I. Introduction and Context

Country Context

Tajikistan is a small landlocked country vulnerable to natural disasters and external economic conditions. Located in the heart of Central Asia, it is blessed with abundant water resources, contributing to its specialization in cotton production. Tajikistan also has considerable hydropower potential—inexpensive electricity has led to its other specialization: processing of aluminum. Only 7 percent of the country’s total land area is arable; high mountain ranges make communication between different parts of the country difficult, especially in winter. Tajikistan is regularly affected by floods, landslides, earthquakes, and droughts. These factors combine to make it one of the world’s poorest economies. In 2010, Tajikistan’s gross national income (GNI) per capita was estimated at US $800. Limited employment opportunities have led 40 percent of working age population to seek jobs abroad, mainly Russia. Shortly after independence in 1991, the country descended into a civil war that lasted until mid-1997, which brought widespread physical damage and loss of life.

Strong economic growth during the past decade reflected post conflict ‘catch-up’ and rising domestic demand fuelled by remittances. The economy grew at an average of 8.6 percent per year during 2000-2008. Total investment, dominated by public investment, has hovered around 20 percent of GDP with private investment stagnating at around 5 percent of GDP. Strong growth was made possible by five favorable factors: the peace agreement that permitted businesses and households to return to normal economic activity; Government’s success in stabilizing the economy; the growing global and regional economy that led to rising aluminum and cotton exports and remittances; rising inflows of donor assistance, including from the IFIs; and reforms that permitted existing businesses and households to take advantage of emerging opportunities.

The Government’s reforms, though gradual, covered areas relevant for the country to benefit from a growing world economy. In the early years, Tajikistan opened up trade, established a central bank and a commercial banking system, negotiated visa-free access for Tajik workers to go to Russia and removed taxes on remittance inflows. Private businesses grew as a large number of small and medium-size enterprises were privatized, and land reform provided more land for private farms and households. In recent years, reforms have sought to improve further the private investment climate, increase access to air transportation, rationalize cotton sector operations, remove restrictions on exports and strengthen governance in selected areas like the National Bank of Tajikistan (NBT), large state-owned enterprises (SOEs) and public expenditure management.

Sectoral and Institutional Context

Tax reform is a high priority of the Government of Tajikistan (GoT) and an important foundation for achieving the country’s development goals of reducing poverty and ensuring growth. Achieving these objectives will require a strong public sector that effectively raises revenue and provides high quality public service. Maximizing revenue collection and closing the tax gap are needed to provide fiscal space needed for investments in key public services and infrastructure to deliver poverty reduction and spur economic growth.

Ownership for tax administration reforms is high in the government. In December 2010 the GoT passed Resolution No. 686 adopting a comprehensive Tax Reform Program (TRP) for 2012-15 broadly in line with the recommendations of the Bank and the IMF. Tax administration reform is reiterated in the National Development Strategy 2012-15, the Poverty Reduction Strategy 20100-12, and the Public Finance Management Strategy 2009-18. The major objectives of the TRP include: (i) structural and functional reorganization of the Tax Committee; (ii) improving IT technologies and automation of processes; (iii) strengthening the Large Taxpayer Inspectorate; (iv) establishing the Medium Size Taxpayer Inspectorates along the functional organization lines; (v)
capacity building of staff; (vi) improving taxpayer services; (vii) improving debt management; (viii) implementing an effective tax control system; and (ix) simplification of tax regime. Many of these reforms will require significant changes to the legislative framework. Also to simplify the tax regime and tax administration procedures, the Government has created a Working Group to develop a new Tax Code which is expected to be adopted by the Parliament by the end 2012.

Tajikistan faces substantial challenges in revenue collection because of low capacity of the Tax Committee (TC) to detect tax evasion and locate non-filers and weak capacity of the MOF to do good quality tax policy analysis, forecasting and policy formulation. There has been very little investment in the last ten years to modernize the tax system. The low revenue performance is a huge concern and a major macroeconomic risk for an economy that is the world’s most dependent on foreign remittances. The tax-to-GDP ratio (table 1) at less than 20 percent (including social contributions) is the lowest in the CIS and weak relative to comparators. At the same time, a complex tax regime with a large number of nuisance taxes and reported corrupt practices by tax officials raise the compliance costs for taxpayers and undercut the business climate and private sector growth. At the same time, there are tax privileges and exemptions for some favored industry sectors.

Recent IMF and Bank analyses have pointed to the fact that reform progress is too slow to help Tajikistan cope with the fiscal challenges. There is weak capacity to detect and penalize tax frauds. Audit and investigation capacity is weak. There is insufficient information on taxpayer behavior for audit planning. Risk-based audit selection is not used yet. Improved methods are needed to locate taxpayers in the informal sector. Some of the other key sectoral and institutional issues are highlighted in the following paragraphs.

The TC and its local offices are not organized on a functional basis. The TC headquarters is a mixture of revenue type, functional type and taxpayer type. The horizontal definition of reporting lines and functional responsibilities of tax collection are not always clear.

There are an excessive number of field offices with insufficient staffing that creates problems for providing timely and professional processing of different types of taxes. The TC has a staff of 1,760, working in 79 offices including the central headquarters, a large taxpayers inspectorate (LTI) with 4 sub-offices, Dushanbe city office with 4 district offices, Sogd regional office with 18 district offices, Khatlon regional office with 25 district offices, Badakhshan regional office with 9 district offices and 13 district offices reporting directly to the central headquarters (Please see Annex 1 for details). About a third of the offices do not have their own premises and lack office equipment. These 79 offices service about 39,000 legal entities paying 14 different taxes and about 150,000 physical persons paying social security and one or several of the 10 other taxes (including VAT, income tax, patent, certificate, land tax, real estate tax, unified tax, simplified tax, motor vehicle tax, and retail sales tax).

Due to complexity of the current tax legislation demand for taxpayer services is high. Yet the level of taxpayer service is low. This is a problem for taxpayer registration, complicated tax declarations and payment procedures. Since more than 75 percent of field tax offices have less than 20 employees, maintaining the required professional skills to satisfy growing taxpayers’ demand for services is difficult. To enhance effectiveness in providing taxpayer services, some delegation of authorities between headquarter and field offices would be necessary.

Technical capacity of staff is inadequate, particularly auditors in the Large Taxpayers Inspectorate. Staff training is grossly insufficient and knowledge of tax legislation, especially in remote offices, is minimal. There is lack of analytical capacity and insufficient knowledge of modern computer technologies for analysis, audit and investigation of tax fraud.

One of the most serious problems facing with the TC is a growing stock of tax arrears. Tax arrears have been increasing significantly over the past years. Total tax arrears have increased to more than 25 percent of total revenues collected by the TC. The TC needs to considerably strengthen its debt management program which will be required: (1) the legal framework governing debt management; (2) the debt management strategy and its supporting business processes; and (3) the management and structure of enforcement resources.

The level of computerization within the TC remains minimal. The only significant IT systems in use are the taxpayer registration system and the taxpayer accounting system. The vast majority of tax declarations are received on paper (although the legislation allows for the e-filing of scanned documents) and most declarations are presented in person. Direct e-filing is currently not available to taxpayers. Consequently there are no analytic data kept electronically for most tax types. The payment data is entered manually on the taxpayer accounts. This is onerous and prone to data entry errors. Although currently TC is running six tax administration information programs, they are not well integrated and require additional work on consolidating information.

Over the past year, the TC has undertaken some activities to improve tax administration. Achievements include: (i) payments through banks; (ii) the self-reporting system is in place; (iii) the LTI is in operation and is organized along functional lines; (iv) business registration has been greatly simplified; (v) internal control has been improved and performance evaluation system of local inspectorates has been developed; (vi) development of communication networks is in progress; (vii) electronic kiosks to simplify tax payments have been introduced; (viii) the functional reorganization has been piloted; (ix) the department of medium size enterprises has been initiated; and (x) the system for the taxation of small enterprises has been simplified by increasing the VAT threshold and exempting them from road tax.

Relationship to CAS
The proposed intervention is consistent with the CAS for 2010-2013 result 4: Strengthen Business Enabling Environment, and result 10: Strengthen Transparency and Accountability in PFM. An effective and service-oriented tax administration is one of the key elements of a healthy business environment. Lack of an effective tax administration was one of the reasons of Tajikistan’s low score in the recent Doing Business Survey. PEFA 2007 Assessment identified poor tax administration as one of the weaknesses of the current Tajik PFM system. It is expected that implementing the proposed project would contribute to improved business climate and enhanced effectiveness of PFM. The reform aims at improving the quality of tax administration, strengthening the appeal system, reducing the compliance burden on taxpayers and increasing revenue collection. A modern tax administration integrated with the budget process enhances overall effectiveness of PFM.

II. Proposed Development Objective(s)

Proposed Development Objective(s)
The development objective of the TARP is to reform the tax administration to become more efficient and effective in collecting revenue while providing quality service to taxpayers. Specifically, the project aims to: (i) enhance the level of voluntary compliance; (ii) strengthen the effectiveness of the Tax Committee to fight tax evasion and reduce the size of the shadow economy; (iii) strengthen the institutional and human capacity in order to improve the professionalism of tax officials and reduce the avenues for corruption.; and (iv) modernize processes that would reduce administrative cost for the government and compliance burden for taxpayers, thereby improving Tajikistan’s business environment and competitiveness.

Key Results
18. The results of the project will be monitored on the basis of the agreed performance indicators. The key results indicators correspond to the development objectives of the Government and are as follows:
   • Increase in Voluntary Compliance will be measured as increase in the total number of registered taxpayers;
   • Improved Efficiency will be measured by the increase the in average tax revenue collected per tax official;
   • Enhanced Effectiveness will be measured by the: (i) reduction in tax gap; and (ii) increase in adjustments as a result of tax audit per auditor.
   • Reduction in Compliance Cost will be measured by: (i) increase in the percentage of taxpayers filing electronically; and (ii) the reduction in average time to comply
   • Improvement in professionalism and integrity will be measured through periodic taxpayer perception surveys.

III. Preliminary Description

Concept Description
It is envisaged that the project would consist of four components, the implementation of which would be managed by different units of the Tax Committee.

Component 1: Institutional Development.
This component will aim to build capacity for strategic planning and organizational management; improve the revenue forecasting and tax analysis capacity of the MOF and TC; provide support for restructuring and consolidating the organization to match functional requirement; develop human resource management information system, staff training, distance education and e-learning; and focus on motivation, honesty and integrity of tax officials.

Component 2: Process Modernization and Operational Development.
This component will aim at streamlining business processes based on self assessment and risk management; strengthening tax functions including registration, return processing, collection, audit, and appeals; enhancing the capacity of the large taxpayers’ office, arrear collection; improving taxpayer service and education; and development of a modern call center).

Component 3: Information Technology Infrastructure Development.
This component will attempt to upgrade IT infrastructure in the TC to develop an integrated tax management system which will unify business processes and support e-filing, e-payment, web-based taxpayer information; improve telecommunications and connectivity; and develop a data management system (with data mining, data warehousing and data exchange capabilities).

Component 4: Project Management.
This component will finance the project management costs and associated expenses to ensure the timely and efficient implementation of project activities.

Preliminary cost estimate for the proposed Bank-funded project is $12-15 million.

IV. Safeguard Policies that might apply

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Forests OP/BP 4.36  
Pest Management OP 4.09  
Physical Cultural Resources OP/BP 4.11  
Indigenous Peoples OP/BP 4.10  
Involuntary Resettlement OP/BP 4.12  
Safety of Dams OP/BP 4.37  
Projects on International Waterways OP/BP 7.50  
Projects in Disputed Areas OP/BP 7.60

V. Tentative financing

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