

16 September 2004

MEMORANDUM FOR

Mr. Kalman Mizsei

cc: Ms. Karin Lissakers

From: Bob Conrad

Subject: Tax Issues: Georgia

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Some tax policy and implementation issues are noted below in preparation for your meeting.

I. Policy

a. Personal Income Tax (PIT)

- i. A personal exemption is necessary. The draft code should be amended to include a personal exemption to ease administration and to provide some progressive element into the personal income tax structure.
- ii. There is still time to coordinate the rates of the personal income tax and the social taxes. Rate coordination is important for revenue purposes during the transition. Over the longer term, social tax rates should be determined in relation to reforms of pensions, health care and other social programs. (I proposed to have one combined rate for social tax and personal income tax, with the summation of the two rates fixed at a predetermined level. The personal exemption and the personal income tax rate would then determine the allocation of revenues between the personal income tax and the social fund[s]).

b. VAT

- i. Pragmatism about the VAT rate is necessary. The VAT rate (and rates of selective excises) should be based on overall budgetary needs.
- ii. The VAT base proposed in the draft code is reasonable and the Government should resist attempts to enact additional exemptions during the parliamentary debates.

- iii. The Government will enhance the success of overall reform if export refunds are paid promptly and input credits are allowed when declared. (It is better to lose some revenue via evasion than to impose administratively complex compliance measures that harm honest taxpayers (and reduce economic activity).)

c. Profits Tax

- i. Keep one depreciation rate per asset classification.
- ii. Keep accounting simplified by developing clear rules for transfer pricing and related party transactions.

d. Administration

- i. Ensure public participation and comment on regulations and on dispute resolution methods. (A tax administration advisory board might be appropriate. The board might consist of private sector representatives, academics and even international experts.)
- ii. Develop a dispute resolution system that is transparent and impartial. Some type of tax arbitration board composed of experts from the public and private sectors might be used during the transition period.

II. Implementation

- a. The new rates (for all taxes?) can be introduced at any time.
- b. The personal income tax can be implemented on 1 January 2005.
- c. The VAT reform can take place at the beginning of any month (given the nature of the VAT) and thus preparations should be completed before implementation begins.
- d. The profits tax is the most complicated tax and some transition rules are necessary. It might be best to phase the profits tax change, implementing depreciation reform and rate changes next year and implementing the remaining changes in the second year.
- e. Continue public dialogue, taxpayer education and administrative reforms. Ensure that administrative reforms coincide with policy changes.