The Flat Tax Spreads to Georgia

By Alvin Rabushka

On December 22, 2004, by an overwhelming vote of 107 to 11, Georgia's parliament adopted a new tax code. It slashed the size and weight of the code by about 95%. Key to the new legislation is the adoption of a 12% flat income tax. Effective January 1, 2005, it replaces the previous system which taxed personal income at four rates: 12% on income exceeding 200 Georgian laries, 15% between 201 and 350 laries, 17% between 351 and 600 laries, and 20% above 600 laries, with each individual receiving a monthly deduction of 9 laries per year. ($1 equals GEL 1.7784, an appreciation of 17.5% from GEL 2.156 in January 2004).

Adoption of the flat tax honors the pledge made by President Mikhail Saakashvili five days after his inauguration on January 25, 2004, when he stated that one of his new government's top two economic priorities was to introduce a new flat-rate tax system.

The new tax code retains the former 20% profit tax rate, but cuts the rate on social insurance from 33% to 20% and VAT from 20% to 18%.

Dividends and interest payments will be taxed only once at 10% at the source of payment. Georgian enterprises and individuals that receive dividend and interest payments will not pay a second tax.

Adoption of the flat tax in Georgia extends the list of countries that have adopted the flat tax to seven. The chronology is Estonia (1994: 26% to be reduced to 20% in 2007); Latvia (1995: 25%), Russia (2000: 13%); Serbia (2003: 14%); Ukraine (2004: 13%); and, Slovakia (2004: 19%).

The choice of 12% was to insure the most competitive flat rate in Central and Eastern Europe.