World Bank Technical Assistance on Improving Country Policy and Institutional Assessment (CPIA) Rating

Tax Mission to Uzbekistan March 9-20, 2009

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I’d like to express my appreciation to Mr. E. Gadoev, First Deputy Chairman of the State Tax Committee, Ms. I. Golysheva, Head of Main Tax Department of the Ministry of Finance and members of their staffs for all the information, assistance and courtesies extended me. This mission would not have been possible without the exceptional capabilities of Eskender Trushin, mission’s member, and the staff of the World Bank Country Office in Uzbekistan. I, also, had the opportunity to meet with representatives of the UNDP Public Finance Reform Project, Japan International Cooperation Agency, International Finance Corporation, and Mr. Alisher Shakhkov, Chairman of the Chamber of Commerce and Industry of Uzbekistan. A list of individuals contacted during the mission can be found in Attachment II.
MISSION BACKGROUND and INTRODUCTION

The mission was tasked to work in two areas:

1) conduct diagnostic work and assessment of the overall pattern of revenue mobilization in accordance with the Bank’s CPIA ratings and provide recommendations to improve the rating;
2) Develop recommendations on requested topics in accordance with international best practice. Bank staff requested that I focus on monitoring the implementation of the new tax code, risk management in task collection, and reforms in self-assessment of taxes. Therefore, my involvement in tax policy was limited.

Details of the scope of the mission are provided in Attachment I.

The mission’s assessments and recommendations were reflected in submission of new CPIA ratings for both tax policy and tax administration for approval by the World Bank headquarters staff.
Mission Approach and Activities

After obtaining background information including discussions with IFC and UNDP project staff, separate introductory meetings were held with both Mr. Gadoev and Ms. Golysheva to discuss mission objectives and scope of assistance. I explained to Ms. Golysheva that a follow-on mission would provide the specific tax policy assistance she requested. However, I did provide her with an outline for a legislative implementation planning process (Attachment IV). Since the new tax code took effect on January 1, 2008, a review process to improve the code was established which is supported by the UNDP Public Finance Reform Project. To date over seventy amendments have been promulgated and the work by a review committee is ongoing. Unfortunately, English versions of the amendments were unavailable during the mission so I could not comment on the changes to the code.

The bulk of my time was spent in numerous meetings with all major tax administration departments and in a visit to a Bishkek regional tax office. Early in the mission I provided the State Tax Committee with copies of a Russian translation of a paper I had previously developed for the World Bank (IFC) describing common characteristics of tax administrations in developing economies prior to reform, describing international best practices in all facets of tax administration, and providing a blueprint for change. (Attachment V). In the latter part of the second week of the mission, I met with all department heads with whom I had previously met individually, to discuss the current state of the State Tax Committee. The discussion was open and free flowing and, in effect, served as a self evaluation by State Tax Committee staff of the current situation as compared to international best practice. It, also, resulted in requests for additional assistance which are contained in the recommendations provided in the next section of this report. There were immediate requests for examples of organizational structures of more advanced tax administrations as well as samples of strategic business plans. Prior to my departure I provided organizational charts for ten countries from the former Soviet Union, Central and Eastern Europe and other regions. I, also, provided strategic business plans from three countries. Some of this material was in Russian but most was or was being translated. I made it clear that the materials were for illustration purposes only and what was really needed was a structured approach to further develop a function based organization structure and to review the current number, location, activities and staffing of tax offices at the headquarters, oblast and local level. The development of both a strategic business plan and a strategic planning process would likewise require a structured approach. International technical assistance would be extremely helpful in both these areas.

During my closeout meeting with First Deputy Chairman, I reviewed the below listed summary of my findings and recommendations. I advised him that his department heads had requested additional assistance with regards to: organizational restructuring; the strategic planning process; and an annual performance based employee evaluation process. I’m in the process of obtaining examples of various tax administration performance based employee evaluation systems and will forward them to the World Bank Country Office for translation. I explained that if the STC would like to pursue additional technical assistance, an official request by the First Deputy
Prime-Minister would be required. Additionally, I mentioned that other international and bi-
lateral donors could, also, provide similar assistance.

At my closeout with Ms. Golysheva, I indicated that I would attempt to locate a model tax
regime for non-residents. However, what’s really needed is a mission by a tax policy expert to
review the current Uzbek regime and assist in development of legislation adapting best practice
to the Uzbek reality. In our discussions it, also, became clear that improvements to the MoF tax
modeling process are necessary in order to best deal with their request in item 4 of the terms of
reference. At present the total tax burden of business taxpayers is quite high. I suggest that a tax
modeling expert be part of a follow-on mission on improving tax policy.
Summary of Tax Administration Review and Recommendations

- The new tax code adopted on January 1, 2008 has reduced the administrative burden on both the tax administration and taxpayers.

- Taxpayer rights are now codified

- The frequency of tax inspections and audits have been reduced

- The tax administration provides taxpayer services and assistance at local offices and taxpayers can both download tax returns and other forms as well as review their tax account on the web with secure access. However, taxpayer service is not organized as a separate department within the tax administration.

- The STC collects non-tax obligations (fees, charges) which would normally be handled by local government if they had the capacity.

- The STC has focused on providing good facilities and equipment throughout the country.

- All taxpayers are assigned a unique tax identification number (TIN) which is the basis for the STC information management system. The TIN is also used by Customs, business registration and other state bodies.

- There is no organizational unit dedicated to audit or administration of large tax payers. The general situation in most transitional counties is that 20% of taxpayers produce 80% of tax revenue. Therefore, establishment of large taxpayers units are a common feature of most tax administrations.

- The STC has instituted electronic tax return filing and indicates that almost 10% of business taxpayers now file electronically.

- Less than 2% of business taxpayers are subject to field audits and approximately one third of business taxpayers are subjected to cameral (office) audits

- Based on their compliance history, inspection visits are made business taxpayers to ensure they are using cash registers and issuing receipts.

- The STC has introduced a limited audit case selection process based on risk analysis for “planned” audits. However, planned audits comprise approximately half of total audits. A rudimentary audit case selection based on risk analysis is currently done by regions in accordance with national guidelines. UNDP is providing assistance in developing an enhanced risk based audit case selection methodology.
The STC IT system currently links all tax offices by satellite communications but fiber optic linkage is presently underway and is scheduled to be completed by the end of 2009.

When all offices are fiber optic linked, the STC will be able to have national databases for both physical and legal persons. This will permit development of a nationwide risk based audit case selection system which represents international best practice.

STC offices regional offices have at least 60 computers for every 100 employees. All oblast and central office staff are provided computers, however, a number are fairly old.

The IT department is adequately staffed.

Software development is outsourced to an independent state research and technology center which is self-financed and does all STC software development on a charge back basis. Center employees receive a higher salary than STC staff.

STC staff receives a higher salary than most other civil servants and are eligible for bonuses.

There are three tax colleges and a tax academy which are used to train both future and current tax administration staff.

While the STC has developed a three year strategic IT plan, the STC has neither developed an overall Strategic Business Plan or strategic planning process.

There is no independent appeals process within the STC. Taxpayers can protest to the head of a regional office and then with some exceptions (involving very large taxpayers who can avail themselves to a review by an inter-ministerial commission) appeal directly to the administrative court.

Enforced collection by the STC is limited to administrative attachment of bank accounts. Seizure and sale of other tangible or intangible property requires application through the courts.

Installment payments of delinquent taxes can only be approved by an external commission.

Neither the MoF or the STC has a formalized legislative implementation planning process.

The STC has limited features of a best practice organizational structure based on function or business process.

Tax penalties can be imposed and assessed for a variety of reasons; however there is no legal provision to charge interest on delinquent taxes.
Recommendations

- The STC should consider reviewing its organizational structure to move further towards a best practice structure based on tax function (business process) to improve operational efficiency and effectiveness at the central, oblast, and regional level. Consideration should also be given to formation of a large taxpayer organization with the organizational status of an oblast office. Additionally, the organizational review should consider rationalization of the number and staffing levels of oblast and regional levels, the establishment of one or more returns processing centers, and the establishment of one or two taxpayer service call centers.

- The STC should consider adopting an annual written performance based employee evaluation process that base promotions and awards on factors beyond meeting revenue targets.

- The STC should consider adopting a dynamic strategic planning process which includes measures of organizational effectiveness.

- The STC should consider adopting other operational changes based on international best practices contained in material provided to the STC during the mission. It is recognized that some legislative changes will be required.
Additional Comments on Selected Review Items, Recommendations, and ToR Requirements

Use of Risk Analysis for Audit Case Selection

As indicated above, use of risk analysis is rudimentary. Cases are selected at the local office level based upon limited criteria set by the headquarters office. Once the fiber optic linkage between all outlying offices and the central database is completed, a nationwide case selection system can be developed at the headquarters office using eight to ten criteria. Software can then be developed and run against the national taxpayer database so that taxpayer returns will receive a ranking or score. The cases will then be assigned to local offices in rank order for audit, based on the national scoring system. This represents international best practice. Also, when the fiber optic system is complete and electronic linkages are made to other state bodies, the number of cameral audits can be significantly reduced and be replaced by document matching programs. At some point in future the number of cash register compliance checks can also be reduced.

Use of Risk Analysis for Prioritizing Enforced Collection Assignments

In addition to collecting major national taxes, State Tax Committee is, also, responsible for the collection of what are normally considered local taxes and fees as well as unpaid electricity bills. While legislative changes would be required to change this mandate, the State Tax Committee would benefit from an enforced collection scoring system which would rank cases based on such factors as amount of outstanding delinquency, and compliance history. It should be noted that a number of best practice collection techniques (e.g. installment payments of delinquent taxes) cannot be utilized by the STC due to legislative an administrative barriers)

Self Assessment

Uzbekistan Tax Code establishes a self-assessment system. Physical persons (individual taxpayers) who are subject to tax withholding by an employer or withholding agent are not required to file tax returns.
Tax Policy and Administration

This task consists of the following elements.

First, a diagnostic and assessment of the overall pattern of revenue mobilization—not only the tax structure as it exists on paper, but revenue from all sources as they are actually collected. The two components of this sub-task are (a) tax policy and (b) tax administration. In carrying out this assessment, particular attention will be paid to the criteria that have been developed for the CPIA exercise (see below).

1 a. Tax base is extremely narrow with many open-ended exemptions. Most tax revenues are collected from foreign trade and other distortionary taxes. There are high, multiple, and widely ranged import tariffs, which change frequently or are applied in a highly discretionary manner. Little is collected from income taxes.

   b. Tax administration is extremely weak, with very low collection rates. It is organized by type of tax and business processes have not been reviewed and reformed. Computerization is limited to very basic functions. Many taxpayers must make several or more personal visits to tax offices. Corruption is endemic among tax and customs officials.

2 a. Tax system is poorly designed, with a narrow base and many open-ended exemptions. Taxes on foreign trade, turnover taxes and other distortionary taxes are the dominant source of revenue. There are high and multiple import tariffs. Both company and personal income taxes have high rates on a very narrow base and generate little revenue.

   b. Tax administration is weak due to complex laws, poor information systems, corruption, weak capacity and political interference. Collection rates are low. Tax obligations are negotiable rather than rule-based. Appeals and other dispute resolution mechanisms have not been developed.

3 a. Taxes on trade are the dominant source of revenue; turnover and other distortionary taxes and levies remain. Consumption based taxes (e.g., a VAT) are planned or in limited use. Import tariffs are moderate, but there are too many rates. Income tax base is narrow and the rate structure is only partly rationalized.

   b. Tax administration is weak, but tax laws are not inordinately complex, and information systems are functioning (e.g., unique taxpayer identification numbers used). Corruption exists, but there are efforts to improve integrity as well as capacity.

4 a. A significant amount of revenue is being generated by low-distortion taxes such as retail sales/VAT, property, etc. VAT has not been fully operational to include activities at the retail stage. Non-trivial amounts of revenue are generated from company and personal income taxes. Tax base is broad and exemptions are moderate and made time-bound, especially for promotion schemes. Trade taxes have few and low rates.

   b. Tax administration is solid, cost of revenue generation has been reduced and there are relatively few cases of corruption and political interference. Eligibility for preferential rates and exemptions is largely transparent.

5 a. The bulk of revenues are generated by low-distortion taxes such as sales/VAT, property, etc. Import tariffs are low and relatively uniform, and export rebate or duty drawback are functional. There is a single statutory corporate tax rate comparable to the maximum personal income tax rate. Tax base for major taxes is broad and free of arbitrary exemptions.

   b. Tax administration is effective, and entirely rule-based. Administrative and compliance costs are low. A taxpayer service and information program, and an efficient and effective appeals mechanism, have been established.
Criteria for “5” on both sub-ratings are fully met. There are no warning signs of possible deterioration, and there is widespread expectation of continued strong or improving performance.

Second, a review will be undertaken of the tax regime for non-residents, with a view to making recommendations for reform in line with international good practice.

Third, advice will be provided on how best the monitoring of the implementation of the new tax code can be conducted.

Fourth, a detailed strategy of the methods and ways in which the tax burden can be reduced will be developed. This will take into account the economic and fiscal effects of possible changes in tax rates, bases and regimes, with a view to ensuring neutrality and maximizing the incentives for growth.

Fifth, in the area of tax administration, a diagnostic of risk management methods in tax collection will be carried out and advice provided for reforms. An evaluation will be made with reforms in self-assessment of taxes.

The work under this programme will be undertaken in stages, with the first task to be initiated in March, 2009. The team will work in close partnership with the Ministry of Finance and the State Tax Committee in this task.
Officials Met during the Mission

Ministry of Finance

Head of Main Tax Department of the Ministry of Finance
I.Golysheva

STC Staff

First Deputy Chairman of the State Tax Committee
E. Gadoev

Main Department for Control over Tax Law Execution by Legal Entities
N.Shmakova – Deputy Head of Central Administrative Board
O.Nabiev – Resource Taxes Department Head

Main Department for Control over Tax Law Execution by Physical Persons
B.Normirzae – Head of Central Administrative Board

Department for Documentary Inspection, Administrative Practice Unit
A.Tagaev – Deputy Department Head
D.Zagornyakov – Chief State Tax Inspector
B.Mirzaev - Administrative Practice Unit Head

Computer Department
A.Kariev – Unit Head
V.Umarova - Chief State Tax Inspector
Z. Khudaibergenova - Chief State Tax Inspector

Department for Reporting and Analysis of Tax Proceeds
A.Tangirkulov – Department Head
R.Khairutdinov - Department Head

Department for collection of payments to EBFs
M.Pardaev – Department Head

Arrears Analysis Unit
Kh.Ismatov – Unit Head

Cash Flow Analysis and Monitoring Department
I.Norov – Department Head
F. Mirjalilov - Chief State Tax Inspector
Kh. Raupov - Chief State Tax Inspector

Main Department on Operation and Human Resources
K. Babaev – Main Department Head
T. Tadjibaev – Head of Human Resources Department
A. Tadjiev – Unit Head

Scientific Information Center
R. Mustafakulov – Director

IFC

Project Manager, Uzbekistan BEE Project
V. Payevskiy

Economic Policy Researcher
S. Tashpulatova

Japan International Cooperation Agency

Country Representative
O. Sugimoto

Chamber of Commerce and Industry of Uzbekistan

Chairman
A. Shaykhov

UNDP Public Finance Reform Project

Project Manager
D. Tadjibaeva

Research Coordinator
V. Anoshkina
Modern tax policy and tax administration bodies develop legislative implementation plans to outline the necessary activities required to implement legislative changes. The process normally involves having representatives of both organizations, formally or informally, participate in the development of the legislation. This provides an “early warning” of the nature and scope of the changes and permits initial estimates of the impact of the legislative changes on both the tax bodies as well as taxpayers.

The main focus of the tax policy body is to estimate the revenue impact of legislative changes while the main focus of the tax administration body is to assess the impact of the legislation on the operations of the tax administration as well as to facilitate taxpayer understanding and compliance with the legislative changes.

The tax policy body employs tax modeling techniques to determine revenue impact of the legislation. It then must estimate the time needed to develop required regulations (secondary legislation) and subsequently develop the regulations. The tax administration body must estimate the time necessary to ensure that the legislation can be effectively administered. Both bodies must advise the Parliament of the timelines necessary to complete these tasks and suggest alternative approaches to reduce the burden on both the tax administration and taxpayers prior to the legislation being finalized.

Specific actions include:
- Determine revenue impact using tax models
- Determine taxpayer burden
- Determine time needed to develop implementing regulations
- Determine impact on the tax administration body including time and costs of developing necessary:
  - Procedural guidelines (methodology)
  - Tax form and information system changes
  - Developing taxpayer education programs including public service announcements and informational brochures
  - Developing training for tax administration staff

Once the legislative changes are enacted a detailed implementation plan should be prepared. The plan should assign organizational responsibility for all tasks necessary to be completed to effectively implement the legislation as well as to set timelines for completion. This can be done by using an EXCEL spreadsheet or similar tool. Periodic status reports for all elements of the plan need to be prepared to keep top management officials apprised of implementation progress.

The World Bank
March 17, 2009
Attachment IV

See: