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Republic of Kazakhstan

Tax Administration Reform and Modernization

(In Two Volumes) Volume II:
Tax Strategy Paper

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CURRENCY AND EQUIVALENT UNITS

(Exchange Rate Effective as of March 31, 2008)

Currency Unit = Kazakhstan Tenge (KZT)

KZT 1 = US\$0.018

US\$1 = 120.65 KZT

WEIGHTS AND MEASURES

Metric System

GOVERNMENT FISCAL YEAR

January 1 to December 31

ABBREVIATIONS AND ACRONYMS

CIT	Corporate Income Tax
IMF	International Monetary Fund
KZT	Kazakhstan Tenge
LT	Large Taxpayer
MSSP	Market Selection Segmentation Program
OECD	Organization for Economic Cooperation and Development
OJT	On The Job Training
PIT	Personal Income Tax
SARA	Semi-Autonomous Revenue Authority
TC	Tax Committee
TC-IA	Internal Affairs Division
TC-IA-1	Unit of Prevention of Official Violations and Corruption
TC-IA-2	Internal Control Unit
TC-INT	International Taxation Division
TC-LTP	Large Taxpayers Monitoring
TC-NP	Non-Productive Payments Division
TC-TA	Tax Administration Division
TSE	Tax Payer Service and Education
US IRS	United States Internal Revenue Service
VAT	Value Added Tax

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EXECUTIVE SUMMARY

1. Sound tax policy alone will not effectuate the desired improvements in the tax structure of the Republic of Kazakhstan (as recommended in Volume I of the Tax Strategy Paper). As rates are lowered and the tax base is widened, the ability to improve revenues, or reduce red tape will depend increasingly on administrative improvements. The main aim of any improvements to tax administration should be to increase voluntary compliance by taxpayers, and most recommendations for improvements must be keyed to this goal.

2. Volume II of the Tax Strategy Paper examines tax administration issues in Kazakhstan, and identifies functional areas that require attention in the short, medium and longer term. This examination represents an initial diagnostic and is not a final blueprint for modernization. The nine areas diagnosed are: Organizational Structure, Human Resource and Training; Anti-Corruption; Taxpayer Service and Education; Large Taxpayers; Audit/Inspection; Collection; Information Technology; and Legal and Appeals. These areas are summarized below along with recommended actions to be taken within a strategic planning framework.

3. Voluntary compliance, like a tripod, rests on three pillars: a sound system of audit (inspection) of taxpayers' returns (declarations) and records; an efficient system for the collection (including enforced collection), accounting, and recording of all payments due; and a comprehensive taxpayer service and education program that reduces the cost of compliance for taxpayers. All activities of the tax administration apparatus must be judged on the basis of how well they improve performance in these areas. To this end our review consisted of an assessment and diagnostic analysis of the current administration, procedures and policies, and recommendations for improvement consisting of short, medium and long term steps which may be taken to achieve the significantly improved systems necessary to maximize voluntary compliance.

4. While we have set forth a number of specific areas of concern, this is not to serve as an indication that substantial progress has not been made. The Tax Committee has achieved considerable and commendable progress toward simplification, modernization, and automation of its systems over the short period of its life. We found significant progress toward development of a comprehensive IT system of record keeping in all aspects of operations. All indications are that these systems are operational in the field, albeit not as well organized and equipped as at headquarters. Especially noteworthy are the improvements in e-filing of returns and declarations which have greatly improved the speed and efficiency of operations, and enhanced the management information systems requisite to responsive and supportive headquarters elements. While these efforts would still require continued attention and tightening, they nonetheless deserve praise.

5. There are several critical areas for improvement, most of them common to one or more of the nine sections of the report, and are briefly summarized below.

Planning, Organization, and Staffing

6. To be comprehensive in the reform effort, the Tax Committee (including the Ministry of Finance) should develop a strategic plan within a medium to long-term

framework (from three to seven years). The process should begin with a realistic assessment of current tax administration operations. Then a detailed modernization plan should be prepared encompassing investments and organizational changes in key functional areas. The modernization plan should include cost approximations and a timetable over the mid-term. All plans should have measurable indicators of progress, both quantitative and qualitative.

7. Restructuring of the organization and redeployment of human and other resources requires a comprehensive study designed to improve incentives and concentrate on the most profitable areas. These studies should serve to rationalize and balance workload and staffing requirements with management priorities established during the planning process. These should include a comprehensive review of field offices, including their number, distribution, staffing, and internal structure.

8. To ensure proper oversight of both the field and central offices, the span of control of the TC chair should be reduced. This could be done by using several Deputy Chairmen (two are permitted, although by statute as many as five can be appointed), or higher ranking Department heads, to supervise the field and central offices, respectively. They should also supervise special activities, which should be outside the normal chain of command of field operations, such as the Ombudsman, Internal Inspection and Audit, and Appeals functions.

9. The authorities may consider rebalancing field and headquarters functions to separate those responsible for preparation of policies and procedures, and inspection of local offices, from those responsible for the conduct of field operations and case work which involves interactions with taxpayers. These steps will serve to:

- Separate enforcement and taxpayer service work from political influence;
- Ensure objectivity and uniformity in decision making nation-wide;
- Allow headquarters elements to plan operations, prescribe procedures for all activities, and monitor performance by all field units, without the distraction of carrying out tax assessment work;
- Concentrate scarce enforcement staff at appropriate levels of the organization based on risk management needs, and not based on mere geographical presence, so as to maximize compliance and taxpayer service efforts.

10. In addition, personnel with skill levels necessary for each type of work should be reassigned or rotated to the relevant units of the organization.

Anti-Corruption

11. All levels of management recognize that one of the strongest factors inhibiting administrative improvement is corruption. This effort too needs reorganization and reconstruction. A realistic and relevant Code of Conduct must be promulgated. Units within the Tax Committee should be created to detect and combat corruption and should report directly to the Chairman or a senior official reporting directly to him/her. Protocols and procedures for reporting, preventing, and detecting corrupt practices must be instituted. Organizationally, investigation of such offenses should be a responsibility of the Tax Committee itself, at least in the first instance.

12. Systems should be so constructed as to require management controls and reviews that expose transactions and operations vulnerable to abuse, and risk assessments must be undertaken at all steps in case processing so as to require management involvement and interface and, make corruptive practices harder to employ.

13. Information systems too must be designed to track and minimize corrupt incidents and ease investigation of same.

14. A Code of Conduct and new organizational alignments will not alone yield results in terms of reducing corruption. A systemic effort to review procedures, assess human resources issues (e.g., rotations, compensation, qualifications for hiring and retention, disciplinary actions) is equally important.

Taxpayer Service and Education

15. As is evident from a mere perusal of the organizational descriptions of headquarters and field elements of the Tax Committee, taxpayer service and education is not accorded the prominence it should have as one of the three mutually supportive legs of the tax administration tripod. Taxpayer service programs and activities must complement enforcement activities in order to maximize voluntary compliance. To this end, the taxpayer service structure must be a separate division with constituent distinct elements in all field offices and with its own dedicated resources. Taxpayer service strategies and plans should be prepared and implemented quickly. There is a great array of international experiences available in this area which the TC can utilize.

16. As a means of measuring taxpayer satisfaction all functions and capabilities need to be measured and analyzed from time to time. The first of such surveys will serve to establish base lines against which improvement or deterioration in services, as perceived by taxpayers and practitioners, needs to be measured at intervals thereafter. The results of these surveys will point to areas requiring improvement, and such surveys should be an integral part of Tax Committee's planning and operations.

Large Taxpayer Operations

17. While we commend the efforts made over the past few years to form the current Large Taxpayer (LT) operations (including the Inter-regional Committee for Sub-soil Users), the recent emphasis on dedicated units for special regimes have made the administration lose its focus on this key activity. As a result the LTO has not kept up with the development of large industries in Kazakhstan.

18. There must be a much greater dedication of staffing to large taxpayer operations. Constituting 65 percent plus of the revenues, this sector of operations must receive highly specialized training and its entire effort should be reorganized.

19. Computer-assisted auditing and other specialties must be constituent elements of audit teams, and team audit, package audit, and integrated audit concepts must be improved or employed.

20. Greater expertise in specific industry and business operations must be acquired, documented and internalized. As in other areas, administrative portions of the Tax Code need to be amended to accommodate these steps.

Audit System

21. Inspections should only be conducted in the field and the TC Headquarters should not have responsibility for tax cases. It should focus exclusively on prescribing policies and procedures for audit and monitoring audit in the field to ensure conformity and consistency.
22. The qualifications for recruitment of new inspectors need to be revised. Greater emphasis should be given to accounting training in an academic setting as opposed to obtaining candidates with economics degrees. Extensive training should be undertaken to improve the quality of audits.
23. An objective methodology for the risk-based selection of audit cases must be instituted for non-cameral control, so that low-risk cases are not audited, while focus .
24. An Annual Audit Plan should be created It should prescribe qualitative and quantitative measurements in each area of audit activity.
25. The Tax Code needs to be rationalized with respect to the frequency and duration of audits to ensure that integrated audits are conducted to minimize repetitive visits to taxpayers.
26. The integrated audit should be a coordinated examination of the taxpayer and all related entities or principals. It should also be a one-stop audit, covering all taxes--payroll, PIT or CIT, VAT, Excise in one visit.
27. An Audit Manual needs to be compiled for the use of all inspectors to guide them in the conduct of audits. Precedent and historic experiences gathered from previous examinations should be preserved and published for the benefit of Inspectors and to inform future cases.

Collection

28. The Tax Code should be amended and procedures promulgated to enable write-off of uncollectible accounts. These should be subject to tight management controls and higher levels of approval to ensure against abuse.
29. The Code also should be clarified and appropriate procedures put in place to permit automatic offset of any tax refund due to a taxpayer against indebtedness for any tax owed.
30. The Tax Committee should consider, as part of the recommended workload and organization study, the creation of a specialist position for tax collection separate from Inspection/Audit functions.
31. An enforcement mechanism should also be modeled on most modern tax administrations by which certain tax obligations (e.g., taxes withheld on wages or dividends) survive the liquidation of an entity, and can be applied against responsible officers of the taxpayer entity who were responsible for paying such taxes to the government but failed to do so.
32. An analysis of the age of all arrears should be undertaken to assess the quality and nature of collection efforts and the currency and worth of accrued indebtedness.

33. The advisability and relative advantages to be enjoyed by freeing the TC from the responsibility of collecting local taxes, obligatory payments and state duties should also be considered.

Information Systems

34. E-systems for taxpayer interface and inputs must be expanded and made more user-friendly. The present efforts in this area are highly commendable but more resources must be injected to expand and simplify tax reporting and payment and compliment such systems with taxpayer friendly instructions and educative links.

35. Management reporting and information systems must be expanded to permit monitoring at all critical junctures within the “pipelines” of all processes so as to keep management apprised of system efficiency. This will allow for timely intercession in all potential and actual problem areas as they are identified.

36. Technology management, technology development and technology support should be segregated for better specialization.

37. Registration requirements and procedures need to be streamlined and simplified. Better cross referencing of files and matching with databases of other ministries should be effectuated.

38. The capacity of hardware and equipments need to be enhanced and upgraded.

Legal and Appeals

39. The Appeals structure should be placed outside the normal chain of command and subordinated directly to the Appeals Division in the Central Office. This division should report directly to the Tax Committee Chairman or a Deputy.

40. The Appeals Committee in the Central Office should be abolished. The decision of the Tax Appeals Division should be the final step in the administrative appeals process.

41. The position of “Appeals Officer” should be created. Appeals Officers should be permitted to negotiate with the appellants taking into account the risks of litigation.

42. Appropriate government authorities should consider the establishment of a branch of the judiciary to be dedicated to adjudicating tax cases.

1. INTRODUCTION

A. THE CHALLENGES OF A MODERN TAX ADMINISTRATION

1.1 It is well understood that tax administration plays a key role in determining the success or failure of a tax system. A tax system can never work better than its administration.¹ The general complexity of tax laws coupled with the relatively large populations of taxpayers to be administered mean that, fundamentally, all revenue authorities must rely significantly on taxpayers' voluntary compliance to achieve their revenue goals. Increased voluntary compliance not only brings additional revenue at lower costs, it also allows tax administrations to focus audit and enforcement activities on taxpayers who pose higher risks to revenue.

1.2 Thus the overall goal of any modern tax administration is to both collect revenue and increasing voluntary compliance. Success in maximizing compliance depends on facilitating compliance while making noncompliance difficult. Many factors impact on the efficiency and effectiveness of tax administration and thus on compliance outcome. These include the political and socio-economic environment, compliance cultures, tax legislation, the organizational set up of the tax agency, management approach, institutional knowledge and training, resource allocations, IT-systems, taxpayer services and education, deterrent instruments, as well as staff moral and corruption levels.

1.3 Tax administrations enhance taxpayer confidence in the administration through the display of fairness, impartiality, honesty and professionalism and through the development of transparent systems and procedures. An independent appeals system, a highly trained, professional and courteous work force and an effective program of taxpayer services are critical compliance instruments. Transparency in the tax system is enhanced by publishing rules, procedures and interpretations on websites, providing information and assistance through call centers and emails, and making taxpayer accounts available online for restricted taxpayer access. Minimizing contact between taxpayer and tax inspector, and eliminating the need for taxpayers to visit tax offices through use of e-filing and email correspondences go a long way in encouraging better compliance.

1.4 The operational priorities of tax administrations should be driven through the process of risk assessment. Strategies to identify risks, including internal risks, are developed. In the framework of its national and international environment, the tax administration analyzes the business and legislative trends and anticipates the risk of tax avoidance and other foreseeable changes. The selection of taxpayers to be audited and selected for other types of control is based on the assessment of risk and the development of risk-based selection techniques.

1.5 Risk management techniques must, as a practical matter, group taxpayers by a few major types of risks, picking visible characteristics as a proxy for underlying compliance behavior. Not all risks require treatment through audit and enforcement; several may be addressed through targeted taxpayer services in the form of information

¹ Jenkins, Glenn P. (1991): Tax Reform: Lessons Learned. In: Reforming Economic Systems in Developing Countries, Cambridge, MA: Harvard Institute for International Development.

campaigns, call centers and online information. Regular consultation with association of taxpayers are important to address their concerns and issues, and for feedback on initiatives to change tax legislation. Such actions are less costly than audits and may impact on compliance for all taxpayers. Thus, a well balanced use of compliance instruments will increase substantially the revenue authority's options for improving its performance.

B. THE TAX ADMINISTRATION IN THE KAZAKHSTAN CONTEXT

1.6 Soon after independence in 1991, Kazakhstan went through five years of economic stagnation characterized by hyperinflation, high unemployment, and a sharp decline in GDP. However, in recent years, thanks largely to the growth of the petroleum sector, average annual GDP growth has been around 10 percent and inflation has been brought down. The increase in petroleum revenues has allowed the government to maintain a budget surplus consistently from 2001 onwards.

1.7 High oil prices have increased export and fiscal earnings, and have helped boost Kazakhstan's current account and fiscal surpluses. As a result of this, the overall fiscal surpluses increased from about 6 percent of GDP in 2005 to about 8 percent of GDP in 2006. Most of the fiscal surplus from oil revenues is accumulated in the National Fund of the Republic of Kazakhstan (NFRK) which, apart from its stabilization and savings functions, is currently fully used for foreign exchange sterilization.

1.8 These surpluses however, obscure the rapid increase in public consumption which may become unsustainable in the long run. The level of public spending grew on average by 20 percent in real terms (CPI adjusted) between 2003 and 2005, but slowed down to 13 percent in 2006. Fiscal policy, while not always consistent with macroeconomic stability, is consistent with debt sustainability. Government's borrowing policies are very prudent in light of the fact that oil revenue is flowing in amounts that cannot easily be absorbed.

1.9 Total government revenues in recent year have been in the range of about 26 percent of GDP of which non-oil revenues accounts for around 19 percent, the rest being oil revenues. The percentages are obviously impacted by the international price of oil. The share of VAT revenues is about 4.6 percent of GDP while excise taxes account for roughly one percent. As in many resource-rich countries, Kazakhstan derives a large part of its revenues from the taxation of corporations. Corporate income tax (CIT) accounts for 7.6 percent of GDP, of which non-oil companies account for about two-thirds of CIT revenues. The tax reform package for 2007-10 has a number of commendable features. This includes increasing participation in the formal economy and reducing the tax burden in the non-extractive sectors, further reductions in VAT rates (to a proposed 12 percent over the medium term), the introduction of a 10 percent flat PIT rate, and a compression of the regressive rates that apply to the social tax.

1.10 While Kazakhstan has made significant effort to modernize its tax system, there has been some degree of complacency in carrying out certain aspects of tax administration reforms. According to the World Bank Doing Business Report – Paying Taxes 2008, Kazakhstan ranks overall 44th in terms of ease of paying taxes, the best ranking in the CIS countries. According to the Report and the methodology applied,

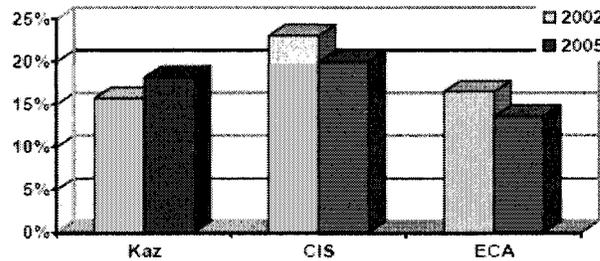
Kazakhstan scores well in terms of the number of tax payments (ranked 15th in the world with only 9 annual payments), and reasonably well in the area of total tax rates (ranked 58th with a comprehensive rate of 36.7%). The area, according to the Report, that is a matter of most concern is the time it takes taxpayers to comply with tax obligations (ranked 105th, taking 271 hours to comply). Kazakhstan continues to face significant challenges which stem from tax administration and dispute resolution.

1.11 While here have been significant improvement at the technology level, and the success in computerization, including electronic filing and return processing, have been impressive., serious problems still remain in corruption, the size of the tax bureaucracy, taxpayer services, and weaknesses in audit and appeal system.

1.12 Bribery still remains a problem. The results of triennial surveys conducted by the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) indicate the percentage of firms that stated that bribery is frequent has risen in Kazakhstan. Although this is somewhat lower than the average for CIS countries, it is significantly higher than the average for Europe & Central Asia (ECA) countries.

Figure 1.1 Level of Unofficial Payments (BEEPS 2005)

Unofficial Payments for Tax Collection
Percent of firms that stated that bribery is frequent for tax collection purposes

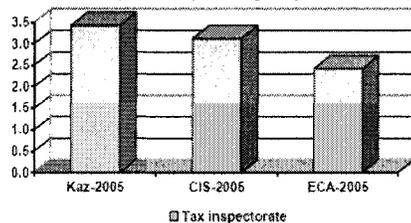


1.13 Also, the average number of inspections done by the tax administration during a year is higher than for the average for CIS or ECA countries, although the duration of these inspections was relatively smaller.

Figure 1.2 Number and Duration of Tax Inspections (BEEPS 2005)

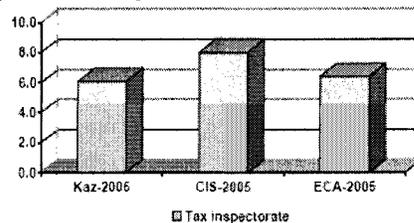
Number of Inspections – Taxes

How many times in the last 12 months was your establishment inspected by this agency?



Duration of inspections – Taxes

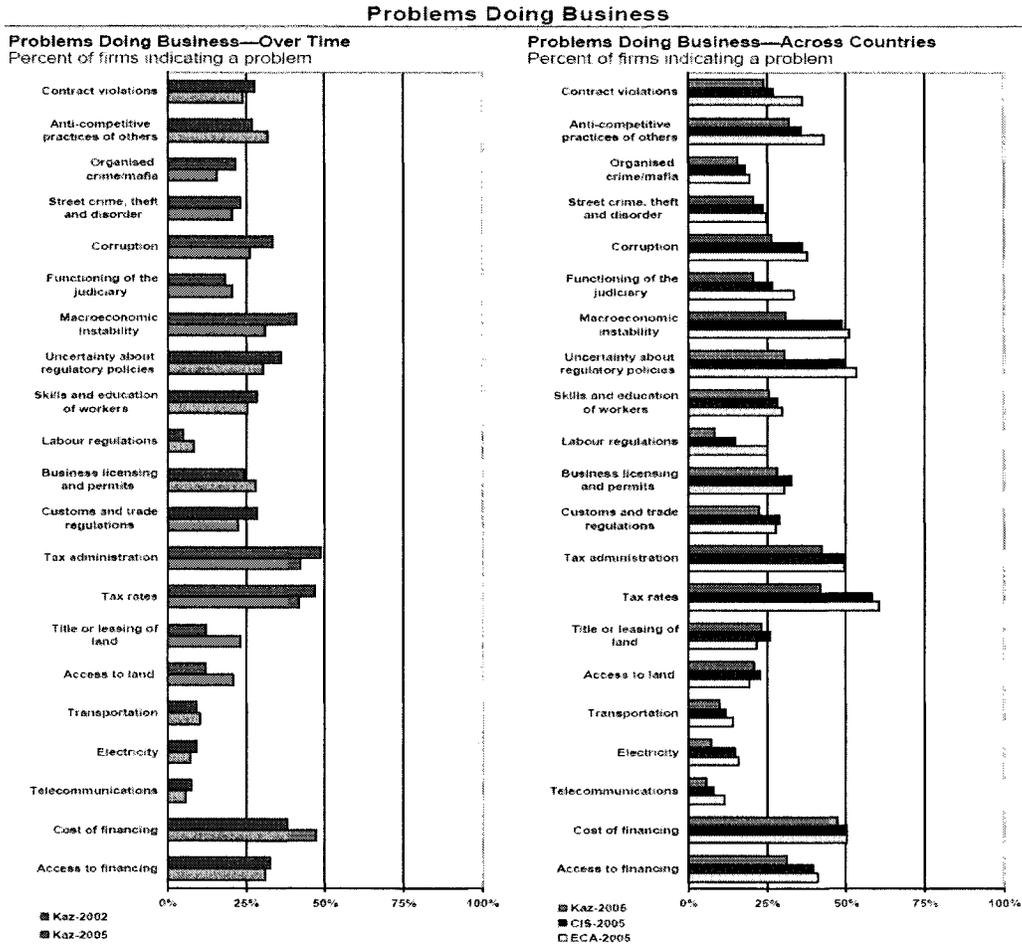
What was the average duration of these inspections/meetings? (hours-visit)



1.14 However, the overall perception of tax administration has indeed improved. The results of triennial surveys conducted by BEEPS indicate that firms rate the tax

administration in Kazakhstan better than the average for CIS countries and the average for countries in ECA region. Around 40 percent firms in Kazakhstan report the tax administration as a problem for doing business, compared to about 50 percent on an average in the CIS and ECA region. Also, the indicator shows that there has been some improvement in this perception between 2002 and 2005.

Figure 1.3 Tax Administration in relation to Problems Doing Business (BEEPS 2005)



BEEPS-at-a-Glance

Kazakhstan

1.15 In terms of the effectiveness of the tax administration in Kazakhstan in detecting tax evasion, the record is mixed. Effectiveness is usually measured in terms of productivity of a particular tax. VAT productivity rate is the ratio of VAT collections to GDP divided by the nominal VAT rate. In effect, it tells us what percentage of GDP is collected at a VAT rate of one percent. This allows international comparativeness, since the rate of one percent is laid out as common to all countries. Figure 1.4 shows that the VAT productivity of Kazakhstan is the sixth lowest (at about 0.3%) among the countries

of Europe and Central Asia.² On the other hand, in Figure 1.5 the corporate income tax (CIT) productivity is impressive, being the second highest (at about 0.3%). This shows that while CIT is performing well, there are serious problems with VAT administration.

Figure 1.1: VAT Revenue Productivity, 2004

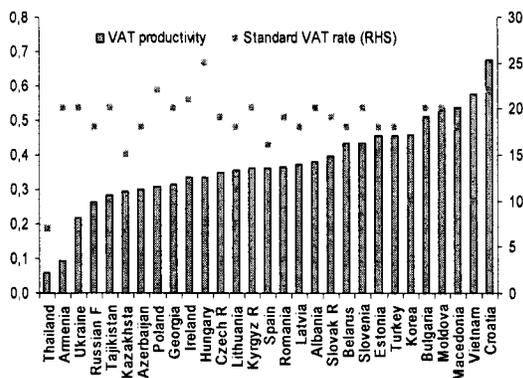
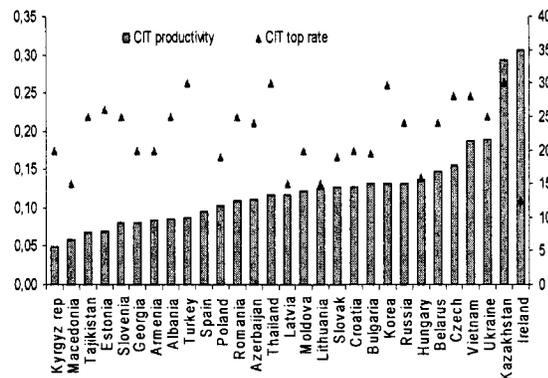


Figure 1.2: CIT Revenue Productivity, 2004



Note : VAT/CIT productivity is defined as VAT/CIT revenue as a share of GDP divided by the standard top rate.

Source: Various, staff calculations.

1.16 It is important to point out that revenue productivity of a particular tax (VAT or CIT, or any other) reflects not only on the tax administration, but also on tax policy – in terms of the number and magnitude of exemptions, and other tax breaks provided in the tax law. However, it is well understood that sound tax policy alone will not bring about the desired improvements in the tax system. As rates are lowered and the tax base is widened, (see Volume I of this Report), the ability to improve revenues and reduce red tape will depend increasingly on administrative improvements in support of better compliance.

1.17 The Tax Committee (TC), which is the tax authority in Kazakhstan, began operations in 1999. It is a subordinate unit of the Ministry of Finance (MOF), as authorized by Resolution of the Government No. 1127 of October 29, 2004 (amended through February 27, 2006), and operates on the basis of provisions of the Tax Code (Code), which sets forth the objectives, powers and structure of the TC, and the rights and obligations of taxpayers.

1.18 The TC has a central headquarters in Astana, and operates through approximately 198 rayon offices, which are subordinate to 16 oblast, regional, and city (Astana and Almaty) committees. In addition, there are five specialized TCs which have responsibility for certain free economic zones or industries (including especially subsoil users). There is approximately 11,000 staff, of which 3,000 are Tax Inspectors who engage in enforcement duties.

² “Assessing overall fiscal effort in ECA 1995-2004,” Emilia Skrok and Aristomene Varoudakis, World Bank Regional Study, 2007.

1.19 The Tax Committee has made considerable progress in moving toward a modern tax organization during the relatively short history of its operations. Significant progress can be seen in the development of a comprehensive information system for operational recordkeeping. And preliminary indications in oblasts and rayons suggest this system is functioning reasonably well, though local offices are not as well organized or equipped as headquarters. Additional noteworthy modernization advances include more taxpayers filing returns and declarations electronically. This development has greatly increased the speed and efficiency of operations and enhanced the response and support of headquarters functions.

1.20 However, not enough attention is paid to the organizational structure of the tax administration, although that is the driver of tax reforms. The organizational structure is an important tool to properly align the work of the tax administration to revenue risks and organizational responses to modernization needs. In modern tax administrations, the organizational structure has changed from a geographic focus (where, as in Kazakhstan, there is a tax presence in every rayon and oblast), to a thematic and functional focus, where resources are allocated according to business needs and specialization needs of the various revenue functions.

1.21 Modern revenue administrations are organized to meet the most significant revenue risks and priorities, pretty much like any business organization. Also, modern tax administrations maintain a human resource management system that supports the achievement of the administration's objectives and at the same time explicitly recognizes that human resources are the most valuable resources of the organization.

1.22 Progress in tax administration should be geared to improving voluntary compliance. In fact, modernization effort should be keyed on achieving this goal. The diagnosis and recommendations presented in this Volume II of the Tax Strategy Paper are thus meant to support efforts to achieve higher levels of voluntary compliance, as found in modern tax administrations internationally. In this regard, the voluntary compliance improvements should be based on: (i) a soundly administered system of audit; (ii) an efficient system for collection (including enforced collection), accounting, and recording of all payments due; and (iii) a comprehensive taxpayer service and education program that helps lower compliance cost for taxpayers. The merit of all functions of tax administration can be judged by how well they improve performance in these three areas.

1.23 This Volume aims at highlighting the reform measures taken so far by the TC, and identifying the key challenges with the current system, taking a closer look, in separate chapters, at the main weaknesses in the various areas and functions of the TC, including organizational structure, the business processes, audit and collection, dispute resolution, and the technological infrastructure. Each chapter then presents a menu of recommendations and policy options for modernizing the tax administration. The organizational and management issues are discussed in the next three chapters: **Organizational Structure** (Chapter 2), **Human Resources** (Chapter 3), and **Anti-Corruption** (Chapter 4). The next four chapters deal with operational issues: **Taxpayer Service and Education** (Chapter 5), **Large Taxpayers** (Chapter 6), **Audit and Inspection** (Chapter 7), and **Collection** (Chapter 8). The achievements in the development of information and communications technology, and the key changes therein, are elaborated in **Information Technology** (Chapter 9). The concerns with dispute resolution are

discussed in *Legal and Appeals* (Chapter 10). The final chapter presents some ideas on the strategy for future measures for reform and modernization: *Framework for a Tax Administration Reform Program* (Chapter 11).

1.24 This diagnostic review is intended to identify what areas need improvement in Kazakhstan's tax administration and how this can be accomplished. Recommendations for improvement consisting of short, medium and long term steps to be taken to significantly improve the organization, administration, functions, and systems to maximize voluntary compliance.

2. ORGANIZATIONAL STRUCTURE

A. CURRENT ORGANIZATIONAL STRUCTURE AND CHALLENGES

2.1 The current organizational structure of the Tax Committee (TC) has several deficiencies, in terms of reporting relationships, delegation, powers and functions that prevent it from operating as a modern tax administration with best international practices.

2.2 The TC is a subordinate unit of the Ministry of Finance (as authorized by Resolution of the Government No. 1127 of October 29, 2004, as amended through February 27, 2006), and operates pursuant to the provisions of the Tax Code (Code), which sets forth the objectives, powers, and structure of the TC, as well as the rights and obligations of taxpayers. At the lowest level, the TC operates through approximately 198 rayon offices, which are subordinate to 16 oblast regional and city (Astana and Almaty) committees. In addition, there are five (5) specialized TCs that have responsibility for designated free economic zones or industries (including especially subsoil users). The TC also has a state-owned enterprise under its control and direction, the “KazAlco Center”.

2.3 While the Code allows up to five Deputies, the Chairman of the TC is presently authorized only two. The duties of these Deputies are to assist the Chairman across the full spectrum of policies and operations of the TC.

Powers of the Revenue Authorities

2.4 Rule Making. Kazakhstan differs from many modern economies in that the Ministry of Finance (MOF) is essentially the Ministry of Revenues and Treasury. The functions of economic policy and budget planning rest with the Ministry of Economy and Budget Planning (MOEBP). The Minister of Finance oversees the work of the Customs and Tax Administrations. Furthermore, the MOF is not responsible for budget preparation or tax policy. In this respect, the Ministry resembles to some extent the Canadian Revenue Service. Since the internal organization of the Ministry of Finance (MOF), and in particular its relationship towards the Chairmen of the customs and tax administration, is outside of the scope of this review, the discussions of the powers of the revenue authorities refers to the roles and responsibilities of the executive management in the MOF (the Minister, the deputy ministers, and the chairmen of the customs and tax administration).

2.5 Most modern fiscal systems confer full authority for rule making with respect to administrative (not substantive provisions of the tax law) matters on the revenue authorities. Hence, the Tax Chairman, in most countries, would be empowered to formulate administrative rules regarding procedures for complying with taxpayer obligations under the Code. This includes matters dealing with filing, payment, due dates, audit procedures, and appellate procedures. In the case of Kazakhstan, the MOF should deal with issues of coordination between the Tax and Customs Administrations as well as setting their strategies, but not with the administrative rules for running them.

2.6 In Kazakhstan, the Code is too detailed, and exhaustively delineates many of the administrative issues. Legislators are not expected to know all details and contingencies of administering a tax system. While the TC (and, thus, its direct supervising ministry, the Ministry of Finance) has ostensible rule-making authority (under Article 16 of the Code), in practice this authority has been unduly circumscribed. Much of the detailed content of the Code could be devolved to the TC (for administrative matters) or to the Ministry (for substantive tax requirements) without compromising legislative intent - provided the legislature establishes some method for reviewing regulations. While oversight to ensure against administrative abuse must reside with the MOF, the basic jurisdiction should be vested in the Tax Chairman.

2.7 Power to Reorganize. The Tax Chairman and the Minister of Finance should be vested with full power to organize/reorganize the TC to improve efficiency, taking into account needed budgetary and legal requirements in this regard.

Separating Administration Policy Making from Policy Execution

2.8 There are approximately 300 employees in the Headquarters (HQ) of the TC. They are organized into 12 Divisions covering almost all spheres of activity of the TC. The HQ has oversight of their assigned functions, including the preparation of policies and procedures governing these functions. However, little inspection work is conducted in the field by the HQ. The work of the HQ should include monitoring and inspection of field offices to ensure that prescribed policies and procedures are being executed properly and uniformly throughout the nation.

2.9 Several TC divisions have both staff and line functions. For instance, divisions such as Tax Administration (TC-TA), Large Taxpayers Monitoring (TC-LTP), International Taxation (TC-INT), and Nonproductive Payments (TC-NP) have both monitoring and tax assessment functions. This dual responsibility is unhealthy from a management perspective, and makes it difficult to perform either function satisfactorily.

Supervision and Organization of Field Activities

2.10 Several indicators point to the need for a study of staffing including assignment to functions across the spectrum of TC operations:

- **Span of Control of TC Chairman.** The span of control of the Chairman seems excessive and makes it difficult to adequately exercise executive control and oversight of numerous subordinates. With 16 oblasts, interregional committees, and the HQ with 12 Division heads, the span of control is immense. Some of the less strategic functions can easily be delegated to Deputy Chairmen.
- **The current number of Deputy Chairmen (2)** needs to be increased to provide for more effective supervision of line functions. Five are statutorily permissible but only two are in position. For comparative purposes, Ukraine has five Deputy Chairmen, and many other countries have roughly similar numbers.

- **Spans of Control (oblasts to rayons).** The span of control of oblasts to rayons appears excessive. The average oblast appears to have more than 12 subordinate rayons and several have even more.
- **Number of Rayons.** While Kazakhstan is a vast country, the number of full-service rayon offices needs to be reviewed. It could be that the workload and staffing study recommended below can be directed to examine possibilities for office consolidation. Certain geographical areas could possibly be just as well served by a sub-office being a satellite of, and administered by, a larger rayon office. In some cases, elimination or consolidation of two or more rayons may be possible without a diminution of effectiveness in service or enforcement. Indeed, consolidation might well focus scarce audit staff on more complex tasks, which could lead to more complete taxpayer service and education offered to their jurisdiction. As automation and use of internet services advance, organizing into fewer offices will become more operationally sensible and employees and units can be assigned or consolidated to more profitable activities.
- **Control of Field Offices.** In many countries, field units report to one central executive (ideally at the Deputy Chairman level), thus relieving the Chairman of direct responsibility and easing his span of control. The management of field operations can then be concentrated in one Deputy responsible for assuring that HQ policies are being properly executed. In Kazakhstan, however, the oblast chiefs report to the Chairman. Control might best be facilitated by having oblast heads report to one of the Deputies who, in turn, would report to the Chairman. This executive could be responsible for coordinating activities jointly among oblasts, and resolving conflicts or inconsistencies among divisions.

Functional Organization

2.11 Our analysis indicates that field offices retain some organization by tax type. For example, in the Sayarkon Rayon (Astana City) there are separate units for excise, indirect tax audit, non-productive payments, separate audit units for physical entities, legal entities and individual entrepreneurs, and separate Receipt/Processing Units for Legal Entities, Physical Entities, and Individual Entrepreneurs. Such an arrangement creates an unwieldy span of control for the rayon chief.

2.12 Organizing by function and not tax. Modernized tax administrations have found that organization around functions, rather than according to taxes or tax type, leads to greater integration of operations, better management of staff, and improved compliance and enforcement. This is especially true in the field offices. For instance, it is considered suboptimal to have the tax administration organized into the VAT, Income Tax, and Excise Departments, and better to have them organized into Audit, Taxpayer Services, IT, Enforcement and Collection Departments.

2.13 **Field Office Organization.** The internal organization of field offices (especially at the oblast level) should correspond with the alignment of HQ functions to the extent possible. This would allow for maximum clarity and effective assignment of responsibilities. For example, the units in the field offices participating in audit and

inspection activities or enforced collections should be clearly delineated, and should receive guidance from the corresponding unit in the HQ. This will facilitate functional reporting and planning and better coordination and liaison. The recommended study on organization and work should also focus on this issue.

Special Reporting Relationships

2.14 Certain activities, because of their special nature, require a direct line of supervision from the head of the organization, and should report to the Chairman or a Deputy dedicated to these purposes. Key among these functions are:

- **Appeals.** Appeals are currently a line function subordinate to the same chain of command as the oblast/rayon units from whose work the appeals arose. It is prudent to remove this function from local control and to provide the function with a separate reporting line direct to the Chairman or one of his Deputies. In brief, such a proposed arrangement would prevent the appeals officers from having undue local influence; minimize corruption, increase the confidence of the public in the independence of the appeal process and advance the credibility of the TC as balanced and fair, and reduce the cases going to the courts.
- **Internal Investigations.** At present, investigations of misconduct (not involving criminal activity) of employees is conducted by a small unit, (Unit of Prevention of Official Violations and Corruption), within the Internal Affairs Division (TC-IA) which investigates such matters and reports to management. If criminal implications are evident, the case is referred to the Financial Police. This function should be separated from the Internal Affairs Division, as it is not relevant to personnel matters per se, but is a function requiring investigative and law enforcement skills, not personnel skills. Best practice is to separate such investigation activity in an independent line of command reporting directly to the Chairman or one of his Deputies - or if shared with the Customs Committee, reporting directly to the Minister of Finance.
- **Internal Audit.** This unit should be staffed to perform internal audits and risk assessment of all TC operations and offices. To this end, it should be vested with authority and resources to conduct spot checks and internal auditing of all offices according to its own plans, with a separate line of reporting to the Chairman or one of his Deputies.

2.15 It is common in many jurisdictions to combine in one organization the responsibility for internal audit, internal investigations, and prevention of corruption functions, reporting directly to the Chairman or one of his Deputies. This is outlined in the Anti-Corruption Section of this Report.

Organizing Criminal Investigation Activities

2.16 Most OECD nations have criminal investigation units within the Tax Authority or Revenue Service. Most recently, Ukraine has switched from a Tax Police outside the State Tax Administration (STA) to a system where criminal investigation is within the STA. Internationally, criminal tax investigations are found to be more efficiently

conducted by the tax service, which either has a subordinate Financial Police Division or another separate division at the HQ responsible for criminal investigations. In Kazakhstan, the Financial Police is outside the TC and under the MOF. It would be more effective to transfer to the TC the responsibility for criminal investigation of all tax crimes under the Code. There would then be subordinate criminal investigation divisions at the oblast or city offices as well.

Other Organizational Issues

2.17 There are several other organizational issues that deserve attention:

- **Taxpayer Service and Education.** No central organization is responsible for policy and procedures for this vital function.
- **Ombudsman.** Most OECD countries now have an Ombudsman or similar official whose chief function is to review complaints and inquiries from taxpayers and intercede when unfair treatment or errors in processing occur. The Ombudsman also usually has the authority to suspend cases temporarily and make formal inquiries and recommendations for corrective action to relevant officials.

B. RECOMMENDATIONS

2.18 A comprehensive workload and functional review should be undertaken to consider the organizational, staffing and training recommendations which follow.

2.19 Authority ought to be conferred on the TC for rule making on administrative matters. If needed, the Code or decrees should be amended to provide for this.

2.20 The complement of Deputy Chairmen should be increased to allow for a realistic span of control and for certain activities (e.g., appeals, internal investigations) to have independent chains of command to the top of the organization.

2.21 Spans of control of the Chairman and of the oblast heads must be reduced.

2.22 Management could be strengthened by creating a Deputy Chairman for Field Operations and a Deputy Chairman for Centralized Operations. This would free the Chairman from many routine duties and allow him to focus on the overall supervision and policy of TC operations.

2.23 The top management of the TC should be vested with full power to organize/reorganize the TC as deemed necessary for efficiency, as long as it remains within budgetary constraints and other civil service and general laws.

2.24 There should be a clear division between HQ functions and field functions. The HQ should not be involved in case work. Policy-making and procedure design should be within the domain of HQ and procedural manuals should emanate from there. Handling taxpayer cases and other execution functions should be done exclusively by field offices.

2.25 The HQ should be tasked and resourced to monitor and inspect execution of prescribed policies by the field offices. Oblasts should also be tasked and equipped to perform supervisory activities at their subordinate rayons.

2.26 Consider reduction and consolidation of the number of rayon offices. Some offices could be reduced in the scope of services provided.

2.27 The organization of field offices should be totally reassessed to determine if further efforts should be made to reorganize along functional lines, as opposed to organization by tax type, as is true presently in parts of these offices.

2.28 The functional organization of field offices should be aligned to parallel the organization at the HQ to ease coordination and control, and allow for more focused staff guidance on technical and planning matters.

2.29 There is a need to create a Taxpayer Service and Education (TSE) Division at the HQ and at field levels.

2.30 The TC should provide certain functions with a separate reporting line to the Chairman, or a designated Deputy Chairman, in order to maintain their objectivity, and to keep them from influence and interference by lower management. These include appeals, internal investigation, internal audit, and ombudsman activities.

2.31 The Government should consider the consolidation of all anti-corruption elements of the TC (internal audit, internal investigations, and the corruption prevention programs) under one organization.

2.32 The Government should also consider centralizing revenue crime investigation functions (tax and customs) at the level of the Ministry of Finance. This would also necessitate the creation a new and separate occupational specialty of criminal tax investigator. This occupation would blend the best of audit and accounting skills and criminal/police investigative capabilities in one specialty - thus creating a force of personnel trained especially for combating tax fraud and revenue crimes.

3. HUMAN RESOURCES

A. CURRENT HUMAN RESOURCE CHALLENGES

3.1 Although the TC has benefited from a fair degree of automation and communication network, the staffing pattern has not adjusted to the changed electronic environment. There are still too many low-skilled officials doing routine processing jobs at local levels, while the high-skilled audit, investigation, intelligence, and enforcement functions have not been developed enough to meet the challenges of an emerging and increasingly complex economy. With computerization, many of the routine processing jobs (which can now be done by computers), should be replaced with highly trained and specialized audit and other functions.

3.2 Administrative public officials work in tax authorities in accordance with the Register of Administrative Public Positions approved by Presidential Decree No. 501 dated 28 December 2007, On Measures for Optimizing Public Positions. Qualification requirements are approved for each administrative public position by Order of First Deputy Chairman of Public Service Agency No.02-01-02/5 dated 9 April, 2008, On Approval of Standard Qualification Requirements to Categories of Administrative Public Positions.

Staffing Issues

3.3 Staff ratio. The nationwide staff totals approximately 11,000 spread over about 200 offices and the TC HQ. Of the total staff, only 3,000 are “inspectors” who engage in enforcement and audit functions. This ratio of high-skilled enforcement/audit personnel to total staff is very small by international comparison of modern tax administrations. These numbers suggest the need to conduct a more exhaustive workload and staffing analysis.

3.4 Specialization. Beyond the general title of inspectors, there is not much specialization. In some cases a lower skilled specialty might be desirable, so that inspectors could be free to engage in more demanding and technical activities related to auditing. Those inspectors engaged in enforced collection or taxpayer service require different technical capacity and training for their successful performance, compared to those conducting audits and investigation. Likewise, those inspectors conducting audit of large corporations, for example, require more specialized skills, than those auditing small and medium business. Thus there is need to examine whether to create additional occupational specialties apart from the general title of inspector.

3.5 In many cases, some audit and investigation duties are, or should be, so highly specialized and demanding that they require additional training and education, and should be graded higher in the compensation schedule than inspectors of similar longevity who are not involved in complex cases. These higher-level, non-managerial “senior inspectors” could also be used to fill other high-skilled positions for the training cadre, or as Appeals Commissioners.

3.6 The TC should also consider a new occupational specialty necessary in the fight against tax evasion and other crimes - a Criminal Tax Investigator - whose duties would require a combination of audit skills and criminal investigative techniques and powers. This could be the mainstream occupation within the Criminal Tax Division, which could be created within the TC if the government were to transfer these functions from the Financial Police (see recommendation under the Chapter 2).

3.7 Staff Control. Human resource (HR) management should be under a separate Deputy Chairman, who would be responsible for assuring that the staff is properly discharging its function and that planning and policy-making is coordinated among the HQ activities. He/she would also be responsible for balancing conflicting resource demands among the staff functions and coordinating with the Deputy for Field Operations in prioritizing activities appropriately for instruction and guidance of field management.

3.8 Recruiting. In Kazakhstan, many of the tax inspectors have an economics background. An economics background is not sufficient upon which to build the training of an inspector. Most modern tax administrations recruit enforcement personnel from college graduates with an academic grounding in law, business administration, accounting and/or auditing. The Tax Committee supports the proposal that tax officers should have several academic backgrounds. Because their work is multi-disciplinary. Availability of such officers will significantly improve the quality of tax authorities' performance and accordingly of public services provided to taxpayers.

3.9 Screening and Testing. Recruits should be screened for their adaptability to auditing duties and degree of knowledge of analytical skills. Possession of an academic background or credentials does not suffice. General government testing is inadequate for recruiting personnel for tax audit and enforcement. New employees should be held in a probationary status for at least a year, while their full value and skills are assessed, so that they may be removed without recourse to the usual full gamut of civil service requirements.

3.10 Performance Appraisal. At present, tax authorities apply rating stipulated in Government Resolution No. 1367 dated 29 December, 2007 on Approval of Rules for Performance Review of Administrative Public Officials for evaluating the work of administrative public officials. Other than a triennial assessment performed in accordance with this government-wide regulations, and which for most TC employees is not very relevant, and is inapplicable to their work, there is no objective basis on which to measure merit or lack thereof. No system is in place to identify training and technical weakness or superiority, and thus it can be argued that there is little objective basis for rewards and promotions.

3.11 Seasonal Workers. Seasonal hires can be a fruitful source of labor for routine clerical duties that may arise seasonally, as during filing periods. Lower paid workforce might be provided with such work so as not to distract from duties normally carried out by permanent workforce and enforcement personnel. Employment of temporary or seasonal workers is economical, reduces lost "revenue opportunities," and can be an economic boon to geographical areas experiencing unemployment or underemployment.

Training Issues

3.12 The existing training program is under-funded and does not address the actual training needs of the TC. These training deficiencies throw new light on the character and content of complaints by citizens, taxpayers, and practitioners that Inspectors do not understand tax issues, business practices, or industries, and have a poor command of tax laws and of audit and accounting practices and procedures.

3.13 Tax Committee has been conducting training in the newly established International Financial Recording Standards (IFRS) and the National Financial Recording Standards (NFRS). It recently conducted workshop, attended by 27 officials, on IFRS and NFRS as well as on GAAP practices, in order to prepare officials for qualification examination for obtaining ACCA Diploma on International Financial Reporting Standards. Sixty eight auditors from field units recently participated in training under a joint project of the Ministry of Finance and USAID.

3.14 However, specialized training in tax administration and management issues is not institutionalized in the TC. While records are kept about training that should be scheduled and administered, the TC has no power over its own program, as this is regarded as a MOF responsibility available to the TC only upon request. Of course, there is a role for the MOF to coordinate training across the Customs and Tax administration, and, if so it wishes, it may want to organize the full training function within the ministry, as long as it is transparently administered (to cover Customs, Tax, and perhaps also Treasury). Specific deficiencies can be summarized as follows:

- **No specialized regional or national tax training center exists** except at the ministry and government levels³. Workshops for senior tax officials appointed for managerial positions and newly recruited people for public service are annually held at the Public Administration Academy in accordance with a government-wide Training Schedule and Plan. There are so many TC employees at various levels of management and technical expertise, that examination of a training calendar alone would justify and mandate a central facility and a realistic budget in order to address the need. The MOF has pledged greater funding⁴ for in future years, but this does not address the obvious requirement that tax training demands separate and unique disciplines and skills not normally provided by a non-tax agency, especially when it competes for resources with other ministry programs or components. A noteworthy example of such a central tax training center is Ukraine's National Academy of the State Tax Service at Irpin (see http://www.asta.edu.ua/eng/academy/other/gen/_info.php.)
- **A training curriculum** specifying all essential skills required for employees at entry and higher levels, and the content of training to meet the need, is not now

³ For instance a Training Center for Financial System Specialists was established pursuant to Government Resolution No. 624 dated 24 July, 2007 to ensure efficient and effective transition to the International Financial Reporting Standards, international auditing standards.

⁴ In 2008 allocations for training officials of the Tax Committee and its field offices are 49 million KZT, which in 2009 will increase to 72 million KZT.

available. A training needs assessment should be conducted. The curriculum should be based on management input on skills needed and current capacity gaps.

- The **training cadre** is not drawn from experienced inspectors but is outsourced. For some skills this might be a realistic means to meet the need; however, for general occupational training this deprives recruits and other trainees of the hands-on experience available from inspectors on staff. No personnel are presently detailed, seconded, or assigned to training cadre duties except on an ad hoc or informal basis for certain lessons in training courses.
- In this regard, **instructor training**, and training in **training management** skills is also a necessity to spread training capabilities throughout the organization.
- No formal **on-the-job training (OJT) program** exists for assessing new employees, coaching them, and identifying their training weaknesses. A system of OJT coaches should be established, whereby recruits are assigned to a preceptor Inspector who finishes the training that instruction in an academic setting has begun, and rates the recruits progress and fitness before he is confirmed in the job on a permanent basis. Informal programs are in place to fill these needs, but they are administered without control and consistency.
- **Specialty training** in high-skill tax administration areas is currently inadequate. Computer audit is one of several programs that should be arranged through outsourcing, or by sending selected personnel to formal training in other countries if necessary.
- **Resources.** The Ministry's authority over training funds hampers planning and control of the training program. The TC should be granted independent funding of its training needs. This would help planning and allow the TC to catch up with its priority training gaps.
- Other than for general **management training**, which is available at government institutes⁵, no training in the intricacies of managing tax auditors, inspectors, analysts and similar personnel is provided. Most state tax agencies prescribe and provide basic, intermediate, and advanced management training for new managers, managers of first-line managers, and managers of intermediate-level managers.
- There is no formal **executive training** provided for specific to tax functions. This is especially necessary and relevant, as many executives come to the TC from other ministries or agencies and need grounding in the special problems inherent to tax administration.
- Executive training is a necessary adjunct to "succession planning," which is also an activity not systematically undertaken by the TC. Most organizations of large size, public or private, are constantly engaged in planning how and when they will be filling key management and technical vacancies as they occur in the future.

⁵ Workshops for senior tax officials are held in the Public Administration Academy.

B. RECOMMENDATIONS

3.15 An exhaustive workload and staffing analysis of the TC should be conducted by an outside agency, preferably a specialized consulting firm. The goals would be to: (i) ascertain staffing levels and skill mixes appropriate to all offices; (ii) balance workload and staffing to in the interest of determining the broadest and most productive coverage of all levels of taxpayers in every geographic areas; and (iii) to structure offices and organizations at all levels for greatest efficiency and service.

3.16 Additional occupational specialties should be created in addition to the general “inspector” category. These should be graded based on complexity of task and the degree of training, experience, and preparation required for the duties. Such specialty occupations might include: Computer Audit Specialist, Appeals Officer, Taxpayer Service Specialist, Criminal Tax Investigator, Internal Auditor, and Collection Officer.

To recruit the best new personnel, the TC should consider adopting additional requirements stressing accounting and auditing skills and abilities acquired through work experience, or in academic institutions, instead of the general academic background or Economics certification now required. The Tax Committee supports this approach that, when recruiting auditors they must have basic knowledge in accounting. For this, relevant changes will have to be made in the qualification requirements to auditors.

3.17 To ensure the best recruitment, a screening and testing program specifically geared to the unique requirements of the TC should be established to identify potential personnel best suited to tax specialties, occupation by occupation.

3.18 In addition to, or as a substitute for, the present government-wide triennial appraisal system, the TC should establish an annual performance assessment program applicable to tax personnel. The system should not be based just on meeting revenue targets but on qualitative performance, and should be characterized by thorough documentation of work ethic, communication skills, and technical abilities, by their managers. The system should form the basis for a performance incentive program to reward officers for above average performance and to identify those who need additional training or counseling in order to improve.

3.19 The TC should consider the use of seasonal and temporary workforces for use at peak times in document processing and other routine duties, in order to maximize efficiency in the organization’s work flow, without diverting the work of inspectors.

3.20 The TC should be engaged in succession planning to ensure a continuous supply of talent is available and trained to replace predictable and unexpected loss of key staff and managers.

3.21 Revamping of the training capability of the TC is critical for the success of the TC. This would include the establishment of a Training Center exclusive to the TC and subordinate to the TC Chairman. This Center might have satellite installations (oblast or regional training centers) in other key locations. It would require creation of a comprehensive training curriculum, and its own training cadre or faculty, some of whom would have rotational assignments to training duties and some permanently assigned to the Training Center(s). A separate training branch or unit would be appropriate for the oversight and execution of the training functions, with corresponding subordinate

branches in the field. External institutions may be appropriate for certain training needs, but the mainstream tasks would be most appropriately trained by TC's own staff.

3.22 Training of trainers and course developers ought to be instituted to include especially basic instructor training for all personnel assigned to instructional duties.

3.23 Management training, in addition to that generally offered by the government, and specific to the functions and peculiarities of the tax service, should be instituted. This should eventually encompass management at all tiers, from first-level supervisory to executive development programs.

3.24 Specialty training programs for every specialty must be initiated. It is encouraging that the Tax Committee participated in training workshop on IFRS, NFRS and GAAP. Some may need to be contracted externally, or even through foreign assignments and secondment to tax agencies in other countries.

4. ANTI-CORRUPTION

A. ANTI-CORRUPTION ACTIVITIES AND POLICIES

4.1 The MOF and the TC are to be commended for their frank and open approach to the question of corruption and its recognition that corrupt practices by some of its employees are constraining its ability to improve efficiency in many of its functions. The TC is also suffering in incalculable ways by virtue of the loss of its credibility due to the perception that taxpayers have of its operations and motivations. Necessary as many of its enforcement operations and procedures are, they are too often perceived by a skeptical public as being part of a corrupt scheme designed to enrich the personnel who are administering them. Innocent mistakes are suspected as being part of an extortive scheme, and practices common to most tax services become the reason for skepticism. Low public opinion of a tax administration's honesty and service contribute to lower voluntary compliance and limit taxpayer cooperation.

4.2 In the end, public perception of corrupt practices in any tax administration impedes efficiency and adds to the cost of all operations. In addition, it makes it harder in Kazakhstan for the TC to recruit the best talent to its ranks, and to retain them. Low credibility of the organization lead to low organizational morale. All of these circumstances create a vicious cycle of distrust in which low expectations become the norm for the agency. The top leadership of the TC is striving to break this cycle.

4.3 It is unrealistic to believe that corruption can be eliminated totally. The aim should be to make bribery and other corrupt practices the rare exception. To achieve this goal, a comprehensive set of reforms must be undertaken. These reforms encompass many of the recommendations included elsewhere in the report because improvements in efficiency generally will reduce avenues for corruption and increase pride in the organization. This is a necessary step before more specific measures can be taken.

4.4 Corruption must be shown to be dangerous and unprofitable for the employees and managers, as well as for the taxpayers who resort to it. Anti-corruption reforms must contain a strong enforcement and prevention component. It is not enough to just make compensation and benefits better. Cases against employees involved in bribery must be vigorously pursued, and result not merely in dismissal or other disciplinary action but in criminal prosecution and incarceration when justified⁶. When employees are prosecuted and convicted, the workforce will know that management is serious about eliminating corruption in the ranks.

4.5 It is important to emphasize, however, that combating corruption requires a comprehensive approach. In that respect, most recommendations made in this Report form part of the solution to the problem. The improvements recommended in personnel practices and in compensation, for example, are essential ingredients, as is the administrative streamlining and automation advances advocated. Enforcement and disciplinary measures alone will not serve to mitigate the problem. It must also be

⁶ The number of corruption cases in the Tax Committee appears low by international standards, which suggests the Committee may have a significant problem in detecting cases.

underscored that in the end reducing corruption is the task of all employees; hence, all personnel must be trained to understand this and play their part in the total effort.

4.6 According to the Financial Police that there were 46 corruption related cases in 2004 concerning tax officials, 22 of them relating to bribery, 11 to abuse of authority, and 13 to other articles of the Criminal Code. In 2005, total cases declined to 27 (16 for bribery). These data do not adequately portray the problem of assigning responsibility for corruption investigation cases in the TC. Further, no mention is made of cases that move from prosecution to criminal conviction. The TC has a clear interest in pursuing the investigation of these cases through to prosecution to the fullest extent possible, were it given such responsibility.

4.7 A substantial level of corruption does exist in TC operations. There is a variety of means through which this can be inferred and subject to measurement indirectly. Anecdotal evidence supplied by taxpayers and the types of complaints regarding the service they encounter when in contact with tax officials is valuable. In addition, the extent of corruption can be gauged from various indicators. These include the number and frequency of inspections and visits and the variety of documented justifications on which visits are based. The frequency that audit deficiencies are appealed and the success rate these appeals enjoy in terms of reduced deficiency assessments are also indicators. Management should be cognizant of these corruption indicators, periodically measure them, and isolate them to the specific units and individuals involved. An analysis of detected cases could also reveal the degree to which collusion had to be present, and the degree to which others did not act to prevent the scheme.

4.8 Systems characterized by excessive and unnecessary or repetitive submissions or other demands on taxpayers are fertile ground on which bribes are solicited to informally “streamline” the processes. That is the reason that streamlining and simplifying procedures also creates more openness and honesty and decreases avenues for corruption.

4.9 Most modern tax administrations have a comprehensive program or required to reducing corrupt practices, consist of several integrated components all of which must work in tandem for maximum success. These are discussed below.

An Anti-Corruption Division

4.10 At present, investigations of staff misconduct (not involving criminal activity) occur in a small unit in the Internal Affairs Division (primarily an HR Division), which investigates and pursues such matters and reports them to management. If the unit detects or suspects criminal implications, the matter is referred to the Financial Police. No other unit within the TC exists or is engaged in anti-corruption activity per se. Best international practice is to separate such investigation activity into an independent line of command reporting directly to the Chairman or one of his Deputies⁷. This function should not be part of the HR or personnel administration, since it is a function calling for investigative and law enforcement skills not germane to duties of a personnel specialist.

⁷ If shared with the Customs Committee, this unit could report to the MOF.

4.11 The Internal Control Unit should be organized and staffed to perform internal audits of operations of tax officials. It should be vested with authority and resources to conduct spot checks and internal auditing of all offices based on its own plans, and should also have a separate line of reporting to the Chairman. (See also Chapter 2.) This auditing would be aimed at assessing risks to the revenue, verifying controls, formulating recommendations for improvement, and monitoring to ensure compliance with all applicable laws and regulations. It would operate similarly to the internal auditors of any large private corporation and would possess a broad commission to inquire into all activities independent of approval of intermediately higher levels of management.

4.12 There is currently no unit responsible for the prevention of corruption. This function requires training and development of methodologies. Among other things, this unit would also have primary responsibility for preparation of a Code of Conduct and Ethics for TC personnel, training employees in its contents, answering employee inquiries, and provide opinion on the application of the Code to specific situations.

4.13 It is common in many countries to combine responsibilities for internal audit, internal investigations, and prevention of corruption in one organization, reporting directly to the Chairman or one of his Deputies. All investigations leading to criminal prosecutions also would be vested in such an organization. It would require further organizational study to determine how and whether this function could be transferred from the Financial Police. The government should carefully examine this area.

4.14 Another critical consideration should be to include in this proposed organization the responsibility for protection of staff against harm or threats. Many tax and enforcement agencies do this to ensure that employees would perceive the organization to be dedicated not only to removing corruption but to providing protection to staff against baseless charges and threats in the performance of their legal tasks.

4.15 It is common for such an organization to have direct control of its own field offices in the major oblasts and cities for maximum responsiveness and convenience to employees, and to minimize interference by, or dependence on, field management. The organization would have branches for internal audit and internal investigation at each such level to facilitate control. Obviously for effectiveness, investigators assigned to this organization should be vested with law enforcement and investigative powers as those enjoyed by other police agencies. The training of such personnel would include police and investigative subjects as well as auditing, accounting, and tax enforcement subjects.

Annual Programs for Internal Audit and Review of Cases

4.16 Both internal audit and internal investigation should each operate proactively by establishing strategic and annual plans, as well as monitoring to ensure compliance. These plans could be based on feedback and experience gathered from past audits or investigations, and document intentions as to the offices, programs and activities to be examined in the forthcoming period as well as identify resources to be applied.

4.17 Essential to the success of such programs is a systematic plan and program for review of cases. While it is usual to sample and review closed transactions and files, sometimes review of open cases is required to ascertain the true condition of internal

controls and weaknesses. The purpose of review activities is to discover fraud, abuse, illegality or error, and to establish a basis for assessing revenue risks on which future plans and programs can be based to tighten controls. Case reviews can indicate defects in the Tax code, inconsistent treatment of taxpayers, inefficient practices, poor productivity, waste, corruption, and can serve to indicate training needs.

4.18 Review of cases is not, and should not only be an internal audit or investigative tool, but be undertaken by all functions of the TC to improve honesty and work quality. It should be the responsibility of all managers to periodically check the quality of the work of their subordinates or subordinate units. This is currently not a systematic activity within the TC.

Control and Supervision

4.19 The controls which heads of HQ divisions have over their organizations and activities are impressive. Corruption however is endemic, and management control and supervision in the field must be tightened. Corruption is only possible where it is tolerated as a cost of doing business and a means of supplementing poor salaries. If management presents a solid front against such abuse and punishes transgressors, the scope for corruption will be substantially reduced.

4.20 How well this is accomplished by managers should be the subject of the performance appraisal system that provides incentives for exemplary results. Managers generally know all the pressure points in an organization and should be the strongest line of defense against undue influence, by being on top of their employees' workloads and being involved in case management.

Audit Trails

4.21 All systems should be designed with audit in mind. Each system, whether automated or manual, should have available a historic record of who performed/authorized each transaction, when, how, and why. All documents should clearly show who is vested with custodial responsibility. These are basic elements for preserving system integrity and fixing responsibility for abuse and error. This is not the prevailing practice but it should be monitored, especially as the TC advances its automation. Without such controls, corruption can flourish. While the tax processing is centralized, it appears that field offices can effect changes to certain records and transactions directly. This can be a troublesome area. It is common to conduct risk assessments on all such systems during and after system design and installation.

Organizational Relationships

4.22 All systems and processes should contain controls so as to compartmentalize each unit or person and vest only those powers needed to effectuate transactions relevant to the person/unit's assigned duties. No person should have authority to alter accounts or make final decisions without appropriate approval or endorsement from other affected units, or without being subject to close or automatic review. Discussions with staff indicate that this is not true in all cases, especially in enforcement or inspection, where the inspector is alone with the taxpayer.

4.23 In addition, a standard requirement should be rotation of inspectors after a fixed period of time to prevent collusive relationships and ensure objectivity. This is not common practice in Kazakhstan. Rather, the rule appears to be that an inspector, being knowledgeable about the taxpayer's business or industry, can retain this taxpayer in his assigned caseload indefinitely.

Training and Education

4.24 Except for entry-level training on government-wide ethics laws and rules, applicable to all government employees, there is no Code of Conduct and Ethics to which TC staff is bound, and there is no regular training on ethical matters. Many modern tax administrations conduct ethics training routinely on entry, with regular refresher courses thereafter. Such training should be conducted by Internal Audit/Investigation personnel to permit them to become familiar with the employees and vice versa. Typically such training should include live examples extracted from actual recent corruption cases.

Incentives

4.25 There are no specific incentives to reward employees for good conduct, e.g., for revealing instances of corruption, or for other cooperation in anti-corruption matters. There is no appraisal system to form the basis for an incentives program; thus, cooperation in anti-corruption initiatives or cases and the employee's integrity level generally are not normally a part of the criteria used to assess individual performance. Cash incentives and other rewards should be available for those who expose corrupt employees. Honest employees take risks to avoid corruption, and those who actively oppose corrupt practices should be rewarded for their efforts.

Resources

4.26 Many anti-corruption initiatives fail because they are not given adequate resources and time to accomplish their aims. Management should not labor under a belief that the efforts to make a workforce more honest will be directly measurable over a brief period. The results of such efforts will eventually be shown in a myriad of other measurements, from higher assessments after audit, to increased penalties assessed, but none will be directly attributable to anti-corruption efforts themselves. There must be sufficient auditors and investigators in the field and at headquarters, and they must be provided with equipment and facilities appropriate to their work. The Government must adequately compensate its revenue employees. Present compensation levels are extremely low in relation to comparable professional positions in the private sector.

Transparency

4.27 When the tax procedures are transparent, the taxpayers can understand which procedures depart from the norm, making corruption more visible, and less likely. A necessary ingredient in the anti-corruption mix therefore is to publish all procedures and make them widely available on TC's websites. The public should also be advised to report cases where certain deviation from procedures is evident. .

Obtaining Public Input and Cooperation

4.28 There should be a concerted program to encourage the public to come forward, to protect the confidentiality of information supplied, and the source. Without cooperation by taxpayers, an effective anti-corruption program cannot be sufficiently implemented. Taxpayers can be useful in another way as well. The taxpayer attitudes toward TC efficiency and honesty can be measured through satisfaction surveys and polling. As shown in Ukraine and other countries, the extent and prevalence of corruption can be estimated on the basis of taxpayer answers to questions about their experiences with the TC. Periodic surveys will assist in measuring progress (or lack thereof) from the baseline determined in the initial survey. The survey data for Kazakhstan, Ukraine, Russia, and the EU8 provides some comparative statistics and indeed shows corruption rising from 2000 to 2005 in Russia and Kazakhstan, and declining in the EU8 and Ukraine. (See the table in the next chapter).

4.29 The TC does not now have a formal hot line whereby taxpayers can call in their complaints or information about corrupt practices by employees. Unless there is a secure and confidential medium established for the public to communicate to appropriate offices of the TC, public cooperation will be deterred.

Reducing Subjectivity

4.30 When discretionary actions of tax officials are removed as much as possible from decision-making, the opportunities for bribery are reduced. Within the TC various programs for triggering audit or enforcement actions should be automated. A prime example would be the decision to select taxpayers for audit or inspection. When automatic criteria are used for key decisions and the human element is reduced, corrupt employees will find it difficult to regard taxpayers as targets for rent-seeking behavior.

B. RECOMMENDATIONS

4.31 While making the following recommendations, it must be acknowledged that, by Order No. 689⁸ dated 26 September 2007, the Chairman of the Tax Committee has taken these recommendations into account and, specifically, elaborated the concept of arranging departmental control in tax authorities, including the establishment of departmental control units directly reporting to the Headquarters.

4.32 To measure the extent of the corruption problem, the TC should examine and analyze all performance measurements that would help identify probable patterns of corruption, and track these indicators down to specific units or groups of employees.

4.33 To establish examples, and to convince employees of the serious emphasis that management places on such matters, steps should be taken to ensure that employees found, after investigation, to have engaged in corrupt activity, are prosecuted beyond merely disciplinary measures, as criminals, and to the full extent of the law.

⁸ Order No. 689 dated 26 September 2007 on “*Some Issues of Anti-Corruption in Tax Authorities of the Republic of Kazakhstan*” approved the Anti-Corruption Strategy for Tax Authorities of the Republic of Kazakhstan and List of Corruption Areas in Tax Relations and Measures for Eliminating Corruption.

- 4.34 The TC should continue its efforts to streamline and simplify all procedures for taxpayers, and make them transparent to the taxpayers.
- 4.35 The Government should consider vesting jurisdiction of all investigations (civil and criminal) of personnel within the TC (or if shared with the Customs Committee, to the MOF directly). The current performance of the Financial Police may not justify continuance of its jurisdiction. Such an organization should have a presence in all oblasts and key rayon offices and report through a separate Deputy Chairman.
- 4.36 This organization would have the responsibility for internal investigations, internal auditing, and anti-corruption operations, including education and training of all personnel on anti-corruption matters.
- 4.37 This organization should also have primary responsibility for the protection of TC personnel against harm, threats, or coercion.
- 4.38 Investigators assigned to integrity cases should have the status of police and be accorded all necessary and usual police powers and equipments.
- 4.39 Both internal audit and internal investigation should establish strategic and annual plans and monitoring activities to ensure compliance.
- 4.40 There should be a regular review program for all functions of the TC to ensure better quality work product, and to serve in detecting possible instances of corruption. Accordingly, the Internal Audit function should use case reviews as a tool for ascertaining whether or not systems are operating in accordance with the law, regulations, and established procedures.
- 4.41 All procedures should be documented and operational manuals published to guide employees and to inform the public of how normal cases are administered.
- 4.42 IT systems and procedures should be designed with audit in mind, and should have available a historic record (audit trail) of who performed/authorized each transaction, when, how, and why.
- 4.43 All systems and processes should contain controls to compartmentalize each unit or person, and provide only those powers needed to conduct transactions relevant to the person/unit's assigned duties.
- 4.44 There should be a standard policy to rotate inspectors after a fixed time period to prevent collusive relationships and ensure objectivity.
- 4.45 A Code of Conduct and Ethics for tax officials should be promulgated. It should be specific to the demands and challenges that inspectors face in their daily work and should be more specific than the general Code of Ethics for other government employees.
- 4.46 Ethics training should be routinely on entry into service, with regular refresher course. Such training ideally should be conducted by Internal Audit/Investigation personnel to permit them to become familiar with the employees and vice versa.
- 4.47 The anti-corruption organization must be resourced sufficiently with investigators and auditors appropriate to perform their function at every level.

4.48 A full complement of anti-corruption incentives should be established. These should be administered under the performance appraisal system recommended in the previous chapter.

4.49 The public should be advised and encouraged to report cases where certain indicators involving employee behavior are evident. The “Hot Line” to report employee misconduct or abuse should be improved and widely advertised.

4.50 The TC should undertake taxpayer perception surveys to monitor the extent of corruption or the public’s perception of it.

4.51 To the maximum extent possible, enforcement activities and processes should remove opportunity for subjective judgments concerning taxpayers. A prime example is audit selection, which should be automated to the extent possible.

5. TAXPAYER SERVICE AND EDUCATION

A. ANALYSIS OF TAXPAYER SERVICE IN THE TAX COMMITTEE

5.1 Taxpayer service and taxpayer education are important components of any modern tax administration that strives to maximize voluntary compliance. The less the compliance costs, the simpler the procedures, the more likely it is for taxpayers to comply voluntarily. Modern tax agencies inculcate a service-oriented approach rather than an enforcement approach to tax compliance, where taxpayers are treated as clients rather than subjects.

5.2 In Kazakhstan, taxpayer services are provided by the TC field offices and operating divisions, but there is no centralized division in the HQ dedicated to the Taxpayer Service and Education (TSE) functions. Each operating division or field unit educates and informs the public about that division's specific programs and policies. Although some of TSE functions need to be performed locally, there is need for a centralized approach in the design, guidance and monitoring of TSE. This allows for a uniform, consistent and comprehensive approach to improve the public understanding of taxpayer rights and responsibilities. This would also promote uniform quality of service provided from one geographic area to another. It also help focus on proper planning, specialized training, technological advancement, development of user requirements for automated methods for delivery of taxpayer service.

Specialized Taxpayer Service and Centralized Approach

5.3 A centralized division in the HQ would be able to monitor improvement or decline in the public's perception of taxpayer service or TC efficiency by conducting periodic taxpayer satisfaction surveys. Proper human and financial resources could be allocated for this task.

5.4 An organizational study would need to be undertaken to identify where existing TSE functions are now being conducted and how and where they could be consolidated for greatest efficiency. Strategic and annual planning in this area can be undertaken exclusively for TSE functions.

5.5 Taxpayer service requires special training and skills. Currently, there is no specific task designated for TSE duties, and such duties are performed by audit or administrative personnel, in addition to routine functions. This diminishes staff effectiveness and increases workload resulting from more complaints, appeals, omissions, or mistakes committed by taxpayers, which in turn handicap the filing, payment, collections, and payments processes. In fact, the performance and productivity of all enforcement processes could be improved if there were an effective TSE organization and presence in the field which follows international trends in taxpayer services (Box 5.1)

Box 5.1 International Trends in Taxpayer Services

- Treating taxpayers as clients with rights that are codified and published in a charter of rights.
- Balance of resources between enforcement and service is critical in achieving higher overall tax compliance.
- Tailored approach of service delivery to match the needs of various taxpayer segments and their risk to revenue.
- Trained and qualified service staff to respond to the queries of taxpayers and their accountants and advisors.
- Centralized client call centers and to ensure delivery of consistent, high quality service that enables specialization.
- Availability of e-services (e.g. interactive telephones, e-filing, online taxpayer accounts and web-pages).
- Provision of dedicated inquiry services for tax professionals.
- Taxpayer services typically consume about 10 percent of a tax agency's human resources.
- Regular consultation with associations of taxpayers and tax professionals to obtain useful feedback on the problems faced by, and issues that concern, compliant taxpayers.
- Monitoring service delivery performance according to prescribed performance standards; measuring client satisfaction; and demonstrating accountability by publicizing the levels of performance achieved against service standards set.

5.6 The Government should also consider the function that an Ombudsman who could intercede in cases of undue hardship or injustice, obvious administrative error, non-conformity to the law, regulations, decrees, policies, or tax procedures. Such an entity would only minimally interfere with regular operations but could greatly increase transparency and accessibility for aggrieved taxpayers. Unlike the Anti-corruption Unit, the Ombudsman focus not on misconduct of officials but on cases where the systems are failing to service taxpayer needs adequately, either generally or in specific cases.

Training

5.7 Only scant training and internal instructions or manuals exist for the guidance of personnel in TSE duties. A comprehensive set of manuals to guide TSE officers in the conduct of the duties involved in TSE is needed in areas such as call center operations and management, managing mass taxpayer education programs, preparation of forms, publications, and instructions, managing the TC website professionally, handling inquiries received by mail, email, and telephone. Specialized training is essential for designing educational materials for general taxpayers or specific targeted groups like small or new businesses.

Website and Call Center

5.8 The TC has established and maintains a website that provides valuable information for taxpayers, the business community, and tax practitioners. Links and automated procedures for obtaining information are available, but could be improved. Inquiries through these systems, as well as those received by mail or phone, are only partially tracked. Answers or responses made to these inquiries are not systematically tracked, and the quality of responses is not assessed. Evaluation of the responses would provide management with information about the training needs of personnel as well as identify procedural improvements that might be needed.

5.9 While dedicated lines are available for taxpayer inquiries, what is needed in Kazakhstan is a toll free telephone call center, as is available in most modern tax administrations. Such a facility services callers countrywide and provides taxpayers with a simple, uniform, consistent, professional and cost-free avenue for answering their questions, ordering forms and publications, ascertaining the status of their accounts, and referral to other offices for complex issues or information on cases in progress. It also reduces unnecessary contact between the tax officials and the taxpayers, thus reducing compliance costs, as well as avenues for corruption.

5.10 The call center should also be linked to, or closely associated with, the internet operation and the mail center, so as to consolidate the handling of taxpayer inquiries and maximize efficiency and economy. A call center also would allow resources in the various offices now receiving calls to be directed to other activities, with savings in staff resources and reduction of lost revenue opportunities.

Taxpayer Satisfaction Surveys

5.11 The TC does not undertake directly, or by outsourcing, any surveys to ascertain how the public perceives its performance and to measure satisfaction or dissatisfaction in each area of operation. Such surveys measure public perceptions and provide TC with useful insights on how to address perceived weaknesses.

5.12 They also help identify corruption and training gaps both in general, in the organization, or geographically. They can be a source of fruitful suggestions for change or improvement in laws and procedures, and provide indicators for further measurement of performance. Such surveys, once conducted, provide a baseline from which to measure progress (or lack thereof) through follow-up surveys.

5.13 A sample of results obtained from such surveys for Kazakhstan and other countries, undertaken by the World Bank and EBRD's Business Environment Enterprise Performance Survey (BEEPS) are given in Table 5.1 below. Comparison of survey results when compared with other similarly situated countries can be of invaluable use to management, as shown by analysis of this table.

Table 5.1: Summary of Tax Administration Issues in BEEPS

2005 BEEPS-At-A-Glance-Statistics	Kazakhstan	Russia	Ukraine	EU8
1. Tax rates (Percent of firms indicating tax rates as a problem doing business)				
2002	0.47	0.56	0.65	0.65
2005	0.42	0.54	0.73	0.64
2. Tax administration (Percent of firms indicating tax administration as a problem doing business)				
2002	0.49	0.62	0.60	0.50
2005	0.42	0.60	0.44	0.51
3. Annual Sales Reported for Tax Purposes (Percentage of total annual sales reported for tax purposes)				
2002	82.72	81.96	85.44	88.39
2005	93.51	84.45	89.34	90.66
4. Unofficial Payments for Tax Collection (Percent of firms that stated that bribery is frequent for tax collection purposes)				
2002	0.16	0.18	0.21	0.06
2005	0.18	0.20	0.14	0.05
5. Tax inspectorate (# of inspection in the last 12 months)				
2005	3.43	1.96	4.54	1.31
6. Tax inspectorate (average duration of inspections/meetings? (hours/visit)				
2005	6.08	8.30	5.47	5.23

Source: BEEPS.

Note: EU8 members – the eight most recent members of the European Union

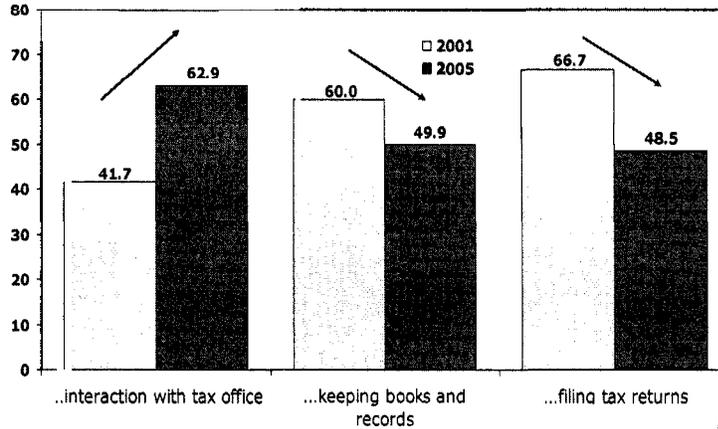
5.14 Surveys can also be conducted for determining the compliance cost, i.e., the costs borne by taxpayers and businesses in complying with tax reporting and other tax related responsibilities. This provides a rational base on which to assess the reasonableness of tax procedures, audit frequencies and duration, and other processes. Statistics on this are lacking for Kazakhstan. Below is an example of such a survey conducted by the tax administration in Ukraine (Figure 5.1).

Figure 5.1: Example of Taxpayer Survey: Compliance Costs in Ukraine

Tax Compliance Costs Indicator's Components
% negative responses

Lack of burden in incurring costs associated with...

8

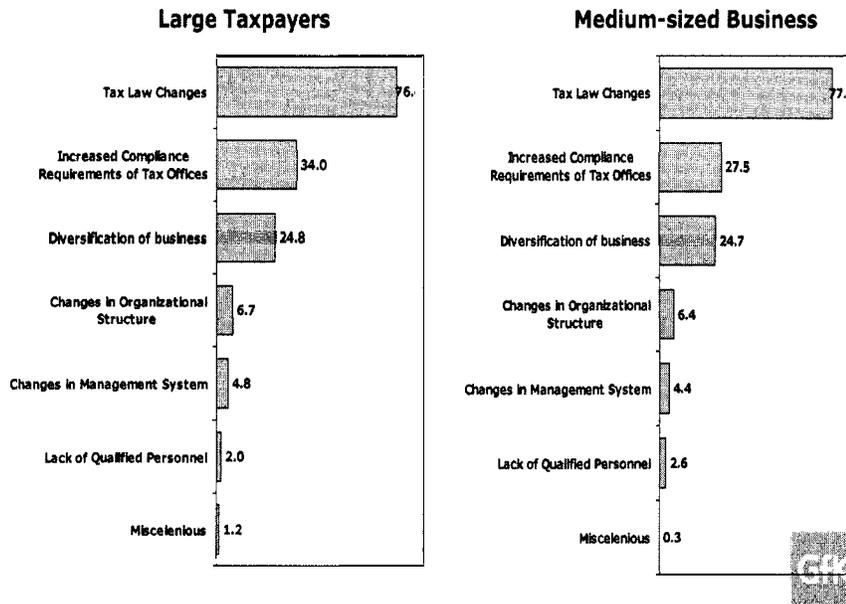


Question: Do you believe that keeping books and records, filing returns, and interacting with tax office presents a financial burden?

Reasons for the Increase in Tax Compliance Costs (1)

% of all respondents within a category of taxpayers

10



Source: Public survey results conducted by GfK Ukraine for the Ukraine State Tax Administration, April 3, 2006.

Taxpayers' Rights

5.15 While Article 11 and other provisions of the Tax Code do list generally taxpayer rights, there is no comprehensive list of such rights available to taxpayers, nor are they always informed of how they can avail themselves of these rights. Systematic efforts to inform taxpayers of these rights at each stage of the process or procedure in which they are engaged can be improved. For example, at the conclusion of an audit, a brochure could be issued to the taxpayers describing in detail his/her appeal rights and procedures. Another pamphlet could outline for taxpayers the enforced collection process and penalties applicable for nonpayment.

B. RECOMMENDATIONS

5.16 Taxpayer service should be recognized as a separate and specialized function of the TC, and should not be conducted as part of other regular functions.

5.17 A TSE Division should be created in the HQ of the TC. It should be responsible for the production and dissemination of all TSE plans, programs, policies, manuals, and procedures in all field offices. To the extent possible, all existing TSE activities at HQ, such as the preparation of forms and publications, should be centralized and consolidated into the new Division.

5.18 As centralized operations are created, their operation should fall under a unit of the Division. At each oblast or rayon, TSE units dedicated to this function should be created. The TSE Division should monitor and inspect the oblasts level TSE units to ensure consistency and compliance with the HQ policies.

5.19 A new professional category for specialized TSE activities should be created. As personnel are recruited or transferred to these positions, they should be trained, not only in relevant laws and procedures, but also in the interpersonal and other communication skills required to successfully interact with taxpayers and the public.

5.20 TSE should be an element of the TC's Strategic Planning. The TSE Division should develop its own annual plans containing quantitative and qualitative performance indicators. Since this is a relatively new area for the TC, external guidance could be sought on the array of international experience in this area.

5.21 Manuals and other instructions to staff on the methods and procedures for TSE should be published. This will advance consistency of taxpayer treatment and lead to better administration of the function.

5.22 A staffing study should be undertaken to determine the appropriate level of human resources to be accorded to this function at all levels. In the smallest offices TSE may only require a part time position or a person detailed or seconded to the function; in larger offices, it might require an entire unit.

5.23 The Government should invest in a fully computerized call center, with appropriate tracking systems, should be established to maximize resources, capitalize on

available expertise and training, and obtain the highest quality service and consistency in response to taxpayer inquiries.

5.24 Taxpayer Satisfaction Surveys should be undertaken to measure taxpayer perceptions of the TC's performance and integrity in key areas. The first of these should serve to establish baselines from which future improvement may be measured.

5.25 Surveys should also be conducted periodically to ascertain the costs borne by taxpayers of all types and classes in satisfying tax responsibilities under the Code. As part of this effort, taxpayers should be encouraged to identify to the TC tools and methods to obtain better service, especially ways to work toward a less paper-intensive environment, less reporting, and better and more automatic exchange of information.

5.26 An Ombudsman and supporting infrastructure should be established for the resolution of taxpayer grievances not involving employee misconduct.

5.27 More detailed guidance to taxpayers needs to be prepared and disseminated about their rights and responsibilities at each step of the tax processes.

6. LARGE TAXPAYERS

A. STATUS OF LARGE TAXPAYER UNIT

6.1 Many tax administrations now give special consideration to administering different types of taxpayers taking account of their particular characteristics. This is sometimes referred to as taxpayer segmentation. Large taxpayers are typically distinct legal entities. They are few in number but important from the revenue collected from them. They usually have many employees, high turnover; and are often involved in complex international transactions, perhaps through subsidiaries or related companies. Often, they wield influence within the market and government. They seek professional accounting and legal assistance to interpret the law to their advantage. This is why, many countries have established large taxpayer units to address the issues of this segment of taxpayers.

6.2 Kazakhstan instituted the special treatment to Large Taxpayers (LTs) in 1999, and has shown relative improvement in this area. LTs account for more than 60 percent of the tax revenue of Kazakhstan. There are two tiers of such taxpayers: those subject to supervision at the HQ (at present 276 entities); and a set of smaller LTs supervised at the regional level, consisting of 310 entities. LTs are defined and selected for inclusion in these categories on the basis of economic indicators, including sales, turnover, and tax paid to the oblast. They include the largest corporate entities in the country, including foreign-based companies, many of whom are engaged in extractive or subsoil-use industries. The criteria for selection of LTs are not clearly defined in the Code.

6.3 The IMF paper, "Occasional Paper No. 215, "Improving Large Taxpayer Compliance, A Review of Country Experience", 2002 (pp. 37-39), sets forth the lessons learned in administering large taxpayer units (LTUs) in revenue agencies in transition countries. The diagnostic analysis, in part, relies on this advice, in gauging the effectiveness of TC's large taxpayer operations.

Criteria for Selection and Treatment of Large Taxpayers

6.4 The criteria for inclusion in the LT classification at the regional and national levels are unclear, and result in a much larger number of LTs than can be reasonably audited and serviced. Criteria for inclusion in the LT category, as with most policies, should be transparent, manageable, and realistic.

6.5 The thresholds that define entry into these categories are determined internally by the HQ and vary for different types of activity. According to article 545 of the Tax Code, the LTs monitoring list at the central level is defined by the Government Resolution (prepared by the HQ), and the LTs monitoring list at the regional level is defined by the authorized state body (approved by the order of the TC Chairman. Both lists (and their updates) are published and can be accessed through the electronic database.

6.6 National level LTs are subject to the jurisdiction and supervision of the Large Taxpayer Monitoring Division (LTMD) in the HQ, whereas the regional level LTs are controlled at the oblast within which their corporate headquarters or principal operations

are to be found. No clear published criteria exists as to which oblast has jurisdiction for those regional LTs with operations in multiple oblasts, although this does not seem to be a problem to the TC. Best practice internationally is that such entities are usually controlled by the region where the corporation maintains its headquarters or its corporate records for all or most controlled subsidiaries.

6.7 While the Code provides specific detail on the handling of various special entities (e.g., those under special tax regimes, or those in Special Economic Zones), there is no reference to these entities or how they are defined or selected, nor is there any recognition in the procedural/administrative portions of the Code of the special handling these entities require to be supervised properly. For example, serious problems arise because the duration and frequency of inspections of such entities is governed by the detailed time limits set forth in articles 533-535, and the procedures for conducting tax audits in articles 536-541. Both sets of provisions governing the audit of all entities are often not relevant to the needs concerning control of these entities.

Frequency and Duration of Audit of Large Taxpayers

6.8 Both the frequency and duration of audits of LTs are inadequate or irrelevant to the nature of the taxpayers and their records or operations. The provisions of the Code as regards such audits are unduly restrictive for LTs, and force the TC to undertake audits in impossibly short time frames. The duration of audit of LTs should not be subject to the same limits appropriate for smaller entities. In the case of the LTs, a continuous presence at the headquarters of such entities may sometimes be necessary, provided the inspection does not assume the character of harassment, and is conducted in a way to complement ongoing corporate recordkeeping and accounting operations. (The Internal Revenue Manual of the U.S. IRS contains useful guidance on this aspect of operations).

6.9 The numbers and types of audits make it possible for an entity to be repeatedly visited separately and in an uncoordinated fashion. In fact VAT audits of different offices of the same company are frequently uncoordinated, as these are conducted by different regional offices and at different times. Complaints by the private sector by or on behalf of all types of taxpayers, including LTs, bear witness to the harassment these visits entail. "Integrated audit" for all taxes, if properly planned and conducted, is the most efficient and effective method of dealing with LT cases.

6.10 Some coordination of audits is being attempted among regions and the central office so as to provide for a fully integrated approach for all taxes, and to minimize visits to the LT, but this area needs to be improved.

6.11 Audits of LTs should be conducted contemporaneous with audits of the corporation's principals (corporate or individual). These "coordinated examinations," are not now the usual practice in Kazakhstan. By conducting coordinated audits, abuse of company assets, diversion to personal use, and omitted income of the principals can be detected. Also, excessive or improper deductions by the corporation can be revealed. In most OECD nations such a procedure is normal.

Audit Selection of Large Taxpayers

6.12 No realistic and risk-based audit selection criteria are employed, and all LTs are subjected to a comprehensive audit annually. This constitutes a waste of scarce resources and is very costly in terms of absence of probing enquiries in high risk cases. Selection should eventually be based on the greatest degree of risk to the revenues among LTs.

6.13 If adequate audit selection criteria and methodology were employed, many audits of LTs might be avoided altogether, or their frequency reduced to once every two or three years to focus resources on the most risky targets. It is also possible that some audits could be focused on several key issues or areas. Better audit selection criteria permit better planning, preparation, and conduct of each audit. The present instructions are to comprehensively audit all LTs, at least annually. Since the current resources cannot meet this target, the auditing is cursory, and not professional.

Audit Planning and Database of Large Taxpayers Cases

6.14 Annual planning for LTs focus on revenue targets, but does not specify the number and types of entities to be audited, the productivity and quality criteria, nor the risk group to be targeted - geographic, industrial, and otherwise. There is inadequate strategic audit planning. National and regional audit plans should be in place to govern the entire LT operation, based on national and regional strategic plans. While management regularly monitors LT revenue performance, comparison of other accomplishments are not adequately conducted, and therefore operations are not truly measured against a determined sets of criteria.

6.15 No permanent published set of instructions or LT Audit Manual exists to guide the LT MD in the conduct of audits except for a set of irregular and un-indexed circulars. Little effort is devoted to institutionalizing case experience and industrial or business practices for the guidance and training of inspection personnel for the future. Consequently valuable case experience is lost, as there is no structured institutional memory outside of the case files.

Staffing of Large Taxpayers Units

6.16 The staffing for audit of LTs is weak, consisting of a small group of 14 inspectors at the LTMD. In addition to normal audit work, these officials are often diverted to other duties for preparation of policies and procedures on LT, and inspection of regional level LTs. Another 40 inspectors from the Inter-Regional Committee for Subsoil Users conduct oblast-level audit. In addition, the HQ can refer work to, or otherwise tap the resources of, inspectors from oblasts. Overall, only 54 inspectors serve LTs of the approximately 3,000 inspectors nationwide. Since the LTMD often employs audit team of about 10 inspectors, the Division is clearly understaffed, and cannot conduct many probing audits.

6.17 The composition of the audit teams depends on a number of factors, including geographic location, type of business/industry; and specialist skills required. Critical specialties such as engineers, petroleum analysts, valuers, appraisers, transfer pricing specialists, and other experts are borrowed from other ministries of the government. Their availability is often problematic, since they already have full time jobs. This means

that audit team composition frequently lacks the expertise and skills necessary to cover important areas of the LT operations, resulting in audit deficiencies. Teams do not contain private experts from outside the government.

6.18 Most importantly, the TC lacks personnel skilled in computer-based audit of LTs. Since many LTs maintain accounts and records in electronic form, the process of audit, including matching and sampling documents, and their analysis, cannot be accomplished without such expertise. To audit such entities without computerized procedures, software, and protocols is difficult in today's world. This lack of capability is critical.

6.19 The government must provide the LT operation with enough resources (staffing, physical infrastructure, etc.). We believe that significant amounts of funds are being lost to the revenue because of this shortfall. Staffing in the areas of analysis and planning at the Central Office of the LTMD also needs to be increased so that the Central Office can better plan, coordinate and inspect LT field activities.

6.20 Not only is inspection staff inadequate in numbers but the required technical specialties are weak. Engineers must be part of the TC staffing, as should other specialties, for evaluating and analyzing particular types of industrial operations. Obtaining such specialties from other ministries does not seem to be a convenient arrangement. The TC lacks dedicated specialty staffing, and little effort is made to secure such resources from the private sector through outside contracting.

B. RECOMMENDATIONS

6.21 Clarify the criteria for inclusion of entities in both the regional and national LT categories. Make these criteria transparent and adjust the same realistically to existing staffing resources.

6.22 Staffing, training and other infrastructure resources must be dedicated to LT operations. The practice of utilizing industrial or economic experts from other ministries should be minimized, and efforts must be made to hire critical specialist skills within the TC, and to contract private sector experts to supplement their resources.

6.23 The analysis and planning staffs of the LTMD need to be expanded.

6.24 Computer-based audit specialists must be recruited, trained and employed in the audit teams. Here too the TC should consider securing experts by contract as opposed to hiring. Foreign training may be needed or preparing such personnel for their duties. The TC is considering the possibility for conducting short-time workshops to provide theoretical and practical foundation on most frequently used accounting software applied by large taxpayers.

6.25 As to frequency and duration of LT inspections, the Tax Code should be amended to permit the flexibility needed for a proper inspection regime, and to improve the quality of audits. The current frequency and duration of audits are unduly restrictive for large taxpayers with turnovers running into billions KZT, and forces the Tax Committee to undertake audits in impossibly short time frames.

6.26 LT audit should increasingly be selected based on risk criteria, so as to focus resources on the most risky targets.

6.27 A comprehensive LT Audit Manual for the guidance of inspectors should be prepared and published.

6.28 Historical audit experience should be retained, indexed, and published for the guidance of staff on the conduct of future audits, and to provide them with background on the business/industrial practices in order to conduct effective examinations. Examples for guidance in this area would be the U.S. Internal Revenue Service's "Market Selection Segmentation Program" (MSSP), and Argentina's or Chile's "Economic Sector Manual.

6.29 The "coordinated audit" concept should be employed when auditing LTs. Audit of all corporate principals (legal and physical) should be contemporaneous and coordinated with the audit of the main company. The Tax Committee supports this approach and has requested for technical assistance to prepare manuals and guidelines for this similar to those in OECD countries.

6.30 All "integrated audits" should be fully comprehensive and examine all taxes in one visit to the extent possible.

6.31 Better coordination among regions and the Central Office must be instituted to avoid duplicative or repetitive audits of the same LT and to maximize resources.

7. AUDIT/INSPECTION

A. CURRENT SET UP, PROCEDURES AND RESULTS OF AUDIT/INSPECTION

7.1 An effective audit system is a crucial element of a well functioning tax administration and is critical to taxing hard-to-tax sectors effectively. The information gathered during audit should provide feedback into the intelligence network and the risk management database to facilitate audit selection. Tax administration must build expertise and also prepare guidelines for auditing special sectors of the economy. A necessary step is to have the staff trained in topics such as transfer pricing, thin capitalization, risk analysis and methods of auditing. Risk based selection of cases for audit is an effective way of managing available resources for best results.

7.2 The selection of taxpayers to be audited and selected for other types of control is based on the assessment of risk and the development of risk-based selection techniques. Modern tax administrations apply systems for risk-scoring taxpayers across major tax types in the targeting of high-risk compliance workload. Risk scoring systems use the characteristics of taxpayers to identify and assess their risk of noncompliance. This allows appropriate prioritization of audit and taxpayer service workload and allocates resources against the highest risks.

7.3 Risk management techniques must, as a practical matter, group taxpayers by a few major types of risks, picking visible characteristics as a proxy for underlying compliance behavior. Size is typically a starting point for this process, although multiple criteria are commonly used. In modern tax administrations, compliance strategies for the largest taxpayers are further refined by industry sector to develop industry financial norms and staff expertise necessary to perform effective audits of complex multinational businesses. And specific targeting of groups within the small taxpayer population is also undertaken, particularly for categories of businesses that have been identified as posing compliance problems.

Organization of the Audit Unit in Kazakhstan

7.4 In Kazakhstan, the Tax Audit Unit of the Tax Administration Division (TC-TA) at the TC Headquarters not only establishes policies and procedures governing the performance of audits at all levels, but also audits cases. Mixing these two tasks, especially with the limited staff available in the unit, creates a diversion of resources from the priority tasks of designing procedures and plans and overseeing audit performance in the field.

7.5 TC-TA is also responsible for policy and procedures governing enforced collection throughout the country. As with audit, TC-TA also handles some collection enforcement cases as well (see the Chapter on Collection below).

7.6 The audit/inspection activity appears greatly understaffed and will require increased resources to meet its planned objectives of expanding control to other taxes, and to establish better methodologies and procedures. In most advanced tax organizations, roughly half the staff is engaged in audit, inspection and enforcement

activities. In Kazakhstan there are about 3,000 inspectors out of 11,000 total staff. This suggests an excess of staff working in routine, low-skilled, non-enforcement duties. A workload and organizational study is necessary to fully address this issue and to rationalize correctly the staffing complement for auditing, especially to ensure its proper allocation in offices across the country. Analysis of the number and distribution of offices at the rayon and oblast levels is also necessary, as the number of rayon level offices, each with its own inspector complement, appears excessive.

Cameral/Desk Audit System

7.7 The Division is making steady progress toward implementing a comprehensive cameral control system which electronically monitors VAT filings and identifies cases for further screening or inspection based on returns deemed most worthy of inspection. The internal control system now in place, and scheduled for expansion, also matches other relevant documents, filings, invoices, and returns, and has led to some dramatic improvements in focusing resources and attention on those firms whose transactions and operations are deemed most questionable. The Division has gradually expanded the system to CIT and PIT returns. The characteristic features of cameral control are highly automated procedures used with regularity and continuity. With the objectives to:

- Enhance the effectiveness of tax control using improved technologies
- Reduce costs and man-hours of tax authorities for undertaking control functions
- Enhance the effectiveness and productivity of tax inspectors through use of quality selection of cases for audit

Box 7.1. Functions Performed by the Automated Cameral Control System for VAT

1. Format and logical control of VAT tax reporting forms (300.00, 310.00 and 307.00)
2. Control of registration data (TIN, VAT registration certificate)
3. Control over correctness of the invoice issuance data
4. Control over correctness of offsetting of VAT credit amounts
5. Control over “self-invoicing”
6. Control over correctness of TIN supplier, whose VAT has been credited
7. Control over conformity of sales turnover in the supplier’s declaration (300.00) and invoices register (307.00)
8. Control over correctness of estimation of a tax period
9. Compulsory registration of VAT payer
10. Control over submission of tax declaration within the statutory timeframe
11. Identification of taxpayers that do not submit tax declarations but issue invoices.

7.8 Once a violation is detected, the tax authorities send an advice note to the taxpayer to correct the error. If there are administrative violations, proceedings are initiated. These also trigger the case as potentially high risk and is included in the plan of

tax audit or inspection, or handed over to the financial police depending on the nature and severity of the violation.

Box 7.2 Results of Cameral Control

- As a result of cameral control taxpayers declared additional VAT sales of KZT 6,175 million
- During 2003-05, TC conducted 7,404 inspections initiated as a result of cameral control. An additional KZT 20.1 billion of taxes and penalties were charged.
- Cameral control detected 1,810 cases where taxpayers filled out invoices but did not submit tax reports. These cases of tax fraud were handed over to the financial police.

7.9 As presently operated, the cameral control system utilizes electronic mass processing operations to identify misreporting and questionable activities, query taxpayers, assess additional deficiencies, and make additional collections by procedures. The results are good, and emphasize how much more efficient a system can be when electronic processing and analysis is coupled with procedures and criteria designed to select returns on the basis of risk assessment. Unfortunately, the same type of selection methodology is not applied to auditing in general.

Table 7.1 Results of Enforcement Action Information System in 2005

Category of Taxpayers	Number	VAT revenue (KZT million)	CIT revenue (KZT million)
Firms found to be fake enterprises	85	640.6	1,232.6
Taxpayers against whom criminal cases were initiated (or suspended due to the impossibility of identifying the offender)	41	844.8	1,692.6
Taxpayers found to be absent from their legal address, but issuing invoices	380	24,638.4	49,560.6
Taxpayers not submitting tax declarations but issuing invoices	3,086	5,108.9	10,217.7
Taxpayers found to be absent from their legal address, but issuing invoices and submitting tax declaration showing zero results.	146	1,100.9	2,062.5
Total	3,740	32,333.6	64,766.0

Audit Selection

7.10 The audit/inspection for CIT, PIT and VAT (other than those under the cameral control regime), selection for audit is subjective, and frequently taxpayers are selected for inspection without risk-based criteria such as:

- Potential for revenue;
- Items identified as questionable from examination of the return;
- Third-party provided information;
- Document mismatches;
- Previous conduct indicating patterns of underreporting or omissions;
- Issues identified as having potential for adjustments based on audit experience of specific industry or business;
- Local patterns of delinquency based on experiential analysis; and
- Other risk assessment indicators.

7.11 Discussions with taxpayers, and especially credible and authoritative sources among tax practitioners, point to several areas of weakness in audit procedures that preliminary analysis confirmed. These include: (a) inconsistency in conducting audits; (b) repetitive audits; (c) frequency and duration of inspections; (d) practices to harass taxpayers and induce corrupt payments; (e) misuse of penalties; and undue delay in closure of audit. Tax practitioners have also expressed concern about lack of adequate training, expertise, and professionalism of inspectors and management. There is also inadequate review of cases by management either before or after closure.

Audit Practices

7.12 As to the conduct of audits, there are abundant cases where all invoices or other documents are examined and the inspection is unduly prolonged because inspectors are not trained in sampling techniques designed to probe for deficiencies or omissions. Given the large number of firms to be examined (all entities are examined at least every three years, and larger entities more frequently), this is a serious shortcoming. In part, it can be attributed to lack of a comprehensive Audit Manual. In its place, there is a set of ad hoc notifications relating to specific issues. In part this may be attributable to poor pre-audit planning, which is also symptomatic of the absence of a comprehensive audit manual or lack of management attention to this issue. Managers should be actively supervising even the most experienced inspectors to ensure their audit work is planned in advance, and that appropriate research into the business/industry is conducted before the audit is undertaken. There are also many cases where closure of an audit is unduly delayed leading to uncertainty of results by audited taxpayers. Taxpayers are entitled to timely resolution and closure of audit cases, unless, of course, where fraud is detected.

7.13 The conduct of audits and their results indicate that there should be a reexamination of the quality of auditors, the initial qualifications and prerequisites for their recruitment, as well as the quality and quantity of training they receive. There does not seem to be the requirement that inspectors have a basic knowledge of accounting.

Rather, an Economics degree is considered sufficient qualification. In the U.S., for instance, at least 24 credit hours in accounting, or a law degree, are required to qualify as an auditor. In addition, new recruits require a year of formal and on-the-job-training before they are confirmed. In Chile, a degree in public accounting is required. Generally such requirements can only be instituted when there is a material improvement in compensation for inspectors.

7.14 A related problem is that inspectors lack an understanding of what are truly material transactions or documents, and tend to look at everything, especially in VAT audits. Examining everything suggests a possibility that truly important and relevant documents may not be identified. This is symptomatic of weak audit training.

7.15 Penalties seem to be applied punitively, relying for their justification on a literal authorization under the Code. Penalties should be regarded not as punitive but as exemplary and educative in purpose. Taxpayers complain and offer examples of cases where penalties as administered and applied by inspectors are frequently too harsh for the offence.

Audit Duration and Frequency

7.16 The frequency and duration of inspections present problems. The Code provisions permit extension of inspections in some instances and allow for too much curtailment of inspections in cases warranting a longer audit (e.g., in more complex large taxpayer cases). These are constraints further inhibiting the quality of audit, mandating for the wrong kinds of cases where more frequent inspections are necessary. This creates opportunities for corruption. The ideal inspection should be an “integrated inspection” that examines all taxes in one visit and thus, in most cases, will eliminate the need for further inspections during the tax period.

7.17 Repetitive audits are commonplace. Under Articles 533 et seq. of the Tax Code a variety of audits is permissible; however, in practice most of these inspections subject taxpayers to multiple visits for each tax type and at inconvenient times, contrary to the intent of the Code: Inspection include:

- Integrated audits;
- Scheduled inspections;
- Raid inspections;
- Subject inspections;
- Off schedule inspections;
- Counter inspections;
- Spot inspections.

7.18 Audits should be planned or timed to subject all related entities and taxpayer principals (e.g., subsidiary entities, joint ventures, corporate officers, partners etc.) to simultaneous examination. In this regard, provisions should be enacted requiring audited taxpayers to furnish information from affiliated foreign companies, where necessary, and where such information is not received, to reverse the burden of proof and make the audited taxpayer responsible for the consequences of the TC not receiving the information required. The relationship and transactions between related entities and/or principals frequently reveal deficiencies or questionable practices not discoverable during

the course of audits conducted individually. “Coordinated examinations” should be the rule, especially when examining large and medium taxpayers (see Large Taxpayer section). Many of these audits/inspections are conducted in local offices of the taxpayers at varying times, which makes the conduct of these inspections and their timing problematic for the taxpayers and their staff.

7.19 The aforesaid Article 533 of the Code should be clarified. Taxpayers complain that this complexity and the resultant confusion constitute harassment and perceive that there is a corrupt intent to this practice. The MOF ought to consider the advisability of allowing the Chairman the authority to prescribe regulations to simplify this process, but also to retain sufficient flexibility, where warranted, and to propose deletion of this provision from the Code.

Audit Performance and Quality

7.20 As in other divisions, TC-TA evaluates audit performance only based on revenue targets, without a comprehensive Annual Plan. Operations thus become ad hoc, reactive, or, if planned, are not in accordance with national-level guidance. This results in inconsistency and inequality of treatment of similar taxpayers.

7.21 On an average, 3.3 percent of audit/inspection cases are disputed by taxpayers in appeal. While the total number of appeals taken (Table 7.2) does not appear excessive (except in certain oblasts), this could be interpreted as either poor quality of probing investigation, or collusive deal between taxpayer and tax inspectors, or to the unlikely possibility of low incidence of tax fraud. The reduction in taxes as a result of appellate decision appears excessive (Table 7.3).

Table 7.2: Percentage of Appealed Inspections in Total - 2005

#	Tax authority	Number of performed tax inspections	Number of considered appeals	Percentage of appealed inspections
1.	Akmola Oblast TC	2,311	59	2.6%
2.	Aktobe Oblast TC	1,721	70	4.1%
3.	Almaty Oblast TC	2,205	39	1.8%
4.	Atyrau Oblast TC	954	73	7.7%
5.	East-Kazakhstan Oblast TC	3,200	225	7.0%
6.	Zhambyl Oblast TC	1,270	27	2.1%
7.	West-Kazakhstan Oblast TC	1,486	31	2.1%
8.	Karaganda Oblast TC	5,780	107	1.9%
9.	Kostanai Oblast TC	2,658	51	1.9%
10.	Kzylorda Oblast TC	1,298	11	0.8%
11.	Mangistau Oblast TC	1,764	24	1.4%
12.	Pavlodar Oblast TC	1,639	33	2.0%
13.	North-Kazakhstan Oblast TC	2,847	68	2.4%
14.	South-Kazakhstan Oblast TC	3,258	51	1.6%
15.	Almaty city TC	3,354	270	8.1%
16.	Astana city TC	1,291	48	3.7%
17.	FEZ Astana Zhanakala TC	107	9	8.4%
18.	RTC #1 TC M of RK	48	22	45.8%
	TOTAL	37,191	1,218	3.3%

7.22 Data in Table 7.3 could be indicative of the poor quality of inspections that do not stand the test of appeals. It shows that most of the audits that do not stand the test of appeals are those conducted by the HQ. This confirms the point that field functions of audit should not be done at the HQ level, which should be concerned with monitoring, supervising, and laying down the policies and procedures for audit, and the development of a comprehensive audit manual. The data on poor performance at the appellate stage also confirms the need to review the performance evaluation criteria. Typically, an inspector's performance should be judged by the quality of the audit, measured in terms of how much of the adjustments made during audit are sustained in appeal.

**Table 7.3: Reduction in Assessed Tax as a Result of Appellate Decisions - 2003-05
(million KZT)**

No.	Office	2003			2004			2005		
		Extra charged	Reduced	%	Extra charged	Reduced	%	Extra charged	Reduced	%
1	Akmola Oblast TC	26.4	10.8	41%	61.8	52.7	85%	58.4	5.9	10%
2	Aktobe Oblast TC	309.5	116.9	38%	221.1	24.2	11%	556.3	240.2	43%
3	Almaty Oblast TC	196.1	29.5	15%	44.4	26.8	60%	194.6	22.6	12%
4	Atyrau Oblast TC	18.8	6.9	37%	1.4	0.03	2%	10.4	2.5	24%
5	East-Kazakhstan Oblast TC	250.1	36.8	15%	453.9	74.2	16%	597.2	32.4	5%
6	Zhambyl Oblast TC	6.8	1.9	28%	7.7	0.8	10%	0.5	0.5	100%
7	West-Kazakhstan Oblast TC	16.5	4.8	29%	24.5	1.6	7%	26.7	3.2	12%
8	Karaganda Oblast TC	467.0	32.5	7%	176.4	57.5	33%	727.9	75.7	10%
9	Kostanai Oblast TC	98.7	17.3	18%	223.1	36.7	16%	19.1	5.3	28%
10	Kzylorda Oblast TC	11.6	10.0	86%	2.2	2.0	91%	10.9	3.7	34%
11	Mangistau Oblast TC	25.2	5.3	21%	0.1	0.03	60%	14.3	3.0	21%
12	Pavlodar Oblast TC	28.9	17.2	60%	357.7	45.6	13%	160.6	3.4	2%
13	North-Kazakhstan Oblast TC	87.5	42.1	48%	83.9	21.1	25%	92.9	40.1	43%
14	South-Kazakhstan Oblast TC	100.3	76.5	76%	156.3	8.4	5%	316.4	87.9	28%
15	Almaty city TC	3213.4	337.8	11%	2018.7	255.7	13%	2060.6	457.8	22%
16	Astana city TC	71.2	17.0	24%	131.2	38.9	30%	451.8	136.8	30%
	TOTAL for local audits	4928.0	763.3	15%	3964.4	646.3	16%	5298.6	1121.0	21%
17	Audit conducted by TC HQ	50156.2	36816	73%	31617.2	15220	48%	42113.5	12225.5	29%
	TOTAL for Kazakhstan	55084.2	37579	68%	35581.6	15866	45%	47412.1	13346.5	28%

7.23 Last, one can also rate the quality of inspection procedures by the amount and quality of referrals of serious cases for criminal investigation. These referrals are now being inhibited in part because evasion and similar cases must first pass a minimum, threshold test related to the amount of income stated on the return. (e.g., for physical entities the threshold is an understatement of income of 500 times minimum stated income MSI. for legal entities the threshold for referral is 2,000 x MSI.). Why there should be such a difference between the two is not clear. Moreover, aggravating factors such a whether this is a pattern repeated over time, whether this is a multiple-year case, or grows out of criminal activity, appear to be ignored. Inspectors' ability to make referrals should also be a factor in their overall performance appraisal, and suitable rewards or other incentives should encourage referrals.

7.24 Precedent and historical practices garnered from examinations are not being routinely gathered, indexed and published, so that all inspectors may profit from the lessons learned in these audits, and institutionalize what is being learned about each industry or business type, and thus improve the quality of appeals.

7.25 An aggressive and regular program of case review, both before and after final assessment, should improve the quality of assessments and remedy other inspection weaknesses discussed above and in the Large Taxpayer section of this report. Cases should be sampled and reviewed by senior inspectors to determine how well issues are being recognized and dealt with, identifying training needs, and detecting the possible presence of corrupt practices. Results of case review might also constitute a basis for assessing Inspector performance.

B. RECOMMENDATIONS

7.26 Inspections should be conducted in the field and the Tax Administration Division, Tax Audit Unit, should not have responsibility for tax cases. Rather, it should be focused exclusively on prescribing policies and procedures for execution in the field and monitoring (inspecting) to ensure conformity and consistency.

7.27 A workload and organizational analysis should be conducted as the number of inspection personnel relative to total TC personnel appears low. The analysis should include a study of whether the distribution of inspectors by office is appropriate to the workload in these offices or the importance of the taxpayers located there.

7.28 An objective methodology for the risk-based selection of audit cases must be instituted for non-cameral control cases. The criteria for case selection should include, inter alia, the factors listed in the above discussion.

7.29 An Annual National Audit Plan should be created to meld with and support the National Strategic Plan. It should prescribe and measure qualitative and quantitative measurements in each area of audit activity and for all major field offices (oblasts and inter-regional committees).

7.30 Extensive efforts and training/retraining need to be made to improve the quality of audits. Sampling techniques to test compliance rather than a 100 percent audit of all documents need to be the prevailing practice. The materiality of transactions needs to be better understood by Inspectors.

7.31 The Tax Code needs to be clarified and rationalized with respect to the frequency of audits. Best practice would be to remove these provisions from the Code and empower the Chairman to prescribe regulations (subject to review by the MOF) which aim at reducing the periodicity and frequency of audits and to ensure that integrated audits are conducted to eliminate repetitive visits to taxpayers except where absolutely necessary, and required by the size and complexity of the taxpayer and related affairs.

7.32 The “integrated audit” contemplated by the Code should, wherever practicable, be a coordinated examination of the taxpayer and all related entities or principals. It should also be a one-stop audit, covering all taxes--payroll, PIT or CIT, VAT, Excise in one visit. The practice of repeated audits of VAT payers every reporting period should cease and a regime of selective audits based on the taxpayer’s previous compliance record

should be substituted. The burden of proof related to audit issues should shift to the taxpayer when information requested from affiliated companies by the TC is not forthcoming. The Tax Committee supports this approach and has requested technical assistance for preparing manual/guidelines on such audits as applied in OECD countries.

7.33 The qualifications for recruitment of new inspectors need to be revised. Greater emphasis should be given to accounting training in an academic setting as opposed to obtaining candidates with economics degrees. The Tax Committee supports this approach.

7.34 An Audit Manual needs to be compiled for the use of all inspectors to guide them in the conduct of audits.

7.35 A case review program needs to be instituted. Review can be conducted prior to and/or post assessment. Inspectors conducting reviews should be senior and well experienced, and should report their findings to appropriate managers. Ideally, reviewers of closed cases would be in a separate office, or report to a different supervisor than the Inspector whose cases are to be reviewed. Management too should be involved as a first level of review. The results of reviews should be analyzed to identify training issues and instances of corrupt practice.

7.36 Precedent and historic experiences gathered from previous examinations should be preserved and published for the benefit of Inspectors and to inform future cases. They might also be included in the Audit Manual recommended above.

7.37 Efforts should be made to encourage referrals for criminal investigation. Arbitrary thresholds for consideration of such cases should be removed or amended to provide greater discretion on the basis of other objective criteria.

C. ACTION ON THE ABOVE RECOMMENDATIONS

7.38 A working group has been recently established to draft a new Tax Code where the TC has proposed inclusion of the following recommendations related to tax audits:

- The system for selecting taxpayers for examination must incorporate both selections by criteria and by random sampling as it encourages taxpayers to duly apply tax provisions. Random sampling percentage should not be high, from 0.5% to 1%.
- Taxpayer should know in advance that if taxes paid are large, the probability of tax examinations significantly reduces.
- Selection of taxpayers for examination should be based on a principle 'better fewer but of better quality and more effective'.
- To identify limitations for frequency of examinations as this will help to reduce corruption-related crimes.
- The commencement of examination should count from the time efforts are made by tax authorities. If a notification on examination is not delivered in time, then the time of examination is extended for the period from the moment when a notification is issued to the moment when an examination actually starts. A

similar approach can be followed when delivering examination report if a taxpayer eludes signing the report.

- A notification of examination should be presented to a taxpayer except for cases when there is a threat that a taxpayer will disappear.
- A new department, called the Investigation Bureau should be established in the Tax Committee responsible for due diligence.
- No special tax regime for small businesses, only simplified tax returns.
- Tax Code should limit motivation for establishing affiliated companies.
- Penalty enforcement systems should be discounted depending on type of violation. If there is malafide intention, the penalty should be significantly higher.
- To reduce the number of false companies, special attention should be given taxpayer registration. Physical location should be verified by the TC.

8. COLLECTION

A. CURRENT STATUS AND CHALLENGES IN COLLECTION PROCEDURES

8.1 The structure for tax collection is well automated and linked closely to the banks through which most such payments are made. Taxpayers file their declarations directly with the TC office having jurisdiction over their account (geographic or otherwise). Such returns are filed by mail and increasingly by electronic means (more than 60 percent of returns are now filed electronically). In the case of electronic filing, there is an effective protocol for certification in advance of the signature(s) required, and consent (electronic signature agreement) to have electronic filings deemed as equivalent for all purposes as for a hard copy of the return. Receipts for payment at the Bank need not accompany the return, as the automated system will set up a credit on the taxpayer's account whether or not a corresponding debit representing the tax owed has already reached the account. When the payment credit matches the debit on the return, the account is settled, except for any future additional or amended assessments that may arise, (e.g., after an audit/inspection). The system is straightforward and seems to be functioning well. An effort is underway to encourage more electronic filing that appears to be yielding results.

8.2 There are, however, problems stemming from inaccurate or delayed data reaching the TC for registration of taxpayers. Many registrations contain missing or inaccurate information that burden the TC with the task of correcting this information. Some of these inaccuracies are intentional; for example, many fraudulent VAT refund schemes have been discovered both before and after refunds are paid. The TC's Tax Administration Division (TC-TA) and its Tax Registration Unit (TC-TA-5) have become more sophisticated and active in identifying these schemes before they become a revenue loss. These problems arise because many governmental agencies (approximately 37 such entities) involved in or dealing with the government-wide automated "RENION" system for recording new business licenses and registrations are not automated, and/or are not functioning efficiently. Information is frequently delayed as is the updating of information submitted by registrants/taxpayers.

8.3 Enforced collection procedures begin when the monthly automatic match of debits and credits reveals non-payment or underpayment. This is triggered when the required time for payment of the amount self-assessed on the return lapses, or an amended assessment or a deficiency assessed after an audit is not addressed. The schematic presented in the Annex 2 shows the procedure applicable in enforced collection cases.

8.4 Under the Code there are several time limitations for payment and due dates. To simplify bookkeeping and reduce confusion, it would seem that an effort should be made to make these time limitations as uniform as possible.

8.5 A notice is generated and sent by regular mail to the last known address of the taxpayer. Effort is being made to establish an electronic format for these communications. The system then computes the penalty and interest on the underpayment, which continues until full payment is made. The rate of interest appears sufficient to deter those who would use this delay as a de facto loan from the government.

8.6 If the delinquent account remains unsatisfied, the next step is to place a lien on the bank account of the delinquent taxpayer. (Banks are required to notify the TC of account information within three days of the opening of any account). The banks are then obligated by law (Article 46) to freeze the accounts in question and to ultimately collect balances remaining in such accounts (Article 50). If the system is working with respect to the law and relevant decrees, the property of the taxpayer is also inventoried (usually by the TC office at the rayon. Unlike in many transition economies, no court orders are necessary, as the process of enforced collection continues, although (as noted in the “Legal and Appeals” Chapter below), filing an appeal either against the assessment or the collection methods or procedures employed could suspend the collection process.

8.7 In this regard, the Tax Code seems deficient in that it does not prevent the filing of a court suit to enjoin proceedings. Internationally, the Code contains a statute barring any injunctions against the assessment or collection of tax, and leaving the taxpayer only an administrative remedy, and thence to the court; or resort to the court directly by paying (in whole or in part), and then suing for a refund.

8.8 The rayon conducts its inventory of taxpayer assets, including checking against data kept by other ministries; for example, road police for vehicle registrations, and real estate departments for ownership of real property. The law allows the TC to assume ownership by virtue of possession alone. Distraint actions by the rayon include filing a lien on the property of the taxpayer at the local office for property transactions. Property may be seized when it is believed that it may be forcibly rescued, again without court order.

8.9 The distrained property is then sold by auction which is administered by the Center for Sales of Seized Property in the MOF. This agency handles sales of seized articles by Customs as well. An evaluation should be made of whether this is the most expeditious or profitable way to handle such sales or whether this function should reside in an office of the TC itself.

8.10 The system for enforced collection is reasonably efficient, although some improvements could be made. There is, for instance, no expedited system for sale of perishable commodities (e.g., foodstuffs, flowers, plants). There is no method to write off uncollectible accounts or de minimis amounts. This means that a large number of accounts remain on the books because no authority has been given for their write-off. This burdens the system and inflates the data for accrued uncollectible accounts. Assuming that procedures to guard against the corrupt possibilities inherent in such authority were established, there is no apparent reason why such authority should not be conferred upon the TC.

8.11 The Code does not permit the offset of one tax due against a refund for another type of tax due the same taxpayer. The return forms do not permit this offset to be made, whereas the Code does permit a taxpayer to request such an offset (Article 39(2) (2)). The Code could be clarified so as to authorize an offset, with or without taxpayer

⁹ The IMF has published a paper, “Review of Indirect Tax Performance and Tax Administration” for Croatia (February, 2006), which sets forth criteria that could serve the TC as a guide for writing off uncollectible arrears.

consent, or to construe a return declaring a refund due to be the equivalent of a request for offset under Art.39.

8.12 It appears that inspectors are employed in enforced collection procedures and these inspectors specialize in this function. There are also eight inspectors employed in such capacity at the HQ. As part of the organization and workload study recommended in this report, the TC would be well advised to consider returning inspectors to their audit and inspection duties and creating a new, specialized function of "Tax Collector" to be stationed at appropriate locations and in suitable numbers. This might free up more inspectors for audit duties, and economize on salaries for this specialty, which does not usually require auditing or accounting skills. Moreover, tax collection function should not be performed at the HQ, and in such any activity should be delegated entirely to field offices.

8.13 Many countries employ a methodology known as "jeopardy assessment" procedures when no return has been filed, the tax period has not yet expired, and, in both instances, assets are, in the judgment of the tax authorities, about to be disposed of or removed from the country to frustrate revenue collection. Such procedures are frequently employed against known delinquents, criminal enterprises, and in some cases entities about to become defunct. This permits the tax authorities on its own to declare the tax period closed, assess the tax due on the basis of evidence available or the last period's return, and declare the amount immediately payable. This is followed immediately after notice is given to the taxpayer for the immediate distraint of assets, as described above. While such measures appear at first to be excessive, appropriate management controls can be put in place to ensure that these procedures are reserved for only the most flagrant cases. The Tax Code does not seem to permit this in Kazakhstan. Nevertheless, this is deemed to be a most important tool for the protection of the revenues, especially when dealing with tax obligations of criminal enterprises and non-residents, who might leave the jurisdiction and take their assets with them.

8.14 It is not clear what priority taxes that are due or owed are accorded under the bankruptcy laws and procedures in Kazakhstan. Based on discussions with tax officials, this appears to be an area requiring further study. In most countries, as against most claims on a bankrupt's estate, tax liens or judgments are accorded higher priority than all other claims except wages and property pledged, or subject to a specific indebtedness, such as an equipment trust.

8.15 Another area of concern is the apparent lack of an enforcement mechanism when a legal entity becomes defunct, as tax indebtedness does not survive the liquidation--even against those officers specifically responsible for paying taxes withheld and collected from employees' wages, amounts withheld from payments made to contractors, or from dividends paid to taxpayers. In most countries such taxes are deemed to be held in trust for the government ("trust fund taxes"). As in most trusts, the beneficiary, in this case the government, may pursue the deficiency in the form of an assessed penalty against the responsible officer(s) of the company in an amount equal to the taxes diverted. In the U.S. this is referred to as a "100 percent penalty case". While this may constitute a criminal violation, the prosecution is either taken against the defunct entity or ignored, as against responsible officers.

8.16 An analysis should be undertaken of the age of all arrears to determine the efficiency of the regime and methodology for collections and collection enforcement. Such an analysis would also be a vehicle for measuring the true value and collectibility of accrued arrears in much the same way a bank periodically should account for the value of its portfolio of outstanding loans. These data are not readily available, although total arrears by tax as of January 1, 2005 and 2006 is known. According to this data more than 40 billion KZT remains outstanding. While this represents a slight improvement from the year before, the size of the amount suggests an analysis is warranted to determine the true proportion of arrears that are collectible and their age.

8.17 A variety of local taxes are collected by local tax committees. In addition, there is a large diversion of attention and resources to the variety of “other obligatory payments” and “state duties” under Section 16, (Chapters 68 through 90) of the Code. It is not clear why such duties and payments should not be collected by the ministries and agencies responsible for the functions concerned. The proliferation of such special imposts and fees, and their administration would appear to divert scarce enforcement resources from the more profitable areas of taxation. For example, it would seem reasonable that the agency responsible for issuance of permits for use of the radio frequency spectrum under Article 441 should be responsible for collection of the fees involved and their remittance to the Treasury. This is not now the case.

B. RECOMMENDATIONS

8.18 Efforts to advance and expand electronic filing should continue. In this regard, the Taxpayer Service and Education (TSE) function should play an important role in advancing this activity.

8.19 The government must be fully engaged in advancing the automation of all agencies responsible for inputs to the system for registration of entities (RENION). Resources must be applied to this activity to maximize tax enforcement and minimize loss of revenues.

8.20 An effort should be made to reduce the multiplicity of tax payment due dates to a few uniform standards for all taxes to the extent possible.

8.21 The Tax Code should be amended to provide for an “anti-injunction statute” barring any injunctions against the assessment or collection of tax. This would leave the taxpayer with an administrative remedy and then an appeal to the courts; or the taxpayer could resort to courts directly by paying (in whole or in part), and then suing for a refund.

8.22 A study should be made as to whether sales of seized assets should continue to be performed by the MOF’s Center for the Sale of Seized Property, or whether this function would be more expeditiously handled by an office within the TC.

8.23 The Code should be amended to provide an expedited method for seizure and sale of perishable assets.

8.24 The Code should be amended, and procedures promulgated for the write-off of de minimis or uncollectible accounts. These should be subject to tight management controls and higher levels of approval to ensure against abuse.

8.25 The Code should be clarified, and appropriate procedures put in place, to allow automatic offset of any tax refund due to a taxpayer against indebtedness for any tax owed. Alternatively, tax declarations could be amended or construed to provide automatic consent to such offsets. There is no good reason why the TC should be compelled to affect a refund when the taxpayer owes the TC for other taxes due.

8.26 The TC should consider as part of the workload and organization study recommended in other parts of this report:

- a. Creation of a separate occupation for tax collection duties at a lower pay scale than that used for Inspection duties;
- b. Returning Inspectors now engaged in collection work to inspection duties;
- c. Positioning such collection functions within the organization in the various geographic locations;
- d. Implementation of the general theory that all case-related work be delegated to the field offices; central office elements be divorced from such work; and central office components be engaged only in preparation of policies and procedures and overseeing the execution at the field level.

8.27 The Code and implementing regulations should be provided for “jeopardy assessment” procedures where the revenues are in danger as a result of dissipation or removal of assets.

8.28 Bankruptcy laws should give higher priority to tax liens or other tax indebtedness instead of other unsecured creditors of a bankrupt.

8.29 An enforcement mechanism modeled similar to that in many tax authorities should be instituted by which certain tax obligations (e.g., taxes withheld on wages or dividends) survive the liquidation of an entity, and may be applied against responsible officers of the taxpayer entity who were responsible for paying such taxes to the government and failed to do so.

8.30 An analysis of the age of all arrears should be undertaken to assess the quality and character of collection efforts and the currency and worth of accrued indebtedness.

8.31 The responsibility of the TC collecting a variety of local taxes, obligatory fees, and state duties, should be examined, so find out the possibility of delegating some of these to agencies relevant to policing such areas of activity.

9. INFORMATION SYSTEMS

A. ACHIEVEMENTS IN INFORMATION TECHNOLOGY IN THE TAX COMMITTEE

Data Collection and Processing Centers

9.1 Data Collection and Processing Centers have been operating in the Kazakhstan TC since 2002. They serve taxpayers through tax collection and processing of returns, notification of desk audits, registration of taxpayers, and processing of taxpayers' queries on the status of tax settlements. These Centers also introduce a standardized structure based on the principle of front- and back-office functions, where contact with taxpayers is focused in the customer service area, while analysis, monitoring, and cameral audit are carried out as desk functions, with no direct contact with taxpayers. In this sense, they create conditions for contact-free processing of taxpayers' liabilities, and thus prevent corruption.

9.2 For the convenience of taxpayers, Taxpayer Terminals were introduced in November 2003 across all territorial tax authorities. They enable preparation and submission by taxpayers of their tax returns in electronic format directly at the tax office. Taxpayers have free access to computers using the Taxpayer Terminal software, as well as communication channels to send their tax returns.

Electronic Filing

9.3 Electronic filing has become the most popular method of submitting tax returns in Kazakhstan. By January 1, 2007, there were 430,000 electronic filers. However, the increase in the number of e-filers has resulted in increased traffic and load on the servers.

9.4 The advantages of e-filing are obvious. First, taxpayers avoid tedious and time-consuming paperwork and visit tax offices much less frequently, if at all. Second, electronic filing is available 24/7, i.e., taxpayers may send their returns by e-mail any time, any day (including weekends and holidays). Third, the software provided by the TC for e-filing provides an option of checking returns automatically for arithmetic and logic errors. Therefore, taxpayers have the possibility of correcting inconsistencies and errors on their tax returns even before they submit them to the tax authorities. This eliminates notification by the tax authority about any detection of such errors in the course of desk audits.

9.5 E-filing also improves the speed of data processing by the tax authority, eliminates technical errors, and automatically verifies information assigned to their personal accounts. Moreover, taxpayers can receive statements of their personal accounts, as well as information about collection and processing of their tax returns around-the-clock.

The Integrated Tax Information System

9.6 The Integrated Tax Information System (ITIS) began operation on January 1, 2002. This system is installed in all tax offices and enables centralized accounting and registration of taxpayers and their personal accounts.

9.7 With the implementation of the ITIS Personal Account Management module in 2003, tax authorities now maintain records of tax payments, mandatory pension contributions, and social deductions, as well as manage individual taxpayer accounts and related tax filing. This allows the TC to switch to centralized processing, freeing inspectors from manual routine work on return processing and collection of payment information from the Treasury and the State Center for Pension Payments (SCPP). Documents collected from the Treasury and SCPP are processed automatically at the central level in Astana, and corresponding payments are distributed automatically in real time across taxpayers' personal accounts in the regions. On average, 50,000 documents are received daily from the Treasury, 13,000 from the SCPP on mandatory pension contributions, and 6,000 on social deductions.

9.8 In 2004, a new functionality was introduced for collection and processing of aggregate payment documents from the second-tier banks based on taxpayer identification number (TIN). This is essential for tax accounting purposes.

9.9 The transition to centralized processing and accounting enables control, reporting, and analysis of completeness and timeliness of tax and social payments, as well as monitoring of revenue forecasting at different levels of the tax system: rayon, oblast, and central). The system also stores taxpayer information on patterns of ownership, types of activities, and size of businesses. The system also enables control functions concerning taxpayer rights in terms of timely delivery of information on settlement of tax payments (reconciliation reports, statements of personal accounts, inquiries) that are also generated automatically. Other accounting functions are also automated, such as calculation of fines in personal accounts, generation of notices to taxpayers, final assessment, payment orders for offsets and returns, and generation of collection orders based on account analysis.

9.10 For providing information on taxpayer arrears--including, arrears of mandatory pension payments and social deductions--is an essential instrument of tax administration. The ITIS generates inquiries that provide summary statements of personal accounts based on information collected from all tax agencies. Inquiries of firms reporting to one tax agency are generated within two business days. Inquiries of firms having divisions in several tax authorities are generated within five business days on submission of written request by the taxpayer. Similarly, tax assessment amounts are collected and allocated across individual taxpayer accounts.

Electronic Desk Audit of VAT Returns

9.11 Introduction of e-filing has provided the possibility of implementing electronic desk audits of tax returns. E-desk audit allows tax authorities to efficiently and accurately detect mistakes as well as promptly notify taxpayers of any errors detected.

9.12 The ITIS applies VAT desk audits on a regular basis. Thirteen desk audit procedures were implemented by January 1, 2005, including detection of fictitious invoices. Desk audits of VAT allow tax authorities to draft a plan of field inspections and identification of pseudo-firms and detection of non-filers. This mode facilitates prompt detection of:

- issuance of fictitious invoices by taxpayers who are not VAT payers;
- suspicious taxpayers; and

- underreporting of the sale of goods, works, and services by VAT payers.

9.13 At the same time, this mode is constantly being updated and replenished with feedback from results of desk audits of corporate income tax.

9.14 According to the results of performance analysis by the tax authority, the vast majority of additionally assessed taxes and penalties result from tax inspections initiated through the findings of desk audits.

9.15 The Tax Code allows taxpayers notified of mistakes detected in desk audit to correct them on their own within 10 business days. If a taxpayer eliminates the irregularities, there are efficiency gains, as it allows the tax administration to focus their efforts on prevention of tax offences.

9.16 Two new analytical reports on “Pyramid of suppliers” and “Pyramid of buyers” were developed in 2004 with a view to strengthen VAT administration. They have since been used to reveal tax evasion schemes such as: (i) pseudo-businesses, (ii) submission of fictitious copies of VAT payer certificates, (iii) absence of sales transactions in tax returns, and (iv) “ghost” firms and issuance of fictitious invoices by liquidated businesses.

9.17 As many as 173 fraudulent businesses were identified by January 1, 2007, and their VAT registrations were subsequently cancelled, with all corporate income tax and VAT-related transactions subject to adjustment. The list of these taxpayers is posted on the web portal at www.taxkz.kz.

9.18 It is also proposed to develop a mechanism for interaction with the Customs Automated Information System (CAIS) in 2008, with a view to monitor movement of goods across customs borders. This will allow detection of pseudo-exporters and checking of the validity of assigned VAT amounts by matching information provided in VAT declarations and customs information.

Module of Electronic Control of Tax Audit

9.19 It is possible to achieve efficiency of tax control, improve quality of tax inspections, and better control implementation of all procedures in the course of inspections through improvement in the automation processes of tax administration and of information systems directly involved in implementation of these functions. The “Electronic Control of Tax Audit” (ECTA) information system was been developed to accomplish this objective. The main objective of ECTA is the regulation of procedures associated with due diligence in meeting tax obligations by taxpayers. The information system is focused on:

- maintenance and update of the uniform database of tax inspections;
- elimination of red tape and restricting corrupt practices by tax authorities;
- standardization of the workflow associated with tax inspections and their results;
- tracking procedures for appealing additionally assessed tax amounts;
- supervision by the TC HQ of compliance with regulations governing tax inspections and registration of results.

9.20 Automation of the work planning process in the ECTA system allows several important advantages:

- improvement in the performance of tax experts in the course of inspections, by establishing the rating of tax auditors with a view to making recommendations on replacement and strengthening of personnel, which will in turn result in improvement of the quality of tax inspections, and a decrease in the share of appeals against tax inspection results;
- carrying out an ongoing system analysis of efficiency and quality of tax inspections, as well as inspections for validation of VAT amounts claimed for refund; and
- generation of analytical reports on instructions by quantity and quality of tax inspections, by results of tax inspections (additionally assessed, reduced and collected amounts of taxes, fines), as well as by results of inspection by tax authorities.

9.21 At present, taxpayers are selected for inspection in strict accordance with the results of desk audits, based on the “irregularity-calls-for-inspection” principle. Efficiency of tax inspections is maintained by covering the tax period within which the tax irregularity falls.

Maintaining a Taxpayer Registry

9.22 Tax authorities register taxpayers with the ITIS. Registration information is accessible to each tax office, which is critical as taxpayers are mobile and may be simultaneously involved in activities in different regions. The information system facilitates identifying taxpayers who are not eligible for simplified procedures with reduced rates, as the system is capable of tracking overall taxpayer information.

9.23 The “one-stop-shop” principle has been introduced and applied successfully by judicial authorities, statisticians, and tax authorities since September 20, 2004. This principle provides for the simplified procedure of registration (re-registration) of legal entities, branches, and representative offices. An opportunity for both external and internal monitoring of electronic notifications processing based on a “one-stop-shop” principle is embedded in the system, which allows supervising compliance with registration procedures across the country. New procedures create favorable conditions for registration with three government authorities, while elimination of unnecessary contacts with tax officials precludes corrupt practices at all stages of the registration process. The e-ITIS-client software was developed and implemented in 2003 as an information service for taxpayers, with the possibility of remote viewing and changing registration data.

9.24 The establishment of information systems on tax return formats enabled automatic generation of lists of taxpayers subject to conditional exceptions. Conditional exception means that idle taxpayers that are conditionally excluded from the State Register of Taxpayers for tax purposes are suspended, and all mutual settlements of payments with them are open to determination. To preclude taxpayers from dubious transactions, lists of conditionally excluded taxpayers were published in the “Directory of Accountant”

(appendix to the “Bulletin of Accountant” magazine) in November 2004, and posted on the web portal for taxpayers to view at www.taxkz.kz.

Registry of Land and Property Records

9.25 The tax roll information system mentioned above (register of taxpayers and tax entities, RTTE) enables automation of the following functions:

- maintaining records of taxpayers and tax entities;
- calculation of land, property, and road tax amounts;
- performing desk audits for land and road tax with calculations made by the system.

9.26 The system generates a printout of notices of assessed land and property tax amounts for natural persons; reports based on data on objects of authorized bodies; and delivers services to taxpayers through the “Web access to RTTE” by remote access to information on the registered titles to real estate, including land parcels, and vehicles owned by a particular taxpayer. It also provides information on tax liabilities.

9.27 Desk audit of land and road taxes is designed to check completeness of filling a database with information from tax authorities and state bodies, as well as to verify completeness and accuracy of taxpayer liabilities.

Web Portal for Taxpayers

9.28 A web portal for taxpayers [www.taxkz.kz] was created in 2002 and now includes eight specialized websites designed for administration of electronic filing, remote personal accounts of taxpayers, search engines, regulatory documents and explanatory notes, and on-line access to information for taxpayers on availability of servers through the web portal. For instance, the VAT-related website has a search engine that enables prompt access to information on taxpayers registered as VAT payers, with a view to eliminating cases of assigning VAT amounts as offsets against invoices of VAT payers. You can search either the taxpayer’s registration number (TIN) or both TIN and the series and number of the certificate of registration of a tax entity as a VAT payer to verify data from the certificate with a TIN. The search engine on the ITIS site allows searching for taxpayers by TIN, provided they are registered with the tax authority, as well as seeing the list of taxpayers conditionally excluded from the State Register of Taxpayers.

9.29 The program and information web complex (“Call Center”) will establish a uniform database of answers to frequently asked questions of taxpayers regarding support service. All tax offices and taxpayers can use this information.

9.30 At present, the TC is in the process of introducing a Microsoft Project-based project management information system (PMIS) that would include an integrated approach to project management using best business practices. This information system will help develop the Corporate Project Management Standard and templates for typical documents for all projects, as well as organize efforts of all members of project teams in the uniform information field, which would allow TC management to have reports and monitoring status of all projects quickly.

9.31 This approach facilitates creation of information systems based on the tax authority development strategy, as well as planning strategic development of information systems for tax administration purposes. This could, become a preliminary stage for management certification of tax authorities based on requirements of ISO international standards.

B. KEY CHALLENGES

9.32 The major problems faced by the Data Collection and Processing Centers include an insufficient number of hardware equipment, obsolete available computers, and low bandwidth of communication channels. The budget request for 2008 does include allocations for construction and reconstruction of the Centers, as well as for upgrading hardware.

9.33 The matrix structure for all project work needs improvement. The manager of the project is engaged in both project development and technical support. A considerable share of time (up to 80-85%) is spent for support and maintenance of the IT system. When problems arise, the manager must coordinate efforts of employees of core departments, contractors, managers and territorial bodies, and thus becomes a “crisis manager.”

9.34 Twelve large projects are now under implementation in the TC. They include information system projects, six departmental system projects, a number of projects on interaction with other state bodies and second-tier banks. Only seven staff members of the IT Unit are involved in the development and support of these projects.

9.35 Of the 23 staff members sanctioned for the IT Unit, only 18 now work in the IT Unit. Of these, three persons manage the Unit, three prepare and keep tenders and contract documents, four ensure information and technical safety and maintenance service, and one person tracks the workflow. Such a heavy workload on employees results in delays in meeting routine tasks, and increases considerably the risk of failure to execute any project on time. As a result, it becomes essentially impossible to free staff to participate in special training courses.

9.36 At present, efforts of staff members working on these projects have not resulted in appreciable improvement of the situation, and the projects are often implemented under chaotic and non-formalized project management environments. For instance, all members of task forces, including the project supervisor, perform their functional duties within the unit and take the role of project manager. Such an organizational structure makes it difficult to implement any project efficiently.

9.37 All tax offices confront the issue of completeness of registration data on tax entities, as well as adequacy of computer equipment required. Moreover, some offices still maintain paper-based files, or lack a centralized information database. Efforts are ongoing to enter these data into departmental information systems.

9.38 In 2002, special units were created within the core departments of the TC with a view to organizing efforts for establishment of information systems: an tax audit and ECTA implementation analysis unit, a unit for introduction of information systems on formats of tax returns, a unit for organization and introduction of electronic monitoring,

and RTTE unit, a unit for introduction of ITIS, and a registration unit. Subsequently, functional duties and staff structure of these units have changed slightly, but their members are still actually involved in implementation of information systems and carry out management functions. However, it is not possible to ensure quality improvement of these functions without involvement of the IT Unit experts, which leads to overlapping of functions.

9.39 Based on an analysis of the Ukrainian experience in project management of IT, which was undertaken during a study visit to Kiev, it was found that separation of processes was essential for successful implementation of IT projects. All operations of the IT Unit are divided into two major processes:

- **Technology development**, including the process of implementing decisions associated with modifying the techniques of implementing enterprise operations. Based on the International Standard, established by the Project Management Body of Knowledge of the ANSI Project Management Institute (ANSI PMI PMBoK), overall project management consists of five major processes: initiation, planning, implementation, monitoring, and completion.
- **Technology support**, including processes of support for routine operations of an organization.

C. RECOMMENDATIONS

9.40 Hardware, software and obsolete equipments should be upgraded, and the number of equipments increased to match growing workload.

9.41 The bandwidth of communication channels also should be increased substantially to meet the needs of faster and real-time flow of information.

9.42 Modern project management techniques require a process-oriented structure of the IT Unit. Such a structure facilitates uninterrupted operation of information systems, including maintenance of quality assurance throughout the life cycle of a product or service, as well as strategic planning.

9.43 The matrix structure for all project work needs improvement. Technology management, design and support should be segregated for maximizing specialization and efficient functioning.

9.44 For implementation and accomplishment of strategic objectives of the TC, approaches to organization of information system development need to be reviewed. The following items, in particular, need to be carefully taken into account:

- Clear differentiation in the organizational structure and functional duties of ITU needs to be made of for staff involved in IT development and technology support;
- Development of processes of all IT systems needs to be organized in the form of a project management structure within the ITU.

9.45 It will be necessary to include into the structure of the ITU, employees from the units involved in automation of tax functions, without changing their functional duties.

Project teams need to include employees of ITU as well as core departments, who will work together in the project development activities. By setting objectives and supervising their accomplishment, task forces will thereby retain the project management function.

9.46 ITU should have the role of “design office” for the core departments, thereby making it possible to develop and follow up on application of the uniform project management methodology, achieve a uniform budgeting and contracting approach, and place appropriate emphasis on software quality.

9.47 As IT clients, core departments must set their own objectives within a project framework, and allocate adequate human resources to meet the objectives. After completion of a given project, employees from the core departments return to their respective units from the ITU.

10. LEGAL AND APPEALS

A. CURRENT ORGANIZATION, PROCEDURES AND POLICIES

10.1 Taxpayer appeals of decisions by the TC are outlined in Section 18 of the Tax Code (Arts. 552-568). The appeals provisions of the Code allow for appeals administratively within the TC's apparatus, or directly to the courts. In the case of appeals to the courts, the assessment of taxes or other actions that are the subject of the appeal are suspended pending their resolution.

10.2 A brief chart outlining the process appears in Annex 3. As can be seen from this chart, appeals through the administrative route within the tiers of the TC can last up to 105 days, and possibly longer, if extensions are allowed under Art. 553, et seq. Appeals through the courts can last for years. While appeals are pending under either regime, assessments are suspended as is the accrual of interest (penalties). It is only after decisions have been rendered, and applicable further appeal avenues exhausted, that penalties (interest) on deficiencies remaining begin to run again. Interest on the amount of deficiency, as finally determined for the period in which the appeal was pending, is frequently not asserted. Further, since there is no requirement that any portion of the deficiency be paid before an appeal may be lodged, appellants may utilize the system as a means of extracting a "loan" from the government equal to the amount of the ultimately determined deficiency, a form of tax roulette that in many cases may prejudice the government's revenue collections. This system needs to be further studied to prevent misuse.

10.3 Appeals offices in oblasts are subject to the same chain of management as the units that rendered the decision. There is no separate line of management and control for appeals except at the Central Office, which leads to a perception that appeals within the TC are not being conducted objectively.

10.4 While decisions are circulated to officials within the TC, there is no requirement, or even recommendation, that they be perceived as binding on cases involving similar issues; nor does the issuance from the Central Office's Appeals Division act as binding instructions. While the formal organ of the TC, "Vestnik," publishes some of these documents, there is no central archive or index that archives these cases for the public or internally within the TC. The Appeals division does publish a Manual (one of the few divisions that does) that guides the conduct of Appeals Officers in the field.

10.5 Tax appeals taken to court are frequently heard by judges unfamiliar with tax litigation and the complexities of the Tax Code. This increases the risk of an incorrect outcome and loss of revenues. Further, under Kazakhstan law, except for decisions from the Supreme Court, decisions in cases are not binding and do not serve as precedents for similar cases considered at a later date.

10.6 Analysis of the tax appeals data for 2003-05 indicates that a high percentage of additions made during assessment are reduced in appeals. There have been improvements over this period. For example, in 2005, 13.3 billion KZT of assessments were reduced after appeal, amounting to 28 percent of additional assessments, and this includes

deficiencies already reduced at the oblast level appeal, and further appeal to the Central Office. In Astana City, 30 percent of deficiency assessments were reduced after appeal.

10.7 Appeals may not be negotiated with the appellants on the basis of the hazards of litigation, which makes the data cited above even more compelling.

10.8 The number and distribution of Appeals Officers is generally constant across all oblasts (5-7 in each), which would appear to indicate an imbalance when compared with the appeals prosecuted within each oblast. If Appeals Officers are also engaged in conducting inspections in oblasts with a light appeals workload, then the perception that such officers would be less than objective may also become an issue.

10.9 The TC does issue advance rulings on the tax consequences of transactions contemplated by business or investor interests. But these rulings are not binding on the TC, even when the hypothetical facts on which a ruling was based have not changed. Business representatives complain that this uncertainty of outcome inhibits investment and creates opportunities for corrupt practices.

10.10 Suspension of penalties or interest during pending appeals creates a situation where taxpayers may seek to postpone their obligations. In the case of appeals to the courts, this may result in delays to the revenue for years. For administrative appeals, this may take at least 105 days or more, as extensions are permissible under the code. Revenues are delayed and frequently penalties from, on, and after the date the additional deficiencies were first assessed are not asserted for all or most of this time. Advance payment for any portion of the underpayment is not required as a prerequisite for lodging an appeal.

10.11 The Code permits for further extensions of time for lodging appeals after application by the taxpayer. This leads to special and inconsistent dealing with similar categories of taxpayers.

10.12 Appeals units in the field are within the same chain of command as the inspection units that determined the appealed deficiencies. This creates taxpayer mistrust or lack of confidence in the system. Furthermore, for administrative appeals, the ultimate arbiter is the Appeals Committee of the TC, and not by a separate and purely appellate body within the TC. An Appeals Committee consisting of Division Heads within the Central Office. Since these officials are also within the enforcement chain of command, and not exclusively allocated to appellate functions, their decisions may be perceived as biased toward the tax authority's views on the issues, no matter how objective the Appeals Committee may actually be.

10.13 There is no judiciary dedicated exclusively to tax matters, creating uncertainty as to the outcome of appealed cases. Tax cases are adjudicated by judges unschooled or unfamiliar with tax matters. Especially aggravating is that such decisions are not binding in similar cases (they are not *stare decisis*), as this is not a "common law jurisdiction." So litigation that could clarify confusing or complex issues is not available.

10.14 Unlike other areas of the TC, an Appeals Manual (a series of issuances guiding the conduct of appeals and issued to field units) is published and disseminated. The public has no access to decisions, except those cited in "Vestnik," and these are not available or accessible on the internet or in a central indexed archive. This lack of a

precedent on which to base future actions, and which might serve as a guide to taxpayers and their representatives, serves to reinforce the opinion that TC actions lack transparency.

10.15 The amount and percentage of assessment reduced after appeal are extremely high and appear to indicate that further management attention and analysis must be given to the process of audit as well as appeals. While recent improvements are noted, available data could be a result of one or more of several factors:

- The probability of corruption in both the audit and appellate processes;
- A need for training of audit and appellate staff on tax issues;
- The need for a thorough and on-going review of audit cases before assessment of additional deficiencies and of sampled cases after closing (see recommendations for review in Audit/Inspections, above).

10.16 Appeals may not be negotiated with the appellants on the basis of the hazards of litigation, which tends to unduly prolong litigation and increase the uncertainty of the outcome. There is no recognition of the potential for receiving a reduced amount now as opposed to the possibility of nothing later.

10.17 Workload and staffing of Appellate Officers in the field appears unbalanced within and across the oblasts.

10.18 Advance rulings are not binding on the TC, thus deterring investors from making important decisions and increasing uncertainty. This inhibits national development and is a source of chronic complaint among business and tax practitioner communities.

B. RECOMMENDATIONS

10.19 The appeals structure should be placed completely outside the normal chain of command and subordinated to the Appeals Division in the Central Office. This division should report directly to the Tax Committee Chairman or a Deputy to which this function could be delegated. The Appeals units in the field should be subordinate to Oblast Chairs only for routine administrative matters. [*The Government has recently accepted this recommendation. It is intended to have one level of appeal in the new Tax Code.*]

10.20 The Appeals Committee in the Central Office should be abolished and the decision of the Tax Appeals Division should be the final stage of the administrative appeals process. [*This has already been accepted. The Tax Committee has issued orders to abolish the Appeals Committee in the Headquarters.*]

10.21 The Code should be amended to require payment of a part of the assessed deficiency before an appeal can be lodged. This would deter filing frivolous appeals. Refunds in appropriate cases, together with interest to be paid by the Tax Committee, may sometimes be necessary when the prepayment is larger than the ultimately determined deficiency. The Tax Committee considers this premature to introduce at this stage, because it would require a mechanism of paying refunds and interest whenever an excess amount has been paid by the taxpayer. We would recommend setting up this mechanism.

10.22 The Code should be amended to remove any possibility of extending the time for filing appeals--except in the most extenuating circumstances. This will make the process transparent and consistent. *[This recommendation has been accepted and is proposed to be reflected in new iteration of the Tax Code.]*

10.23 Appropriate government authorities should consider establishing a judicial branch dedicated to tax cases. The judges within this special court should be encouraged to consider previous verdicts on similar issues and cases as guidelines or precedents for future adjudications. This will permit a reasonable degree of certainty for practitioners, taxpayers and Tax Committee staff, and lead to consistency and rationality of tax decisions. *[Decision in this regard has to be made by the Government in conjunction with the Ministry of Finance and the Ministry of Justice.]*

10.24 Appeals and judicial decisions should all be published and indexed by issue and made available to the public in hard copy and/or accessible through the internet. Currently, publication of appellate decisions is considered a violation of tax secrecy under Article 518 of the Tax Code. This issue needs to be resolved in consultation with the Ministry of Justice, since transparency in the appellate system is an important element in building taxpayer confidence, and in improving voluntary compliance. Some efforts in this direction have been made recently. The Tax Appeals Office of the Tax Committee has recently elaborated a Handbook of Most Frequent Violations for the benefit of tax auditors. Also, the Rules for Processing Taxpayer Appeals against Tax Audit Findings is available at the Tax Committee's portal (www.salyk.kz).

10.25 Currently the normal process of hearing appellants and admitting their arguments and clarifications exist. However, to prevent long drawn appeals, in appropriate cases, the Appeals Offices should be authorized to negotiate with the appellants to discuss settlement of cases outside the appeal system, on the basis of the hazards of litigation. This would require appropriate official instructions in the exercise of discretion; as well as supervisory approvals based on documented rationales for the record in each case. Such cases should be reviewed by superior authorities before the final assessment is made. This will shorten the process, decrease litigation, and resolve cases when there are issues that make the outcome uncertain.

10.26 A workload and staffing study is necessary to assure optimal assignment of Appeals Officers in the field and Central Office. *[The Tax Committee has recently conducted the recommended analysis. Optimal assignment of Appeal Officers should now follow.]*

11. FRAMEWORK FOR TAX REFORM PROGRAM

Strategic Framework of Reform

11.1 Constant changes in business environment and business methods, as a result of globalization, and innovations in communications and IT, have made it imperative for, tax administrations to anticipate and adapt to change in time. Recent years, therefore, have seen major reforms in tax administration all over the world. Central to these reforms has been the establishment business-like corporate governance practices.

11.2 The main strategy of tax reform should be to build trust and partnership with the taxpayers, while ensuring that taxpayers understand that the administration has the processes and technological tools to detect fraud and punish fraudulent behavior. To achieve this, tax administrations use a mix of compliance tools, including simple laws, awareness campaigns, taxpayer services, e-services, and a fair dispute resolution mechanism, on the one hand, and highly skilled audit, third party information, sophisticated risk management systems, information matching, enforcement, and deterrent actions, on the other.

11.3 Many other factors, however, impact on the efficiency and effectiveness of tax systems and thus on compliance outcome. These include the political, socio-economic, compliance cultures and organizational context, as well as the tax policy and legislation, under which the system operates. Likewise, the organizational set up of the tax authority, management approach, institutional knowledge, resource allocations, the current status of IT-systems, taxpayer services and education, staff skills, as well as staff moral and corruption levels are important factors.

11.4 Planning of the reform process is crucial for its successful implementation. A long-term strategy needs to be designed, and a medium-term business plan formulated for defining the priorities and the needs of the TC. The strategic plan would typically include the reform concept, objectives and approach, as well as the program design for the short, medium and long term, usually encompassing three to five years.

Political Support for the Vision and Objectives of Reform

11.5 The clear vision of the objectives of tax reform needs to be formulated as a first step. This vision must be supported by strong and sustained political leadership and ownership, and be followed by defining the right level and overall strategy for tax reform. A successful reform process must take a wide array of relevant political, administrative, legislative, budgetary and staff issues into consideration in order to ensure sustainability. The Government must decide on the tools and strategies that best fit the circumstances of Kazakhstan. Professional assistance, local and international, may be needed to develop these tools and strategies, and implementation plan.

Institutional Framework for Managing the Reforms

11.6 Tax reform is not a static process conducted at intervals. The TC has to always keep pace with the evolving business environment and business methods. Therefore, it is important to conceive tax reform as a continuous process. In order to deal with this

approach, the TC must, at the start of the reform, **establish a Modernization and Strategic Development Department (MSDD)**. This Department should not only ensure a well-coordinated and effective implementation of reform activities, but also consistently seek and study innovative ideas, cutting edge technology and modern business processes being practiced or experimented elsewhere. The Department should be under the direct supervision of the Chairman or one of his deputies, and should be staffed by competent full-time personnel who are motivated for the reform task ahead of them.

11.7 To ensure effective coordination, implementation and coherence between different reform components, component-specific **Thematic Working Groups (TWG)** should be established. This should be constituted of senior officials drawn from each of the operational Departments who will serve in an ex-officio capacity. They will be responsible for design and implementation of their respective reform components. They will also develop terms of reference and technical specifications for respective reform activities, and participate in evaluation of proposals and selection of consultants, etc., and contribute to progress reports on the reform. To ensure management and coordination at the territorial level, several senior tax officials in regional units should also be nominated to the TWGs.

Internal Communication and Stakeholder Involvement in Design and Implementation

11.8 Every tax administration is shaped by its historic development, and represents its own organizational culture. The TC should, therefore, manage the change by maintaining constant dialogue with the staff about the reform process. In most OECD countries where tax reforms were undertaken recently, there was broad-based consultation, where all staff was invited to participate in drafting the new vision and reform concept. This vision was accepted by staff across the administrations, and they all had had a background in the process and its impact.

11.9 The Government should also involve other key stakeholders - taxpayers, related government agencies, civil society and tax professionals - in the design and implementation. Many countries undertaking reform establish two important structures for this purpose. The first is the **Inter-agency Working Group (IWG)** headed by the Finance Minister, where the different ministries and government agencies related to tax reforms (e.g., the Ministries of Finance, Economy & Budget Planning, Industry, Trade, Justice, etc.) are represented, so that inter-ministerial issues are decided at the highest level. The second is a **Public Collegium**, representing taxpayers, civil society and tax professional, which becomes a channel through which public debate and support for the tax reform, and tax legislation proposals are achieved.

Program Design and thematic Components

11.10 In the preceding chapters of this report, some of the key strengths and challenges in different areas and functions of the TC have been identified. Recommendations have been made on reforms in organizational set up, processes, functions and legislation in order to promote voluntary compliance, and improve effectiveness and efficiency of administration. The priority of the Government's tax reform program should be based on these principles.

11.11 Most successful reform designs divide the reform agenda into several thematic reform components. The design and implementation of each separate component should be supervised by the respective Thematic Working Group that should be set up at the start of the reform process. By way of guidance and example, recent best practice tax reforms in several EU accession countries have had the following components:

- a. **Organization and Management.** This component focuses on three major areas: Organizational Development; Human Resources and Training; and Anti-Corruption. In the case of Kazakhstan, this component could focus on:
 - (i) modifying the organizational structure of the TC as recommended in this report, including separation of headquarter functions from field functions;
 - (ii) creating new departments for taxpayer services, training and anti-corruption;
 - (iii) providing consultancy service for functional and workload reviews, workforce planning;
 - (iv) planning for new specialized occupational skills and expertise;
 - (v) modernizing recruitment, selection, and hiring procedures, designing compensation policies and practices, and performance incentive systems;
 - (vi) management and development of training curriculum, HR policies and procedures to raise the level of professionalism and integrity;
 - (vii) development and publication of a separate staff manual for the TC, prescribing all duties;
 - (viii) formulation of a Code of Ethics and Conduct, and development of operational manuals and proactive plans for both internal audit and internal security;
 - (ix) designing surveys to gauge the extent of corruption and identify areas with the gravest possibilities of abuse.
- b. **Operational Efficiency.** This component is usually aimed at activities for improving operational efficiency and effectiveness in collection, audit, return processing, adopting new streamlined business processes, and strengthening large taxpayer audit. For the TC, this should typically include:
 - (i) developing new criteria for large taxpayer classifications, and designing the framework for more focused large taxpayer operations;
 - (ii) revising audit procedures to correct problems referred to in the report;
 - (iii) revising the audit selection criteria based on an integrated risk assessment;
 - (iv) designing the framework for comprehensive and integrated audits, and developing audit plans based on the results of workload analysis and risk management;
 - (v) publication of a detailed audit manual incorporating comprehensive and integrated audit concepts,

- (vi) undertaking analysis of all arrears, and incorporate the information into collection plans and directives.
- c. **Legislative Initiatives and Appeals System.** Under this component, changes in the Tax Code and other relevant decrees and rules, recommended in this report could be undertaken, and the appeals system should be remodeled to make it more independent. Many of the amendments would relate to organizational and operational changes. The component would support:
- (i) identifying gaps in primary and secondary legislation and preparing recommendations and adjustments to facilitate organizational changes and improve operational effectiveness of the TC, including amendment regarding frequency and duration of LT inspections and other specialized audits;
 - (ii) restructuring the tax appeals system to make it an independent dispute resolution mechanism outside the normal chain of command;
 - (iii) creating occupational specialty of Appeals Officers, formulate job description and provide specialized training for such officers;
 - (iv) identify and index tax appeal, tax rulings, and judicial decisions for public dissemination.
- d. **Taxpayer Services.** This component would promote greater emphasis on taxpayer service. This would include:
- (i) establishing a new department for taxpayer service, and fill new positions for this function;
 - (ii) establishing a Public Collegium to ensure citizen voice and participation in tax administration, and to obtain feedback;
 - (iii) developing Call Centers to provide information and services to taxpayers,
 - (iv) disseminating publications and other media for taxpayer education,
 - (v) designing and conducting periodic taxpayer satisfaction surveys to assess progress;
 - (vi) conducting periodic analysis for capturing taxpayer compliance cost.
- e. **Facilities Upgrading.** This component would focus on upgrade of existing facilities and information and communication systems to support integrated business functions, as well as the establishment of specialized tax training centers.

Implementation Plan

11.12 Once the design of the reform program is formulated by the TC and discussed and agreed with the IWC, a detailed plan for program implementation should be elaborated. This should contain an action plan listing the main reform milestones, and how they are to be achieved, and the relationship and priorities between the various actions and tasks. The implementation plan should lay down the estimated cost of each activity, as well as the aggregate costs, and the possible source of financing. Dates for the

delivery/completion of various outputs, the sequencing of the reform activities, and the persons who will be responsible for each task should be determined.

Duration and Sequencing of reform Activities

11.13 Institutional reform and capacity building in the area of tax reforms are, at the very least, medium term endeavors requiring careful sequencing. The TC will necessarily require careful sequencing and adequate resources. The TC will need to plan for a multi-year implementation period, given the comprehensiveness of the reform agenda. While the duration of reform could vary, there is an obvious advantage of a faster implementation period of 3 to 4 years, because the goals of the reform are reached earlier. It is likely that the organization will have transitional hurdles during the early reform phase, and the faster the reform process is, the better it is from this perspective. A successful reform requires the attention and support of a number of different stakeholders. Delays might distract and cause loss of focus due to other developments and circumstances. In such cases, it is important to adjust the process according to evolving changes in the environment.

11.14 Determining the appropriate sequencing of the various components of the reform is critical. If the first priority is increasing effectiveness, this should be secured first, before efforts and resources are put into increasing the efficiency of the organization. In essence, motives and strategies must be linked; and the implementation process should be carefully sequenced and necessary adjustments made. Some useful lessons learned from successful tax administration reforms suggest the following:

- a. an appropriate governance structure, such as the MSDD, IWG and the TWG should be established at the start of the reform process to manage, coordinate, and oversee the process;
- b. a strategic plan with mission objectives for the tax administration reform should precede the program design and the detailed implementation plan;
- c. analyses which will provide input to, and determine, the design of the reform, such as the functional review, IT review, workload review and business process review, should be conducted, before the reform design and implementation plan are formulated;
- d. institutional reorganization, capacity building, and legal and procedural reforms should precede, or be undertaken simultaneously with, improving operational effectiveness and IT upgrading;
- e. pilot projects, and careful involvement and education of tax officials and management enables the gestation period to be shortened;
- f. a dedicated change management unit with appropriate powers is necessary for successful reforms.

Key Performance Indicators

11.15 Finally, measuring the success of the reform requires identifying specific measurable, realistic results framework to meet the key objectives of improving efficiency, effectiveness, professional integrity, and voluntary compliance. A set of key

performance indicators should be developed, which will take into account quantitative and qualitative aspects of the reform program and will be regularly reviewed and improved, to measure success. For measuring efficiency, commonly used indicator is administrative costs per revenue collected. For effectiveness, a variety of indicators are commonly used, such as additional taxes collected as a result of audit, or the tax arrears recovered, or reduced, in a year. For voluntary compliance, the commonly used indicators are the increase in the number of registered taxpayers, or the increase in declared income or sales voluntarily reported. Taxpayer satisfaction surveys are used to determine the professionalism and the honesty of tax officials, as well as to get a feedback on the quality of taxpayer service provided by the tax administration.

ANNEX 1: INTERNATIONAL EXPERIENCE ON PERFORMANCE MEASUREMENT FOR TAX ADMINISTRATIONS

1. INTRODUCTION

A1.1 International tax administration benchmarks and performance measures (PMs) allow for a comparative cross-country or cross-regional analysis of the tax administration (TA) performance, as well as measurement of progress over time and comparison of actual performance with established targets.

A1.2 Although national governments and international institutions have been assessing tax systems performance, there have been very few attempts to draw on best practices in the tax administration performance and to develop a comprehensive system of comparable tax administration indicators. This annex reviews the available literature and international experience in implementing and maintaining tax administration performance measurement systems.

2. DESCRIPTION OF APPROACHES

A1.3 Tax administration performance may be evaluated through direct measurement of process/time or cost of specific processes, stakeholder satisfaction surveys or a combination of both.

i. Direct Process Measurement

A1.4 This approach is based on developing a set of indicators to establish trends in performance for key processes, comparing actual performance with country targets and making comparisons against regional or international benchmarks. Performance indicators may be described as input, output, efficiency and outcome indicators:

- **Input indicators** measure the availability of resources (e.g., human resources skills or number, office equipment, IT systems, annual budgetary allocations) as well as processes (e.g., number of audits carried out per tax official);
- **Output and outcome indicators** measure the results of the client-related processes and may include revenues collected, tax declarations processed, appeals decided, revenue arrears recovered, and number of days taken to process a claim or a refund. These are best if analyzed in relation to a target or a benchmark such as the percentage deviation of the actual revenue collected from a target.
- **Efficiency indicators** (output per unit of input) may include things such as the ratio between the amount of revenues collected and administrative costs or the number of staff per 1000 of the population.

A1.5 The most common performance indicators and benchmarks are: tax structure (VAT collection as percent of total tax revenues, number of taxes making up 75 percent of collections), enforcement (VAT evasion, number of tax administrators per 1000

national population), payments and collections (late payments as percentage of total tax receipts), human resources (percentage of employees with university or college degree).

A1.6 An example of international and regional benchmarks and proposed performance indicators may be found in an USAID research paper¹⁰ This report includes tables with proposed international benchmarks; it lists several country case studies where the proposed methodology has been applied; and it provides a summary of other available sources on benchmarks in the TA assessment (Table A1.1 below was taken from this source).

A1.7 Although the international benchmarking provides countries with a useful tool in measuring the deviation of their tax systems performance from best-practice standards, most of these benchmarks fail to control for country-specific variables that may affect the TA performance, such as the TA structure and budget, technological capacity, income per capita, etc.

A1.8 Thus, the more common trend in measuring the performance in tax administrations is based on establishing country-specific performance targets and building an evaluation mechanism, or so-called management information system (MIS), to conduct periodical assessments of progress against the predetermined timelines and performance metrics, and to help make adjustments where needed.

A1.9 An example of possible tax administration indicators and performance measurement system may be found in a report of the working group formed by several countries and established with the sponsorship of France and the Inter-American Center of Tax Administration (CIAT). It provides guidelines to the CIAT member countries in establishing their own PM system by proposing the list of performance indicators and calculation formulas.¹¹

A1.10 As a result of the 2002 CIAT-France initiative in developing benchmarking practices in tax administration, several CIAT member countries publish annual PM reports to share their experiences in the TA performance measurement. Table A1.2 below includes indicators from the France's 2004 annual report (part of the CIAT Annual Management Reports electronic database) for key areas of tax administration. Examples are also available for Argentina, Brazil, Czech Republic, France, Mexico, Paraguay, Spain, and the Netherlands.¹²

¹⁰ Gallagher, Mark, *Assessing Tax Systems Using a Benchmarking Methodology*, USAID, April 2004, (accessed June 7, 2006); available from http://pdf.dec.org/pdf_docs/PNADC940.pdf.

¹¹ *Tax and Customs Indicators*, CIAT, October 2002, (accessed June 7, 2006); available from http://www.ciat.org/in/estu/docu/fiscal%20customs_management_indicators.pdf

¹² *Annual Management Reports*, CIAT, (accessed June 7, 2006); available from <http://www.ciat.org/in/estu/infor.asp>.

<i>Indicator</i>	<i>International Benchmark</i>	<i>Central America Benchmark</i>
Tax Structure		
Number of taxes making up 75% of collections	6	4
Broad tax base with limited exemptions	Yes	No
Percent of all taxpayers that pay the top 75% of revenues	5%	1%
Limited number of tax rates	Yes	Yes
Domestic VAT as percent of VAT on imports	n.a.	100%
Indirect taxes as % of total tax revenues	50%	70%
VAT collection as percent of total tax take	35%	45%
VAT rate	16%	13%
Tax ratio: high income countries	40%	n.a.
Tax ratio: middle income countries	25%	n.a.
Tax ratio: low income countries	18%	14%
Enforcement		
VAT evasion	10%	25%
VAT productivity	0.58	0.39
VAT Gross Compliance Rate	69%	46%
Use of performance indicators for audits and auditors	Yes	No
Number of tax administrators per 1000 national population	1.00 to 2.00	0.27
Ratio of active taxpayers to tax administrators	150 to 250:1	81:1
Audited taxpayers as % of total taxpayers, per year	1%	2%
Unified domestic and import audits	Trend	No
Ex post customs audits	Trend	No
Separation of taxpayers by size or nature	Yes	Yes
Payments and Collections		
Banking system payments	Yes	Yes
Percent of large taxpayers declaring via Internet	100%	n.a.
"Stop-filers" as % of active taxpayers	5%	n.a.
Late payments as % of total tax receipts	5%	n.a.
Administrative cost as % of total receipts	1%	1.5%
Share of adjustments and fines collected	80%	n.a.
Institution that establishes revenue targets	Ministry	Ministry
Use of automated systems for daily	Yes	Yes

Table A1.2: International Benchmarks (continued)

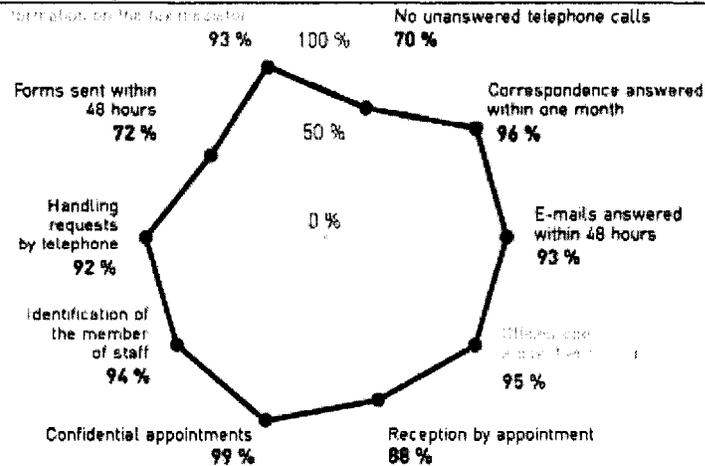
<i>Indicator</i>	<i>International Benchmark</i>	<i>Central America Benchmark</i>
Interconnectivity between HQ and local tax offices	Yes	Yes
Backup systems for all uses	Yes	Limited
Operating taxpayer current account (also under enforcement)	Yes	Yes
Clean and operating taxpayer registry	Yes	Yes
Automated audit case selection	Yes	Yes
Tax declaration entry with automatic error correction	Yes	Yes
Use of exogenous information (filers>vehicles>real estate)	Yes	Trend
Use of third party databases	Yes	Trend
Data crossing among taxes	Yes	Trend
Late or stop filers system	Yes	Trend
Planning and Coordination		
Appropriate use of planning, monitoring, and evaluation systems for tax organization	Yes	Limited
Coordination of data flows among tax administration, Ministry, and other agencies	Yes	Trend
Human Resources		
% of employees with university or college degrees	70%	40%
Ratio between director and auditor salaries	2:1	4:1
Ratio between average tax administrator's salary and average GDP per capita	2:1	5:1
Existence of administrative career plan	Yes	Trend
Existence of formal retirement plan	Yes	Trend
Sanctions and Penalties		
Tax code	Trend	Some, new
Tax fraud felony	Trend	Some, new
Application of tax fraud felony sanctions	Little	Very little
Appeals tribunal	Yes	Yes
Organization, Institutional Credibility and Public Confidence		
Stability of top-level leadership	Fixed appointment	Variable
Professionalism of top-level staff	Excellent	Good
Tax fraud unit in tax administration	Yes	n.a.
Unit for investigation of internal corruption	Yes	n.a.
Diversity and quality of taxpayer services	Yes	Limited
Internal regulation	Yes	Trend

Table A1.3: Benchmarking in France

1. Consolidating and Continuing to Promote Taxpayers' Compliance

Indicators	2004	Goal 2004	Goal 2005
Private taxpayers' compliance with income tax return obligations	97.8%	97.6%	97.8%
Business taxpayers' compliance with VAT return obligations	88.5%	84.0%	86%
Payment of business taxes on time	98.5%	98.0% to 98.5%	98.0% to 98.5%

2. Becoming a Benchmark Service Administration



Indicators	Result 2003	Result 2004	Goal 2005
General public: number of online income tax returns	601,025	1,252,311	> 1,500,000
Businesses: number of online VAT returns using the TélÉTVA application	57,395	81,572	250,000

4. The Efficiency of the Tax Audit Quality Chain Has Improved with the Topping of the Contract-Based Targets.

Indicators	Result 2003	Result 2004	Goal 2004	Goal 2005
Audit operations for enforcement purposes	18.1%	20.3%	16.5%	17%
Investigation operations for enforcement purposes	29.2%	34%	31%	35%
Cumulative rate of large accounts audits over the 2003-2005 period	32.3%	68.2%	66%	100%
Collection rate following an external tax audit in N-2 (taxes and penalties)	50.6%	56%	49%	49.5%
Percentage of legal and administrative disputes handled within six months	72.8%	83.2%	80%	85%

A1.11 Another interesting example is that of Chile. The Internal Revenue Service of Chile (SII) has developed a set of PMs to measure the administration's effectiveness based on the institution's objectives which include improving efficiency, promoting professional and personal development among its staff, reducing levels of tax evasion and avoidance, facilitating tax compliance and improving taxpayer services, ensuring equity and legal precision in the application of tax laws and strengthening and developing greater technological capacity.¹⁴

A1.12 The Chilean Government also rates the SII performance, using the tax revenue collection indicator. The benchmark is set equal to the revenue collected during the previous year, adjusted by that year's rate of GDP growth times 1.1 (which reflects the elasticity of tax revenue collection with respect to GDP). The SII employees earn bonuses that are tied to this target.¹⁵ Table A1.3 includes examples of some of the SII performance indicators in four areas.¹⁶

Table A1.4: SII Performance Indicators

Counter-line waiting time statistics		
	Number of taxpayers assisted (thousands)	% waiting longer than 30 minutes
1998		7.2
1999		0.2
2000	1,439	0.2
2001	1,542	0.6
2002	1,657	1.0

Source: SII, Subdirección de Fiscalización.

¹³ DGI Performance Report (2004), Ministère de l'Économie, des Finances et de l'Industrie, (accessed June 7, 2006); available from http://www2.impots.gouv.fr/documentation/rapports/activites/dgi/2004/version-anglaise/dgi_rp_performance_01.html.

¹⁴ Serra, Pablo, Performance Measures in Tax Administration: Chile as a Case Study, 2005, (accessed June 7, 2006); available from <http://www3.interscience.wiley.com/cgi-bin/fulltext/110471526/PDFSTART>

¹⁵ Serra (2005)

¹⁶ The table is presented in Serra (2005).

Use of internet in tax returns

	Form 29			Income Tax Returns		
	2000	2001	2002	2000	2001	2002
Internet	557	602	1,237	467	789	1133
Paper	11,635	11,163	11,175	1365	1107	936
Total	12,192	11,765	12,412	1832	1896	2069

Source: SII, Subdirección de Fiscalización.

Performance in Revenue Collection

Year	Tax rate	SII budget	Potential VAT tax revenue	Actual VAT tax collection	Compliance rate %
Current Ch\$					
1988	18.00	4,440	518,839	375,828	72.4
1989	16.00	4,894	619,954	452,750	73.0
1990	17.00	6,028	834,349	602,291	72.2
1991	18.00	8,626	1,181,926	875,605	74.1
1992	18.00	11,466	1,554,605	1,190,190	76.6
1993	18.00	15,608	1,849,531	1,515,285	81.9
1994	18.00	18,778	2,197,500	1,695,860	77.2
1995	18.00	22,013	2,612,959	1,990,068	76.2
1996	18.00	25,763	2,995,280	2,328,578	77.7
1997	18.00	26,979	3,248,164	2,619,917	80.7
1998	18.00	33,465	3,560,788	2,710,816	76.1
1999	18.00	39,641	3,580,041	2,793,349	78.0
2000	18.00	47,423	3,914,990	3,086,629	78.8
2001	18.00	53,200	4,245,324	3,404,920	80.2
2002	18.00	63,620	4,443,538	3,700,460	83.3
2003	18.25	64,821	4,788,331	4,036,873	84.3

VAT Enforcement Performance (Millions of Chilean Pesos)

	1991	1992	1993	1994	1995	1996
VAT sanction collection	7,640	11,911	10,680	13,530	12,368	13,806
VAT auditors' assessment	55,147	40,126	36,746	42,834	40,387	40,043
VAT penalty collection (%)	13.9	29.7	29.1	31.6	30.6	34.5
VAT non-compliance amount	636,360	610,531	515,143	577,182	646,982	673,272
Fines levied as a % of VAT non-compliance amount	1.20	1.95	2.07	2.34	1.91	2.05

Source: SII, Subdirección de Estudios.
Source: Taken from SERRA (2005)

ii. Stakeholder satisfaction surveys

A1.13 There are several empirical evidences that voluntary compliance by taxpayers improves when the administration provides better services. Therefore, a tax administration should strive to improve the quality of its services and minimize compliance costs for taxpayers, for example, the costs associated with book-keeping, costs of tax advisors services. To evaluate taxpayers' satisfaction with the services

provided by a tax administration, countries develop and conduct annual stakeholder satisfactory surveys (taxpayers' and employees' surveys).

A1.14 One such survey is carried out jointly by the World Bank and the European Bank for Reconstruction and Development. It is called the Business Environment and Enterprise Survey (BEEPS) and covers investment climate issues beyond tax administration. Table 2 in Chapter 4 (above) illustrated the main results of the BEEPS for tax administration indicators in a selected set of countries.

A1.15 There are also numerous examples of surveys carried out by the national authorities. One such survey is that of Ukraine. The survey has been conducted for several years throughout a computer-aided telephone interview of randomly selected private entrepreneurs and companies. Table A1.4 below include some of the survey's questions.

Table A1.5: Ukraine Taxpayer Survey

Issue 1: Interpretation of Legislation

Answers to the question «Can explanations and consultations by tax authorities ensure unambiguous interpretation of the tax legislation?»

Answer option	2001 survey, % of responses	2005 survey, % of responses
Yes	23.0	49.5
Partially	43.2	—
No	32.4	41.3
Difficult to say	1.4	9.2
Indicator of unambiguous interpretation	45.2	49.5

Issue 2: Compliance Cost

Do you consider as burdensome costs for...?

% of responses «no»

	2001	2005				
		Total	Small-sized	Medium-sized	Large-sized	Private entrepreneurs
...tax accounting?	60.0	49.9	39.9	40.2	33.5	51.2
...tax reports submission?	66.7	48.5	38.4	42.1	39.5	49.8
...interaction with tax authorities?	41.7	62.9	60.8	59.8	57.0	63.2
Indicator value	56.1	53.8	46.4	47.4	43.3	54.7

Issue 3: Likelihood of detecting Tax Non-compliance/Non-payment**How do you assess the capability of tax authorities to detect tax evasion cases?**

% of responses

	2001	2005				
		Total	Small-sized	Medium-sized	Large-sized	Private entrepreneurs
High	21.1	24.4	33.3	26.1	2.7	23.3
Medium	49.3	60.3	51.5	59.4	56.2	61.4
Low	29.6	15.3	15.2	14.5	19.1	15.3
Indicator value	51.7	57.6	62.1	58.7	56.6	57.1

Issue 4: Quality and integrity of the State Tax Service (STS) in tax administering and delivery of taxpayer services**STS performance**

% of responses «yes»

	2001	2005				
		Total	Small-sized	Medium-sized	Large-sized	Private entrepreneurs
Can explanations and consultations by tax authorities ensure unambiguous interpretation of the tax legislation?	45.2	49.5	32.9	19.4	13.5	51.8
Do you consider tax staff operations as:						
Competent?	36.8	73.7	67.3	65.0	60.1	74.6
Conscientious?	5.4	60.8	64.3	63.3	59.1	60.4
Unbiased?	46.3	51.5	50.2	44.9	41.6	51.7
Transparent?	34.0	49.0	50.0	46.2	42.3	48.9
Indicator value	33.6	56.9	52.9	47.8	43.3	57.5

A1.16 The Chilean internal revenue service also used a variety of service quality measures. In the 1990s it sample-surveyed customers to measure their satisfaction with the services, but it has since discontinued this practice and relies more on direct measurements as explained before. Tables A1.5 and A1.6 below includes examples of the results of previously conducted surveys in Chile.¹⁷

¹⁷ Serra (2005).

Table A1.6: SII Evaluation by Taxpayers
(% of respondents grading the SII 5 or above in a scale 1 to 7)

	1992	1996	2000
Modernization	75	60.9	80.7
Agility	52.6	31.4	47.9
Technological level	83.2	62.8	83.0
Professionalism	75.8	58.7	64.0
Efficiency	72.4	51.5	63.6
Honesty	78.9	73.3	81.8
Strictness	83.6	87.6	83.4
Customer servicing	59.0	51.2	56.0
Accuracy	79.1	77.7	74.6
Progress in computerization	88.2	68.9	89.5

Source: Adimark surveys (SII website)

Table A1.7: Customer Satisfaction with SII Workplace Services
(% of visitors satisfied or highly satisfied)

	Income Tax Procedures			Life-cycle Procedures	
	1994	1996	1997	1996	1997
Employees	72.4	86.8	83.2	77.9	84.6
Published tax guidelines	70.8	78.2	77.8	74.4	77.5
Overall satisfaction	60.3	58.5	64.1	66.4	72.5
Office quality	45.7	58.5	61.9	78.1	83.9
Counter-line waiting time	31.3	39.6	51.9	48.4	61.5
Equality in treatment	34.0	75.0	74.9	64.8	72.3
Taxpayers that completed the procedure in one visit (%)	68.9	70.1	69.7	63.6	64.3
Taxpayers that spent more than 30 minutes in the procedure (%)				36.6	27.4

Source: Adimark surveys (SII website)

3. INTERPRETING PERFORMANCE INDICATORS AND SURVEY RESULTS

A1.17 The challenge in assessing the performance of a tax administration is not only to establish the right targets and performance indicators. The right interpretation of performance measures is just as important and challenging. It may present a problem of controlling for variables that are out of the TA power and require adjustments for all external factors that might affect the TA performance.

A1.18 For example, the “tax gap” (the percentage deviation of the actual revenue collection from a maximum achievable outcome) is often used as a measure of the performance, although this indicator needs to be adjusted for other factors that also contribute to compliance and the total revenue collection, specifically, the tax base, the tax rate, per capita income, the size of the penalty for evading taxes, etc.

A1.19 The main problem with measuring the administration service via taxpayer surveys, on the other hand, is objectivity. One of the practices in assessing taxpayer survey results is complementing them with more objective data such as percentage compliance with service standards data. For example, Canada has developed 45 taxpayer service standards that include counter-service waiting time of 20 minutes (the target is 85 percent served within 20 minutes and in 2001-2002 the 85 percent standard was met). For

the client-resolution program the service standard is to respond to costumers within 15 days and the target is 100 percent, but the standard was only met in 66 percent of cases.¹⁸

¹⁸ Serra, Pablo, *Performance Measures in Tax Administration: Chile as a Case Study*, 2005, (accessed June 7, 2006); available from <http://www3.interscience.wiley.com/cgi-bin/fulltext/110471526/PDFSTART>

ANNEX 2: METHODS TO ENSURE EXECUTION OF OVERDUE TAX LIABILITY AND FORCED COLLECTION OF TAX LIABILITIES



ANNEX 3: APPEALS PROCEDURES

