

To: The Minister of Finance of Georgia

Mr. Lasha Khutsishvili

Position Paper

Difficulties faced by IT companies with a Virtual Zone Person Status

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INTRODUCTION

With this joint letter from the European Business Association (EBA) and the Association of Georgian Virtual Zone Persons, we would like to bring your attention to one of the problematic issues that IT companies with a Virtual Zone Person (VZP) Status face due to the recent actions of the Revenue Service of Georgia - penalizing dozens of IT companies with a VZP status operating in Georgia.

The EBA unites over 100 Georgian and European companies. The organization's vision is that doing business in Georgia will be the same as doing business in Europe. The mission covers two main directions: 1. To advocate/lobby for European businesses in Georgia; 2. To facilitate the development of trade and investment between Georgia and Europe.

The Association of Georgian VZP is a non-profit organization that unites foreign investors and representatives of IT companies. The organization's primary goal is to protect the interests of the members of the Association and to provide transparency in the regulation of their activities.

Both Associations are European Economic Cooperation Platform ([EECP](#)) members created within the EU-funded project "Promoting European Business and Economic Interests in Georgia" to facilitate a dialogue between representatives of the business sector, including BSOs/Bilateral Chambers/NGOs, IFIs, the European diplomatic community, and policymakers to develop a favorable social-economic climate and non-discriminatory, transparent business environment, which would be attractive for investment.

SUBJECT OVERVIEW

Both Associations positively assess the reforms made by the Ministry of Finance in recent years. However, several issues are still ignored, which may cause harm to foreign investment.

In December 2010, the Parliament of Georgia adopted the Law of Georgia on Information Technology Zones, which provides for the status of a virtual zone for a legal entity carrying out information technology activities. The main purpose of this law was to obtain investments and create an attractive environment for those who will carry out economic activities in the field of information and IT technologies. The attractiveness of this law is that the profit obtained as the result of the delivery of the information technologies created by the legal entity of the virtual zone outside Georgia (profit distribution) is exempt from the profit tax and, in some cases, charged at 5% of the dividend income. Many foreigners took

advantage of the “goodness” of the law mentioned above and established a virtual zone enterprise in Georgia.

To promote the development of a strong and stable domestic IT industry and knowledge economy, it is crucial to protect an image of stability and transparency and to ensure that IT companies willing to invest in Georgia are treated fairly. However, the recent actions of the Revenue Service run counter to this policy objective.

Ten years after the adoption of the law mentioned above, and more precisely starting from 2021, the Revenue Service has changed its approach to the taxation of “the entities of virtual zone” quite roughly, without establishing any communication with the business. In particular, in the spring of 2021, the tax office began to request the representatives of the entities of the virtual zone to provide evidence that they delivered the information technologies created on the territory of Georgia to foreign clients. All the documents of the companies were checked, and the companies, whose founders are mainly foreigners, were explained that they had to allocate in Georgia and sell the product from here. Otherwise, they would not be able to enjoy the 15% profit discount and will have to retrospectively charge the profit as 15% of the dividend income. Those companies that did not agree with the tax authority's rigid, unfair, and unexpected approach were fined retroactively. Additionally, the companies were penalized up to 50% of the amount payable.

JOINT POSITION concerning Difficulties faced by IT companies with a VZP Status.

Considering all the difficulties mentioned above, to protect the image of a healthy, transparent, and open investment climate in Georgia, we would like to request the Ministry of Finance of Georgia **VZP companies to be judged based on their behavior from the moment of establishment of these criteria onwards and not retroactively.**

Dozens of companies who were proud to be operating in and from Georgia are now penalized by the Revenue Service. With this, Georgia does not send a positive signal to the broader international IT sector, which might consider investing in a Georgian IT presence.

It is unclear why the interest in this issue arose, and the change of approach incurred after so many years, which had the most negative impact on the business of each entrepreneur - resulted in hundreds of investors leaving the country (*including the entire monetary capital of the companies was withdrawn from the country*). Additionally, principles of fairness and transparency are questioned, given that so many companies are being fined retrospectively when there was no situational guidance on the subject at that time, and the record of the law is still ambiguous and not foreseeable. It was only in February 2022, with the order of the Head of the Revenue Service, that a vague methodological reference to the taxation of the profit of the entity in the virtual zone was adopted, which was declared invalid on March 25. A second methodological reference was approved in March, which also requires clarification.

No investor denies the fact that any entity should pay taxes unconditionally, and any investor does not avoid this; however, only when this is clearly and fairly provided by the law and from the moment

of establishment of clear criteria onwards, and not retroactively, which is not the case with companies with the VZP. Unfortunately, the proceedings in all instances of the Ministry of Finance were resolved to the detriment of businesses.

It is crucial to send a strong signal that the Government of Georgia is an attractive and reliable partner to any IT company that is ready to invest and grow its operations in Georgia. Many companies have a significant presence in Georgia through highly educated (IT) personnel, supportive personnel, office space, and other tangential activities. Each year they bring in significant tax revenue that would otherwise not have ended up in Georgia. Even more importantly, VZP companies provide dozens, if not hundreds, of new high-value jobs to the burgeoning Georgian IT sector every year.

Both Associations express their readiness to take an active part in developing processes to overcome the challenges faced by the business sector mentioned above through joint dialogue and cooperation. Hence, we would like to request **a working meeting with the Ministry's representatives to discuss this issue further.**

Sincerely,



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