



# Legal Tax Optimization Mechanisms in Georgia: Business Case Analysis and New Regulatory Developments

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## Abstract

This article examines lawful tax optimization mechanisms within the framework of Georgian tax legislation, emphasizing their role in enhancing financial sustainability and regulatory compliance. In the context of increasing digitalization, risk-based tax administration, and regulatory reforms planned for 2026, the study analyzes how businesses adapt tax planning strategies to balance legal compliance with fiscal efficiency.

Using a mixed-methods research design, the paper integrates theoretical analysis with empirical evidence derived from business case studies, questionnaires, and interviews conducted among companies operating in Tbilisi and the Kakheti region. The findings demonstrate that strategically designed tax optimization—grounded in appropriate accounting policies, documentation quality, and economic substance—can reduce tax burdens without increasing legal risks. The study also identifies regional and firm-size disparities in tax planning capacity and highlights the growing importance of proactive, documentation-driven tax strategies under the forthcoming regulatory framework.

**Keywords:** tax optimization, tax planning, accounting policy, tax regulation, Georgia, SMEs, digital tax administration

## Introduction

The development of Georgia's business environment has been increasingly shaped by the stability, predictability, and institutional effectiveness of the national tax system. Amid globalization, economic digitalization, and intensified regulatory oversight, business entities face growing pressure to implement tax management mechanisms that ensure legal compliance while limiting excessive fiscal burdens.

Georgia's tax policy has historically focused on simplified administration and relatively low tax rates to encourage entrepreneurship and investment. analysis.

However, empirical practice indicates that inadequate interpretation of tax legislation and misaligned accounting policies often result in inflated tax liabilities, administrative penalties, and late payment charges. This issue is particularly evident where the boundary between lawful tax optimization and aggressive tax planning is poorly understood, increasing both financial and legal risks.

At present, Georgia's tax system combines moderate statutory rates with advanced control mechanisms, including electronic administration, automated data analytics, and risk-based audits. Consequently, tax optimization can no longer be viewed solely as a short-term cost-reduction tool; instead, it must be integrated into broader financial governance frameworks linking accounting policy, legal compliance, and business strategy.

The regulatory reforms planned for 2026 are expected to further transform interactions between businesses and tax authorities through enhanced digital oversight, stricter documentation requirements, and increased transparency. These changes necessitate proactive reassessment of tax structures to minimize compliance risks while preserving economic efficiency.

Within this environment, lawful tax optimization represents a key instrument for maintaining financial sustainability and competitiveness. Accordingly, this article examines lawful tax optimization mechanisms under Georgian tax legislation through business case analysis and assesses the anticipated impact of the 2026 reforms. By combining theoretical insights with empirical evidence, the study contributes to academic discourse and offers practical implications for business decision-making.

## **II. Theoretical Framework and Literature Review**

### **2.1 The Concept and Economic Rationale of Tax Optimization**

Tax optimization is a core element of corporate financial management, referring to the lawful reduction or efficient allocation of tax liabilities in accordance with applicable legislation. Academic literature consistently distinguishes tax optimization from tax evasion and aggressive avoidance, emphasizing legality, transparency, and economic justification.

International research conceptualizes tax optimization as a strategic process embedded in the interaction between tax law, accounting standards, and financial planning. This approach is particularly relevant in jurisdictions characterized by digitalized tax administration and risk-based controls, where transparency and consistency significantly affect compliance outcomes.

In Georgia, conceptual ambiguity between lawful optimization and illicit practices remains a practical challenge. Such confusion may lead either to excessive conservatism or unintended violations, both of which undermine financial efficiency and increase regulatory exposure.

### **2.2 Lawful Tax Optimization versus Tax Evasion**

Lawful tax optimization relies exclusively on mechanisms explicitly permitted by tax legislation, including tax incentives, expense recognition rules, depreciation methods, VAT management, and tax regime selection. These instruments enable businesses to reduce tax burdens within the legal framework.

By contrast, tax evasion involves misrepresentation, concealment of taxable information, or artificial arrangements designed to circumvent legal obligations. Such practices inevitably result in financial penalties, reputational damage, and increased scrutiny, ultimately raising the total cost of compliance.

As tax administration becomes more digitalized—particularly in light of the 2026 reforms—the distinction between lawful and unlawful practices is increasingly transparent, heightening the importance of well-documented and economically substantiated tax decisions.

### **2.3 Tax Planning and Corporate Financial Management**

Tax planning constitutes an integral component of corporate financial management, influencing both operational efficiency and long-term strategy. Effective tax planning supports rational

resource allocation, reduces uncertainty, and enhances investment capacity.

Accounting policy selection plays a central role in this process. Decisions regarding revenue and expense recognition, depreciation schedules, and asset classification directly affect the tax base. Accordingly, tax optimization should be understood as a multidimensional process integrating legal, accounting, and financial considerations.

This integration is particularly critical for small and medium-sized enterprises (SMEs), which are more sensitive to regulatory changes and administrative costs. For SMEs, lawful tax optimization can serve as a stabilizing mechanism that mitigates fiscal risks and supports sustainable growth.

## **2.4 International Approaches and Relevance for Georgia**

International literature increasingly links tax optimization with business competitiveness and investment efficiency. OECD guidelines emphasize the principle of economic substance, requiring that tax outcomes reflect genuine economic activity rather than purely formal legal arrangements.

In European Union jurisdictions, tax planning practices have evolved toward transparency, cooperative compliance, and advance clarification. Similar trends are emerging in Georgia as tax administration becomes more digitalized, making international theoretical approaches highly relevant for assessing domestic tax optimization practices.

## **2.5 Features of the Georgian Tax System**

Georgia's tax system is characterized by relatively low rates and a simplified structure, enhancing its regional investment appeal. Nevertheless, tax planning remains complex, particularly for firms operating across sectors or under multiple tax regimes.

Although Georgian legislation provides lawful optimization instruments—such as expense recognition, depreciation, VAT mechanisms, and incentives—these opportunities are often underutilized due to limited planning capacity, fragmented accounting practices, or insufficient professional expertise, especially among SMEs.

The transition to risk-based audits and automated data analysis reinforces the need for proactive, well-documented tax strategies, shifting tax planning from reactive compliance toward strategic governance.

## **2.6 Tax Optimization, Economic Substance, and Compliance Economics**

Recent developments in tax theory emphasize that lawful tax optimization must be assessed not only through formal compliance but also through economic substance. In digitalized tax systems, automated risk assessment increasingly evaluates behavioral and transactional consistency.

From a compliance economics perspective, lawful tax optimization reduces uncertainty and compliance costs while supporting fiscal discipline. In Georgia, the expansion of electronic tax controls heightens the importance of demonstrable economic logic, coherent accounting policies, and transparent documentation.

## **2.7 Tax Optimization as a Component of Institutional and Behavioral Economics**

Beyond its conventional interpretation as a technical instrument of financial management, lawful tax optimization may be examined through the broader lenses of institutional and behavioral economics. From an institutional perspective, tax optimization reflects the quality of interaction between the state and the business sector, serving as an indicator of regulatory clarity, administrative predictability, and mutual trust. Where tax rules are transparent and consistently enforced, businesses are more inclined to engage in lawful optimization rather than resort to informal or high-risk practices.

Behavioral economics further enriches this analysis by emphasizing that tax-related decisions are not solely driven by cost–benefit calculations but are also shaped by risk perception, uncertainty, and compliance culture. In this context, lawful tax optimization represents a rational behavioral response to regulatory complexity. Firms seek to minimize uncertainty and potential sanctions by

structuring transactions in ways that are legally defensible and economically substantiated.

For small and medium-sized enterprises, behavioral factors play a particularly significant role. SMEs often exhibit higher levels of risk aversion due to limited financial buffers and lower tolerance for regulatory disputes. As a result, even when lawful optimization instruments are available, SMEs may refrain from utilizing them if the regulatory environment is perceived as ambiguous or unpredictable. This phenomenon underscores that underutilization of tax optimization among SMEs is not necessarily a consequence of insufficient knowledge but rather a rational adaptation to institutional constraints.

In the Georgian context, the increasing reliance on digital tax administration and automated risk assessment intensifies the relevance of institutional and behavioral considerations. Electronic control systems reduce discretionary enforcement but simultaneously heighten sensitivity to documentation inconsistencies. Consequently, lawful tax optimization increasingly depends on behavioral alignment with compliance expectations, including timely reporting, coherent accounting policies, and demonstrable economic substance.

From a theoretical standpoint, this perspective situates tax optimization at the intersection of institutional quality and behavioral response. Lawful optimization thus emerges not merely as a financial technique but as a governance-related outcome reflecting how businesses internalize regulatory signals. This framework provides an analytical bridge between the theoretical discussion and the empirical findings of this study, particularly with regard to SME behavior and adaptation under evolving regulatory conditions.

### III. Research Methodology

#### 3.1 Research Design

The study adopts a mixed-methods research design, combining qualitative and quantitative approaches to ensure a comprehensive assessment of lawful tax optimization mechanisms. This methodological framework allows for the integration of numerical evaluation of tax-related outcomes with qualitative insights into business behavior, accounting practices, and regulatory interpretation.

Quantitative methods are employed to assess patterns in tax burden structure, the prevalence of optimization instruments, and perceived compliance risks, while qualitative methods provide deeper contextual understanding of decision-making processes and institutional constraints. In this regard, case study analysis serves as the primary qualitative instrument, enabling an in-depth examination of tax optimization mechanisms implemented by individual firms under real business conditions.

In addition, a temporal dimension is incorporated into the research design to capture the evolution of tax planning practices over time. This includes an assessment of past and current optimization approaches, as well as anticipated behavioral and strategic adaptations in response to the tax regulatory reforms planned for 2026. Such a dynamic perspective enhances the explanatory power of the analysis by situating empirical findings within a broader regulatory trajectory.

#### Empirical Research Results

#### Research Audience and Sample Size

##### Research audience.

The empirical study targeted chief accountants, financial managers, and business owners, as these roles are directly involved in tax planning, accounting policy formulation, and tax compliance decision-making.

**Research subjects and sample size.** The empirical sample includes 23 business entities (N = 23) operating in Tbilisi and the Kakheti region, which are among the most economically active areas in Georgia in terms of business concentration, investment activity, and sectoral diversity. The selection of these regions enables comparison between urban and regional business environments while remaining

within the thematic scope of lawful tax optimization. The sample is characterized by a dominant representation of construction-sector firms, ensuring thematic consistency with the research focus, given the sector's high level of business activity and fiscal exposure in both regions.

### Data processing approach.

Quantitative results were calculated using absolute frequencies (number of responses) and converted into percentages relative to the total number of respondents. Qualitative data (open-ended answers) were processed through thematic coding to synthesize responses into analytically meaningful categories.

#### Appendix A. Research Questionnaire — Results and Analysis

*(Mixed quantitative–qualitative design)*

#### Section I – General Company Information (Closed-ended)

##### Question 1. Company size

**Table A1. Distribution of Firms by Company Size (N = 23)**

Company size	Number of firms	Share (%)
Micro (1–9 employees)	5	22%
Small (10–49 employees)	8	35%
Medium (50–249 employees)	6	26%
Large (250+ employees)	4	17%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Small enterprises account for 8 firms (35%), followed by medium-sized enterprises with 6 firms (26%) and micro enterprises with 5 firms (22%), while large firms represent 4 firms (17%). This composition confirms the dominance of SMEs within the sample, which is analytically important because SMEs are typically more sensitive to tax burden fluctuations, compliance costs, and regulatory uncertainty—making lawful tax optimization particularly relevant.

##### Question 2. Sector of activity

**Table A2. Sectoral Distribution of Respondent Firms (N = 23)**

Sector	Number of firms	Share (%)
Construction	11	48%
Services	6	26%

Sector	Number of firms	Share (%)
Agriculture	4	17%
Manufacturing	2	9%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Construction firms constitute 11 cases (48%), followed by services with 6 cases (26%), agriculture with 4 cases (17%), and manufacturing with 2 cases (9%). The dominance of construction is methodologically justified given the sector's higher tax exposure and documentation complexity, which strengthens the relevance of examining lawful tax optimization practices under intensified compliance requirements.

#### Question 3. Geographic location

**Table A3. Geographic Distribution of Firms (N = 23)**

Location	Number of firms	Share (%)
Tbilisi	15	65%
Kakheti	8	35%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Firms operating in Tbilisi account for **15 cases (65%)**, while Kakheti-based firms represent **8 cases (35%)**. This distribution supports a meaningful urban–regional comparison: Tbilisi firms generally benefit from stronger advisory ecosystems and more developed digital infrastructure, which can translate into higher tax planning and optimization capacity relative to regional enterprises.

#### Question 4. Applied tax regime (*multiple responses allowed*)

**Table A4. Applied Tax Regimes among Respondent Firms (N = 23)**

Tax regime	Number of firms	Share (%)
Corporate Income Tax (Estonian model)	13	57%
VAT payer	14	61%
Small business status	5	22%

#### Analysis:

A total of 14 firms (61%) report VAT payer status, 13 firms (57%) operate under the Estonian corporate

income tax model, and 5 firms (22%) benefit from small business status. The overlap indicates that many firms face multiple tax obligations simultaneously, highlighting the importance of coherent accounting policies and structured tax planning frameworks to manage compliance and optimize lawful tax outcomes.

#### Appendix A. Research Questionnaire — Results and Analysis (Continued)

##### Section II – Tax Burden and Structure (Closed-ended)

#### Question 5. Approximate Share of Tax Expenses in Total Annual Revenue

**Table A5. Share of Tax Expenses in Total Annual Revenue (N = 23)**

Tax burden share	Number of firms	Share (%)
Less than 10%	3	13%
10–20%	7	30%
20–30%	9	39%
More than 30%	4	18%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

The results indicate that 9 firms (39%) report tax expenses accounting for 20–30% of their total annual revenue, while 4 firms (18%) face a tax burden exceeding 30%. An additional 7 firms (30%) operate within the 10–20% range, and only 3 firms (13%) report tax expenses below 10% of revenue. These findings demonstrate that the majority of surveyed firms experience moderate to high tax pressure, which creates strong economic incentives for the application of lawful tax optimization mechanisms.

#### Question 6. Taxes Constituting the Largest Share of the Tax Burden

*(multiple responses allowed)*

**Table A6. Major Components of the Tax Burden (N = 23)**

Tax type	Number of firms	Share (%)
VAT	17	74%
Corporate income tax	14	61%
Payroll taxes	11	48%
Property tax	5	22%

**Analysis:**

VAT is identified as a major component of the tax burden by 17 firms (74%), making it the most significant fiscal pressure point. Corporate income tax follows with 14 firms (61%), while payroll taxes affect 11 firms (48%). Property tax is cited by 5 firms (22%). The dominance of VAT and corporate income tax highlights the strategic importance of VAT management and income tax planning within lawful tax optimization frameworks.

## Section III – Lawful Tax Optimization Mechanisms (Closed-ended)

**Question 7. Application of Lawful Tax Optimization Mechanisms****Table A7. Application of Lawful Tax Optimization (N = 23)**

Response	Number of firms	Share (%)
Yes	16	70%
No	7	30%
<b>Total</b>	<b>23</b>	<b>100%</b>

**Analysis:**

A total of 16 firms (70%) report applying lawful tax optimization mechanisms, while 7 firms (30%) do not. Although the majority of respondents engage in optimization practices, the presence of a substantial non-user group suggests persistent constraints related to knowledge, documentation capacity, or risk perception.

**Question 8. Applied Lawful Tax Optimization Instruments**

(multiple responses allowed)

**Table A8. Applied Lawful Tax Optimization Instruments (N = 23)**

Instrument	Number of firms	Share (%)
Expense recognition optimization	17	74%
VAT management	15	65%
Depreciation method selection	13	57%
Contract structuring	9	39%
Tax incentives	8	35%

**Analysis:**

The most frequently applied instrument is expense recognition optimization, used by 17 firms (72%),

followed by VAT management applied by 15 firms (65%). Depreciation method selection is used by 13 firms (57%), while more complex instruments such as contract structuring (9 firms, 39%) and tax incentives (8 firms, 35%) are less commonly applied. This distribution suggests that firms prioritize relatively straightforward tools, whereas advanced tax planning instruments remain underutilized.

### Question 9. Estimated Tax Burden Reduction Achieved through Optimization

Table A9. Estimated Tax Burden Reduction (N = 23)

Reduction range	Number of firms	Share (%)
0–5%	6	26%
5–10%	8	35%
10–15%	6	26%
More than 15%	3	13%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

The most common outcome is a tax burden reduction of 5–10%, reported by 8 firms (35%). Reductions of 0–5% and 10–15% are each reported by 6 firms (26%), while only 3 firms (13%) achieve reductions exceeding 15%. These results suggest that substantial tax savings are typically associated with more integrated and systematically applied tax planning models.

### Question 10. Documentation of Accounting Policies

Table A10. Documentation of Accounting Policies (N = 23)

Response	Number of firms	Share (%)
Yes	11	48%
Partially	8	35%
No	4	17%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Fully documented and regularly updated accounting policies are reported by 11 firms (48%), while 8 firms (35%) indicate partial documentation and 4 firms (17%) report no formal documentation. The findings indicate a positive relationship between the level of accounting policy formalization and the effectiveness of lawful tax optimization and compliance outcomes.

## Section IV – Tax Risks and Compliance (Closed-ended)

**Question 11. Experience of Tax Penalties or Late Payment Charges****Table A11. Tax Penalties and Late Payment Charges (N = 23)**

Response	Number of firms	Share (%)
Yes	9	39%
No	14	61%
<b>Total</b>	<b>23</b>	<b>100%</b>

**Analysis:**

A total of 9 firms (39%) report having faced tax penalties or late payment charges in the past three years, while 14 firms (61%) have not. This indicates that a significant proportion of firms continue to experience compliance-related challenges, often linked to documentation quality and regulatory interpretation.

**Question 12. Main Sources of Tax-Related Risk**

*(multiple responses allowed)*

**Table A12. Main Sources of Tax-Related Risk (N = 23)**

Risk factor	Number of firms	Share (%)
Insufficient documentation	15	65%
Regulatory changes	13	57%
Incorrect interpretation of tax legislation	12	52%
Lack of professional consultation	11	48%
Accounting errors	10	43%

**Analysis:**

Insufficient documentation is identified as the primary source of tax-related risk by 15 firms (65%). Regulatory changes are cited by 13 firms (57%), followed by incorrect interpretation of tax legislation (12 firms, 52%). These findings underline the critical role of documentation discipline and professional expertise in mitigating tax risks.

**Question 13. Level of Confidence in Current Tax Compliance****Table A13. Confidence in Tax Compliance (N = 23)**

Confidence level	Number of firms	Share (%)
High	7	30%
Medium	11	48%
Low	5	22%
<b>Total</b>	<b>23</b>	<b>100%</b>

**Analysis:**

Most firms report a medium level of confidence in their tax compliance (11 firms, 48%), while 7 firms (30%) express high confidence and 5 firms (22%) report low confidence. Lower confidence levels are generally associated with insufficient documentation and limited strategic tax planning capacity.

## Section V – 2026 Regulatory Changes (Closed-ended)

**Question 14. Awareness of the 2026 Tax Regulations****Table A14. Awareness of Planned 2026 Tax Regulations (N = 23)**

Response	Number of firms	Share (%)
Yes	10	43%
Partially	8	35%
No	5	22%
<b>Total</b>	<b>23</b>	<b>100%</b>

**Analysis:**

Only 10 firms (43%) report full awareness of the tax regulations planned for 2026, while 8 firms (35%) indicate partial awareness and 5 firms (22%) report no awareness. This suggests the presence of informational gaps that may hinder adequate preparation for upcoming regulatory changes.

**Question 15. Expected Impact of the 2026 Regulations****Table A15. Expected Impact of the 2026 Regulations (N = 23)**

Expected impact	Number of firms	Share (%)
Positive	6	26%

Expected impact	Number of firms	Share (%)
		6%
Neutral	9	39%
Negative	8	35%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Expectations regarding the impact of the 2026 reforms are mixed. A neutral impact is expected by 9 firms (39%), while 6 firms (26%) anticipate positive effects and 8 firms (35%) expect negative consequences. This distribution reflects varying levels of preparedness and differing perceptions of regulatory risk.

### Question 16. Preparedness for Increased Documentation and Digital Reporting

Table A16. Preparedness for 2026 Regulatory Requirements (N = 23)

Preparedness level	Number of firms	Share (%)
Yes	5	22%
Partially	10	43%
No	8	35%
<b>Total</b>	<b>23</b>	<b>100%</b>

#### Analysis:

Only 5 firms (22%) report being fully prepared for increased documentation and digital reporting requirements, while 10 firms (43%) indicate partial readiness and 8 firms (35%) are not prepared. These results highlight a significant preparedness gap, particularly among SMEs, underscoring the need for proactive capacity-building and strategically integrated tax planning.

### General Empirical Findings

The empirical findings demonstrate that the research sample is predominantly composed of small and medium-sized enterprises, reflecting the structural characteristics of Georgia's business environment. Specifically, 35% of respondents are small enterprises, 26% medium-sized, and 22% micro enterprises, while large firms account for only 17%. This structure underscores the particular relevance of lawful tax optimization for SMEs, which are more sensitive to tax burden dynamics and regulatory risks.

Sectoral analysis reveals that nearly half of the surveyed firms (48%) operate in the construction sector, a field characterized by high tax exposure and complex documentation requirements. The presence of services (26%), agriculture (17%), and manufacturing (9%) provides

sectoral diversity; however, the results clearly indicate that the need for tax optimization is most pronounced in sectors facing intensified fiscal pressure.

Geographically, 65% of firms are based in Tbilisi and 35% in the Kakheti region, enabling meaningful comparison between urban and regional business environments. The findings suggest that firms operating in the capital benefit from stronger advisory ecosystems and more developed digital infrastructure, which enhances their tax planning and optimization capacity.

Analysis of tax burden intensity indicates that most firms operate under moderate to high tax pressure. In particular, 39% of respondents report tax expenses amounting to 20–30% of annual revenue, while 18% face tax burdens exceeding 30%. These conditions create strong economic incentives for the adoption of lawful tax optimization mechanisms.

The study shows that 70% of surveyed firms apply lawful tax optimization practices. The most widely used instruments include expense recognition optimization (72%), VAT management (65%), and depreciation policy selection (57%). In contrast, more complex tools such as contract structuring (39%) and tax incentives (35%) are less frequently applied, indicating limited strategic tax planning capacity, especially among SMEs.

Tax risk analysis identifies insufficient documentation as the most significant risk factor, cited by 65% of respondents, followed by regulatory changes (57%) and incorrect interpretation of tax legislation (52%). These findings confirm that documentation quality and accounting policy formalization are critical determinants of effective tax compliance in a digitalized tax administration environment.

Regarding the tax reforms planned for 2026, only 22% of firms report being fully prepared, while 43% indicate partial readiness and 35% report no preparedness. This highlights a substantial preparedness gap and reinforces the importance of proactive, documentation-driven tax planning under the forthcoming regulatory framework.

Overall, the empirical findings confirm that lawful tax optimization in Georgia functions not merely as a tool for reducing fiscal burden but as a strategic mechanism supporting financial sustainability, regulatory compliance, and long-term business resilience, particularly for small and medium-sized enterprises.

### 3.2 Research Object, Subject, and Hypotheses

The research object comprises business entities operating in Georgia within the framework of the existing tax legislation.

The research subject focuses on lawful tax optimization mechanisms and their impact on corporate financial performance, tax risk exposure, and compliance behavior.

Based on the theoretical framework and prior empirical studies, the following hypotheses are formulated and tested:

- **H1:** Lawful tax optimization has a statistically significant effect on reducing corporate tax burdens without violating tax legislation.
- **H2:** The selection and formalization of appropriate accounting policies reduce tax-related risks and additional financial costs.
- **H3:** The tax regulatory reforms planned for 2026 increase the demand for proactive, documentation-driven, and strategically integrated tax planning.

These hypotheses reflect the central research question concerning the relationship between tax optimization practices, regulatory evolution, and business behavior.

### 3.3 Data Sources

The study relies on both primary and secondary data sources.

Primary data were collected through structured questionnaires and in-depth interviews

conducted with accountants and financial managers of firms operating in Tbilisi and the Kakheti region. This approach ensured access to first-hand information regarding applied tax optimization mechanisms, accounting practices, and perceptions of regulatory risk.

Secondary data include Georgian tax legislation, official publications and explanatory materials issued by the Revenue Service of Georgia, and analytical reports produced by international organizations such as the OECD, the International Monetary Fund (IMF), and the World Bank. The use of secondary sources supports contextualization of empirical findings within both national and international policy frameworks.

### **3.4 Questionnaire Structure**

The questionnaire was designed to capture both structural and behavioral dimensions of lawful tax optimization. It covered the following key areas: company characteristics, tax burden composition, applied optimization instruments, exposure to tax-related risks, documentation practices, and expectations regarding the regulatory changes planned for 2026.

The questionnaire combined closed-ended questions, enabling quantitative analysis of patterns and trends, with open-ended questions, allowing respondents to elaborate on practical challenges, interpretative ambiguities, and strategic considerations. This structure facilitated methodological triangulation and enhanced the analytical depth of the empirical findings.

### **3.5 Research Limitations**

The study is subject to several limitations. These relate primarily to data confidentiality constraints, which restrict access to detailed firm-level financial information, and to the relatively limited sample size, reflecting the sensitivity of tax-related data and the voluntary nature of participation.

To mitigate these limitations, strict anonymization procedures were applied, and results were interpreted cautiously. The emphasis was placed on identifying qualitative patterns and structural relationships rather than on broad statistical generalization. As such, the findings should be understood as analytically indicative rather than universally representative.

### **3.6 Validity, Reliability, and Ethical Considerations**

To enhance the methodological robustness of the research, particular attention was given to issues of validity, reliability, and ethical compliance.

Construct validity was ensured by aligning questionnaire items and interview questions directly with the theoretical concepts of lawful tax optimization, accounting policy selection, and tax risk management. Reliability was strengthened through the use of standardized questionnaires and consistent interview protocols across participating firms. Where feasible, respondent statements were cross-validated against available financial documentation and publicly accessible tax information.

Ethical considerations were addressed through the voluntary participation of respondents, the anonymization of company-specific data, and the reporting of findings in aggregated form. Given the sensitivity of tax-related information, these measures were essential to ensuring both research integrity and respondent protection.

## **IV. Empirical Analysis**

### **4.1 Sample Formation**

The empirical component of the study is based on a purposive sample of 20–25 business entities operating in Tbilisi and the Kakheti region, with a primary focus on the construction sector. The selection of this sector is justified by its relatively high tax exposure, capital intensity, and complex documentation requirements, which make tax planning and compliance particularly relevant.

The inclusion of both the capital city and a regional economic environment allows for comparative analysis across different institutional and infrastructural conditions. Firms in Tbilisi

typically operate within more developed financial and advisory ecosystems, while regional enterprises often face limited access to professional tax and accounting services. This geographical differentiation enhances the analytical value of the sample by capturing structural disparities in tax optimization capacity.

## 4.2 Empirical Findings

The empirical findings reveal clear differences in the application and effectiveness of lawful tax optimization mechanisms across regions and firm sizes. Companies operating in Tbilisi demonstrate higher levels of tax optimization efficiency, supported by structured accounting systems, documented accounting policies, and access to professional expertise. These firms tend to apply optimization instruments in a systematic and forward-looking manner.

By contrast, small and medium-sized enterprises operating in Kakheti rely primarily on basic optimization tools and often apply them without comprehensive planning. As a result, these firms achieve lower tax reduction rates and exhibit higher exposure to compliance risks. The findings indicate that the effectiveness of lawful tax optimization is strongly correlated with institutional capacity rather than merely with statutory eligibility.

## 4.3 Case Study Evidence

The case study analysis further substantiates the quantitative findings. Medium-sized construction firms operating in Tbilisi typically combine expense recognition, depreciation policy optimization, and VAT management within an integrated tax planning framework. These firms achieve tax burden reductions ranging from 12% to 15 while maintaining full regulatory compliance.

In contrast, small construction enterprises in Kakheti tend to apply partial optimization measures, primarily limited to expense recognition and selective VAT management. Due to insufficient documentation practices and limited digital reporting experience, the resulting tax burden reduction remains within the range of 5% to 8%. These cases illustrate that lawful tax optimization outcomes depend not only on legal instruments but also on the organizational capacity to implement them coherently.

## 4.4 Impact of the 2026 Regulations

The regulatory reforms planned for 2026 introduce a qualitative shift in Georgia's tax administration framework. Enhanced electronic controls, stricter documentation requirements, and expanded risk-based assessments significantly increase the importance of advance tax planning and internal control mechanisms.

From an empirical perspective, the findings suggest that firms already engaged in structured tax planning are better positioned to adapt to the forthcoming regulatory environment. Conversely, businesses relying on reactive compliance practices are likely to face increased administrative pressure and higher perceived tax risks under the new framework.

## 4.5 Comparative Analysis: SMEs versus Medium and Large Enterprises

A comparative assessment of firm size reveals pronounced structural differences in tax optimization capacity. Medium and large enterprises benefit from internal accounting departments, formalized control systems, and advanced digital reporting tools. These factors enable proactive tax planning and facilitate compliance with evolving regulatory requirements.

Small and medium-sized enterprises, particularly in regional contexts, often operate under fragmented accounting arrangements and limited institutional resources. Although these firms are legally entitled to various tax optimization instruments, their practical utilization is constrained by insufficient expertise, documentation gaps, and regulatory uncertainty. Consequently, SMEs face higher relative tax risks and reduced financial resilience.

## 4.6 Regulatory Risk and Behavioral Adaptation under the 2026 Framework

The anticipated regulatory changes are expected to influence not only formal compliance

procedures but also business behavior. The transition toward real-time monitoring and data-driven risk profiling increases the cost of inadequate documentation and informal practices.

Under these conditions, businesses are likely to shift from ex post correction to preventive compliance models. Lawful tax optimization will increasingly depend on behavioral adaptation, including systematic documentation, internal control mechanisms, and closer integration between accounting and legal functions. This shift aligns Georgian practice with international compliance standards while raising the strategic importance of tax planning.

#### **4.7 Structural Constraints and Tax Optimization Capacity of SMEs**

Despite their central role in Georgia's economic structure, SMEs face disproportionate challenges in implementing lawful tax optimization mechanisms. Limited financial resources, constrained human capital, and fragmented organizational structures directly affect their ability to design and sustain strategic tax planning models.

Outsourced accounting services, while cost-efficient, often lack the strategic focus required for comprehensive tax optimization. As a result, compliance remains largely reactive, oriented toward meeting immediate reporting obligations rather than optimizing tax outcomes within the legal framework. Regulatory uncertainty further reinforces conservative tax behavior, leading SMEs to forgo lawful optimization opportunities.

Digitalization simultaneously offers opportunities and imposes challenges. While electronic tax systems enhance transparency, they also require higher levels of digital literacy and documentation discipline. SMEs lacking these competencies are less able to benefit from optimization instruments, reinforcing disparities between firm sizes and regions.

#### **4.8 Regulatory Impact of the 2026 Tax Reforms: Opportunities and Compliance Risks**

The 2026 tax reforms represent a strategic recalibration of Georgia's tax governance model. Intensified digital oversight and algorithmic risk assessment are expected to improve enforcement efficiency and reduce discretionary practices. For firms with established compliance frameworks, these developments may enhance predictability and reduce long-term uncertainty.

However, the reforms also introduce new compliance costs, particularly for SMEs. Increased documentation standards and pre-transaction substantiation requirements may elevate administrative burdens and discourage lawful tax optimization if not accompanied by adequate guidance and transitional support.

The effectiveness of the reforms will ultimately depend on the balance between enforcement and facilitation. Transparent interpretative guidance, advance clarification mechanisms, and digital advisory tools can transform regulatory tightening into an opportunity for strengthening voluntary compliance and institutionalizing lawful tax optimization.

#### **4.9 Tax Optimization Outcomes and Business Sustainability**

While the immediate effect of lawful tax optimization is typically measured in terms of reduced tax liabilities, its broader economic implications extend to business sustainability and long-term financial resilience. Empirical evidence from the surveyed firms indicates that effective tax optimization contributes to improved cash flow stability, enhanced reinvestment capacity, and greater tolerance to external shocks.

For medium-sized enterprises with structured tax planning practices, tax savings achieved through lawful optimization are frequently reinvested into operational expansion, technological upgrades, or workforce development. These reinvestments, in turn, strengthen competitive positioning and reduce vulnerability to cyclical fluctuations. In this sense, tax optimization functions as an indirect mechanism supporting productivity and growth rather than merely as a cost-minimization tool.

Among SMEs, the relationship between tax optimization and sustainability is more nuanced. Although the absolute tax savings achieved by small firms are comparatively lower, their relative

importance is often greater due to constrained liquidity. Even modest reductions in tax burden may significantly affect an SME's ability to meet short-term obligations, maintain solvency, or avoid reliance on high-cost external financing.

However, the findings also suggest that sustainability benefits materialize only when tax optimization is embedded within coherent financial and accounting frameworks. Firms applying optimization measures sporadically or without adequate documentation fail to translate short-term tax reductions into long-term stability. In some cases, such practices increase exposure to future compliance risks, offsetting initial financial gains.

These observations highlight that lawful tax optimization contributes to business sustainability not automatically, but conditionally. The positive effects depend on the integration of tax planning with broader financial governance structures, including cash flow management, internal controls, and strategic investment planning. This insight reinforces the argument that tax optimization should be conceptualized as a strategic instrument rather than an isolated fiscal adjustment.

## V. Practical Recommendations and Future Research

5.1 The findings of this study underscore the necessity of integrating tax planning into broader business strategy. Firms are encouraged to formalize accounting policies, enhance documentation quality, and invest in digital competencies to minimize tax risks and improve compliance outcomes.

From an institutional perspective, tax authorities and business support organizations play a critical role in shaping the effectiveness of lawful tax optimization. Predictable enforcement practices, accessible interpretative guidance, and targeted SME support mechanisms can significantly enhance compliance while preserving entrepreneurial incentives.

Future research should expand sectoral coverage beyond construction, conduct longitudinal analysis following the implementation of the 2026 reforms, and explore firm-size-specific policy instruments aimed at strengthening tax optimization capacity among SMEs.

### 5.2 Policy-Oriented Implications for SME Tax Governance

The findings of this study carry important policy implications for the design of SME-oriented tax governance frameworks in Georgia. As regulatory oversight intensifies through digitalization and risk-based controls, the challenge lies in ensuring that compliance requirements do not inadvertently discourage lawful tax optimization or entrepreneurial activity.

From a policy perspective, one key priority is the enhancement of regulatory clarity. SMEs require accessible and authoritative interpretative guidance that reduces ambiguity surrounding the application of tax rules. Advance clarification mechanisms, standardized explanatory materials, and sector-specific guidelines can significantly lower perceived compliance risks and encourage lawful optimization.

Another critical dimension concerns administrative proportionality. While digital control systems improve enforcement efficiency, their design should account for the limited institutional capacity of SMEs. Simplified documentation requirements for low-risk transactions and phased implementation of new reporting obligations could mitigate compliance costs without compromising fiscal objectives.

Digital advisory tools represent an additional opportunity for improving SME tax governance. Integrated online platforms offering simulation of tax outcomes, compliance checklists, and real-time guidance could transform digitalization from a control-oriented instrument into a facilitative mechanism. Such tools would support voluntary compliance while enhancing the effectiveness of lawful tax optimization.

Finally, capacity-building initiatives targeting SMEs—such as training programs, subsidized advisory services, and collaboration with professional associations—can strengthen accounting literacy

and documentation practices. By addressing structural constraints rather than focusing solely on enforcement, tax authorities can foster a compliance environment in which lawful tax optimization aligns with broader economic development goals.

Taken together, these policy-oriented measures suggest that lawful tax optimization should be viewed not as a threat to public revenue but as a complementary mechanism that promotes transparency, financial sustainability, and long-term compliance within the SME sector.

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## Appendix A. Research Questionnaire

*(Instrument used for the empirical study; mixed quantitative–qualitative design)*

### Section I – General Company Information (Closed-ended)

#### 1. Company size:

- Micro (1–9 employees)
- Small (10–49 employees)
- Medium (50–249 employees)
- Large (250+ employees)

#### 2. Sector of activity:

- Construction
- Agriculture
- Manufacturing
- Services
- Other: \_\_\_\_\_

#### 3. Geographic location:

- Tbilisi
- Kakheti
- Other region: \_\_\_\_\_

#### 4. Applied tax regime:

- Corporate Income Tax (Estonian model)
- VAT payer
- Small business status
- Other: \_\_\_\_\_

### Section II – Tax Burden and Structure (Closed-ended)

#### 5. Approximate share of tax expenses in total annual revenue:

- Less than 10%
- 10–20%
- 20–30%
- More than 30%

#### 6. Taxes constituting the largest share of the tax burden (multiple choice):

- Corporate income tax
- VAT
- Payroll taxes
- Property tax
- Other: \_\_\_\_\_

### Section III – Lawful Tax Optimization Mechanisms (Closed-ended)

#### 7. Does your company apply lawful tax optimization mechanisms?

- Yes
- No

8. **Which instruments are applied?** (multiple choice)
- Expense recognition optimization
  - Depreciation method selection
  - VAT management
  - Contract structuring
  - Tax incentives
  - None
9. **Estimated tax burden reduction achieved through optimization:**
- 0–5%
  - 5–10%
  - 10–15%
  - More than 15%
10. **Are accounting policies formally documented and regularly updated?**
- Yes
  - Partially
  - No

#### **Section IV – Tax Risks and Compliance (Closed-ended)**

11. **Has your company faced tax penalties or late payment charges in the past three years?**
- Yes
  - No
12. **Main sources of tax-related risks** (multiple choice):
- Insufficient documentation
  - Incorrect interpretation of tax legislation
  - Accounting errors
  - Regulatory changes
  - Lack of professional consultation
13. **Level of confidence in current tax compliance:**
- High
  - Medium
  - Low

#### **Section V – 2026 Regulatory Changes (Closed-ended)**

14. **Are you familiar with the tax regulations planned for 2026?**
- Yes
  - Partially
  - No
15. **Expected impact of the 2026 regulations on your business:**
- Positive
  - Neutral
  - Negative
16. **Is your company prepared to adapt to increased documentation and digital reporting requirements?**

- Yes
- Partially
- No

### **Section VI – Open-ended Questions**

17. What are the main challenges businesses face when applying lawful tax optimization mechanisms in Georgia?
18. How do you distinguish lawful tax optimization from aggressive tax planning in your business practice?
19. What role does accounting policy play in reducing tax risks within your company?
20. How have digital tax administration systems affected your tax planning and compliance processes?
21. What changes do you expect the 2026 tax regulations to introduce into your tax planning strategy?
22. In your opinion, which support mechanisms (guidelines, consultations, digital tools) would most effectively improve lawful tax optimization for SMEs in Georgia?

### **Methodological Note**

The combination of closed-ended and open-ended questions enabled quantitative measurement of tax optimization outcomes while capturing qualitative insights into business behavior, regulatory perception, and strategic decision-making. This mixed-methods approach ensured triangulation and strengthened the validity of the empirical findings.