



**USAID**  
FROM THE AMERICAN PEOPLE

# EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

YEAR 2 – ANNUAL REPORT

Contract Number EEM-I-00-07-00005-00

This publication was produced for review by the United States Agency for International Development. It was prepared by Deloitte Consulting LLP.

# **EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)**

**YEAR 2 – ANNUAL REPORT**

(APRIL 15, 2011 – APRIL 14, 2012)

CONTRACT NUMBER EEM-I-00-07-00005-00

**DISCLAIMER:**

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

# CONTENTS

- 1 ESTAK ANNUAL REPORT SUMMARY ..... 1**
- 2 ACHIEVEMENTS AND SUCCESS STORIES ..... 2**
- 3 PROJECT PROGRESS IN YEAR 2 ..... 3**
  - 3.1 OBJECTIVE 1 - STRENGTHEN THE CAPACITY OF TAK TO ADMINISTER ITS RESPONSIBILITIES ..... 3
    - 3.1.1 (A) SKILLS DEVELOPMENT/TRAINING .....3
    - 3.1.2 (B) IMPROVING MANAGEMENT EFFECTIVENESS.....5
    - 3.1.3 (C) DETERMINING RESOURCE NEEDS.....7
    - 3.1.4 (D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION .....10
    - 3.1.5 (E) SIGTAS IT SYSTEM .....12
  - 3.2 OBJECTIVE 2 - INCREASE TAXPAYER COMPLIANCE ..... 13
    - 3.2.1 (A) IMPLEMENTATION OF TAX LEGISLATION (RULES AND REGULATIONS) .....13
    - 3.2.2 (B) ROBUST AND FAIR AUDIT FUNCTION .....16
    - 3.2.3 (C) ROBUST AND FAIR COLLECTIONS FUNCTION .....18
    - 3.2.4 (D) PUBLIC EDUCATION ON TAX COMPLIANCE.....21
  - 3.3 OBJECTIVE 3 - DONOR COORDINATION ..... 23
- 4 PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS ..... 25**
- 5 VARIANCES FROM THE YEAR 2 WORK PLAN..... 27**
- 6 UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT YEAR..... 29**

## LIST OF ACRONYMS

ACD	Automatic Call Distribution
ADDIE	Analysis, Design, Development, Implementation, Evaluation (model)
AQM	Audit Quality Measurement
BEEP	Business Enabling Environment Program (USAID funded)
BRAK	Business Registration Agency of Kosovo
DCoP	Deputy Chief of Party
DEMI	Democratic Effective Municipalities Initiative (USAID funded)
DFID	Department for International Development (UK)
DG	Director-General
ECLO	European Commission Liaison Office
E-filing	Electronic Filing
E-payment	Electronic Payment
ESTAK	Efficient and Sustainable Tax Administration of Kosovo (USAID funded)
EU	European Union
EU-CTA	European Union Customs and Tax Assistance (EU funded project)
EULEX	European Union Rule of Law Mission in Kosovo
FTE	Full Time Equivalent
GFSI	Growth and Fiscal Stability Initiative (USAID funded project)
GIZ	Gesellschaft für Internationale Zusammenarbeit (Germany)
GoK	Government of Kosovo
HQ	Headquarters
HR	Human Resources
ICO	International Civilian Office, Kosovo
IFC	International Finance Corporation (World Bank group)
IMF	International Monetary Fund
ISD	Instructional Systems Design
IT	Information Technology
KIPA	Kosovo Institute of Public Administration
KJC	Kosovo Judicial Council

KPI	Key Performance Indicator
KPST	Kosovo Pension Savings Trust
LTU	Large Taxpayer Unit
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTI	Ministry of Trade and Industry
OJT	On the Job Training
PAK	Privatization Agency of Kosovo
POE	Publicly Owned Enterprise
SEAD	Systems for Enforcing Agreements and Decisions (USAID funded)
SIGTAS	Standard Integrated Government Tax Administration System
SOE	State-Owned Enterprise
TAIEX	Technical Assistance and Information Exchange (EU program)
TAK	Tax Administration of Kosovo
TEB	Turk Ekonomi Bankasi (Turkish Economic Bank)
TNA	Training Needs Assessment
UNMIK	United Nations Mission In Kosovo
US	United States of America
USAID	United States Agency for International Development
VAT	Value-Added Tax
YEP	Young Entrepreneurs Program (USAID funded)

# 1 ESTAK ANNUAL REPORT SUMMARY

The Task Order for the ESTAK program envisages a dual focus on strengthening capacities of the Tax Administration of Kosovo (TAK) and on increasing taxpayer compliance. ESTAK has made good progress in both areas during its second year as reflected in the progress details that follow.

Significant progress has been made with the continued development of TAK's training processes. Much of the development work conducted by TAK has now been handed over to TAK's Training Department and a network of TAK internal trainers. In particular, the Train the Trainers program has been re-established and, as a result, TAK now design and deliver its own training courses using the Instructional Systems Design/ADDIE methodology.

These achievements were complemented by significant efforts in recruiting 36 high quality new hires in September 2011 under a transparent selection process and the subsequent development of a comprehensive 12-month induction program for them involving on and off the job training, a program which is continuing but is now under TAK management.

During the year ESTAK has also assisted with the completion a range of foundational reference materials for TAK staff (e.g. Taxpayer Audit Manual, Collections Handbook) which have become the basis for a broad range of internal training programs.

ESTAK has played a lead role in the establishment of a Call Center within TAK to support enforced collection efforts. While focusing only on making out-calls during its first five months of operation, the Call Center has generated over 800,000 euro in revenue.

ESTAK has also given enhanced focus to Taxpayer Education during Year 2, including designing various taxpayer guides and flyers, assisting with the update of TAK's Taxpayer Charter, the introduction of a new logo for TAK, the introduction of new services including e-filing, and assisting with accommodation alterations as TAK establishes a specific taxpayer service "center of excellence" within Pristina.

At TAK management level, ESTAK has continued to provide significant assistance to TAK HQ and regional office managers. These efforts were supplemented by the commencement of ESTAK's six module management training program.

Towards the end of Year 2, ESTAK has also assisted the TAK DG with the design of a revised organization structure and has supported him with the implementation of the change process. Other important assistance provided has included the preparation of reports on a strategy for replacing TAK's SIGTAS IT system, on the feasibility of merging TAK and Kosovo Customs into a single revenue agency by 2014, and on how TAK should develop its "intelligence" activities, complementary to the risk management work where the IMF is assisting TAK.

ESTAK operated at full strength and by year-end total contract spending had reached approximately two-thirds of the total allocated for the three-year life of the project. A separate report has been prepared outlining ESTAK's proposed work plan for Year 3. The progress made in Years 1 and 2 will allow ESTAK to complete the balance of its substantive tasks in the task order in its third year, while also allowing a focus on capacity-building.

## 2 ACHIEVEMENTS AND SUCCESS STORIES

The main success stories for ESTAK in Year 2 have been: (1) the successful recruitment of 36 new TAK staff via a transparent selection process and the subsequent development and delivery of a comprehensive 12-month induction training program for those new hires; and (2) the establishment of a Call Center in TAK which during its first five months collected more than 800,000 euro. Other notable ESTAK achievements during Year 2 have been:

- Assistance with SIGTAS upgrade implementation including developing a strategy for the eventual replacement of SIGTAS
- Assistance with the introduction of an e-filing pilot which has allowed Kosovo's largest taxpayers to e-file their monthly VAT declarations, and supplemented by plans (in conjunction with KPST) to extend e-filing to employers in respect of proposed merged monthly wage withholding tax/pension contribution forms
- Assistance with revising tax registration and tax form filing processes designed to assist with elevating improve Kosovo's ranking in "Doing Business" indicators rankings
- Assistance with preparation of a revised TAK organization structure, and with the initial steps of its implementation
- Assistance towards the partial re-opening of TAK's sub-office in North Mitrovica
- Assistance with the introduction of sector specialization within the audit teams in TAK's Large Taxpayer Unit
- Assistance, together with the IMF, with the development of TAK's 2012-2015 Compliance Strategy and 2012 Risk Response Plan
- Completion of a comprehensive Taxpayer Audit Manual and Collections Handbook
- Completion of the Taxpayer Education segment of TAK's 2012 Operational Plan
- Completion of various taxpayer guides, flyers and other promotional material, and assisting TAK with accommodation alterations in Pristina to create a taxpayer service "center of excellence"
- Assistance with updating TAK's Taxpayer Charter and introduction of a new TAK logo
- Re-establishment of TAK's Train the Trainers program empowering internal trainers to begin a program of designing and delivering tax technical courses
- Commencement of ESTAK's management training program
- TAK adoption of the ISD methodology promoted by ESTAK in relation to all its internally developed training programs (and a requirement that future externally provided training is provided consistent with that methodology)
- Completion of a report recommending the introduction of an Intelligence Unit within TAK
- Completion of a research paper on the merits of merging TAK and Kosovo Customs into a single revenue agency

# 3 PROJECT PROGRESS IN YEAR 2

## 3.1 OBJECTIVE 1 - STRENGTHEN THE CAPACITY OF TAK TO ADMINISTER ITS RESPONSIBILITIES

### 3.1.1 (A) SKILLS DEVELOPMENT/TRAINING

In Year 1 the focus of ESTAK training effort was on the re-establishment of a functional Training Department and on the completion of a comprehensive training needs assessment (TNA), the first stage of the proposed introduction of ISD training methodology in TAK. These steps formed the base for a comprehensive ESTAK plan for a series of technical, soft skills and management training courses to be designed and delivered during Year 2.

In Year 2 it was envisaged that a range of training activities would be undertaken in relation to (1) TAK's Train the Trainer program, (2) management training, and (3) tax technical training. Progress in each of these areas follows:

- Train the Trainers program

ESTAK commenced TAK's Train the Trainer program with curriculum development training for 27 selected internal trainers during April/May 2011. Trainees were given some time to prepare training courses before they received presentation & facilitation skills and test writing training between September and November 2011. By the end of these courses, 23 TAK staff were certified as internal trainers. An additional 15 staff have since been selected as potential internal trainers and the first of the three Train the Trainer courses was delivered to this group in April 2012 jointly by ESTAK and the TAK Training Department so that the latter can run such courses in future.

- Management training program

The management training program developed by ESTAK comprises 6 courses that to date have been delivered to two groups of managers. The first group of team leaders for the 2011 has received training in 4 of these courses (Managing for Results, Managing Performance, Managing Change and Managing Teams) with a fifth course (Managing Operations) due to be delivered in the near future. The second group of TAK regional office managers and some TAK HQ managers has received training in the first two courses. A third group of TAK top management personnel has been identified as the next audience for training under this program.

For each course, ESTAK identified TAK management representatives who agreed to deliver training courses in future after they have received the training themselves. (For the top management group, ESTAK will deliver the training). As previously reported, delivery of this training program during Year 2 was deferred for several months while per USAID and TAK request, ESTAK placed its training emphasis on induction training for new hires.

- Technical training program

The core team of TAK trainers has continued to design and develop a range of technical training courses as part of their Train the Trainers program learning. Some of them have since delivered technical courses focusing on Kosovo's tax laws, collection procedures, customer services and SIGTAS with ESTAK having provided support with the preparation of their courses when requested. It should be noted that post-training evaluation on these courses revealed knowledge retention rates of over 90% three months after the training had been completed.

In addition to the above training programs, ESTAK also custom designed and co-delivered an induction training program for the 2011 new hires. Following the completion of the first period of classroom training

in October 2011, the new hires undertook the first of three “on the job” training phases based on a comprehensive OJT guide prepared by ESTAK. Following a USAID review of ESTAK progress in November, the ownership of the new hire training transitioned from the ESTAK team to TAK, with TAK appointing an induction training lead in October 2011 and ESTAK now plays a support and oversight role.

Over the course of ESTAK’s second year, 46 training courses were conducted which ESTAK advisors delivered and/or directly supported, covering 811 participants.

In addition to the activities described above, the ESTAK team completed the following activities:

- Co-ordinated TAK’s second Employee Opinion Survey in October 2011 (based on the survey completed a year earlier as part of ESTAK Training Needs Assessment work) and analysed the results from that survey;
- In conjunction with TAK IT, developed an automated personal development form for capturing training needs data from staff based on 18 core competencies. TAK adopted this automated process in place of the paper-based process used by the Ministry of Public Administration throughout the rest of the civil service. After the introduction of the newly developed automated form, the Ministry of Public Administration indicated their interest in implementing it across the civil service in future;
- Continued work on the development of a Standard Operations Procedures Manual for Training. The Design and Development Policy and Forms section was approved by TAK management and the balance of the manual is proposed to be completed later in 2012;
- Continued work on development of a combined HR/Training Access database which would allow data on training to be entered for TAK staff;
- Implemented training assistance agreements for TAK staff attending training outside of Kosovo (this requires attendees to provide a copy of their course materials to the TAK training department for inclusion in the electronic course catalogue, complete a post-training evaluation form, prepare an action plan citing three activities they plan to implement following the training and provide a prorated amount of their training fee to TAK if they leave before the agreed service period);
- Following TAK’s acquisition of additional office premises in Pristina, the team visited the new training room and prepared an assessment of the furniture and equipment needs for the training facility as well as for not equipped training rooms in Mitrovica and Prizren offices;
- Facilitated discussions between the TAK, Customs and KIPA training departments to examine possibilities for co-operation in relation to soft skills training; and
- On-going facilitation of TAK Training Commission meetings with ESTAK focus now on assisting the chairperson of the Commission.

ESTAK is pleased to report that following the appointments of an induction program lead and an IT training and development support specialist, that TAK’s Training Department now has the resources to manage internal (induction and non-induction), donor and vendor training.

ESTAK has also provided “on the job” training to selected TAK staff on:

- The penalty relief provisions of the Tax Administration and Procedures Law (for regional Enforced Collection team leaders and selected staff)
- “Collection” aspects of the Tax Administration and Procedures Law (for regional Enforced Collection Team Leaders), as well as the then draft Collection Handbook
- Other technical aspects of the tax laws (as part of assisting TAK HQ and Large Taxpayer Unit staff with technical tax inquiries)

- Taxpayer education topics (e.g. the Taxpayer Charter, e-filing processes), and on Call Center operations

***Task order tasks completed during year two***

- Establish a “train the trainers” program
- Establish a formal internal training program for the core occupations

**3.1.2 (B) IMPROVING MANAGEMENT EFFECTIVENESS**

In the Year 2 work plan, a number of discrete management effectiveness tasks were planned to be completed.

***Organization structure***

The first task was assessing the organizational structure in the context of relevant recommendations from a February/March 2011 IMF tax mission. (This followed an earlier ESTAK review of the TAK organizational structure which focused on TAK regional offices and identified little need for restructuring, although making a series of recommendations on other aspects of organizational design including highlighting the need for addressing capability problems. ESTAK had noted that TAK capability problems would continue and could not be resolved through the TAK approach of constant changes to organizational structure and continuous and often apparently arbitrary staff rotations).

The February/March 2011 IMF mission recommended organizational structure changes in four areas:

- establishing an enduring taxpayer accounting unit to deal with more complex data integrity issues and errors;
- merging HR and training functions;
- expanding the analysis unit in the Operations Department; and
- conducting a structured review of the design, functionality and staffing of the Large Taxpayer Unit.

ESTAK agreed with some but not all of the IMF mission's organizational structure change recommendations as they were based on the assumption that a large pool of technically skilled staff already existed within TAK. To the extent that such a pool was in fact small, ESTAK supported TAK's approach to delay full implementation of all of the IMF recommendations.

In any event, it became clear during the year that the TAK DG was increasingly concerned about the performance of a number of his direct reports and about TAK's enforced collection and taxpayer education performance. As a result, ESTAK discussed with the DG a number of potential changes to TAK's organization structure. Some of these changes were previously identified by the DG, some were recommended in previous IMF mission reports, and some were suggested by ESTAK in order to improve TAK performance. ESTAK's recommendations included proposals for the creation of an international tax unit and to convert the Special Audit unit into an Intelligence unit taking into account the new Compliance Strategy that had been developed during 2011. ESTAK provided support to the DG in ongoing discussions and by preparing materials for briefing TAK management and staff on the proposed changes. The DG announced initial details of the proposed new structure to his senior management team at an off-site meeting facilitated by ESTAK in January 2012 and, following further consideration by ESTAK in conjunction with USAID's external tax reviewer, announced a final version of the changes which began to come into effect from 1 March 2012. Since that time ESTAK has been assisting the DG implement the changes including participating in a TAK working group that is preparing job descriptions reflecting responsibilities of new position holders and updating functional descriptions for each directorate.

The DG also decided to open a third TAK regional office in Pristina with division of workload between Pristina regional offices on a geographic basis. While this change was different from earlier ESTAK recommendations (that consideration be given to one large regional office for Pristina instead), ESTAK acknowledged the right of the DG to make such decisions and assisted him with its implementation along with the other organizational structure changes.

### ***SIGTAS replacement***

Another task due for completion during the year was providing initial support to TAK regarding proposals for a new IT system in place of SIGTAS. The need to replace SIGTAS was recognized by TAK, the Government of Kosovo, the IMF and other donors, and it was acknowledged that this would be a major multi-year undertaking. The need for this change has become more acute as the level of support provided by the SIGTAS vendor has begun to deteriorate due to turnover of the vendor's experienced personnel. ESTAK's IT Advisor thus discussed with TAK IT management proposed steps for system replacement, and prepared a SIGTAS replacement strategy for TAK consideration. The strategy envisages the acquisition of a commercially provided core system (registration, recordation, payment, account maintenance) to be integrated with a series of individual modules (collection, audit, etc) developed by TAK, with progressive implementation over a 3 to 4-year period. Donor support during the period of development and implementation will be needed, from a perspective of both technical assistance (systems architecture and development oversight) and funding assistance (on a shared basis with the Government of Kosovo). This strategy was approved by TAK management in December 2011 and, as agreed with USAID, this represents ESTAK's last involvement with SIGTAS replacement, setting the stage for TAK and MoF to implement.

### ***Performance management***

In terms of assistance to TAK senior managers on a more direct basis, ESTAK has continued to work towards the progressive introduction of a properly operating performance management system (compared with the previously used largely paper-based exercise). In particular, ESTAK prepared comprehensive performance management material and conducted a series of one-day performance management workshops for TAK's 60+ team leaders in June/July 2011.

ESTAK recognized that the existing performance management system needed to be enhanced to more clearly introduce the culture of accountability and delegated responsibility within TAK personnel. This entails a major shift from the tendency of many staff to unnecessarily refer all decisions for director-level approval and to avoid dealing with performance problems and underlying capability deficiencies. ESTAK has emphasized to TAK managers that performance appraisal ratings need to be honest and reflect a "normal" distribution, a message that appears to have been understood by most as trends indicate rating movements in that direction across the two years of ESTAK involvement.

However despite such positive developments within TAK regional office management, TAK HQ has not committed to reform, particularly at TAK top management level. As a consequence and after discussion with USAID during the mid-project review of ESTAK progress in November 2011, TAK was advised that ESTAK's assistance in this area could continue only if TAK increased their commitment to performance management. In February 2012, this position was reinforced and since then ESTAK support for performance management has been confined solely to continued management training.

### ***Management assistance***

Throughout the year, ESTAK has directly supported the TAK DG in performing his duties and maintained a good working relationship with him. While not always taking ESTAK advice, particularly regarding communication on staffing redeployment decisions, the DG nonetheless regularly seeks advice from ESTAK advisors and invests a high degree of personal trust in these relationships.

TAK Deputy Directors, HQ managers and the Large Taxpayer Unit Manager (and to a lesser extent the other regional office managers) have also received regular assistance from ESTAK. In addition, ESTAK advisors assisted TAK management through their regular attendance at TAK HQ senior management meetings and TAK regional manager meetings, and through continued drafting for the DG of monthly information bulletins for all staff (a task that has now been handed over to and taken on by TAK staff).

### ***Large Taxpayer Unit assistance***

In other areas of improving management effectiveness, ESTAK assisted TAK senior management with the implementation of sector specialization within its Large Taxpayer Unit (LTU) taxpayer audit teams, with proposals to develop taxpayer education within the LTU using the specialization approach, and with a review of taxpayer cases that met the LTU criteria but who were not being managed by the LTU.

### ***Single revenue agency consideration***

Additionally, USAID asked ESTAK to undertake initial work on the GoK proposal to create a single revenue agency (merging TAK and Kosovo Customs) by 2014. A short-term advisor was engaged for this to conduct research on the preconditions that should be met before making such a change. His assessment concluded that while it was too early to make such a change in Kosovo, that there were a number of areas where both agencies could work more closely together in the interim. These initial conclusions were accepted by USAID and a final report documenting them was prepared and discussed with the DGs of both TAK and Kosovo Customs.

### ***Task order tasks completed during year two***

- Assess the current organization structure of TAK and determine changes needed if it is to be adequate to support achievement of the current strategic plan and ESTAK objectives
- Engage constructively regarding support for a new IT system

### **3.1.3 (C) DETERMINING RESOURCE NEEDS**

In the Year 2 work plan, resource need tasks mainly relate to the 2012 Budget cycle, covering the provision of assistance in identifying TAK resource needs to feed into 2012 Budget submissions and supporting TAK with the progress on those submissions and their eventual implementation.

As witnessed in 2010, TAK resourcing plans continue to be largely based on arbitrary decisions made in consultations between the TAK DG and the Minister of Finance. The 2012 Budget process continued in a similar vein with TAK initially requesting a significant funding increase, which was reduced in subsequent budgetary hearings. The end result was an increase in TAK's budget from 6.836m euro in 2011 (comprising 4.705m personnel costs, 1.564m operating costs and 0.566m capital costs) to 7.77m euro in 2012 (comprising 4.882 personnel costs, 1.658 operating costs and 1.23m capital costs). However while funding increased in all areas, no additional staffing increase for TAK for 2012 above the maximum authorized number of 760 for 2011 was provided – it is accordingly now more important than ever that TAK's existing staff are fully employed in relevant work and that poor performance is appropriately dealt with.

In Quarter 1, ESTAK continued its resourcing focus on personnel as it had done during Year 1. Two important resourcing developments took place during that quarter, the implementation of significantly increased remuneration for most TAK staff and the allocation of additional office space to TAK in Pristina, which addressed two of the longest-running problems in TAK operations (low salaries and poor working conditions in Pristina).

ESTAK assisted the TAK DG with finalizing a new pay scale for TAK staff, based on a similar pay scale approved for the Kosovo Customs Service. It resulted in significant pay increases for most TAK staff effective from the end of April 2011. This change enhanced the "minor" increases which the Government had implemented for all civil servants from March 2011 but which in TAK's case had been associated with the removal of meal allowances.

With the allocation of additional office space for TAK in Pristina, ESTAK recommended that the new premises should be partially occupied by staff from TAK's Pristina 2 office thereby relieving the long-standing accommodation problems for both staff and taxpayers in the Germia building. That building will be redeveloped into TAK's main taxpayer assistance site given its central city location.

Aside from these developments, the ESTAK team also focused their efforts during Quarter 1 on supporting the implementation of 2011 Budget decisions, in particular with the recruitment of many of the additional 48 FTE that TAK was allocated for 2011 (to 760 from 712 in 2010). ESTAK assisted with the recruitment of:

- three new positions (Public Relations Advisor, International Tax Liaison Officer and Executive Manager of the DG's office)

- seven reinstated positions in TAK's proposed reopened sub-office in North Mitrovica
- 33 tax audit inspectors and 3 tax fraud investigation unit staff. With over 900 applicants for these positions and concerns about transparency the DG sought ESTAK assistance with the organization of candidate testing using the new civil service appointment procedures that came into effect on 1 January 2011. Over 600 candidates were evaluated based on a 3-hour written test in exam conditions of which 125 candidates were shortlisted for interview over 6 days. ESTAK advisors played a lead role throughout the process including preparing tests (based on the criteria specified in the appointment procedures), pre-testing the difficulty of questions on existing experienced TAK staff, ensuring confidentiality of the tests, arranging logistics for use of university lecture room facilities to minimize opportunity for cheating, maintaining custody over completed tests, briefing the appointment panel on how to mark essay questions, providing advice to the interview panel on how to conduct interviews of shortlisted candidates, and providing feedback on the results of interview marking. This was a major exercise that was even more complicated due to the new civil service appointment procedures which are not suited for testing large numbers of candidates. It is hoped that TAK will adopt ESTAK's proposed recruitment procedures in future as soon as the necessary Administrative Instruction is signed by the Minister of Finance. The DG has been particularly complimentary of ESTAK's efforts which reduced the external pressure he had had to appoint certain candidates. The ESTAK process also attracted interest and positive feedback from many other external stakeholders.

From Quarter 2, ESTAK resourcing focus shifted to TAK's physical resources. In recent years, Ministry Budget hearings have usually disallowed TAK's vehicle and computer requests and have thus not allowed TAK to introduce asset replacement plans in relation to its vehicle fleet and its computers. The result has been that:

- TAK's vehicle fleet of around 90 vehicles was aging, with no new vehicles purchased for over 5 years, despite the need to visit taxpayers for tax compliance work and despite increases in staffing, and increasing maintenance costs. (Fortunately, arrangements were subsequently made for EULEX to provide TAK with 20 of their surplus vehicles and these were handed over to TAK in early April 2012);
- Many of the computers used by TAK staff in its regional offices were very old requiring around 15 minutes to log on and very few laptops had been allocated at regional office level thereby denying staff the ability to take computers to taxpayer premises.

During the year TAK completed a framework contract procurement process which identified a supplier for its furniture and equipment needs. An order was subsequently placed for over 250 desktop computers and over 100 laptop computers, all of which were delivered to TAK in early 2012 and have since been distributed to TAK staff primarily to replace existing computers that were more than 6 years old. (It should be noted that even with the new allocation, TAK still has over 50 computers that are over 6 years old). ESTAK monitored and influenced the proposed allocation to try to ensure that new equipment was given to those most in need and in particular to those staff who did not have computers at all (the Pristina-based new hires that were recruited in September 2011 and more recently the new staff hired for TAK's North Mitrovica sub-office) in place of the past practice of giving the best equipment to TAK HQ and regional managers.

The ESTAK Task Order refers to the need to ensure that TAK management is capable of developing and defending an adequate annual budget. To date, ESTAK's periodic assistance in this area has not been fully embraced by TAK, and budget planning continues to be approached on a reactive basis without any transparency. It appears that there is little or no meaningful forward planning involved in the budgeting process and that perhaps informal understandings on resource availability inform how budgets are finalized and agreed rather than as a result of a process characterized by well supported and systematically analyzed resource requirements with a clear strategic and operational rationale on the part

of TAK or noticeably robust challenge on the requested resources on the part of MoF for the budgets approved.

In 2012, this has resulted in approval by MoF of a budget for the year which is already understood to be insufficient to meet even basic costs in some areas. As a result of this, the TAK DG requested ESTAK support for a mid-year re-budgeting process whereby an updated budget bid for 2012 and beyond will be requested. Related to this, the TAK DG has also agreed with an ESTAK recommendation to establish a TAK Strategic Finance unit within its new organization structure as distinct from its Budget unit.

Being conscious that the 2013 Budget cycle is the last chance for ESTAK to provide assistance in these areas, ESTAK has proposed to provide some specific budget/finance assistance in ESTAK Year 3 and TAK management has recently agreed to the following terms of reference for that work:

1. To ensure that TAK prepares a well researched and defensible budget bid for the second half of 2012 and for 2013 based on documented and systematically identified organizational requirements, with appropriate engagement with key internal stakeholders. This would need to take account of a number of important items not reflected in the 2012 budget or as yet quantified or planned in relation to 2013 budgetary requirements. Included among these are:
  - Unplanned salary increases announced in January 2012 for 90+ staff;
  - The costs of providing to taxpayers toll-free inbound calling to the Call Center;
  - Postage/printing costs for assessment and reminder notes to high volume taxpayers;
  - Additional publicity costs for implementing TAK's Risk Response Plan (as well as other publicity activities more supporting enhanced taxpayer education initiatives more generally);
  - Additional personnel required for the call center (to support inbound call functionality) and a range of new positions created within the revised TAK organizational structure (taking into account redeployment/redundancy opportunities);
  - The possible need to support the introduction of health insurance collection by TAK in 2013;
  - The possible need to undertake increased business registration work if the fiscal number becomes the same number used for business registration purposes.
2. To provide a series of recommendations to ESTAK senior management which will better enable TAK to appreciate its current budget strengths and weaknesses and to take management decisions which support a more risk-efficient and productive budget unit and budget planning process in the future. This may include but not be restricted to comments upon:
  - i. The current scope of the activities undertaken by the TAK budget unit and the adequacy and accuracy of the job descriptions of the manager and staff of the Budget Unit;
  - ii. The existence of any significant technical/behavioral skills gaps within the TAK budget unit and an indication of how these should be addressed;
  - iii. Recommendations for any necessary changes to the Budget Unit in terms of human/technical resources (qualitative and quantitative) job/team design, process and systems deficiencies, opportunities etc, with an emphasis on modern best practice and on applicable audit standards.

3. To provide support to TAK in the establishment of a finance role/function within the new Strategy and Planning unit within the TAK senior management team structure. We would anticipate this extending to:
  - i. Recommendations for key resource requirements (human, technical etc);
  - ii. A draft scope of work for the unit/role;
  - iii. Draft job descriptions and personnel specifications.

#### ***Task order tasks completed during year two***

- Assist management in determining their resource needs, including capital investments and recurring equipment needs (completed in respect of 2012 budget cycle in relation to physical resources)

### **3.1.4 (D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION**

#### ***Taxpayer registration***

In the Year 2 work plan, the taxpayer registration task planned to be completed was to assist TAK counterparts in ensuring sustainable operation of an efficient and accurate system of taxpayer registration. During the year, the following was achieved:

- in accordance with previous USAID BEEP/ESTAK project decisions, most taxpayers are receiving fiscal numbers on the day of their application, with taxpayer education/compliance visits being undertaken after fiscal number allocation (to the extent TAK resourcing allows)
- TAK has continued to receive information from the Business Registration Agency regarding businesses that have applied for a business registration number and used this to identify cases that have received a business registration number but who have not applied for a fiscal number – ESTAK has urged regional offices to follow-up in these cases
- ESTAK has identified that the problems relating to individuals with multiple business enterprises have not as yet been fully resolved to enable smooth tax declaration processing using the one fiscal number of the owner (there are about 800 taxpayers covering about 1,700 businesses that are affected). TAK established a project team to deal with these cases but progress to date has been slow as the work involved in correcting each case can be significant
- ESTAK identified that of TAK's 60,000 taxpayers with fiscal numbers, over 11,000 were "passive" having had no tax declarations filed or payments made since 1 January 2008. To help TAK focus on true non-compliant taxpayers, these "passive" taxpayer cases have since been recorded in a separate part of the database and taken off the list to be actively policed by TAK staff.

With the registration database inaccuracies now having been substantially resolved, ESTAK's focus shifted to improving government-wide registrations particularly in relation to businesses. During the year and as part of a joint MoF/MTI initiative supported by the ESTAK and BEEP projects, TAK has participated in regular meetings to plan for the establishing of municipal level "one-stop shops". These entities will serve for fiscal number allocation, business registration, and similar items necessary for starting up a business.

The initial concept developed by TAK, with ESTAK assistance, was for the TAK fiscal number to be the primary identification number issued to taxpayers, so that TAK can ensure control over its database and can prevent a return to the problem issues that were faced before starting to issue fiscal numbers. While this concept was also supported by other USAID projects, MTI, along with their World Bank/IFC donor,

have insisted that business registration numbers continue to be separately maintained. As a result the “one stop shops”, of which there are now 22 in existence (with a further 6 due to open in the near future), will now issue business registration certificates showing both fiscal and business registration numbers, along with optional issue of VAT certificates and import/export certificates. A “test” registration certificate has been successfully produced and the new system will be ready for implementation in the near future.

A MoU was signed between MoF and MTI in April 2012 which outlines the new roles of the respective parties in relation to tax/business registration. ESTAK has also directly assisted by drafting amendments to existing Administrative Instructions to allow these registration process changes, and has referred to TAK an updated version of those amendments (taking into account input received from the BEEP project) for consideration and onward referral to the Minister of Finance for approval. The amendments also remove the need for TAK to visit businesses either prior to or subsequent to their fiscal number allocation, but will allow for TAK to conduct “educational” visits to taxpayers following their fiscal number issuance in those cases where taxpayers have requested such a visit. Completion of these steps will allow Kosovo to obtain a significant improvement in its Doing Business rating for “starting a business”.

### **Returns processing**

ESTAK plans envisaged assisting TAK counterparts in developing and implementing a prioritized action plan to clear the backlog arising from delays in return processing while taxpayer data was converted from “old” to “new” SIGTAS. ESTAK assisted in this area by drafting procedures for resolution of error declarations and unprocessed declarations. As a result, the SIGTAS conversion backlog has been cleared with unprocessed declarations on hand having returned to normal levels. Database clean-up efforts included:

- The Pristina 1 backlog of over 10,000 error declarations was dealt with by a special task force, with all declarations having been input, except for those requiring further contact with the taxpayer, which the region has continued to deal with through their own resources;
- TAK’s Processing Department processed 789 penalty abatement cases that had been pending for several months with total amount abated of over 3 million euro;
- An additional task group worked in the LTU to deal with debt cases that are not real debts because TAK records do not reflect the same information as the taxpayer records. Over 50% of the LTU debt cases were considered to be the result of erroneous assessments. Some of these were the result of IT issues (losses or credits not carried forward correctly), but many related to missing declarations that have an impact on the VAT credit carried forward.

An additional specific task required to be completed was the development of procedures and monitoring plans to assure that the past backlog problems do not recur. ESTAK notes that workload monitoring across TAK’s processing areas (which have now been partially decentralized) has improved after the responsibility for the Processing Department was shifted from TAK IT to TAK’s “business owners” which has resulted in earlier detection of any future processing backlogs. ESTAK worked with TAK to develop a reporting process which tracks declarations sent for further processing in the regional offices and identifies those that are returned versus those that are still outstanding providing much better control over this process.

In addition, ESTAK advised TAK on development of a process for advising taxpayers when TAK makes an adjustment to their returns during processing. TAK IT subsequently established a report that identifies the correction made by the system. Discussions are continuing within TAK senior management as to the best method of advising taxpayers of the discrepancy (notice in the mail or telephone call).

ESTAK also continues to support tax form/processing reduction efforts to further improve Kosovo’s Doing Business “paying taxes” rating. TAK has agreed with ESTAK’s suggested merging of employer monthly tax and pension forms and this is expected to be introduced from April 2012 (and will first apply in respect of monthly forms due to be filed during May 2012). This change will reduce the number of tax/pension forms required to be completed by an employer each year from 29 to 13 (although it should be noted that past Doing Business ratings were already incorrectly based on 13 forms being filed, so that this change by itself would simply maintain past ratings and prevent a reduction in that rating in future). It is expected

that all employers who currently e-file pension information to KPST will e-file the new merged wages tax/pension forms while others will be encouraged to do so, thereby representing the next step in increasing the extent of e-filing, a development that also assists in improving Doing Business ratings. ESTAK has played a major role in supporting this change, developing an implementation plan and facilitating on-going meetings between TAK and KPST to ensure co-ordinated progress. ESTAK has also directly assisted by drafting a new “Employers Guide” and arranging publicity for these changes due to commence after employers have filed their March 2012 monthly declarations in mid-April 2012.

A previously developed proposal for a reduction in VAT declaration filing frequency from monthly to quarterly for smaller VAT registrants (reducing the number of VAT declarations required to be filed from 12 to 4 for smaller businesses and reducing the total number of VAT declarations requiring to be completed and processed by 50% will be pursued later in 2012 once the impending changes have been implemented.

During the year, ESTAK has progressively provided updates to USAID/BEEP project on the implementation of the above developments.

#### ***Task order tasks completed during year two***

- Assist TAK counterparts in developing and implementing a robust, prioritized action plan to clear the processing backlog at each of the regional offices (completed in respect of the backlog that arose due to SIGTAS upgrade implementation issues)
- Develop procedures and monitoring plans to assure that the problem does not recur

#### **3.1.5 (E) SIGTAS IT SYSTEM**

In the Year 2 work plan, four on-going tasks were expected to be progressed during each quarter. Those areas and the progress on each follow:

- Ongoing support for TAK in its efforts to sustain SIGTAS until a replacement system comes online - ESTAK assistance is continuing, with particular emphasis on the proposed implementation of Stage 2 of the SIGTAS upgrade (the addition of various modules tailored to taxpayer audit activity, enforced collection activity and taxpayer objections/appeals). ESTAK identified implementation of the “collections” module as the highest priority given the revenue implications arising from improved management of taxpayer debt cases. A review of the functionality of that module indicated that while it will assist with the recording of debt repayment installment arrangements, it does not provide the debt case management ability sought by TAK. It is thus intended to implement the installment arrangements part of that module in the near future, while at the same time TAK IT develops debt case management functionality (with ESTAK support) building on the case management system it had previously developed for the specific debt cases that are being dealt with by the Call Center. The taxpayer audit module has been modified to better suit TAK’s needs and this will also be ready for implementation in the near future
- Support the ongoing evolution of e-filing and online taxpayer service support - ESTAK actively supported the implementation of an e-filing pilot which commenced with August 2011 VAT declarations by large taxpayers that were filed in September. Since that time the number of monthly LTU e-filers has increased to 150 which is about 1/3 of all LTU taxpayers. ESTAK considers that the next important steps to encourage use of e-filing are (1) the proposed e-filing by employers of new merged monthly wages tax/pension forms first due to be filed in May 2012 (which will build on the base of employers already e-filing pension information for KPST) and (2) development of e-payment facilities so that taxpayers can both file and pay electronically rather than being able to file electronically but still having to go to a bank to pay. ESTAK understands that the TEB bank has developed e-payment functionality and that 2 taxpayers have recently

successfully paid tax electronically. As news of this ability becomes known, it is expected that other commercial banks will also begin to offer e-payment ability to their customers

- Support ongoing improvements in management information through SIGTAS - ESTAK assistance continuing. Reporting processes identifying non-payers and non-filers were simplified, with improvements presented to TAK regional managers by ESTAK. TAK has continued to review the reports in SharePoint (information derived from SIGTAS tables) to verify their need and accuracy and ESTAK monitors the KPI data that is displayed in SharePoint. ESTAK has used such information to identify for the TAK DG which were the best performing TAK regional offices in 2011, in order that the DG could recognize their efforts
- Ongoing improvements in the exchange of information among interested users - In addition to the data TAK already receives regularly from Customs, the Treasury and selected large organizations, TAK is now receiving data, as required by law, from taxpayers on all suppliers from whom they have had annual purchases over 500 euro and is receiving data electronically from most of the businesses that have installed fiscal cash registers. TAK also now has access to property tax and vehicle registration data. However ESTAK is concerned that the data being received is not being used effectively by TAK – for example none of the recently received data is currently being used to update TAK’s taxpayer audit risk model or to help in the identification of cases that could be referred to TAK’s Tax Investigation Unit. ESTAK has proposed that TAK address this issue as it commences its “intelligence” work, as detailed later in this report

#### ***Task order tasks completed during year two***

- Support TAK in its efforts to sustain SIGTAS until the replacement system comes online (completed in respect of SIGTAS upgrade stage 2 implementation preparations)
- Support the evolution of e-filing and online taxpayer service support (supported during Year 2 after an e-filing “pilot” commenced in September 2011)
- Improve the exchange of information among interested users in support of robust taxpayer compliance efforts (improvements during Year 2)

## **3.2 OBJECTIVE 2 - INCREASE TAXPAYER COMPLIANCE**

### **3.2.1 (A) IMPLEMENTATION OF TAX LEGISLATION (RULES AND REGULATIONS)**

#### ***Income Tax laws***

The Task Order tasks relating to the Personal and Corporate Income Tax laws that were enacted in December 2009 were completed during ESTAK Year 1.

In October 2011 however, an IMF tax policy mission recommended a number of further amendments to these laws. After consideration by GoK/MoF only one change to each of those laws was agreed (an increase in the presumptive tax rate for professional services providers from 5% to 9%). The law amendments to give effect to this change were drafted within MoF and are currently before the Assembly. They are expected to be enacted in the near future.

It is expected that the changes will be implemented with effect from 1 July 2012 and that they will be able to be implemented by TAK with only minimal ESTAK assistance (for example, it is not expected that any sub-legal acts will be needed to explain the changes).

#### ***Tax Administration and Procedures law***

The Task Order tasks relating to the Tax Administration and Procedures law enacted in July 2010 were completed during ESTAK Year 1.

In late 2011 however, following Independent Review Board review work by an EU/TAIEX funded expert which recommended the replacement of the Independent Review Board by a specialist financial division in the Courts, MoF drafted further amendments to this law to give effect to that proposal. These amendments are also currently before the Assembly. They are expected to be enacted in the near future.

It is expected that a division of the Basic Court in Pristina will commence hearing tax and customs appeal disputes (rather than the Independent Review Board) from 1 December 2012. At the same time, the Independent Review Board is likely to remain in existence until the end of 2013, to clear the backlog of cases currently waiting to be heard along with the new cases that will be referred to it in the period up to 30 November 2012. It is anticipated that this work will be implemented with minimal ESTAK assistance.

This effectively confirms that all of the sub-legal act work envisaged under ESTAK has already been completed as there are no current proposals to further amend any of the above laws.

### ***VAT law***

Since ESTAK inception, the prime responsibility for assisting TAK on VAT issues has rested with the EU-CTA project. That project has previously completed the VAT sub-legal act for the VAT law that came into effect from 1 July 2010. That project also prepared an additional series of amendments to the VAT law which also included the ESTAK Task Order envisaged reduction in the VAT registration threshold, and these amendments were duly referred to GoK for consideration.

After the EU-CTA project ended in September 2011, ESTAK temporarily took over responsibility for assisting TAK with VAT issues until an EU/TAIEX funded VAT expert commenced work in TAK in March 2012. That expert has since left TAK but it is expected that a TAIEX replacement will continue this work, for a further 5 months, in the near future.

The package of VAT law amendments is currently before the Assembly and is expected to be enacted in the near future. The package was however amended to remove the proposed registration threshold reduction following IMF intervention (a position not supported by ESTAK). The package has also been amended, after ESTAK-raised concerns, to include a provision to extend the transitional period before certain provisions within that law apply for a further two years to 31 December 2014.

Assuming continued EU/TAIEX support to assist with completion of the sub-legal act to cover these amendments and to provide training on them, and the likely need to prepare an unofficial consolidation of the VAT law (given the extent of the package of amendments), any ESTAK assistance is expected to be limited to review of drafts prepared by the VAT expert. If however, such assistance is not provided, ESTAK may be called to take on this role.

### ***Double tax treaties***

At the beginning of ESTAK Year 2 Kosovo had only one treaty in effect (with Albania, from 2005), but with provisions of the former double tax treaties made with Yugoslavia still also having some effect. During the past year:

- a further double tax treaty, that was signed with Macedonia in April 2011, has come into effect
- a proposed double tax treaty that was negotiated with Turkey in 2010, continues to await formal signing
- negotiations on double tax treaties were completed with the Czech Republic and Hungary and both now await formal signing
- negotiations on double tax treaties have commenced but have not yet been completed with Albania (as a replacement for the previous UNMIK signed agreement) and the United Kingdom

ESTAK has continued to assist a MoF/Ministry of Foreign Affairs working group with this work, a process that is expected to continue as Kosovo continues to follow up with the other 10 to 15 countries that it has requested entering into a double tax treaty with.

ESTAK also recommended to TAK the establishment of a new International Tax unit as part of its Legal and Appeals function in the recently approved TAK organization structure to deal with double tax treaty negotiations and their technical interpretation, a recommendation that was accepted although no appointments have yet been made to the new unit.

### ***Legal barriers***

ESTAK assisted TAK with monitoring and identifying legal barriers to TAK collection and enforcement. Focus during this year has been on the development of a range of MoUs between TAK and third parties in order to remove or minimize legal barriers. In particular, with ESTAK drafting assistance, TAK has signed MoUs with:

- the Privatization Agency of Kosovo (PAK) – two agreements regarding the tax treatment of SOEs and their debts. Since January 2011 TAK has had the ability to seize and sell assets of SOEs with tax debts, but exercising these powers can interfere with PAK's efforts to privatize and liquidate various SOEs. The first MoU provides that TAK will not seize assets of SOEs which are scheduled for privatization (which occurs when the PAK board agrees to proceed with privatization). The second MoU relates to the transfer of 12 months of SOE VAT liability to the Newcos that are formed when SOEs are privatized
- the Kosovo Judicial Council (KJC), as a result of which TAK will provide KJC with employment information to assist in their efforts to collect Court-ordered judgments (this agreement was arranged in conjunction with USAID's SEAD project)
- the Business Registration Agency of Kosovo (BRAK), to cover the proposed involvement of BRAK in taxpayer registration thus allowing business and tax registration processes to be managed through "one-stop shops"

ESTAK advisors also proposed an MoU with the central cadastral agency which would allow TAK to record liens against immovable property online without payment of a fee, but while the agency did not agree to this, they noted that TAK could request online access to property information to do research prior to recording a lien or prior to taking enforcement action.

The ESTAK team also worked with USAID's BEEP project on proposals to further develop credit registers in Kosovo as well as assisting in a World Bank initiative that is focusing on reviewing creditor rights in Kosovo.

Following requests from the MoF, ESTAK also conducted a review of the interest rates used by TAK. As a result of this review, ESTAK recommended that the interest charged on late tax payments be reduced from 18% to 15% per annum (from 1.5% to 1.25% per month). The review also recommended an increase in the interest rate paid by TAK on delayed refunds and repaid tax in dispute from 1.5% to 2.4% per annum. The recommendations were accepted by the Minister and implemented from 1 January 2012

After visiting TAK regional offices, ESTAK identified a potential barrier to establishing installment agreements with taxpayers to pay back tax debts (with no payment of interest and penalties). The issue is the requirement for taxpayers to make an up-front payment of at least 20% of their tax debt. As a result ESTAK prepared a proposed amendment to the relevant Administrative Instruction to remove the 20% requirement and thus remove this detrimental impact on TAK's debt collection efforts. TAK management agreed only to a reduction from 20% to 15% for installment agreements "with no interest".

### ***Task order tasks completed during year two***

- Assist TAK in addressing any legal barriers to collection and enforcement that are determined to be significant impediments to achieving revenue realization targets

### **3.2.2 (B) ROBUST AND FAIR AUDIT FUNCTION**

Typical for most tax administrations, the audit function involves the biggest proportion of tax staff. Until September 2011, donor assistance for this function in TAK was jointly co-ordinated through the EU-CTA project's Audit Advisor and ESTAK's DCoP. (Following the completion of the EU-CTA project last September, ESTAK has continued as the sole provider of technical assistance in this area).

#### ***Taxpayer Audit Manual***

In the first half of the year, the two projects worked together in completing a comprehensive updating of TAK's Taxpayer Audit Manual and in their combined delivery of staff training on that manual to TAK audit staff. Following an initial class jointly conducted by ESTAK and EU-CTA, TAK's own instructors took on training responsibility for subsequent classes with advisors only playing an oversight role. Subsequently ESTAK worked with TAK's instructors to modify the training material to prepare it for presentation to TAK's new tax inspector/tax investigation unit hires as part of their induction training.

#### ***Risk-based audit selection system***

In the Year 2 work plan, one audit area requiring on-going assistance was the support and development of TAK's risk-based audit selection system. During the year, ESTAK continued to support the model encouraging TAK to use the information provided by it (rather than continuing to rely on their own methods) in their decisions on the taxpayer cases to be subject to audit. Changes to the audit risk model to reflect changes to the data fields on VAT declarations made in 2010 were updated by TAK IT with ESTAK assisting in the testing process. Next steps with the audit risk model are for (1) TAK IT to make the simplifications to the income tax formulae previously recommended by ESTAK and agreed by TAK management, (2) TAK HQ to train audit managers and staff on the recent changes and to look at simplifying the VAT formulae, and (3) arrangements to be made so that some of the additional third party and other information now received by TAK is utilized in the audit risk model.

#### ***Audit quality measurement***

Another audit area requiring on-going assistance is the support and development of TAK's audit quality measurement (AQM) program. During the year, ESTAK continued to assist this program by (1) assisting with an update of the audit quality standards so that they were consistent with TAK's Taxpayer Audit Manual, (2) assisting TAK with the introduction of three new templates covering audit time recording, taxpayer contact, and historical information for audit files, (3) reviewing some of the cases reviewed by the AQM personnel and suggesting changes to Audit management, and (4) drafting quality standards for compliance "visits" (which AQM have started monitoring in 2012). ESTAK also emphasized the expectation that standards must either be met or not met and the case must stand on the information documented in the case (there should be no contact with the field to determine what was done and why certain decisions were made). Since the program was re-introduced in April 2011, 135 audit cases have been quality reviewed with results showing audit quality compliance ranging from 64% to 76% across TAK's regional offices.

#### ***VAT administration capacity***

A further audit area requiring on-going assistance is the building of VAT administration capacity to reduce the turnover threshold for VAT taxpayer registration. The EU-CTA project assumed main responsibility for this task until their cessation in September 2011. Pending the commencement of an EU/TAIEX funded VAT advisor in March 2012, ESTAK provided VAT assistance by: (1) reviewing a draft of a proposed package of amendments to the VAT law and (2) drafting an updated VAT Guide for taxpayers. ESTAK also reviewed taxpayer VAT credit information to identify the reasons for a high amount of VAT credit for taxpayers who are not claiming refunds – a first review indicated problems with the data which inflated the amount of unclaimed VAT credit, while a second review of the largest cases was referred to TAK with suggestions on further checking action.

## ***Enclaves***

A final audit area requiring on-going assistance has been providing TAK with assistance with its operations in the enclaves. ESTAK has focused its enclave assistance on urging the reopening of TAK's sub-office in North Mitrovica. That sub-office was re-opened in December 2011 in ICO-provided premises, but after 2 weeks tax assistance for North Mitrovica taxpayers reverted to being provided from TAK's main Mitrovica office due to difficulties with that accommodation. Following confirmation that TAK's previously employed sub-office staff continued to be reluctant to return to work, TAK advertised and filled 3 new positions for that sub-office and the new staff commenced in March 2012 with formal training for them planned during April 2012. The "co-ordinator" of TAK's Gracanica sub-office was also reassigned to become the "co-ordinator/team leader" of the North Mitrovica sub-office. Further work on re-establishing the sub-office will continue throughout 2012, which includes finalizing alternative office accommodation in North Mitrovica, addressing the new staff's training needs and furnishing them with newer computers (and subsequently access to SIGTAS and SharePoint). It is envisaged that once this has been done, the primary focus will be ensuring that North Mitrovica taxpayers are registered and aware of their tax obligations. It is also envisaged that discussions would later take place with the appointed TAK staff to determine how best to address non-compliance, both audit and enforced collection activity, in that environment. One of the issues to be discussed is whether any special amnesty should apply in respect of past non-compliance.

ESTAK also obtained from TAK IT information on the level of tax compliance in the enclaves. Such information was presented to a workshop with representatives of TAK HQ and TAK's staff working in its Gracanica and Shterpce sub-offices in July 2011 at which the opportunity was also taken to review the level of support provided to those sub-offices.

## ***Compliance Strategy***

The Year 2 work plan also envisaged the design of a specific Compliance Strategy for TAK and the subsequent development of TAK's 2012 Operational Plan by the end of 2011. ESTAK provided input to TAK in drafting the Compliance Strategy finalized in September 2011 in conjunction with the IMF risk management expert. In relation to the Operational Plan, a TAK working team took responsibility for developing a Risk Response Plan subsequently reviewed and updated by the IMF risk management expert with ESTAK's participation. ESTAK separately took responsibility for working with TAK to prepare the "taxpayer education/voluntary compliance" aspects of the operational plan, included in the "public education on tax compliance" section of this report.

## ***Intelligence capacity***

During the November review of ESTAK progress, it was noted that one area that TAK had not been giving sufficient attention to the identification of "outside the system" taxpayers. Most non-compliance activities (audits, debt and return non-filing follow up) have focused on taxpayers who are already known to TAK. While significant information is available through third parties, this information is not used effectively. In order to address this deficiency, it was decided that ESTAK would focus on developing "intelligence" capacity within TAK. After discussions with relevant stakeholders, ESTAK completed a report recommending the creation of an Intelligence Unit in TAK. TAK accepted this recommendation and included a new unit in its organization structure. TAK decided to locate this unit and a related non-criminal investigation task force (to continue the joint TAK/Customs and other audits previously undertaken by TAK's Special Audit unit, which was disbanded as part of these changes) within the Tax Investigation Unit structure. A manager has been appointed to the new Intelligence Unit and an agreement has been reached between TAK and Kosovo Customs for the latter organization to provide support to TAK in the development of its "intelligence" activities. ESTAK assisted TAK with their preparation of an EU/TAIEX funding application for a suitably qualified expert to assist TAK in this area in the second half of 2012.

### ***Assistance for audited taxpayers***

In addition to supporting TAK with its audit processes, ESTAK also drafted a guide for taxpayers selected for audit setting out their rights and obligations and what they can expect during the audit process. This initiative was welcomed by TAK management. The guide is being printed and is expected to be provided to all taxpayers who have been selected for audit in the near future.

### ***Task order tasks completed during year two***

- Build TAK capacity to improve quality of audit planning, application of the law and report writing
- Build TAK capacity so that audit effectiveness is enhanced  
(both achieved via completion of a comprehensive Taxpayer Audit Manual and subsequent staff training in relation to it)

### **3.2.3 (C) ROBUST AND FAIR COLLECTIONS FUNCTION**

In the Year 2 work plan, the first collections task requiring assistance was the development of improved practices for enforced collection. Our main objective achievement this year was the completion of TAK's Collections Handbook, which upon TAK management approval, was made available to all staff on TAK's SharePoint portal. This followed a series of meetings with Enforced Collection team leaders who progressively reviewed sections of the handbook. The Collections Handbook will provide a solid base for future staff training and team leaders have been expected to go over chapters with their teams. Selected TAK instructors used the handbook as a basis for the training courses they developed.

ESTAK participated with HQ collection staff in training for the new SIGTAS Collections Module, scheduled as part of Phase 2 of the SIGTAS upgrade. ESTAK has identified this module as the one with the highest priority due to the revenue implications from improved management of tax debt cases. However, ESTAK has also identified a number of deficiencies with the delivered module and documented them for the SIGTAS supplier. Based on the further development work required, the time needed by the supplier to do that work and the cost of this work, TAK has decided to implement the installment arrangements part of that module, while TAK IT develops debt case management functionality, building on the case management system it had previously developed for the specific debt cases that are addressed by the Call Center.

In mid-2011 a meeting of all TAK managers was held to review what actions needed to be taken by TAK to improve revenue collections during the latter part of 2011. In accordance with ESTAK advice, TAK agreed to set specific regional targets covering the collection of debts, reduction in debt inventory levels and on non-filer actions. The collection targets were reduced from levels set earlier in the year to reflect poor performance in the first half of the year. The debt level reduction targets were based on progressively reducing tax debt, exclusive of penalties and interest, to a level of 20% of prior year collections by the end of 2011. However, despite this move and despite regular ESTAK recommendations to TAK management on the need for regional offices to focus on non-filers and stop-filers and on segmenting their tax debts, TAK progress has continued to be slow. It is now expected that non-filer/stop-filer and debtor cases will be more effectively addressed later in 2012. Follow-up letters will be automatically issued, a step proposed after TAK's Call Center introduces in-call capacity so it can deal with taxpayer enquiries triggered by the issue of such letters.

During the year, the ESTAK Collections Advisor, in conjunction with TAK's Collections Manager, participated in informational seminars for Enforced Collection regional team leaders on their responsibilities and authority under the Law on Tax Administration and Procedures. ESTAK visited TAK regional offices, met with deputy regional managers with the responsibility for enforced collections and their collections team leaders to review the status and progress on the largest debt collection cases. These visits have addressed future actions in specific "live" debt cases, identified cases where debts have arisen due to processing errors, and examined common areas of uncollectable debt (e.g. many

SOE debt cases and cases where taxpayers have long been out of business which continue to be recorded as debt cases). The visits were well appreciated by regional offices and provided an opportunity to identify systemic collection issues to be escalated for action at TAK HQ level.

Systemic issues that ESTAK helped TAK address at HQ level during the year included:

- facilitating the introduction of a system fix to allow “closing” of taxpayer accounts for delinquent filers
- assisting with the resolution of lien recording issues after changes were made within the Pledge Registry meant that TAK staff then experienced difficulty in recording liens. ESTAK assisted in the resolution of this issue which now requires the involvement of TAK’s IT administrator
- facilitating the introduction of a manual process to transfer VAT credits between tax periods to offset against debts where appropriate (pending final correction of the SIGTAS refund module)
- development of a script to ensure that all quarterly installment payments made by income taxpayers in respect of the year when SIGTAS was converted to its current new version were correctly transferred (previously some installment payments had not been carried forward resulting in incorrect debt levels in about 2,000 taxpayer cases)
- identification of residual problems where system changes had not carried forward VAT credits and corporate income tax losses in some cases
- incorrect levying on the personal bank accounts of managers of POEs and other legal entities

Additional ESTAK assistance included:

- leading two workshops for Enforced Collection team leaders and selected staff on the application of the penalty provisions of the Tax Administration & Procedures law. The emphasis of such workshops was on the circumstances in which penalties can be relieved based on legal requirements and where penalty relief must be considered by a commission based on written requests by the taxpayer and the relevant TAK regional office
- following the expiry of the moratorium on enforced collection against SOEs from 1 January 2011, assisting with the development of two MoUs signed with the Privatization Agency of Kosovo (PAK) in June 2011
- liaising with the USAID-funded SEAD project on tax administration laws and practices impact on caseloads in the Courts. These activities resulted in TAK signing a MoU with the Kosovo Judicial Council as noted above under “legal barriers”
- assisting World Bank officials conducting a study on creditor rights.

In addition to supporting TAK with its enforced collection processes, ESTAK drafted a guide for taxpayers with tax debts setting out their rights and obligations and laying out available options to repay their debt, an initiative that was welcomed by TAK management. Work has commenced on a similar guide covering the range of penalties and sanctions that can be applied in non-compliant taxpayer cases.

Another key ESTAK achievement, which for now has a collection function focus, has been the commencement of a Call Center within TAK in November 2011. The Call Center currently has a staff level of 8 (one manager and 7 technicians) and is based in the TAK HQ building. At this stage the Call Center makes out-calls to taxpayers with aggregate debts of between 500 and 3,000 euro, and in these cases follows up both the outstanding debt and any outstanding tax declarations. Cases above 3,000 euro are dealt with at regional office level.

In establishing the Call Center, ESTAK assisted with the following activities:

- confirming the initial and future Call Center sites – while initially located in TAK HQ for operational support reasons, it is proposed it will be later shifted to the Germia building (where

accommodation alterations have been identified ready for their completion during the next 3 months)

- fitting out the Call Center with purpose-built workstations and telephone equipment
- confirming the types of delinquent debt and delinquent declaration-filing taxpayers that will be managed by the Call Center in its early stages and working with TAK IT to ensure such information was available
- completing work on the procedures to be followed in the Call Center (including how long cases will be worked on by the Call Center, the number of call attempts to be made to each taxpayer, and the casework recording processes) with their inclusion in a Call Center procedural guide
- pre-implementation training for the 7 new Call Center technical employees, delivered by the Call Center manager with ESTAK advisor assistance, covering the mission and design of the Call Center, basic tax laws, telephone techniques, inventory analysis and reporting, case related research utilizing SIGTAS and collection procedures

After the Call Center commenced with a manual inventory delivery and management system, ESTAK worked with TAK IT to develop an automated call center inventory management and workflow system, and with Call Center staff to test that system before its implementation. During its period of operation to date, ESTAK has also assisted with:

- arranging for TAK regional offices to provide details to the Call Center of taxpayer cases which are already paying off their debt under an installment arrangement, so that the Call Center does not also follow up those cases. Note, the existing SIGTAS system does not have a capacity for recording this, but it is included in the yet to be implemented Collections Module;
- arranging for TAK to automatically close taxpayer debt accounts where the 6-year collection period has expired, so that those cases were not included in the inventory of taxpayers that the Call Center deals with;
- defining Call Center performance indicators for both staff performance and call characteristics;
- assisting TAK's Call Center manager with improving the productivity of Call Center staff by emphasizing appropriate work practices and monitoring individual staff performance.

As a result of Call Center activities during its first five months of operation, over 800,000 euro has been collected from almost 15,000 out-call attempts with over 8,000 actual conversations with taxpayers (including multiple contacts with some taxpayers). Such phone contacts have also resulted in the filing of over 30,000 delinquent taxpayer declarations.

The final stage of Call Center development (with in-calls) is proposed to take place later in 2012 and ESTAK progress towards this stage is detailed in the "public education" section that follows.

It was acknowledged during the USAID review of project progress in November that the future level of ESTAK assistance to TAK's enforced collection activities could be reduced given that appropriate laws and administrative actions had been completed, the Collections Handbook had been completed and training was conducted by TAK staff. This also coincided with the completion of assistance from ESTAK's long-term Enforced Collection advisor, but ESTAK still continues to provide enforced collection support to TAK through its local advisors.

### ***Task order tasks completed during year two***

- Develop and institute improved practices for enforced collection (as evidenced by the completion of TAK's Collections Handbook and by the delivery of training in relation to it)

- Institutionalize a process of segmenting overdue accounts into appropriate categories & matching improvements in TAK collection techniques to these accounts that are most appropriate for these categories (as evidenced by the Call Center dealing with debt cases of up to 3,000 euro)

### **3.2.4 (D) PUBLIC EDUCATION ON TAX COMPLIANCE**

During 2011 ESTAK has been focused on improving TAK's taxpayer education. The need for continued focus in this area was confirmed by the TAK DG and USAID during the November review of ESTAK progress. As a consequence, ESTAK directly assisted TAK with a taxpayer education/voluntary compliance section for its 2012 Operational Plan, while TAK was focused on the "non-compliance" aspects of that Plan. This proposed section of the Plan has been approved by TAK senior management and includes the following:

- shifting some of the responsibility for responding to taxpayer enquiries from TAK HQ to the regional offices (but leaving the "rulings" area at HQ level), while also recognizing that telephone enquiries will go to the Call Center in the first instance in the near future
- removing or streamlining the work that TAK regional taxpayer education staff currently perform on certificates for visa, Government procurement and other purposes, recognizing that regional taxpayer education staff will not be able to take on much additional work without such changes
- creating a different approach with taxpayer education for LTU taxpayers, by giving specific tax auditors in LTU's specialized sector teams an educational as well as an audit responsibility (a move which has been supported by the IMF's March 2012 Tax Administration mission)
- clarification of responsibilities and expected timeframes for responding to taxpayer enquiries, particularly written enquiries, the timeliness of which has been subject to on-going criticism in taxpayer satisfaction survey responses

The ESTAK-designed communications strategy envisaged the development of taxpayer education materials for taxpayers that wanted to voluntarily comply, before increasing publicity efforts for those who had not complied. In line with this strategy, ESTAK has progressively assisted TAK with:

- preparation of income tax, VAT and e-filing guides;
- simplification of tax forms, with current focus being on the proposed introduction of merged monthly wages tax/pension contribution forms for employers;
- completion of separate flyers for VAT, corporate income tax, personal income tax, and on TAK and its role;
- preparation of a 2012 tax calendar for taxpayers;
- compilation and publication of an updated Kosovo tax legislation book (which also incorporate sections from Administrative Instructions next to the relevant legal provisions); and
- drafting, in conjunction with TAK and KPST, of an Employer's Guide to include details on the proposed merged wage withholding tax/pension forms which employers will be required to complete from April 2012.

Following the commencement of the e-filing pilot in August 2011, ESTAK continued to promote the use of e-filing by LTU taxpayers and worked with TAK LTU management and staff to ensure their taxpayers had received the necessary tokens, contracts and guides to enable them to e-file. Over 90% of LTU taxpayers can now e-file their VAT declarations but only around a 1/3 of these taxpayers are doing so on a regular basis. ESTAK considers that the next stages of e-filing development are (1) to introduce e-payment ability in conjunction with the banking system, (2) to allow e-filing (this time without the need for tokens) for employers for the new merged tax/pension forms, particularly since the processes for the new form will replace existing e-filing arrangements between employers and KPST, and (3) to expand the amount of information that e-filers will be able to access from the TAK computer system regarding their tax position.

ESTAK also continued to oversee progress on plans to modify TAK's "front office" accommodation in the Germia building to ensure that the facilities provided to taxpayers are expanded so that they can be improved to the standards of a commercial bank and that are being provided by other TAK regional offices. Following delays due to TAK budgetary constraints, ESTAK oversaw the tender process and is now actively involved in working with the selected contractor as the alterations in that building progress. It is envisaged that once these alterations are completed, Taxpayer Education/Pensions staff from TAK's Pristina 3 office will shift back to the Germia building so as to provide a centralized taxpayer education service from a central location with ground floor access.

The alterations to the Germia building also cater for an expanded Call Center which will then have the capacity to respond to taxpayer in-calls, and where the existing out-call work will be performed during periods where staff are not taking in-calls. In preparation for this development, ESTAK assisted TAK with the acquisition of Automatic Call Distribution (ACD) equipment (ESTAK prepared technical specifications, served as a technical advisor to the tender evaluation panel and participated in clarification meetings with two bidders and has been working with the selected vendor on training Call Center staff on the capabilities of the now installed ACD equipment at TAK's HQ site and on how to interpret and react to performance data generated by that system. Linked with this development, ESTAK also documented the additional training requirements (particularly on standard answers that should be provided to a wide range of expected questions) that new and additional Call Center staff will need in order to deal with taxpayer in-calls.

ESTAK supported TAK in developing a new logo in conjunction with a public relations firm. ESTAK assistance included working with TAK to obtain Minister of Finance approval for TAK to have its own identity and participating in discussions with a public relations firm on identifying the promotional opportunities that a new logo introduced. In accordance with the ESTAK work plan, ESTAK facilitated a process of TAK updating its Taxpayer Charter. ESTAK developed a plan for its update which included:

- distribution of a questionnaire to staff to ascertain their awareness of the charter and identification of any areas where they felt change was necessary – surprisingly many staff were not aware of the existence of the previously prepared Taxpayer Charter, but this has now significantly improved with over 300 TAK employees responding to the questionnaire
- visits to TAK's regional offices to discuss the Charter with selected staff – ESTAK participated in the Pristina office visits with TAK HQ staff taking on this responsibility in other regional offices
- drafting an updated Charter for TAK management consideration, taking into account the questionnaire responses and other feedback from staff

The new logo was launched along with the updated taxpayer charter in January 2012. The logo has since been progressively included on all of TAK's reports, publications, its letterhead and its website.

During the first quarter of the year ESTAK actively supported TAK's public relations activities, and completed the following tasks:

- developed templates for TAK media releases, announcements, news and media monitoring
- developed an 8-stage checklist for organizing media conferences
- introduced media monitoring processes and tracking procedures in line with a previous Media Monitoring guide prepared by ESTAK
- provided on-going direct assistance for the DG with media events including TAK quarterly results reporting, MoU signing sessions and the annual Taxpayers of the Year awards
- prepared a draft media release covering enforcement actions taken by TAK

- provided interim oversight to the management of the TAK website and assisted with the development of a job description for a new TAK webmaster position to which an appointment was subsequently made
- provided oversight and support to the recruitment process for TAK's appointment of a public relations advisor, the appointee having started in June 2011 and that person subsequently receiving “on the job” training and advice from ESTAK's public relations advisor

Following the appointment referred to above, ESTAK's public relations activity significantly reduced with ESTAK's advisor switching roles to address the other taxpayer education activities described in this section.

During the year, ESTAK assisted with the analysis of further results from completed taxpayer satisfaction surveys conducted by TAK. In particular, 206 taxpayer surveys completed by taxpayers have been analysed. On a scale of 1 to 5 (where 5 is the highest) taxpayers ranked service from taxpayer education at 4.47, enforced collection at 3.96 and taxpayer audit at 3.74. Of those taxpayers who chose to make written comments, 24 ranked TAK service as very good, 20 complained about inaccurate data in the TAK system requiring them to make many photocopies, 14 complained about TAK staff being impolite, and 29 commented on having to wait a long time for a response to their written questions.

ESTAK also continued to assist with the operation of the Taxpayer Advocate position and the incumbent successfully resolved a number of cases in which taxpayers had previously been unable to obtain relief from inappropriate tax assessments.

***Task order tasks completed during year two***

- Develop or update manuals and guidelines on taxpayer education and public relations to enhance compliance
- Develop and help TAK conduct awareness campaigns on rights and responsibilities of taxpayers (as evidenced by updating of TAK's Taxpayer Charter and its subsequent public launch)

### **3.3 OBJECTIVE 3 - DONOR COORDINATION**

In the Year 2 work plan, the only donor co-ordination task to be performed was the on-going active participation of ESTAK in a donor co-ordination forum. Various attempts to establish such a forum in the past have been unsuccessful and instead ESTAK liaison with donors is now co-ordinated through:

- TAK-run workshops - held at key times when the need for TAK donor/stakeholder input is considered appropriate. The first workshop was held in July 2011 at the time that TAK was commencing its work on developing an IMF-recommended Compliance Strategy. A second TAK-run workshop was held in January 2012 which not only allowed TAK to report back on the results of the Compliance Strategy work but also to discuss TAK's plans to establish an intelligence capacity. Both workshops were timed to coincide with visits by the IMF risk management expert assisting TAK with its Compliance Strategy and Risk Response Plan work; and
- MoF-organized “Customs and Taxation” donor co-ordination sector sub-working group meetings – ESTAK participated at the April 2012 meeting of this group and presented a matrix which listed current and proposed donor activities within TAK

Between such workshops and group meetings, ESTAK continues its successful cooperation at an operating level with other donor projects assisting TAK. During Year 2 ESTAK has liaised with:

- the EU-CTA project, until that project ended in September 2011;
- various EU/TAIEX funded experts (in relation to a review of Independent Review Board operations, to support for TAK's Tax Investigation Unit, and to the provision of VAT technical advice);

- the US Treasury expert who has been providing assistance to TAK's Gambling unit and amendments to Kosovo's Law on Games of Chance;
- the IMF (with regular contact with visiting finance, tax administration and tax policy missions, the IMF representative office in Kosovo, and the IMF expert who has been assisting TAK with its compliance strategy work);
- the DFID-funded tax gap measurement study consultants; and
- GIZ-funded experts (in relation to VAT and auditing using indirect methods training assistance with the Bavarian Government).

While donor assistance to TAK during ESTAK Year 1 was primarily provided by two donor-funded teams (the USAID ESTAK project and the ECLO EU-CTA project), during Year 2 such assistance has changed to now being provided by the ESTAK project team alongside a range of individual experts from multiple donors. As this multiple donor environment has developed, ESTAK has played an increased role in ensuring that donor activities in TAK are complementary to its own efforts. In some cases, this has meant that ESTAK has assisted other donor funded experts with their introduction into the TAK environment.

During the year ESTAK also assisted TAK with the appointment of a new International Tax Liaison Officer whose role is as a liaison point of contact for TAK with international organizations and visiting missions.

It should also be noted that during Year 2 ESTAK has also liaised with the following USAID projects:

- the GFSI project, in relation to property tax and business registration issues;
- the BEEP project, in relation to tax/business registration issues and to other "Doing Business" issues, and in relation to credit register work;
- the YEP project, in relation to tax/business registration issues;
- the SEAD project, in relation to provision of assistance to the Kosovo Judicial Council; and
- the DEMI project, in relation to municipality revenue proposals.

***Task order tasks completed during year two***

- Actively participate in coordination forums (Active participation during Year 2)

## 4 PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

Throughout Year 2 ESTAK has noted in its quarterly reports various problems encountered and has reported progress, if any, on their resolution. Problems that may impact ESTAK's ability to achieve its goals and objectives remain in the following four areas previously reported:

1. Not adequately managing the performance of TAK staff
2. Constant HQ-driven changes by a largely invisible senior management
3. Funding limitations
4. Information received by TAK not efficiently used to detect non-compliers

Details of each of these problems and steps taken to resolve them to date follow.

### ***(a) Not adequately managing the performance of TAK staff:***

ESTAK continues to believe that one of the most significant issues which is impeding reform progress and improved revenue collection performance is the reluctance by TAK managers to effectively and robustly manage the performance of their direct reports.

**The problem** - Despite sustained support for performance management by ESTAK in Years 1 and 2, insufficient tangible support has been forthcoming from the TAK leadership team. Comprehensive competency standards have been introduced for all key job roles and training has been provided to most managers including all Team Leaders in the regions. The indications are that there is some appetite for the practice to take root in parts of the organization – particularly in the regional offices - however this has not gained traction due to the absence of leadership commitment, either to sanctioning poor performers or to meaningfully utilizing identified top talent in the organization due to the continued unwillingness to make organizational decisions on the basis of employee merit.

**Proposed solution** - As a consequence and after discussion with USAID during the mid-project review of ESTAK progress in November 2011, TAK was advised that ESTAK's assistance in this area could continue only if TAK increased their commitment to performance management. Given subsequent lack of change in approach, ESTAK has discontinued its support in this area with effect from February 2012 with the exception of the performance management component of the management training program now under way.

### ***(b) Constant HQ-driven changes by a largely invisible senior management:***

**The problem** – Many staff rotational and organization structure changes have been dictated directly from the TAK DG with limited (and often, no) input from his intermediate managers. Exacerbating the demotivational impact of these changes, has been the normal lack of any explanation for the changes. Taken together with the almost complete lack of visits by TAK senior managers to regional offices, let alone around HQ, TAK staff feel that they are not treated as stakeholders.

**Proposed solution** - ESTAK has undertaken work with the senior management team to explore the dysfunctional nature of decision-making within the organization and an unhealthy degree of upward referral of decision-making. Among the recommendations made in response to this was the introduction of an executive office which would enable the DG to delegate more freely and also to have a closely aligned office able to budget his time and energies more effectively; in turn, this could enable the DG to be less inclined towards micromanagement and more disposed to strategic leadership. The new Senior Manager for the Executive Office commenced in March 2012 and is enjoying ESTAK support during that office's inception phase.

***(c) Funding limitations:***

**The problem** - The 2012 TAK budget is significantly short as a result of Government expenditure restrictions, poor planning on the part of TAK and a range of other factors. There is an expectation that additional resources will be provided to TAK during a mid-year Budget review, but of course there is no guarantee that this will happen. In the meantime TAK has insufficient funds within its budget to pay its current staff for the full year.

**Proposed solution** - As requested by the TAK DG, ESTAK will be involving itself in the re-budgeting process scheduled for mid-year 2012. In the process, a more thorough analysis of the capability of the budget unit will be undertaken and recommendations submitted to the DG for consideration on necessary reforms (technical, procedural, human, etc). In addition, ESTAK will advise TAK on the establishment of its inaugural Finance unit to support the future strategic needs of the institution.

***(d) Information received by TAK not efficiently used to detect non-compliers:***

**The problem** – During the last year ESTAK has assisted TAK in obtaining external information from a range of sources. In addition to the previously arranged on-going data exchanges with Kosovo Customs and the Treasury, TAK now also has access to property tax and vehicle registration data. TAK also now receives significant additional data from taxpayers following the legal requirements to report on annual purchase transactions over 500 euro, and to install fiscal cash registers which report electronic sales data to TAK. While the Customs and Treasury data is used in TAK's risk-based audit selection model, none of the additional data now received is currently used for that purpose or for any other action to identify non-compliers.

**Proposed solution** – ESTAK has recommended that TAK establish an Intelligence Unit to amongst other things, review the sources of data tax receives and to ensure that such data is useful for identifying non-compliers. In effect, such a review would also serve as a post-implementation review of the over 500 euro purchase transaction and fiscal cash register initiatives to determine whether the benefits TAK gets from such data exceeds the compliance costs that taxpayers incur in providing such data to TAK. TAK has agreed to the establishment of an Intelligence Unit and while a manager for that unit has been appointed, additional recruiting is awaited to fill the other positions in that unit so that the proposed review work can commence.

## 5 VARIANCES FROM THE YEAR 2 WORK PLAN

In the early stages of Year 2, there were no major changes to the Work Plan. Changes required to the schedule of training initiatives were mainly due to a shift of training emphasis, made at USAID request, to focus on orientation training for most of TAK's new hires in 2011. As a result, some of ESTAK's planned training courses for Year 2 were deferred.

ESTAK work also continued with the following additions to the tasks envisaged in the Task Order:

- extensive assistance with the preparation of an extended orientation program for 33 new tax inspectors and 3 new tax investigation unit staff which commenced from 5 September 2011 with an initial 5-week training program followed by rotating phases of “on the job” and classroom training
- the addition of a local advisor to assist the Director-General of TAK, and more recently a newly appointed TAK public relations officer, with TAK public relations activities, including co-managing the TAK website for a temporary period until an appointment was made to a TAK webmaster position
- the continuous work on tax simplification proposals to assist Kosovo in improving its “Doing Business” rankings
- proposals to merge TAK and the Kosovo Customs Service under a single revenue authority.

The ESTAK project reached the midpoint of its three-year timeframe in October 2011. Accordingly, it was an appropriate time to review the progress of ESTAK in November in conjunction with the TAK DG. As a result, several changes in direction were envisaged as follows:

- it was decided that the then focus on delivering comprehensive induction training for TAK's new hires should be transferred to TAK with ESTAK's role reducing to an advisory/oversight one. A similar change was envisaged with other planned training, except for management training where ESTAK would need to play the lead role for the time being
- following the completion of laws, administrative instructions and a Collections Handbook, and with TAK staff having taken on the responsibility of conducting collections training, it was felt that the that the future level of ESTAK assistance to TAK's enforced collection activities could be reduced in the future. This also coincided with the completion of assistance from ESTAK's long-term Enforced Collection advisor.
- it was decided that ESTAK work on working towards a replacement for SIGTAS would conclude with TAK's approval of a SIGTAS replacement strategy document. This was in recognition of the fact that TAK would need to find another donor to continue this long-term work (which would extend beyond the ESTAK timeframe) and that it was likely that any additional work carried out by ESTAK in this area would likely be repeated for the new donor
- following a report on interim findings regarding the GoK proposal to work towards a merged TAK/Customs single revenue agency in Kosovo, it was decided that it was too early to progress this issue and that instead a report should be prepared based on the interim findings
- in view of concerns about the lack of action being taken by TAK to identify taxpayers “outside the system” and the ineffective use that was being made of a wide range of third party information now being received, it was felt that ESTAK should consider these issues as part of new work to assist TAK with the development of an “intelligence” capacity
- it was confirmed that ESTAK should continue a focus on improving taxpayer education capacity

It was also noted that despite extensive assistance provided to TAK in relation to performance management, that there continued to be a lack of commitment by TAK management to adopt ESTAK's proposals in practice. As a result, it was decided that progress in this area would be reviewed during the visit of the USAID external reviewer in February 2012. At that time it was concluded that TAK was not making significant progress in relation to ESTAK proposals, and thus ESTAK assistance in the performance management area has now ceased, except for continued performance management training.

Given these changes, it was also decided to prepare a revised ESTAK work plan to cover the period from 1 January 2012 to the end of ESTAK in April 2013. This report records progress made against the previous ESTAK Year 2 work plan and against the first part of the revised work plan.

## **6 UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT YEAR**

Following on from the work completed to date, details of ESTAK activities in Year 3 are listed in a separate ESTAK Work Plan document.