

COVID-19 PANDEMIC AS THE BEST OPPORTUNITY TO IDENTIFY DEFICIENCIES IN GEORGIAN TAX LEGISLATION

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Abstract

Georgia's economy has always been vulnerable and unstable to crises and external shocks over the past three decades, further exacerbated by the Covid-19 pandemic, which has put on the agenda the feasibility of revising the mechanism for distributing the current tax burden and income between taxpayers. The crisis has clearly revealed the advantage of elastic taxes with respect to the taxation base and the need to use a progressive taxation method for certain taxes. Due to the absence of a tax-free minimum and a method of progressive income taxation the situation of the low-income population in Georgia has deteriorated sharply in the context of the pandemic. In a country where the annual income of more than 96% of the employed population is under GEL 40,000 (USD 12,744), the tax burden under the standard VAT rate, which is not differentiated depending on the types of goods and services supplied, is heavy. The property tax of natural persons does not ensure the efficient use of property.

The purpose of this article is to assess the state of the Georgian economy before the pandemic and in the context of a pandemic and to substantiate the need for changes in tax legislation to improve the quality of life of employed people, reduce the tax burden for a significant segment of market entities that have not withstood the crisis caused by the Covid 19 pandemic. The Research methods of this article are: scientific abstraction, comparison of information, generalization, analysis and synthesis were also used. The empirical basis of the research is the official information of the National Statistics Office of Georgia, the normative acts of the Government of Georgia, the Georgian Tax Code and scientific publications. The theoretical and empirical methods used in the article confirm the inefficiency of the existing taxation method. Using the scientific abstraction of the research, as well as the method of analysis and synthesis, the official information of the National Statistics Office of Georgia has been processed, the correlation between economic events has been studied and the result has been generalized in the sense that the distribution of income under the conditions of application of the existing taxation method creates social inequality for employees while also impeding the development of the real sector of the economy.

The study concludes that in order to ensure fiscal sustainability and economic growth of the budget, it is important to revise income, property and value added taxes, which, in turn, will be a task of social importance in particular, in order to create equal development opportunities for market participants, it is important to review the value-added tax and set optimal differentiated rates; In order to improve the quality of life of working people and to overcome social inequality, it is advisable to replace the existing 20% proportional method of income tax with the progressive method of taxation. It is also necessary to adopt a tax-free minimum; In order to increase the efficiency of property tax, it is advisable to revise the rates of the tax on agricultural land and established benefits for individuals, as well as revise the property tax (excluding land) and make it progressive based on the market value of the property, which will also result in an increase in local budget revenues.

COVID-19 can help Georgia to learn lessons from the problems that emerged during the crisis, and implement legislation amendments and correctly plan reforms because the existing situation increases and deepens financial inequality.

Keywords: income tax, property tax, social inequality, tax burden and value added tax

Introduction

In recent years, Georgia has been trying to bring national legislation closer to the European Union's one under the Association Agreement with the EU, as well as to conclude free trade agreements with various countries, but this is happen at a time when the economy is not yet ready for competition because a real sector of the economy is not developed properly and there is no way to stimulate the agricultural sector. Against this background, due to the natural climatic conditions of the country, tourism has gradually become one of the leading sectors of the economy. The Covid 19 pandemic once again confirmed the instability of the country's economy, especially the tourism sector, and the country faces a need for urgent changes in the fundamental principles of economic policy.

The article discusses the impact of the Covid 19 pandemic and current tax legislation on Georgia's fragile and unstable economy. The importance and urgency of the topic lie in identifying the causes that led to external challenges, economic instability, and unsteadiness in general, and the worsening of the difficult situation of employees and entrepreneurs in a pandemic, one of the solutions is considered the feasibility of changing the methods of taxation of individual taxes.

The Covid-19 crisis has also shown that even developed European countries may face the issue of revising fiscal norms „In the long run, European institutions, and eurozone governments in particular, need to be aware that changes are unavoidable, as the current crisis renders fiscal rules and existing treaties outdated and inapplicable“. (Botta, A., Caverzasi, E., Russo, A. 2020).

The article presents the following hypothesis of the study - without changes in the tax legislation, it will not be possible to stimulate market participants to gradually overcome the difficulties that emerged in the pre-pandemic and pandemic periods, and to be able to ensure stable economic growth.

The objectives of the article are: To study and analyze challenges faced by the country's economy, which was further aggravated by the current tax legislation in conditions of the Covid 19 pandemic, and to develop relevant recommendations.

Research methods: scientific abstraction, comparison of information, generalization, analysis and synthesis were also used. The empirical basis of the research is the official information of the National Statistics Office of Georgia, the normative acts of the Government of Georgia, the Georgian Tax Code and scientific publications.

Research Results

Analysis of the current state of the economy

Georgia, under the Association Agreement with the European Union, is trying to bring national legislation closer to the Europe's, to conclude free trade agreements with various countries, but does not take into account that the economy is not yet ready for competition and without significant legislative changes, local production can neither develop nor compete imported products.

The economic stagnation induced by the Covid 19 pandemic in Georgia has necessitated urgent reforms in the fundamental principles of economic policy in order to achieve long-term and steady economic growth in accordance with the Georgian Constitution. The covid 19 pandemics have shown how the situation of taxpayers can deteriorate in times of crisis, under the current tax system. Accordingly, there is a need to amend tax legislation to improve the existing mechanism of tax burden and redistribution of income between taxpayers, taking into account the need to ensure fiscal sustainability and economic growth in the post-crisis period.

Georgia faced a pandemic with a very weak economy, which was due to:

1. Underdevelopment of the real sector of the economy, including agriculture, which is still considered a traditional sector of the agrarian country.

2. With a chronic investment deficit (Fig. 1) due to improperly designed investment policies. The share of foreign direct investment in GDP in 2018 was 7.4%, in 2019 7.5% (\$ 1.3 billion), and in 2020 3.8% (National Statistics Office, 2021). The agricultural sector has always been characterized by a particular lack of investment, where 5.7 million USD was invested in 2019, which increased slightly during the pandemic and amounted to USD 8.9 million in 2020 (Foreign Direct Investments, 2021). Direct foreign investments, in most cases, were not directed to the development of production and introduction of new equipment and technologies.

The country's economic policy didn't turn out to be compatible with existing resources and economic potential, which made it possible for a tourism sector, instead of developing and strengthening a real sector, to become an important part of the economy, because of natural-climatic conditions in the country, in particular, travel expenses of non-residents for business and personal purposes in 2017 amounted to 2.7 billion US dollars, in 2018 - 3.2 billion US dollars, in 2019 - 3.3 billion US dollars, and in 2020 – this indicator was reduced to 0.5 billion dollars (Balance of Payments, 2021)

The current situation in the economy is reflected in the following:

a). The balance of payments, which was chronically deficient, and was exerting a negative impact on the exchange rate. The devaluation of the national currency, in turn, led to inflation, which became permanent. The impact of inflation was reflected in both GDP and tax revenues, as evidenced by the GDP deflator, which was 111.4% in 2017, 116.1% in 2018, 122.3% in 2019, and 130.7% in 2020.

b) Low rate of GDP growth (Fig. 1). (Gross Domestic Product, 2021)

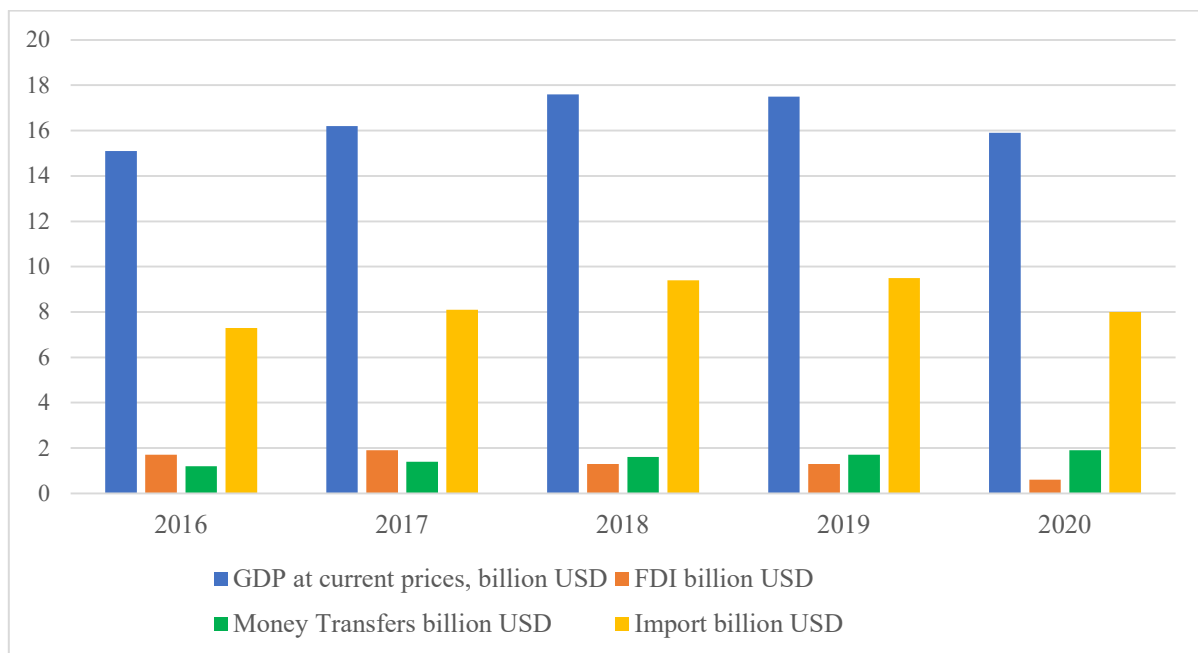


Fig. 1. Some indicators defining the economic state of Georgia (National Statistics Office of Georgia 2021)

c.) The lag of the tax revenue growth rate at the GDP growth rate (State Budget, 2021). For example, the growth rate of tax revenues in 2019 compared to the previous year was 8.6% and the GDP growth rate at current prices was 10.5% compared to the previous year, the growth rate of tax revenues in 2020 compared to the previous year -3.9%, and the GDP growth rate compared to the previous year at current prices was 0.2%.

d) The dependence of a significant part of the population on remittances received from abroad, the volume of which sometimes exceeds the volume of foreign direct investment. In 2019, remittances amounted to \$ 1.7 billion, and in 2020 to \$ 1.9 billion (Fig. 1) (Money Transfers by..., 2021).

e) On the foreign trade balance, which was negative all year, and the share of imports (Fig. 1) in foreign trade turnover ranged from 70-75% (External Trade, 2021).

Under the Covid 19 pandemic, in 2020, GDP fell was 6.2 percent year-on-year, and average inflation was 5.2 percent. In 2020, the GEL exchange rate against the US dollar depreciated by 14.3 percent compared to 2019. In 2020, net remittances increased by 9.6 percent year-on-year to \$ 1.8 billion. In 2020, 1,747,000 visitors visited Georgia (the number of visitors in 2019 was 9,358,000), which is 81.3 percent less than the same period last year. In 2020, according to preliminary data, the volume of foreign direct investment in Georgia decreased by 52.9 percent and amounted to 616.9 million US dollars. In the last quarter of 2020, compared to the same period last year, the number of people employed in the business sector decreased by 72.3 thousand people (Statistical Yearbook of Georgia, 2021). Against this background, with a standard VAT rate of 18%, the financial resources of a large number of market participants, on the one hand, and the effective demand of the majority of working individuals, on the other hand, decreased even more. The reduction of solvent demand for employed individuals was also affected by the existence of a proportional 20% rate of income tax.

Discussion of tax policy

Georgia's economy needs fundamental changes, however, at this stage, changes in tax legislation will make it possible to introduce the principles of fair distribution of tax burden on taxpayers, which has not been done so far. It was during the pandemic that the use of tax breaks became one of the most effective ways to partially alleviate the tax burden on taxpayers. The government, through legislative changes, from December 1, 2020, for 6 calendar months, allowed an employer to reduce or not pay to the budget the income tax withheld and payable from the salary up to 750 GEL paid to an employee, if the salary received by this employee from the same employer during 1 calendar month did not exceed GEL 1500. The purpose of this benefit was to enable employers to retain as many jobs as possible and to pay wages to employees. In the tourism sector, in February, March, April, and May 2020, the payment of income tax was postponed until December 2020.

Tax legislation in Georgia was substantially changed once in 2005 and only six of the 21 existing taxes were retained. The aim of the reform was to promote investment attractiveness and economic growth, as well as reduce the tax burden. The declared goal could not be achieved except in reducing the tax burden, which averages 23 percent (Fig. 2) and is much lower than the EU average, where it stands at 34%. Exactly this low rate of the tax burden, calculated at the country level and in relation to GDP, creates the illusion of low taxes and does not actually reflect the scale of the tax burden on a significant part of individual taxpayers, due to its unequal distribution. The current model of taxation has a negative impact on the level of well-being of the vast majority of employed people, on the development of medium and small enterprises and on the development of the sector, in conditions of competition from imports, which was revealed during the crisis.

Unequal distribution of tax burden towards taxpayers creates social inequality in society „To meet the SDG target for strengthening fiscal capacity and to avoid inequality-increasing forms of taxation, the IMF needs to reconsider the appropriateness of its tax policy advice toward developing countries“ (Reinsberg, B., Stubbs, T., & Kentikelenis, A. 2020), therefore, for a developing country such as Georgia, it is advisable to apply the method of elastic taxation to the tax base and the method of progressive taxation to individual taxes.

The past period has shown that taxes in Georgia have often been part of the politics. The tax legislation of Georgia was unable to redistribute the tax burden between taxpayers, which, on the one hand, would contribute to the development of the real sector of the economy, and on the other hand, it would be optimal during the crisis. In order to improve the standard of living of the majority of the employed

population and have equal development opportunities for all market participants, at this stage, it is necessary to revise the tax legislation in relation to both value-added tax and property tax and income tax, including the preferential part.

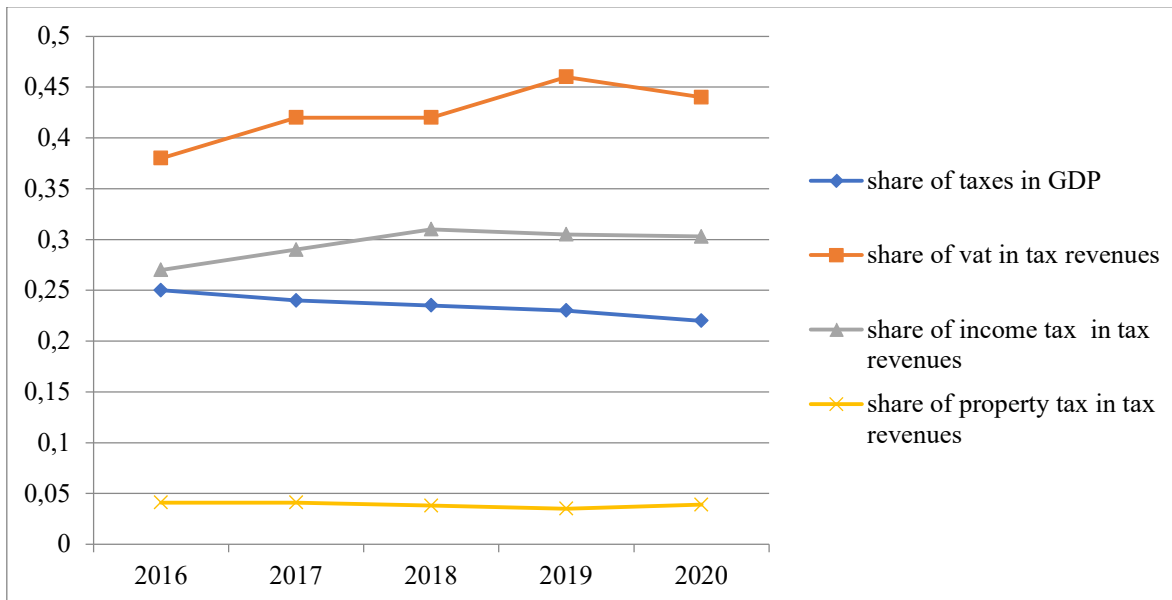


Fig. 2. Share of some taxes in tax revenues and in GDP (State Budget. 2021)

Value added tax

Value-added tax is the most significant tax in the revenue part of the budget of Georgia, its share in tax revenues in 2019 was 46%, 5,239 million GEL (1,858.3 million USD), and in 2020 44%, 4,837.2 million GEL (1,555.5 million USD) (Fig. 2). The standard tax rate is 18%, and it is not differentiated by the type of goods supplied and the type of services provided (Value-Added tax Act, 2020). Because of pandemic reduced the solvent demand for low income individuals as well as for people who lost their jobs and for those who are unemployed, whereas basic necessities (including food) are taxed at 18% and the rate is not differentiated. Under the standard VAT rate, the financial resources of small and medium-sized enterprises were further reduced and some of them were on the verge of bankruptcy.

In 2019, the turnover of large enterprises with an annual turnover of more than 60 million GEL amounted to 60,50.6 million GEL, which in 2020, increased under the pandemic and amounted to 64,922.8 million GEL. During the same period, the turnover of small and medium enterprises decreased, in particular, in 2020, compared to the previous year, the turnover of medium enterprises decreased by GEL 2,096.3 million, while the turnover of small enterprises decreased by GEL 1,743.2 million. Therefore, it is important to optimally distribute the VAT burden between individuals and legal entities paying taxes.

A review of value-added tax and the establishment of differentiated rates according to the types of goods and services provided would play an important role in overcoming the difficulties caused by the Covid 19 pandemic. The minimum and maximum rates of VAT should be determined taking into account the fiscal sustainability of the budget. It is advisable to tax the supply of basic goods and services at the minimum rate, as well as the goods supplied by the agricultural processing industry, and the maximum rate to the supply of luxury goods and services of non-primary demand. "VAT reduction is necessary to reduce enterprises' business costs and assist market entities in overcoming difficulties and realizing development. Based on the

simulation results, the 2018–2019 VAT rate reduction stimulated the vitality of market entities and expanded total demand, thereby stimulating economic growth”. (Yue, M., Yun, R. 2021).

Property tax

Property tax is one of the sources of local budget revenues, although its share of consolidated budget tax revenues does not exceed 4% (Fig. 2). In 2019, 474.3 million GEL were mobilized in local budgets across the country in the form of property taxes (168.2 million USD), and in 2020 433.6 million GEL (139.4 mln. USD). This tax, for a long time, can not fulfill either the fiscal or the stimulus function, because it can not ensure the efficient use of the property, nor can it fill the local budgets without transfers and regulatory taxes.

The maximum rate of property tax (excluding land) is 1 percent, while the tax on agricultural land is differentiated according to administrative-territorial units and land categories. Effective use of agricultural land is hampered by the exemption for individuals, according to which, as of March 1, 2004, up to 5 hectares of agricultural land owned by a natural person are exempt from property tax (Property Tax Act, 2020). Under such conditions the land remains uncultivated and unused. Economic growth in agriculture of 3.6% in 2020, as well as an increase in investment of GEL 3.2 million compared to the previous year, is evidenced by the fact that the cultivation of agricultural land under the Covid 19 pandemic was facilitated by a slight reduction in competition from imports and the urgent need to produce agricultural products. Ultimately, this suggests that there is no mechanism in tax legislation that forces landowners to use land effectively, especially in a small country like Georgia.

Revision of property tax for individuals, in the direction of its growth, will not only contribute to the efficient use of property, but it will also become a task of social importance „If reducing top income inequality is an important societal objective, wealth taxation may be necessary.“ (Zorn, N., & Pressman, S. 2020). Therefore, it is advisable to review the rates of agricultural land tax and established benefits, and as for property tax (excluding land), it is better to be progressive based on the market value of the property.

These measures will contribute to both the efficient use of the property and the increase of local budget revenues, and they will be less dependent on central budget transfers and will increase the degree of their financial independence. The change in attitudes towards property taxes has had a positive effect in Greece. Until a few years ago recurrent property taxation was playing a minimal role in the Greek tax system. In the middle of the recent severe crisis a new scheme of recurrent property taxation was introduced, initially covering only buildings connected to the electricity grid, but then extended to all types of real estate. The new tax had high collectability, boosted public revenues and helped substantially the fiscal stabilization effort of the country. (Andriopoulou, E., Kanavitsa, E., Leventi, C., Tsakoglou P. 2020)

Income tax

Income tax occupies an important place in the tax revenues of the budget of Georgia, in particular, the tax revenues of 2019 were supplemented with the mentioned tax by 3,482.8 million GEL (1235.4 million USD) and amounted to 30.5% of tax revenues (Fig. 2), and in 2020 was filled with 3,326.7 million (1069.7 mln. USD) and accounted for 30.3% of tax revenue. If we take into account that income taxation in Georgia does not provide for tax-free minimums and other deductions for employees, also the majority of income is very low, and a very small part has an income of more than 12 thousand USD per year, it becomes clear that the main burden of income tax falls on low-income employees.

In Georgia, the number of people employed in 2018 was 903.5 thousand people, of which 191 thousand people earned up to 100 GEL (\$ 39) per month, 543 thousand people earned up to 500 GEL (\$ 197) and around 25 people earned more than 5000 GEL (1972 USD) (Table 1). In the face of such income differentiation, the use of a proportional method of taxation and the taxation of both low- and high-income employees at the same rate contributes to the deepening of social inequality and social tensions.

In order to alleviate the tax burden on low-income employees, it is advisable to replace the existing 20% proportional method of income tax with a progressive method of taxation (Income tax Act, 2020), and

Table 1

Revenue Service data for 2018 on employee salaries in Georgia (Minimal salary. 2021).

Salary of persons working under a official contract, per month	Approximate number of employed citizens
1-100	191 000
100-200	110 000
200-300	95 000
300-400	80 000
400-500	67 000
500-600	64 000
600-800	116 000
800-1000	92 000

the minimum and maximum rates, as well as the range between degrees, should be determined by considering the fiscal sustainability of the budget „In terms of aggregate welfare, it would be optimal to increase the progressivity of the personal income tax. In addition, the reform would reduce income and wealth inequality“ (Serrano-Puente, D. 2020). It should also be taken into account that the tax-free minimum, as a financial expression of the right to life, should be reflected in the tax legislation, equal to the subsistence level and its amount should be determined taking into account the number of dependent family members of the hired person.

Conclusion

In the face of the Covid 19 pandemic, it was finally confirmed that the start of the process of recovery of the Georgian economy requires the creation of equal development opportunities for all market participants, which means the introduction of the principles of fair distribution of tax burden for taxpayers.

The main purpose of the article is to improve the quality of life of employed people, reduce the tax burden for a significant segment of market entities that have not withstood the crisis caused by the Covid 19 pandemic, and increase the efficiency of property tax, which have only a partial fiscal function and no stimulus function.

The results of the research show following:

1. The standard 18% VAT rate on goods and services supplied does not create equal development opportunities for all market participants.
2. The method of proportional taxation of 20% of income tax and the absence of a tax-free minimum deepen social inequality, as the taxable income of the vast majority of employed people is very low.
3. Effective use of property tax is impeded by the exemptions and tax rates established for individuals on tax on agricultural land. The maximum rate of 1% of property tax (excluding land) fails to fully perform its fiscal function and to meet local budgets.

Thus,

In the process of overcoming the difficulties caused by the Covid 19 pandemic, in order to create equal development opportunities for market participants, it is important to review the value-added tax and set optimal differentiated rates according to the types of goods and services provided;

In order to increase the efficiency of property tax, it is advisable to revise the rates of the tax on agricultural land and established benefits for individuals, as well as revise the property tax (excluding land) and make it progressive based on the market value of the property.

In order to improve the quality of life of working people and to overcome social inequality, it is advisable to replace the existing 20% proportional method of income tax with the progressive method of taxation, and the scale of the minimum and maximum rates, as well as the range between degrees, should be determined by taking into account the fiscal sustainability of the budget. It is also necessary to adopt a tax-free minimum.

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