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The Scope of Discretionary Powers of Tax Authorities

RESUME

There are sharply different opinions about the scope of discretionary powers of tax authorities. This is to some extent related to the absence of a common discourse on the key issues of discretionary powers of the tax administration - what does discretion mean in taxation? What is the place of discretion in the tax system? What is the optimal model of discretion and can it be achieved in taxation? Different approaches are related to legal traditions of different families of law, different administrative and judicial practices, and hypotheses developed in the science of tax law. This paper analyzes the manifestation, characteristics, and scope of discretionary powers of tax authorities.

Keywords: Discretionary powers, tax authorities, taxpayer's interest, principles of law, scope of discretionary powers.

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Few aspects of revenue law generate stronger feelings than the exercise of discretionary power by tax authorities.¹

I. Introduction

There is no universal definition of the discretionary powers of tax authorities. In broad expression, it corresponds to the active role of the tax administration in the process of interpretation and application of general or vague legal norms², which includes the specification of relevant norms in regulations and other legal instruments, as well as their adjustment to specific cases.³

In order to fully understand the essence of the discretionary powers of tax authorities, it is important to distinguish the discretionary powers, which are explicitly, clearly assigned to tax authorities by law, or implicitly, derived from the definition of the law from the freedom of actions, which are related to the legislative authority of tax administration, interpretation of Tax Law, especially super-abstract and vague concepts, or the exercise of authority, which lacks a clear legal basis.⁴

In tax literature, the definition of discretionary powers of tax authorities is related to the essence of administrative discretion and implies a choice between two or more alternative outcomes determined by law by tax authorities, which includes a subjective assessment of the actual circumstances and is not controlled by the court. According to this opinion, discretion has three main characteristics - 1. It is explicitly or implicitly assigned to the tax authority, the first of which implies the granting of appropriate authority by the law, and the last one derives from the definition of the law; 2. It requires a case-by-case assessment; 3. The subjective assessment of specific factual circumstances by the tax authority is out of the interpretation of the law and therefore is not controlled by the court, otherwise, one subjective assessment will be replaced by another subjective assessment.⁵

Determining the discretionary powers of tax authorities in the literature has a different perspective as well. There are two directions of such determination - the descriptive definition, which considers the source and consequences of discretionary

¹ The Delicate Balance: Tax, Discretion and the Rule of Law, Edited by C. Evans, J. Freedman, and R. Krever, IBFD, 2011, 1.

² For the purpose of the article, the concept of vague legal norms includes the vague concepts and ambiguous norms as in tax literature they are often used alternately or even as synonyms.

³ The Delicate Balance: Tax, Discretion and the Rule of Law, Edited by C. Evans, J. Freedman and R. Krever, IBFD, 2011, 10.

⁴ Ibid, 2.

⁵ Ibid, 14-15.

powers, and the normative definition, which describes the system of tax norms and the role of discretionary powers in the system.⁶

II. The Essence of Discretionary Powers of Tax Authorities

The essence of discretionary powers of tax authorities is based on the concept of administrative discretion. Accordingly, the characteristics of such power are considered to be the existence of a legal framework granting discretion, the exercise of discretion within the competence of the tax authority, making a choice between legal alternatives, taking into account specific factual circumstances, and making an optimal decision as a result of the exercise of discretionary powers. Important signs of discretionary powers include making a decision based on a subjective assessment of objective circumstances, and the influence of legal and extra-legal factors on the decision.⁷

In order to ensure the principle of legality in taxation, the tax law should be the basis for the discretion of the tax authorities. The tax law must clearly indicate the granting of discretionary powers to the tax administration or such authority must be derived from the interpretation of the legal norms and/or the principles of law. Some norms of the Georgian Tax Code clearly establish the existence of discretionary powers, in particular, the Revenue Service may refuse to sign a tax agreement with the taxpayer or to submit the application along with appended documents, to the Minister of Finance of Georgia for consideration at the Government Meeting;⁸ The tax authority may release a faithful taxpayer from a tax sanction under this Code if the tax offense was caused by the payer's mistake/lack of knowledge.⁹ The Revenue Service may, on the basis of a person's application, issue an advance tax ruling according to a future or completed transaction.¹⁰ In some cases, the discretionary powers of the tax authority derive from the analysis of the Georgian Tax Code norms. Examples of discretionary powers implicitly granted to the tax authority are: Determining the market price of goods/services using methods for determining expenditure, possible sales price, or receivable benefit.¹¹ The norm does not literally indicate the discretionary power of the tax authority, although the administration of taxes is carried out by the tax authority and in case of impossibility of using the basic principles of determining

⁶ Ibid, 2.

⁷ Demin A. V., Discretion in Tax Law, Perm University Herald, Juridical Sciences, Issue 35, 2017, 45.

⁸ Tax Code of Georgia, Article 293 (1).

⁹ Discretion is also granted to the authority considering a dispute or the court; Tax Code of Georgia, Article 269 (7).

¹⁰ Ibid, Article 47 (1).

¹¹ Ibid, Article 18 (6).

the price of goods/services, tax administration is given the power to use one of the methods; The transfer pricing regulation, in particular, if the established terms of the transaction are not conducted as if it were at arm's length, any profits that would have accrued to one of the enterprises if the established terms of the transaction had been conducted at arm's length, but have not so accrued by reason of nonconformity with an arm's length transaction, may be included in the profits of that enterprise and taxed accordingly.¹² According to the norm, in case of specific conditions, the tax authority will decide how to form the profits of the enterprise; Determination of the arm's length price of a controlled transaction by the method that best suits each particular transfer pricing instance.¹³ Based on the interpretation of the norm, the tax authority is given the discretion to select the most optimal method for the purpose of evaluating the controlled operation.

The general limits of the competence of the authorized person exercising discretionary power can be determined by the normative and individual administrative acts regulating the activity of the tax authority and authorized person. In addition, this characteristic is directly related to the determination of the scope of discretionary authority, the general basis of which is also created by the General Administrative Code of Georgia. According to the Code, an authority must exercise discretionary powers within the scope of the law and solely for the purpose for which the power was granted.¹⁴ The purpose of the legislator may be recognized directly from the Tax Code and/or derived from the main purpose of taxation, the public interest, to mobilize the tax revenues in the budget of the appropriate level to subsequently finance public goods. The discussion about the scope of discretionary powers will be presented below.

The discretionary powers of the tax authority exist if it has the possibility to choose between legal alternatives. The choice may relate to the option of action or inaction by the tax authority or to a choice between several actions. An example of the former is the ability of the Revenue Service to release a faithful taxpayer from a tax sanction.¹⁵ In the latter case, the tax authority has the alternative of choosing one of several methods (methods for determining expenditure, possible sales price or receivable benefit) to determine the market price of goods/services.¹⁶ However, the choice between several actions may be limited or unlimited by law. In the first case, the law lists all the alternatives within which the tax authority can make a decision.

¹² Ibid, Article 127 (3).

¹³ Ibid, Article 128 (2).

¹⁴ General Administrative Code of Georgia, Article 6.

¹⁵ Tax Code of Georgia, Article 269 (7).

¹⁶ Ibid, Article 18 (6).

For example, a notice should be sent to the taxpayer in written or electronic form at least 10 working days prior to the commencement of the audit.¹⁷ In the second case, the law does not limit the choice of the tax authority. For example, the Tax Code gives the tax administration the authority to seal documents or other materials, the list of which is not established by law, and the tax organ can make a choice at his/her discretion.¹⁸

Consideration of specific factual circumstances when making a decision is one of the characteristics of discretionary authority. Moreover, it is the main legitimate basis for granting discretionary powers to the executive branch. It is known that the legislator cannot foresee, and accurately describe all kinds of potential circumstances in advance and regulate every matter in detail.¹⁹ Hence, in complex tax relations, the tax authority needs freedom of action in order to fully take into account the factual circumstances in each specific case and make the most optimal decision.

The more complex and special the case, the more factors, including extra-legal determinants, such as public goals, the government's declared course, tax administration strategy, administration's practice, principles of efficiency and effectiveness,²⁰ the expected reaction of society to the decision, the tax authority has to take into account. In addition, a subjective assessment of the objective factual circumstances by the tax inspector is inevitable in each specific case. In particular, the decision can be influenced by such factors as a person's knowledge and skills, moral values, individual social experience, and social orientation, public opinion, and even psychological factors, including emotions, stereotypes, mood, etc.²¹

Based on the General Administrative Code of Georgia, the tax authority must select the most acceptable decision as a result of the exercise of discretionary powers.²² The concept of an acceptable decision undoubtedly implies a legal decision. However, the essence of an acceptable decision also includes making the most appropriate decision as a result of a complete investigation of the factual circumstances of a particular case. What is the appropriate decision in each specific case, the tax authority decides under the influence of the above-mentioned objective and subjective factors?

If the tax authority has no choice, there is no discretion. It is possible that the legal norm formally gives the tax authority the possibility to select one or more of the

¹⁷ Ibid, Article 264 (2).

¹⁸ Ibid, Article 49 (1) (m).

¹⁹ Country Reports: Netherlands in Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 151.

²⁰ These are important principles of the 2021-2024 strategy of the Revenue Service. See: Revenue Service Strategy for 2021-2024, <<https://cutt.ly/b9WTA22>> [28.07.2022].

²¹ Demin A. V., Discretion in Tax Law, Perm University Herald, Juridical Sciences, Issue 35, 2017, 48.

²² General Administrative Code of Georgia, Article 2 (1) (k).

alternative choices, but it uniquely defines or from its definition derives the preconditions for decision selection. In such a case, discretionary authority is “reduced to zero”. In accordance with the Tax Code of Georgia,²³ „The authorized person of the tax authority makes a decision on charging or not charging taxes and/or sanctions on the basis of the tax inspection act.”

The norm gives the tax authority the opportunity to choose one of the alternative solutions, although such alternatives could be regarded as illusory. The tax administration’s decision must be based on factual circumstances and if there is a prerequisite for charging taxes and/or sanctions, tax authority should charge the taxpayer and vice versa. Accordingly, the legal result directly derives from the factual circumstances, and the tax authority does not have the freedom of choice, because the legal result inconsistent with the factual circumstances will be illegal.²⁴

III. Manifestation of Discretionary Powers of Tax Administration in the Tax Law of Georgia

Tax law-applying is directly related to the process of individualization of legal norms by tax authorities, in particular, to the process of interpretation and application.

The tax authorities interpret principles of tax law as well as the legal norms, including general/abstract and vague statutory norms. The existence of abstract and vague norms in tax law and need for their interpretation, as well as the application of the legal principles in tax administering process, creates a particularly large area of freedom of tax administration. The application of legal principles, as the highest level of abstraction,²⁵ by the law enforcer is a subject of constant controversies. There is no agreement on such issues as whether principles carry normative value in tax law or are only used to clarify legal norms, tax legislation should be rule-based or principle-based, which of them provides more legal clarity in taxation and effectively counters aggressive tax planning.²⁶ There are also differing views on what exactly is meant by rule-based or principle-based tax legislation.

²³ Tax Code of Georgia, Article 268 (1).

²⁴ Demin A. V., Discretion in Tax Law, Perm University Herald, Juridical Sciences, Issue 35, 2017, 47.

²⁵ Jones J. A., Tax Law: Rules or Principles, Text of the IFS Annual Lecture 1996 delivered at the Chartered Accountants’ Hall, Fiscal Studies, London, 1996, Vol. 17, No. 3, 1996, 76.

²⁶ Ibid, 63–89; Freedman J., Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited, British Tax Review, Vol. 6, 2010, 717-736; Braithwaite J., Rules and Principles: A Theory of Legal Certainty, Australian Journal of Legal Philosophy, 27, 2002, 47-82; Freedman J., Responsive Regulation, Risk and Rules: Applying the Theory to Tax Practice, U.B.C. Law Review, vol. 44, No. 3, 2011, 627-662; James M., Humpty Dumpty’s Guide to Tax Law: Rules, Principles and Certainty in Taxation, Critical Perspectives on Accounting, Vol. 21, Issue 7, 2010, 573–583.

Georgian Tax Code provides both general principles of tax legislation²⁷ and principles of administration of taxes, including principles of determining the price of goods/services,²⁸ principles of accounting for small business income and costs,²⁹ general principles of transfer pricing,³⁰ principles of accounting for income and expenses,³¹ general principles of tax liability³² and tax dispute settlement principles.³³ The Code contains the principles that should be interpreted and applied to a specific case. According to the Tax Code, the tax legislation of Georgia in effect at the moment when the tax liability arises shall be used for taxation;³⁴ When regulating tax matters, the terms and concepts of the legislation of Georgia used in this Code shall have the same meanings as they have in the respective legislation unless otherwise provided for by this Code.³⁵ If any amount is used for the interests of a particular person, the amount shall be deemed to have been received by that person;³⁶ When imposing a penalty for a tax offense, if the responsibility for such an act has been abolished or mitigated by the law, the norm under the new law shall apply, whereas if the responsibility has been introduced or aggravated by the law, the norm being in force at the time of committing the act shall apply;³⁷ The tax authority, the authority considering a dispute or the court may release a faithful taxpayer from a tax sanction under this Code if the tax offense was caused by the payer's mistake/lack of knowledge.³⁸ They are characterized by more or less clarity, and the greater the range of their definition, the greater the space for freedom of action of the tax administration.

The existence of general and abstract norms in the legislative acts is related to the need to create an abstract normative model regulating social relations. On the one hand, the general regulation of conduct serves to bring all potential cases within the scope of the law, and on the other hand, in the process of their application, it provides the opportunity to make a fair decision. However, such norms, due to their abstract nature, lead to excessive or reduced inclusiveness. In certain circumstances, more or fewer cases than the legislator intended may fall under the regulation of general

²⁷ Tax Code of Georgia, Article 5.

²⁸ Ibid, Article 18.

²⁹ Ibid, Article 91.

³⁰ Ibid, Article 127.

³¹ Ibid, Article 136.

³² Ibid, Article 269.

³³ Ibid, Article 298.

³⁴ Ibid, Article 2(2).

³⁵ Ibid, Article 2(6).

³⁶ Ibid, Article 73(4).

³⁷ Ibid, Article 269(2).

³⁸ Ibid, Article 269(7).

norms. The existence of general and abstract legal norms is always connected with the issue of legal certainty. While existing such norms, one of the ways to achieve legal certainty is the consistent practice of interpretation and application of these norms by tax authorities and courts.³⁹

A special manifestation of general and abstract statutory constructions are the Anti-Avoidance Rules (GAAR) and other norm-principles.⁴⁰ In general, the rules for combating tax avoidance represent the so-called super-abstract norm-principles,⁴¹ which are mainly directed against aggressive tax planning. Legislators deliberately formulate them in a general way. As a result, more cases fall under the rule than are justified by the underlying aim of the rule.⁴² Anti-Avoidance Rules and norm-principles are a significant source of legal uncertainty and are considered highly contested legal instruments in tax relations.

Different legal traditions, including approaches to tax law, lead to the existence of different types of GAARs and principles. The diversity of specific cases and different traditions of interpretation and application of anti-avoidance rules lead to the formation of different judicial doctrines.⁴³ Nevertheless, certain uniform approaches make it possible to group them. Among the anti-avoidance principles and doctrines are abuse of law, *fraus legis*, business purpose or principal purpose test, genuine commercial reasons, substance over form, genuine transactions, artificiality, etc.

Article 73 of the Georgian Tax Code regulates the method of determining an object of taxation and tax liability in certain cases, including the right of the tax authority: a) not to take into account business transactions of no substantial economic impact; b) to change the classification of a business transaction based on its form and substance if the form of the transaction does not correspond with its substance. The first of them represents the expression of the doctrine of economic substance, and the second is the principle of substance over form. The effect of the named norms applies to all taxes and, accordingly, to unlimited types of transactions. The principle of substance over form is one of the most contradictory principles, and Georgian legislation does contain additional regulations regarding it.⁴⁴ Tax authorities actively

³⁹ Country Reports: Netherlands in Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 155.

⁴⁰ *Ibid*, 151.

⁴¹ Demin A.V., Discretion in Tax Law, Perm University Herald, Juridical Sciences, Issue 35, 2017, 50.

⁴² Country Reports: Netherlands in Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 155.

⁴³ Tax Avoidance Revisited in the EU BEPS Context, Edited by A. P. Dourado, Amsterdam, 2017, 4.

⁴⁴ From 1st of August 2022 came into force the guideline (Order of the Head of Revenue Service, 28.07.2022, N20231) regarding the changing the qualification of operation, that is not the part of legislation, although is mandatory to Revenue Service's officers.

use this principle, and court practice is still developing. At this stage, it is difficult to say whether clear and consistent doctrines will be formed based on the application of this principle, although judgments expressing the sham transaction doctrine can be seen in court decisions.⁴⁵

Vague concepts are one of the main sources of freedom of action of tax administrations. They cause significant uncertainty in tax relations. In the interpretation and application of such norms, usually legal arguments are not enough, which means that the law does not have a sufficient binding force. The vaguer and more ambiguous the legal norm, the greater the area of freedom of action of tax administrations.⁴⁶

The relationship between vague concepts and administrative discretion was a subject of wide discussion in the continental European legal system in the 20th century. Under the influence of the characteristics of the constitutional monarchy, in the presence of vague concepts, the free actions of administrative bodies went beyond the scope of the law, were not governed by the law, and practically represented a process of law creation by the executive, which was not subject to judicial control. As a result of the ongoing discussions in legal theory and philosophy since the end of the 19th century, the area of freedom of action of the administrative body on the basis of vague norms was narrowed. It fell into the framework of interpretation and application of the law and thus under judicial control. Administrative discretion is related to the possibility of choosing between several alternatives defined by law.⁴⁷

In the tax literature, in some cases, the term “discretion” is used to denote the freedom of action granted to the tax administration by vague concepts. Some authors attribute its use to the broad understanding of the term “discretion”,⁴⁸ while others call it “metaphorical discretion” in order to distinguish from the genuine meaning of “discretion”.⁴⁹ The presence of vague concepts in tax law, as a rule, does not give rise to administrative discretion in its narrow sense.⁵⁰ This approach is based on the prin-

⁴⁵ Ruling N-bs-702-695 (2k-16) of the Administrative Affairs Chamber of the Supreme Court of Georgia of March 14, 2017; Judgment N-bs-854-846 (k-16) of the Administrative Affairs Chamber of the Supreme Court of Georgia of July 18, 2018; Judgment N-bs-1275 (k-18) of the Administrative Affairs Chamber of the Supreme Court of Georgia of November 25, 2021.

⁴⁶ Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 45.

⁴⁷ Ibid. According to the opponents of judicial control over the interpretation and application of vague norms, it was pointless to replace the freedom of assessment of the administrative body with the freedom of assessment of the court.

⁴⁸ Ibid.

⁴⁹ Country Reports: Netherlands in Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 151.

⁵⁰ Especially in the cases of Austria, Germany, Greece, Italy, Japan.

ciple of legality of taxation, according to which discretionary powers must be explicitly or implicitly granted by law and must be exercised within the framework of the law.

Although vague legal norms give tax authorities a wide area of freedom of action in the process of their interpretation and application, it is not synonymous with administrative discretion.⁵¹

In most jurisdictions (both continental and common law) the courts⁵² have the final word in the interpretation of vague norms and in determining the legality of their application.⁵³ There are cases when vague norms are specified and clarified by the legislative body itself by adopting new interpretive legislative acts⁵⁴ or by acts of the executive authority, which constitute part of the legislation and have binding force for the courts.⁵⁵ In oversight the legality of determining the taxpayer's tax liability on the basis of vague norms, it is decisive how the court actually fulfills this authority, and how it interprets the vague concepts.⁵⁶

Georgian Tax Code contains vague concepts such as questionable data,⁵⁷ sufficient degrees of consistency,⁵⁸ faithful taxpayer,⁵⁹ other reliable information,⁶⁰ significant difference,⁶¹ similar information,⁶² etc. The tax authority in each specific case defines these concepts and adapts them to the actual circumstances. The courts play a significant role in the definition of vague norms. A consistent practice of defining some vague concepts was established by the Georgian Supreme Court. The concept of a faithful taxpayer was referred to as a concept of general nature by the Georgian Supreme Court, which decided to overcome the indeterminacy by a progressive, dynamic and logical interpretation of the legal norm.⁶³

⁵¹ Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 42.

⁵² In this context, it does not mean the body exercising constitutional control.

⁵³ In the USA, the UK, Canada, Germany, Austria, Belgium, Japan, France, Poland, etc.

⁵⁴ In Belgium, Greece.

⁵⁵ In Austria, Denmark, France, Spain.

⁵⁶ Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 49.

⁵⁷ Tax Code of Georgia, Article 27(2).

⁵⁸ Ibid, Article 157 (c).

⁵⁹ Ibid, Article 269 (7).

⁶⁰ Ibid, Article 18 (7).

⁶¹ Ibid, Article 127 (4) (a).

⁶² Ibid, Article 73 (5).

⁶³ For the concept of faithful taxpayer, Ruling N-bs-100(2k-22) of the Administrative Affairs Chamber of the Supreme Court of Georgia of April 14, 2022; Ruling N-bs-272(k-21) of the Administrative Affairs Chamber of the Supreme Court of Georgia of March 17, 2022; Ruling N-bs-404-404(2k-18) of the Administrative Affairs Chamber of the Supreme Court of Georgia of July 5, 2018; Ruling N-bs-463-460(2k-17) of the Administrative Affairs Chamber of the Supreme Court of Georgia of July 20, 2017;

One of the manifestations of the discretionary powers of tax authorities is so-called open-ended concepts, that give the law-enforcer the opportunity to expand them, to fill them with new elements. According to the Georgian Tax Code.⁶⁴ If a tax audit cannot be continued due to Force-Majeure or any other circumstances, an authorized person of the tax authority shall make a decision on suspending the tax audit.”

On the basis of this norm, the authorized person can, except for the case of force majeure, determine the circumstances for which he/she will suspend the tax audit. According to another norm,⁶⁵ Tax authorities within their competence and in the manner established by the legislation of Georgia have the right to install readers and/or obtain their readings and seal documents and other materials in the manner provided for by this Code.”

In each specific case, based on the factual circumstances, the authorized person determines the materials that he considers appropriate to seal.

Besides, for the purpose of defining gross income Tax Code lists what belongs to the Georgian source income. The list is not exhaustive, and in a specific case, other income received from activities in Georgia can be considered as such.⁶⁶

Discretionary powers of tax authorities manifested when the law provides an opportunity for the authority to deviate from the rule defined by the Tax Law. On the basis of such a norm, in specific cases, the tax administration decides whether to use the possibility of different behavior given by the norm. Article 18 of the Georgian Tax Code defines the principles of determining the price of goods/services. Where such provisions cannot apply, the market price of goods/services shall be established using methods for determining expenditure, possible sales price or receivable benefit.⁶⁷ Possibility of using basic principles for defining the price of goods/services will be determined by the authorized person and he/she will make the decision as well to use one of the alternatives established by law.

According to the Tax Code of Georgia, If the established terms of the transaction specified in the Code are not conducted as if it were at arm’s length, any profits that would have accrued to one of the enterprises if the established terms of the transaction had been conducted at arm’s length, but have not so accrued by reason of nonconformity with an arm’s length transaction, may be included in the profits of that enterprise and taxed accordingly.⁶⁸ Tax authority determines compliance of

Judgment N-bs-222-219(K-14) of the Administrative Affairs Chamber of the Supreme Court of Georgia of October 7, 2014.

⁶⁴ Tax Code of Georgia, Article 264 (9).

⁶⁵ Ibid, Article 49 (1) (m).

⁶⁶ Ibid, Article 104 (1) (q).

⁶⁷ Ibid, Article 18 (6).

⁶⁸ Ibid, Article 127 (3).

the established conditions of the transaction with the arm's length principle and the feasibility of including the profit in the taxable profit of the enterprise.

One of the most common examples of the discretionary powers of administrative bodies is decision-making on sanctions. The Tax Code of Georgia generally does not grant discretion to the tax authorities in applying tax sanctions. Tax Code norms in most cases imperatively determine the responsibilities for the violation of the law, only a few norms give discretion to the tax authority.⁶⁹

The broad discretion is related to the determination of tax liabilities by indirect methods,⁷⁰ of which are called "presumptive taxation" in the tax literature.⁷¹ The term is related to the legal presumption that the taxpayer's income is not less than the amount determined by the indirect method. The use of indirect methods is related to various reasons. They can be used to combat tax evasion or tax avoidance, to determine objective indicators of taxation in the absence of accounting documentation or the impossibility of determining the object of taxation using accounting documentation. Besides, the possibility of using indirect methods encourages taxpayers to produce accounting documents. Indirect methods are mainly used in relation to direct taxes, although they may also be used to determine indirect taxes (VAT, excise tax). The use of indirect methods, as a rule, gives wide discretion to the tax authority, which creates a high risk of arbitrary decisions.⁷²

According to the Tax Code of Georgia, in certain conditions, a tax authority may determine a person's tax liabilities by using indirect methods (based on the volume of assets, operating income, and costs, by comparing information on the person with any other tax period of his/her business or with the data on other taxpayers who are subject to the same taxes, as well as based on analyses of similar information).⁷³ The norm gives wide discretion to the tax authority, in particular, the tax administration determines in what cases another taxpayer is considered a comparable taxpayer or what is considered to be other similar information, on the basis of which the taxpayer's tax obligations should be determined.

Tax Code of Georgia grants wide discretion to the tax administration. In order to ensure the values of the rule of law, including the principles of legality in taxation and legal clarity, it is important to frame this power.

⁶⁹ Ibid, Chapter XL; only in few cases a warning instead of a monetary penalty may be applied by the tax administration (for offences (except for the offences committed repeatedly) provided for in Articles 281, 286(1) and (11) and 291 of the Revenue Code).

⁷⁰ Demin A.V., Discretion in Tax Law, Perm University Herald, Juridical Sciences, Issue 35, 2017, 51-52.

⁷¹ Turonyi V., Presumptive Taxation in Tax Law Design and Drafting, IMF, 1996, 401.

⁷² Ibid, 401-406.

⁷³ Tax Code of Georgia, Article 73 (5).

IV. The Scope of Discretionary Powers

1. Legal Principles as Limits of Discretionary Powers of Tax Administration

Based on the goals of modern tax administration, the question of granting discretionary powers to tax authorities and its compatibility with the principle of separation of powers no longer raises questions. However, the extent and scope of discretionary powers of tax authorities has been debated in the legal literature, and the discourse varies across legal systems and traditions.

The fundamental regulatory principle of the relationship between the state and the individual - the rule of law, is also the basis of tax relations, namely, it forms the scale of the resource mobilization model at the expense of citizens' property for the purpose of financing public goods. Although its universal definition does not exist and it acquired a different extent in different countries, its main purpose is to protect the individual from the arbitrary and excessive use of state power. The model of bringing public administration within the framework of legality is derived from the idea of rule of law.⁷⁴

Even if the written or unwritten constitutions are imbued with the idea of rule of law, it should not remain only as a decoration of the constitution. The rule of law should become a legal reality and be reflected in the everyday life of people, including taxpayers, in the process of interpretation and application of legal norms.⁷⁵

The basic basis for determining the limits of discretionary powers of tax authorities is the principle of legality, that is a characteristic of a legal state. In some legal systems, legality is used as part of or even synonymous with the rule of law. The principle of legality expresses the idea that the exercise of public authority is legitimate only when it is legal.⁷⁶ The obligation of the administrative body to exercise the discretionary powers in the purpose granted by the law and within the established limits derives from the idea of this principle.⁷⁷ The principle of legality is reflected in different forms, such are legal values, constitutional principles, human rights instruments,⁷⁸ and legal

⁷⁴ Pistone P., Roeleveld J., Hattingh J., Nogueira J., West C., *Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration*, IBFD, 2019, 11-13.

⁷⁵ *Ibid*, 15.

⁷⁶ *Ibid*, 15-16.

⁷⁷ OECD, *Administrative Procedures and the Supervision of Administration in Hungary, Poland, Bulgaria, Estonia and Albania*, SIGMA Papers, No. 17, OECD Publishing, Paris, 1997, 13.

⁷⁸ *The Delicate Balance: Tax, Discretion and the Rule of Law*, Edited by C. Evans, J. Freedman and R. Krever, IBFD, 2011, 1-9.

norms regulating administrative procedures.⁷⁹ Among them, the principle of equality, legal certainty, proportionality, legitimate expectations, and fair administrative proceedings are noteworthy. The Constitution of Georgia envisages the right to fair administrative proceedings, in particular, everyone has the right to a fair hearing of his/her case by an administrative body within a reasonable time.⁸⁰ The constitutional norm is extended by the General Administrative Code and the administrative bodies are obliged to make legal and fair administrative decisions.⁸¹ The administrative body is also obliged to investigate all the circumstances of essential importance during the administrative proceedings and to make the decision based on the evaluation and reconciliation of these circumstances.⁸² In addition, activities of public administrative bodies are limited by specific terms,⁸³ in order to ensure the constitutional right to fair administrative proceedings including the making decision within a reasonable time.

The right to fair administration proceedings in the context of the tax administration process implies that tax authorities must respect the principle of equality and exclude discrimination, the taxpayer should have access to information, decisions should be made within a reasonable time, administration procedures should be conducted fairly, the principle of proportionality must be respected, decisions of tax authorities should be justified, legitimate expectations must be ensured, etc. Some of the named rights and principles are considered by the Tax Code of Georgia. Chapter IV of the Tax Code - Legal Protection of Taxpayers, ensures some of the rights, for example, the right to excess of information – taxpayers may become familiar with information held by a tax authority about them⁸⁴ as well as taxpayers may obtain from tax authorities information on the application of the tax legislation of Georgia, on the protection of taxpayer's rights, and may access information on them in the possession of tax authorities.⁸⁵ For most tax proceedings, time frame is defined by the Tax Code.⁸⁶ Some regulations of tax offense and tax control proceedings may lead to the fair decision of tax administration – a tax offense report shall be presented to the person having committed the offense, who shall have the right to provide

⁷⁹ OECD, *Administrative Procedures and the Supervision of Administration in Hungary, Poland, Bulgaria, Estonia and Albania*, SIGMA Papers, No. 17, OECD Publishing, Paris, 1997, 13-14.

⁸⁰ Constitution of Georgia, Article 18 (1).

⁸¹ General Administrative Code of Georgia, Articles 4, 5, 6, 7, 8.

⁸² *Ibid*, Articles 96-97.

⁸³ *Ibid*, Articles 100, 113, 120.

⁸⁴ Tax Code of Georgia, Article 41(1, A).

⁸⁵ *Ibid*, Article 38 (1).

⁸⁶ *Ibid*, Articles 32 (7), 145(7), 257, 2571, 264 (2, 3, 6), 265(2) etc.

clarifications and notes that shall be reflected in or appended to the report; If a tax offense report does not reflect any details defined by the legislation of Georgia, or a tax offense report is executed in violation of the law, the head of the relevant authority or the authority considering the case shall release the person from tax liability; the taxpayer may provide appropriate explanations to a tax authority when subjected to a tax control; taxpayer also may attend tax field audits conducted in relation to them, receive from a tax authority original or certified copies of any decision pertaining to them, and demand compliance with the legislation of Georgia during these activities.⁸⁷ Some of the regulations of the tax code protect the legitimate expectations of the taxpayer, for example, if a person acts under an advance tax ruling, controlling/law-enforcement authorities may not make decisions contradicting the advance tax ruling or impose any charges and/or sanctions;⁸⁸ If there is a contradiction between two public rulings or between a public ruling and an advance tax ruling, the person concerned may act according to one of the rulings at its discretion.⁸⁹

The obligation of tax authorities to justify the decisions is the most important issue in the context of exercising discretionary powers. The obligation is merely based on General Administrative Code, which obliges the administrative body to justify the decisions, especially those that are adopted within discretionary powers. Furthermore, an administrative body may not base its decision on circumstances, facts, evidence, or arguments not examined or studied during the course of its administrative proceedings.⁹⁰

The principles of fairness and equality are considered by the Tax Code only in line with the tax disputes,⁹¹ although the obligation of fair administrative proceedings and equal treatment derived from the constitutional rights.⁹²

The principle of legality requires the discretionary powers to be exercised within the limits defined by the law. The scope of discretionary powers of tax authorities should be determined by the legislator. The general basis of the scope of discretionary powers of the tax administration is the General Administrative Code of Georgia, according to which the administrative body is obliged to exercise discretionary

⁸⁷ Ibid, Articles 271 (5, 6), 41 (1, G, H) etc.

⁸⁸ Ibid, Article 47 (5).

⁸⁹ Ibid, Article 461 (8).

⁹⁰ General Administrative Code of Georgia, Article 53: An individual administrative act issued in writing must include written substantiation; If an administrative body was acting within discretionary powers when issuing an administrative act, the written substantiation shall contain all relevant factual circumstances having importance at the time of its issuance.

⁹¹ Tax Code of Georgia, Article 298 (1).

⁹² Constitution of Georgia, Articles 11, 18 (1).

powers within the scope of the law and solely for the purpose for which they have been granted.⁹³ The Code limits the decision of the authority when exercising discretionary powers to the principle of proportionality between human rights and public interest, and also requires justification when restricting the legal rights and interests of a person.⁹⁴

It should be taken into account that when exercising discretionary authority, there is always an increased risk of making a mistake, abuse of power, and arbitrary, biased action. Granting unregulated, unjustifiably broad, and absolute discretionary powers is inconsistent with the principle of legality in taxation and, at the same time, increases the risk of abuse of power.⁹⁵

In order to ensure the principle of legality in taxation, other principles and values based on its idea, and the rights of the taxpayer, it is important to define the scope of discretionary powers by the norm granting such authority.

A norm of tax law should put delegated discretion into a legal framework and clearly define its scope. In accordance with the criteria and conditions strictly defined by the legislator, the authority granted to the tax authority ensures the protection of a fair balance between the goals of the discretion and the risk of its abuse and, at the same time, makes the discretion's basis and prerequisites foreseeable to the taxpayer.⁹⁶

Since the second half of the 20th century, the tendency to bring executive power into the framework has strengthened. There is no longer any justification for indefinite discretionary powers. The paradigms of the separation of powers and the principles of legality have also changed. On the one hand, the legislator has the right to define the scope of the discretionary authority of the administrative body, and on the other hand, the decisions of the administrative body have been subject to judicial control. The interpretation of the law by the administrative body, the general verification of the legality of decision, and the protection of human rights and constitutional principles during the exercise of discretionary powers by the administrative body came under judicial supervision.⁹⁷

⁹³ General Administrative Code of Georgia, Article 6.

⁹⁴ *Ibid*, Article 7.

⁹⁵ "JSC Telenet" v. Parliament of Georgia, Decision N2/7/667 of the Constitutional Court of Georgia, 28 December 2017, III-56.

⁹⁶ *Ibid*.

⁹⁷ Woehrling J. M., Protecting Legality: Public administration and judiciary in EU countries How to conciliate executive accountability and judicial review? Conference on Public Administration Reform and European Integration, Budva, 2009, 3-7, <<https://www.sigmaweb.org/publications/42755351.pdf>> [28.07.2022].

The rule of law has not only an abstract essence but also carries important practical aspects. It requires the taxpayers to have the ability to adjust their behavior to the requirements of law and foresee the consequences of their activities. This idea is manifested in the requirements of legal certainty. First of all, it obliges the lawmaker to formulate the norms of the law in such a way that the taxpayer clearly perceives his/her rights and the requirements of the law. The norms of the law should be general, but clear and not vague.

Legal certainty is important for both observing the rule of law and achieving economic development.⁹⁸ Clarity and simplicity of tax legislation, recognized by international organizations, is an important task that is constantly faced by the governments of both developing and developed countries. This applies not only to international taxation mechanisms but also to the issue of the development of national legislation.⁹⁹ A number of international organizations and business entities recognize the importance of clarity of tax legislation for investment attraction and sustainable and inclusive development.¹⁰⁰

There are different opinions regarding the technique of tax lawmaking, in particular, whether legal clarity is achievable by general and abstract legislative norms or whether they should be as detailed and specific as possible. Regardless of which law making technique the legislature chooses, one thing is clear, based on the norm of the tax law, the taxpayer must be able to perceive what the law requires of him/her, and to foresee the consequences of both his/her and the tax authority's actions.

General, abstract and vague legal norms are an important source of uncertainty in tax relations.¹⁰¹ As it was mentioned above, such concepts create a wide area of freedom of action for tax authorities. Among super-abstract concepts are rules against tax avoidance, including norm-principles. Due to formulation by the legislator in an overly general form, they become undefined concepts.¹⁰²

According to the Tax Code of Georgia, a tax authority has the right to change the qualification of an economic operation in order to determine the tax liability, if

⁹⁸ Report on the Rule of Law, European Commission for Democracy Through Law (Venice Commission), 25-26 March 2011, 10-11.

⁹⁹ Update on Tax Certainty, IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, 2018, 5, 25, <<https://cutt.ly/b9YgfXI>> [28.07.2022].

¹⁰⁰ Tax Certainty, IMF/OECD Report for G20 Finance Ministers, 2017, 63-76, <<https://cutt.ly/l9YhNMZ>> [28.07.2022]; Update on Tax Certainty, IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, 2018, 5, <<https://cutt.ly/b9YgfXI>> [28.07.2022]; 2019 Progress Report on Tax Certainty, IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, 2019, 6, 8, <<https://cutt.ly/l9Yk044>> [28.07.2022].

¹⁰¹ Tax Certainty, IMF/OECD Report for G20 Finance Ministers, 2017, 19, <<https://cutt.ly/l9YhNMZ>> [28.07.2022].

¹⁰² Country Reports: Netherlands in Separation of Powers in Tax Law, Edited by A. P. Dourado, Report of 2009 EATLP Congress, Santiago de Compostela, 2009, 160.

the form of the operation does not correspond to its content.¹⁰³ This norm gives the tax authority wide discretionary powers based on one of the most contradictory principles - the principle of substance over form. Based on the wording of the norm, its effect applies to all taxes and, accordingly, to unlimited types of transactions.

In the part of the actual composition, the norm contains a super-abstract concept, which can be equated with an undefined legal concept, and in the part of the legal result - discretionary power. First of all, the tax administration must determine in which case the preconditions of the norm will be fulfilled, i.e. when the case of non-compliance of form and substance will occur, and then determine the legal consequence, i.e. whether to change the form of the transaction or not.

The actual composition of the legal norm is too general and allows for various interpretations. The legislation of Georgia does not provide for additional regulations regarding its use.

Based on the abstractness of the norm and the practice developed on its basis, a number of questions arise regarding the realization of the principle, which can be formulated as follows - what kind of criteria should the tax authority take into account to determine the fact of non-compliance of the form and substance of the transaction? In which cases should the administration change the qualification of the transaction?¹⁰⁴

The answers to these questions in most cases are vague. That is why the principle is characterized as a subjective, largely fact-dependent, and, therefore, uncertain doctrine.¹⁰⁵

In practice, the named norm gives rise to many different approaches, in particular, in which case the issue of the questionable relationship between the form and substance of the transaction arises; what do the “form” and “substance” of the transaction mean; “substance” means the legal or economic content of the operation; in case of inconsistency, preference should be given to form or substance; what conditions must be met in order for the substance to overcome the form; whether should be determined the taxpayer’s goal of choosing a specific legal form of economic activity or not; when tax legislation uses the concepts of other branches of law, legal qualification of the transaction should be made according to the meaning it has in the specific field of law, or its economic essence should be determined and given a different qualification for taxation purposes.

¹⁰³ Tax Code of Georgia, Article 73 (9)(b).

¹⁰⁴ The very recent guideline gives some answers for revenue service’s officers (see note 400), but there are not any cases brought to the court yet for assessing the legality of revenue administration’s actions based on the guideline.

¹⁰⁵ Form and Substance in Tax Law, edited by F. Zimmer, IFA Cahiers, The Hague, 2002, 49.

Difficulty in the interpretation and application of this norm is evidenced by the different approaches of tax authorities, the authority considering tax disputes, and the courts.¹⁰⁶

The regulation of the Georgian Tax Code regarding the principle of substance over form creates the possibility of its ambiguous interpretation and the risk of different applications to taxpayers. The norm gives excessive discretionary power to the tax authority. The extent of freedom granted to tax authorities needs additional research.

2. Incompatibility of Absolute Discretion with Human Rights

The principle of good governance in modern tax administration and the idea of protecting the taxpayer's rights reinforce each other.¹⁰⁷ Moreover, the principle of good governance requires tax authorities not only to increase the effectiveness of their activities in favor of public interests but also to make their decisions conform to the requirements of the rule of law, which at the same time implies the protection of the rights of taxpayers.¹⁰⁸ Since the taxpayer's rights derive from the highest value of the protection of human rights, in the conflict between the principles of good governance and the taxpayer's rights, the latter should prevail.¹⁰⁹

The inconsistency of the norm granting absolute discretion to the tax authority by the Tax Code with human rights, in particular with the right to equality, was found to be the basis for recognizing this norm as unconstitutional by the Constitutional Court of Georgia. "The contested norm granted discretionary power to the tax authority to administer the property tax, in particular, the tax authority was authorized, during a tax audit, to determine the value of a taxable property of a taxpayer at its market price.¹¹⁰ The disputed or any other norms of the tax code did not define any kind of criterion, or guiding principle, which should be taken into account when making a decision within the discretion of the tax authority. Accordingly, the disputed norm or any related legal regulation did not specify the criteria

¹⁰⁶ Ruling N-bs-702-695 (2k-16) of the Administrative Affairs Chamber of the Supreme Court of Georgia of March 14, 2017; Judgment N-bs-854-846 (k-16) of the Administrative Affairs Chamber of the Supreme Court of Georgia of July 18, 2018; Decision N8284/2/2019 of the Dispute Resolution Council under the Ministry of Finance of Georgia of September 25, 2019; Ruling N-3/b-336-2019 of the Court of Appeal of Kutaisi of October 18, 2019.

¹⁰⁷ *The Practical Protection of Taxpayers' Fundamental Rights*, edited by P. Baker and P. Pistone, IFA Cahiers, Vol. 100B, 2015, 22.

¹⁰⁸ *Tax Procedures*, Edited by P. Pistone, IBFD, 2019, 10.

¹⁰⁹ *The practical protection of taxpayers' fundamental rights*, edited by P. Baker and P. Pistone, IFA Cahiers, Vol. 100B, 2015, 22.

¹¹⁰ Tax Code of Georgia, Article 202 (4).

based on which the tax authority should make different individual decisions towards different taxpayers.”¹¹¹

According to the court’s position, “the disputed norm did not provide any protective mechanism, any kind of guarantee that would protect taxpayers from discriminatory tendencies arising from the decision of the administrative body. At the same time, there were no criteria that, in the case of an appeal of the decision, would give the superior administrative body or the court direct guidance regarding the discretion established by the norm, fundamental legal principles for determining the compliance of the specific decision of the administrative body with the legislation.”¹¹²

The Constitutional Court considered that “the discretionary power established by the contested norm had an absolute character, the differentiation caused by its implementation was not related to any reasonable criteria and provided the possibility of discriminatory use of the norm and, therefore, contradicted the constitutional right to equality.”¹¹³

V. Conclusion

Discretionary powers of tax authorities are one of the greatest challenges of tax relations. A fair balancing of the interests of effective tax administration on the one hand and the protection of taxpayers’ rights on the other is a difficult task. At the same time, discretionary powers in taxation should be exercised in accordance with the principle of legality.

The Georgian Tax Code grants wide discretion to tax authorities. In the process of individualization of the norms of the tax law, the balance between the goal of making the most optimal and fair decision and the conflict with the principle of legality of taxation by giving excessive freedom to the tax authority can be achieved by defining the scope of the discretionary powers by the legislator and by strict judicial control of the legality of the decisions made within this authority.

However, discretionary powers of tax authorities will continue to remain a vulnerable issue that should always be under the attention of legislators, courts, and legal doctrine.

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