

ANALYTICAL REPORT

Business Environment in GEORGIA

2006

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IN GEORGIA

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Foreword

This is the second and, thus far, largest survey of small- and medium-sized enterprise (SME) sector of Georgia ¹, conducted by the International Finance Corporation. The survey was made possible with financial support from BP and its Oil and Gas Partners and the Canadian International Development Agency (CIDA).

The report provides a snapshot of the business environment in Georgia as of 2006. The sample was specifically constructed to be representative of the Georgian SME sector, with firms selected based on a fixed quota established for each business sector and region. The entire survey (covering 1880 small and medium enterprises ² and sole proprietors ³) was carried out in Tbilisi and ten regions of Georgia in spring 2006, with participants answering 162 questions on numerous aspects of their operations. The survey sample and methodology were designed to make it possible to collect data comparable to the data IFC collected through its baseline survey of Georgian entrepreneurs in 2004. By comparing 2006 results with the baseline established in 2004, this report is able to monitor changes in the business climate, as witnessed by typical Georgian entrepreneurs operating in key sectors of the economy.

In addition to the quantitative assessment provided by the survey, numerous focus groups and in-depth interviews were held with business representatives, in order to provide a qualitative assessment of the changes that have occurred in the past few years. These discussions helped to refine and prioritize survey results, and have been of value in developing and testing the report's main findings.

It is beyond the scope of this report to provide a comprehensive overview of all problems faced by Georgian entrepreneurs. Rather, the focus is placed on those issues that require immediate attention, and in those cases where the state can play a meaningful role in improving the business climate in the country. In this manner, in addition to a purely monitoring function, this report builds on the views expressed by the local private sector and pinpoints a select number of concrete, practical reforms that can be implemented in the short-to-medium term, in order to promote Georgia's attractiveness for investment activity further and ensure sustainable economic growth.

Through its advisory services work, IFC will continue to cooperate with the government to streamline the regulatory environment and further improve the business climate in Georgia. IFC will also continue to conduct surveys of entrepreneurs, to assist the government in monitoring and evaluating the results of ongoing reforms in Georgia and set priorities for reform based on the needs of the private sector.

The report is published in Georgian and English. Additional copies are available in print and electronic format at the following address:

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¹ The first survey was conducted in spring 2004. The survey report is available at www.ifc.org/eca.

² The definition of small and medium enterprises is based on the Law on Support to Small and Medium Enterprises that was effective throughout 2005 and was repealed on 24 May, 2006. According to the Law, a small enterprise has no more than 20 employees and an annual turnover not exceeding GEL 500,000, while a medium-sized enterprise has no more than 100 employees and an annual turnover not exceeding GEL 1,500,000. Currently no active statute provides a similar definition in Georgia.

³ "Individual entrepreneurs", as they are commonly referred to in Georgia.

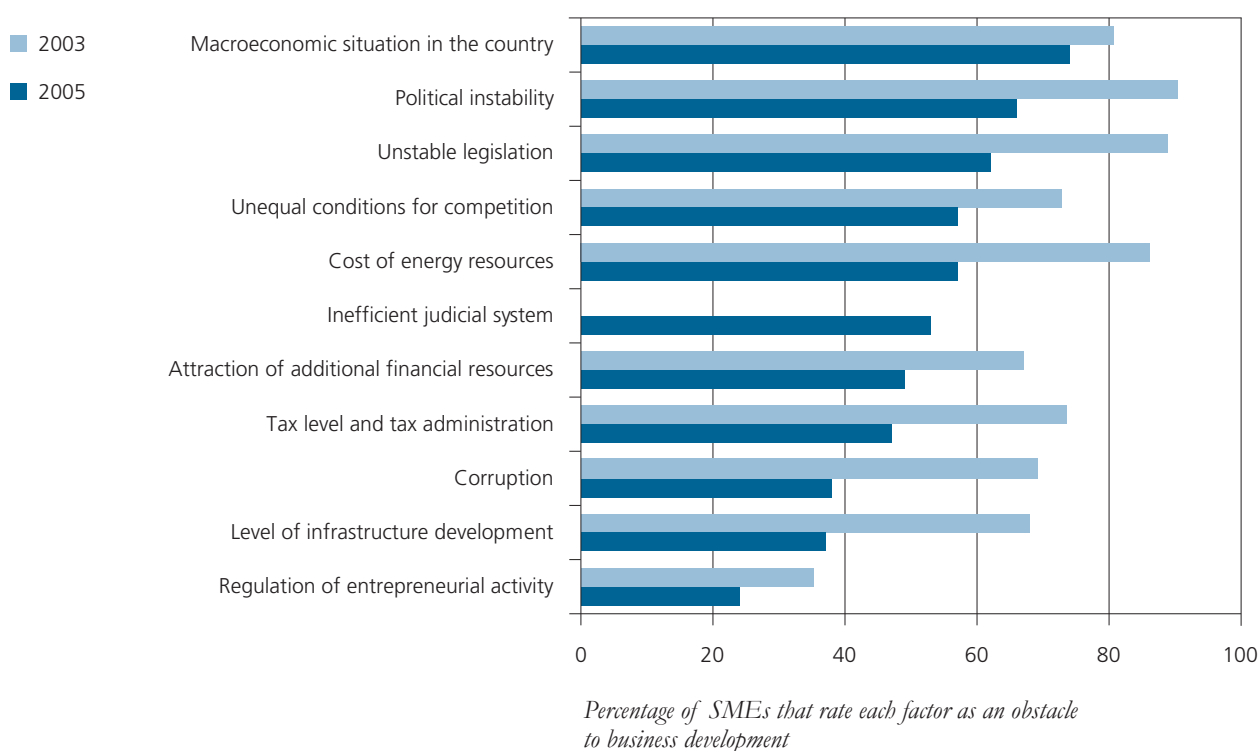
Chapter I

EXECUTIVE SUMMARY

Since late 2003, the new Georgian government has actively promoted Georgia as a fledgling democracy and natural crossroads for the development of commerce and industrial activity alike. Among the many efforts that have been undertaken in this direction, this survey places particular emphasis on the assessment of regulatory reforms, their impact to date and the steps that still need to be undertaken in order to attract increased business activity to the country.

The government's efforts have resulted in a more hospitable environment to engage in business. This is clearly evidenced by the observations of survey respondents. The following chart displays the extent to which entrepreneurs believe that each of the factors below represents obstacles to business development:

Chart 1

Entrepreneurs confirm improvement in the business environment

The above chart illustrates that Georgian entrepreneurs feel most vulnerable to the global factors which affect their daily business, including increasing energy tariffs, rate of political and legislative change, and finally – demand for their products. Georgian businessmen's appraisal of problems shows that businesses are most concerned with the general business climate than with specific regulatory processes administered by the state. While this is an obvious achievement of the reformist policies that Georgia has implemented since 2004, it is clear that many of the issues which continue to concern entrepreneurs – from tax administration, unstable legislation, judicial system and infrastructure development to corruption and 'unequal competition' – are all closely related to quality of government regulation and quality of the personnel working in government structures.

The ability of the government to set equal rules for businesses through regulation and to employ and motivate trained personnel able to apply new regulations objectively will determine the success of the recent reforms in the longer term. While the country has embarked upon a long path of reforms relatively recently, the government has the opportunity to draw upon lessons from other regional countries which have implemented similar changes within the past decade.

Georgia Rises in the Rankings

In addition to the changes noted by entrepreneurs, Georgia's improved conditions for doing business have been confirmed by the country's rise in international ratings. With a steady pace of reforms, the Georgian government has achieved considerable visibility in the majority of international rankings:

- Standard & Poor's gave Georgia a credit rating of B+/B, with positive outlook;⁴
- The joint World Bank / IFC report "Doing Business in 2007: How to Reform" rated Georgia as #1 reformer.⁵ In overall ease-of-doing-business ratings Georgia came 37th (among 175 surveyed economies) – an unprecedented leap of 75 points compared to the previous year's 112th place;
- According to the Business Environment and Enterprise Performance Survey (BEEPS), developed jointly by the World Bank and the European Bank for Reconstruction and Development, in 2002-2005 Georgia saw the largest reduction in corruption among transition countries (as reported by businesses);
- Under Transparency International's Corruption Perception Index (CPI), Georgia has improved its performance and moved from 130th place in 2005 to 99th place in 2006 among 159 nations surveyed. (Moldova and Armenia, respectively ranked 79th and 93rd in the 2006 CPI, have the best ratings among CIS countries).

These ratings are an acknowledgement of the Georgian government's resolve to transform the country into a welcome place for business for local, regional and international investors alike. 2006 was the second consecutive year when the majority of economic indices for Georgia continued steady improvement.

Regulation of Business: The View of the Entrepreneur

The survey conducted in Spring 2006 by IFC's Georgia SME Policy Project analyses the effect of the recent reforms by marking them against baseline data gathered in 2004, and attempts to diagnose the further actions needed to ensure that nascent growth in the country's economy does not halt, as it did in the mid-1990s. While the positive changes over the past few years are rightly praised, as the reforms have been both swift and fundamental, a closer look at the details indicated in this report diagnoses some disturbing tendencies. The purpose of focusing on these areas is to assist the government and other key stakeholders to address these issues as well.

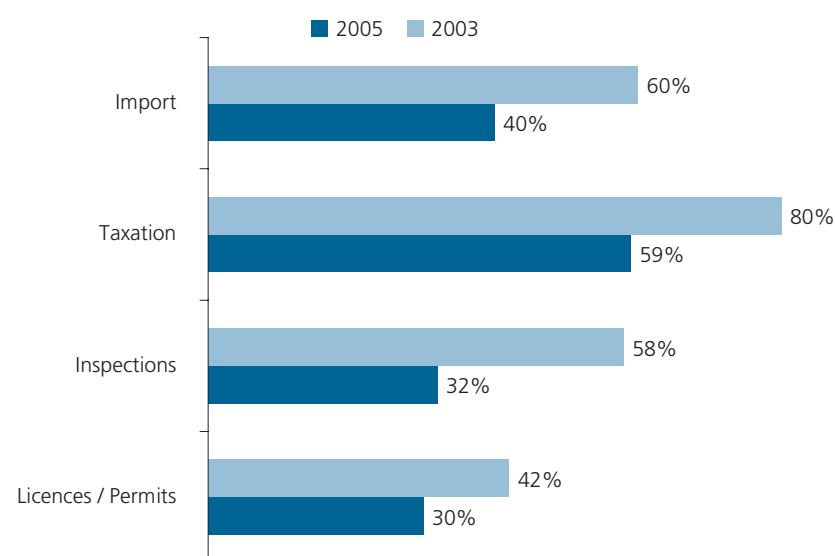
4 In early December 2006 the S&P changed the outlook rating to stable.

5 The previous year Georgia had ranked second among reformers, ceding the top title to Serbia.

This report concentrates on an area that government policy can directly impact in the short term -- the quality of regulation of the private sector. Specifically, it focuses on four principal regulatory areas that the survey and focus groups have demonstrated as significantly impacting growth of business activity. While there has been an overall improvement in administrative processes in recent years, these select areas remain of considerable concern to businesses, as can be seen below:

Chart 2

Taxes, foreign trade, business inspections and obtaining permits remain problematic according to entrepreneurs



Percentage of SMEs that have rated government processes as "difficult" or "very difficult"

Additional results from the survey show that despite positive assessments of the changes to date, SMEs' optimism towards the future is declining: when asked to assess the outlook for further positive changes in the business enabling environment in Georgia, 3 out of 4 business owners were optimistic in 2003. In 2005, only 40% of firms believed that the business environment would continue to improve in the coming year.

The Georgian government has adopted an economic agenda that sets, as one of its top priorities, the creation of a growth-inducing environment. The small and medium enterprise sector, as opposed to large-size players, will provide the basis for stable growth of the economy and its resistance to detrimental influences. But it needs a system in which the administration is transparent, legislation is conducive towards maximising business potential and government efforts are directed towards the achievement of these goals.

Tracking Georgia's SME sector

In most European economies, SMEs (roughly, companies with less than 250 employees) make up over 90% of businesses, employ three-fourths of the labour force, and account for over half of GDP. Official statistics in Georgia report strong recent growth in the private sector. The Tax Department cites 83,400 operating entities (including individual entrepreneurs) in Georgia in 2005, growing to 122,000 operating entities in 2006. Most of the newly registered entities can be assumed to be small enterprises and individual entrepreneurs, which indeed shows strong progress.

However, in Georgia businesses are not tracked by size. Therefore, it is impossible to understand exactly what share of operating Georgian enterprises are SMEs and how these firms contribute to production and employment. This likewise makes it impossible to compare enterprises in Georgia with those operating in European and CIS countries. An essential step to underline the government's intent to support the growth of small business would be the development and publication of basic statistics on SMEs, as is done in European countries and, increasingly, in CIS countries.

Snapshot of Survey Findings and Recommendations

Given the scope of reforms in recent years, where has the reform been most successful, what challenges does the government currently face and what else needs to change in the future? This survey will provide an in-depth analysis of four key regulatory issues: Licences and Permits, Inspections, Tax Administration and Import Operations. The following section summarizes the key achievements and remaining challenges identified during the enterprise survey, together with a snapshot of recommendations that are largely based on best practices of countries that have successfully implemented similar or related reforms not so long ago.

Licenses and Permits

ACHIEVEMENTS:

2005 saw substantial and fundamental reform of the licensing system of Georgia. The highlights of the new Law on Licenses and Permits ⁶ are:

- **Fewer licences and permits:** the total number of licenses and permits has been reduced from 909 to 145 ⁷ (only 93 licenses and 52 permits exist).
- **Less waiting time:** the law enacts a 30-day deadline to issue the majority of licences, and a 20-day deadline for all permits.
- **Silence is consent:** a permit or a licence is automatically granted if no government action is undertaken within the stipulated timeframes.
- **Auctioned licences:** Licences that are not governed by deadlines are openly auctioned.
- **One stop shop principle** has been declared mandatory for all issuance procedures.

⁶ Adopted by the Parliament on 24 June, 2005.

⁷ A recent additional licence for the use of non-timber resources has been added to the original 144 licenses and permits foreseen in the law.

CHALLENGES:

- **Absence of the Secondary Legislation required to implement Framework Law**

Despite the successful introduction of the Law on Licences and Permits (i.e., “Framework Law”), and, contrary to its provisions, Georgia has failed to complement it with secondary legislation on specific licences and permits. To this date, licence-specific statutes have not been enacted. In the interim, the issuance process is regulated by the Government’s temporary regulations that are often incomplete or confusing. In total, some 60 specialised statutes would need to be either amended or altogether replaced.

- **Poor transfer control with three-day Silence-Is-Consent deadlines**

Licences for the utilisation of state resources (e.g., mining, forestry, telecoms frequencies, etc.) may only be obtained through auction. An additional novelty is that these licences may be re-sold or transferred, partly or fully, subject to the licensor’s approval. This approval is granted within three days under the “silence-is-consent” principle. Unfortunately the state cannot always guarantee the completion of all necessary procedures to validate a licence transfer in three days. If not properly arranged and supervised, such transfer may cause unpredictable outcomes and may jeopardise public safety.

- **Absence of clear licence-issuance guidelines results in arbitrary delays**

The Framework Law regulates that licences and permits must be issued in a maximum of 30 and 20 days respectively, upon submission of an application. Government institutions often fail these deadlines. The Framework Law entitles licensing agencies to extend the deadline in such instances by up to three months, “in order to ascertain circumstances of material importance” and again by three to six months, based on a relevant government resolution. Interviewed businesses indicate that such “extension notices” from licensing institutions are fairly frequent, but they almost always fail to explain the actual and specific reasons for such extensions.

RECOMMENDATIONS:

- **Adopt implementing legislation; define functions of secondary agencies and timelines.**

Secondary legislation on licensing should (i) stipulate the full list of necessary documents required to obtain a particular licence or permit; (ii) define the full list of secondary agencies involved in application review; (iii) provide a detailed description of each secondary agency’s scope of authority; and (iv) review deadlines for each stage. This will help promote transparency and predictability of the process, no doubt a key intent of the original Framework Law. In addition, solid secondary legislation will introduce clarity of interpretation and thus reduce delays, usually associated with differences in understanding legal provisions.

- **Extend deadlines, regulate transfer review.**

In order to protect the public interest, it is advisable to extend the three-day transfer review deadline, currently stipulated by the Framework Law, to a more reasonable time that allows licence-issuing agencies to review the details of the transfer properly. The extended timeframe would be aimed at reducing the likelihood of negative effects from transfer to an unqualified licence- or permit-holder.

- **Establish auction rules.**

All utility licences in Georgia are divested at public auctions. Each licence-issuing agency is authorised to issue its individual version of auction rules. To avoid legislative volatility, general auction rules should be established that would be applicable to the eight types of utility licences envisaged by Framework Law. A standard auction procedure would add to the predictability and transparency of the process, serving as an incentive for all interested parties to participate.

Inspections

ACHIEVEMENTS:

The government has not undertaken any targeted policy steps towards regulating the inspection process, but a number of interesting trends have emerged within the context of a wider regulatory / institutional reform:

- **Fewer controlling agencies:** overall number of inspection bodies has come down from 46 agencies in 2003 to just 30 in 2005⁸;
- **Focus on larger businesses:** the greater a company's turnover, the more probable an inspection;
- **Fewer inspections:** only 32% of surveyed companies were inspected by at least one state inspection authority in 2005, down from 78% in 2003.
- **Food Safety Service to introduce international best practice:** the recently created Food Safety, Veterinary and Plant Protection Service of the Ministry of Agriculture is the first agency that is legally required to employ risk management tools in the conduct of inspections.

CHALLENGES:

- **Majority of inspections occur within poorly defined procedures**

Safeguards do exist to protect businesses against unauthorised inspections, outlined in the Law on Control of Entrepreneurial Activity. Yet tax authorities, which account for 70% of all inspections conducted in Georgia, are among the 12 agencies exempt from the scope of the law.

- **Practical reality different from legal provisions**

Inspected businesses frequently complain that in practice, the necessity of a court warrant prior to inspection is often ignored while written summaries of rights and obligations are rarely handed over to enterprises. Contrary to law, inspectors often exceed their specific authority and examine issues that lie clearly beyond their scope.

- **Inspection procedures are neither clearly established, nor documented**

Georgian legislation poorly regulates the procedures to follow when conducting an inspection. Contrary to best international practices, the law does not obligate inspectors to establish a check-list of issues that are typically examined during an inspection and to make this list available to businesses. Little is known of whether government officials are required to document the steps, findings or procedures that take place during an inspection.

⁸ These figures exclude regional representations / branches of central inspections agencies; list of specific agencies is available in Annex 2.

- **Penalty-oriented instead of focusing on voluntary compliance**

Inspections continue to focus on penalizing businesses - about 32% of regular tax inspections and 76% of Financial Police inspections result in sanctions. While sanctions should be the result of repeated or significant instances of non-compliance, the share of firms failing to comply could be reduced significantly by providing businesses with clear information on how to meet requirements. The system should be geared to implementing procedures that promote voluntary compliance by firms, thereby also reducing the burden on inspectorates.

- **Appeal procedures are discouraging**

The majority of entrepreneurs that were penalised as a result of an inspection did not appeal the decision. Businesses explain widespread mistrust towards the judicial system with the observation that courts almost unvaryingly side with the state rather than the private sector.

- **Budgetary and human resources are scarce**

Inspection agencies are in need of qualified personnel who can operate within a set framework. Without clear guidelines on what kind of companies to inspect, nor details on when and how to conduct the inspections, Georgian inspection agencies find it more difficult to execute their agenda of protecting the public interest. Such guidelines, in the form of internal manuals, checklists and the introduction of risk-based principles for inspections, exist in nearly all developed countries. The government should expend more time, resources and efforts to ensure that the employees at inspection agencies are fully familiar with their rights and obligations as well with applicable inspection procedures.

RECOMMENDATIONS:

- **Introduce risk management in most typical business inspections.** Risk-based management of the inspection process is a proven tool for achieving regulatory efficiency. Enterprises are selected for inspection based on the probability and possible effects of a violation. Risk management leads to a more transparent, customer-friendly and compliance-oriented inspections system that operates efficiently in an environment where qualified resources for the protection of public goods are scarce. Introduction of risk-based management will save state resources by reducing the overall frequency of inspections while improving their quality. Additionally, it will foster fair competition, encourage compliance with legislation and improve efficiency of businesses. As a result, the more law-abiding the businesses in the economy, the easier it will be for state-run inspections to ensure the safety and quality of Georgian-made products, making them more competitive on regional and international markets.
- **Document the inspection procedure and its stages.** Documented inspections are more results-oriented, transparent and efficiently manageable. Civil servants should be required to record the grounds, actions, decisions and findings (including violations) of an inspection. Documenting the inspection process clearly will result in better awareness by businesses of regulations, including their rights and obligations. It will lead to a more consistent and predictable inspection procedures that take less time. As a result, the number of violations will decrease.

- **Examine applicable standards, rules and procedures.** The dissolution of the Soviet Union and the subsequent frequent changes in government have left Georgia with a plethora of regulations that establish applicable norms and standards for a variety of business processes, including sanitary protection, hygiene, construction, food production and processing, operation of heavy machinery, etc. A review and inventory needs to be conducted, to determine which regulations are still in force and what areas they cover. Follow-on steps include the removal of overlapping regulations identified in the process and the promulgation of norms in line with the best examples of EU legislation.
- **Improve appeals process.** The judiciary needs to apply serious efforts to ensure the impartiality of Georgian judges and prove and communicate this message to businesses effectively. As a result, entrepreneurs will have more trust in the system to appeal against illegal actions of inspectors. Provided that the appeal process is fair, the court rulings will give rise to precedents that the tax officers will have to take into consideration, thereby promoting uniform interpretation of legislation. Furthermore, the appeal process should become less time-consuming. Similarly, administrative appeal within individual inspections should become more streamlined and transparent.
- **Inform businesses how inspections operate.** Neither inspection agencies nor business associations have a policy on informing businesses how inspections are conducted or their rights and obligations during an inspection. Inspection agencies and policymakers should engage in public dialogue, conduct basic awareness campaigns and issue clear compliance policies in order to explain to the wider public how these agencies operate and what results should be expected of them.
- **Introduce third-party certifications.** Handing select inspections functions over to private firms, as in a number of European countries, could potentially help to save budget resources, improve the quality of inspections and reduce corruption. However, handing over a poorly-defined state monopoly to the private sector does not always result in improved practices or reduced corruption. The government should carefully consider which activities, and to what extent, can be delegated to private inspectors, and introduce a pilot in a low-risk sector in the near term.

Tax Administration

ACHIEVEMENTS:

Effective 1 January, 2005, Georgia introduced a new Tax Code that brought about significant procedural and institutional innovations:

- **Fewer taxes:** the new Tax Code levies only 7 taxes, namely income tax, profit tax, social tax, excise tax, value-added tax, and local taxes such as property and gambling business taxes;
- **Lower tax rates:** *Income tax* has changed from a 12-20% progressive tax to a 12% flat tax, one of the lowest in the region. *Social tax* has been reduced to 20% instead of the previous 33% and *VAT* is now only 18% as opposed to 20%. The profit tax rate has remained steady at 20%.

- **Accelerated depreciation:** companies can now include 100% of depreciation costs in the first year of investment, thereby reducing their taxable profit;
- **VAT refund:** refund of VAT paid for investments in fixed assets and for exports takes one month; in other cases – no more than six months;
- **No penalty:** a taxpayer may adjust his or her tax declaration without any penalty, if the correction is made voluntarily before a notice of inspection.
- **Small business incentives:** self-employed proprietors that do not employ any work force and have an annual turnover of up to GEL 100,000⁹ are not liable for the payment of income tax and social taxes (Articles 168 and 270 of the Tax Code). A wide variety of temporary incentives (including social-, property-, profit- and income-tax holidays) have been extended to individual farmers engaged in agricultural production.

CHALLENGES:

- **Frequent changes make tax legislation unstable**

Since its introduction in January 2005, the Tax Code has been amended 17 times (as of November 2006), affecting a total of 123 provisions, with amendments entering into force on 21 different dates. This adds to the complexity of tax planning and accounting for businesses, and is especially burdensome for smaller ones, who find complying with the frequently-changing statute especially costly.

- **Tax Code is unclear, ambiguous and complicated**

Only 20% of surveyed companies can easily understand tax legislation. Respondents claimed that the Tax Code is ambiguous, and official instructions often contain grey areas that are open for interpretation. According to businessmen, tax officials always interpret ambiguity in their favour.

- **Attitude towards businesses is unfriendly**

Tax administration is not user-friendly. The Tax Code states that any clarification provided by tax officials to taxpayers are of an advisory nature only. This frees tax officials from taking responsibility for their own communications to taxpayers, and affects their professionalism. Furthermore, there have been increasing reports of the Financial Police conducting tax audits and ordinary inspections of businesses without involving the tax authorities. This government agency, tasked to prevent and fight against financial crime, often suspect businesses of criminal actions or intent. For example, in an areas such as valuation of transactions, the Financial Police typically assume that a business has contracted a deal based on distorted, non-market prices. A businessman that wishes to appeal the inspection results often finds that resolutions are poorly supported by factual evidence, thereby making it more difficult for an entrepreneur to defend his/her cause.

- **Instead of compliance, the system is penalty-oriented**

While corruption has considerably decreased, many fiscal agencies still choose to impose the maximum penalty sanctions on businesses rather than promoting voluntary compliance. The drive to increase budget earnings is demonstrated in the extent of fines and monthly collection targets for fiscal agencies, both of which are reputed to be unreasonably high.

⁹ Approximately USD \$55,000 (average 2005 exchange rate: GEL 1.8125 to USD 1).

■ Tax appeal process is ineffective

When faced with an option to appeal against tax authorities, many businesses are unsure of success because, as a rule, tax officers' decisions are not overturned by higher fiscal instances or courts. Although it now takes less time to appeal than before, the survey demonstrated that only 18% of tax authorities' decisions are appealed. Entrepreneurs complain that procedures and deadlines have intentionally been tightened on the businesses' side to discourage companies from appealing.

RECOMMENDATIONS

- **Regulate how often and when Tax Code changes may take effect.** To ensure stability and predictability of the tax legislation, Georgia should follow the example of many developed countries and regulate that changes to the Tax Code can be introduced only once or twice a year, regardless of the date of adoption. Alternatively, the state could regulate that the changes which adversely affect the taxpayer materially may become effective only from the next fiscal year and within no less than three months from the date of adoption. Such practice provides an adequate period for businesses to learn, familiarise and prepare themselves for the change in tax treatment. A predictable tax regime would have a positive impact on the confidence of businesses and even help tax inspectors in their learning curve, which can result in less violations and better tax administration.
- **Restore an independent tax tribunal and speed up dispute settlement.** An independent forum for tax appeals would be highly beneficial for boosting business confidence in the system of tax administration. A tax arbitration existed in early 2005, but was soon abolished. Re-establishment of a similar independent specialised tax tribunal is long overdue in Georgia, where many businesses have lost confidence in the fairness and timing of judicial procedures. In terms of introducing quick reforms, a more immediate measure to ensure the fairness of the tax appeals system would be to introduce independent members to the Dispute Resolution Council of the Ministry of Finance. This is currently composed of seven government officials, subject to the Government's resolution, with four members of Parliament additionally participating in its discussions.
- **Make penalty dependent on the scope of violation.** Tax administration should be oriented towards fostering compliance rather than imposing penalties. The penalty sum should depend on the scope of violation found.
- **Adopt "customer-friendly" communication with taxpayers.** Businesses should be treated as customers, and processes within the inspection administration should be aligned in accordance with the needs of taxpayers. This making the interface more "user-friendly". Tax authorities should issue more specific instructions that clarify grey areas within the Tax Code and describe the taxation process in an understandable manner. Apart from specific instructions, it is an established practice in many developed countries to allow for "tax inquiry", whereby a taxpayer can inquire with the tax authorities on the specific taxation regime that will apply to the taxpayer's activities. Tax authorities provide an explanation that clarifies the tax treatment for a certain period in the future.
- **Repeal provision on "advisory nature" of tax officials' communications, institute "Silence Is Consent" principle.** Both the "advisory nature" of tax officials' communications and the "silence means dissent" provision described in the Tax Administration Chapter are patterns of a system that favours tax inspectors over businesses and frees the former from accountability for their own deeds while placing the burden of proof on the latter. With such alignment of incentives, the immediate result that follows is decreased accountability and increased irresponsibility of tax officials, rather than compliance by businesses. It is difficult to pin down either a private or public benefit from a system where tax authorities are, to an extent, given the liberty to disregard the lawful interests of taxpayers.

Import Procedures

ACHIEVEMENTS:

In order to foster economic growth and promote Georgia's strategic location as a transportation corridor, the government has championed the following changes:

- Effective 1 September, 2006 the Law on Customs Tariffs equalised the customs treatment of WTO member and non-member states alike, introduced only three tariff rates (0%, 5% and 12%) instead of the previous 16 (ranging from 0% to 30%) and, most importantly, provided that the majority of imports are effectively zero-rated save for some agricultural products and construction materials;
- Effective 1 January, 2007, Georgia will have a new Customs Code which is harmonised with European legislation and provides for simplified procedures: the previous 15 customs regimes are reduced to only 7, importers will only need a maximum of 9 documents (down from 19) to clear goods and the One-Stop Shop should be in operation at all customs clearance points;

CHALLENGES:

- **Customs clearance is inefficient**

According to current practices, all who pass through customs are subject to mandatory inspections. The resulting delays and difficulties translate into costs incurred by all participants and the system at large. Sometimes unofficial payments are still used to circumvent these difficulties, adding to the complexity of procedures.

- **"Reserve" valuation is widespread**

The majority of businesses confirm that during import procedures, their goods were appraised based on the "reserve" method of valuation. Under this method, unit prices for most typical products imported into Georgia are defined not by the price indicated in the accompanying invoice, but by the government-ordained price list that is updated every three months. Within the existing customs clearance procedure reserve valuation is believed to be the most widespread injustice.

- **Budget revenues are a priority at any cost**

Customs units, like other fiscal agencies described above, have monthly collection targets that encourage officers to impose high sanctions and penalties on inspected businesses.

- **Appeal process is ineffective**

Empirical evidence shows that appeal is a waste of a business' resources. Since goods cannot be cleared until the dispute is resolved, businesses are discouraged from appealing out of fear that goods may deteriorate coupled with extortionate storage charges at terminals. Businessmen are often compelled to reconcile and sign the declaration, even if they disagree with customs officers. In contrast, modern practice is to separate the physical release of goods and customs clearance issues for all but some sensitive groups of products (mostly those that are subject to excise).

- **One-Stop-Shop requires practical implementation**

The customs One Stop Shop, envisaged by the new Customs Code, has yet to be implemented. According to entrepreneurs, customs procedures remain complex, comprising several stages and necessitating time, patience and persistence.

- **Customs officers lack professionalism**

Businesses rate lack of professionalism among the top five difficulties in customs clearance procedures. Lower-tier customs officers lack relevant training and are therefore reluctant to make a decision or unable to manage the process quickly and fairly. Instead, they often require additional documents that they are not authorised to request.

- **Lack of adequate information**

Businesses should be better informed about ongoing reforms in foreign trade regulation and the opportunities that these reforms enable. Smaller businesses cannot afford expensive customs consultants. Customs should consider establishing customer-information centres, redesigning and re-launching its website and other proactive procedures to increase awareness about reforms.

RECOMMENDATIONS:

- **Carry out valuation of goods according to WTO rules.** Applying “reserve” valuation to transactions by default or in a majority of cases is against WTO regulations. Neither is it a default procedure under the currently existing customs regime or under the new Customs Code. Therefore, the fact that it is still nevertheless quite widely applied underscores the importance of ensuring the practical implementation of legal provisions.
- **Release goods under deposit or guarantee terms, provided that customs retain post-import inspection right.** When the correct value of goods cannot be determined off-hand and more time is required to ascertain all relevant data, an importer should be entitled to clear goods under deposit/guarantee terms. This clearance allows the importer to haul the goods freely and assume full responsibility for their storage and safety, provided customs retain the post-import inspection rights as well as a deposit equal to the value of possible violation.
- **Introduce risk-based system of customs clearance.** Customs should institute a system whereby goods, vehicles or importers that are more likely to violate prescribed rules or have a previous history of violation are also more likely to be subject to inspection than others. Apart from procuring and installing software to help process information, customs should pay closer attention to the training and qualification of officers who will undertake inspections.
- **Implement One Stop Shop at all customs terminals.** One Stop Shop is currently a declared principle of the new Customs Code., and it will take a certain amount of time and efforts to operate the principle at all customs terminals. This should not daunt the Georgian government from continuing to implement it. Otherwise, Georgia will be a less attractive country for import-export operations.
- **Improve information service.** Information on trade related issues and customs clearance procedures should be available on the customs web-site; booklets explaining customs legislation should be published and disseminated among businesses and through information desks at customs-clearance points. Increased awareness means better understanding, leading to fewer violations and, overall, improved administration.

- **Collections vs. quality or/and speed of procedures: need to prioritise.** Customs collections have, year after year, been an important stream of budget revenue. The new reduced tariff scheme and customs legislation will likely bring revenue indicators down for a certain time until economic activity increases. This is high time for customs to concentrate on the introduction and implementation of new policies and procedures, aimed at more transparent, user-friendly and compliance-oriented administration.
- **Improve the professionalism of officials working at customs checkpoints.** The government needs qualified professionals to operate the customs administration in compliance with new principles and procedures. To achieve this result, customs needs to invest in improving the training and qualification of its officers.

Other Reforms

A review of the regulatory reform process in Georgia would not be complete without a mention of those innovations that were introduced over the course of the past two years and have significantly liberalised the conditions for conducting business activity in the country:

BUSINESS REGISTRATION

Amendments to the Georgian company legislation, effective 1 September 2005, have made Georgia one of the easiest countries for commencing business activity:

- **Unified registration:** business registration and tax registration occur simultaneously now that the registration process has been entirely shifted into the realm of tax authority;
- **Less capital requirement:** charter capital has decreased from GEL 200¹⁰ (instead of previous GEL 2000), plus the usual registration fees and charges, to establish an LLC (the most popular business vehicle in Georgia)
- **Less time:** now it takes only one day to register a sole proprietorship and three days for an LLC.

TECHNICAL REGULATIONS

The state launched several legislative initiatives¹¹ aimed at reforming technical regulations and liberalising Georgian legislation on standards for products and services:

- **Competences delineated:** the old standards agency, SakStandarti, was reorganised and split into the National Agency for Standards, Technical Regulations and Metrology (NASTRM) and the National Accreditation Centre (NAC). The agency that sets and / or registers standards (NASTRM) no longer supervises their compliance. The latter function has been shifted to private entities that will be accredited with the NAC.

¹⁰ Approximately USD 110.

¹¹ Amendment to the Law on Certification of Goods and Services, Amendments to the Law on Integrity of Measurements (both dated 24 June 2005), Law on Food Safety and Quality (27 December, 2005) and the Government Resolution on the Recognition and Operation of Foreign Technical Regulations (24 February 2006).

- **Voluntary standards:** state intervention has been reduced by the gradual shift to voluntary standards. Entrepreneurs are free to choose from among a variety of standards registered with the National Agency for Standards, Technical Regulations and Metrology.
- **Universal standards:** Apart from CIS-endorsed GOSTs, Georgia has also adopted the majority of technical regulations from the EU and OECD countries, thereby granting all these standards an equal status;
- **Food safety:** the National Service for Food Safety, Veterinary and Plant Protection has been established to enforce technical regulations on food and develop food safety criteria using risk-based management as the basis for food inspections.

In addition to the above reforms in 2005, the Government has undertaken several progressive steps in 2006 that deserve equal mention:

LABOUR CODE

A new liberal Labour Code adopted in June 2006 significantly simplifies the procedure and reduces the cost of hiring and firing workers.. It introduces the following principles:

- Preference to contract-based relationships
- Low hiring and firing costs
- No mandatory minimum wage
- No obligatory overtime costs
- No obligations for an employer to notify employee prior to dismissal.

The following table exemplifies the challenges remaining in the Georgian business regulatory environment according to the survey results and IFC's suggestions on how these issues could be addressed to achieve a more predictable and transparent climate for fostering investments:

Table of Key Recommendations

LICENSES AND PERMITS			
Main Problems	Short Term Recommendations	Long Term Recommendations	Expected Impact
<ul style="list-style-type: none"> ■ Absence of Secondary Legislation; ■ Poor transfer control with short Silence-Is-Consent deadlines; ■ Absence of clear licence-issuance guidelines resulting in arbitrary delays 	<ul style="list-style-type: none"> ■ Adopt licensing implementing legislation; define functions of secondary agencies and timelines; ■ Extend deadlines for licence transfer, regulate transfer review; ■ Establish auction rules for issuing utility licences 	<ul style="list-style-type: none"> ■ Continue to regularly monitor impact of licensing and permits system on private sector 	<ul style="list-style-type: none"> ■ Licensing process will be streamlined; ■ Licensing process will be predictable; ■ Process will become more transparent; ■ Licensing institutions will provide better quality service
INSPECTIONS			
Main Problems	Short Term Recommendations	Long Term Recommendations	Expected Impact
<ul style="list-style-type: none"> ■ Majority of inspections occur with poorly defined procedures; ■ Practical reality different from legal provisions; ■ Inspection procedures are not clearly established or documented; ■ Penalty-oriented inspections system; ■ Appeal procedures are discouraging 	<ul style="list-style-type: none"> ■ Document the inspection procedure and its stages (introduce checklist during the inspections process); ■ Introduce Risk Management system in most typical business inspections 	<ul style="list-style-type: none"> ■ Introduce third-party certifications ■ Review applicable standards, rules and procedures to make them in line with EU regulations; ■ Improve appeal process 	<ul style="list-style-type: none"> ■ Efficiency of the inspection process will be improved; ■ Improved compliance, reduced violations; ■ Fewer inspections, reduced corruption; ■ Improved services/products to consumers; ■ Better access to foreign markets; ■ More confidence in the judiciary, improved business environment
TAX ADMINISTRATION			
Main Problems	Short Term Recommendations	Long Term Recommendations	Expected Impact
<ul style="list-style-type: none"> ■ Frequent changes to legislation; ■ Tax Code is ambiguous and complicated; ■ Attitude towards businesses is unfriendly; ■ Instead of compliance, the system is penalty-oriented; ■ Tax appeal process is ineffective 	<ul style="list-style-type: none"> ■ Regulate frequency of enactment of Tax Code changes or permit changes in the Tax Code to come into force only in the beginning of each quarter; ■ Restore independent tax tribunal and speed up dispute settlement system; ■ Link sanctions to scope of violation; ■ Repeal provision on “advisory nature” of tax officials’ communications, institute “Silence Is Consent” 		<ul style="list-style-type: none"> ■ Adequate time for businesses to adapt to changes; ■ Single interpretation, less ambiguity; ■ More trust to tax system, more compliance; ■ More efficient processes
IMPORT PROCEDURES			
Main Problems	Short Term Recommendations	Long Term Recommendations	Expected Impact
<ul style="list-style-type: none"> ■ Customs clearance is inefficient; ■ “Reserve” valuation is widespread; ■ Budget revenues are a priority at any cost; ■ One-Stop-Shop requires practical implementation; ■ Customs officers lack professionalism; ■ Companies lack adequate information 	<ul style="list-style-type: none"> ■ Carry out valuation of goods according to WTO rules; ■ Release goods under deposit or guarantee terms, provided that customs retain post-import inspection right; ■ Properly implement One Stop Shop at all customs terminals envisaged by legislation; ■ Improve information-provision to clients; ■ Prioritize needs: maximum collections or speedy procedures 	<ul style="list-style-type: none"> ■ Introduce risk-based management system of customs clearance; ■ Improve the professionalism of officials working at customs checkpoints 	<ul style="list-style-type: none"> ■ Interests of importers are not violated; ■ More transparent customs clearance procedures; ■ Decreased cost for importing; ■ Increased import volumes and a greater share of businesses involved in foreign trade

Chapter II

LICENCES AND PERMITS

Recommendations

- Adopt implementing legislation; define scope and timelines allocated to secondary agencies
- Establish auction rules
- Ensure due process for the transfer of utilisation licences
- Allow professional associations to self-regulate 47 medical activities (currently licensed by state)

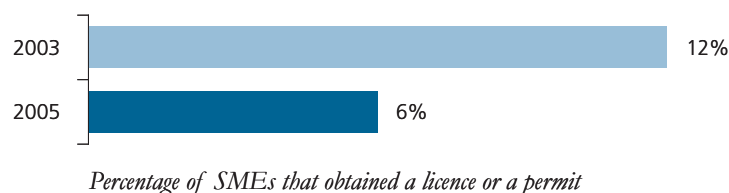
Steps of the Government

As this report is being written, Georgia’s ambitious framework Law on Licences and Permits has already marked its first anniversary. Adopted on 24 June 2005, the law entered into force on 10 July of the same year and declared drastic reforms for the licensing system of Georgia; namely:

- The number of licences and permits was slashed from 909 to 144 ¹²;
- One-Stop-Shop (“OSS”) mechanism and Silence-Is-Consent principle were declared as goals;
- Licences were categorised into activity licences and utilisation licences ¹³;
- Utilisation licences are auctioned publicly instead of being divested through tenders.
- Interrelated licences are collectively referred to as General Licence and individually as Special Licences ¹⁴.

Chart 3

Reach of regulation has been significantly reduced by the new Law on Licenses and Permits



What was the result of such radical reforms? Previous survey data shows that 12% of enterprises reported receiving a permit or a license in 2003. In 2005, this figure was halved – to just 6% of all entrepreneurs.

12 Shortly after the survey was conducted the government adopted changes to the law on Licences and Permits adding one more licence for the use of non-timber resources, increasing the total number of licences to 145.

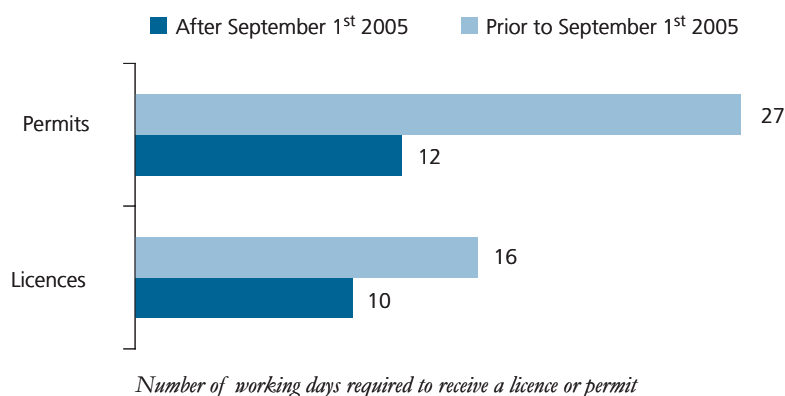
13 Activity licences are issued for the conduct of a certain activity — such as medical treatment, educational institutions, import and export of special materials and substances subject to special control, production of specific substances (e.g., biological pesticides, nuclear substances, etc.) — whereas utilisation licences are issued for the utilisation of a specific and unique resource, such as telecommunications frequency or mineral reserves.

14 In other words, one general licence may encompass several special licences that permit operation of specific activities in a selected field.

Businesses report that since September 2005¹⁵, they spend an average of 10 days to obtain a licence, a decrease from 16 days spent in 2003). Permits repeat the same trend:

Chart 4

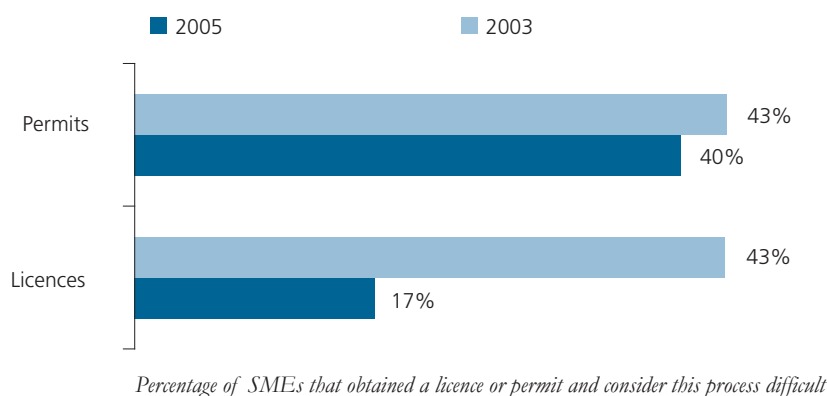
Obtaining a licence or a permit has become less time-consuming



Furthermore, fewer respondents found licences and permits difficult to obtain in Georgia: in 2003, 43% of surveyed companies believed that obtaining both licences and permits was a difficult exercise. In 2005 these figures have come down. For licences, the drop has been significant — only 17% found the process difficult. The improvement in the permit process has not, however, been significant according to entrepreneurs: 40% of firms continue to report difficulties.

Chart 5

Obtaining licences is easier, while improvement in permits is marginal



¹⁵ To facilitate polling, 1 September, 2005 was selected as the date when the simplified registration procedure was introduced (please see Other Reforms on p. 16 of Executive Summary) and the new licensing regime had already been in force.

Existing Problems

Absence of secondary legislation

The Framework Law that has been hailed for its progressive spirit is not an exhaustive set of rules that regulate all aspects of the licensing process. Rather, it is a policy-setting statute of very general applicability. Specific issues in relation to individual licences or their groups – the entities authorised to issue, description of activities subject to a licence, terms and conditions, validity et al. – are to be regulated by licence-specific laws, or the so-called “secondary legislation”. The Framework Law gave the government a transitional period until 15 November, 2005 to draft these secondary statutes dealing with specific licences. In the interim, the issuance process would be regulated by the government’s temporary regulations. To date, none of the secondary laws have been considered or adopted and the system continues to be governed by the said temporary regulations.

In several instances the temporary regulations simply refer to the old legislative acts¹⁶. In total, some 60 specialised statutes would need to be either amended or altogether replaced in order to bring the system in compliance with the provisions of the Framework Law. Annex 1 provides a tentative list of those licences and permits, in relation to which implementing legislation should have been adopted so far.

Why has taken so long for secondary legislation to be adopted? After the visible success and publicity of the licensing reform in quantitative terms the government seems to have taken a break in terms of adopting and implementing licence-specific laws that would be aimed at the qualitative features of the licence/permit issuance process. Rather, it has issued and even repeatedly amended temporary regulations in the meantime¹⁷. Although licences and permits are no longer necessary for the majority of businesses, those that do require them are faced with contradictions and ambiguities caused by the absence of secondary laws. These uncertainties tend to give way to discretionary interpretation by mid-level officials and create a feeling of unpredictability in the business environment. Unless the government completes the reform by adopting special statutes, the registered high optimism accompanying the Framework Law is likely to wane when businesses counter further administrative barriers at the level of implementation.

Poor transfer control with short Silence-Is-Consent deadlines

Utilisation licences are obtainable through auction only and are almost regarded as securities, since they may be re-sold or transferred partly or fully from the initial licence holder to third parties subject to the licensor’s approval. There is an argument that licence-trading may lead to far-reaching economic benefits for the country by ensuring that resources end up with a party that is best able to pay for and manage them. Yet, if not properly arranged and supervised, such transfer may cause unpredictable outcomes and possibly jeopardise public safety (one of the basic motives for the licensing regime).

¹⁶ For instance, mining activity is currently regulated by the Government’s temporary Regulation # 136 on Rules and Procedures for the Issuance of a Mining Licence dated 11 August, 2005. This regulation contains references to the Law on Mining (dated 17 May 1996) which is still in force and provides that licences are granted through tenders and are non-transferable. Further, the old Law on Mining provides that exploration activity is subject to licensing. These provisions are clearly in contradiction with the new Framework Law; contradictions are also observed in other laws e.g. the Law on Wildlife, Forestry Code etc.

¹⁷ the mining regulation above was amended 4 times, while Regulation #132 on Rules and Procedures for the Issuance of a Forestry Licence – 7 times.

Under the new legislation, the licensor has just three days to transfer a licence. Under the “Silence Is Consent” principle, the transfer is considered completed if there has been no reply from the licensor within that time. Unfortunately, the state cannot always guarantee the completion of all necessary procedures to validate the licence transfer in three days, due to the following reasons:

- Neither the Framework Law nor any specialised statutes provide any guidelines on the entry requirements for transferees of utilisation licences. In the worst case scenario, a new licence-holder is less likely to undergo the government scrutiny than the initial one.
- Licence transfer should ideally involve as many secondary agencies as the issuance process does. Unfortunately, a three-day period is not sufficient to ensure the participation of all secondary agencies in the transfer process, and neither the Framework Law nor temporary regulations provide any policy rules concerning the transfer. Given that silence “is consent”, at the end of Day Three, the licensor is faced with an obligation to either issue the licence or lose a prospective litigation with an unsatisfied applicant.

Absence of clear licence-issuance guidelines results in arbitrary delays

The Framework Law regulates that licences shall be issued in a maximum of 30 days upon the submission of an application. For permits, the deadline has been shortened to 20 days. However, government institutions often fail to meet these deadlines. The Framework Law entitles licensing agencies to extend the deadline in such instances by up to three months “in order to ascertain circumstances of material importance” and again by a further three to six months, based on the relevant resolution of the Georgian government. Interviewed businesses indicate that they receive such “extension notices” from licensing institutions fairly frequently, which almost always fail to explain the actual and specific reasons for such an extension. A closer examination reveals the deficiencies of the system, as described above, and the need to streamline the system in order to ensure that applications are properly processed.

Recommendations

Adopt implementing legislation; define scope and timelines allocated to secondary agencies

When and if the government embarks on the process of drafting the secondary legislation, particular emphasis should be placed on ensuring that these laws specify which other secondary agencies, apart from the principal licensor, take part in processing the application and how their competences are delineated. Similarly, secondary laws need to provide an exhaustive list of documents required to obtain a licence or permit. Currently the Framework Law (Clause 18.5) authorises licensors to set “additional terms and conditions” to obtain a utilisation licence, “subject to the state or public interests”. Clearly, this does not add to the predictability and transparency of the licence/permit issuing process and does not induce compliance among businesses.

Possible Impact Legislation that provides (i) list of secondary agencies (ii) detailed description of each secondary agency’s scope of authority, (iii) review deadlines, and (iv) a list of necessary documents will streamline the licensing process and promote its predictability. In addition, solid secondary legislation is necessary to introduce clarity of interpretation and thus reduce the occurrence of delays that are most often associated with differences in understanding various legal provisions.

Extend deadlines, regulate transfer review

If a licence-holder decides to sell, transfer or divide the licence, all that the legislation mandates is a simple notification to the licensing department of the issuing agency. In order to protect the public interests, it is advisable to extend the three-day period, currently stipulated by the Framework Law, to a reasonable time that allows licence-issuing agencies to conduct proper examination and cross-checking of the transferor and, more importantly, the recipient of the transferred licence. This should be performed not only by the licensing-issuing authority but by pertinent secondary agencies as well.

Possible Impact Currently licence transfer approval may not exceed three working days. While more streamlined interface between various institutions of the state is clearly necessary, having an extended time period will empower licensing institutions to provide improved quality of services to the applicants and public, and will reduce the chance of potential harm that an unqualified licence- or permit-holder may cause.

Establish auction rules

As mentioned above, all utility licences in Georgia are divested at public auctions. However, the Framework Law indicates that auction rules and proceedings shall be individually regulated by the licence-issuing agency. In practical terms, that usually means that simple orders of ministers or independent regulators tend to be amended or re-issued prior to every important auction. In order to avoid legislative volatility and boost a predictable business climate, especially in relation to such resources that are scarce, it would be meaningful to establish general auction rules that can apply to all eight types of utility licences that are envisaged by Georgian legislation.

Possible Impact Even though auctions per se are a better tool for divesting valuable resources and identifying the most willing bidder, a more detailed auction procedure will greatly add to the predictability and transparency of the process, serving as an incentive to a larger number of interested parties to participate in the auctions.

Allow professional associations to regulate 47 medical activity licences as regulated professions

According to European legislation medical activity is a regulated profession, usually self-governed rather than state-controlled. Among licensable activities the Framework Law includes a lengthy list of 47 various medical specialisations. In most other countries medical profession is regulated through professional associations that require applicants to meet certain qualification requirements (i.e. graduation from a recognized educational establishment) and / or to obtain accreditation with professional bodies. It would be more efficient for the state to shift the licensing of medical activity up to the professional association, similar to the bar association reform that is still underway.

Possible Impact The experience of various developed countries demonstrates that the medical profession is among those trades that are better self-regulated rather than controlled directly by the state. The comprehensive medical sector reform that the Georgian government is currently undertaking should also include the gradual change in regulation of medical activity and transfer of these functions to the professional associations.

Chapter III

INSPECTIONS

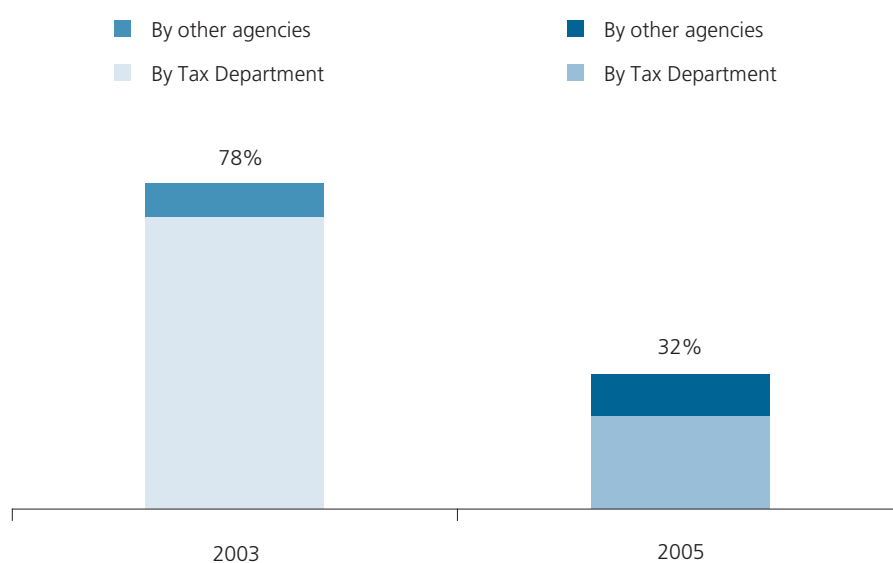
Recommendations

- Introduce risk management in most typical business inspections
- Document the inspection procedure and its stages
- Improve appeal process
- Inform businesses how inspections operate
- Introduce third-party certifications

The survey demonstrated that inspections are among the regulatory areas showing improvements. Two thirds of companies had reported an inspection in 2003 – in 2005, only one third of surveyed firms were inspected. Of these, 70% were inspected by tax authorities, showing that inspections of a technical nature are now quite rarely conducted in Georgia.

Chart 6

Inspections reach has been reduced



Percentage of SMEs inspected per year

Even when an inspection does occur, it takes less time: according to the survey, the average duration of all inspections has decreased from 10 to 5 workdays. Furthermore, only 32% of companies instead of the previous 58% rated inspections procedures as ‘problematic’ or ‘very problematic’.

Chart 7 illustrates that many inspections continue to result in some form of sanctions for the enterprise. While there has been a significant decrease in this indicator, the data show interesting patterns. Each sanctioned firm paid out an average of 1200 USD as a result of violations found at the enterprise in 2005. In 2003, sanctioned firms only paid an average of 287 USD in fines.

The remaining rather high rate of sanctions shows that inspectorates need to improve the information that they make available to entrepreneurs. Moving to international best practice means not only decreasing inspections frequency, but also ensuring that entrepreneurs have the tools and information to comply with regulations -- even if they are being inspected less frequently.

Chart 7

High rate of sanctions continues



Percentage of SMEs sanctioned as a result of violations found during inspection of their enterprise

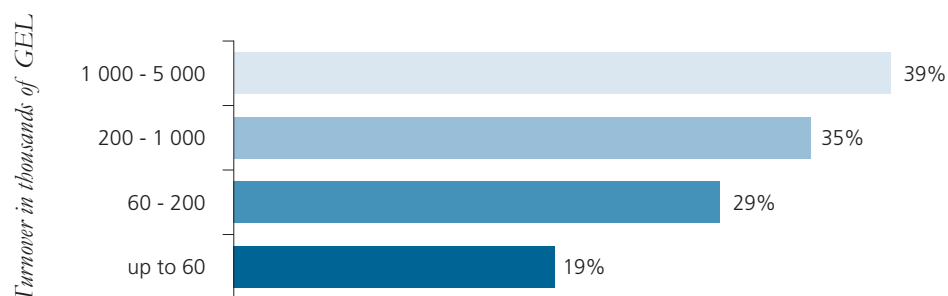
Steps of the Government

Given the willingness of the government to improve the regulatory environment for Georgian businesses, several specific developments can better explain and demonstrate the details of the evident decrease in business inspections; namely:

- **General decrease in the quantity of controlling agencies¹⁸:** between the two surveys the number of agencies authorised to inspect businesses has considerably decreased. Some inspections were re-structured, such as several local agencies that were consolidated into the Tbilisi Supervision Service¹⁹, which is responsible for the overall safety and maintenance of the capital city. Certain others (such as the State Price Inspection) were altogether abolished²⁰ from obsolescence. Annex 2 provides an illustration on how many inspection agencies existed during the previous survey and how these figures have changed to date.
- **Focus on large businesses:** Following the Rose Revolution in 2003, the government noticeably shifted its focus from inspecting all businesses to inspecting larger enterprises. The same trend continued in 2005. In fact, the chart to the right exemplifies how a rise in turnover figures means more tax inspections for businesses in Georgia. This allowed small and medium businesses to develop with less intervention by the State.

Chart 8.

The higher the turnover, the more likely the inspection



Percentage of SMEs inspected by tax authorities, by turnover

¹⁸ Inspection bodies are often referred to as “controlling agencies” in Georgia.

¹⁹ Order of Tbilisi Mayor # 62 dated 2 September, 2005.

²⁰ Law on Free Trade and Competition, dated 3 June, 2005.

- **Decrease in funding:** The sizeable reduction in inspection frequency may also be associated with several cuts in budget of some inspection agencies in Georgia. Although some inspection agencies operated on increased budgets in the same year, the Department of Statistics, Architectural Inspection, Labour Inspection and several other institutions experienced a drop in funding in 2005. This may have affected the overall frequency of inspections, along with the general decrease in numbers and shift to larger businesses²¹. According to the survey, companies were inspected only 0.6 times in 2005 on average, down from 1.9 times in 2003.

As the above observations demonstrate, these recent successes are largely quantitative and result from less government money allocated to a smaller number of inspecting bodies. Nevertheless, when and if inspections actually do take place, the procedures for their conduct continue to remain opaque and poorly defined.²²

Given the success of the recent quantitative changes, qualitative improvements are now necessary to ensure the efficient operation of Georgia's inspections infrastructure. As state institutions develop, the demand for a system that manages to ensure the protection of public goods optimally — food safety, environmental safety, sanitation systems, hygiene, safe and proper operation and maintenance of technical appliances and structures — whether large or small, is only bound to grow. What are those aspects that require optimisation?

Existing Problems

Inspections are regulated by the 2001 Law on Control of Entrepreneurial Activity²³. This statute contains several provisions that are specifically aimed at protecting the interests of businesses:

- An inspection body must register with the Ministry of Justice to hold the title of “Controlling Agency” and be authorised to inspect. No government institution can inspect a business without being listed in the Registry of Inspecting Agencies, which is publicly available to any interested party.
- In order to conduct the actual inspection, a controlling agency has to apply to local court for permission to inspect, indicating what convincing evidence they have to suspect the inspected company in violations.
- Businesses cannot be inspected twice in a given year by the same agency or by several agencies on the same issue.
- An inspection must hand an inspected business a written roster of the latter's rights and obligations prior to conducting an inspection.

21 The decrease in funding continued for several agencies in 2006 as well, with the Law on 2006 Budget disbanding the Sanitary Supervision Inspection (accounting for 11% of inspections in 2005, according to the survey) and the Labour Inspection (Clause 50.13 of the said law). On a different occasion, the government has regulated that some agencies decentralise, with their regional offices now subordinated entirely to local authorities, leaving it to the latter to decide the fate of local inspections in each specific case (Amendments to the Law on Veterinary Activity, dated 28 December, 2005).

22 An exception is the recently established Food Safety, Veterinary and Plant Protection Service at the Ministry of Agriculture that, subject to the provisions of the recent Law on Food Safety and Quality, is legally mandated to employ risk management in its operation.

23 Adopted on 7 June, 2001.

Despite the progressive spirit of these provisions, IFC has observed several drawbacks in the quality of practical inspection procedures in Georgia:

The majority of inspections occur with poorly defined procedures

Up to 12 agencies (see Annex 3), among them such active inspections as the Tax Department and the Technical Supervision Inspection, are exempted from the Law on Control of Entrepreneurial Activity. Based on the results of the survey, 69% of inspections in Georgia are therefore not covered by this Law (with the majority of these coming from the Tax Department – see Chart 6).

Practical reality differs from legal provisions

Inspected businesses frequently complain that in practice inspections often fail to abide by statutory requirements. The necessity of a court warrant is often ignored and written summaries of rights and obligations are almost never handed to enterprises. Contrary to the provisions of the law, inspectors exceed their specific authority and examine such issues that lie clearly beyond their competence. The good spirit of the law is being heavily compromised by bad implementation. The lack of efficient infrastructure that would enforce statutory provisions is obvious. On the one hand, there are businesses that are poorly aware of their rights and the inspection process at large. Furthermore, these businesses (usually small and medium in size) are not typically organised in business associations that would defend their rights against unregulated intervention by the state. On the other hand, the state could try to address the temporary deficiencies of the inspections system with a fair and quickpaced appeals process, and invalidate those decisions that were taken by circumventing due process²⁴.

SakStandarti entered my premises without prior notification, sealed the production lines, and inspected packaging, labelling, metrology as well as the financial documentation which were outside its competence – Focus Group Participant.

Inspection procedures are neither clearly established nor documented

Apart from the little that the Georgian legislation requests, but the government does not implement, as paragraphs above illustrate, the legislation lacks further guidance on inspection procedures. Contrary to best international practices, the law does not obligate inspectors to establish a checklist and inform businesses of issues that are typically examined during an inspection. Little is known if and how government officials are required to document the steps, findings or procedures that take place during an inspection.

²⁴ The appeals process is more closely discussed in a separate section below.

The system is penalty-oriented instead of focusing on voluntary compliance

The survey demonstrates that 32% of tax inspections and 76% of Financial Police inspections resulted in such sanctions as penalties, suspension of business activities, confiscation of goods, etc. While specific issues associated with tax administration are discussed in more detail in a separate chapter, it is evident that to a large extent inspections are still used to intimidate businesses.

Survey respondents and focus group participants most frequently reported that the Financial Police have a daunting effect on businesses and government officials alike. Unlike similar inspecting agencies, its functioning is regulated by a separate Law on Financial Police²⁵. The law vests the incumbent agency with a wide area of competencies ranging from criminal investigations to inventories and revisions of assets to the examination and search of vehicles and persons' identity documents. Moreover, beyond investigations, the Financial Police is authorised to impose sanctions unilaterally on the wrongdoers and violators it has identified²⁶. Initially a swift-acting unit against corrupt officials and criminalised businessmen of the previous era, discussion with focus group participants show that the Financial Police have gradually shifted focus on to smaller transactions and, understandably, smaller businesses.

Interviewed businesses confirmed a more frequent involvement of the Financial Police in ordinary inspections and report that its officers do not observe the requirement of a court warrant prior to the inspection visit (although the Financial Police are not listed among the agencies exempt from this ruling). Nor do the Financial Police inform businesses beforehand, verbally or in writing, on their rights and responsibilities. Entrepreneurs report that the Financial Police often exceed their scope of competence, examining those aspects of business activity (such as licensing) that are clearly beyond their authority. More alarmingly, low-level government officials, especially tax inspectors and customs officers, seem to be no less intimidated by the Financial Police than the private sector, as the sections on Tax Administration and Import Procedures demonstrate.

Appeal procedures are discouraging

As the survey evidenced, over one half of the entrepreneurs that believed they were wrongly penalised as a result of an inspection did not appeal the decision of the controlling agency. The most frequently quoted reason for such reluctance is a widespread distrust towards the judicial system. According to the survey, 53% of businesses consider the current judicial system as an obstacle to their activity. Focus group participants claim that there is no reason to appeal the actions of the government officials in courts, as the latter almost unvaryingly side with the state rather than the private sector. Moreover, several businesses quoted the fear of possible "complications" with state agencies as a sizable deterrent against holding a controlling agency answerable for its deeds before the court.

25 Adopted on February 24, 2004.

26 Peculiarly, the Financial Police is also authorised to "conduct other activity envisaged by legislation".

Counterproductive provisions

Several experts have questioned the effectiveness of the current mechanism whereby an inspecting agency must first obtain a court clearance to conduct an inspection. By requesting that agencies obtain court approval to conduct their activities, the government effectively concedes that its inspections system is not credible.

Budgetary as well as human resources are scarce

The table below demonstrates the number of inspectors at some of the most active inspection agencies in Georgia. With no clear guidelines on which companies to inspect, when and how, Georgian controlling agencies will find it very difficult to cope with their agenda of protecting the public interests. On top of that, the government should expend more time, resources and efforts to ensure that the employees at inspection agencies are fully familiar with their rights and obligations as well as the applicable norms and inspection procedures.

Inspection	# of inspectors in 2006	# of entities inspected in 2006
Tax Inspections	1243	4017 (including 960 sole proprietors)
Customs	955	12 622
Financial Police (Tax-related inspections)	79	504
Technical Supervision	51	1873
Architectural & Construction Inspection	5	15
Drug Agency	10	216

Source: each respective inspectorate

Recommendations

Introduce risk management in most typical business inspections

Risk based inspection proved to be one of the most effective methods both in developed Western economies where this approach has been operating for decades, as well as post-Communist countries where it has been recently introduced. Enterprises are selected for inspection based on the probability, magnitude and effects of a potential violation. Risk management leads to a more transparent, customer-friendly and compliance-oriented inspection system that operates efficiently in an environment where qualified resources for the protection of public goods are scarce. Annex 5 provides details on how inspections have been reformed and operate in other countries.

Document the Inspection Procedure and its Stages

Empirical evidence of successful reforms in many countries (for example, in Latvia and Mexico) suggests that documentation of the inspection procedure plays an important role in the overall improvement of the inspection process, making it more result-oriented, transparent and efficiently manageable. Process documentation usually splits the inspection work into three stages: (i) preparation and appointment of inspection, (ii) conduct of an inspection and (iii) inspection appeal. For each stage, civil servants should be required to clearly document their decisions, explain the grounds for such decision and indicate what findings were made (including violations) during an inspection.

An important part of documenting the inspection process is the use of checklists that contain a list of all those issues over which a specific inspectorate has authority. For instance, Annex 5 illustrates how the Swedish Municipal Sanitary Service employs checklists to have a detailed roster of all those areas that it is competent to examine when inspecting a business. Checklists should be easily available for any interested party, thus allowing businesses to become familiar with all the issues that will be checked by a given inspectorate in advance, and to prepare for the inspector's visit. An inspector who is required to use checklists is also less likely to exceed his / her authority but more likely to provide sound argumentation for the results, taking into account a potential appeal.

Examine applicable Standards, Rules and Procedures

The dissolution of the Soviet Union and the frequent changes in government ever since have left Georgia with a plethora of rules and regulations that establish applicable norms and standards for a variety of business processes, including sanitary protection, hygiene, construction, food production and processing, operation of heavy machinery, etc. A careful review needs to be conducted to ascertain which regulations are still in force and what areas they cover. The following steps include removal of any overlaps that may be identified in the process and the promulgation of such norms that are in line with the best examples of EU legislation.

Improve Appeal Process

As far as the court appeals are concerned, the judiciary needs to apply serious efforts to ensure the impartiality of Georgian judges and effectively prove and communicate this message to businesses. As a result, entrepreneurs will have more trust of the system to appeal against illegal actions of inspectors. Provided that the appeal process is fair, court rulings will give rise to precedents that the inspectors will have to take into consideration, thereby promoting uniform interpretation of legislation. Furthermore, the appeal process should become more streamlined and less time-consuming.

Similar to the judiciary appeal, administrative appeal within individual inspections should become more streamlined and transparent, as our more thorough analysis of tax appeals demonstrates in the next chapter.

Inform Businesses How Inspections Operate

Focus group participants almost unanimously stated that they are unaware of the procedures that regulates an inspector's visit. Informing businesses on what they should and should not expect from an inspection does not seem to be on the government's agenda. This clearly contrasts with practices in developed countries, where government institutions engage in public dialogue, conduct information campaigns and are required to issue compliance policies to explain to the wider public what a specific agency serves and how it aims to achieve those goals. Neither inspection agencies and other public institutions nor business associations provide any guidance to businesses on how inspections are conducted in Georgia or what rights and obligations are vested with the inspectors and the inspected. Public awareness of and accountability for its activities should become a priority for each controlling agency. An effective communication strategy should include information dissemination efforts through television, Internet, and print, as well as through special service centres and hotlines, where necessary, that assist businesses in complying with the legislation, prior to punishing them for the failure to do so.

Introduce Third-Party Certifications

In a variety of instances, controlling agencies have the authority to certify that private operators conform to certain processes, products or methods with governing regulations and standards. Such certification may be authorised by state inspection agencies, or as is the case in several countries, by private third-party organisations that are accredited with the national bodies and have authority to confirm such compliance in exchange for an adequate fee. The ultimate goal of the government is to maintain necessary level of safety requirements with minimum resources. Private certification companies with a proven record of corresponding experience may provide such services, as experiences in Mexico and several other jurisdictions demonstrate. The government can decide which certification activities, and to what extent, can be "outsourced" to private players, and can accept the result as satisfying all or a significant portion of the compliance requirement.

Possible Impacts

- **Improved efficiency.** The resources available to the state for supervising business activities are usually scarce and cannot be distributed to all the entities that should be inspected. Risk management permits efficient management of resources, so that greater risk areas are targeted through state control, thereby reducing potential hazards to public health and safety.
- **Improved compliance, reduced violations.** Risk-based inspection management means that companies that comply are less likely to be inspected. Thus risk management effectively encourages compliance among the entire business sector. Moreover, with publicly available checklists, businesses know what it takes to comply and thereby decrease the incidence of violations. Provided that compliance is more resource-effective, more businesses will be willing to comply with requirements than violate them.
- **Rationally targeted inspections, reduced corruption.** Since inspections will be targeted at potentially hazardous enterprises, there will be fewer inspections necessary. Coupled with improved compliance, risk management will reduce the number of inspections the average business experiences per year. However, firms with a history of non-compliance or those involved in potentially hazardous activities would see a proportionally higher number of inspections. A system which rationalizes the reasoning for an inspection visit is also likely to reduce unwarranted inspections, and generally raise the level of responsibility that each inspectorate must take for its decision to visit a particular firm.
- **Improved quality of inspections and services/products to consumers.** Risk management will preclude selection of inspected businesses based on personal decisions of civil servants. Checklists are a handy tool to ensure the equal level of inspections quality, regardless of the level of the inspectors' professionalism. In addition, information campaigns will teach businessmen how to perform their obligations and defend their rights. These efforts minimise chances for inspectors to abuse their power and examine areas that are outside their scope of competences.
- **More confidence in the judiciary, improved business environment.** A just and efficiently operating appeal system, whether in courts or through administrative review, is essential for making Georgia an attractive place to do business. The judiciary is a key factor to consider when assessing a country's business enabling climate. Georgia needs to concentrate its efforts in this direction in order to boost its investment appeal.

Chapter IV

TAX ADMINISTRATION

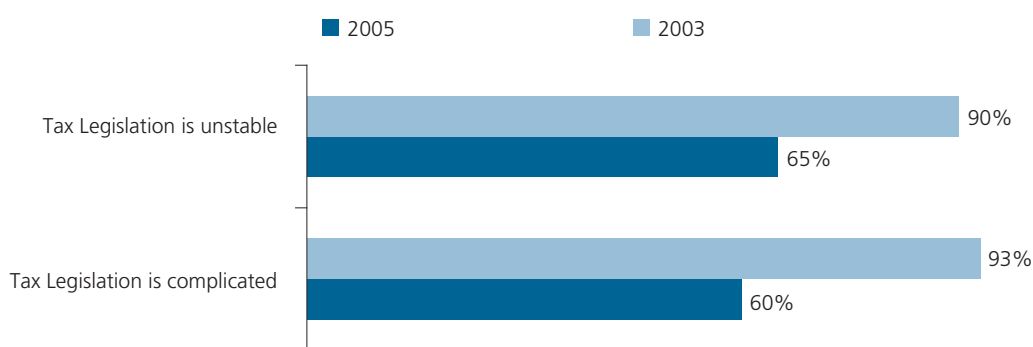
Recommendations

- Regulate how often Tax Code changes may take effect
- Restore tax tribunal and speed up dispute settlement system
- Make penalty sum dependent on the scope of violation
- Adopt “customer-friendly” communication with taxpayers
- Repeal provision on “advisory nature” of tax officials’ communications, institute “Silence Is Consent”

The survey results have shown visible progress in the reform of tax administration in Georgia. The chart below illustrates how the percentage of respondents that rate tax legislation as “unstable” or “complicated” has decreased between the two surveys.

Chart 9

Although less problematic, tax administration remains a concern for the majority of businesses



Percentage of SMEs naming various difficulties in relation to the Tax legislation

Nevertheless, continued difficulties in their dealings with tax authorities have caused 59% of all respondents to evaluate the tax administration system as problematic overall. Consequently, while the decrease in negative ratings is considerable, it would be premature to assume that the reform agenda has already been realised. As the survey results demonstrate, the share of surveyed businesses that continue to give negative answers to taxation-related questions exceeds one half. The changes the government has so far initiated and its plans to continue reform indicate that more improvements are to be expected further ahead. What has been implemented so far and how critical/timely were these reforms?

Steps of the Government

New Tax Code

In early 2005 Georgia adopted a new Tax Code that reduced the number of existing taxes as well as their rates. The seven remaining taxes (instead of the previous 21) are as follows: income, profit, social, excise, value-added tax, and local taxes such as property and gambling business taxes. The table below demonstrates how the rates of the three important taxes have decreased, while profit tax has remained at 20%.

Taxes	Before January 2005	After January 2005
Income tax	12-20% progressive	12% flat
Social tax	33%	20%
VAT	20%	18%
Profit tax	20%	20%

Another advantage introduced by the new Tax Code is the possibility to include 100% of depreciation costs in the first year of investment, thereby allowing companies to reduce their taxable profit.

One more advantage of the New Tax Code is that VAT paid for investments in fixed assets and VAT paid for exports can be refunded within one month. In other cases VAT refund takes a maximum of six months.

Moreover, a taxpayer may adjust his/her tax declaration without any penalty, if the correction is made voluntarily before a notice of inspection (Article 97 of the Tax Code).

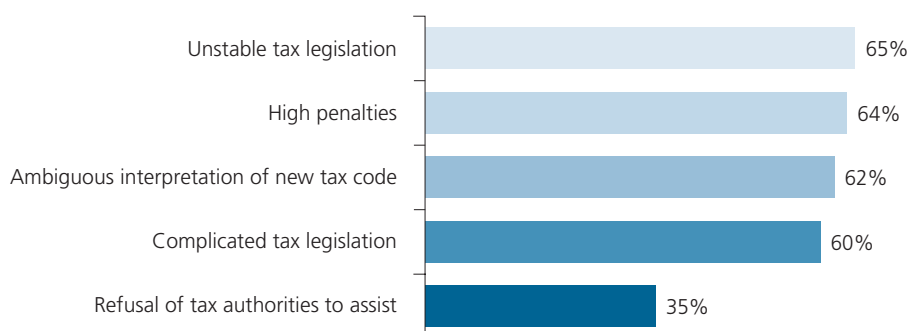
In addition, some incentives have been offered to small-sized businesses: self-employed proprietors that do not employ any work force and have an annual turnover of up to GEL 100,000 (approximately USD 55,000) are not liable for the payment of income tax and social taxes (Articles 168 and 270 of the Tax Code). A wide variety of temporary incentives (including social-, property-, profit- and income-tax holidays) have been extended to individual farmers engaged in agricultural production.

Existing Problems

The survey attempted to identify those specific factors within the general area of tax administration that cause most of the difficulties to small- and medium-sized businesses. The chart below illustrates how SMEs rate various tax issues in terms of obstacles to the development of their business.

Chart 10

Entrepreneurs' assessment of key tax issues impeding development of small and medium business



Percentage of SMEs that rated each factor as impeding the development of their businesses

Frequent changes make tax legislation unstable

Although adopted only in January 2005, the Tax Code has already been amended a total of 17 times at the time of writing in November, 2006 -- nine times in 2005 and eight more amendments as of November 2006. These figures may pale in comparison to previous years – there were 45 and 61 amendments to the old tax code in 2003 and 2004, respectively – yet these 17 amendments have changed 123 provisions since the new code has been in force. Businesses, especially small in size and unable to hire a separate full-time tax consultant, still find it difficult to update their knowledge and keep pace with the changes. It is not surprising that “volatility” has been the top complaint among businesses in relation to the Tax Code.

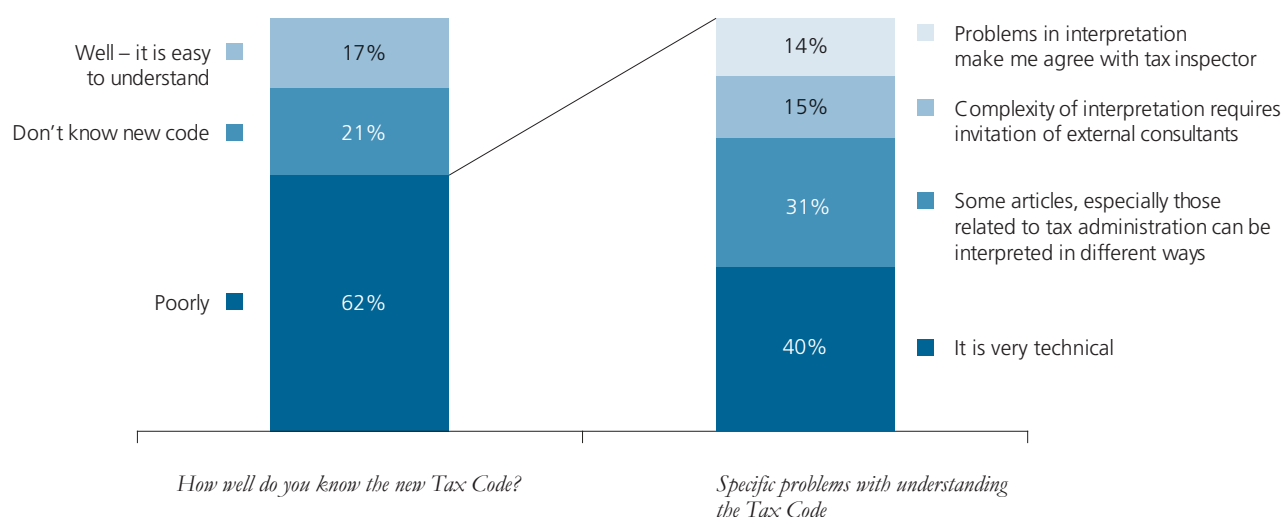
The new Tax Code has been changing so often that I have to buy a new edition every month to have the latest version – Focus Group participant.

Tax Code is unclear, ambiguous and complicated

Respondents complained that the Tax Code is ambiguous and open to interpretation. During focus group sessions, even tax inspectors confirmed having difficulty understanding certain provisions of the code ²⁷. Only 17% of surveyed companies claim that they easily understand tax legislation. This seems to be somehow suitable for tax officials that, as businesses complained, always interpret ambiguity in their favour. More specifically, the following chart demonstrates how businesses have rated their troubles about understanding the Tax Code:

Chart 11

Less than 20% of Georgian entrepreneurs understand the New Tax Code



²⁷ For instance, several businesses have complained that the code is not clear on what qualifies as expenses incurred for the repair and renovation of capital assets, why certain maintenance expenses are exempted from this category, and how these expenses can be deducted from income to calculate the base for profit tax (Tax Code, Articles 12, 177, 178, 183, 184, 186 and 211).

As can be seen, fully one-fifth of Georgian entrepreneurs are not familiar with the Tax Code at all and a further 62% of them name various difficulties (namely, the technicality of its provisions, ambiguous interpretation of its articles and the necessity of involving external consultants, absent which businesses feel compelled to agree with tax inspectors' arguments) in connection with its enforcement and operation.

As a general observation, tax statutes are usually quite complex and never an easy read. To make up for the technical language of tax legislation, authorities in almost every country issue special guidelines that explain how to submit declarations, fill out forms, calculate taxable bases, offset tax credits, make deductions and plan payments. An opinion shared by many businesses and tax experts alike is that the instructions issued by Georgian tax offices often fail to shed light to the grey areas within the Tax Code. As an example, many refer to a widespread blunder in relation to property tax payments, especially those made in 2005 in connection with property owned in 2004²⁸.

The Tax Code has several provisions that contradict others. I think what they do is amend one article and forget that this amendment affects a related clause. This gets everybody confused and if you ask around, you'd hear a variety of opinions and it's up to you to decide which interpretation is correct. Before you do so, you'll likely to get penalised – Focus group participant.

Attitude towards businesses is unfriendly

When faced with uncertainty, businesses find that there is little value in seeking clarification from the Tax Department. The Tax Code expressly states that although the head of a local tax agency or his/her deputy may provide taxpayers with a written explanation concerning a taxation issue, these explanations are only recommendatory in nature and do not have a binding legal effect²⁹. This provision gives tax officials an effective liberty to renege the statements or clarifications that they have provided to taxpayers on previous occasions, and consequently hold taxpayers responsible for a variety of charges, including compliance with their own "recommendations". Moreover, such practice definitely does not boost the level of professionalism among tax officials as they are not held accountable for their own statements.

We are required to submit tax declarations at the end of every month. Whenever we have questions we inquire with the local tax department but the instructions we get from various officials are dissimilar. This is not normal when two tax inspectors advise you to act in different ways and get us confused instead of making things clear. Last year, we had to re-submit October declarations and pay some fines on several occasions until we managed to get everyone within the tax department to agree with what we are and are not liable for. – Focus group participant.

In situations like these, the practice of "tax inquiry", which allows a business to obtain a written clarification from the state on the details of its future tax treatment, is virtually meaningless. Tax instructions and tax inquiries are both regulatory tools that the government employs to make tax administration transparent and the business climate predictable and attractive

28 In 2005, many businesses were mistakenly forced to pay property taxes for 2004 based on the new tax legislation that only entered into force on 1 January, 2005.

29 Article 47 of the Tax Code.

for local and international investors alike. The importance of employing “user-friendly” measures in order to promote economic growth cannot be overemphasised. Although “unendorsed” information materials and tax commentary are somewhat helpful for gaining clarity of understanding, these sources cannot altogether replace an official communication from the state agency that has competence over the administration of taxes.

Another problem that businesses seem to face frequently is the accountability and grounding of conclusions made by tax officials and staff of the Financial Police. Although Financial Police have been granted ample authority to inspect businesses under the relevant law ³⁰, the primary purposes of this agency are the prevention of and fight against crime, rather than tax audit and ordinary inspection of businesses. Yet an increasing trend, observed by many interviewed companies, is that their books and accounts are being inspected by Financial Police. Such inspections are most likely to entail identification of some violation and imposition of the highest sanctions on a business. A typical example of such incident, quoted by many interviewed managers, is the valuation of transactions. The Tax Code ³¹ empowers heads or deputy heads of local tax units to apply a “market price” to a transaction where pricing raises doubts, provided that the relevant resolution is based on sound grounds. Most usually, Financial Police are involved in such proceedings to the extent that the components of criminal intent or activity are present. A businessman that wishes to appeal the actions, inspection results, findings or sanctions of tax and Financial Police authorities often discovers that his/her cause is difficult to defend, as sanctions are poorly supported by factual evidence or otherwise deemed confidential.

Instead of compliance, the system is penalty-oriented

According to BEEPS ³², Georgia saw the largest reduction in corruption among transition countries between 2002 and 2005. Indeed, interviewed businesses no longer list bribes as a default means of dealing with officialdom. The fear of dismissal and the state’s persistence towards curbing corruption has effectively discouraged civil servants from seeking unofficial payments from businesses. However, the new culture that is being introduced in many fiscal agencies is primarily aimed at extorting the maximum money from businesses rather than promoting voluntary compliance. As is the case with customs-related problems, the authorities’ drive to increase payments to the budget may be another evidence of a common practice whereby every instrumentality is given its monthly plan of collections and a failure to comply with the plan may serve as grounds for dismissal or disqualification. While clearly liberalistic on the one hand, the new Tax Code is also more ruthless towards those who are believed to have violated it. As several focus group participants remarked, the official fines that they are now at times required to pay are very often unfair and much more “expensive” for an average company than unofficial payments made in the past.

An inspector is likely to be accused of being “in conspiracy” with a business, held accountable or get fired if he does not impose maximum penalties on the taxpayer (regardless of the scale of violation) or if a revenue target has not been fulfilled – Tax Inspector.

30 The Law on Financial Police was adopted on 24 February 2004, shortly after the Rose Revolution.

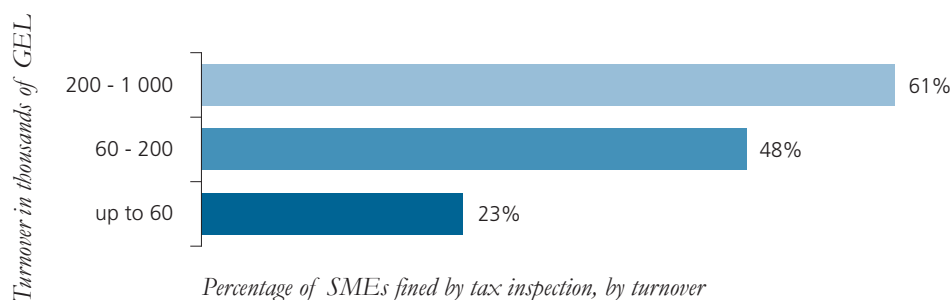
31 Article 22.10.

32 “Business Environment and Enterprise Performance Survey”, developed jointly by the World Bank and the European Bank for Reconstruction and Development.

What is the penalty system under the new Tax Code and how does the state administer it?

Chart 12

As turnover increases, so does likelihood of a tax violation



The minimum penalty for most accounting mistakes is usually GEL 3,000 (approximately USD 1,655)³³. Further, a mistakenly claimed VAT may cost a business three times the amount in question and a mistake in accounting revenues and expenses, even if not resulting in decreased tax liability, will set a business back GEL 1000. Examples of penalties currently in use are given in Annex 6 to this report.

Everybody knows that good accountants are hard to get in Tbilisi, worse so in the regions. On average, you won't get a worthy specialist for less than USD 500 a month, and that's no small amount of money for me. But even good accountants sometimes make mistakes or miss deadlines. Even if it's a technical error, you would still have to pay humongous fines. Our company was fined GEL 25,000 just for a blunder in the declaration. We thought this was outrageous when we had to take credit from the bank to pay salaries for our employees. – Focus Group participant, July, 2006

Tax appeal process is ineffective

A noteworthy fact about the tax administration process is that upon inspection, fines are imposed by the same officers who actually conducted the inspection. When faced with an option to appeal, many businesses stated they were unsure of their success because, as a rule, tax officers' decisions are not overturned by higher tax instances or courts. According to the survey results, only 18% of cases are appealed. It is worth noting that the three basic stages of the tax appeal process have common basic rules:

- Upon making a judgement, tax authorities, although obligated, may actually not deliver the response – Articles 154, 156 and 159 provide that absence of a response qualifies as a negative response by the tax department³⁴;

³³ Tax Code, Article 133.

³⁴ Instead of applying Silence Is Consent principle, the state seems to have decided to convey the opposite message to taxpayers.

- While filing an appeal complaint, the taxpayer must specify which superior agency within the hierarchy of fiscal bodies (e.g., Tax Department or the Dispute Resolution Council at the Ministry of Finance) will hear the next appeal instance. The Tax Code is explicit that the taxpayer is not entitled to appeal the case in the next fiscal instance if the latter is not indicated in the appeal complaint³⁵. Failing this requirement will disqualify the appeal process further up to the fiscal agencies³⁶.
- In contrast with the strict regulation of appeals to fiscal bodies, the taxpayer at his own discretion may choose to submit the issue to courts at any stage of appeal.

Entrepreneurs complain that the procedures and deadlines have intentionally been tightened to discourage companies from appealing (see Annex 7 – Stages of Tax Appeal Process). The shorter deadlines are characteristic not only to the new Tax Code, but also to the Administrative Procedural Code, which reduced the six-month appeal provision in court to one month in 2005. Therefore, companies that have opted for appeal within the structures of the Ministry of Finance may find that their one-month court appeal deadline has expired while they were busy asserting their case in the next instance of a tax inspection. Furthermore, conflict of interests is clearly visible at the first round of appeal, when the complaints are actually filed with the same agency that conducted the inspection and issued the penalty. When technical constraints do not serve as a deterrent, businesses say they have learned a lesson that a stubborn appellant runs a high risk of being visited by the Financial Police for an inspection which is not likely to be beneficial for a business.

In France, if a tax violation is found, the taxpayer submits comments within 30 days to prove the truth, which is considered in a final decision made by the tax administration. If it is proved that the tax violation was not deliberate, the sanctions are reduced significantly (source – Finansy magazine, pp 32-34 #10, 2004).

Recommendations

Regulate how often Tax Code changes may take effect

In most European Union countries, tax amendments are introduced only once or twice a year, regardless of the date of adoption. This provides ample time for tax authorities to issue specific instructions and for businesses to communicate internally, discuss the practical implications of the novelty and thus prepare for the introduction of the new regime. A predictable tax regime has a positive impact on the confidence of businesses and even helps tax inspectors in their learning curve. For the economy at large, a stable tax legislation frees up the frequently occurring compliance costs that the private sector continues to bear yearly. Alternatively, the state could regulate that those changes that adversely affect the taxpayer materially may become effective only from the next fiscal year and within no less than three months from the date of adoption in any case.

35 Article 146.5 of the Tax Code.

36 Articles 155 and 157 of the Tax Code.

Restore tax tribunal and speed up dispute settlement system

The Dispute Resolution Council at the Ministry of Finance has, to an extent, assumed the burden of reviewing and ruling upon the numerous tax disputes filed in Georgia. Nevertheless, the judiciary system to this day retains its status as the last resort for all tax claims, although most businesses that refer their cases to courts find adjudication procedures lengthy and, as many observers point out, flawed. Business-related issues, especially those referring to tax liability, imply a fair amount of calculation as well as sophistication with such concepts as VAT offsets, interest accruals, allowable deductions, amortisation rates, etc. The level of professionalism of ordinary judges does not always support a thorough discussion on these aspects. A parallel forum for tax claims would be highly beneficial for boosting business confidence in the system of tax administration.

The current Georgian tax code has a brief history of independent tax arbitration which was quickly abolished after its initial introduction. The operation of a specialised and independent tax tribunal is a measure that is long overdue in Georgia, where businesses have to a large extent lost confidence in the fairness and timing of judicial procedures. A tax tribunal that operates beyond the authority of the government could boost both the confidence of businesses in government processes and the competence of tax officials in fiscal legislation. In terms of introducing quick reforms, a more immediate measure to ensure the fairness of the tax appeals system would be the introduction of independent members to the Dispute Resolution Council of the Ministry of Finance, currently composed of seven government officials, subject to the Government's resolution, with four members of Parliament additionally participating in its discussions.

Make penalty sum dependent on the scope of violation

The system of taxation should become compliance-oriented instead of penalty-oriented. Penalty sum should depend on the scope of violation. For instance, the minimum penalty for filing an incorrect declaration is GEL 3000 (approximately USD 1,655), without regard to the size or turnover of the company.

Communication with taxpayers: "customer-friendly"

Official tax instructions should, through practical examples, plainly explain the provisions of the tax code, elucidate grey areas and describe the taxation process in an understandable manner. Clarity and predictability of the system greatly benefit those countries where "tax inquiry" is an established practice: i.e., a taxpayer is allowed to inquire with tax authorities on the specific taxation regime governing its business activities. In response, tax authorities provide a written confirmation of the tax treatment (including such issues as allowable deductions, calculation of taxable bases, applicable exemptions, timing of payments, etc.) for the specific applicant for a certain period in the future. Tax inquiry is not a negotiable agreement between the taxpayer and the state. Rather, it is a clarification by the state agency of the specific rules that it intends to employ in its dealings with the taxpayer, used to avoid ambiguity.

Repeal provision on "advisory nature" of tax officials' communications, institute "Silence Is Consent"

Both the "advisory nature" of tax officials' communications and the "silence means dissent" provision (both as described above) frees the former from responsibility while placing the burden of proof on the latter.

Possible Impacts

- **Adequate time to adapt for changes.** Regulating how often tax changes may take effect sends a clear message that the government is aware of the problems faced by businesses and is attempting to mitigate the costs the regulatory burden has created. A staged introduction of tax amendments provides for a more stable and less seasonal taxation system, which also benefits from the input of both regulators and affected parties alike. Most importantly, businesses will have an opportunity to learn about impending changes, consult with specialists and each other, prepare for the new regime and plan future operations accordingly.
- **Single interpretation, less ambiguity.** Clear and specific instructions and tax inquiry leads to convergence in interpretations, better educated taxpayers, more professional tax officials, greater responsibility of decision makers and higher trust towards the system at large.
- **More trust to tax system, more compliance.** Businesses have greater confidence in an environment that is predictable. A constructive and trust-based dialogue, transparent procedures and the “user friendly” approach lead to a more law-abiding taxpayer with fewer violations and less public funds administered at their prevention or prosecution. The better businesses understand the Tax Code, the more they will comply with its requirements.
- **More efficient processes.** A parallel tax tribunal would expedite the tax appeals process, especially for the many cases that eventually end up in courts and often fall victim to protracted litigation periods. Such a venue would most likely be adjudicated by specifically trained and competent professionals that would also contribute to the uniform interpretation of the tax legislation and the growth of professionalism of all parties involved.

Chapter V

IMPORT PROCEDURES

Recommendations

- Carry out valuation of goods according to WTO rules
- Release goods under deposit terms. Customs retains the post-import inspection right
- Introduce risk-based system of customs clearance
- Implement One Stop Shop principle at all customs terminals
- Improve information provision service
- Collections vs. quality or/and speed of procedures: need to prioritise
- Improve the professionalism of officials working at customs checkpoints

Steps of the Government

Over the last two years Georgia has been actively implementing trade facilitation measures. These efforts have materialised in the Law on Customs Tariffs³⁷, which entered into force in September, 2006 and the new Customs Code that has been harmonised with European legislation and takes effect in January, 2007. Even before these changes were introduced, businesses observed a considerable easing of difficulty level in customs procedures between 2005 and 2003.

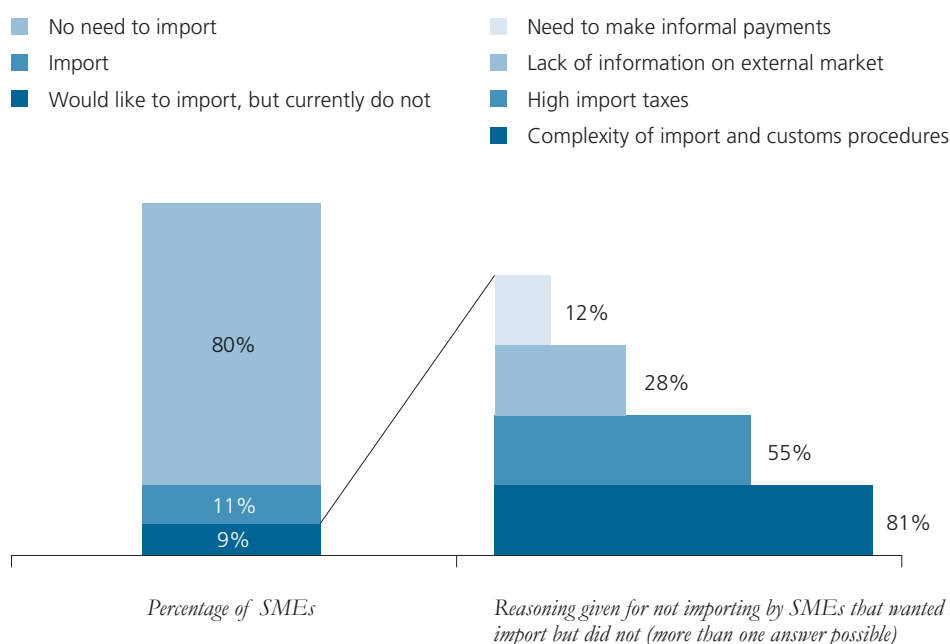
Chart 13 Import procedures continue to pose difficulty for SMEs



Percentage of SMEs that imported in a given year and rated import procedures as “complex” or “very complex”

While fewer respondents rate customs procedures as “complex”, fully 9% of surveyed entrepreneurs not engaged in importing indicate they refrained from importing due to a variety of difficulties, among which “complexity of customs procedures” ranks at the top of the list. Considering that only 11% of SMEs are currently importing, this shows that the number of firms involved in foreign trade could grow significantly in the near term, if procedures are simplified.

Chart 14 Share of SMEs importing could double if key barriers removed



³⁷ The law drastically reduces import tariffs into Georgia which is party to WTO, where key players are still grappling with further liberalisation measures, following the Doha round.

The figures above serve as an indication that while considerable progress has been achieved, the reform has only begun. Over the past three years the Georgian government has continued its efforts to rehabilitate the customs administration. The chart below aims to analyse which of the processes rated most problematic have been tackled in one way or another by the state:

Problems	Actions of the government towards resolution of the problems
Complexity of customs and import procedures	<ul style="list-style-type: none"> ▪ new Customs Code reduces customs regimes³⁸ from 15 to only 7; ▪ customs tariffs have been equalised for WTO member and non-member states alike (Law on Customs Tariffs); ▪ only 9 documents are required, instead of the previous 19, to import goods into Georgia (new Customs Code); ▪ One Stop Shop to be introduced at all terminals (New Customs Code); ▪ Georgia has unilaterally adopted³⁹ EU and OECD production- and service-safety norms that are considered mandatory. These norms shall operate alongside the old Soviet GOSTs that are effective in Georgia, subject to the relevant CIS treaties; ▪ import-related mandatory licenses and permits have been reduced from 14 to 8⁴⁰
High import taxes	Instead of the previous 16 tariff bounds ranging from 0% to 30%, Georgia now has only 3 tariff rates: 0%, 5% and 12%; in fact, most imports except for agricultural produce and some construction materials are free from customs tariffs (Law on Customs Tariffs)
Need to make informal payments	The tariff system has been simplified and the rates have been reduced, which should lead to reduction of informal payments

Existing problems

The reforms listed above are crucial for the establishment and functioning of a transparent, user-friendly and compliance-oriented customs network. Yet the obstacles identified during the survey might be a useful guide to those directions where the reform has to focus further to bring the system close to developed country standards. According to official statistics, overall imports in 2005 increased by 118% as compared to 2003. However, survey results show that the SME sector’s share has remained effectively the same, as chart 15 demonstrates:

Customs administration is a set of interrelated processes that the country operates as part of its state function. What are the specific hurdles that the businesses observe in the customs process, and what stage of the process has been the most problematic for ordinary businessmen?

At imports, customs officials reject invoices that do not bear the seller’s signature and seal. We asked several experienced lawyers and they all say the laws do not contain this requirement -- but we are better off going the extra mile to include these details than face another chance of being rejected. – Focus group participant

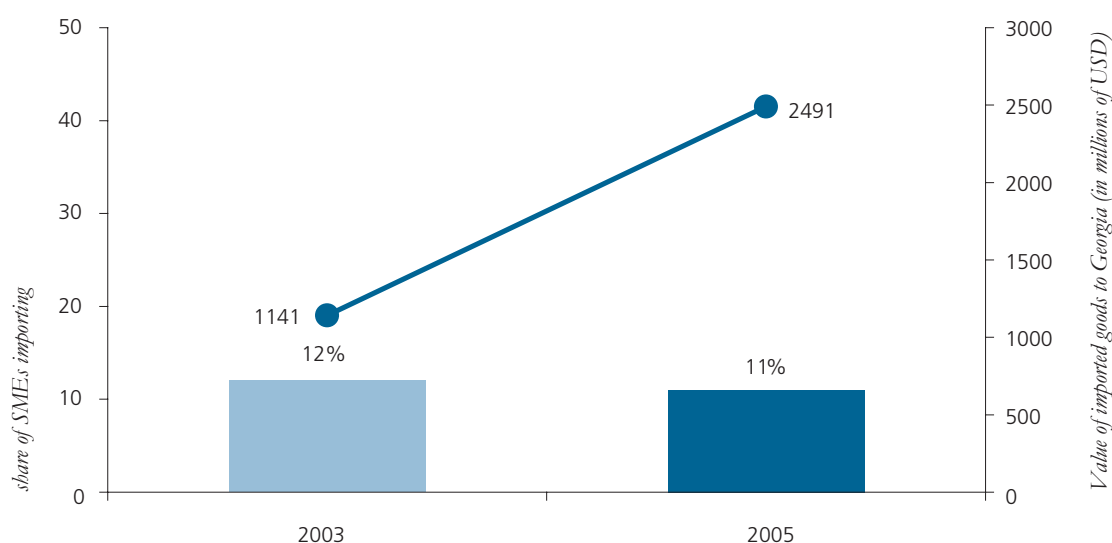
38 Currently, the remaining regimes are: release of goods for free circulation (import); transit of goods; customs warehousing of goods; inward processing of goods; temporary admission of goods; outward processing of goods; and export of goods.

39 Government Resolution #45, 24 February, 2006.

40 Implemented as part of the overall reform in connection with the introduction of the framework Law on Licences and Permits in July, 2005. Please see the relevant chapter for more analysis of this statute.

Chart 15

The share of SMEs involved in import activity is stagnating, despite a doubling of overall volume of imports into Georgia



Customs clearance is inefficient

According to the current practises, 100% of imports passing through customs terminal are subject to mandatory inspection. This arrangement considerably increases costs and creates delays and difficulties that translate into expenses incurred by the system at large. In order to circumvent these delays, businesses often have to recourse to unofficial payments. While the rate of corruption has drastically decreased, businesses often complained that unofficial payments to customs officials are still commonplace for obtaining quick and undisturbed clearance of goods.

“Reserve” valuation is widespread

The majority of entrepreneurs cited the valuation of goods as the most widespread injustice within the existing customs clearance procedure. According to the current system ⁴¹ (which is in line with WTO-ordained rules and procedures), customs officials are required to employ the following six methods to ascertain the value of imported goods, in the following order: (i) transaction value; (ii) transaction value of identical goods; (iii) transaction value of similar goods; (iv) unit price of goods; (v) computed value; (vi) Reserve method (i.e., reference price method – see Annex 8). Each method shall be applied only when the previous method cannot be applied. In other words, the second method may only be used if officials are unable to determine the customs value of goods based on the first method. The sixth method is the last resort for determining customs value. However, according to focus group results, most entrepreneurs indicate that their goods were cleared into Georgia by the use of the reserve valuation method.

My company was required to clear imported fish for a fixed price of 1500 USD, while in reality the fish cost 380 USD. – Focus group participant.

41 Currently the customs valuation system is spelled out in Decree # 736 by the Minister of Finance of Georgia dated by November 8, 2004.

It seems that in order to maximise budget earnings, the customs department almost exclusively uses the reserve method. Under this method, the unit prices for most of the typical products imported into Georgia are defined not in accordance with accompanying documents, but by the order of the Minister of Finance of Georgia. The price list, established by the government, is distributed to all customs offices. However, it is very difficult to obtain for lay people and is not available on public databases or official publications of the Ministry of Justice. Apparently, the list is updated every three months, but information on the methods used for calculating and setting reference prices is not publicly available.

Focus groups revealed that customs officials use these reference prices because they believe that businesses are likely to reduce the amount indicated in the invoice intentionally to have a lesser taxable base for import duties and levies. It is also often inferred by customs officials that reference prices are more typically used for Asian imports, as many countries from that region use export-promotion schemes that are protectionist in nature and difficult to identify at the border point.

Even disregarding this noncompliance with WTO rules, the material long-term benefits of “reference pricing” scheme are arguable. Given the “zeroing” measure applied to most import tariffs, it is surprising that the government is concerned with a theoretical and oftentimes questionable difference between the indicated and actual paid prices that may skip the budget revenue stream. The government seems to ignore the fact that businesses use the price indicated in an invoice as an expense to offset against their income; decreasing the value of imported goods, therefore, would be contrary to many business’ interests, especially in the current situation, where corruption has been curbed and companies are shifting to fully transparent accounting practices. The eventual price charged for products containing imports is undeniably higher than would have been without a reference price system, and these higher costs are passed down to Georgian consumers. Moreover, with reference price “guidelines” not publicly available and changing every three months, importing into Georgia becomes a highly unpredictable process for entrepreneurs.

Starting from 1 January, 2007 Georgia introduces a new Customs Code that directly incorporates the above six valuation methods as well as their hierarchy in accordance with WTO standards. In contrast with the current regime, which provides valuation methods in a separate ministerial order, the inclusion of valuation methods into the text of the new Customs Code seems to indicate the readiness of the government to implement these prescribed procedures. Much remains to be seen in 2007: on the one hand, the state has demonstrated its allegiance to reform, and it would be unwise for customs administrators not to pursue WTO-ordained valuation procedures. On the other hand, these rules, albeit not contained in the customs code, have already been part of the customs-related legislation. As is the case with inspections legislation, the greatest problem is with the actual implementation of these norms and not with their inclusion into one statute or another.

Based on information from focus groups, the Financial Police play an important role in the operation of the reference pricing system. Interviewed businesses state that the Financial Police punish customs officials for “not applying the highest allowable rate to the import”. While the extent of such control by the Financial Police cannot be measured due to the absence of relevant data, there seems to be an official push to have reference pricing as the default method for calculating customs value of goods, as budget earnings have been given high priority. Is this attitude likely to change in 2007?

I cleared goods according to the invoice. When I left the terminal, I was stopped by the Financial Police who checked the validity of the customs documents. Based on the inspection, the Financial Police determined that the fixed price paid by me was incorrect, and the customs official was at fault. The inspection resulted in additional payment, fine of my company and the customs officer's firing. – Focus group participant.

Budget earnings are a priority

Continued use of the reference pricing system may also be due to the use of a monthly target plan in Georgia. These are semi-formal monthly revenue collection targets that are set for individual tax and customs offices by central departments. A customs officer that does not comply with the monthly plan may risk losing his/her job, while a surplus in monthly collections may result in higher targets set for the next planning period. A number of focus group participants recounted that at the end of a calendar month, customs officials customarily suspend the processing of declarations citing power failures and software errors as the reason for the suspension.

Appeal process is ineffective

Given that the reference price system is so disadvantageous, why haven't businesses exercised sufficient pressure to have a more transparent and predictable regime? Focus groups reveal that appealing against a customs officer's deliberations usually renders few results but incurs additional expenses for the firm, thereby discouraging businesses to defend their case in court. A party that challenges a decision by a customs officer encounters problems that begin at the customs terminal, where the goods are locked, and do not end until all disputed amounts are paid. Meanwhile, storage charges accrue daily to discourage importers from appealing. Even if the case is won, the goods have often deteriorated and the customs department holds no liability for the losses incurred by businessmen in connection to a challenged/invalidated decision. Therefore, at customs an importer is compelled to reconcile and sign the declaration, which already indicates a "reference" value for the goods. Since the price is "agreed" and signed by the importer, it becomes difficult to insist on the opposite afterwards.

I have to sign the declaration where the price imposed by customs is indicated. Otherwise goods will be spoiled and I will pay for storage. Thus I am losing money. Afterwards it doesn't make sense to go to court, as by signing this declaration, I "agree" with declaration price. I find myself in a "magic circle". – Focus group participant.

One-Stop-Shop requires practical implementation

Contrary to declarations, information obtained for this report shows that the one-stop-shop mechanism envisaged in the new Customs Code does not operate in practice. The chart below illustrates a typical customs clearance procedure at Tbilisi airport.

Typical customs clearance in Tbilisi airport

Steps	Practical Procedures
STEP 1 Filling declaration upon arrival of goods at the checkpoint	<ol style="list-style-type: none"> 1. Commodity – Transport waybill 2. Invoice of supplier (original) 3. Sealed invoice received at Telecom Georgia – SUPPORTING DOCUMENT
STEP 2 Submission of declaration	<ol style="list-style-type: none"> 1. Documents verification by customs officer (Building N1) 2. Documents submission to receive C code (Building N2)
STEP 3 Receive imported goods from warehouse	<ol style="list-style-type: none"> 1. Declaration submission to receive A code (Building N1) 2. Declaration submission to receive K code (Building N2) 3. Declaration submission to customs officer (Building N1)

As the chart demonstrates, customs procedures are still unjustifiably complex, and the One Stop Shop principle does not function in reality. As we see from the table above, customs clearance procedure at Tbilisi airport consists of three steps and eight procedures that take place in different buildings and require much time to proceed.

Lack of professionalism

One area where the government should immediately start investing more resources is the professionalism of customs officials. However progressive and compliance-oriented new provisions may be, the reforms will not take effect unless the government has qualified professionals to operate the system. Businesses complain that lower-tier customs officers are often newly-recruited civil servants that lack relevant training and are therefore reluctant to take a decision or unable to manage the process quickly and fairly. According to survey results, lack of professionalism is among the top five difficulties during the customs clearance process. Usually, due to the poor knowledge of import procedures, customs officials tend to require unnecessary documents that create additional obstacles to customers, such as long delays at clearance points. Most businesses observe the trend that customs officers are not sufficiently qualified to provide businesses with competent information on regulations.

My company sent various product samples to the international trade fair through the Sarpi customs checkpoint. The customs officials registered them as exported products. Upon bringing the samples back to Georgia, officials claimed that those were imported goods and we were required to undergo all related import procedures. – Focus group participant.

Lack of adequate information

One of the most challenging issues is providing companies with adequate information about the ongoing reforms in the legislative sphere regarding customs and trade issues. According to focus groups results, there are so many changes introduced to the legislation that businessmen cannot follow the process. The web site of the Customs Department has been designed, but it does not function well. Considering the small turnover of SMEs and the fact that they lack the resources to hire qualified and well paid consultants, it is clear that SMEs face much difficulty keeping up to date with legislative changes. Moreover, there are no service centres at the Customs Department that are very important for SMEs, as most of them do not have access to Internet.

Recommendations

Carry out valuation of goods according to WTO rules

WTO Agreement on Implementation of Article VII of the GATT 1994 states that customs valuation shall, except in specified circumstances, be based on the actual price of the goods to be valued, generally indicated on the invoice. For cases in which there is no transaction value, or where the transaction value is not acceptable as the customs value because the price has been distorted as a result of certain conditions, the Agreement lays down five other methods of customs valuation, to be applied in the prescribed hierarchical order. In cases where customs officer has reasonable doubt as to the truth or accuracy of the declared value, as a first step customs may ask the importer to provide further explanation that the declared value represents the total amount actually paid or payable for the imported goods. If an importer nevertheless fails to provide a plausible explanation, customs officer may determine that the value cannot be assessed pursuant to the transaction value method. Before a final decision on a valuation method is taken, customs must communicate its reasoning to the importer, who, in turn, must be given reasonable time to respond. In addition, the reasoning of the final decision must be communicated to the importer in writing.

Release goods under deposit terms, provided that customs retain post-import inspection right

Modern practice is to separate the physical release of goods and customs clearance issues for all but some sensitive groups of products (mostly those that are subject to excise). The goods valuation system should become more transparent and effective so that it does not harm the interests of the private sector. In cases where more time is needed to ascertain the correct value of goods, an importer should be entitled to clear goods under the deposit terms. By virtue of such clearance the importer is allowed to freely haul the goods and assume full responsibility for their storage and safety, provided that customs retains the post-import inspection rights and a deposit tantamount to the possible breach value.

Same is provided under the WTO Agreement on Implementation of Article VII of the GATT 1994. If it becomes necessary to delay the final determination of customs value, the importer of the goods shall nevertheless be able to withdraw them from customs if, where so required, the importer provides sufficient guarantee in the form of a surety, a deposit or some other appropriate instrument.

Introduce risk-based system of customs clearance

Risk management at customs means that those goods, vehicles or importers that are likely to violate prescribed rules or have a previous history of violation are more likely to face an inspection than others. It is said that the introduction of a specialised software system for the clearance and management of goods is a progressive step towards transition to risk management. However, special importance should be attached to the adoption of relevant regulation that implements risk management schemes as well as to the training of personnel.

Implement One Stop Shop principle at all customs terminals

While the new Customs Code declares One Stop Shop as a mandatory principle, it will take a certain amount of time and effort to have it implemented in practice. However, the failure to do so creates delays and difficulties at customs clearance centres, thereby making Georgia a less attractive country for import-export operations.

Apart from a simple schematic change, the introduction of one stop shop process implies an overall simplification of customs clearance procedures, leading to tighter co-ordination between various instrumentalities of the government as well as within the Customs Department itself.

Improve information provision service

It is very important to improve knowledge on trade issues (including export/import procedures) among SMEs. Certain measures need to be taken to increase knowledge on trade legislation and procedures, namely:

- all necessary information on trade related issues and customs clearance should be available on the customs web site;
- booklets containing information on legislation for businesses should be published and widely disseminated among SMEs;
- information desks at clearance points should exist to provide complete information on trading issues.

Collections vs. quality or/and speed of procedures: need to prioritise

While customs has always been an important contributor to state coffers, the customs agency should be focused on better supervision of the process and improved services to clients rather than simply increasing the state revenue. Customs should concentrate on improving procedures and administration so that the interests of businesses and the demand fluctuations are predictable and thus manageable. To this end, the agency should use the reference price method strictly in accordance with the legislation, and introduce a risk-based management system and more user-friendly approach. In the long run, these actions will likely increase budget revenues without being specifically oriented to do so, as improved administration can create preconditions for increased earnings.

Improve the professionalism of officials working at customs checkpoints

Customs officials should be hired on the basis of merit and trained properly to ensure that they are qualified and professional. Lack of relevant training, especially for new recruits, on trade legislation and export/import procedures leads to an inability to make decisions and ineffective time management in the process of customs clearance.


It is necessary to underline that Georgia's new Customs Code, effective 1 January, 2007 contains a variety of provisions that, if properly implemented, would lead to a fairer and more transparent regime for importing and exporting goods. The key is the actual practical implementation of these provisions and the will of the customs administration to create a system that facilitates trade on the one hand and identifies and removes violations on the other.

Possible Impacts

- **Interests of importers are not violated.** Measures such as clearing goods through customs in accordance with WTO rules, releasing goods under deposit, and implementing a risk based inspections system will introduce a modern, client-oriented approach to customs procedures and will help to make the process less difficult for importers.
- **More transparent customs clearance procedures.** Improved provision of information to businesses will significantly contribute to the transparency of the customs process. Application of the One Stop Shop principle will further streamline the clearance process and promote predictability. Training to raise the qualifications of customs officials will serve to improve service quality.
- **Decreased cost for importing.** Implementation of risk-based inspections will reduce the occurrence of needless delays in the clearance process, streamlining procedures and decreasing costs. Implementation of a One Stop Shop mechanism at all customs terminals will also serve to reduce both direct and opportunity costs for businesses.
- **Increased import volumes and a greater share of businesses involved in foreign trade.** As procedures are simplified and made more transparent, more businesses are expected to become involved in foreign trade. Public information campaigns, which explain customs clearance procedures and the rights and obligations of entrepreneurs during the customs process, would help to increase private sector involvement in foreign trade.

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SURVEY METHODOLOGY



The survey questionnaire consisted of 162 questions. The questionnaire was based on the previous version developed for the survey conducted in 2004, but took into account changes in the business regulatory framework in 2004-2005. Entrepreneurs were asked to give information on their experiences over the previous calendar year. For this reason, the 2006 survey covers 2005 data.

A local research company, ACT Research, was contracted to carry out face-to-face interviews with businesses and entered collected information into the database between March and May, 2006. The survey was conducted in Tbilisi as well as ten regions of Georgia. In addition to questionnaire-based interviews, the survey results were discussed with focus groups consisting of representatives of SMEs, Tax Department and professional organizations, such as consulting and accounting companies, auditors and various experts. Moreover, to summarize overall results, IFC met with representatives of several government agencies to elucidate key issues covered in the report.

Sampling

Information on existing SMEs as of the year 2005 was obtained from Georgia's State Department of Statistics. The sample was designed to provide representative data in terms of economic sector, country region and company size. The sample consisted of 1880 companies, namely 1238 small and 231 medium size enterprises (main sample) and 411 sole proprietors (additional sample). Compared to SMEs that were selected based on fixed quotas established for each business size, sector and region, sole proprietors were equally selected from each region (35 entrepreneurs from each) except for Tbilisi (50 entrepreneurs) and Mtskheta-Mtianeti (46 entrepreneurs).

Selection of firms was based on fixed quotas established for each sector of business activity, region and company size. The sample made possible obtaining data representative for the entire SME sector in Georgia.

Target population: Distribution of SMEs by economic sectors

Sectors	Total number of SMEs	Small	Medium	Individual Entrepreneur	% of Total
Agriculture	191	156	35	19	1
Manufacturing	3123	2714	409	1427	12
Construction	688	464	224	37	3
Wholesale and retail	17026	16715	311	12858	66
Service	3938	3238	700	931	15
Transport	722	565	157	25	3
Total in Georgia	25688⁴²	23852	1836	15297	100

Target population: Distribution of SMEs by Regions

Regions	Total number of SMEs	Small	Medium	Individual Entrepreneur	% of Total
Adjara	2194	2021	173	1331	9
Guria	744	715	29	620	3
Imereti	4039	3820	219	2891	16
Kakheti	1841	1760	81	1414	7
Mtskheta-Mtianeti	842	799	43	624	3
Kvemo Kartli	2051	1910	141	1303	8
Racha-Lechkhumi and Kvemo Svaneti	487	460	27	386	2
Samtskhe Javakheti	905	868	37	694	4
Samegrelo and Zemo Svaneti	2089	1962	127	1424	8
Shida Kartli	1178	1088	90	831	5
Tbilisi	9319	8450	869	3781	36
Total in Georgia	25688	23852	1836	15297	100

42 The information available on active SMEs from the Department of Statistics is limited. The figures above were provided by the Department as a representative sample of the share of SMEs operating in particular regions and sectors, by size and organizational form.

Sample: Distribution of SMEs by sector

Sectors	Total	Small	Medium	Individual Entrepreneur
Agriculture	74	51	12	11
Manufacturing	333	238	41	54
Construction	203	131	62	10
Wholesale and retail	581	369	7	205
Service	489	304	64	121
Transport	200	145	45	10
Total in sample	1880	1238	231	411

Sample: Distribution of SMEs by Region

Regions	Total	Small	Medium	Individual Entrepreneur
Adjara	182	123	24	35
Guria	97	51	11	35
Imereti	227	165	27	35
Kakheti	139	87	17	35
Mtskheta-Mtianeti	124	65	13	46
Kvemo Kartli	187	127	25	35
Racha-Lechkhumi and Kvemo Svaneti	88	47	6	35
Samtskhe Javakheti	122	77	10	35
Samegrelo and Zemo Svaneti	192	132	25	35
Shida Kartli	145	92	18	35
Tbilisi	377	272	55	50
Total in sample	1880	1238	231	411

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ANNEXES

Annex 1. Types of licences and permits

Licences and permits issued for the following activities are still regulated by temporary government regulations in lieu of adopting specific secondary laws and/or new statutes. *The figures in parenthesis, as applicable, indicate the number of licences that would need to be covered for each area.*

Licences:

1. Medical activity licences (48),
2. Infant food production and import licences (2);
3. Licences for nuclear and radiation activity (6);
4. Licence for production of biological pesticides;
5. Licence for import of security surveillance equipment;
6. Public broadcasting licences (2);
7. Oil and gas distribution, import, processing and transportation licences (5);
8. Licences for educational institutions (5);
9. Insurance licences (3);
10. Banking licences (2);
11. Licences for activities on securities market (5);
12. Licences for utilisation of natural resources (forest, mining, underground spaces, fishing, hunting grounds - 5);
13. Oil and gas production;
14. Use of radio frequency and numerology resources (2);
15. Customs shipper's and brokerage licences (2);
16. Licences for production, import, export and reparation of weapons (2).

Permits:

1. Permits for transit and import of products subject to veterinary control (2);
2. Permit for import of goods subject to special phyto-sanitary control;
3. Environment impact permit;
4. Surface water lifting and discharge permits (2);
5. The permit for export, import, re-export or transit species of wild flora and fauna under threat of extinction;
6. Permit for hunting;
7. Construction permit;
8. Permit for local/municipal transportation of passengers;
9. The permit for export/import, transit and re-export of products of double purposes;
10. Aviation permit;
11. Permit for international regular transportation of passengers and cargo based on international agreements (3);
12. Permits for duty-free, customs warehousing, temporary import/export and processing of goods (5);
13. Pharmaceutical permits (6);
14. Permit for import of non-iodized salt;
15. Permits for archaeological, monumental and cultural heritage related activities (3);
16. Permit for construction and operation of special objects (2);
17. Permit to organize gambling business (6);
18. Permit for production, transportation, import, export, re-export or transit of materials with limited turnover;
19. Permit for use of production explosives;
20. Permits for purchase and handling of nuclear and radioactive facilities, nuclear materials, radioactive substances and radioactive residuals (2);
21. Firearms and ammunition related permits (10).

Annex 2. List of Controlling Agencies Registered According to the “Law on Control of Entrepreneurial Activity” (Entered into Force on 08.01.2001) in the Registry of Controlling Agencies of the Ministry of Justice of Georgia

Inspections in 2003			Inspections in 2005			Inspections after October, 2006		
Inspection	Registered	Abolished	Inspection	Registered	Abolished	Inspection	Registered	Abolished
1. Department of Statistics	20.08.2001		1. Department of Statistics	20.08.2001		1. Department of Statistics	20.08.2001	
2. Fire Department	23.08.2001		2. Fire Department	23.08.2001		2. Fire Department	23.08.2001	
3. Tech-supervision Inspection	23.08.2001		3. Tech-supervision Inspection	23.08.2001		3. Tech-supervision Inspection	23.08.2001	
4. Ministry of Environment	06.09.2001		4. Ministry of Environment	06.09.2001		4. Ministry of Environment	06.09.2001	
5. Architectural Inspection	11.09.2001		5. Architectural Inspection	11.09.2001		5. Architectural Inspection	11.09.2001	
6. Precious Metals & Stones Dept	11.09.2001		6. Precious Metals & Stones Dept	11.09.2001		6. Precious Metals & Stones Dept	11.09.2001	
7. National Bank of Georgia	11.09.2001		7. National Bank of Georgia	11.09.2001		7. National Bank of Georgia	11.09.2001	
8. Chamber of Control	11.09.2001		8. Chamber of Control	11.09.2001		8. Chamber of Control	11.09.2001	
9. Oil & Gas Regulatory Agency	11.09.2001		9. Oil & Gas Regulatory Agency	11.09.2001		9. Oil & Gas Regulatory Agency	11.09.2001	
10. Energy Regulatory Commission	12.09.2001		10. Energy Regulatory Commission	12.09.2001		10. Energy Regulatory Commission	12.09.2001	
11. Insurance Supervision Service	14.09.2001		11. Insurance Supervision Service	14.09.2001		11. Insurance Supervision Service	14.09.2001	
12. Customs Department	21.09.2001		12. Customs Department	21.09.2001		12. Customs Department	21.09.2001	
13. Securities Commission	03.10.2001		13. Securities Commission	03.10.2001		13. Securities Commission	03.10.2001	
14. Communications Commission	03.10.2001		14. Communications Commission	03.10.2001		14. Communications Commission	03.10.2001	
15. Audit Council	03.10.2001		15. Audit Council	03.10.2001		15. Audit Council	03.10.2001	
16. Tax Department	12.10.2001		16. Tax Department	12.10.2001		16. Tax Department	12.10.2001	
17. Department of Forestry	05.02.2002		17. Department of Forestry	05.02.2002		17. Department of Forestry	05.02.2002	
18. Motor Vehicle Administration	02.12.2002		18. Motor Vehicle Administration	02.12.2002		18. Motor Vehicle Administration	02.12.2002	
19. Ministry of Finance	19.08.2003		19. Ministry of Finance	19.08.2003		19. Ministry of Finance	19.08.2003	
20. Sanitary/Hygiene Inspection	20.08.2001	20.11.2003	20. Social Insurance Fund	16.02.2004		20. Social Insurance Fund	16.02.2004	
21. Food Monitoring Service	22.08.2003	28.04.2004	21. Financial Police	19.03.2004		21. Financial Police	19.03.2004	
22. Emergency Legion	23.08.2001	26.08.2003	22. Excise Payers' Inspection	06.09.2004		22. Excise Payers' Inspection	06.09.2004	
23. Land Management Dept	23.08.2001	07.09.2004	23. Patrol Police	12.10.2004		23. Patrol Police	12.10.2004	
24. Pharmacy & Narcotics Inspection	13.02.2002	23.09.2004	24. Drug Agency	26.10.2004		24. Drug Agency	26.10.2004	
25. Border SES	20.08.2001	07.22.2004	25. Samtresti	18.05.2005		25. Samtresti	18.05.2005	
			26. Tbilisi Municipal Supervision Service	02.09.2005		26. Tbilisi Municipal Supervision Service	02.09.2005	
26. Tbilisi Municipal SES	27.11.2003	09.02.2005				27. Medical Activities Inspection	03.02.2006	
27. Antimonopoly Service	06.09.2001	07.03.2005				28. Food Safety, Veterinary & Plant Service		
28. Geodesy & Cartography dept	06.09.2001		27. Geodesy & Cartography dept	06.09.2001	06.07.2006	29. Environment Protection Inspection ⁴³		
29. Goods & Services Inspection of Sakstandarti	04.11.2003		28. Goods & Services Inspection of Sakstandarti	04.11.2003	04.08.2005	30. Agency For Free Trade and Competition ⁴⁴		
			29. Sakminkhiltskali – beer & soft drink insp.	24.11.2004	03.14.2006	31. Sakminkhiltskali – beer & soft drink insp.	24.11.2004	03.14.2006
30. Veterinary Department	20.08.2001		30. Veterinary Department	20.08.2001	01.01.2006			
31. Flour Quality Inspection	20.08.2001		31. Flour Quality Inspection	20.08.2001	01.01.2006			
32. Fuel & Energy Quality Department	14.09.2001		32. Fuel & Energy Quality Department	14.09.2001	04.22.2005			
33. Department of Geology	05.10.2001		33. Department of Geology	05.10.2001	04.10.2006			
34. Border Phytosanitary Inspection	09.10.2001		34. Border Phytosanitary Inspection	09.10.2001	07.15.2006			
35. Plant Protection Service	09.10.2001		35. Plant Protection Service	09.10.2001	01.01.2006			
36. Labor Inspection	07.08.2001		36. Labor Inspection	07.08.2001	01.01.2006			
37. Prices Inspection	17.08.2001		37. Prices Inspection	17.08.2001	01.01.2006			
			38. Medical Service Quality Inspection	01.10.2004	01.01.2006			
			39. Sanitary Inspection	19.10.2004	01.01.2006			
			40. Sakstandarti	24.01.2005	04.08.2005			

□ Registered before or in 2003

■ Registered after 2003

■ Registered After 2006

■ Abolished between 2003 and 2005

■ Abolished between 2005 and 2006

■ Abolished after 2006

⁴³ The agency has both law-enforcement and inspecting functions, but it was not entered into registry yet.

⁴⁴ Currently the Agency is under supervision of the Ministry of Economic Development, but according to the law on “Free Trade and Competition”, by June, 2006 the Agency was supposed to be turned into independent institution reporting directly to the cabinet of ministers. According to the law, the agency shall have all functions of a controlling agency, though it is not yet registered as such.

Annex 3. Inspecting agencies that are exempt from the requirements of the “Law on Controlling the Entrepreneurial Activity” to obtain court warrants

1. Tax Department
2. Excise Payer’s Inspection
3. National Bank of Georgia;
4. Chamber of Control of Georgia
5. State Insurance Supervision Service;
6. National Securities Regulatory Commission;
7. National Energy Regulatory Commission;
8. National Transport Regulatory Commission;
9. National Communications Regulatory Commission;
10. Oil and Gas Resources Regulatory State Agency;
11. Social Insurance Unified State Fund;
12. Technical Supervision Inspection.

Annex 4. International Best Practices: Inspections

CROATIA: consolidating many inspecting agencies into the State Inspectorate, 1999. All inspecting agencies were unified under one organization called the State Inspectorate. The advantages of creating the Inspectorate were a reduction in the number of necessary inspections, inspecting agencies and inspectors, elimination of duplicated functions and application of a simplified approach that was beneficial for the state and businesses as well. On the other hand, disadvantage of such a unified approach was the need to train inspectors in various areas.

In implementing inspections reform, the state addressed the following issues as well:

- Inspectors are required to complete reports for each inspection, regardless of whether violations have been found;
- Investors receive a copy of inspection reports. Both the investor and the inspector sign the inspection reports;
- There is room on the inspection report for investors to make comments
- Inspectors are required to report daily to the State Inspectorate.

LATVIA: Inspectorate Improvement Program, 1999-2003. This envisaged a multi-faceted approach, including legislative change, training in procedures and client-orientation, experimentation through pilot projects, and cooperation among the inspectorates, government and private sector. One of the underlying principles in the inspectorate reform program in Latvia was a focus away from punishment for violations, toward ensuring compliance with health and safety rules.

The government-adopted inspectorate reform program included:

- A new government “instruction” for the inspectorates to specify the rights and responsibilities of government inspectors vis-à-vis those inspected (in particular private sector businesses);
- Increased information available to businesses about the inspection process in general and about each specific inspection in particular;
- Annual (regional) meetings between inspectorates and client groups for selected inspectorates;
- A requirement for written inspection reports after each inspection;
- Formation of an Inspection Coordination Council;
- Compulsory annual performance reports that are publicly available;
- Training for inspectors in how to improve strategic focus and develop a “client orientation” in their work;
- Development of performance indicators in several key inspectorates.

MEXICO: reduction of discretion and introduction of more transparent and straightforward procedures, 1990s. The key goal was improved transparency and certainty of the inspection activities. Mexico undertook a systematic reduction of the discretion used in issuing and managing formalities, as it was clear that many inspectors checked mostly papers and licenses rather than actual performance. More specifically, the government enacted the following reforms:

- Special Identification Card, protected against counterfeiting, for inspectors;
- “Inspection order” stating in detail the legal mandate of the inspection;
- “Exhaustive inspection record” including a specific checklist of items to be inspected that were publicly available before the inspection;
- Internal inspection manual detailing the inspection procedure;
- Transparency in inspection procedures (such as posting all information requirements on the Internet);
- “Inspection order” can be signed only by the Heads of the inspection services;
- Closing a process or installation can be done only by senior officials, under a strict administrative procedure.

POLAND: new Law on Freedom of Economic Activity sets minimum procedural standards and rights of businesses, 2004. The new Law on Freedom of Economic Activity provided a unified regulation of the overall procedural aspects of government control and inspection. The aim was to ensure that the key minimum procedural requirements apply across the inspections. The key provisions of the Law on Freedom of Economic Activity were the following:

- in cases, the inspection may be conducted by the employees of a controlling administrative body, only if they have presented an official identity card and an authorization to conduct the control;
- the inspection may be conducted only in the presence of the entrepreneur or a person authorized by him (with the exception of the controls due to immediate risks of health, safety or the environment);
- the entrepreneur is obliged to maintain a book of inspections;
- it is forbidden to conduct more than one inspection simultaneously at a given business (except for those enumerated in the Law – e.g., control due to health and safety risks, or when the implementation of the control results of obligations imposed by European community legislation on the protection of competition);
- the total duration of all controls for SMEs should not exceed 4 weeks annually.

ROMANIA: a set of measures, including consolidating a number of inspections into the National Control Authority, 2003. The reforms undertaken to streamline the inspections regime, to ensure effective coordination and oversight of individual inspectorates and reduce corruption were the following:

- Establishment of the National Control Authority (NCA). The NCA had the following institutions and activities under its jurisdiction: the National Environment Guard, the State Inspectorate in Construction, the Financial Guard, the National Customs Authority Customs Inspection and Customs control functions. The following public control authorities are “in coordination”: National Control Agency for Export, Labor Inspection, Veterinary-Sanitary Inspection, Sanitary Inspection, National Authority for Consumer Protection, National Commission for Nuclear Control, National Office for Prevention and Fight with Money Laundering. In addition, the NCA (according to the Decree on the structure and functions of the NCA) coordinates other controlling bodies inside the ministries and the central public authorities;
- Implementation of the Unique Register for Control (URC). In accordance with the legislation, inspecting authorities are required, upon arrival at the premises, to register at each company, specifying the reasons for the inspection, the duration and the results;
- Code of Conduct and a Guide for Controllers was implemented in the Tax inspection and Customs.

GERMANY: How it is done. In general, large enterprises are inspected a minimum of once a year and a maximum of once in 6 months. Taxpayers are first inspected on a random basis. Financial inspections are conducted by the order of the Ministry of Finance and approval of the Bundestag. Taxpayer is notified about a possible inspection 1-4 weeks prior to the inspection. The average duration of small enterprises is 6-8 days, and for large businesses 25-30 days. After inspection, a taxpayer is notified of the results of the inspection to be discussed and be summarized in “act”.

Comparative criteria for selecting enterprises for inspections

Republic of Latvia:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections	
State fire-fighting and rescue service	High risk/hazard (A)	Businesses where highly explosive and flammable chemical substances and chemical products (hereinafter referred to as flammable substances) are kept for at least 2 days:	Extremely flammable, highly flammable and flammable chemical substances and chemical products in the amount of 5,000 to 50,000 tons.	Legislation does not limit inspection frequency. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	Inspections Coordination Council, whose only function is to establish information contacts between the inspectorates.
		Facilities of railway stations and railway infrastructure in which hazardous freight is carried and near which the volume of flammable substances simultaneously stored exceeds the established minimum amounts.	Liquid combustible chemical substances and chemical products, from 10,000 to 100,000 tons.		
			Explosive gases (under normal circumstances and normal pressure) from 10,000 to 100,000 m ³ .		
			Extremely flammable, highly flammable and flammable chemical substances and chemical products, from 5,000 to 50,000 tons.		
	Facilities recognized by the Cabinet of Ministers as especially significant on the advice of the Ministry of Internal Affairs. ⁴⁵	Liquid combustible chemical substances and chemical products, from 10,000 to 100,000 tons.			
		Explosive gases (under normal circumstances and normal pressure) from 10,000 to 100,000 m ³ .			
Average risk/hazard (B)					
Low risk/hazard (C)					

Germany:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections
State tax authority	High risk/hazard (A)	Large businesses.	No less than once a year, but no more than once in six months.	Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection.)
		Businesses identified for priority inspection by the tax calculation unit, as well as other inspectorates with grounds for an inspection (i.e., if there are doubts concerning the reliability of tax statements and accounting reports.) Businesses that are overdue for an inspection.	Frequency of other inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than once every two years)	
	Average risk/hazard (B)			
Low risk/hazard (C)				

⁴⁵ See Attachment 1 to the Table.

England, Cardiff County:

Inspectorate	Risk Level	Number of businesses to be inspected	Frequency of inspections (based on the risk level)	Number of facilities to be inspected in 2004/2005	Assessment to identify the risk category of the businesses (based on points)	Coordination of inspections
Environmental protection and health agency	High risk/hazard (A)	8	Once a year	8	>=186	Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection)
	Average risk/hazard (B1)	14	Every 2 years	1	171-185	
	Average risk/hazard (B2)	55	Every 3 years	10	156-170	
	Average risk/hazard (B3)	124	Every 4 years	4	141-155	
	Average risk/hazard (B4)	203	Every 5 years	34	126-140	
	Low risk/hazard (C)	968	Every 10 years	34	<=125	

Canada:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections
Food inspection agency	High risk/hazard	Preparation of hazardous foodstuffs (any foodstuff with the potential to develop toxin-producing pathogens). Multistage storage and processing of foodstuffs that often cause dangerous food-related diseases. <i>Example: Restaurant with a full assortment of dishes; large banquet halls.</i>	No less than every 4 months (3 times a year)	Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection.)
	Average risk	Preparation of hazardous foodstuffs. Preparation of non-hazardous foodstuffs in large amounts. <i>Example: Snack bars, bakeries.</i>	No less than every 6 months (twice a year).	
	Low risk	No preparation of hazardous foodstuffs. Sale of hermetically sealed perishable foodstuffs. Preparation and distribution of non-hazardous products. <i>Example: Multi-purpose general stalls, premises for storing partially prepared foods.</i>	No less than every 12 months (once a year).	

Jordan:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections
Jordanian Customs Service	High risk/ red line (A) Average risk/ yellow line (B) Low risk/ green line (C)	The type of exported/imported products (more attention is paid to farm produce, telecommunications equipment, and manufacturing equipment). Imported products subject to high customs duties and taxes. Products imported from certain countries, from which imported goods previously violated standards set by law. History of importer/exporter (for example, a stable business engaged in import/export for a long time). Incidence of violations by the business. Other criteria.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years).	The activities of inspectorates are coordinated solely for the purpose of establishing information contacts between agencies and organizing joint inspections.

Mexico:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections
Labor inspection of Mexico	High risk (A) Average risk (B) Low risk (C)	There are over 156 criteria for selecting businesses to be inspected.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than once every two years).	The activities of inspectorates are coordinated solely for the purpose of establishing information contacts between agencies.

Netherlands:

Inspectorate	Risk Level	Criteria for selecting businesses to be inspected	Frequency of inspections (based on the risk level)	Coordination of inspections
Radio-communication agency	High risk (A) Average risk (B) Low risk (C)	There are over 50 criteria for selecting businesses to be inspected.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than once every two years).	The activities of inspectorates are coordinated solely for the purpose of establishing information contacts between agencies.

Facilities recognized by the Cabinet of Ministers of Latvia as especially significant (highly explosive, flammable materials and especially significant facilities):

No	Name of facility	Location
	I. Riga	
	Petroleum terminal	22 Ezer St.
	Petroleum storage depots and storehouses	7a Tvaik St.
	Riga Shkirotava railway station	81b Krustpils St.
	II. Riga Area	
	TPS-2 production (thermal power station)	Atsone, area around Salaspis Square
	Olain Petroleum storage depot	16th km of the Riga-Elgava highway, Olain District
	Underground gas storage depot in Inchukalns	Ragana, Krimulda District
	III. Daugavpils and Daugavpils Area	
	Daugavpils railway station	138 A. Pumpura St.
	Ilukste inline production controller's office (IPCO) (petroleum storage depot)	Ilukste IPCO, Shedere District
	IV. Elgava	
	Elgava railway station	1a Stasis St.
	V. Liepaja	
	Liepaja railway station	1 Emīlija St., Liepaja
	VI. Rezekne	
	Rezekne-I railway station	11 Lokomotīvu St.
	VII. Saldus Area	
	Petroleum storage depot	Druva, Torni
	VIII. Ventspils	
	Chemical substances, chemical products and petroleum products terminal	66 Dzintaru St.
	Petroleum products terminal	90 Dzintaru St.
	Petroleum products terminal	75 Talsu St.
	Petroleum products terminal	1 Dzelzceļnieku St.

Annex 5. Inspection checklist developed by a municipal sanitary service in Sweden

Inspection Report

Administrative Data

Company name	Line of business	Date
Legal address	Actual address	Inspection type
	Location	Assessment in line with the inspection control table: Food store Version 1.2
Registration number		
	Previous inspection	
	Assessment	
	Measures were taken to fix transgressions identified during a previous inspection	

The food store was inspected in line with Paragraph 24 of the food safety law (1971:511). The inspection was executed in accordance with a notification issued by the Foodstuffs Directorate regarding amendments introduced to the Ordinance SLVFS 1990:10 on rules for supervising foodstuff retailers.

Assessment of the inspected company			
Acceptable		Deviations	
Unacceptable			

An 'unacceptable' assessment means that the control agency identified violation of applicable legislation and the Directorate rates the company's operating conditions as unacceptable. The identified irregularities should be fixed within the stipulated period of time and the control agency will verify compliance. The company is rated as 'unacceptable', if four or more transgressions are revealed in internal control documents or if four or more violations are found in other sections, or if one or more grave violations are found.

Deviations. Codes are explained in the annex.	
Serious deviations (SD)	
Number:	
Deviations (D)	
Number:	
Minor deviations (MD)	
Number:	

Comments

The company is obliged to abide by the law on foodstuffs and instructions as well as EU regulations. The inspected company will repair irregularities detected in line with the deadlines set forth in the inspection annex. The company will provide the control agency with its comments in regard to the inspection report within two weeks of receiving the latter.

If the irregularities revealed are grave, requiring immediate attention, the control agency is empowered under 24 § of the Food Safety law (1971:511) to suspend the company's operations or impose a fine.

On behalf of the control agency

On behalf of the company

Inspector

Company representative

Code	Aspect Inspected	ND*	D	GD	MD	Deadlines for adopting corrective measures
1	CONTROL AGENCY DOCUMENT					
1.1	The current activities and the premises can be rated 'acceptable'					
1.2	Internal control program					

Number of irregularities

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2	INTERNAL CONTROL	ND*	D	GD	MD	Deadlines for adopting corrective measures
2.1	Training					
2.2	Cleaning					
2.3	Maintenance of premises, furnishings and equipment					
2.4	Pests					
2.5	Packaging material					
2.6	Incoming control of goods and packaging					
2.7	Maintenance of a log to record initial markings of beef					
2.8	Temperature of supplied frozen goods					
2.9	Temperature in refrigerators					
2.10	Temperature in freezers					
2.11	Defrosting					
2.12	Cooling					
2.13	Storage of heated goods					
2.14	Re-heating					
2.15	Display temperature					
2.16	Temperature of cooled water supplied					
2.17	Independent water supply					
2.18	Marking					
2.19	Verification and assessment					
2.20	Corrective measures					
2.21	In-house controls					

Number of irregularities and in-house controls

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3	ACCEPTANCE AND DELIVERY OF GOODS	ND*	D	GD	MD	Deadlines for adopting corrective measures
3.1	Acceptance and delivery of goods					
4	STORAGE					
4.1	Storage of unpacked animal products and root plants					
4.2	Storage of raw materials and finished products					
4.3	Other foodstuffs stored					
4.4	Thermometers in freezers and refrigerators					
4.5	De-freezing of freezers and other refrigerating equipment					
4.6	Goods stockpiled on the floor					
4.7	Storage of chemical goods and cleaning equipment					
4.8	Waste					
4.9	Packaging					
4.10	Displays					

* ND = no deviation

Code	Aspect Inspected	ND	D	GD	MD	Deadlines for adopting corective measures
5	PRODUCTION					
5.1	Cooling		■			
5.2	Warming		■			
5.3	Freezing			■		
5.4	Storage at sub-zero temperatures			■		
5.5	Processing of vegetables and root plants		■			
5.6	Temperature of foodstuffs		■			
5.7	Cooking and grilling of food			■		
5.8	Packaging /cutting /fragmentation		■			
6	CLEANING					
6.1	Fat filter, ventilation housing and ventilating equipment			■		
6.2	Floors, walls, ceilings, and furnishings			■		
6.3	Working surfaces		■			
6.4	Equipment, kitchen utensils and storage containers		■			
6.5	Wash stand			■		
6.6	Floor shaft			■		
6.7	Cleaning materials			■		
6.8	Extraneous objects			■		
7	PESTS					
7.1	Pests			■		
8	MAINTENANCE					
8.1	Furnishings and equipment			■		
8.2	Tolls and surfaces			■		
8.3	Floors, walls and ceilings			■		
9	COMPOSITION/MARKING					
9.1	Marking		■			
9.2	Internal feature			■		
9.3	Initial marking			■		
10	PERSONNEL					
10.1	Wash stand with liquid soap and disposable towels		■			
10.2	Personal hygiene			■		
10.3	Risk of infections and injuries (cuts, etc)		■			
10.4	Changing room			■		
Number of irregularities and internal control						
			D	GD	MD	

Comments

The company undertakes to fix the revealed irregularities within the period of time stipulated in the table above .

On behalf of the company

Company representative

Annex 6. Select penalty rates under the Georgian Tax Code

Exchange rate: 1 USD – 1.8125 GEL

Type of violation	Amount of Penalty
Late submission of declaration	5% of unpaid tax amount for each month, but no less than 200 GEL (~USD 110)
Incorrect accounting	1000 GEL (~USD 550)
Incorrect accounting causing reduction of the taxable base	10% of unpaid tax amount, but no less than 3000 GEL (~ USD 1,655)
Avoidance of registration within the Tax Department for more than 90 days	20% of hidden income, but no less than 1000 GEL (~USD 550)
Avoidance of registration within the Tax Department for more than 180 days	50% of hidden income, but no less than 5000 GEL (~USD 2,750)
Incorrect offset or return of taxes	300%
Operating without cash registers	First violation: 500 GEL (~USD 275) Second violation: 5000 GEL (~USD 2,750) Third violation: 10000 GEL (~USD 5,500)
Avoidance of taxes	
up to 15 000 GEL (approximately USD 8,280)	25% of the reduced amount
from 15 000 to 25 000 GEL (approximately from USD 8,280 to 13,800)	50% of the reduced amount
More than 25 000 GEL (approximately USD 13 800)	75% of the reduced amount

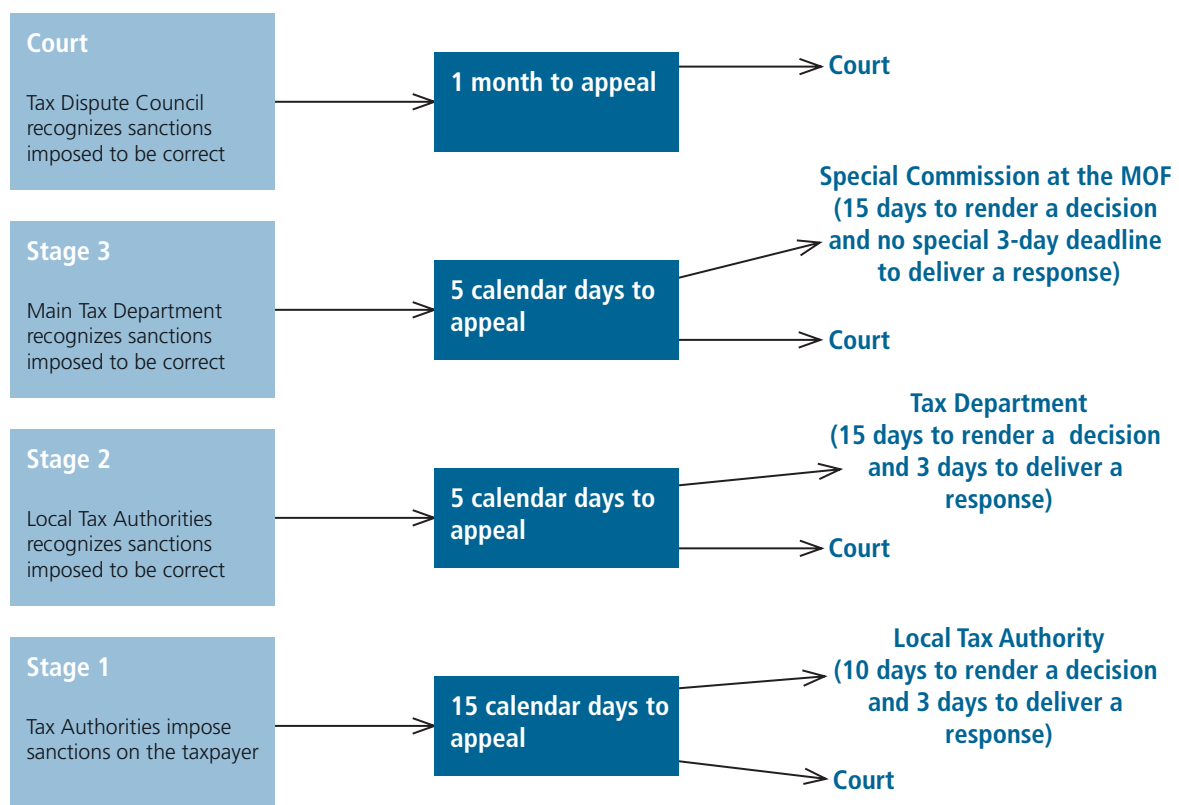
Annex 7. Stages of tax appeal process

First stage: Once the initial inspection has been conducted, violation identified and tax notice delivered, the taxpayer has only 15 calendar days ⁴⁶ to appeal to the same tax office that issued the notice. Most businesses claim that 15 days are not enough to prepare the appeals package. Upon the receipt of an appeal documentation, tax authorities have 10 days to render a decision and an additional three days to deliver the response to the taxpayer (the so called “delivery deadline”, based on Articles 150 and 154 of the Tax Code).

Second stage: Starting from either (i) the date of actual receipt of appeal verdict or (ii) the “delivery deadline” (whichever is earlier), the taxpayer has 5 days to appeal the case to the Tax Department. Here the “delivery deadline” for the Tax Department is increased from 10 to 15 days while an additional 3 days remain effective for the actual delivery (Articles 155 and 156).

Third stage: From the earlier of either (i) the date of actual receipt of appeal verdict from the Tax Department or (ii) the “delivery deadline”, the taxpayer has 5 days to appeal the case to the Dispute Resolution Council of the Ministry of Finance. Chaired by the Minister of Finance. The “delivery deadline” at this stage is again 15 days for the Council, and no special 3-day period is envisaged for the actual delivery; however:

Court : Upon the receipt of the Dispute Resolution Council’s ruling, the taxpayer has 10 calendar days to challenge the ruling with the courts.



⁴⁶ The previous tax code allowed 60 days for the same process.

Annex 8. Customs valuation methods

Methods for valuation of goods	Determination of methods
Transaction value	The customs value of imported goods is the transaction value – i.e., the price of goods paid or to be paid in the exporter country for goods purchased for exportation
Transaction value of identical goods	The transaction value of identical goods is the customs value of identical goods, registered by customs authority, which were imported into Georgia and sold at or about the same time (not earlier than 90 days) as the imported goods.
Transaction value of similar goods	The transaction value of similar goods is the customs value of similar goods, registered by customs authority, which were imported into Georgia and sold at or about the same time (not earlier than 90 days) as the imported goods.
Unit price of goods	If the imported goods or identical or similar imported goods are sold in Georgia in the same condition as they were imported into Georgia (unaltered), the customs valuation of imported goods will be based on the unit price of goods, at which price the imported goods or identical or similar imported goods were sold to the person, not related with the seller in the greatest aggregate quantity, i.e., in largest possible lots at or about the time of the importation of goods being valued (not later than 90 days) (exceptions are applied)
Computed value	The customs value of the goods is the computed value , comprising of the following elements: <ol style="list-style-type: none"> i. costs of materials, used during production of the goods, production and procession costs; ii. the amount of profit and general expenses incurred in the exporter county in connection with the sale of goods of the same class and kind as those, to be exported in Georgia; iii. the transportation costs, loading and handling charges (as well as warehousing charges). If various consignments of goods are conveyed by same means of transport, then transportation costs shall be apportioned pro rata; and insurance related expenses.
Reserve method	The customs value of goods shall be determined by the database of prices of goods in Georgia, which is defined by the decree of the Minister of Finance.



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