Transfer Pricing Newsletter

Issue №1
November 2018

TRANSFER PRICING IN GEORGIA - ARE YOU TRADING AT ARM'S LENGTH?

What does the term "arm's length" mean to you? The term is frequently used to describe the commercial and financial relations between independent parties when they engage in trading activities, and is usually synonymous with market conditions. However, when companies forming part of the same multinational group enter into intra-group transactions with each other, the commercial and financial conditions of the arrangement might be more in favour of one of the parties to the transaction. Within limit, this could be considered as effective tax planning. However when transactions are structured to artificially reduce or increase the taxable profits of related group companies in other countries, it could potentially result in non arm's length transactions or even profit shifting.

Transfer pricing, which historically was a subject of limited interest, has in recent years become a common word for most companies with a global footprint. Substantial increases of global business models and unprecedented public scrutiny over the tax practices of multinational enterprises (as was the case with Amazon, Google, Starbucks, etc.), makes transfer pricing a widely debated topic in the world. The echoes of the global developments in transfer pricing can also be seen in the Georgian environment.

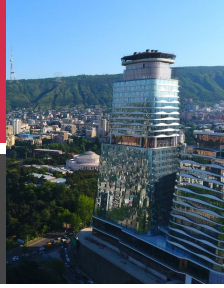
Although, transfer pricing is not in itself illegal, or necessarily abusive, the manipulation of intercompany pricing is in most cases inadmissible. Countries use a system of laws and practices to ensure that any intra-group transactions related to goods, services and intellectual property are priced at "arm's length" i.e. at the price which would have been established, had the parties been independent.

Transfer pricing rules in Georgia were first introduced in 2011, as part of the Tax Code. Articles 126-129 of the law define parties to and general principles of examining international controlled operations. The detailed methodology was enacted with Finance Minister Decree #423 on 'Approving the Instruction on Assessment of International Controlled Operations'. Georgian legislation is based on the 2010 edition of Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations by Organization for Co-operation and Development ("OECD Guidelines"). The OECD Guidelines represents recommendations for multinational enterprises, entering into intra-group transactions, for conducting its business in a responsible manner which results in an appropriate tax base in each jurisdiction and the avoidance of double taxation. This has the effect of minimising conflict between tax administrations and promoting international trade and investment. According to recent global developments, the OECD Guidelines are becoming an international pricing standard, despite being only recommendatory and non-binding in nature. Similar to best practice, the Georgian Revenue Service ("GRS") usually accepts transfer prices only if they are in line with the arm's length principle.

Since the transfer pricing rules came into force, the GRS has carried out several transfer pricing examinations with growing frequency on a yearly basis. This supports the observation that the GRS transfer pricing team is advancing in both number and expertise. The growing focus on transfer pricing by the GRS directly affects the development of local regulations and processes.

Transfer Pricing Newsletter

Issue №1
November 2018



IS YOUR GEORGIAN BASED COMPANY SUBJECT TO THESE REGULATIONS?

Georgian resident companies could be subject to Georgian transfer pricing regulations, regardless of its legal form or status within the group (i.e. parent, subsidiary, branch, representative office, etc.). Thus, any transactions with a foreign related party or with a party located in a low-tax jurisdictions (according to Georgian legislation this is defined as a territory where the corporate income tax does not exceed to 5%, or is fully relieved) could fall within the Georgian transfer pricing net. Furthermore, local legislation does not include any transactional materiality threshold meaning that all intra-group transactions, regardless of the size, could be subject to transfer pricing inquiry. These intra-group transactions include, but are not limited to: buying and selling of goods, manufacturing activities, receiving and/or provision of various intra-group services, (e.g. management services, financing and accounting services, information technology services, etc.), use of a group's brand or tradename, intercompany loans, etc.

Our experience shows that non-compliance with Georgian transfer pricing regulations can be costly for multinational companies as it could lead to double taxation, interest on tax underpayment and substantial penalties. It can also result in extended disputes with the GRS, including litigation. A first line of defence for a company, putting in place a robust transfer pricing policy which is supported by a detailed transfer pricing document.

The objective of the PwC newsletter series is to raise general awareness on this moderately explored field. For this purpose, PwC will be sharing our experience on some topics and providing some insights into recent developments in the Georgian transfer pricing practice.

The newsletters will also add value to companies who are still uncertain whether their business is affected by transfer pricing. The information will assist in identifying potential transfer pricing related risks, after which a meeting can be arranged with PwC to discuss the options available in more detail. PwC has one of the best transfer pricing teams in Georgia which consists of a local director and two managers. The team has extensive experience both in the Georgian as well as international markets.

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

Sergi Kobakhidze
Director, Tax Services

Tel.: (+995 32) 250 80 66
Email: sergi.kobakhidze@pwc.com

Ben Pietersen
Manager

Tel.: (+995 32) 250 80 50
Email: ben.pietersen@pwc.com

Anastasia Kipiani
Manager

Tel.: (+995 32) 250 80 50
Email: anastasia.kipiani@pwc.com