Learning by doing in Georgia
Building tax audit capacity in the Georgia Revenue Service
Georgia, a lower middle-income country located at the crossroads between Western Asia and Eastern Europe, has undertaken a series of progressive reforms since 2008, including anti-corruption efforts, a reform of the tax system, and improvements to the essential infrastructure of the country. The reforms have resulted in a great flow of foreign direct investment and positive gross domestic product growth. The World Bank ranks Georgia among the highest performing countries in the region in terms of control of corruption and as one of the most business-friendly countries globally.

Between 2010 and 2019, Georgia’s GDP per capita grew at an average annual rate of 4.8%. The main national taxes in Georgia collectively account for 21.74% of GDP. Fiscal policy has appropriately balanced infrastructure investment and social spending with fiscal discipline. Tax collection has exceeded projections, partly due to an improved tax administration. In 2020, the real GDP growth is projected to sharply slow to near zero and the fiscal deficit will increase to around 5.2% of GDP, mainly due to the COVID-19 crisis.

With higher levels of investment there are also risks of more multinational enterprises (MNEs) shifting profits, taking advantage of the loopholes and mismatches between different countries’ tax systems. Importantly, as fiscal space tightens in the COVID-19 crisis environment, the taxation of MNEs will be critical to domestic resource mobilisation (DRM) efforts in Georgia.

Georgia is actively contributing to the international efforts to tackle tax evasion and tax avoidance through its membership in the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) and the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The Tax Inspectors Without Borders (TIWB) initiative complements those efforts and has become a vital partner of the Georgia Revenue Service in helping to create a competitive business environment in which MNEs pay their fair share of taxes.
The TIWB programmes in Georgia have helped build the tax auditors’ skills and confidence leading to organisational change, improved service delivery, better co-operation with taxpayers and increased tax compliance.

Human resource development

The TIWB experts deployed in Georgia confirm that through the TIWB programmes, the Georgia Revenue Service auditors have improved their ability to conduct high quality audits. The hands-on, practical approach of TIWB support has improved auditors’ skills and confidence in managing complex transfer pricing audit cases. Georgia Revenue Service officials report that they were able to select the companies and conduct the audits and get to the outcomes by themselves at the end of the project. Significant progress has been made throughout the whole audit process: from pre-audit assessment, documentary research, requesting and analysing taxpayer information, to conducting onsite audits. The auditors obtained risk assessment skills and knowledge on transfer pricing and other international tax topics, including transfer pricing methods, dealing with related party transactions involving intangibles, services and financial products, as well as valuation techniques and dealing with permanent establishments. At the same time, they gained valuable experience in dealing with taxpayers in the banking and oil and gas sectors. Officials also reported increased confidence in approaching taxpayers. Moreover, a member of the transfer pricing division will soon participate in TIWB programmes as an expert mentee.

These positive outcomes in terms of confidence and competence follow a pattern in many countries where TIWB has been in action (see Figure 1).

Figure 1: Increased perceived competence of auditors trained through TIWB programmes in various countries

Source: TIWB Secretariat, based on self-evaluations with a scale of 1 (poor) to 5 (excellent), completed by 52 tax auditors at the beginning and end of TIWB programmes.
On the advice of the TIWB expert, a transfer pricing division was established

The Georgia Revenue Service initially had a transfer pricing team composed of four members when it requested its first TIWB programme in 2016. As the programme commenced and the TIWB expert started working with the local auditors, the Georgia Revenue Service recognised the impact of transfer pricing audits on their DRM efforts.

As a result, the Georgia Revenue Service created a dedicated transfer pricing division and expanded the team to include ten members, who are now fully engaged in transfer pricing audits. Setting up the division has enabled the division members to build expertise in this highly specialised area of tax.

Organisational development

The TIWB programmes in Georgia have triggered significant organisational changes leading to improved service delivery and better co-operation with taxpayers. TIWB allowed Georgia to bring international best practices and experiences into the tax administration providing quality services for the taxpayers as well as assessments and adjustments, which are in line with international standards.

- Through the TIWB programmes, working methods were improved and new tools, methods and guidance have been developed, for example:
  - The transfer pricing division strengthened the co-operation with the general audit teams within the Georgia Revenue Service to increase knowledge sharing.
  - Georgia Revenue Service auditors successfully apply a five-step audit methodology (1. risk selection, 2. documentation review and written request for information, 3. analysis of company's data and information, request for additional information, if required, 4. field audit and additional questions, 5. taxation decision in accordance with legal procedure). Through this approach, transfer pricing information is requested in a more efficient way from companies. Moreover, the number of field audits has increased, and these are also better prepared through more deskwork and research.
  - The transfer pricing division can now access company data and information via a database. This has helped increase its credibility with taxpayers.
  - A simplified risk assessment profile has been developed to select the most relevant cases for audit.

- The Georgia Revenue Service is currently working on the implementation of an Advance Pricing Agreement (APA) programme, supported by international experts under a technical assistance programme of the Asian Development Bank. The Georgia Revenue Service plans to engage an expert under a new TIWB programme to support the team in issuing its first APAs.

- Building on these organisational changes, in future the TIWB expert’s assistance will be sought to help develop new performance management tools for auditors in order to consolidate and capitalise on these developments.

Georgia Revenue Service officials report that taxpayers and the tax administration are satisfied with the results of the TIWB programmes in Georgia, which have worked well to improve outcomes through mutual co-operation.

Impact on tax compliance

The Georgia Revenue Service has noted an improvement in tax compliance following the enhancements to the quality of its audits. Taxpayers are becoming more attentive to the clarity and completeness of the information they disclose in their tax returns. Examples show that taxpayers have adjusted their transfer pricing reports because of the increased expertise of auditors, and more comprehensive audit approaches. They now avoid more aggressive practices in the determination of related party interest rates, management fees, and royalty rates. Taxpayers’ documentation of their related party transactions has also improved. These outcomes illustrate how TIWB complements the broader efforts on tax transparency and BEPS.
How the Georgia Revenue Service and TIWB have been working together to build tax audit capacity

Before the TIWB project started in Georgia, the Revenue Service felt that their auditors had the knowledge but no practical experience in conducting transfer pricing audits. Transfer pricing regulations were introduced in Georgia in 2011. In 2015, the first transfer pricing audit was conducted. The Georgia Revenue Service was attracted by the practical format of TIWB, its learning-by-doing approach, providing the opportunity to conduct transfer pricing audits from the very beginning to the end with the help of experienced international experts. TIWB experts are not a substitute for local audit staff but work side-by-side with them on real cases during onsite and virtual missions.

The initial TIWB programme commenced in early 2016. The TIWB expert worked with Georgian tax officials on eight audit cases. With this general tax audit support, the Georgia Revenue Service was able to issue amended assessments amounting to USD 2.16 million in tax revenues, an important contribution to the global revenue impact of TIWB as shown in Figure 2.

Figure 2: Tax Inspectors Without Borders Global Revenue Impact to date

USD 537 million in increased tax revenues
USD 1.84 billion in tax assessments

Note: 2012 to 30 June 2020.
Source: TIWB Secretariat.
Following this successful experience, Georgia requested a second TIWB programme, which was launched in April 2018 in the presence of Mr. Mamuka Terashvili, First Deputy Director General of the Georgia Revenue Service, Dr. André Nsabimana, TIWB expert, and Dr. Amna Khalifa, TIWB Project Manager. A dedicated meeting with the UNDP Country Office was held to identify complementary areas of co-operation with other international organisations to avoid potential conflicts or overlaps with other technical assistance programmes.

This initial mission was an opportunity for TIWB to assess the ongoing work undertaken at the Georgia Revenue Service, which had been strongly engaged in the OECD/G20 BEPS Project since its very beginning. Indeed, Georgia is making very good progress in implementing the four BEPS minimum standards9 and is, for example, among the first developing countries that have signed and ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (known as the Multilateral Instrument or MLI). Regarding tax transparency, Georgia has recently committed to implementing the Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI Standard) by 2023 and is benefiting from a capacity building programme under a pilot project on implementing the AEOI standard10, through a partnership of Georgia with Germany and the Global Forum.

During the second programme, the TIWB expert worked with Georgian tax officials on ten audit cases. The programme focused on company evaluation, risk assessment, permanent establishments, and APAs, thus helping with making transfer pricing and other BEPS related rules a reality.

The two TIWB programmes in Georgia covered various sectors, such as banking, construction, e-commerce, finance, manufacturing, sales and distribution, as well as oil and gas.

The Georgia Revenue Service commended the TIWB experts’ skills and experience on transfer pricing and auditing MNEs, their advice, interpretation of legislation and their involvement in the process through onsite missions and also remotely. In February 2020, the Georgia Revenue Service requested a new TIWB programme which will start in 2021. Through this new programme, the Georgia Revenue Service is aiming to conduct audits in the extractives sector to address profit shifting by large companies.

“The TIWB programmes gave us new opportunities. We see the progress in the quality and quantity of transfer pricing audit cases conducted. We also observe the positive behavioural changes of taxpayers and advisory firms regarding tax planning.”

Paata Kiladze, Head of Audit Department, Georgia Revenue Service
As the Georgia Revenue Service’s experience shows, TIWB’s low-cost, high-impact practical interventions fill a gap in technical assistance, enabling host administration staff to take ownership of their cases with limited and focused support from foreign experts. Outcomes of TIWB assistance are threefold: tax revenue generated through assisted audits, enhanced auditor skills and confidence building, and overall improved tax compliance by MNEs operating in the country.

The Georgia Revenue Service auditors’ motivation was a key factor to the success of the TIWB programmes in Georgia. There was a real interest in transfer pricing issues, a willingness to learn and unwavering perseverance in onsite audits. In addition, the positive atmosphere within the team allowed for teamwork and knowledge sharing between the newest and most experienced auditors.

The TIWB method of combining training and practical support on the audits strengthened the auditors’ technical knowledge. This approach helped improve self-confidence - auditors feel better prepared for meetings with taxpayers, companies, and consultants.

The involvement of other departments within the Georgia Revenue Service has made it possible to disseminate transfer pricing knowledge to all parts of the tax audit chain.

Regular discussions with the Georgia Revenue Service management helped raise awareness of the importance of transfer pricing audits and resources required for the transfer pricing team to work most effectively. The interest of the senior management in the TIWB process was another key factor to the success of the programmes.

The UNDP country offices can play a proactive role in the TIWB capacity building work by reaching out to policy makers. The UNDP country offices can also offer a platform for coordination with other international organisations for exploring synergies between ongoing projects.

TIWB was inspired by the 2008 financial crisis, when governments came together to fight for tax transparency and begin the battle against BEPS. With a track record of quick revenue wins, TIWB has never been more relevant than in the current COVID-19 crisis environment.

TIWB’s results as of 30 June 2020:

- Additional tax revenues raised by developing countries in connection with TIWB programmes amount to USD 537 million, and overall tax assessments exceed USD 1.84 billion (see Figure 2).
- TIWB programmes represent good value for money. On average, USD 70 in additional tax revenues have been recovered by host administrations for every dollar spent on TIWB operating costs.*
- As of 15 November 2020, the initiative covers 44 jurisdictions with 40 completed programmes, 42 programmes underway and 18 programmes in the pipeline.

Despite the COVID-19 crisis, TIWB has remained open for business with most operations having switched to remote assistance and with procedures in place to protect taxpayer confidentiality. TIWB is now expanding into new areas, such as criminal investigations, which will help in the global fight against Illicit Financial Flows. Pilot programmes are also planned on the effective use of information received through AEOI channels, taxation and natural resource contracts, and tax and the environment.

*Based on estimates by the TIWB Secretariat.
7. An APA is an administrative approach that attempts to prevent transfer pricing disputes from arising by determining criteria for applying the arm’s length principle to transactions in advance of those transactions taking place. This contrasts with traditional audit techniques that look to whether transactions, which have already taken place, reflect the correct application of the arm’s length principle.

8. The total tax collected is not reported yet as some cases are currently in the litigation process.

9. As an output of the OECD/G20 BEPS project, four mandatory minimum standards were agreed to tackle issues in the following areas where no action by some countries or jurisdictions would have created negative spillovers in others: harmful tax practices (BEPS action 5), tax treaty abuse (BEPS action 6), Country-by-Country Reporting for the activities of MNEs (BEPS action 13), and dispute resolution (BEPS action 14).

10. The AEOI Pilot Project is a flagship Global Forum programme in which developing countries partner with a more experienced country that has implemented the AEOI Standard, and the Global Forum Secretariat.

Endnotes


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