



Ivane Javakhishvili Tbilisi State University

Faculty of Law

Journal of Law

№2, 2017

The following issue is dedicated to the bright memory of the prominent representative of Georgian legal science, Professor Emeritus Guram Nachkebia



უნივერსიტეტის
გამომცემლობა

UDC(uak) 34(051.2)
s-216

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ISSN 2233-3746

Mariam Grigalashvili*

Exempting *bona fide* Taxpayer from the Sanction on the Examples of Georgia and the United States of America

The present article is dedicated to the research of the legal regulation and practice of using good faith to relieve taxpayer from sanctions. The notion of bona fide tax payer is a novelty for tax law. The norm, in question, does not give possibility to determine preconditions for application of the norm in which revenue authority, dispute settlement authorities and courts were entitled to exempt tax payer from the imposed sanction. Consequently, the issue of its use in practice becomes more relevant and interesting. The legal norm on exemption from sanction of taxpayer gives comprehensive discretion to taxation authorities and court to assess an act of taxpayer in each particular case and thus it invokes the establishment of incorrect practices and the formation of different approaches. In this regard, the discussion in the article is based on the comparative analysis of the legislation and practices of Georgia and the United States of America. The main features of the American regulation, which are given in the article, provide the opportunity to learn about the experience of the most successful tax system.

The article discusses and evaluates current practice of tax authorities and the courts as well. As far as practice and literature about the issue of exempting bona fide taxpayer from the sanction is one of the less researched issue and consequently it is quite controversial one. According to author's opinion it is necessary to specify the norm, to interpret correctly the preconditions of the use of the norm and establish the burden of proof is crucial too, in order to guarantee public and private interests in the dispute process.

Keywords: tax, bona fide taxpayer, good faith, exemption from sanctions, preconditions for the exemption of from a penalty, a mistake/ignorance, discretion, burden of proof.

1. Introduction

Significant amendments have been introduced to the Taxation Code of Georgia (TCG), as the revenue authority, dispute settlement authority and court were entitled to exempt tax payer from the imposed sanction in cases where the offence was a result of a mistake/ignorance of the tax payer.¹ The mentioned norm gives wide discretion to the entitled authorities, which requires studying and interpretation. Application of respective power by the administrative bodies, as well as by the court, entails qualified analysis of the essence and purpose of the taxation institute and establishment of legal standards.²

Along with the relevance, taxes and taxation legislation is one of the most difficult and complex fields of law. According to the assessment of American scholars, taxation system and taxation laws represent the most hardly comprehensible and perceivable legislation.³

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¹ Taxation Code of Georgia, Paragraph 7 of Article 269, (published by the Legislative Herald of Georgia 59, (12/12/2010)

² See Decision №bs-222-219(k-14) of October 7 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.01.2017].

³ *Painter K. McG.*, There's no Place Like Home: Projections on the Fate of the Home Mortgage Interest Deduction and the Tentative Minimum Tax in Light of Consumer Behavior, *St John's Journal of legal Commentary Journal*, Vol. 22, Summer 2007, 295.

For the proper development of the country the legislative administering in taxation system has an important role, as far as it is directly related to the financial-economic sustainability of the country, quality of the corporate activity and to the establishment and setting of trust towards management system.⁴

(TCG) does not define what is considered as a mistake or who carries burden of proof in order to establish whether the tax payer acted not having knowledge of the relevant legislation or by mistake. There is no margin set between ignorance and knowledge, which may result in the person's responsibility. This gives to the entitled authorities a quite wide discretion, without any prior criteria, to assess the action of tax payer in certain cases, either as a mistake or result of ignorance.⁵ Therefore, application of this norm requires explanation to exclude its illegal use, breach of the principle of equality and at the same time reach the main purpose for which the norm exists.

In diverse fields of law exemption from liability is prescribed by legislation, notwithstanding whether a person fulfils obligation imposed thereon.⁶ In case of committing tax offence legislation stipulates grounds for exemption from liability, which are set in light of the specificities and meaning of tax offences.⁷

Considering the abovementioned, study of this issue, research of the developed practice and determination of preconditions for application of the norm represent topical and necessary legal question.

2. Notion of *bona fide* Tax Payer

The notion of bona fide tax payer was introduced in the Tax law by the legislator.⁸ In the Georgian legislation the protection of the bona fide principle was initially found in the Civil Code of Georgia.⁹ TCG does not define the criteria which are needed to evaluate level of conscientiousness of a tax payer, such standard definition is not established neither in decisions of court and tax dispute resolution bodies, what creates problem with regard to the qualified and in bona fide application of this right. The mentioned does not comply with the purpose and aim of enactment of principles of fairness, legality of management and justice, as well as with public order.¹⁰ Taxation Code does not define concepts like "conscientious" or "unconscientious", however the matter of conscientious has special significance in the process of decision-making in taxation disputes and application of certain taxation legislative norm.¹¹ In one of the decisions the cassation court considered that such circumstance is a consequence of the essence of legislative norm and it must be overcome by progressive, dynamic and logical explanation thereof.¹²

Various functions of bona fide concept caused the fact, that courts used it for setting the fair outcome and avoiding evident unfair result.¹³ Conscientiousness in an abstract and comprehensive notion, the standard of which shall be specified and established based on the evaluative criteria and according to the practice of legal settlement,¹⁴ to make possible its application in practice. The court must determine requirements of the "bona fide principle" with regard to factual circumstances. However, it shall be noted that the judge is not entitled to

⁴ See Decision №bs-222-219(k-14) of October 7 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.01.2017].

⁵ *Gvaramadze T.*, Dissertation Legal grounds for tax liability (Comparative legal analysis), 2012, 169.

⁶ *Rogava Z.*, Taxes, taxation System and Tax Law, Bakmi, Publishing House of Bondo Matsaberidze, Tbilisi, 2002, 325.

⁷ *Gvaramadze T.*, Dissertation Legal Grounds for Tax liability (Comparative legal analysis), Tbilisi, 2012, 164.

⁸ See Decision №bs-222-219(k-14) of October 7 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, 32 <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.01.2017].

⁹ Civil Code of Georgia, Article 8, published by the Legislative Herald of Georgia, [26.06.1997].

¹⁰ See Decision №bs-222-219 (k-14) of October 7 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>> [25.06.2017].

¹¹ *Ibid.*

¹² *Ibid.*

¹³ *Ioseliani A.*, Principle of bona fide in the Contract Law (Comparative Legal Analysis), Journ. "Review of Georgian Law" Special Edition, 2007, 12.

¹⁴ See Decision №bs-222-219(k-14) of October 7 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.01.2017].

act in light of his/her subjective observations. While applying the bona fide principle, she/he shall act relying on objective criteria, to the extent possible.¹⁵

The bona fide principle is mostly related to the moral standards. Conscientiousness means – sincerity, sanctity, impartiality, objectiveness, fairness, devotion, etc.¹⁶ Bona fide principle or the principle of protection of conscientious legal relations have general legal nature, as far as the notion of “conscientiousness” as the main principle of civil legal relation, is mainly applied in legal acts regulating civil legal relations.¹⁷

On the one hand bona fide principle is of objective nature. If the party acts unreasonably or unfairly, then it is not convenient to prove during the court proceeding that she/he acted reasonably and fairly. On the other hand, the principle of bona fide mainly arises with subjective criterion, according to which, mental attitude of person is decisive.¹⁸ The cassation court explains that the conscientiousness of tax payer entails subjective attitude towards the committed action. The person believes that his/her action is legal and not wrongful. At the same time, person acts in circumstance of excusable mistake, i.e. she/he did not and could not know that he/she was committing something prohibited. In case of excusable mistake person thinks, that there is no norm which prohibits the concerned action. Therefore, he/she does not have the awareness of committing an offence. In case where the mistake is not excusable (for instance, person acted self-confidently or negligently) person shall not be exempted from tax liability.¹⁹ With regard to the subjective aspect of the conscientiousness, there is a quite interesting decision №9750/2/15 of 26 March 2016 made by the Council of Tax Appeals under the Ministry of Finance, which exempted tax payer from the sanction as the commitment of the offence by this person derived from his/her mistake, tax payer acted with believe, that his/her action was not unlawful.²⁰ In current case the Council deliberated on the conscientiousness in light of the subjective criterion and linked the mistake of tax payer to his/her attitude, that he/she was not committing an offence.

However, in the decision of the Council of Tax Appeals there are not objective circumstances which might have excluded the negligence from the side of tax payer. Determination of tax payer acting in bona fide only by consideration of subjective criterion is not sufficient, yet very important circumstance. Hence, whenever expelling the tax payer from sanction, it is necessary to evaluate subjective and objective criteria of conscientiousness. Moreover, the reasonable cause to exclude from sanction may exist when tax payer was refrained from fulfilling his/her tax obligation and the period for which he/she could not do so - is also reasonable.²¹

3. Preconditions for the Exemption of bona fide Tax Payer from a Sanction on the Example of Georgia and United States of America

According to the paragraph 7 of Article 269 of the TCG, tax payer may be exempted from the sanction prescribed by the code in cases when he/she is acting in bona fide and his/her action is caused by a mistake/ignorance of tax payer.²² The revenue service of the United States, as well as the Court, when deciding on the exemption from penalties takes into consideration those circumstances that give indication to whether tax payer had a reasonable

¹⁵ See *Ioseliani A.*, Principle of bona fide in the Contract Law (Comparative Legal Analysis), Review of Georgian Law, Special Edition, 2007, 34.

¹⁶ *Ibid*, 34.

¹⁷ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

¹⁸ *Ioseliani A.*, Principle of bona fide in the Contract Law (Comparative Legal Analysis), Review of Georgian Law – Special Edition, 2007, 20.

¹⁹ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

²⁰ Decision №9750/2/15 of 26 March 2015 of the Council of Tax Appeals under the Ministry of Finance <http://www.taxdisputes.gov.ge/Default.aspx?sec_id=4043&lang=1>, [25.06.2017].

²¹ Internal Revenue Manual - 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.01.2017].

²² TCG, Article 269, Paragraph 7, (published by the Legislative Herald of Georgia 59. 12/12/2010) As of January 25, 2017.

cause and whether he acted in bona fide while committing an offence.²³ The reasonable cause must be based on all existing facts and conditions in each particular case. Consequently, what may be considered excusable for one tax payer, may be considered as a breach for the other.²⁴

In the USA there is an internal manual for revenue service (herein after referred as Manual) which is used when imposing penalties and it entails explanation of those conditions which must be in place in case of the exemption from penalties.²⁵ According to the Manual, the core purpose of the imposition of a sanction is reached even when tax payer in bona fide tries to fulfill obligations stipulated under the taxation code.²⁶ In such case all circumstances shall be established, it shall be determined what happened and when, what was the period of breach of the obligation and which facts were the obstacle for tax payer in fulfilling his/her obligations. How these facts and conditions had an impact on noncompliance with the obligation and what was the effort from the side of tax payer aiming to fulfill that obligation. Whether or not he/she tried to fulfill the tax obligation after the change of circumstances.²⁷

There are main circumstances outlined in the Manual, which may have an impact on the exemption from sanction of the tax payer, namely:

- a) Required attentiveness typical for the entrepreneur and making mistake regardless precaution.
- b) Death, serious disease or inevitable absence.
- c) Ambiguity and controversy of the applicable norm.
- d) Wrongful advice from taxation consulting companies, taxation authorities.
- e) Mistake.²⁸

According to the general rule, the most important condition in case of the exemption of tax payer from sanction is the extent for which the tax payer tries to fulfill the obligations prescribed under tax legislation. Those conditions which indicate to the reasonable cause and conscientiousness, shall be determined taking into consideration experience, knowledge and education of tax payer.²⁹

3.1 Required Attentiveness Typical for the Entrepreneur and Making Mistake Regardless Precaution

According to the Manual to check the required attentiveness and precaution typical for the entrepreneur, the following conditions must be determined:

- f) Compliance of facts, explanations and evidence.
- g) What is the tax payment history of tax payer? The last three years have to be checked, how the tax payer pays taxes. Whether he/she is fined for the same offence, which excluded the attentiveness typical for the entrepreneur.
- h) The duration of time shall be taken into consideration. The reason when that conditions took place which became obstacle for fulfillment of tax obligation. Therefore, following shall be established: (1) when was the due time for the fulfillment of obligation. (2) The period in which tax payer could not fulfill the obligation. (3) When he actually fulfilled the obligation.

²³ 26 CFR 1. 6664-4- Reasonable Cause and Good Faith Exception to Section 6662 Penalties, Cornell University Law School <<https://www.law.cornell.edu/cfr/text/26/1.6664-4>>, [26.06.2017].

²⁴ Ibid.

²⁵ Internal Revenue Manual - 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ 26 CFR 1. 6664-4- Reasonable Cause and Good Faith Exception to Section 6662 Penalties, Cornell University Law School <<https://www.law.cornell.edu/cfr/text/26/1.6664-4>>, [26.06.2017].

- i) Circumstances which are not under tax payer control. It should be determined whether tax payer could foresee the circumstances which created obstacles for the fulfillment of obligations. The efforts from the side of tax payer to fulfill the obligations have to be continuous even after the requirements of legislation are already infringed.³⁰

Similar approach had the Supreme Court of Georgia when it indicated in its decision, that the Appellate Court did not take measures to obtain additional pieces of evidence, information, and considered claimant as acting in bona fide, not having even checked his/her tax payment history.³¹ With regard to the tax payment history of tax payer it is interesting to consider decision 9750/2/15 of the Council of Tax Appeals of the Ministry of Finance dated of 26 March 2015, where the Council exempted the tax payer from sanction and took into consideration the fact that the offence was the first occasion.³² Consequently, the payment history of tax payer represents an important circumstance for exemption from sanction of the tax payer acting in bona fide.

3.2 Death, Serious Disease or Inevitable Absence

In the US death or serious disease (of tax payer and/or member of family) may be the reason for exemption from sanction of tax payer, where such reason caused the commitment of the offence, however existence of several conditions have to be determined in that case.

- j) Relation between tax payer and the person who died;
- k) Date of death;
- l) Duration and complexity of the disease;
- m) How the disease intervened fulfillment of obligation;
- n) Whether other business obligations were fulfilled or not;
- o) Whether the infringement of the obligation lasted for reasonable period of time;³³

For instance, in the case *Fitch v. Commissioner* tax payer was charging-off purely operational expenses of the company. The revenue service considered it as unacceptable because the tax payer did not have proper evidence, documentation proving the charging-off of expenses. Husband, who worked as a certified public accountant was diseased with brain aneurism. The court did not take into consideration his health condition as a ground for exemption from the sanction.³⁴

3.3 Ambiguity and Controversy of the Applicable Norm

Taxpayer may conscientiously have a wrong understanding of essence of a law, if the norm gives possibility of differentiated interpretation because of its explicitly ambiguous and equivocal content.³⁵

The taxation legislation shall not be ambiguous and equivocal in order to allow realization of constitutional obligations of citizens. They must be formulated with proper accuracy. Ambiguous and equivocal norms are inconsistent with the principles of legal State and are basis for the arbitrary actions from state bodies and author-

³⁰ Internal Revenue Manual - 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

³¹ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

³² Decision №9750/2/15 of 26 March 2015 of the Council of Tax Appeals under the Ministry of Finance <http://www.taxdisputes.gov.ge/Default.aspx?sec_id=4043&lang=1>, [25.06.2017].

³³ Internal Revenue Manual - 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

³⁴ Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 343, see citation: T.C. Memo, 2012, 358.

³⁵ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

ized officials, which infringes the constitutional principle of equality before the law.³⁶

Deriving from the constitutional principle of equality of citizens before the law and administrative bodies, the legal norm has to be expressly determined, clear and unequivocal. In the law enforcement process equality of citizens may only be provided with the condition of uniform understanding and interpretation of the norm. Non-specific content of the legal norm leaves room for differentiated understanding-explanation in the legal settlement process, as well as for the arbitrariness, which finally leads to the infringement of principles of equality and rule of law.³⁷

As mentioned above, taxation legislation is one of the most challenging and complex field of law. It represents a legislation which is hardly understandable and perceivable.³⁸

Taxpayer has to show proper attentiveness and caution for determination of fulfillment of his/her tax responsibilities.³⁹ As a general rule not knowing the law does not exclude from liability.⁴⁰ The cassation court of Georgia considers inadmissible to establish in practice an understanding and interpretation of the mistake of taxpayer in a not legal way, i.e. in a way of life, and explains that in current case the purpose of the law is to exempt from tax liability a person ordinarily making a mistake, but the one who acts in the context of legal mistake, as in this occasion a person wrongfully assesses the legal content of the action committed and the legal outcome deriving therefrom.⁴¹

As outlined in the Manual, the revenue service may exempt taxpayer from a sanction because of the ambiguous norm existing in the legislation. In such case following conditions must be checked with regard to the infringement of law obligations:

- 1) Education of taxpayer;
- 2) Whether taxpayer had to pay taxes previously;
- 3) If he/she was fined;
- 4) Whether there were recent changes in light of the taxation reform and how reasonable and predictable was the ignorance of taxpayer in this regard;
- 5) The complexity of the fulfillment of tax obligation shall be taken into consideration;⁴²

It is impossible to equate legal mistake with ignorance of the law, which take place when a person entirely had no knowledge of the existence of a law enacted by the legislative authority of Georgia enforced in through established legislative procedure, whereas he/she had to have and objectively was capable to have knowledge thereof. As a rule, not knowing the law does not release person from liability.⁴³ Therefore, a person may be exempted from tax liability, if he/she was misled by explicitly ambiguous and equivocal content of the tax norm and he/she made a mistake conscientiously. Thereby, the court interprets ambiguity, equivocality and controver-

³⁶ Ibid.

³⁷ Ibid.

³⁸ *Gvaramadze T.*, Dissertation Legal grounds for Tax Liability (Comparative legal analysis), 2012, 7; See K. McG. Painter, There's no Place Like Home: Projections on the Fate of the Home Mortgage Interest Deduction and the Tentative Minimum Tax in Light of Consumer Behavior, *St John's Journal of legal Commentary Journal*, volume 22, Summer 2007, 295.

³⁹ Internal Revenue Manual- 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

⁴⁰ Civil Code of Georgia, Published by the Legislative Herald of Georgia, [25.06.2017].

⁴¹ See Decision №bs-222-219(k-14) of October 7, 2014 Delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁴² Internal Revenue Manual- 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

⁴³ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>> [25.06.2017].

sy in the taxation legislation in favor of taxpayer.⁴⁴ In the US, in cases of inability to understand complex taxation code, the court is more loyal with regard to mistakes made because of such reason,⁴⁵ whereas it treats strictly the negligent attitude of taxpayer towards the fulfillment of the obligation. For instance in the case *Striefel v. Commissioner* the taxpayer destroyed documents as he found out that he was soon going to die. Of course the court analyzed that taxpayer was nervous, but still considered, that taxpayer acted negligently and infringed the obligation to store documents related to levying.⁴⁶

3.4 Wrongful Advice from Taxation Consulting Companies, Taxation Authorities

In practice there are often occasions when taxpayer has questions with regard to the application of taxation code. Certain part of taxpayers, in light of their conscientiousness, want to fulfil tax obligation with respect to their country. However they often can not get answers from Taxation Code and the normative acts enacted based on Taxation Code, or sometimes find several alternatives of levying.⁴⁷

In the USA exemption if taxpayer from liability is prescribed under the legislation in cases when they have not deliberately hidden taxes, or the commitment of the offence was a result of wrongful explanations of taxation legislation delivered by taxation authorities.⁴⁸

As stated by the Internal Manual of the USA revenue service, an advice may be of three different types, in cases where there is a possibility to be exempted from sanction:

- 1) Written advice of the revenue service;
- 2) Oral advice of the revenue service;
- 3) Advice received from the professional of the field of taxation;⁴⁹

Advice shall not be founded on unreasonable factual or legal assumptions and there must not be unreasonable trust from the side of taxpayer.⁵⁰ Taxpayer shall not trust an advice which derives from a norm already amended or repealed.⁵¹

Taxpayer has a possibility to get in advance special interpretations on the application of taxation legislation from taxation authorities while implementing concrete agreement.⁵²

One of the widespread disputable questions is – whether trust in taxation specialist means reasonable behavior. Are education of taxpayer, business experience corresponding for determining whether it was reasonable to trust the advice? For this to be considered reasonable, taxpayer has to prove following circumstances:

- 1) Whether adviser was competent, who had sufficient experience;
- 2) Whether taxpayer have provided necessary and accurate information to the adviser;

⁴⁴ Ibid.

⁴⁵ Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 342, see citation: *Armstrong v. Cimmer*, 139 T.C. No. 18 (2012).

⁴⁶ See Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 343. See citation, *supra*, note 28.

⁴⁷ See *Nadaraia L., Rogava Z., Rukhadze K., Bolkvadze B.*, Commentaries on the Taxation Code of Georgia, Book First, 326.

⁴⁸ *Gvaramadze T.*, Dissertation Legal grounds for tax liability (Comparative legal analysis), 171, See Your Rights as a Taxpayer, Department of the Treasury, International Revenue Service <<https://www.irs.gov/pub/irs-pdf/p1.pdf>>, [25.01.2017].

⁴⁹ See Internal Revenue Manual- 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.06.2017].

⁵⁰ 26 CFR 1. 6664-4- Reasonable Cause and Good faith Exception to Section 6662 Penalties, Cornell University Law School, <<https://www.law.cornell.edu/cfr/text/26/1.6664-4>>, [25.06.2017].

⁵¹ Ibid.

⁵² See Decision Nos-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

3) Whether taxpayer indeed conscientiously trusted the decision of the adviser.⁵³

As mentioned above, taxation legislation is characterized with certain complexity and quite often ambiguities deriving from the taxation legislation take place in this area.

In Georgia, there is a different approach with regard to this issue, the interpretation on taxation legislation delivered by the taxation authority may only be of recommending nature.⁵⁴ This excludes the existence of legitimate trust from the side of taxpayer towards the recommendation and exemption from the liability as in the US, in case of interpretation taking place in relation to the offence committed.⁵⁵ It would be logical that response of a competent authority had a legal force.⁵⁶

According to the decision of the Supreme Court of Georgia implementation of the written explanation issued by the taxation authority may represent excusable reason, which outlines position of the taxation authority with regard to the application of Georgian taxation legislation by taxpayer during implementation of economic operations carried out already or to be carried out in future. If taxpayer acts in line with such explanation, he does not have a comprehension of the offence committed. Notwithstanding the recommendation nature of the explanation, person has trust towards taxation authority and its written explanation.⁵⁷ Because of the high confidence of taxpayer in the revenue service, the entitled authorities while deciding the question of exemption from sanction, in determination of conscientiousness of taxpayer may consider the level of trust toward the recommendation issued by the taxation authority.

In the case *Meinhardt v. Commissioner* Taxpayer was not well aware of the taxation legislation and hired professional practitioner. She/he handed in all documents, which were necessary for counting taxes and provision of declaration. The court has refused the imposition of sanction as the conscientiousness of taxpayer was confirmed.⁵⁸

In comparison with the US, in light of the practice developed in Georgia the written explanation issued by taxation authority, unlike the chargeable provisional decision rendered by the taxation authority does not have legal force. The argument for this is, that the written explanation delivered by the taxation authority on the application of taxation legislation during the implementation of economic operation carried out or to be carried out by taxpayer does not represent an official act of the state and it has explanatory-recommendation nature.⁵⁹

The advice of professional taxation adviser and trust in it does not unconditionally imply conscientiousness and reasonable cause. The mentioned evolves only in cases when the trust in such advice was reasonable and taxpayer acted in bona fide.⁶⁰ The obligation of an administrative body prescribed under the General Administrative Code to deliver legal assistance is also regulated under paragraph 1 of Article 38 of the Civil Code of Georgia, according to which taxpayer is entitled to receive information from administrative body on the application

⁵³ Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 344 *Neonatology Associates, P.a. v. Comm'r*, 115 T.C. 43,99(2000) (citations omitted), *add'd*, 299 F.3D 221(3d Cir., 2002.

⁵⁴ *Gvaramadze T.*, Dissertation Legal grounds for tax liability (Comparative legal analysis), 171, taxation Code of Georgia, Article 46, Paragraph 1, (Published by the Legislative Herald of Georgia 59. 12/12/2010) As of January 25, 2017.

⁵⁵ *Ibid*, 171.

⁵⁶ *Nadaraia L., Rogava Z., Rukhadze K., Bolkvadze B.*, Commentaries to the Taxation Code of Georgia, Book One, 326.

⁵⁷ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁵⁸ Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 345.

⁵⁹ See Decision №bs-222-219(k-14) of October 7, 2014, delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁶⁰ 26 CFR 1. 6664-4- Reasonable Cause and Good Faith Exception to Section 6662 penalties, Cornell University Law School, <<http://www.law.cornell.edu/cfr/text/26/1.6664-4>>, [26.06.2017].

of taxation legislation, protection of rights of taxpayer.⁶¹

For the trust in the advice of specialist in taxation field to be considered as a ground for exemption from sanction, it is necessary to take into consideration all circumstances, for instance education of taxpayer, business experience. Trust in such advice shall not be considered as reasonable cause or action in bona fide, when taxpayer knew or had to know about insufficient qualification of the adviser in taxation legislation or in any part thereof.⁶²

3.5 Mistake

According to the Manual, mistake may not be considered as a ground for exemption from sanction, but it may represent supportive argument if the effort of taxpayer and his/her business attentiveness is confirmed. In such case the following conditions must be determined: a) when and how taxpayer found out about mistake; b) to what extent he/she corrected the mistake; c) what is the relation between taxpayer and subordinated person (if such title is delegated); d) whether he/she took steps for the correction of mistake; e) whether there are documents proving this.⁶³

4. Unjustifiably High Level of Discretion from Entitled Authorities in Case of Exemption from Sanction of Taxpayer Acting in bona fide

Where the administrative body has entitlement to settle individual cases by its own, it can use the right of discretion.⁶⁴ The ground for awarding discretionary title is impossibility to foresee all particular details during the enactment of law.⁶⁵ The legal norm on exemption from sanction of taxpayer gives comprehensive discretion to taxation authorities and court to assess an act of taxpayer in each particular case, without any preconditions, as mistake or result of ignorance.⁶⁶ Therefore, the multiple undetermined notions existing in the norm increases discretionary authority of dispute resolution body and of the court.

Discretionary power gives administrative body a possibility to decide by its own responsibility. This primarily aims at making a fair decision. The main purpose of the administrative body is rendering a fair decision. It is crucial that court comprehends the purpose of this power and understands which factual circumstances have to be considered.⁶⁷

Limitation of discretionary power happens not only on grounds of authorizing norm, but also by legal context. Decision made on grounds of discretionary power shall not contradict with legal norms. Primarily, with the constitutional principle that all people are equal before the law, which represents an important bound for the implementation of discretionary power. The nature of dependence of administrative body on its previous action derives from this norm.⁶⁸ Entitled authorities shall use the power given by this norm in light of the criteria for assessment of taxpayer's conscientiousness, with the purpose based on legality of public administration, equality

⁶¹ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁶² 26 CFR 1. 6664-4- Reasonable Cause and Good Faith Exception to Section 6662 penalties, Cornell University Law School, <<https://www.law.cornell.edu/cfr/text/26/1.6664-4>>, [26.06.2017].

⁶³ Internal Revenue Manual- 29.1.1 Introduction and Penalty Relief, <https://www.irs.gov/irm/part20/irm_20-001-001r.html#d0e991>, [25.01.2017].

⁶⁴ *Zippelius R.*, Doctrine of legal methods, Beck's publishing House, Munich 2006, 131.

⁶⁵ *Zippelius R.*, Doctrine of legal methods, Beck's publishing House, Munich 2006, 131.

⁶⁶ *Gvaramadze T.*, Dissertation Legal grounds for tax liability (Comparative legal analysis), Tbilisi, 2012, 169.

⁶⁷ *Nachkebia A.*, Interpretations of administrative law norms in the practice of Supreme Court, 2015, 10., Case № BS-567-557 (k-12) 26 March, 2013, Tbilisi.

⁶⁸ *Zippelius R.*, Doctrine of legal methods, Beck's publishing House, Munich 2006, 132.

before the law, right of legitimate trust of person and principle of impartiality.⁶⁹ Legal decisions made within the context of discretionary power belong to the sphere of actions which are carried out based on legal entitlement.⁷⁰ The freedom of choice of competent authorities is limited in a way that it is allowed to render decisions that are functionally fair, thus enforcing the purpose of law.⁷¹

The state generally relies on the principle of fairness, which is important not only for interpretation, but also leads to the right choice from the alternatives of actions within the scope of discretionary power. Consequently, discretionary power must legitimately make a balance between interests.⁷² Authorities entitled to decide on exemption from taxation sanction within their discretionary power may render decision with proper argumentation.⁷³ The limits of discretionary power are prescribed in the norm which itself grants the power.⁷⁴ However, in the norm in question the limits are quite extensive.

If the law entails unlimited legal notions, in that case their application creates estimated scope. In this case the question arises – what is interrelation between discretion of action and interpretation. I.e. on the one hand alternatives of actions and on the other hand, diverse possibilities of interpretation and precision.⁷⁵ In both occasions, this choice is not free, as it requires justification. It shall be place in the limits that are required by explanation of applicable norm, will of legislator and balance of optimal and fair interests.⁷⁶ However, regardless the fact that the main purpose of administrative body is to render a fair decision⁷⁷ and administrative body shall deliver a decision providing enforcement of the aim of law,⁷⁸ this does not allow to avoid delivering justified decisions, what is evidenced by the current practice with regard to the application of this norm.⁷⁹

5. Particularity of the Burden of Proof in Case of Exemption from Sanction of Taxpayer Acting in bona fide

There is no definition in the taxation legislation of what can be considered as a mistake, or who bears the burden of proof to establish whether the action of taxpayer was a result of ignorance toward the law or result of a mistake.⁸⁰ In case of considering taxpayer to have acted in bona fide one of the core roles has the issue of distribution of the burden of proof. As far as it determines decision of an administrative body.

The Code on Administrative Offences does not prescribe the distribution of the burden of proof on the administrative body in legal proceeding taking place during appeal of the decision with regard to the offence. The cassation court considers, that transferring the burden of proof with regard to the disputable question, envisaged in the paragraph 2 of Article 17 of the Administrative Procedural Code, on the administrative body shall not be used as far as in this case the disputable question and the matter to be established is not related to the legal aspect of the subject of litigation, but the existence of the fact of the offence, where the burden of proof must be

⁶⁹ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁷⁰ Zippelius R., *Doctrine of Legal Methods*, Beck's publishing House, Munich 2006, 130.

⁷¹ *Ibid*, 132.

⁷² *Ibid*, 133-134.

⁷³ Gvaramadze T., *Dissertation Legal grounds for tax liability (Comparative legal analysis)*, 2012, 171.

⁷⁴ Zippelius R., *Doctrine of legal methods*, Beck's publishing House, Munich 2006, 131.

⁷⁵ Zippelius R., *Doctrine of legal methods*, Beck's publishing House, Munich 2006, 134.

⁷⁶ *Ibid*, 134.

⁷⁷ Nachkebia A., *Interpretations of Administrative Law Norms in the Practice of Supreme Court*, 2015, 10, Case № BS-567-557 (k-12) 26 March, 2013, Tbilisi.

⁷⁸ Zippelius R., *Doctrine of Legal Methods*, Beck's publishing House, Munich 2006, 132.

⁷⁹ Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁸⁰ Gvaramadze T., *Dissertation Legal Grounds for Tax Liability (Comparative legal analysis)*, 2012, 169.

proportionally distributed among litigating parties.⁸¹ In case of filing an appeal on the establishment of invalidity or nullity of the administrative act the burden of proof is on the administrative body which issued the act.⁸² Consequently, the revenue service will bear the burden of proof with regard to the establishment of the authenticity of the offence. However, legislation does not define the question of burden of proof in case of exemption from sanction of the taxpayer.⁸³ The cassation court defines that according to the doctrine every procedural legislation reflects and stipulates legislative institutes, principles, purpose of relevant material fields. Through the administrative legal proceeding person realizes his/her subjective right to address the court, and the court verifies the legality of the action of administration.⁸⁴

Decision of each particular civil law case in the court is related to the relevant fact finding.⁸⁵ All parties who are participants of court assertion have diverse functions, however their actions are aimed at finding the truth. This represents necessary condition for appropriately deciding the case.⁸⁶ It shall be noted, that in comparison to the adversary proceeding principle in the civil procedure,⁸⁷ administrative legal proceeding has significant principle as: principle of formality, which determines the role of administrative justice in the administrative legal proceeding. The court is in the center of procedural activity, the principle of proportionality between public and private interests operational in administrative law obliges the court in the administrative procedural law to carry out procedural actions necessary to reach the balance within the procedural rights of parties participating in the procedural legal relations.⁸⁸

During the litigation in courts of the US the burden of proof is on the revenue service, which must provide sufficient evidence for proving the legality of the sanction, hence the fact of commitment of the offence. Later the burden of proof is transferred on the taxpayer, who must prove the existence of some exception, such as reasonable cause, conscientiousness.⁸⁹

In Georgia the court, relying on the principle of formality, is entitled to make a decision on its initiative with regard to provision of additional information or evidence. This right of the administrative court is established through imposition of obligation of administrative bodies in the article 20 of the Administrative Procedure Code to provide to the court all documents necessary for the hearing the case and delivering decision, and other information.⁹⁰ The power of the court to get evidence or information on its initiative, means that the court must determine occasions when the main principle of justice – principle of equality, the possibility of parties in the litigation to equally defend their rights deriving out of the subordinated position - in under threat.⁹¹

The norm in question outlines the title of competent authorities to exempt from the sanction the taxpayer acting in bona fide, what practically implies the possibility of taxpayer to address competent authorities, provide relevant evidence and be exempted from the sanction if managed to prove the existence of preconditions for application of the norm.

⁸¹ *Nachkebia A.*, Interpretations of Administrative Law Norms in the Practice of Supreme Court, 2015, 266, Case № BS-626-596 (k-07) Tbilisi, 2007.

⁸² Administrative Procedure Code of Georgia [25.06.2017].

⁸³ *Gvaramadze T.*, Dissertation Legal Grounds for Tax Liability (Comparative legal analysis), 2012, 169.

⁸⁴ *Nachkebia A.*, Interpretations of Administrative Law Norms in the Practice of Supreme Court, 2015, 265, Case № BS-626-596 (k-07) 25 December, 2007, Tbilisi.

⁸⁵ *Liluashvili T., Liluashvili G., Khrustali V., Dzlierishvili Z.*, Publishing House “Law”, 2014, 258.

⁸⁶ *Ibid*, 260.

⁸⁷ Civil Procedure Code of Georgia, Article 4, published Legislative Herald of Georgia, [25.06.2017].

⁸⁸ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁸⁹ Taxpayer Advocate Service-2013 Annual report to Congress, Accuracy-related Penalty Under IRC 662(b)(1) and (2), 341, see citation: IRC 7491 (a).see also Tax Court Rule 142 (a).

⁹⁰ See Decision №bs-222-219(k-14) of October 7, 2014 delivered by the Chamber for Administrative Law Cases of the Supreme Court of Georgia, <<http://prg.supremecourt.ge/DetailViewAdmin.aspx>>, [25.06.2017].

⁹¹ *Ibid*.

6. Conclusion

Deriving from the analysis of the practice established in Georgia it is clear, that the understanding, interpretation and application of the norm by the taxation authorities and court responses the requirement of the law and complies with the purpose and aims of legal institutes.⁹² The established practice with regard to the application of the norm, and using the power prescribed by the norm is damaging on the one hand for the prestige of taxation authorities of the country and of the court, and on the other hand for the legal regulation of tax relations.⁹³

According to the presented argumentation, the existing practice, lack of the juridical literature clearly indicated on the ambiguity the issue related to the exemption of taxpayer from the sanction and the necessity to formulate the norm in different manner.

If regardless the interpretation, the application of norms leads us to the unfair, legally unacceptable results, then it is necessary to widen them and interpret properly.⁹⁴ However the mentioned norm is so wide, that in case of the interpretation it still leaves room for making unjustified decision.

Deriving from the issued in question, we may conclude, that it is necessary to limit more the discretion of actions and scope of assessment, and in such manner the possibility to control the court will be guaranteed.⁹⁵ In it essential to stipulate more specifically the norm exempting taxpayer from the sanction, different standard tot the burden of proof must exist, which will ensure the implementation of the title envisaged by the norm.

In Georgia, as well as in the US the existing practice shows that only mistake and ignorance does not give possibility to interpret the framework of the power properly. Therefore, it is necessary to specify the norm, and the competent authorities shall have power to exempt from the sanction only in case of proper justification, in order to know the facts, circumstances on which the competent authority relied while making a decision and to assess whether the preconditions prescribed by the norm were in place.

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⁹² Ibid.

⁹³ Ibid.

⁹⁴ *Zippelius R.*, Doctrine of legal methods, Beck's publishing House, Munich 2006, 15.

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