5.8	6.0
Private	17.2	7.6	7.8	10.8	12.8	14.5	15.4	15.3
Gross national saving	-1.2	3.1	3.4	4.6	7.5	9.7	11.3	12.2
Public	2.2	-0.8	1.9	3.3	3.6	4.0	4.2	4.1
Private	-3.4	3.9	1.5	1.3	3.9	5.7	7.1	8.1
Saving-investment balance	-22.7	-11.3	-11.6	-12.6	-11.4	-10.6	-9.9	-9.1

Figure 3: IMF Macroeconomic Data

Based on the data, we assume that the Georgian Leasing industry can achieve a penetration rate between 20% and 30% of total capital expenditure. In these terms, the potential of new business is indicated as follows:

	2008	2009	2010	2011	2012	2013
Nominal GDP	19,075.00	17,996.00	20,490.00	23,018.00	26,619.00	28,514.00
Investment	21.50%	14.40%	15%	17.20%	18.90%	20.30%
Leasing (20%)	820.23	518.28	614.70	791.82	1,006.20	1,157.67
Leasing (30%)	1,230.34	777.43	922.05	1,187.73	1,509.30	1,736.50

Figure 1: Calculation of the Leasing Potential

Based upon the above calculations, the Georgian leasing portfolio may reach an approximate value of GEL 4.5 billion in the next three years, which would represent a multiple of 100 over the current level. As a next step, it is necessary to undertake a gap analysis to make ensure that Georgia can possess the necessary conditions to develop its leasing industry as shown in the table above.

GAP ANALYSIS BETWEEN CURRENT LAWS AND REGULATIONS AND A SOUND LEGAL POLICY FOR LEASING

The current law in Georgia regulates the financial leasing contract by means of articles 576 through 580 of the Civil Code and in the 2002 Law on promotion of leasing activities. The following is an analysis in comparison with the reality and best practices of the leasing business worldwide:

ARTICLE 576: CONCEPT CONTENT.

1. *Under a finance lease contract, the lessor is obligated to transfer to the use of the lessee, the specified property for a term fixed by the contract. The lessee is obligated to pay compensation to the lessor in accordance with the specified periodicity.*
2. *The lessor is obligated to produce or purchase the property specified under the contract.*
3. *The finance leasing agreement may obligate or entitle the lessee to either purchase or rent the object of the finance lease upon expiration of the term of the agreement, unless the contract ends with the complete depreciation of the thing. In assessing the final value of the thing the fact of depreciation shall be taken into account in any event. Unless there is a contrary provision in the contract, the lessee shall be entitled to purchase the object of the finance lease.”*

One key deficiency of this definition is that it ignores the critical facts that shape a leasing agreement. In Civil Law, the exteriorization of the intention of the parties is critical to understanding the real nature of any agreement. The article above shows

the appearance of the contract but fails to describe the key elements that bind the parties into the lease, namely:

- The need of the lessee to obtain the right to use certain goods, which he or she otherwise could or would not be able to use for lack of financial resources to pay for it in cash terms, or for the conscious choice to use cash for other purposes
- The decision made by the lessor, prior deliberation and credit risk evaluation, to enter into the purchase agreement with the supplier or seller of the goods because such a purchase generates the possibility for the lessor to recover his or her investment in the asset through the financial amortization of its cost through the payments, and eventually, in certain cases, through the proceeds of the value of change or value of use of such assets, beyond the original term of the lease.

Nothing of that sort is indicated in such provision of the Civil Code. Furthermore, none of the further paragraphs of Article 576 help to provide a description of the transaction that should look similar to what the best practices apply.

ARTICLE 3. LEASING AGREEMENT

The gap increases when Article 3 Law of Promotion of Leasing Activities supplements the definition under Article 576, as follows:

1. *An agreement made by the parties for accounting and reporting shall be deemed the leasing agreement if it contains one of the following provisions:*
 - a) *upon expiration of the leasing agreement term the Lessee becomes the owner of the leasing subject in such way that shall not pay any additional amount or such amount is very small;*
 - b) *the term of leasing agreement is essentially equal or exceeds the term of economic maintenance of the leasing subject and the Lessee becomes the owner of the leasing subject by payment of a small amount;*
 - c) *the term of leasing agreement is essentially equal or exceeds the term of economic maintenance of the leasing subject and the Lessee has not right to terminate the leasing agreement at least without the full payment of the leasing charge;*
 - d) *upon expiration of one or some initial terms determined by the leasing agreement the Lessee undertakes to prolong leasing for the full or essentially full term of the economic maintenance of the leasing subject, or to buy the leasing subject;*
 - e) *upon expiration of one or some initial terms determined by the leasing agreement the Lessee has the right to decide whether to prolong or not the leasing for the full or essentially full term of the economic maintenance of the leasing subject without payment of the additional amount or by payment of the amount significantly smaller than the*

market price of the leasing price by the moment of prolongation of leasing;

- f) *upon expiration of one or some initial terms determined by the leasing agreement the Lessee has the right to decide whether to become or not the owner of the leasing subject without payment of the additional amount or by payment of the amount significantly smaller than the market price of the leasing subject by the moment of becoming the owner.*

In addition to any provision of Clause 1 of this Article the leasing agreement shall provide, as a rule, when the leasing subject is deemed as accepted as well as the date of acceptance thereof.”

This article is an insufficient copy of the provisions of the International Accounting Standard No.17, which is already announced to end soon, since in the framework of the convergence between the accounting rules of the Financial Accounting Standard Board and the International Accounting Standard Board, there is already an Exposure Draft that contains an entirely new set of accounting rules. Aside from the fact that this rule will be inapplicable, another key concern is that accounting principles should not define Civil and Commercial Law. The rights and obligations of the parties involved in leasing transactions should be subject to the general principles of the law. The register and accounting should be dependent on economic realities, not changes in the law.

In addition, this provision and all other provisions of the Law on the Promotion of Leasing fail to achieve the title of the law. They include, for example, a provision that is inconsistent with any leasing law in the world and establishes an obligation for the lessor to reward a defaulting lessee by returning any excess value coming out of the proceeds of the repossessed asset. This provision is clearly contrary to international best practices, certainly discourages investment in leasing business as it fails to provide an adequate balance between risk and rewards, and rewards breach of law and contracts by lessees.

OTHER LEGAL ISSUES

Further issues were also identified in the current regulatory environment affecting the leasing industry and are outlined in the following sections.

DEFINING LEASING TRANSACTIONS

Currently, there is no accurate definition of leasing transactions in Georgia. A leasing transaction is a financial transaction, whereby the lessor assumes the role of provider of financing to the lessee, who demands the equipment for his/hers/its business purpose. It is critical for this definition to be inserted in the Georgian Law because this is exactly what explains the difference between a rental agreement and financial leasing⁶.

⁶ Note that the definition “financial leasing” does not anything to do with the accounting definition of “finance lease” or “capital lease”. Financial leasing is a legal concept referred to the feature of a transaction that is financial in its essence, no matter what is the economic calculation of the rentals, or whether or not the lessor or the lessee can be deemed as acting as owner or user. This is beyond such discussion.

Likewise, there is no provision in the Law that provides an effective remedy to the lessee when the lessee may have a claim against the supplier. The current law endorses an inefficient approach of forcing the lessee to claim to the lessor for deficiencies of the asset, who in turns should claim against the supplier. Best practices in leasing law, notably under the 2008 UNIDROIT Model Law on Leasing, provide a direct remedy to such a situation.

A serious issue resulting from the lack of an accurate definition about leasing is the omission of the standard “hell or high water” clause. This clause is essential in financial leasing because it provides a clear explanation that the lessee’s obligation to pay rentals under the lease is precisely the source of recovery of the investment made by the lessor in the asset. Whether or not the lessee uses the asset, or whether or not the asset is operating are risks and circumstances that every lessee shall bear, as it should bear if it were an owner. Equity requires that the obligation to pay rentals shall be unconditional. This is due to the fact that such an obligation is designed to provide recovery of the investment to the lessor. At present, this clause is not in any provisions of the Civil Code or the Law on Promotion on Leasing, and as such, the Georgian system fails to provide the most elementary legal protection to any lessor.

TAX ISSUES

Currently, the tax system for leasing companies is highly discriminatory. A recent study commissioned by the Business Association of Georgia identified several points to be addressed⁷. These points are outlined in the following section.

Leasing transactions and companies are subject to three basic taxes:

- Companies are subject to profit tax at a prescribed rate of 15% (while individuals are subject to Income Tax subject to a prescribed rate of 20%);
- There is a property tax that is assessed over up to 1% of the value of assets
- Leasing is subject to Value Added Tax (VAT) as it is in a large number of countries. The VAT rate is 18%. The rules of Value Added Tax seem to be aligned to best practices and they do not create major issues amongst the practitioners, whilst both profit tax and property tax generate issues.

One of the most concerning issues regarding profit tax in Georgia is that the country’s tax policy is entirely subordinate to and reliant on the standards of a private international body, namely the International Accounting Standard Board. While this type of professional body is technically respectable, relying upon its standards leads to instability in the tax policy and subordination to third party decisions.

In particular, the tax law currently applies rules under International Accounting Standard No.17 (IAS 17) which require lessees to capitalize certain leases, while it requires lessors to keep other leases in their fiscal assets. The practical application of these provisions (in particular Article 17 of the Tax Code) is difficult in a civil law environment, where property rules are based upon the acquisition of title and its

⁷ International Advisory Associates: “Report on the Changes Needed to Achieve a Dynamic Georgian Leasing Industry with Best International Practices”, 22 February, 2011.

permanence rather than financial criteria that demand tax collectors to undertake sophisticated and expensive tests.

Another issue is property tax. It is a tax burden that generates an important effect in the profitability of leasing companies. For the sake of an example, a 1% property tax imposed over total assets of a company represents a 1% burden to the return of assets (ROA). This means that the impact of property tax on the return on equity of company, assuming an 8:1 leverage ratio can be assessed at an 8% burden. This means that, in this scenario, a lessor should price its deals and align its business goals to generate a competitive ROE (let us say 18% to 20% after taxes based upon country risk adjustments) by adding 8% to its goals. In other jurisdictions, property tax operates as an Alternative Minimum Tax to the equivalent of the profit tax. However, in Georgia, this is not possible because property tax is a local tax.

An additional and very specific provision related to property tax that should be reformed is the treatment of medical equipment. The current provision qualifies property tax exemption only if a medical institution owns the medical equipment⁸. This provision produces an effect contrary to what is intended, since either it deprives hospitals and medical institutions of a key source of medical equipment financing or it makes such financing more expensive.

DEPRECIATION

In addition to the general tax issues outlined above, lessors are denied the right to depreciate an asset according to its economic reality and the right to claim alternative depreciation as the rest of the economy can. This results in the effective tax rate of leasing companies being confiscatory, which ultimately becomes a serious deterrent to foreign investment. For these reasons, depreciation rules are among the most critical rules that must be reformed.

The current depreciation rules have three effects:

- They do not conform to economic reality and thus, they provide an inefficient allocation of tax incentives in the economy
- Alternative 100% depreciation is not granted to leasing companies, without a clear explanation of its rationale, but clearly creating obstacles to the formation of capital in the Georgian economy
- In the event of early termination of leases, in particular when termination occurs as a result of the lessee's default, leasing companies are subject to pay additional taxes due to the application of a depreciation system contrary to economic reality.

DISCOUNT RATES

The calculation of the net present value of leases should correspond to the current economic reality. However, it is currently established at an arbitrary discount rate (55% of the rate indicated from time to time by the Ministry of Finance⁹), which is contrary to reality. The effect of this calculation is that depreciation allowances for lessors are ultimately lower than reality. This creates an additional tax burden that

⁸Article 206 of the Tax Code.

⁹Article 17 of the Tax Code.

elevates the effective tax rate, which discourages foreign investment in the leasing industry.

Best practices suggest that discount rates should be real discount rates set forth in the pricing of each lease. A simpler solution for lessees would allow them to deduct rentals as an expense. This is a system widely used in several countries (for example, Brazil) and provides a combination of investment allowances while such capital generates revenues.

The business model in leasing is based on net earnings resulting mainly from the spread between the implicit yield, or rate of a lease, and the average cost of the lessor's funds. Economic reality creates a need for all interest incurred to be deductible either as a cost or expense. Currently, the Tax Code limits the amount of interest that is deductible for purposes of profit tax¹⁰. This is a situation that needs to be amended.

ANTI-AVOIDANCE RULES

Leasing companies are subject to certain anti-avoidance provisions, including thin capitalization and market value adjustments, which create a perception of leasing as a tax avoidance tool. However, nothing could be further from the truth. In reality, leasing companies serve the role of providers of capital, if they can raise the debt capital at least seven to eight times their equity. Provisions imposing thin capitalization based upon a prescribed maximum leverage rate of 3:1 discourage investment in leasing companies and create a serious impairment for capital formation in Georgia¹¹.

Another anti-avoidance rule that creates challenges in the leasing industry is the rule of market value adjustment, if tax revenue auditors feel that the selling price of goods may be other than the market value of the goods¹². These provisions are inappropriate for the leasing industry. In the case of leases designed to recover all or a substantial part of the cost of the asset, the residual value normally associated as the price of the purchase option of the lessee should normally be below the fair market value, since the rest of the market value has been recovered through the stream of rentals.

Furthermore, within the vendor financing business it is very common for vendors or suppliers and lessors to agree on the first granting of a blind discount to the lessor in order to subsidize the cost of a lease for the lessee. These are practices based on reality and are not conducted with the intention of defrauding the tax system. Therefore, such anti-avoidance rules are inappropriate for leasing transactions.

BAD DEBTS

There are two main aspects of bad debt. The first aspect has to do with the possibility of leasing companies to deduct bad debt reserves. This is not currently possible. The second aspect has to do with the imposed taxation on accrued and late charges and penalties associated with a defaulted lease. This imposes taxation on artificial gains.

¹⁰Article 107 of the Tax Code.

¹¹Article 123 of the Tax Code

¹²Article 147 of the Tax Code

Concerning bad debt reserves, international best practices require leasing companies to protect their financial stability by stopping accruals and building reserves of up to 50% after 90 days of past due accounts and to create a 100% reserve after 180 days. Once accruals have ceased, leasing companies are prevented from registering revenues not received and in turn generate reserves to get a protection against potential credit losses.

It is also international best practice to protect bad debt reserves from additional taxation. This practice is widely accepted because a tax relief on such reserves permits leasing companies to implement measures to deal with distressed assets in a constructive way with the potential of generating recovery to viable but distressed enterprises, as opposed to selling their receivables to vultures that would otherwise liquidate viable business, or alternatively to force liquidation at court of such businesses.

In addition, as late charges should not be actual revenues because among other things, their likelihood of recovery is slim, then such late charges and penalties must not be subject to taxation. Therefore, it is suggested that such late charges should be subject to the cash system as opposed to the accrual system that operates today.

OTHER ISSUES

There are several other specific regulatory issues affecting the leasing industry, including:

- Current provisions in the Civil Code and the Law on Promotion of Leasing Activities fail to regulate events leading to the execution, supply agreement perfection, and delivery of the assets. This deficiency leads to many conflicts and prevents lessors from entering into transactions where future delivery of the equipment will be involved.
- Current Georgian law also does not regulate the rights of lessors in cases of insolvency. It is important to define these rights in order to balance the risks of lessors in all enterprises and to provide a framework for economic recovery of companies facing economic trouble.
- The eventual bankruptcy of a leasing company should also be addressed. It is crucial that the law provide a fast, efficient, and painless liquidation process for leasing companies under distress in order to prevent systemic risks.
- There is no clear provision in the Civil Code defining how to allocate the risks of tort liability when the asset causes damages to a third party's goods or person.
- Remedies and effects of termination by cause of default need to be correctly regulated in accordance with best practices. As mentioned before, the existing provisions punish lessors, while rewarding the breach of contracts. The current provisions lack a general definition of the extent of damages according to the UNIDROIT Principles of International Commercial Contracts.

In terms of these and other issues, leasing companies have expressed to the government of Georgia a supportive disposition, while asking only that the legal and tax system reflect their economic reality. They have requested neither property tax

concessions nor revaluation of leased assets, since in most cases it is not possible for lessors to recover any surplus value of assets¹³. Normally such a surplus would ultimately favor lessees rather than lessors after the end of the lease. As far as leasing companies are concerned, the value of the assets is fixed when the assets were acquired. Also, the economic repayment source is predictable and based upon the stream of rentals.

¹³Article 202 of the Tax Code.

RECOMMENDATIONS FOR NEW LAW ON LEASING AND TAX CODE

Based on the gap analysis outlined above, the following actions are recommended:

- Lessors shall be able to depreciate the leased assets according to their economic reality;
- Lessors shall be entitled to the alternative depreciation method that applies to all other taxpayers;
- Lessees shall be entitled to deduct their rentals in full;
- Lessors shall be entitled to deduct interests according to their economic reality, neither subject to legal limits nor subject to presumptions of minimum rates;
- Leasing transactions must not be subject to anti-avoidance provisions, such as thin capitalization, or market value adjustments;
- Funding via sale and lease back shall be available to all Georgian businesses without imposition of excessive taxation;
- Leasing companies shall be able to sell or assign portfolios without incurring additional taxation, for the sole purposes to get funding;
- Property tax shall apply to leasing companies based upon the economic reality and shall be final and expeditious to provide a stable revenue generation to the Georgian Treasury. The property tax exemptions shall be based on the economic nature and purpose of the asset and not the quality of the owner.
- Lessors shall be entitled to deduct bad debt reserves.
- Other provisions:
 - Banks shall be allowed to invest in leasing companies as the rationale and an optimal way to develop the leasing business;
 - Banks can provide non-recourse financing to leasing companies and expand the reach of their financing without limit based upon concentration in one single leasing company.

ECONOMIC IMPACT OF THE PROPOSED DRAFT LAW

The passing and approval of the draft law is expected to generate at several economic impacts outlined in the following section.

CIVIL AND COMMERCIAL LEGAL ASPECTS

The introduction of comprehensive leasing regulations based on international best practices and consistent with the 2008 UNIDROIT Model Law on Leasing is expected to encourage more investment in leasing companies and increase the establishment of new leasing business by these leasing companies. Clear provisions allow lessors to assume larger credit risks and become more available to SME's and critical sectors that have been excluded from financing, such as the agricultural sector.

While it is beyond the scope of this work to undertake econometrics analysis of impacts, it is possible to identify the potential impacts by gathering information and data from the existing leasing players and from the potential lessees and estimate new investment, new jobs generated, and the metrics of better total productivity of economic factors.

BANKING LAW, INSURANCE AND RELATED ASPECTS

Provisions that relate to banking and insurance laws allow banks and insurance companies to allocate more resources to provide funding to leasing transactions. The effect of these provisions can also be calculated by estimating the new amount of potential resources that could be available from Georgian banks and insurance companies to provide funding to leasing companies. Such measures can also generate more funding from international financial institutions.

ECONOMIC IMPACT OF TAX PROVISIONS IN THE DRAFT LAW

The basis of this analysis is the work conducted by EPI's short-term consultants Nino Aladashvili and Zurab Nikvashvili¹⁴. Their analysis provides a clear description of the tax physiology of any leasing transaction. This is the seed of understanding the potential effects that a single leasing transaction may have in terms of fueling tax revenues for the Georgian Government.

The following table was prepared by EPI's short-term consultants.

¹⁴USAID EPI Georgia. Workshop for the Leasing Industry- Tax Aspects, March 11, 2011

Scenario 1: Leasing of an asset with transfer of the ownership to the lessee

INPUT DATA	
Cost of the leasing object (LO)	20,000
Input VAT on LO	3,600
Financing cost of the LO	14%
Number of leasing periods	4
Initial net lease payment	5,000
Periodic net lease payments	7,000
TOTAL PAYMENT	33,000
Required annual rate of return	31%
VAT rate	18%
CIT rate	15%
PT rate	1%

Figure 2: Tax Calculation First Scenario- Full Payout

Note that at the inception of the transaction, an amount of GEL 3,600 has been paid to the Georgian Revenue Service.

The following figure shows the financial effects of that transaction from the standpoint of the lessor:

Scenario 1: Leasing of an asset with transfer of the ownership to the lessee

LEASING TABLE, SCENARIO 1								
Period	Gross payment	Output VAT	Net Payment	%	Interest	Reduction of the princ.	Principal	Property tax
0	5,900	900	5,000			5,000	5,000	
1	8,260	1,260	7,000	31%	2,598	2,402	2,598	138
2	8,260	1,260	7,000	31%	3,861	3,139	4,459	110
3	8,260	1,260	7,000	31%	2,899	4,101	5,358	74
4	8,260	1,260	7,000	31%	1,642	5,358	(0)	27
TOTAL	38,940	5,940	33,000		13,000	20,000		349

Figure 3: Economic reality of the Scenario 1 Leasing transaction

Note that over the life of the lease, the following amount of GEL 5,940 have been paid over the lease, while the leasing company has been entitled to credit the initial amount of GEL 3,600, which means that the net impact of the lease has added GEL 2,340 to the Georgian Revenue Service.

Furthermore, the Tax P&L of the leasing company looks like this:

Scenario 1: Leasing of an asset with transfer of the ownership to the lessee

Tax P/L (declaration)	Period 1	Period 2	Period 3	Period 4	TOTAL
Revenue	12,000	7,000	7,000	7,000	33,000
Depreciation/COGS	(7,402)	(3,139)	(4,101)	(5,358)	(20,000)
Interest expenses	(2,100)	(1,764)	(1,324)	(750)	(5,938)
Property tax	(138)	(110)	(74)	(27)	(349)
Taxable profit	2,360	1,987	1,501	865	6,713
Income tax	(354)	(298)	(225)	(130)	(1,007)
After tax profit	2,006	1,689	1,276	736	5,706

VAT					
Payable/(receivable)	(1,440)	(180)	1,080	2,340	2,340

Figure 4: Tax basis and payments by the Leasing Company

In summary, the following taxes were generated by this leasing transaction:

TAX REVENUES GENERATED	
(A) VAT	5,940.00
(B) PROPERTY TAX	349.00
(C) INCOME (PROFIT) TAX ¹⁵	1,007.00
(D) TOTAL TAXES	7,296.00
(E) EQUIPMENT COST	20,000.00
TAX CONTRIBUTION:(D)/(E)	36.5%

Figure 5: Impact on Tax Revenues by a single transaction

¹⁵ This is assuming that the suggested provision about basing Property Tax solely in the book value of the leased assets is passed. Otherwise, such tax would not be collected since for sure it should be litigated or avoided otherwise.

Therefore, if the Draft Law is passed and the expected commercial, civil, banking and tax measures are in place, the Georgian Tax System should be able to generate additional revenues as follows:

	2008	2009	2010	2011	2012	2013
Nominal GDP	19,075.00	17,996.00	20,490.00	23,018.00	26,619.00	28,514.00
Investment	21.50%	14.40%	15%	17.20%	18.90%	20.30%
Leasing (20%)	820.23	518.28	614.70	791.82	1,006.20	1,157.67
Leasing (30%)	1,230.34	777.43	922.05	1,187.73	1,509.30	1,736.50
Estimated Revenues (20%)				289.01	367.26	422.55
Estimated Revenues (30%)				433.52	550.89	633.82

Figure 6: Estimated Tax revenues- Source: IMF, assumptions and calculations by author

So, in addition to all economic benefits in terms of economic growth, empowerment to SMEs, creation of jobs, increased productivity and competitiveness, the Georgian Revenue Service can reasonably expect to receive between GEL 300 million to GEL 634 million in additional revenues.

FOLLOW-UP ACTIVITIES TO FURTHER PROMOTE LEASING IN GEORGIA

EPI will be providing targeted assistance to further develop the leasing industry in Georgia through series of training events including the following:

Type of Activity	Name	Date
Seminar	Leasing Best Practices (U.S. Perspective)	May 2011
Training	Leasing Legal Framework: Judges	May 2011
Training	Leasing Legal Framework: Revenue Service/NBG	May 2011
Training	Leasing Workshop: Alliance Learning	May 2011
Training	Leasing Workshop: Bank of Georgia Leasing Company	May 2011
Training	Leasing Workshop: Georgian Equipment Vendors	May 2011
Training	Leasing Workshop: Potential Lessees (Kakheti – Farm Service)	June 2011
Training	Leasing Workshop: Potential Lessees (Adjara – Farm Service)	June 2011

ANNEX

DRAFT LAW

PROPOSED DRAFT LAW ON LEASING	RATIONALE
<p>Article 1: This Law entirely regulates the financial leasing transaction defined hereinafter and it repeals in its integrity the 2002 Law on Promotion on Leasing.</p> <p>Article 2: This Law includes provisions that amend independent articles of the Civil Code, of the Tax Code and of the Law on Commercial Banking Activities. The law must be interpreted in its purpose to regulate in its integrity the subject matter of equipment leasing, while all its corresponding provisions that refer to the Civil Code, the Tax Law and the Law on Commercial Banking Activities are to be incorporated in such Statutes for the purposes of the unification of Georgian Law.</p> <p>Article 3: For purposes of incorporation of the provisions of this law, their corresponding numbering will indicate the corresponding articles that will be inserted in the corresponding Statute.</p>	
<p>TITLE I: CIVIL CODE PROVISIONS</p>	
<p>Article 576a – Sphere of application</p> <p>This Law applies to any financial lease of an asset, if the asset is within the territory of Georgia, the center of main interests of the lessee is within Georgia, or the financial lease provides that laws of Georgia governs the transaction.</p>	<p><i>The purpose of this provision is to define the framework of the Leasing Law in the context of International Law. The principle of “locus regitactus” (the place regulates the contract) is expanded by the provisions introduced by the UNCITRAL Model Law in International Insolvency concerning the definition of Center of Main Interests, and in addition it leaves the door open to contractual choice of law and choice of jurisdiction between the parties to a financial lease.</i></p>
<p>Article 576b – Definitions</p> <p>For the purpose of this Law:</p>	
<p>Asset means all property used in the craft,</p>	<p><i>“Asset” includes equipment, land and</i></p>

<p>trade or business of the lessee, including immovables, capital assets, equipment, intangible assets, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No movable shall cease to be an asset for the sole reason that it has become a fixture to or incorporated in an immovable.</p>	<p><i>buildings, future assets (such as unborn animals). It is important to note that intangible assets can also be subject to leases such as software and other Intellectual Property, subject to the provisions regulating Intellectual Property Rights;</i></p>
<p>Financial lease means a contract having as its main purpose the conveyance of use of and asset, with or without an option to purchase all or part of the asset that includes the following characteristics:</p> <p>(a) the lessee specifies the asset and selects the supplier;</p> <p>(b) the lessor acquires the asset in connection with a lease and the supplier has knowledge of that fact; and</p> <p>(c) the rentals or other funds payable under the lease may take into account or may not take into account the amortization of the whole or a substantial part of the investment of the lessor.</p> <p>For the sake of clarity, it is confirmed that the lessor and the supplier may be the same person or a related person, if it is in the normal course of trade of their business to supply and/or lease equipment.</p> <p>In the case of secondary lease, the lessor may not acquire the asset following the instructions of the lessee, but in order to be protected under this law, the lessor must get the confirmation of the free selection of the equipment and its terms by the lessee.</p> <p>Any other conveyance of use in exchange of consideration whereby neither the lessee selects the asset, nor the lessor acquires the asset in connection with the lease, shall be a rental contract and shall be regulated by the applicable law to rental agreements and not by the provisions of this Law.</p> <p>For all legal purposes, a financial lease shall be considered as a financial service.</p>	<p><i>The definition of Financial Lease is accorded to the UNIDROIT Model Law on Leasing, and it makes clear that Financial Lease is a form of financing that includes both the mode of finance lease (or under other terminology “capital leases”) and “operating lease”. Both are financial services, regardless of the fact that in the operating leasing the lessor agrees to assume more risks on the asset than the risks assumed under a finance lease.</i></p> <p><i>The main feature of a Financial Lease is that the lessor always enters into the transaction upon request or inception by the lessee, which reflects the real financing feature of the deal. The nature of the service is essentially rooted in the concept of “credit” and financing, since the lessor only enters into the transaction with the aim to provide financing under the premise of credit (believing) that the lessee shall perform the agreement as stipulated.</i></p> <p><i>All other form of conveyance of use in exchange of money or economic consideration shall be subject to the Chapter of the Civil Code that regulates rentals, as suggested under the Model Law on Leasing under the concept of “lease”, as opposed to “financial lease”.</i></p>
<p>Large aircraft equipment means all “aircraft objects” as defined in the Protocol to the Convention on International Interests in</p>	<p><i>This definition is relevant for the purpose of clarifying the scope of application of the Cape Town Convention, to which Georgia is</i></p>

<p>Mobile Equipment on Matters specific to Aircraft Equipment signed in Cape Town on 16 November 2001.</p>	<p><i>a party.</i></p>
<p>Lease, or any conveyance of use for economic consideration, generally applied, means a transaction in which one person provides another person with the right to possess and use an asset for a specific term in return for rentals. The term includes a sub-lease. All leases that are not financial leases shall be subject to the law of rental and not to this law.</p>	<p><i>This definition corresponds to the generic term that embodies the following:</i> <i>(a) Financial Leases as defined in the Law; (b) Other leases not having the elements of the definition of Financial Leases. Such other leases shall be subject to the law of rentals and not to the Leasing Law.</i></p>
<p>Lessee means a person that under a financial lease (a) specifies the asset and selects the supplier; (b) receives from the supplier the possession or the right to use the asset acquired by the Lessor; (c) and is bound to the unconditional obligation to pay to the lessor, the rentals and/or other funds payable under the lease take into account or do not take into account the amortization of the whole or a substantial part of the investment of the lessor.</p> <p>In the case of a secondary or subsequent lease, the above conditions will be deemed to have been met if the terms as set out under Financial Lease above are complied with.</p> <p>The term Lessee includes any government entity that enters into a financial leasing.</p>	<p><i>The definition of “Lessee” brings the clarity about the role that the Lessee plays in the transaction. It also includes the concept of “hell or high water”. i.e. the unconditional obligation of the lessor to pay the rentals to the lessee. This element is key to define the assignability of the leases, which is a prerequisite to syndicate, assign or securitize lease receivables.</i></p> <p><i>On the other hand the concept of unconditionality of the payment obligation may not be confused with the concept of cancellability that brings the IAS 17 as an element for an operating lease. Operating leases may be cancellable, but the obligation of the lessee must be unconditional.</i></p> <p><i>The definition of Lessee includes all Government entities so that this provision opens the door to leasing to the Government. It also states that Financial Leasing shall be subject to Organic Law on Budget, whenever a Government entity shall enter into a financial lease as lessee.</i></p>
<p>A lessor means a person who provides the service of financial leases, and therefore is a person, who upon request by the lessee, enters into a supply agreement with the supplier of the asset selected by the lessee, and grants the use of such asset to the lessee with or without a purchase option, in exchange of the payment of rentals that are set forth to amortize or not amortize the whole or a substantial part of the cost of the asset.</p> <p>In the case of a secondary or subsequent lease, the above conditions will be deemed to have been met if the terms as set out under Financial Lease above are complied</p>	<p><i>The definition of Lessor brings the most important role of such organization as a financial services provider (This must have implications in all provisions, in particular tax provisions, since leasing must be considered as a form of credit).</i></p> <p><i>The law intends to allow the coexistence in the market bank affiliated lessors, independent lessors and captive lessors. Such players may operate without being regulated by the National Bank of Georgia as it happens in many developing and developed countries (e.g. Mexico as developing country and the United States as a developed country). However, as far as</i></p>

<p>with.</p> <p>A lessor shall be considered always a financial services provider, and can be either a bank affiliated company, an independent company or a captive company. Such lessor shall not be subject to the Law on Activities of Commercial Banks or to the Law on Non-Bank Depository Institutions, and may operate without a license from the National Bank of Georgia and without being subject to the regulations of the National Bank of Georgia, provided that it does not raise deposits from the public.</p>	<p><i>such lessors get involved into the business of raising deposits from the public, they should operate as Non-Bank Financial Institutions.</i></p> <p><i>Due to the consistent bad experience that has been shown on a global basis when banks undertake the leasing business as an additional bank activity, it is suggested to strongly limit the intervention of the banks to be only shareholders and funding providers of lessors, but not as lessors themselves. Requirements under Basel III and the consistent bad experience that shows how unprepared are the banks to run the leasing business, make advisable to exclude banks from that possibility.</i></p>
<p>person means any legal, private or public entity or an individual.</p>	
<p>Supplier means a person from whom a lessor acquires the asset for lease under a financial lease.</p> <p>Supply agreement means an agreement under which a lessor acquires the asset for lease under a financial lease.</p>	<p><i>The inclusion of the Supplier as one of the parties to the transaction is one of the main gaps that needs to be amended in Georgia. Any form of leasing is subject to the necessary connection with the Supply Agreement. As mentioned, without the selection of the equipment and the supplier by the Lessee, no action from the Lessor would be triggered. The claims about the fitness and warranties of the equipment should be addressed to the supplier, etc.;</i></p>
<p>Article 576c – Public Registry</p> <p>1. The leased assets may be registered according to the provisions of the Law of Georgia on State Registry of the Ministry of Justice of Georgia.</p> <p>2. Concerning any lease or a supply agreement for large aircraft equipment, once the 2001 Cape Town Convention becomes effective in Georgia, then this law may not apply to such transactions, unless the lessor, the lessee and the supplier have otherwise agreed in writing.</p>	<p>1. <i>Leased assets that are mobile property can be subject to the system of the 2004 Public Registry Law. This creates a publicity system that make unequivocal the rights of the lessors to repossess certain leased assets. It is important to stress that what should be registered are the “Leased Assets” as such and not the provisions of the Lease Agreements that from time to time may be subject to confidentiality terms.</i></p> <p>2. <i>There is a universal registry for aircrafts in place, namely the Cape Town Convention, regulating leases for large aircraft equipment. The second paragraph anticipates any possible conflict between this Law and the Cape Town Convention once this becomes effective in Georgia.</i></p>
<p>Article 576d – Interpretation</p> <p>1. In the interpretation of this Law,</p>	<p><i>One of the main features of the Financial Leasing is that this is an agreement that has</i></p>

<p>regard is to be made to its international origin and to the need to promote uniformity in its application and the observance of good faith.</p> <p>2. Any issue concerning matters governed by this Law that is not expressly settled in it is to be settled in conformity with the general principles on which this Law is based.</p>	<p><i>been gaining ground internationally and has expanded around the world. The global experience shows that it is not fully covered by the local Civil law and the local Case Law or jurisprudence. There is international case law and precedents that shall help the courts to interpret the leasing law.</i></p> <p><i>Several legal concepts that are not defined can also be subject to the UNIDROIT Principles of International Commercial Contracts.</i></p>
<p>Article 576e – Freedom of contract</p> <p>Except as provided in Articles 576g(4) and 578(3) and the law of Georgia, the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a lease.</p>	<p><i>While Georgia has some Statutes that limit the effects of the freedom of contract, this law intends to remove any limit, except two that are critical for the nature of Financial Leases. These are, in particular, the provisions that make clear that the Lessee must be the beneficiary of the Supply Agreement and the provisions that limit the maximum amount of liquidated damages beyond just the level of economic compensation, to avoid the presence of gross disparity (a concept of the UNIDROIT International Principles of Commercial Contracts which indicates a material inequitable disparity between the economic rights of the parties. One of the applications of the inequitable disparity is the existing provision in Georgian Law that entitle the lessee to receive any excess in the proceeds of a sale of the leased asset over the outstanding value, because it deprives the lessor of its equitable remedy to cover the damages caused by the lessee’s default.</i></p>
<p>EFFECTS OF A LEASE</p> <p>Article 576f – Effectiveness between the parties and as against the third parties</p> <p>Except as otherwise provided in this Law:</p> <p>(a) a lease is effective and enforceable according to its terms between the parties; and</p> <p>(b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.</p>	<p><i>It is suggested that under the National Agency of Public Registry, internet based public notice system it should be feasible to record leased assets in a database that should be accessible and that should provide evidence of lessors rights, lessees exclusion from adverse possession on leased assets, and make feasible that lessors file affidavit in case of default by lessees and provide notices for remedies prior to repossess the asset on the grounds of lessee’s defaults.</i></p>
<p>Article 576g – Lessee under financial lease as beneficiary of supply agreement</p> <p>1. In a financial lease, the duties of the</p>	<p><i>This is one of the most important new provisions in Georgian Law. This article provides privity (“legitimatio ad-causam”)</i></p>

<p>supplier under a supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.</p> <p>2. At the request of the lessee, the lessor shall assign its rights to enforce the supply agreement to the lessee. If the lessor fails to do so, the lessor is deemed to have assumed the duties of the supplier.</p> <p>3. The rights of the lessee under this Article with respect to a supply agreement that was approved by the lessee shall not be affected by a variation of any term of such agreement unless consented to by the lessee. If the lessee did not consent to such variation, the lessor is deemed to have assumed the duties of the supplier to the lessee that were so varied to the extent of the variation.</p> <p>4. The parties may not derogate from or vary the effect of the provisions of paragraphs 1, 2 and 3.</p> <p>5. Nothing in this Article shall entitle the lessee to negotiate a modification, termination or rescission of the supply agreement without the consent of the lessor.</p>	<p><i>between the Lessee and the supplier. It is no longer necessary for a lessee having claims of unfitness or poor warranties of equipment to sue the lessor so that the lessor sues the supplier. This article provides the immediate right to the lessee to sue directly the supplier, if necessary.</i></p>
<p>Article 576h – Priority of liens</p> <p>1. Except as otherwise provided by the law of Georgia:</p> <p>(a) a creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the lease and cannot impair any interest arising under the lease; and</p> <p>(b) a creditor of the lessor takes subject to the rights and remedies of the parties to the lease.</p> <p>2. Therefore, in the event of insolvency, reorganization, or receivership of a lessee, the following rules shall apply:</p> <p>(a) The lessee, if debtor in possession or trustee under receivership may reject the asset on the grounds of the evidence that such asset is not necessary for the</p>	<p><i>It seems that the proposed provisions are consistent with the 2007 Insolvency Georgian Law.</i></p>

<p>continuation of the business of the lessee. In such case, the lessee, if debtor in possession or the trustee under receivership, shall immediately return the equipment to the lessor in the same conditions as the equipment was received except for fair wear and tear;</p> <p>(b) If the lessee, the debtor in possession, or the trustee under a receivership fails to reject the lease of the asset, then the rentals shall be payable as priority operating expenses while the business is under receivership or pending liquidation;</p> <p>(c) Shall such lessee as debtor in possession or the trustee fail to pay the rentals when due, then the lessor is entitled to repossess the asset and dispose immediately of the asset as set forth under Article 580 hereof;</p> <p>3. In case of insolvency, reorganization or receivership of the lessor, the lessor in possession or the trustee in a receivership, shall preserve the leased assets free of any lien. Creditors of the lessor may be paid paripassu, according to the legal priority orders, by means of assignment of leases. Nothing in these assignments should impair the right to quiet possession of the lessee, and/or increase the amount of lessee's obligations under the lease, except for cases of default by the lessee.</p>	
<p>Article 576i – Exclusion of liability of the lessor</p> <p>In a financial lease, the lessor when acting in its capacity of lessor and as owner within the limits of the transaction, as documented under the supply agreement and the lease, shall not be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.</p>	<p><i>This is an important provision that has special importance in Civil Law systems where the concept of objective or vicarious liability was imposed as a rule: A person is liable for damages caused by its owned property.</i></p>
<p>CHAPTER III: PERFORMANCE Article 576j – Irrevocability and independence</p> <p>1. In a financial lease, the duties of the lessor and the lessee become irrevocable and independent when the asset subject to the lease has been delivered to and accepted by the lessee. However, at the moment of agreement between the lessor and the lessee, the parties may agree the terms and conditions prior to the delivery of</p>	<p><i>These provisions are consistent with global best practices in leasing.</i></p>

<p>the equipment such as interim rentals between the date of agreement and the date of effective delivery and other similar provisions.</p> <p>2. Except as otherwise provided in Article 579(1)(c), a duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the lease.</p>	
<p>Article 576k – Risk of loss</p> <p>1. In any financial lease:</p> <p>(a) risk of loss shall pass to the lessee when the lease is entered into; and</p> <p>(b) when an asset is not delivered, is partially delivered, is delivered late, or fails to conform to the lease and the lessee enforces its remedies under Article 576n, the lessee, subject to Article 576r(1), may treat the risk of loss as having remained with the supplier.</p> <p>The parties may agree otherwise.</p>	<p><i>This provision is relevant in terms of clarifying the allocation of risks in the asset. It must be noted that this provision is also consistent with the principles of Civil Law. As mentioned in the report, the parties must be clear in setting forth the rules on risk allocation. No party must be subject to gamble.</i></p>
<p>Article 576l – Damage to the asset</p> <p>In any financial lease, when an asset subject to a lease is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and either accept the asset with due compensation from the supplier for the loss in value or seek such other remedies as are provided by law.</p> <p>In no such events the lessor would carry any liability. All liability shall correspond to the supplier.</p>	<p><i>This article refers to events where an asset is subject to future delivery and the lessor has already committed to purchase the asset from the supplier. If the asset is damaged, then the risk of loss should not be assumed by the lessor. In normal commercial transactions, such assets in transit are subject to insurance, but since the lessee selects both the asset and the supplier, any deficiency of the loss coverage by the insurer should be assumed by the lessee who may transfer such burden to the supplier.</i></p>
<p>Article 576m – Acceptance</p> <p>1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.</p> <p>2. Unless the parties agree otherwise, after the lessee has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.</p>	<p><i>Acceptance of the Asset by the lessee is one of the cornerstone principles of the transaction. In contractual practice, the evidence of acceptance by the lessee, in the form of a “Delivery and Acceptance” (or “D&A”) document is the trigger event for the lessor to pay the asset price to the supplier and to the lessee to start its obligation to pay rentals.</i></p>

<p>Article 576n Remedies</p> <p>In any financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.</p>	<p><i>A slight change was made to the original Model Law on Leasing, consisting in removing the provisions applicable to a leasing other than a financial lease. The rationale for such removal is that a lease or conveyance of use that is not a financial leasing, shall be subject by the regulations of the Civil Code Chapter of rental, and not by the Leasing Law.</i></p>
<p>Article 576o Transfer of rights and duties</p> <p>1. (a) (i) The rights of the lessor under the lease may be transferred without the consent of the lessee.</p> <p>(ii) The lessor and lessee may agree that the lessee shall not raise against a transferee any of its defenses or rights of set-off against the lessor other than those arising from the incapacity of the lessee.</p> <p>(iii) Nothing in this sub-paragraph shall affect the lessee's ability to assert its rights against the lessor.</p> <p>(b) The duties of the lessor under the lease may be transferred only with the consent of the lessee, which may not be unreasonably withheld.</p> <p>2. The rights and duties of the lessee under the lease may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.</p> <p>3. The lessee, lessor and third parties may consent to such transfers in advance.</p> <p>4. Any document containing the assignment or transfers of lease receivables or rights on the asset shall be considered as admitted assets of an insurer carrying on long term specified insurance business, for the purposes of the Law. Such document shall also be admitted investment of pension funds.</p>	<p><i>This provision is necessary for the development of the leasing industry. Lessors must be able to assign or transfer their rights under the leases to get financing on the leases, to provide collateral and even in distressed situations, to safeguard the rights of the lessees.</i></p>
<p>Article 576p Warranty of quiet possession</p> <p>1. In a financial lease:</p> <p>(a) the lessor warrants that the quiet possession of the lessee will not be</p>	<p><i>The warranty of quiet possession is a principle that states what are the continuous obligations of the Lessor while the lease is in force. This is consistent with universal practice.</i></p> <p><i>Article 576b (which is originally Section 3 of</i></p>

<p>disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor; and</p> <p>(b) the lessee that furnishes specifications to the lessor or the supplier shall hold the lessor and the supplier harmless against any claim of infringement that arises out of compliance with the specifications.</p> <p>2. Except as otherwise provided by Article 579.1.c, the sole remedy for a disturbance of the quiet possession of the lessee is an action for damages against the lessor. The lessee shall not have the right to file any injunction or any other claim other than for damages.</p>	<p><i>the Model Law) makes an important definition that must be consistent with the remedies of repossession. The lessee that claims disturbance of quiet possession, only can claim damages, and therefore, the clear principle is set forth, that disturbance of quiet possession may not be prevented if it comes from a superior title from a third party or similar reason. The solvency of the lessor shall be at stake, but not the possession rights of the person who has a better right.</i></p>
<p>Article 576q – Warranty of acceptability and fitness for purpose</p> <p>In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the lease and is fit for the ordinary purposes for which an asset of that description is used. Subject to Article 576.g.2, the warranty is enforceable only against the supplier.</p>	<p><i>This warranty reinforces the privity between the lessee and the supplier and it shall relieve the lessor of any involvement whatsoever in the technical acceptability and purpose of the asset. This is consistent with the fact that the lessee is who selects the asset and the supplier,</i></p>
<p>Article 576r – Duties of the lessee to maintain and return the asset</p> <p>1. (a) The lessee shall take a proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.</p> <p>(b) When a lease sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding subparagraph.</p> <p>2. When the lease comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the</p>	<p><i>This provision is consistent with global best practices. The parties may agree who of the parties takes care of the asset and it is perfectly consistent with the equity inspired in the fact that the lessee is who actually uses and operates such asset.</i></p>

<p>asset to the lessor in the condition specified in the preceding paragraph.</p>	
<p>CHAPTER IV: DEFAULT AND TERMINATION</p> <p>Article 577a – Definition of default</p> <p>1. The parties may agree to the events that constitute a default, or otherwise give rise to the rights and remedies specified in this Chapter.</p> <p>2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the lease or this Law.</p>	<p><i>This is a good guiding principle that brings the Model Law on Leasing.</i></p>
<p>Article 577b – Notices</p> <p>An aggrieved party shall give the defaulting party a notice of default, a notice of enforcement, a notice of termination and a reasonable opportunity to cure.</p>	<p><i>Notices are the steps necessary to provide reasonable opportunity and due process to the defaulting party.</i></p>
<p>Article 577c – Damages</p> <p>Upon default, the aggrieved party shall be entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the lease, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.</p>	<p><i>This is the best definition of the amount of damages and it has consequences to the application of the gross disparity principle. “Gross disparity” means a stipulation or application thereof that gives one party an unjustifiably excessive advantage. The leasing contracts must be fair and the default by a lessee must not carry other consequences that just repairing the harm done to the economy of the Lessor and not to become a source of unjustified enrichment. This is extremely important to be kept for the sake of the sustainability of the leasing industry.</i></p>
<p>Article 578 – Liquidated damages</p> <p>1. When the lease provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.</p> <p>2. Such sum may be reduced to a reasonable amount in case it is grossly excessive in relation to the harm resulting from the default.</p> <p>3. The parties may not derogate from or vary the effect of the provisions of this</p>	<p><i>Liquidated damages are applicable in Georgia by means of the Civil Code.</i></p> <p><i>The provision of gross disparity is clearly set forth so that the courts may apply them, by means of reduction of damages, when applicable.</i></p>

<p>Article.</p>	
<p>Article 579 – Termination</p> <p>1. (a) Subject to sub-paragraph (b), a lease may be terminated by operation of law, by operation of Article 576m, by agreement of the parties or by an aggrieved party upon fundamental default by the lessee or lessor.</p> <p>(b) Except as otherwise provided in sub-paragraph (c), after the asset subject to the lease has been delivered to and accepted by the lessee, the lessee in a financial lease may not terminate the lease upon fundamental default by the lessor or the supplier but is entitled to such other remedies as are provided by the agreement of the parties and by law.</p> <p>(c) In the event of a fundamental default by the lessor in respect of the warranty of quiet possession referred to in Article 576p, the lessee in a financial lease may terminate the lease.</p> <p>2. Subject to Article 576j, on termination all duties under the lease that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.</p>	<p><i>Termination is regulated by default, so that it refers to:</i></p> <ul style="list-style-type: none"> <i>(a) Definition of events of termination, which are encouraged under the freedom of contract principle;</i> <i>(b) It narrows the power of the lessee to terminate, on the grounds that the lessee has initiated the whole deal and has made the parties relied upon its suggestions, and</i> <i>(c) It protects the quiet possession right of the lessee, penalizing the lessor that defaulted on such obligation, and</i> <i>(d) It provides for the continuation of the execution of obligations that are due in the future, even after termination.</i>
<p>Article 580 – Possession and disposition</p> <p>After the lease comes to an end, or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.</p> <p>The lessor may take possession of the asset without resorting to judicial process, and can immediately dispose of the asset. No claim or injunction to limit these rights shall be admissible by any court. Lessor shall have the absolute right to dispose of the asset without prejudice and without delays.</p> <p>In the case where lessor has taken possession of the asset with breach of peace, or if the lessor failed to comply with the obligation to give notice in conformity to Article 576s, then lessee shall be entitled to damages. The courts shall ponder the amount of damages in equity.</p>	<p><i>The right to take possession of the asset is the most important right of the lessor and it is what makes a collateral value in a Financial Lease. Therefore, all injunctions, and potential court delays are removed.</i></p> <p><i>Since it may the case that in certain situations some lessors may abuse of their rights and proceed with repossession remedies without respecting the rights of the lessee, such lessors must be subject to pay damages. However, it must be clear that in no event shall the right to repossess and dispose, be curtailed by the smart intervention of counsel to avoid the effective disposal of the collateral.</i></p>
<p>TITLE II: PROVISIONS OF THE TAX CODE</p>	<p><i>The provisions are entirely based on the</i></p>

	<p><i>findings by the consulting firm IAA-Advisors who gathered the practical findings of their research working with the leasing community and the Business Association of Georgia (the "IAA Report")</i></p>
<p>Article 8 shall have an additional paragraph number 38:</p> <p>...”38. Leasing shall have the meaning set forth under the Civil Code, article 576b”.</p> <p>“39. For tax purposes, leasing companies shall mean legal entities dedicated solely or almost exclusively to enter into financial leasing transactions in capacity of lessor, provided that more than 70% of their revenues come from leasing transactions”.</p> <p>“40. Group of companies, means two or more companies that are affiliated parties, either because one control the other or because they are under common control, provided that the controlling shareholder must have no less than 75% of the capital of the controlled company.”</p>	<p><i>These definitions have been added to bring clarity to the application of the Tax provisions.</i></p>
<p>Article 17 of the Tax Code is hereby repealed in its entirety.</p>	<p><i>Article 17 of the Tax Code is proposed to be phased out of the Georgian legislation because it is contrary to economic reality and because it does not drive any benefit neither to the leasing industry and mush lesser to the Georgian tax system. The article is confusing, does not have any connection with reality and contains a lot of complicated presumptions. Besides, it gives the sovereignty of the Georgian Tax policy by subjecting its application to accounting rules issued by a private body (The International Accounting Standard Board). The text proposed to be repealed is the following:</i></p> <p><i>Article 17. Leasing</i></p> <ol style="list-style-type: none"> <i>1. If a person issues under leasing for a period of more than one year the fixed assets subjected to depreciation, for the purposes of this Code the transaction shall be treated as the provision of services.</i> <i>2. For taxation purposes the amount of leasing services value discounted as a result of the application of an interest rate lower by 55 percent than the rate prescribed under Article 107 of this Code throughout the entire period of leasing of the fixed assets must not be less than the difference between the book</i>

	<p><i>value of fixed assets determined under Article 114(2) of the same Code and its residual (transfer to a lessee (as of the transfer of the title)) value.</i></p> <p><i>3. The lease of property shall be leasing, if one of the following conditions is true: a) after the completion of the lease period it is envisaged to transfer the title to the property or a beneficiary of lease will be entitled to acquire property at a fixed price or price established under the lease agreement; b) the lease period is longer than 75 percent of the useful life of fixed assets. Useful life shall be established in accordance with the principles of international financial reporting standards; c) The expected residual value of leased property at the completion of the lease period is not higher than 15 percent of book value of the property at the commencement of this term determined under Article 114(2) of this Code.</i></p> <p><i>4. For the purposes of this Article the period of leasing comprises the period during which a beneficiary of lease according to a lease agreement is entitled to the renewal of leasing.</i></p> <p><i>5. In case of leasing at the completion of the lease term fixed assets may not be supplied at the price lower than the residual value.</i></p> <p><i>6. For the purposes of this Article, considering the provisions of its Paragraph 2 classification of lease may not be changed and it may not be transformed into leasing, unless the fixed assets were transferred under the leasing agreement from the very beginning.</i></p> <p><i>7. For the purposes of this Article lease includes rent.</i></p>
<p>Article 99. Exemption from tax (15.12.2010 N4061 shall become effective from December 31, 2010)</p> <p>1. The following shall be exempted from profit tax: a) profit of budgetary, international and/or charitable organizations, with the exemption of profit received from economic activity; b) grants, membership contributions and charity contributions received by an organization; c) profit of the National Bank of</p>	<p><i>For purposes of simplification, the articles of the Tax Code are inserted in their order of numbers. The change to article 170 reflects the suggestion to avoid the taxation of sale and lease back transactions and sales of portfolios for funding purposes. As mentioned in the IAA Report, the purpose of this provision is not to curtail the generation of revenues for Georgia, but on the contrary, to facilitate the circulation of resources to</i></p>

<p>Georgia; d) profit received by the Patriarchate of Georgia from the sale of the crosses, candles, icons, books and calendars used for religious purpose; e) profit received from primary supply of agricultural products prior to the industrial processing</p> <p>(changing of a commodity code) produced in Georgia by an individual employed in agricultural production until January 1, 2014, provided total income received by such person from the mentioned supply during the calendar year does not exceed GEL 200,000;</p> <p>f) the portion of profit received from agricultural activity until January 1, 2014 that is reinvested in the frame of such activities;</p> <p>g) profit gained by an international financial company from financial transactions and/or financial services rendered and/or profit received from the sale of securities emitted by a non-resident of Georgia;</p> <p>h) profit received from the sale of emitted securities by an international financial company; i) profit received from the sale of free float securities; j) income received by a nonresident from a source in Georgia, on the basis of the insurance and reinsurance of risk by an enterprise, organization and/or entrepreneur individual;</p> <p>k) income received by a non-resident from leasing out of property that does not belong to a permanent establishment of a non-resident in Georgia; l) profit received from the sale of government or the National Bank of Georgia debt securities and interest profit from the above-mentioned securities and profit received from interest accrued on the funds deposited on the accounts at the National Bank;</p> <p>m) profit received by a free warehouse enterprise from the re-exportation of goods from a free warehouse;</p> <p>n) profit received by an international enterprise from the activities allowable in a free industrial</p>	<p><i>permit more investment in capital goods that must generate more revenues. With these measures: (a) Georgian enterprises, in particular SMEs shall be able to unlock working capital resources while keeping the use of their fixed assets, and (b) leasing companies should be able to raise more funds from both Georgian and international funding sources at reasonable costs. The final effect of both transactions is improvement of economic activity, job creation and generation of revenues for the Georgia Revenue Service by means of all different taxes (VAT, profit tax and other).</i></p>
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<p>zone;</p> <p>o) profit received by an investment fund from the supply of a financial instrument and/or that received from financial transactions and/or financial services, in case an investment fund is an international financial company; p) value of the property transferred to or the value of services rendered gratuitously to the legal entities of public law by the national government and/or local self-government authorities;</p> <p>q) the portion of the profit received by a medical institution (regardless of their organizational and legal form) from medical activity that will be used for reinvesting (rehabilitation of an institution, maintenance of physical infrastructures);</p> <p>r) profit received through the supply of information technologies outside Georgia created by a virtual free zone legal entity;</p> <p>s) profit received from rendering hotel services by an entrepreneur subject of a tourism zone until January 1, 2026;</p> <p>t) value of a land plot (plots) received by a tourism zone entrepreneur subject.</p> <p><u>u) profit received from the sale of equipment in connection with a sale and leaseback transaction, or when such sale is made by a leasing company in order to raise funding for financial leasing transactions, whenever any of such sales is intended to provide security to the purchaser and not to dispose of such property.</u></p>	
<p>Article 107. Limitation of the deduction of interest (17.12.2010.) N4114)</p> <p>1. Considering paragraph 2 of this Article, interests paid and/or payable (according to the method of accrual used) for a credit (loan) shall be deducted within the bounds not higher than the annual interest determined by the Minister of Finance of Georgia, proportionately with the relevant period.</p> <p>2. The amount of deductible interest envisaged under paragraph 1 of this Article in case of an enterprise more than 20 percent of which interest (shares) is directly</p>	<p><i>Leasing companies shall be allowed to be taxed on their economic reality and their economic reality requires to deduct their actual cost of funds. Due to the nature of leasing companies, it is not likely that such companies would conceal or exaggerate their actual cost of funds, since this would affect negatively their performance indicators that are key to raise funds. Therefore, it is suggested to eliminate such limitation as far as leasing companies shall be concerned.</i></p>

<p>or indirectly possessed by legal entities exempted from the profit tax must not be higher than 50 percent of the sum of any interest income gained by a taxpayer and the gross income amounts reduced by allowable deductions (with the exception of deduction of interest).</p> <p>3. <u>No limitation of interest deduction shall apply to leasing companies in connection with their cost of funds related to their leases. [These companies shall be entitled to deduct the actual amount of interest payable and cost of funds as certified in their audited financial statements and tax reports].</u></p>	
<p>Article 109. Deduction of Transfers into Reserve Funds</p> <p>1. A legal entity that carries out licensed insurance activity shall be entitled to deduct insurance/incurred losses, net of a reporting period from total income of the same reporting year, with the exception of the income from regression and surviving property computed according to the rule determined by the National Bank of Georgia. (17.12.2010. N4114)</p> <p>2. Banks and credit unions shall deduct the reserves for possible loan losses according to the rule prescribed by the National Bank of Georgia on the Creation and Use of the Classification of Assets and Possible Reserves for Losses by Commercial Banks.</p> <p>3. <u>Leasing companies shall be entitled to deduct the reserves for potential losses related to leases under the following rules: (a) Leases with 90 day-period overdue and less than 180 days shall allow a deduction of 50% of the outstanding balance of the lease, and (b) Leases past due over 180 days shall allow a deduction of 100% of the outstanding balance of the lease, all the foregoing as certified in their audited financial statements and tax reports; (c) In all cases of termination by default, leasing companies shall be allowed a deduction for the amount of impairment of value of the leased asset compared with the outstanding value of the lease, whether or not the leases are past due over 90 or 180 days.</u></p>	<p><i>The allowance of deduction of bad debt reserves for leasing companies is consistent with the financial nature of their business. The basis for its application is simple and corresponds to best practices applied by leasing companies worldwide in order to create prudential measures to protect their portfolios.</i></p> <p><i>This measure has particular importance for the benefit of the recovery of the Georgian economy. Such lessees that are currently distressed or had suffered the effects of the combination of the global crisis and the war, or who are currently hurt by the continuous devaluation of the Euro and the United States dollar, can get the benefit of the very powerful ability that leasing has to nourish recovery of viable business. Leasing companies may undertake workouts and restructure the payment of their rentals to ease the cash flow burdens of their lessees, relying on the security provided by the leased assets. However, if the tax system makes very expensive the protection of the portfolio, leasing companies would not have other options than to undertake actions in order to be allowed to write off of their leases, which would basically lead to the forceful liquidation and bankruptcy of their customers.</i></p>

<p>Article 111. Depreciation Expenses and Deductions According to Fixed Assets</p> <p>1. Depreciation expenses in terms of fixed assets used in the economic activities shall be deducted according to the conditions envisaged under this Article.</p> <p>2. Depreciation shall not be applied to land, works of art, museum exhibits, sites of historical importance (other than buildings and structures) and other non-depreciable assets. Furthermore, depreciation shall not be applied to fixed assets and biological assets under with value under GEL 1,000. Fixed assets with value under GEL 1,000 shall be deducted from a total income in full in the reporting year when they were transferred into operations, and the costs incurred on biological assets shall be deducted in the reporting year when they were actually incurred.</p> <p>3. Fixed assets subject to depreciation shall be grouped according to the following codes of depreciation:</p> <p>4. The amount of depreciation expenses of each group shall be computed from the value balance of the group at the end of a tax year, in accordance with depreciation rates indicated in paragraph 3 of this Article.</p> <p>Group number</p> <p>Fixed assets</p> <p>Depreciation rate (%)</p> <p>1</p> <p>Passenger cars; motor-and-tractor equipment for the use on roads; office furniture, movable equipment of motor transport; trucks, buses, special motor vehicles and trailers; machinery and equipment for all sectors of industry and the foundry industry; forging and pressing equipment; construction equipment; agricultural vehicles and equipment.</p> <p>20</p> <p>2</p> <p>Special tools, stock and equipment; computers, peripheral devices and equipment for data processing; electronic</p>	<p><i>Three suggestions are taken here: (a) Lessors shall be entitled to alternative depreciation; (b) Normal depreciation applicable to lessors must be conforming to the economic reality of the leases, hence sinking fund system using as discount rate the actual implicit yield rate, as applied in other systems, such as Brazil, and (c) Lessees shall be entitled to deduct the whole of the rentals paid under the lease, instead of being forced to capitalize the assets under lease and depreciate them.</i></p> <p><i>These measures provide clarity and simplicity and allow the growth of the leasing market.</i></p>
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<p>devices.</p> <p>20</p> <p>3</p> <p>Railway, maritime and river transport vehicles; power vehicles and equipment; thermo technical equipment turbine-powered equipment; electric engines and diesel generators; electricity transmission and communication facilities; pipelines.</p> <p>8</p> <p>4</p> <p>Buildings, structures</p> <p>5</p> <p>5</p> <p>Assets subject to depreciation not included in other groups.</p> <p>155. Depreciation shall be applied on the buildings and structures (hereinafter “structure”) separately on each structure. Respectively, each structure shall be treated as a separate group.</p> <p>6. At the end of a tax year the value balance of a group shall be the amount determined according to the following rule – value balance of a group at the end of the tax year prior to the reporting year:</p> <p>a) is reduced: a.a) by the amount of the depreciation charged in the tax year prior to reporting year; a.b) by the amount of deductions effected in accordance with Paragraphs 8 and 9 of this Article; a.c) by the amount of the realization of fixed assets of a group during the reporting tax year, and by market value in case of a gratuitous supply of fixed assets; b) is increased:</p> <p>b.a) by the value of fixed assets (with the exception of fixed assets not subject to depreciation) determined in accordance with Article 148 of this Code that were added to the group during the reporting tax year;</p> <p>b.b) by the amount above the marginal level of repair costs incurred on fixed assets during the reporting tax year in accordance with Article 115(2) of this Code.</p> <p>7. If the proceeds from the sale of fixed</p>	
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assets of a group during the tax year, and market value thereof in case of a gratuitous supply of fixed assets is higher than the value balance of the group at the end of the year, the surplus amount shall be included in total income and the group value balance shall be reduced to zero.

8. If by the end of a year the value balance amount of a group is less than GEL 1,000, the value balance amount of the group shall be subject to deduction.

9. If all fixed assets of a group have been sold or liquidated at the end of the year the value balance of the group shall be subject to deduction from total income.

10. A taxpayer shall be entitled to apply an accelerated depreciation rate for 2nd and 3rd groups, not to be higher than double the rate envisaged under Paragraph 3 of this Article.

11. A non-entrepreneur individual shall not be authorized to deduct depreciation expenses from fixed assets used for economic activity.

12. Leasing companies shall be entitled to separate their fixed assets in two groups, namely "leased assets" and "fixed assets for own use". Such Leasing companies shall be entitled to depreciate their leased assets by applying a financial sinking fund depreciation method, so that annual deductions shall be equal to the amounts to principal financially recorded by lessors by separating from each rental payment the amounts corresponding to principal from the amounts corresponding to the financial yield implicit in each payment. The financial yield implicit in each payment shall be based on the economic reality of the leasing transaction. No other prescribed discount rate shall apply. In connection with the group of "fixed assets for own use", general depreciation systems will apply.

13. Lessees shall be entitled to deduct from their income the total amount of rentals payable under a financial lease in connection with the leased assets, in lieu of depreciation.

14. At the end of the lease, if the lessee acquires the leased asset, the lessee shall apply depreciation on the basis of the acquisition cost of the asset which should be

<p><u>the price paid by the lessee to the lessor for the transfer of the said asset.</u></p>	
<p>New Article 112. Full Deduction of depreciation expenses according to fixed assets (Paragraph 5 is hereby repealed)</p> <p>1. A taxpayer shall be entitled to fully deduct the cost of the assets for fixed assets other than those entered into the enterprise capital in a tax year when fixed assets were entered into operation.</p> <p>2. If a taxpayer utilizes the entitlement to fully deduct the cost of the fixed assets thereof shall be obligated to use the same method in relation to all fixed assets acquired (produced) later;</p> <p>3. In case of full deduction of the value of fixed assets: a) the mentioned fixed assets will not be entered in the value balance of a group envisaged under Article 111 of this Code; b) amounts received and/or receivable when supplying such assets later, and if not applicable, market value without value added tax shall be subject to inclusion in total income.</p> <p>4. In case of full deduction of the cost of fixed assets a taxpayer shall not be entitled to change the selected deduction principle during 5 years. Further, the selection of such principle of deduction shall be selected in the tax year when fixed assets were entered into operation.</p> <p>5. The entitlement to full deduction of the cost of fixed assets shall not be applicable to fixed assets issued under leasing and/or fixed assets that are not subject to depreciation.</p>	
<p>Article 114 of the Tax Code is hereby repealed in its entirety</p>	<p><i>The elimination of article 114 is suggested to reflect economic reality and become the inconvenience of the article which</i></p>
<p>Article 121. Carrying forward of losses and Group Relief</p> <p>1. The losses incurred by an entrepreneur individual from the sale of property shall be compensated by the surplus value generated from the sale of such property. If it is impossible to compensate for losses in the</p>	<p><i>This article contains a suggestion to motivate investment in start-up leasing companies. Group Relief is a legal institution in the United Kingdom, which has been set forth in order to generate relief for certain tax losses within a group, so that the parents of the group keep investing and allocating capital to</i></p>

same year they shall be carried forward for a period of up to five years and compensation thereof shall be effected with the surplus value derived from the sale of such property.

2. The losses incurred by an individual (other than an entrepreneur individual) as a result of the realization of an asset during a tax year shall be compensated by the surplus received from the sale of the same type of asset. Further, if it is impossible to compensate for losses in the same year the losses shall not be carried forward to the following year.

3. The excess of deductions in relation to an entrepreneur individual over the total income received from economic activity thereof which is not related to hired work shall not be deducted against the salary received by such person. It shall be carried forward for up to 5 years and be liquidated at the expense of the excess of total income in future periods not related to hired work over deductions.

Deductions in respect of a legal person stipulated by this Code in excess of gross income

shall be carried forward for a period of up to five years to be covered at the expense of the gross income of future periods.

4. The excess of deductions over total income in relation to a legal entity can either be carried forward for a period of up to five years and be liquidated against the excess of total income in future periods over deductions, or subject to Group Relief, in which case all or part of the excess of deductions of any company belonging to the Group may surrender these losses or excess deductions to a Group member with sufficient taxable profits in the same accounting period. Any payment made by the receiving company to the surrendering company should not be subject to tax in the hands of the receiving company, nor shall it be a tax deductible expense in the hands of the paying company.

5. The excess of the deductions envisaged under this Code over the total income shall not be subject to carrying forward provided it

generate more jobs and productivity. The IAA Report suggested this insertion, and we suggest to follow such recommendation.

<p>has been derived:</p> <p>a) during the period a financial institution enjoys the status of an international financial company;</p> <p>b) during the period a free industrial zone enterprise uses the status of an international financial company;</p> <p>c) during the period a resident enterprise enjoys the status of a free warehouse.</p>	
<p>Article 123. Thin Capitalization</p> <p>1. For the purposes of this Code thin capitalization shall be the ratio of debt taken by an entity to the capital when debt to capital ratio of an entity is higher than 3/1.</p> <p>2. In case of thin capitalization interests (in case there are different interest rates – according to the highest interest rate) paid and/or payable by an entity on debt shall not be deducted from total income thereof. Further, the above-mentioned does not limit the right of a person to deduct interests paid on debt prior to thin capitalization (below the ratio) from total income.</p> <p>3. This Article shall not be applicable: a) in relation to financial institutions; b) if total income of an enterprise does not exceed GEL 200,000; c) if interest expenses are not higher than 20 percent of the amount remaining after deductions (without the deduction of interest expenses) from total income envisaged under this Code; d) in relation to an entrepreneur individual unless a tax authority proves that its debt is three times higher than the market value of assets owned thereof, <u>and (e) in relation to leasing companies.</u></p> <p>4. For the purposes of this Article the debt shall mean debt liabilities in any form, for which the payment of interest is performed, with the exception of the loans taken from government and international financial institutions. The list of international financial institutions shall be determined under the decree of the Government of Georgia.</p> <p>5. For the purposes of this Article capital shall be: a) for a Georgian enterprise: the difference between assets and liabilities</p>	

<p>thereof minus the liabilities of the founders before to such enterprise that are the assets of the enterprise; b) for a foreign enterprise or a permanent establishment of a nonresident: the difference between assets and liabilities thereof.</p> <p>6. Thin capitalization shall be determined according to average annual ratio which rule shall be determined by the Minister of Finance of Georgia.</p> <p>7. This Article shall be applicable only in case the Investigation Service of the Ministry of Finance has established that thin capitalization was applied with the purpose of intentional avoidance of taxes.</p>	
<p>Article 138. The instance of receiving income under the cash method</p> <p>1. The following shall be considered to be the instance of receiving income when using the cash method of accounting:</p> <p>a) in case of cash settlement – the instance of receiving cash;</p> <p>b) in case of non-cash settlement – the transfer of funds in a bank to a taxpayer's settlement account or another account, which disposal or the right to receive these funds from which a taxpayer has.</p> <p>2. In case of the cancellation of or liquidation of financial liabilities of a taxpayer, namely, in case of offsetting the instance of the cancellation or liquidation of such liabilities shall be considered to be the instance of receiving income.</p> <p><u>3. In case of late charges, penalties and liquidated damages under financial leasing agreements, such charges, penalties or liquidated damages shall be considered taxable only and solely at the moment when they have been effective and irrevocably received by Leasing Companies.</u></p>	
<p>Article 141. The instance of receiving income under the accrual method</p> <p>1. A taxpayer's right to receive income (including fine sanctions) shall be deemed acquired in case: a) relevant amount is subject to payment to a taxpayer; b) a taxpayer has fulfilled all obligations envisaged under the transaction</p>	

<p>(agreement);2. If a taxpayer is providing services, the right referred to in Paragraph (1) of this Article shall be deemed obtained thereof at the instance of the completion of the rendering of services envisaged under a transaction (agreement).</p> <p>3. If a taxpayer receives or it is entitled to receive income as interest or through the transfer of property under lease the income shall be deemed received at the instance of the expiration of debt liability or lease agreement. Further, if the term of debt liability or lease agreement comprises several reporting periods the income among the reporting periods shall be distributed according to the amount accrued or subject to accrual in each reporting period.</p> <p>4. Banks shall recognize the interests and fines accrued/charged on loans as income according to the rule determined by the National Bank of Georgia.</p> <p><u>5. Leasing Companies shall recognize late charges, fines and liquidated damages as income only when effective and irrevocably received.</u></p>	
<p>Article 147. Profit and loss at the time of supplying the assets</p> <p>1. The profit derived at the time of the supply of assets shall be a positive balance between the income received from the supply thereof and the cost of such assets that shall be determined in accordance with Article 148 of this Code.</p> <p>2. Losses incurred from the supply of assets shall be a negative difference between the income received from supply thereof and the cost of such assets.</p> <p>3. When assets are supplied gratuitously or at the price lower than prime cost profit of a supplier shall be determined as the positive difference between market price of supplied assets and the cost of the assets determined according to Article 148 of this Code.</p> <p>4. The provisions of Paragraphs (1)-(3) of this Article shall not be applicable in relation to the assets subjected to depreciation under the group method.</p> <p><u>5. The provisions of Paragraphs (1)-(3) of this Article shall not be applicable in relation</u></p>	

<p><u>to assets subjected to financial leasing both in cases of purchases and of sales by Lessor.</u></p>	
<p>Article 161. Taxable Transaction, Transaction amount and Time</p> <p>1. The following shall be VAT taxable transactions: a) supply of goods and/or the provision of services conducted within Georgia during which:</p> <p>a.a) the amount of the taxable transaction is determined according to the amount of compensation received or receivable by a VAT taxpayer (including taxes, duties and other charges) excluding VAT and/or penalty, with the exception of the case stipulated under Paragraph 2 of this Article;</p> <p>a.b) the instance of the supply of goods or the rendering of services shall be regarded as the time of performing a taxable transaction, but:</p> <p>a.b.a) not to be later than the instance of the submission of a payment request (invoice) for the supply of goods or the rendering of services effected by a supplier and/or of the obligation of the payment of amount;</p> <p>a.b.b) not to be later than the last day of each reporting period provided the goods (guaranteed capacity, electric or thermal energy, gas or water) are supplied on a regular basis or continuously. Further, in case an entity records the supply on different days of a reporting period according to the amount of goods supplied during a certain period (cycle), not a calendar month, which may comprise the reporting period, as well as the period preceding the reporting period, the volume of goods recorded according to different days of the reporting period (recorded according to the amount of goods supplied during a certain period (cycle)) shall be regarded supplied during the reporting period, regardless of the volume actually supplied during the reporting period; (17.12.2010. N4114)</p> <p>b) the use of goods/services purchased with VAT for non-economic activity, provided a taxpayer has received a VAT credit for such goods/services, during which:</p> <p>b.a) the amount of a taxable transaction is</p>	<p><i>While it is not the intention of this Draft Law to exempt leasing transactions from the VAT, it is necessary to clarify one point about the practical application of VAT. This is the point of the treatment of late charges of damages received by lessor as a consequence of the lessees default. The economic principle and best practices worldwide provide that payment of damages is not retribution of any service. It is just paying the amounts to keep whole the aggrieved party, and that is not a service. Therefore, such damages must be excluded from the taxable amount.</i></p>

<p>established at the market value of goods/services (including taxes, duties and other charges) without VAT;</p> <p>b.b) the instance of the commencement of the use of goods/services is regarded as the time of effecting a taxable transaction;</p> <p>c) in case of cancellation of a VAT taxpayer registration the balance of goods for which the taxpayer has obtained credit for which:</p> <p>c.a) the amount of a taxable transaction shall be determined at the book balance of the goods as of the deregistration date, for which the taxpayer had obtained credit;</p> <p>c.b) the day preceding the entry of the deregistration into force shall be regarded as the time of effecting a taxable transaction;</p> <p>d) the use of buildings and structures of own production as fixed assets wherewith:</p> <p>d.a) the amount of a taxable transaction shall be determined at the value of the assets set forth under Article 148 of this Code;</p> <p>d.b) the instance of the entry of the fixed asset item into operation shall be treated as the time of effecting a taxable transaction;</p> <p>e) acquisition of services or goods into individual ownership in exchange for the share in a company and/or partnership (in this case taking out and/or registration of property shall be treated as the supply of property by a partnership) wherewith:</p> <p>e.a) the amount of a taxable transaction shall be determined at market value of goods/services (including taxes, duties and other charges) without VAT;</p> <p>e.b) the instance of the acceptance of services or goods into individual ownership shall be treated as the time of effecting a taxable transaction;</p> <p>f) in cases stipulated in Article 115(4) of this Code the return of fixed assets to a lessor in case of the expiration or early termination of a lease agreement wherewith:</p> <p>f.a) the amount of a taxable transaction is equal to the amount deductible from value balance group of the repair costs incurred with respect to the mentioned assets that causes the mentioned group to be zeroed</p>	
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out:

f.b) the instance of expiration or early termination of a lease agreement.

2. The amount of a taxable transaction shall be determined at market value of goods/services (including taxes, duties and other charges) without the VAT:

a) if a VAT taxpayer acquires a right or is entitled to receive the goods/services in exchange for a taxable transaction;

b) in cases stipulated under Article 18(11) of this code; c) in case of the supply of goods/services to employees; d) in case of supply of goods/services without compensation.

3. When supplying goods that involves reloading the instance of the reloading of goods shall be treated as the supply of goods.

4. In case of international telephone communication services the amount received or receivable from the services rendered to a nonresident company shall not be envisaged in the amount of a taxable transaction.

5. The value of the returnable (intended for multi-use) tare shall not be included in a taxable amount with the exception of retail trade where taxable turnover shall be reduced by the amount which the vendor pays to a customer upon returning a tare. If the above-mentioned tare is not returned within 90 calendar days from the supply of goods it shall be considered sold and be taxed according to the rule set forth in this Code.

6. In case of a long-term contract if the condition stipulated in Paragraph 1 of this Article does not occur:

a) the amount of a taxable transaction for the calendar year shall be established according to the volume of actual volume of performance which shall be calculated by contrasting incurred costs against total costs stipulated under the contract;

b) not later than December of each year shall be considered the instance of a taxable transaction.

7. In the case of financial leasing

<p><u>transactions, all late charges, penalties and compensation received by lessor for concept of damages shall be excluded from the amount of the taxable transaction.</u></p>	
<p>Article 202. Property Tax Rate</p> <p>1. The annual rate of property tax for an enterprise/organization shall be determined as not more than 1 percent of the value of taxable property. For the purposes of this Paragraph the value of taxable property shall be the average annual book residual value (is calculated according to the average value of the assets as of the beginning and close of a calendar year), which in the cases listed below must be increased:</p> <p>a) 3 times -- for assets received prior to 2000; b) twice -- for assets received between 2000 and 2004; c) 1.5 times -- for assets received in 2004; d) in the amount determined under Sub-paragraph (a) of this Paragraph -- for the assets information about receiving of which is not available.</p> <p>2. The appreciation of taxable property envisaged under Paragraph 1(a)-(d) of this Article shall not be applicable to:</p> <p>a) an enterprise if it accounts for immovable property recorded on its books using a revaluation method and has the financial reports audited by the entities determined under the decree of the Government of Georgia; further, audited financial reporting may be used only for a 4-year period;</p> <p>b) government enterprises determined by the Government of Georgia.</p> <p><u>c) Leasing Companies having their financial reports audited by the entities determined under the decree of the Government of Georgia.</u></p> <p>3. Annual property tax rate on taxable property transferred under leasing to an enterprise/organization shall be determined as not more than 1 percent of average annual book residual value of taxable property (as calculated according to average value of assets as of the beginning and close of a calendar year). For the purposes of this paragraph the book value of the taxable property issued under leasing shall be the value as of the transfer of property, and for each subsequent year the residual book</p>	

value of the mentioned property that this property would have if it were not transferred under leasing shall be considered to be the residual book value of the mentioned property.

4. A tax authority shall be authorized to determine for a taxpayer average annual book residual value of taxable property at the time of a tax audit at market value, with the exception of the cases envisaged under Paragraph 2 of this Article while a taxpayer shall be entitled to appeal the decision taken by the tax authority with regard to the amount of market price according to the rule established under this Code. If it is ascertained that the market value of taxable property is higher than its book value an entity shall be obligated to pay property tax assessed on the given difference; further, an entity shall not be imposed a sanction envisaged under this Code for the period until the recognition of property tax assessed on the difference and it shall be obligated to apply the mentioned market value in relation to the relevant taxable property during the following 3 tax years. Further, the difference emerged as a result of the recognition shall not be considered the understatement of tax.

5. Annual rate of property tax on taxable property of an individual is differentiated according to the revenues received by a taxpayer's family during a tax year and shall be set according to the following amount:

a) for the families having income of up to GEL 100,000 – at least 0.05 percent and not more than 0.2 percent of market value of taxable property at the end of the tax year;

b) for the families having the income of GEL 100,000 or more – at least 0.8 percent and not more than 1 percent of market value of taxable property at the end of the tax period.

6. For f this Book considering Paragraph 7 of this Article all income including the benefits without considering tax allowances shall be included in the incomes received by a individual's family during a tax year, namely:

a) taxable income received from economic activity; b) any income, including benefit, which is not related to economic activity; c) accrued salary.

<p>7. For the purposes of Paragraph 6 of this Article: a) the value of property received from family members under inheritance, gifting or on the basis of divorce shall not be entered in incomes; b) income received by a individual (including by the 1st line legatee, cumulatively by him/her and a decedent) from the sale of a residential apartment (house) that was under ownership thereof for more than 2 years; c) income in relation to a citizen of Georgia nonresident individual shall be determined according to the income received from a source in Georgia; d) income received from an initial sale of property envisaged under Article 82(1) (m) of this Code shall not be included in the revenues; (7.12.2010. N3882)</p> <p>8. Tax liability on taxable property shall be determined at the rate in effect as of December 31 of a tax year.</p>	
<p>Article 206. Exemption from tax.</p> <p>1. The following shall be exempted from property tax according to a relevant taxable object:</p> <p>(...) (--) property used for medical activity, owned by medical institutions, with the exception of land.</p>	
<p>TITLE III: PROVISIONS OF THE LAW ON ACTIVITIES OF COMMERCIAL BANKS</p>	
<p>Article 20: Banking Activities</p> <p>1. Commercial banks are authorized to engage in only the following types of activities:</p> <ul style="list-style-type: none"> a) receiving interest-bearing and interest-free deposits (time, demand and other) and other returnable means of payment; b) extending consumer loans, mortgage loans, other credits both secured and unsecured and engaging in factoring operations with and without the right of recourse, trade finance including the granting of guaranties, letters of credit, acceptance finance, and forfeiting. c) Buying, selling, paying and 	

<p>receiving monetary instruments, such as notes, drafts and checks, certificates of deposit, as well as securities, futures, options and swaps on debt instruments and interest rates, currencies, foreign exchange, precious metals and precious stones.</p> <p>d) Cash and non-cash settlement operations and the provision of collection services.</p> <p>e) Issuing money orders and managing money circulation (including tax cards, checks and bills of exchange).</p> <p>f) Securities brokerage services;</p> <p>g) Trust operations on behalf of clients and funds management;</p> <p>h) Safekeeping and registration of valuables including securities;</p> <p>i) Credit information services;</p> <p>j) Activities incidental to each of the above types of services, and</p> <p>k) <u>Invest in leasing companies whether or not as controlling shareholders, and provide funding subject to the terms of the law, provided however that banks shall not be authorized to enter into leasing deals in capacity of lessors, but only through their subsidiaries or affiliates;</u></p> <p>l) <u>Extending loans to and buying obligations from leasing companies both with recourse up to 20% of the bank's equity and on a non-recourse basis, by means of the pledge of leasing receivables by such leasing companies in favor of the bank. In the case of loans granted to and obligations issued by leasing companies on a non-recourse basis, the 20% ratio of aggregate amounts of credits to a single customer with respect to the bank's equity shall be calculated taking into account the amount each of the lessees owes to pay the lease receivables pledged to the bank as security instead of the individual leasing company receiving the non-recourse</u></p>	
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<p><u>funding. No restriction shall apply to the interest rate applicable to such loans.</u></p> <p>2. Activities connected to securities operations listed in subsection 1 of this Article shall be regulated by the Law of Georgia on Securities Market”.</p>	
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