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EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

YEAR 1 – ANNUAL REPORT

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LIST OF ACRONYMS

ADDIE	Analysis, Design, Development, Implementation, Evaluation (model)
BEEP	Business Enabling Environment Program (USAID funded)
DFID	Department for International Development (UK)
DG	Director-General
EC	European Commission
ECLO	European Commission Liaison Office
E-filing	Electronic Filing
ESTAK	Efficient and Sustainable Tax Administration of Kosovo (USAID funded)
EU	European Union
EUCTA	European Union Customs and Tax Assistance (EU funded project)
EULEX	European Union Rule of Law Mission in Kosovo
FAQ	Frequently Asked Questions
GFSI	Growth and Fiscal Stability Initiative (USAID funded project)
GIZ/GTZ	Gesellschaft für Internationale Zusammenarbeit (Germany)
HQ	Headquarters
HR	Human Resources
IMF	International Monetary Fund
IRS	Internal Revenue Service (USA)
ISD	Instructional Systems Design
IT	Information Technology
KCPSED	Kosovo Centre for Public Security, Education and Development
KEK	Korporata Energjetike e Kosoves
KIPA	Kosovo Institute of Public Administration
KTA	Kosovo Trust Agency
LSE	London School of Economics
LTU	Large Taxpayer Unit
MDA	Management Development Associates
MOF	Ministry of Finance
MOU	Memorandum of Understanding
OSCE	Organisation for Security and Co-operation in Europe

PAK	Privatization Agency of Kosovo
PTK	Posta i Telekomunikacije Kosova
SCAAK	Society of Certified Accountants and Auditors of Kosovo
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
TNA	Training Needs Assessment
UN	United Nations
US/USA	United States of America
USAID	United States Agency for International Development
VAT	Value-Added Tax

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 first year as reflected in the progress details that follow.

In the first part of the year, ESTAK's work priorities focused on (1) completion of sub-legal acts in respect of tax laws that had been enacted shortly before ESTAK commenced and (2) preparations for the upgrade of TAK's SIGTAS IT software. As these were completed, ESTAK assistance continued in both areas with respectively the development of updated tax forms and taxpayer guides, and with the resolution of problems arising from implementation of the first stage of the upgrade.

Specific focus was also able to be given provided to training (where TAK's Training Department effectively needed to be re-established) and human resources (where the opportunity to develop TAK's own HR procedures separate from the civil service arose after a legal amendment in August 2010) following the appointment of separate ESTAK advisors in those areas. A key training achievement was the completion of a comprehensive Training Needs Assessment which formed the basis for defining future training priorities and plans. On the HR side, assistance included support with the preparation of TAK's 2011 Budget submissions as well as a review of TAK's organization structure.

Following a specific USAID request, a public relations advisor joined the team in September 2010. Emphasis was given to developing a specific communications strategy for TAK as well as providing direct public relations assistance to the TAK Director-General.

At a functional level, ESTAK's long term Enforced Collections Advisor was supplemented by short-term advisors in relation to Taxpayer Audit (who in late 2010 concentrated on audit risk model refinement) and Taxpayer Education (who in early 2011 concentrated on tax form and tax guide updating). Assistance was also provided with plans for the introduction of e-filing, and a study tour to the Internal Revenue Service in the U.S.A was facilitated for TAK senior managers in preparation for plans to introduce a Call Center in TAK during 2011.

ESTAK also concentrated its provided assistance at TAK management levels, service as counter parting to with various TAK HQ managers and providing management assistance to all of TAK's regional office managers and technical assistance to the Large Taxpayer Unit specifically.

As required by the task order, this report summarizes project activities and accomplishments during ESTAK's first year of operations.

In the latter part of the year, ESTAK operated at full strength and by year-end total contract spending had reached approximately one-third 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 2. The progress made in Year 1 will allow ESTAK to complete most of its substantive tasks in its first two years, allowing project activities to focus primarily on capacity-building in Year 3.

2 ACHIEVEMENTS AND SUCCESS STORIES

The main success stories for ESTAK in Year 1 have been: (1) the re-establishment of TAK's Training Department; and (2) the efforts taken to explain Kosovo's tax laws to taxpayers. Other notable main ESTAK achievements during Year 1 have been:

- Assistance with SIGTAS upgrade implementation (stage 1) including assisting with the resolution of problems that arose as a result of the implementation
- Assistance with drafting a consolidated and updated Tax Administration and Procedures law and completion of sub-legal acts covering that law and the previously enacted income tax laws
- Updating of Kosovo's annual income tax declarations (alongside a revision of the formulae used in TAK's audit risk assessment model), and updating of associated income tax guides to assist taxpayers with completing those income tax declarations
- Assistance with the proposed introduction of e-filing and with other compliance cost saving proposals designed to assist with elevating improve Kosovo's ranking in "Doing Business" indicators rankings
- Re-establishment of a functional Training Department in TAK and completion of a comprehensive training needs assessment for TAK
- Review and revision of TAK's resource bid for the 2011 Budget with particular input on designing a revised TAK salary structure for the future including a variable bonus pay element
- Drafting of proposed HR policies and procedures for TAK in areas including recruitment, disciplinary actions and grievances
- Completion of a high-level review of TAK's organization structure, particularly at regional office level
- Assistance towards the re-opening of TAK's sub-office in North Mitrovica
- Assistance with the review and implementation of revised taxpayer selection criteria for the Large Taxpayer and Medium Taxpayer Units
- Completion of a TAK communications strategy alongside ongoing provision of assistance with TAK's public relations activities and with maintaining TAK's website
- Drafting of new monthly update bulletins for the DG to distribute to all TAK staff
- Assistance with the development of TAK's 2011 Business/Operational Plan and with reports on how TAK can achieve a significantly increased tax revenue collection target

Details on these achievements, and of additional achievements, are incorporated throughout the following project progress section of this report.

3 PROJECT PROGRESS IN YEAR 1

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

3.1.1 (A) SKILLS DEVELOPMENT/TRAINING

When ESTAK commenced, training activity in TAK was such that:

- a) TAK's Training Department comprised a single training officer - the manager was absent on long-term medical leave
- b) The only activity that the Training Department was involved in was making the necessary administrative arrangements for training courses, workshops and other meetings held outside Kosovo
- c) Different operational units of TAK arranged their own training on mostly ad hoc and unstructured basis with no training course evaluations being completed and no record of training materials being maintained
- d) TAK's previously approved Training Policy and its Training Commission had gone into abeyance. As a result, Train the Trainers program assistance was limited to that provided by an external provider (KIPA), and support for TAK's regional training initiative had ceased

All of the above was addressed during ESTAK's first year as a new manager was appointed to the Training Department, most TAK training activity is now co-ordinated through that department, training course evaluations are now routine, an electronic training course catalogue has been created, and TAK's Training Policy and Training Commission have been reinstated, together representing a significant improvement in the TAK training environment.

In the Year 1 work plan, numerous skills development/training tasks were proposed to be completed. Significant progress has been made, but the work needed to re-establish a sustainable Training Department in TAK proved a greater challenge than expected with the result, that many of the completion dates for the training tasks have in hindsight proved too ambitious and, as detailed below, remaining work on some of these will be carried forward into Year 2.

In addition to the above, the main emphasis during Year 1 was placed on the completion of a comprehensive training needs assessment (TNA), the first stage of the proposed introduction of ISD training methodology in TAK. In particular, the following steps were taken to gather TNA information:

- 4 Competency Surveys (separate ones for audit inspectors, tax collectors and taxpayer education staff and a generic one for TAK HQ staff) were designed and presented to and completed by TAK regional office staff during one focus group in each of TAK's 9 regional offices and three focus groups in TAK HQ - these surveys were completed by 115 TAK staff (86 regional and 29 HQ)
- An Institution Capacity Survey covering policy and procedures, education and training, career potential, management and senior management, communications and equipment, and working conditions was designed and presented to TAK staff during the same focus groups - also completed by the 115 staff
- 6 meetings were held with TAK identified "trainers" in TAK's regional offices - of the 18 TAK regional trainers, 11 were interviewed in person and 7 were interviewed by telephone
- Analysis was conducted on the requested training needs of staff where this was indicated on their individual work plans (which had been completed by 614 staff at the beginning of 2010)
- Analysis was conducted in relation to the ability and capacity of the TAK Training Unit and of external training providers (KCPSED, KIPA, LSE, MDA and SCAAK)

The TNA report was completed in November 2010 and its findings and recommendations were discussed with TAK HQ senior managers and TAK regional office managers during December 2010 and subsequently with individual managers in relation to the areas that affected them directly. The institutional capacity survey part of the TNA provided TAK's senior managers with a significant amount of information on employee satisfaction and this will form the basis of on-going employee satisfaction surveys proposed to be introduced with ESTAK assistance from 2011.

The TNA report also included a recommended future training strategy/plan for TAK and this was approved by the Training Commission in February 2011. In accordance with this strategy, the plan for ESTAK training during the period from April 2011 to March 2012 has been approved covering the piloting and delivery of new Train the Trainer courses, management courses, and technical training in operational areas with a focus on training for enforced collection and taxpayer education staff.

The other planned skills development/training tasks, and progress against them, are the following:

- Explaining the ISD methodology process to TAK management - this was initially explained to Deputy Directors Corporate Services and the Manager Training and subsequently to the Director-General and other Deputy Directors as part of the presentations on the results of the TNA, and most recently to the re-established Training Commission - complete
- Identifying trainers and subject matter reviewers for training material development and delivery - work on this was delayed until after completion of the training needs assessment - this work has commenced (details outlined below) and will continue into Year 2
- Internal training program development for key occupations and managers -
 - in relation to key occupations, curricula course outlines have been completed for tax audit, collection and education functions and these are included in the TNA report - a total of 76 course topics were identified - the Training Commission reviewed these outlines, reduced the number of needed courses to 57 and training covering 14 of them that will be developed in Year 2 building on various material including the policy and procedure manuals which are currently being developed for each of TAK's functional areas
 - in relation to management training, work on this has commenced with initial training on 7 identified courses proposed to be piloted and delivered in Year 2
- On-line training material library established - a training course catalogue and selected training course material has been made available to staff on TAK's SharePoint portal - complete
- "Train the trainers" trainers selected and trained and conducting training - work on this was delayed until after completion of the training needs assessment - the train the trainers program's 3 courses have been developed, 48 TAK staff applied to be involved as a "trainer", 34 staff were selected as trainers (pending their manager's approval), and training of those selected trainers will commence in April 2011

During the year, the following has also been achieved:

- Implementation of a training policy addendum covering three training forms (Training Department Support Request, Equipment Request and Program Evaluation) which are now being used by TAK operational areas
- Implementation of a monthly End of Program Evaluation Report that summarizes the results of completed training evaluation reports completed by participants
- A Standard Operations Procedures Manual for training has been drafted ready for approval by TAK's Training Commission
- Completed work on the feasibility of installing a Learning Management System - after determining that other training providers' systems were not appropriate for TAK use, work has commenced on an internal Access system that will link with TAK's human resource system

- Establishment of procedures for the booking of TAK's two "training" rooms in Pristina and assistance to TAK with the equipping of its current "empty" training rooms in its Prizren and Mitrovica offices
- Facilitation of extensive EUCTA-funded training courses on VAT and for TAK's newly established Tax Investigation Unit that required the establishment of several administrative training procedures and forms

ESTAK advisors have also provided "on the job" training to selected TAK staff on:

- The Tax Administration and Procedures Law (as part of working party discussions on completing the Administrative Instruction in relation to that law)
- "Collection" aspects of the Tax Administration and Procedures Law (for regional Enforced Collection Team Leaders)
- The Personal and Corporate Income Tax Laws (as part of the working party discussions on the Administrative Instructions that have been completed in relation to those laws)
- Various technical aspects of the tax laws (as part of assisting TAK HQ and Large Taxpayer Unit staff with technical tax inquiries)
- Performance management, specifically performance self-assessment for Regional Managers
- Adult learning theories, Instructional Systems Design (ISD) and the ADDIE Model (for Training Department staff)

Task order tasks completed during year one

- Assist TAK in developing a comprehensive, multi-year training strategy
- Develop curricula for training as well as an online library that can be reference material for employees in the field and maintained for future classes of training

3.1.2 (B) IMPROVING MANAGEMENT EFFECTIVENESS

In the Year 1 work plan, a number of discrete management effectiveness tasks were required to be completed. The following tasks were completed during the year:

(a) Assessing the current organization structure of TAK and determining changes needed to support achievement of the current strategic plan and ESTAK objectives

As most of the previous IMF mission recommended organizational structure changes at HQ level had already been implemented (with ESTAK support, for example, in drafting new or revised job descriptions), the focus of ESTAK's review was on reviewing the organizational structure of TAK's regional offices and modeling the most optimal structure which could be applied across TAK. The TAK regional office structure had not been revised for many years, and the ESTAK review took into account the workload change impacts of the recent SIGTAS upgrade as well as ESTAK proposals to introduce a Call Center during 2011. The proposed new structure was presented to the TAK Director-General in January 2011 and concluded that of the three key aspects of organizational design - people, processes and structure - the structure was the most sound of the three. ESTAK advised TAK not to restructure to take account of shortcomings with particular positions or their incumbents and to ensure that the organizational structure adhered to the organizational strategy. We also recommended the role of Deputy Regional Manager should be disbanded or given specific responsibilities - TAK chose the latter with three larger regional offices subsequently being allowed to appoint a second Deputy Regional Manager (one responsible for Taxpayer Audit, and the other is responsible for Enforced Collections and Taxpayer Education) and the remaining regional offices giving the Deputy Regional Manager responsibility for Enforced Collections and Taxpayer Education (with the Regional Manager looking after Taxpayer Audit).

(b) Reviewing/developing program and staffing plans and assessing staff workload, allocation and budget and recommending changes that will achieve better results

These tasks were completed in the context of assisting TAK staff with the development of TAK's 2011 Budget submissions - details are provided below under 3.1.3 (C) Determining Resource Needs

(c) Assisting management in developing key program performance indicators for all departments

ESTAK worked with TAK's Strategic Planning and Analysis unit to develop performance indicators for each department of TAK's HQ and regional offices. From these a smaller list of "key" performance indicators was selected. This information is now available and regularly updated on TAK's SharePoint portal. The IMF tax mission that visited in February/March 2011 acknowledged these efforts in its report.

Many of the performance indicators developed for TAK are also replicated in ESTAK's separate Performance-based management system (PMP). Additional indicators were developed in relation to employee satisfaction and for taxpayer satisfaction. ESTAK's Training Needs Assessment provided initial baseline data for employee satisfaction. Separate surveys prepared for taxpayers in relation to their dealings with taxpayer education, enforced collection or taxpayer audit were distributed from regional offices in March 2011 to measure taxpayer satisfaction, the first of which have now been returned to TAK HQ and analyzed by ESTAK.

ESTAK developed its own measure to acknowledge the best performing TAK regional offices (based on a combination of indicators rather than just revenue collection as had been established by the MOF)). During a program of visits to TAK regional offices, the development of this measure was discussed along with the concept of benchmarking with comparable regional offices based on number of taxpayers and number of TAK staff. ESTAK also facilitated a visit by the TAK Director-General and Deputy Director Operations to TAK's Ferizaj office (which ESTAK determined was TAK's most improved office between 2009 and 2010) to thank management and staff for their efforts. As the TAK database is cleansed and more correct information becomes available on the number of active taxpayers for each regional office, the ESTAK measures will be refined to more accurately reflect regional office performance.

(d) Assistance with EU tender for new integrated computer system for TAK

ESTAK assisted TAK and an EU contractor with the development of specifications for the tender that was advertised in July 2010 - ultimately the tender process for this system was however canceled after TAK raised concerns about the risks involved with likely suppliers and about the impact on TAK's future operations of developing a replacement system with apparently few additional benefits over TAK's existing computer system following its upgrade.

(e) Assisting the Director General in positively promoting the performance of TAK

In order to further assist the Director-General and TAK management, a decision was made during the Year 1 work plan approval phase to advertise a further local advisor position to assist TAK management in dealing with public relations aspects affecting TAK and by association the ESTAK project. A new ESTAK advisor commenced in this role in September 2010. Since then ESTAK has assisted with:

- developing and implementing publicity campaigns and preparing responses to media enquiries
- preparing the Director-General for his quarterly TAK performance and results media conferences (for example, the preparation of a media kit) and analyzing how future media conferences could be improved (for example, by making modifications to TAK's "conference" room)
- the redesign and progressive updating of TAK's website - including new sections covering FAQs and a new tax calendar - indeed the ESTAK advisor was asked to temporarily take over the role of managing TAK's website until a counterpart for the ESTAK advisor was appointed
- developing a logo for TAK with proposals on how it could be used; accepted by the TAK DG
- reviewing various other aspects of how TAK manages its relationship with the media

Furthermore, ESTAK developed and proposed a comprehensive Communication Strategy for TAK which was accepted by TAK senior management. This strategy commences with an initial focus on developing taxpayer education and publicity materials during the first half of 2011. The appointment of a TAK counterpart for the ESTAK advisor is imminent and once finalized; ESTAK will assist the appointee with implementation of the communication strategy.

The other discrete task to be completed during Year 1 relates to the development of an operational review capacity within TAK to be developed in conjunction with TAK's Internal Audit Unit. This work was commenced but not completed in order that ESTAK efforts could be co-ordinated with an EU-CTA project Internal Audit Advisor who commenced work in March 2011. In this regard ESTAK began reviewing TAK's Internal Audit Strategy, Internal Audit Plan for 2011, and Internal Audit results for 2010. This work will continue into Year 2 and will take into account IMF tax mission recommendations regarding the extent to which the TAK HQ Operations Deputy Director-General is able to exercise effective oversight over the performance of TAK's regional offices.

During Year 1 ESTAK also assisted TAK HQ with the implementation of a new IMF-recommended Risk Management Unit within the Office of Modernization and Strategic Planning. That Unit is now operational, initially with a team leader and one staff member. A relationship has been built between the TAK and Customs Risk Management Units and ongoing support is being provided by ESTAK.

A key change that was also expected to improve TAK's management effectiveness was an amendment to the Law on Tax Administration and Procedures which enables TAK, subject to a Minister of Finance approved Administrative Instruction, to make its own policies and procedures outside the civil service in relation to selected human resource management issues. Following that amendment being incorporated in law effective from August 2010, ESTAK has drafted procedures in relation to:

- a revised pay scale for TAK that includes a performance incentive bonus component
- recruitment and selection
- promotions
- discipline
- grievance
- performance improvement procedure (which includes provision for the termination of substantially/serially under-performing employees)

These draft procedures have been considered by TAK senior management but have not yet been referred to the Ministry of Finance partly because of delays caused by the change of Minister and partly because the TAK Director-General wanted to wait until he could make changes to pay scales in line with similar changes proposed by the Kosovo Customs Service. In the meantime, ESTAK has been assisting TAK with recruitments using the more cumbersome recruitment procedures that are required to be used in the civil service and that came into effect from 1 January 2011 (e.g. ESTAK has been assisting TAK with the preparation and testing of written (essay and multiple choice) and verbal questions to be used by TAK appointment panels).

ESTAK's work on the proposed TAK pay scale was also held up when the Kosovo government announced in December 2010 its intentions towards enhancing base salaries for civil servants (which includes TAK employees) by 30%. The government announcement set an expectation that all employees would receive a non-performance related salary increase which ran contrary to TAK/ESTAK plans to introduce a performance-based salary structure with a variable component of salary based on performance. ESTAK proposals were accordingly revised to take into account this development but retaining the original intention of introducing a performance-based component of pay.. While the proposed TAK pay scale has a performance-related component this only applies to tax inspector positions and ESTAK will continue to push for a more generalized performance-based component of TAK pay.

In terms of assistance provided to TAK senior managers on a more direct basis, ESTAK advisors have continued to assist the introduction of a more recognizable performance management based approach, starting with TAK regional office managers and providing support to the Deputy Director for Operations in relation to this key population of managers. In particular, ESTAK has assisted TAK management in its performance evaluation of Regional Managers at the 2010 half-year and year end stages and has suggested appropriate means of measuring performance (including self-assessment) and adopting a fairer and more transparent means of differentiating between the contributions of regional offices and their managers going forward.

In addition, following the completion of TAKs' operational business plan for 2011, ESTAK has also been supporting the process whereby team and individual objectives set for TAK staff adhere to best practice and support the achievement of the operational business plans. A revised performance management approach, with a strong competency basis, was prepared for use by all TAK staff for 2011 with the intention that managers and team leaders will rate their staff on a basis close to a normal distribution of performance ratings. (An ESTAK-conducted analysis of performance appraisal ratings given to staff in TAK HQ and regional offices for 2009 and 2010 was presented to TAK managers indicating which areas needed to make more change (where the majority of staff were rated highly) than others which had applied a more measured performance rating distribution.

Throughout the year, ESTAK advisors directly assisted the TAK Director-General in the performance of his duties and maintained a good working relationship with him. While not always accepting our recommendations, particularly on staffing deployment, the Director-General nonetheless regularly sought advice from ESTAK advisors. One area where ESTAK and other stakeholder advice was sought was in relation to the Director-General's proposals to continue with rotations with senior managers, a process which he agreed to substantially defer by leaving managers in place but using the performance appraisal process to notify areas where managers could improve their performance.

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 advisors. In addition, ESTAK advisors assisted TAK management through their regular attendance at TAK HQ senior management meetings and TAK regional manager meetings, through assistance with the initial implementation of TAK's 5-year Strategic Plans and through the development of TAK's 2011 Business/Operational Plan, and through continued drafting for the Director-General of monthly information bulletins for all staff (8 of which have been drafted and issued to staff so far).

Task order tasks completed during year one

- Give careful consideration to the November 2009 IMF Report, 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 with the EC regarding their support for a new IT system
- Review/develop program and staffing plans which will support achievement of the strategic plan (completed in respect of 2011 Budget cycle)
- Assess current staff workload, allocation and budget and recommend changes that will achieve better results (completed in respect of 2011 Budget cycle)
- Assist management in developing key program performance indicators for all departments

3.1.3 (C) DETERMINING RESOURCE NEEDS

In the Year 1 work plan, tasks relate to the 2011 Budget cycle, covering assistance in identifying TAK resource needs for the 2011 Budget submissions and supporting TAK with the progress on those submissions and their eventual implementation. The initial Budget cycle timeframes did not allow ESTAK advisors to complete a full staffing review. Nevertheless, ESTAK supported the original TAK proposal for an additional 50 staff positions to be allocated as follows:

- backfilling of the vacancies in TAK resulting from internal appointments to TAK's new Tax (Fraud) Investigation Unit (an IMF requirement - that unit now has 23 staff)
- backfilling of the vacancies in TAK resulting from internal appointments to TAK's new Risk Management Unit (an IMF requirement - that unit now has 2 staff)
- re-open the TAK sub-office in North Mitrovica, following expressions of interest from former staff in that office to return to work (7 appointees are shortly due to commence in that sub-office)
- additional staffing of about 10 positions being half of those needed for the proposed establishment of a Call Center in TAK during 2011 (the other half will be resourced from positions no longer needed from the setting up of the Call Center) taking into account the additional workload requirements arising from the SIGTAS upgrade

ESTAK completed a review of all items initially submitted and succeeded in ensuring that there was an operational rationale for the resource needs reflected in the budget request. As a result, the final consolidated submission in October 2010 was substantially more robust than that originally submitted without any ESTAK support. While the engagement of ESTAK with the Director-General and his senior management team on this issue highlighted the value of genuine collaboration on key priority matters, it has also served to highlight the dearth of technical capability in terms of proper approaches to planning and also on the lack of financial technical capability within TAK currently.

Key recommendations included higher budget requests for:

- employee remuneration (a series of specific pay adjustments, consolidations of allowances into salaries and variable pay implementation)
- postal expenditure (necessary to support mass postal campaigns with taxpayers through PTK following the SIGTAS upgrade). This will necessitate postal expenses above and beyond a conventional annual 'business as usual' figure
- marketing and publicity (to support a radically enhanced and more proactive engagement with taxpayers and other external stakeholders going forward)
- employee mobility (in order to deploy employees in a more efficient and responsive manner to take account of the operational flexibility demands going forward - ESTAK will support the introduction of a mobility policy in 2011)

The Kosovo Government's 2011 Budget was finally approved in late March 2011. In relation to staff numbers, the result effectively agreed with the ESTAK-assisted revised resource request. TAK was allocated 48 additional staff positions (compared with the 50 asked for). However, arbitrary cost reductions were made to TAK's 2011 expenditure request (this is detailed later in this report) meaning that TAK resourcing for 2011 is similar to 2010 levels and thus putting at risk the ability for TAK to now reach the significantly increased tax revenue collection target set for 2011.

Going forward, ESTAK will assist with the implementation of the approved resources in TAK. Following this year's involvement, it is expected that TAK will better be able to determine their own resource requirements in future years and to adopt a more tactical and strategic approach to its resource requirements. In order to consolidate this, it is proposed that ESTAK will support workforce planning and resource modeling techniques to enable a more three dimensional resource planning approach to be taken in 2011 in respect of the 2012 (and beyond) budget planning process. This is necessary as it is clear that to date there has been a significant lack of meaningful engagement between HQ and the field on resource requirements (human, technical etc) with at least a feeling that the regions are often in effect told by the center what they will receive without providing inputs on their requirements. There has therefore been a lack of coordination between regional resourcing decisions and what the regional office network is being required to deliver, operationally and strategically. Similarly, the standard of central

operational support to the regions to date in respect of the provision and maintenance of fit for purpose vehicles, IT and other basic necessary equipment has been poor and ESTAK is supporting improvements to this area.

Task order tasks completed during year one

- Assist management in determining their resource needs, including staffing by type and number, training costs, capital investments, recurring equipment needs (e.g. replacement schedule of 3-5 years should be in place for computer equipment), and outsourcing requirements (completed in respect of 2011 budget cycle)
- Assist in the preparation of the annual budget submission for TAK that will support realization of the strategic plan and enable sustainable operation of the organization (completed in respect of the 2011 budget cycle)
- In close cooperation with TAK management, advocate support for the TAK budget with government counterparts and key international stakeholders (completed in respect of the 2011 budget cycle)

3.1.4 (D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION

In the Year 1 workplan, the only return processing/taxpayer re-registration task required to be completed was the requirement that there be a taxpayer registration system supported by SIGTAS. Progress on this outcome was delayed by the deferral of SIGTAS upgrade implementation until early October 2010 but has now been substantially completed as the new tax roll module has been implemented with the "go-live" of the first stage of the SIGTAS upgrade.

ESTAK played a major role in assisting TAK prepare for the SIGTAS upgrade requirement that the "new" SIGTAS would only accept taxpayer transactions using TAK's fiscal numbers. While TAK had continued to make progress on getting taxpayers to apply for fiscal numbers, there remained several thousand "active" taxpayers who had not obtained a fiscal number. As a consequence and following ESTAK advice, TAK management decided to automatically issue fiscal numbers to a further 5,500 taxpayers who did not have one. In particular, ESTAK assisted with:

- the identification of approximately 11,000 "active" (defined as those with a tax transaction since 1 January 2008) and "passive" (those with tax transactions prior to that date, but with debts over 200 euro) who needed to be automatically allocated a fiscal number - only about half of this number were subsequently automatically allocated a fiscal number as the others represented individuals for which TAK did not have a personal identification number in their database
- confirmation of over 34,000 "individual" business taxpayers who had previously been allocated a fiscal number but had not been able to use it until the SIGTAS upgrade was recently implemented
- drafting two standard letters to be sent to the above taxpayer categories
- reviewing and recommending minor modifications to the postal address data on TAK's database to ensure the standard letters could be successfully delivered by PTK to as many as possible
- meetings with PTK to facilitate the delivery of close to 40,000 letters - indications are that at least 80% of these letters were successfully delivered
- briefing TAK management on the plans, and in particular providing TAK regional offices with listings of the taxpayers from their offices that were automatically being issued a fiscal number
- developing a publicity campaign to complement the issue of the letters through PTK and assisting TAK in its implementation

Together with the automatically allocated fiscal numbers, TAK has now allocated over 60,000 fiscal numbers to taxpayers in Kosovo. Since that exercise, the number of active taxpayers has increased

further as the remaining active taxpayers who had not yet obtained a fiscal number needed to do so in order to be able to download their tax declaration forms from the TAK website. It is estimated that there are about 65,000 active non-employee taxpayers in Kosovo. This is substantially less than the numbers maintained by the Ministry of Trade and Industry's Business Registration Unit and is matched by the 35,000 "passive" taxpayers TAK now has recorded on its database.

During Year 1, ESTAK also played an active role together with USAID's Business Enabling Environment Project in responding to stakeholder desires for Kosovo to lift its "Doing Business" rankings. This has included a particular focus on the processes used to apply for a fiscal number and looking at ways in which to reduce the time for such processes and/or amalgamating them with other registration processes for new businesses. As a result, TAK has changed its fiscal number application processes so that most fiscal numbers can now be allocated on the day of application (with new taxpayer educational visits taking place at a later date rather than as a pre-requisite for number allocation) and the application form has been simplified. TAK will now accept business registration number application forms as providing most of the information needed for a fiscal number. At the same time, ESTAK also promoted other changes that will improve Kosovo's "paying taxes" rankings, namely the proposed introduction of e-filing (discussed further under (e) below) and reductions in the frequency of filing tax declarations, particularly VAT declarations (where a proposal has been made which would halve the number of VAT declarations requiring to be completed and processed annually).

In relation to returns processing, delays in return processing while taxpayer data was converted from "old" to "new" SIGTAS resulted in a temporary return processing backlog. Most of the backlog has since been removed, with most of the remaining cases involving tax declarations on forms that were not downloaded from the TAK website. TAK is now taking action to ensure these declarations can be processed. Until this is finally resolved, TAK staff will not have an accurate record of the current status of taxpayer transactions.

The past problem of tax declarations not being able to be processed due to data errors is also being progressively reduced following the current requirement for taxpayers to download their tax forms from the TAK website which contain various fields of pre-populated data.

TAK also moved the processing function in its HQ from the IT to "Compliance" area so that the business is more involved in processing issues and takes greater ownership of the problems involved. This was an important step in terms of addressing a variety of processing issues. ESTAK has assisted in drafting procedures for resolution of error declarations and unprocessed declarations.

Progress is being made on improving the accuracy and timeliness of TAK data for both TAK staff and taxpayers, and further improvements can be expected following the implementation of the second stage of the SIGTAS upgrade, training on which has commenced and is expected to be implemented in May/June 2011. In particular, the accuracy of the taxpayer registration database will improve once non-filers are actively followed up once they start receiving and responding to reminder letters - work on this has been delayed until TAK clearly separates its "active" and "passive" taxpayers on its database, a process that is currently under way. It is however expected that the TAK database will become increasingly more reliable throughout 2011 and result in this ESTAK objective being substantially achieved by the end of 2011.

Task order tasks completed during year one

- 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 backlog as at beginning of ESTAK, but a different processing backlog subsequently arose due to SIGTAS upgrade implementation issues)
- Assist TAK personnel in bringing the re-registration process to closure

3.1.5 (E) SIGTAS IT SYSTEM

In the Year 1 work plan, the main SIGTAS IT task expected to be completed was to provide assistance with SIGTAS upgrade implementation. It was originally envisaged that SIGTAS upgrade implementation would take place in two stages during the July to September 2010 period, but the first stage was deferred several times until the first week of October 2010 and problem areas arising from this implementation were not finally resolved until 2011, meaning that the second stage of the upgrade implementation was delayed until May/June 2011.

ESTAK played a key role in ensuring that the first stage of the SIGTAS upgrade eventually took place with initial go-live during the first week of October. Assistance was provided both to IT and "business owner" management to ensure both worked towards the same go live date. Assistance to IT management and staff included:

- ensuring that "new" SIGTAS would process payments and apply penalties and interest in accordance with Kosovo laws
- ensuring that assessments and re-assessments could be tracked separately for purposes of calculating the six-year period for collection
- resolution of issues related to issuance of certificates for VAT filers and exporter/importers so they could be printed from new SIGTAS
- briefing TAK senior managers at HQ and regional office level on implementation plans and progress, in particular keeping the final go-live date before TAK senior management and the project manager to keep them involved in solving problems rather than delaying the solution
- resolution of issues that had held up TAK being able to input into SIGTAS details of tax assessments made as a result of taxpayer audits by TAK's tax auditors
- mediation between TAK management and the SIGTAS vendor on matters relating to acceptance of the new system, contract payments, development versus support changes, etc.

The SIGTAS upgrade represents one of the most significant achievements in TAK that will occur during the lifetime of ESTAK. While the first phase of implementation has been completed and taxpayer data has been successfully converted for the vast majority of taxpayers, work on the second stage of SIGTAS implementation (introduction of audit, collection and objection modules) has only recently commenced with training for TAK's business analysts before implementation expected in May/June following the completion of that training. The second stage is expected to involve significantly fewer system implementation issues, but does require more emphasis on user training, with user representatives being co-trained with TAK's business analysts.

In parallel to the SIGTAS upgrade, ESTAK has also assisted TAK on implementation of E-filing and on-line taxpayer service support. While the Year 1 work plan envisaged this implementation taking place in August 2010, due to delays with the SIGTAS upgrade, E-filing implementation is not now due to commence until the second quarter of 2011. E-filing is expected to be phased in over the next 6 to 9 months, beginning with Large Taxpayer Unit taxpayers (and within the LTU beginning with VAT declarations) and then moving on to other regions. Those taxpayers that are e-filers will also be able to access their TAK accounts to ensure that their e-filed return and payment have posted and to see their current status. Over time, this portal will be expanded to all taxpayers and will significantly increase their ability to access information regarding their tax accounts.

Other SIGTAS IT tasks expected to be completed in the Year 1 work plan, and their progress, are as follows:

- TAK IT maintenance agreement in place - Completed. A support agreement with the SIGTAS vendor is in place - additional support has come into effect following implementation of the

systems upgrade. It should be noted that due to the work needed to resolve upgrade implementation issues, the SIGTAS vendor had indicated that TAK had already used up all its 100 support days for its first year, but after ESTAK input, the vendor reduced the support day usage to date to 75 days

- Business modernization system function established - Substantially completed. A TAK Modernization Unit has been established and this has focused on two projects (the management of business analysts conducting testing for the SIGTAS upgrade and the introduction of fiscal cash registers) but a Modernization Steering Committee to support and oversee the operation of that unit, as originally proposed by the IMF, has not yet been established. A proposal for the establishment of a Modernization Steering Committee has been submitted to TAK senior management but as yet has no decision has been made.

ESTAK also acknowledges the assistance of the GFSI project IT advisor in reviewing progress on the SIGTAS upgrade and other TAK IT initiatives, particularly during periods when ESTAK's IT Advisor has not been in country. The GFSI IT advisor has also assisted with setting up additional information exchanges between TAK and other entities. TAK currently receives regular data from Customs (including data on imports in North Mitrovica as monitored by EULEX), the Treasury and selected large organizations (e.g. transactions with Pristina International Airport). Consideration has been given to extending such data exchanges, initially to include property tax data given that this could more easily be arranged (given both TAK and the Property Tax Unit are part of the same ministry) - work in this direction is continuing with the Property Tax Unit in the process of adding a fiscal number field to their system and this need to be followed by a largely manual number loading process given that property tax records are based on land allotments rather than on owner names making matching data difficult.

Task order tasks completed during year one

- Support TAK in its efforts to sustain SIGTAS until the replacement system comes online (completed in respect of SIGTAS upgrade stage 1)
- Provide a sustainable solution for TAK IT maintenance, likely involving outsourcing to the private sector
- Establish a business modernization system function to assist TAK leadership in translating business objectives into specific IT requirements
- Coordinate the establishment of automated data sharing at MoF with the GFSI contractor to ensure that TAK interests are adequately addressed

3.2 OBJECTIVE 2 - INCREASE TAXPAYER COMPLIANCE

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

Income Tax laws

In the Year 1 work plan, the only tax legislation task expected was the completion of work on the Administrative Instructions relating to the Personal and Corporate Income Tax laws. The work on these Administrative Instructions was split into two parts.

The first two Administrative Instructions, covering the more urgent monthly and quarterly provisions were completed by TAK with ESTAK assistance and referred to MOF in May 2010 and were subsequently approved by the Minister. ESTAK subsequently assisted with preparation of the training material and supported TAK trainers who provided training on these instructions to TAK team leaders in September 2010. The second two Administrative Instructions, covering the annual income tax provisions, were completed and signed off by the Minister in November 2010. ESTAK facilitated the TAK working groups that considered these Instructions.

Since that time, ESTAK has assisted TAK with preparation of updated taxpayer guides based on the Instructions in order to assist taxpayers to complete their annual 2010 tax year income tax declarations (which ESTAK also assisted in updating) which were due to be filed by 31 March 2011. Separate personal and corporate income tax guides are now available on the TAK website.

Tax Administration and Procedures law

In addition to the income tax Administrative Instructions, the earlier than expected passing of a consolidated and amended Tax Administration and Procedures law (which came into effect from 18 August 2010) resulted in the need for ESTAK and EUCTA projects to jointly assist TAK with the preparation of an updated Administrative Instruction covering that law. Work on this Administrative Instruction required a significant time commitment from TAK and its advisors, but is now completed and was also signed off by the Minister in November.

Since then ESTAK has assisted with the training of staff on the changes made in this (and the income tax law) Administrative Instruction. This effectively completes all of the sub-legal act work envisaged under ESTAK as there are no current proposals to further amend any of the above laws.

VAT law

As indicated in the Year 1 work plan, the VAT legislation aspects are being led by the EUCTA project team, including work on the Administrative Instruction relating to the new EU-compliant VAT law which came into effect on 1 July 2010. That Administrative Instruction has also been completed and signed off by the Minister.

A proposed amendment to the VAT law is in progress and is being managed under the EUCTA project. ESTAK proposed some additional changes to the EUCTA team and has reviewed the proposed amendments which have now been agreed by TAK and have been submitted to the MoF.

Double tax treaties

In relation to double tax treaties, until recently Kosovo had only one treaty in effect (with Albania), with provisions of the former double tax treaties made with Yugoslavia still also having some effect. During 2010, the Government made contact with 17 countries seeking their interest in finalizing double tax treaties with Kosovo. In most cases, work on developing such treaties is only in the early stages. However, substantive progress has been made in discussions with Macedonia and Turkey with the result that a formal tax treaty was signed with Macedonia in April 2011 and the only step remaining for Turkey is the formal signing of the proposed treaty. ESTAK has assisted MoF/TAK with finalizing such agreements and envisages continuing to provide such support as this is needed by the MoF/TAK committee that is working on progressing double tax treaties.

Legal barriers

ESTAK has also assisted TAK with monitoring and identifying legal barriers to TAK collection and enforcement. As the first liquidations of SOEs by KTA/PAK are now reaching their conclusion, TAK has received the first Liquidation Committee decisions and as they were not as favorable as TAK expected, ESTAK has assisted TAK in deciding whether they should be appealed. ESTAK has also assisted TAK in discussions with the Privatization Agency which has resulted in proposals to develop two MOUs between TAK and PAK, one of which ESTAK assisted with drafting (the other was to be drafted by PAK) and which are expected to be finalized soon.

ESTAK has also been working with USAID's SEAD and BEEP projects on proposals to further develop credit registers in Kosovo and on ways to reduce the backlog of unpaid utility bill cases that are clogging up Kosovo's Courts.

Task order tasks completed during year one

- Assist TAK on the implementation of Law on Tax Administration and Procedures

- Draft and implement a comprehensive set of secondary legislation (sub-legal acts for new VAT, personal, and corporate income tax laws) – note the VAT sub-legal act was completed by the EU-CTA project

3.2.2 (B) ROBUST AND FAIR AUDIT FUNCTION

During Year 1, ESTAK coordinated TAK audit assistance with the EUCTA project. In the Year 1 work plan, the first specific audit function task expected to be completed was audit risk model updating and training work. The ESTAK short-term Audit Advisor, in conjunction with a TAK working group, reviewed and agreed on simplification of the risk assessment formulae that had previously been used. TAK IT staff are now working on making the necessary changes to the formulae alongside changes to the VAT information used in that model following changes made to the VAT declaration by the EUCTA project in mid-2010. Once developed, training will be provided to HQ and regional office audit managers and staff.

The audit risk model review work also included a review and update of TAK's annual income tax declarations, taking into account recent changes in the law and administrative instructions and including a desired change to collect and record information on gross sales in financial statements to be submitted with corporate income tax returns (previously only net profit was reported and then adjustments made for tax purposes but this left no gross income amount, other than that in VAT declarations that could be used for risk purposes). A new income tax return for partnerships was also introduced which, while not being a tax payment form (as partnerships are not separate legal entities in Kosovo), would provide enough information to enable partnerships to also be risk assessed, given that partnerships are the main entity type not covered by the audit risk model.

ESTAK advisors also continued to provide assistance with TAK's use of the audit risk model encouraging TAK to use the information provided by the model (rather than continuing to rely on their own subjective methods) in their decisions on the tax audit cases selected by HQ and working towards greater percentages of HQ selected cases for audit in future years.

ESTAK advisors also continue to support TAK's implementation of the audit quality management program, in particular encouraging TAK HQ to randomly select audit cases to be used as a basis for setting quality baselines under the program rather than seeking to undertake a complete re-audit of completed cases. ESTAK advisors have also proposed a solution to the DG regarding staffing of the audit quality unit (rotating selected regional office audit team leaders on a 6-monthly basis) which has been agreed by TAK senior management but is still in the process of being implemented. This is expected to provide the expertise necessary for valid quality review results and also increase the ability of those team leaders rotated through quality review to address quality issues during the course of an audit.

Arising from the increasing focus that TAK was required to give to the acquisition and installation of fiscal cash registers and which requires ongoing visits to business taxpayers for that purpose, ESTAK advisors proposed a new compliance visit report for use by TAK's audit inspectors which has since been accepted and implemented. The purpose of this visit report is to improve the quality and effectiveness of taxpayer visits by ensuring visits are carried out for multiple compliance purposes (e.g. while checking on fiscal registers, also checking on fiscal number compliance, following up on any non-filing, etc.) and putting a greater focus on preparation work before such visits.

In relation to tax activity in the enclaves, TAK has previously re-established sub-offices in Gračanica and in Shtërpce but continues to have no presence in North Mitrovica since Kosovo's declaration of independence in 2008. However, during 2010, former TAK North Mitrovica staff indicated their willingness to return to work. As a result TAK is on the verge of re-opening its North Mitrovica office with 7 appointed staff from mid/late April 2011. ESTAK has actively supported this development, is assisting with the planned updating of the appointed staff on developments in TAK over the last 3 years and planned for the future, and will conduct separate discussions with those staff on what compliance measures can realistically be taken in North Mitrovica - the expectation is that the initial focus will be on taxpayer

registration (rather than on enforcement and compliance activities) and on developing special procedures in respect of taxpayers who have not previously complied with Kosovo's tax laws.

In relation to North Mitrovica, TAK is also regularly receiving reports from Customs of imports entering through the EULEX border post in North Mitrovica but then subsequently do not cross the Customs post in Mitrovica city. Furthermore, TAK had placed a staff member at the Customs post in Mitrovica city, on a pilot basis, to assist in the blockage of imports from importers with tax due and in the identification of "goods without origin" (undocumented goods). However, until the re-opening of its sub-office in North Mitrovica, TAK's revenue collection activities in the North have been severely limited.

ESTAK has also continued to provide assistance to TAK's Professional Standards Unit, including building a relationship between the Professional Standards Units in TAK and Customs and working towards an arrangement with EUCTA to provide assistance to both revenue agency professional standards units. In addition, ESTAK has reviewed a personal declaration form proposed to be reintroduced for completion by all TAK staff (except those already filling in declarations for Kosovo's anti-corruption agencies, namely TAK's Director-General and Deputy Director-Generals).

Task order tasks completed during year one

- Support implementation of the risk-based audit selection system throughout Kosovo (supported during Year 1)
- Support implementation of the audit quality measurement program (supported during Year 1)

3.2.3 (C) ROBUST AND FAIR COLLECTIONS FUNCTION

In the Year 1 work plan, the initial collections task expected to be completed was the issuance of automated notices for non-filers and non-payers. This issuance of automated notices was planned to commence as the SIGTAS upgrade was progressively implemented. Following the delays with SIGTAS implementation and with subsequent database accuracy concerns, it is now expected that taxpayers with tax due and non-filers will not receive automated notices until after April 2011.

ESTAK advisors have regularly recommended to TAK management the need for regional offices to focus on non-filers and stop-filers and on segmenting their tax debts between statute-barred debts (which need to be written off), larger debts (which they should focus their action on) and smaller debts. Despite ESTAK's efforts, progress to date has continued to be slow, although in preparation for the SIGTAS upgrade over 47 million euro of debt was placed in a passive account. It is expected that non-filers/stop-filers and debtors will be more effectively addressed as soon as follow-up letters are automatically issued.

In the meantime, ESTAK advisors continued to assist the TAK DG with his review of tax debt cases of over 1m euro. ESTAK also assisted TAK with the government agreed period of amnesty from tax penalties in relation to 2008 and prior year tax debts where outstanding tax and interest was paid in one lump sum prior to the end of November 2010 (or where, due to SIGTAS upgrade implementation issues, an audit had been completed by the end of November and payment was made by the end of December).

The ESTAK Compliance Advisor continued to provide informational seminars for Enforced Collection regional team leaders in new capabilities resulting from the amended Law on Tax Administration and Procedures and for processing statute-barred collection cases (cases in which more than 6 years has passed since the tax debt was assessed). The Advisor also commenced work on updating a Collections Procedural Manual in conjunction with experienced TAK collectors who were asked to draft some of the content. This work will continue until its completion in Year 2 and will then become the basis for Enforced Collections staff training courses proposed to be piloted and delivered in that year.

ESTAK advisors have visited regional offices (Pristina 2, Prizren and Mitrovica have been visited to date) to assist TAK understand the requirements for effectively overseeing the collection effort. In conjunction with TAK officials, ESTAK advisors are reviewing tax debt cases greater than 3,000 euro to determine

status of the case and actions currently being taken or planned to resolve those cases. This process will continue into Year 2 of the project.

A particular concern affecting some of TAK's regional offices is the amount of tax debt that relates to SOEs and some privatized Newcos. Until 2010, a moratorium on debt collection action applied in relation to SOEs. In December 2010, ESTAK assisted TAK in discussions with the Privatization Agency of Kosovo (PAK) and, as agreed, subsequently drafted a Memorandum of Understanding between TAK and PAK to continue to apply a moratorium in respect of SOEs that were up to date with their current tax obligations but taking enforcement action against those that were not meeting their current tax obligations.

At the recommendation of ESTAK advisors, responsibility for oversight of the collection work in TAK HQ has been moved from "Operations" to the Enforced Collection Manager in "Compliance". This will create a more effective oversight process. In addition, TAK implemented ESTAK's recommendation to designate the Deputy Regional Manager of each region as responsible for collection and taxpayer education activities. This should relieve some of the burden on Regional Managers and establish better control over collection and taxpayer education activities in the regions, in addition to making the Deputy Regional Manager role a more active and visible role in the regional offices. At the same time, TAK has established an additional Deputy Regional Manager in its three largest regional offices, and designated one as responsible for collections and taxpayer education.

ESTAK has also continued to liaise with the USAID-funded SEAD project on how tax administration laws and practices impact caseloads in the Courts (including drafting of a proposed MoU between TAK and the Kosovo Judicial Council) and worked with that project and the USAID-funded BEEP project regarding the further development of credit registries, including the pledge register, in Kosovo. Regarding the pledge register, ESTAK provided assistance to TAK in increasing the use of the Kosovo Pledge Registry. This is important to the debt collection efforts of TAK as recording tax liens at the Pledge Registry is necessary to establish TAK's priority in movable assets of a tax debtor. While the numbers are not yet significant, at the beginning of the ESTAK project no TAK liens had been recorded at the Pledge Registry and there are now more than 400 TAK liens recorded there.

In relation to the career structure of collection officers, the proposed revised grading structure (which has yet to be confirmed by government) has assumed that the grading levels of experienced collection officers will be increased to match those of tax auditors and tax education staff, while those collection officers assessed as not being able to perform at that level would likely be tasked with dealing with smaller debt cases as part of the Call Center that is proposed to commence later in 2011.

It should be noted that the proposed introduction of a Call Center will not only benefit taxpayer education (see below) but also enforced collection activity. In particular, in the collection area, Call Center staff will have responsibility for responding to calls resulting from the issue of automated notices as well as, to the extent workload capacity allows, having an outgoing call capacity in respect of low value debts. This is a key ESTAK initiative to be implemented in 2011 and a short-term advisor with experience in Call Center management has recently joined ESTAK for this purpose.

Task order tasks completed during year one

- Develop and institute improved practices for enforced collection (supported during Year 1)

3.2.4 (D) PUBLIC EDUCATION ON TAX COMPLIANCE

During the first quarter of 2011, ESTAK prepared corporate and personal income tax guides to facilitate taxpayer compliance with the new tax laws and administrative instructions. These guides are available on the TAK website, along with procedures including an online facility for taxpayers to provide TAK with their annual information on purchase transactions over 500 euro (a new requirement from March 2011). In addition, ESTAK provided educational assistance in relation to the proposed introduction of e-filing and

drafted an outline of a proposed tax guide for the construction industry, an area identified by the business community as an immediate need.

In terms of the other Year 1 work plan taxpayer education tasks, progress was as follows:

- FAQ material developed. An initial set of FAQ questions and their answers was included on the TAK website - this set is being increasingly expanded as more FAQs are identified by TAK staff and through monitoring of a facility on the TAK website which allows taxpayers to directly seek answers to their questions.
- publicity spots regarding Taxpayer Advocate and Taxpayer Charter. In line with the TAK Communication Strategy developed by ESTAK greater emphasis on this is now proposed in the second half of 2011. ESTAK has proposed that TAK "re-launch" the Taxpayer Charter in 2011 but only after TAK staff have been fully briefed on the expectations of those staff in terms of standard response times taxpayers can expect to their enquiries
- publication of enforcement actions. To date, publicity has focused on general enforcement messages rather than also including results of enforcement in specific cases - focus on the latter is dependent on the identification of appropriate cases to publicize which has been limited in recent times - for example, actions with the Police on stopping trucks to check on the documentation of their goods resulted in all 11 cases where the media was present having the correct documentation
- briefings on tax issues for judges and prosecutors. ESTAK has been involved in initial discussions with the EUCTA project regarding this, given that project has been liaising with judges and prosecutors in relation to their Tax Investigation Unit work

As noted earlier, ESTAK has appointed a local Public Relations Advisor to assist TAK, and particularly the Director-General in his dealings with the media and with other TAK stakeholders. Assistance provided in this area was described above under Objective 1(b) and while focused on the needs of the Director-General, is increasingly having an impact on TAK's taxpayer education function.

During Year 1, emphasis was also given to the development of taxpayer satisfaction surveys with these starting to be used from March 2011 and designed to be returned to TAK's Taxpayer Advocate. (Results for the few surveys returned to date are included later in this report). ESTAK advisors 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.

In March 2011, ESTAK hosted a World Learning facilitated study tour for the TAK Director-General and 5 other TAK senior managers to IRS Call Centers in Seattle. The purpose of this visit was to increase TAK management's understanding of a Call Center environment and is in accordance with ESTAK's initiative to introduce a Call Center in TAK during 2011 to not only respond to taxpayer inquiries on technical issues (incoming calls) but also to assist with debt collection (as noted above). Future progress on this initiative requires resolution of TAK accommodation shortages in Pristina (given plans to locate the Call Center in Pristina), although TAK's new Prizren office could also be an alternative location. A short-term Taxpayer Education Advisor with Call Center management experience has just joined the ESTAK team to give a focus to this and other taxpayer education activities.

Task order tasks completed during year one

- Develop or update manuals and guidelines on taxpayer education and public relations to enhance compliance (completed in respect of personal and corporate income tax)
- Develop Frequently Asked Questions (FAQ) section within TAK for internal and external internet use that will address common taxpayer issues

3.3 OBJECTIVE 3 - DONOR COORDINATION

In the Year 1 work plan, the only donor coordination task required to be completed was the establishment of a donor coordination forum. It had been planned that a donor meeting at the end of May 2010 would also confirm the continuation of that group as a regular forum. However, the planned donor meeting was cancelled due to the inability of one of the donors to participate at that time. A subsequent proposal for the IMF to facilitate a similar meeting was also not proceeded with due to the unavailability of donor representatives at the time. To date a replacement has not yet been scheduled. In the meantime, ESTAK continued to work constructively with the EUCTA project at a working level in jointly providing assistance across most areas of TAKs operations.

Following a change of IMF resident representative, ESTAK met with the IMF to re-establish reporting and working relationships with the IMF, particularly in regard to revenue collection targets and future revenue forecasts. A good working relationship has been established and visiting IMF missions now regularly discuss tax administration issues with ESTAK advisors as well as with TAK.

ESTAK has also assisted TAK management in their discussions regarding potential future donor assistance from:

- the European Union, in relation to the "Blueprints" exercise that was undertaken during December 2010 which will assist in the determination of what, if any, future EU assistance will be provided to TAK following the completion of the EUCTA project in September 2011
- the Bavarian Government - following an EUCTA-organized study visit, a delegation from Bavaria visited Kosovo in November 2010 to further define future assistance needs
- the IMF - following IMF tax mission recommendations regarding the need to develop TAK's 2012 Compliance Strategy around minimizing the "tax gap", initial indications are that the IMF will provide short-term assistance (three-weekly visits) with the implementation of this recommendation in June, September and November 2011

In relation to the last of these areas, ESTAK has also indicated its willingness to support plans for a DFID short-term project to measure the tax gap in Kosovo, proposed to be completed by September 2011.

Recent discussions with the EUCTA project tax team leader indicate that it is unlikely there will be any further EU technical assistance in TAK immediately following the completion of the EUCTA project in September 2011, but that the arrangements have been made by that project for further donor-funded assistance to be provided by:

- GIZ (formerly GTZ) in relation to delivery of technical training on indirect calculation methods for audit inspectors and delivery of training on VAT to non-audit function staff
- the Bavarian Government and TAIEX in relation to ongoing assistance for the Tax (Fraud) Investigation Unit (for a further 6 months)

Following those discussions, DFID was approached regarding their ability to fund an IMF tax mission recommended independent review of all tax dispute/appeal processes (including the Independent Review Board), and consideration is being given to asking for TAIEX funding to extend EUCTA's VAT advisor for a further 6 months after EUCTA finishes (to complete remaining work on VAT law changes, VAT sub-legal acts, and VAT guides and, as necessary, training for TAK staff on those changes).

It is clear that during 2011, donor assistance provided to TAK will move from its 2010 base of primarily being a dual donor approach (USAID and ECLO) to one involving multiple additional donors including IMF, DFID, GIZ, the Bavarian Government as well as TAIEX funding in specific areas - accordingly the need for donor co-ordination is expected to be greater in future.

4 PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

Throughout Year 1 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. TAK accommodation in Pristina
2. Independent Review Board backlog
3. Fiscal registers
4. Delays in passing revised Law on Games of Chance

In addition, a recently emerged problem is the limited financial resourcing provided for TAK in the 2011 Budget. Resolution of these problems is now largely outside TAK and ESTAK control. Details of each of these problems and steps taken to resolve them to date follow.

(a) TAK accommodation in Pristina

TAK's accommodation issues in Pristina remain outstanding particularly in the short term (proposals for a longer term public/private partnership construction of a building have recently commenced although there are still concerns regarding its possible location). In the meantime, TAK's accommodation problems in Pristina continue to deteriorate - no more staff can be recruited in the Germia building occupied by the Pristina 1 and 2 regional offices (staff needed to address the continued growth of Pristina and surrounding communities). As a result, TAK staff based outside Pristina have to assist Pristina taxpayers. Furthermore, there is insufficient space for taxpayers visiting these offices, damaging the image of TAK with its largest taxpayer population, and sending a message to taxpayers that the government is not serious about tax collection. ESTAK has estimated a loss of between 4 and 6m euro in revenue for every 10 additional staff not able to be accommodated in Pristina. Space constraints could also adversely impact on ESTAK proposals to establish a TAK Call Center in Pristina later in 2011.

The accommodation problems in Pristina 1 and 2 are acute and have been ongoing for over 5 years. TAK's accommodation for its Pristina-based Large Taxpayer Unit is also substandard and, while the problems are not as acute as the other Pristina regional offices, this has a negative effect on TAK's ability to provide services to the 400 taxpayers that pay approximately 2/3 of annual tax revenues. TAK's HQ is in good standard accommodation except that these premises are also overcrowded and attempts to move the Independent Review Board from these premises to alleviate the space pressures have to date not been successful. Currently, TAK staff in Pristina are spread across four different buildings, adding to operational inefficiency. In Pristina, TAK only has two meeting rooms for all its training activity and media conferences and these are also needed for temporary use by project teams and by external visitors (such as by the Controller and Auditor General reviewers) with the result that ESTAK facilities in Peyton are also used by TAK. The Pristina situation is in marked contrast to the high standard of accommodation that is provided in all of TAK's 6 regional offices and 2 (soon to be 3) sub-offices outside Pristina.

ESTAK has supported TAK in its proposals to move all Pristina-based staff into the recently vacated building previously used by the OSCE (with a proposal for the Controller and Auditor-General's office to move into the TAK HQ building to be co-located with the Independent Review Board) and despite UN support, the TAK request was denoted by the Kosovo Government as the lowest priority out of 5 requests for space in that building. 6 months after decisions made to reallocate accommodation in that building to other Ministries to that building, that building remains largely unoccupied. Other attempts to resolve this issue have been continual raising of this problem with the Minister of Finance and with donor stakeholders (USAID and IMF representatives have both visited the Pristina 1 & 2 building) and the escalation to the US Ambassador and to the Prime Minister. ESTAK has also attempted to get the IMF to

include resolution of this issue as a benchmark required to be resolved by the Kosovo Government as an IMF program condition.

The recently approved 2011 Budget also further worsens this situation as reductions in the "goods and services" allocation mean there is effectively no money available to rent additional premises or to shift staff to alternative Government premises. TAK may also need to consider locating its proposed Call Center in Prizren (where there is available space in the TAK Prizren office) even though it would be more efficiently operated and controlled in Pristina.

(b) Independent Review Board backlog:

There has been a lack of support to address the backlog problems of the Independent Review Board. At the time of ESTAK's meeting with the Board chairman in October 2010, the backlog had reached between 500 and 600 tax cases and about 800 customs cases. While the Board reports to the Assembly, the Ministry of Finance has a vested interest and influence over its operations but its resourcing decisions have not addressed the ever increasing backlog of tax (and customs) dispute cases that are waiting to be heard. This continues to include a substantial dispute regarding KEK which could easily be given priority but this has not happened despite KEK and TAK requests for the Board to do so.

The Board will never operate successfully in its current format and as a result ESTAK requested the IMF to review what steps should be taken to resolve this problem. The IMF tax mission in February/March 2011, while not specifically reviewing the Board, did recommend that an independent review should be conducted of all aspects of the tax disputes process including also the TAK Appeals function. ESTAK considers it would not be independent enough to do this and has recently approached DFID to see whether they can assist. In the meantime Board problems continue to worsen.

Due to a recent amendment to the Tax Administration and Procedures law, there is fortunately now a provision which allows TAK to take enforced collection action in respect of tax disputes before the Board thus stopping disputes being referred there just to avoid paying taxes due. But taxpayers are probably not generally aware of this (and may be appealing with the expectation of deferral) and of course it is not good practice to be taking enforcement action in cases where there is a genuine technical dispute.

(c) Fiscal registers

ESTAK continues to distance itself from the Government's fiscal register initiative, given the potential risk of failure of this initiative, which has proceeded on a basis inconsistent with previous USAID advice. The main concerns are the continuing effective monopoly over the supply of fiscal register devices (which has also over-inflated their prices) and the opportunity cost of TAK staff having to follow up on taxpayers who have not acquired/installed fiscal registers and/or are not issuing fiscal receipts where the only potential revenue is fines (there is no indication yet of increased tax revenues due to the installation of fiscal registers and TAK's future revenue targets have never been directly increased in relation to this initiative).

Taxpayer resistance to the high costs involved in purchasing fiscal registers has meant that TAK has been heavily criticized regarding this issue by business groups and in the media. It has also led to increasing numbers of cases of TAK staff being assaulted or abused when checking on installation and use of fiscal registers and issue of fiscal receipts. Taking into account the number of fiscal registers that have so far been installed (almost 13,000 devices although larger operators have purchased multiple devices), ESTAK considers that the use of fiscal registers should be required only in respect of those taxpayers who are required to register for VAT (i.e. those with an annual turnover over 50,000 euro). However TAK's current plans are to continue with this initiative for all taxpayers and it is thus expected that this project will continue for many years into the future as it has in other Balkan countries (Macedonia has been implementing for 10 years, Croatia abandoned after trying to implement over 8 years).

(d) Delays in passing revised Law on Games of Chance

There has been lack of progress on the revised Law on Games of Chance - it had been the intention that the licenses that operators would pay under that law would compensate for the exemption of VAT now

provided to gambling operators. But while the VAT exemption was introduced from July 2010, the other law has not yet been amended and as a result the Government has since July 2010 been receiving little revenue from the gambling industry.

The law has been held up in the Ministry of Finance. When ESTAK last followed up, the response was that consideration was now giving to an alternative proposal of introducing an excise tax on gambling. ESTAK has consulted with the EUCTA project on this issue and they have included a proposal in their current package of VAT law amendments which in effect re-introduces the VAT on gambling until such time as a revised Law on Games of Chance is introduced. This would at least temporarily re-introduce taxation of gambling revenues assuming that provision continues through the legislative process.

It is understood that a Ministry of Finance committee agreed in April to an excise duty regime for gambling. Assuming this regime will be approved, It is not yet known:

- when the excise regime is proposed to commence and whether it would remove the need for the VAT amendment provision referred to above
- what the revenue impact of this regime will be compared with the previous VAT regime
- whether TAK or Customs will be involved in administering this regime (it is assumed this will be Customs given they collect internal excises in Kosovo) and what impact this will have on the ongoing operations of TAK's Gambling Department

(e) TAK 2011 Budget:

TAK's recently approved 2011 Budget covers the following components:

Salaries and wages - 4,675,969 - this compares with TAK/MoF's agreed request for 5,185,000 with an arbitrary reduction of 500,000 having been made during the Assembly Budget Committee stages. This represents a 17% increase in the budget allocation (compared to 2010), but it is intended to cover both the 30% increase in TAK staff basic salaries effective 1 March 2011 as well as funding for the additional 48 positions allocated. It appears that the reduced increase may be sufficient to cover these aspects as the actual increases received by TAK staff were much less than expected as they were only backdated to 1 March (rather than 1 January), were based on 2008 (rather than 2010) base salaries and were also accompanied by a removal of their previously paid meal allowances.

Despite this, and in order to maintain relativity with the pay structure agreed for Customs, TAK has recently proposed a revised pay structure which would require approximately 200,000 additional euros over the allocated Budget; initial indications are that the MOF will support this additional allocation

Goods and services - 1,470,000 - this compares with the 1,634,388 sought by TAK and the 1,585,873 allocated and 1,521,104 spent in 2010. This reduction made by MoF prior to Assembly consideration can be expected to cause significant problems for TAK given that:

- TAK will have more staff (which generates more costs than just salaries) but less goods and services funding allocated than in 2010
- Additional goods and services funding was being sought to pay for the proposed increased use of PTK to deliver automated notices to defaulting taxpayers - finding funding for this will now have to compete with other needs
- Additional goods and services funding was being sought to introduce an employee mobility policy (to encourage regional employees to work in HQ) and to allow staff to be reimbursed for use of their own vehicles (to get around vehicle restrictions) - ability to proceed with these initiatives is now similarly under threat
- There is no funding provided to allow for alternative accommodation options for TAK's Pristina accommodation

TAK will now need to carefully evaluate all its goods and service expenditures and hard decisions will need to be made in order to make best use of its limited allocation.

Utilities - 188,320 - this is the same as the budget allocation in 2010 (and indeed the same amount in every year from 2008) and compares with the 181,564 spent in 2010 and the 236,680 asked for taking into account significant increases in electricity tariffs that applied from September 2010 - given the relative inability to reduce utilities (electricity, telephone and heating), funding will need to be shifted from goods and services or capital allocations to keep this component within budget.

Capital - 984,377 - this compares with the 924,377 allocated in 2010 and the 845,735 spent in that year - it also compares with the 1,536,687 requested by TAK for 2011 - apparently all capital items requested by TAK were approved by MoF before the Assembly stage except for requested allocations of: (a) 212,310 for 10 to 20 additional vehicles to replace damaged and old vehicles some of which have been recently disposed of by auction - as a result this represents a reduction in TAK's vehicle fleet at a time when TAK will have more staff; and (b) 340,000 for up to 400 replacement computers - effectively the additional staff TAK is allowed to employ would not be provided with computers and would be expected to add to the demands for vehicle usage in order to carry out their work.

It can be readily seen from the above that the 2011 TAK budget allocation is similar to its 2010 (when increased base salaries are adjusted for) despite the increased staffing numbers allocated. Given this, the ability for TAK to achieve its significantly increased revenue target of 270m in 2011 must now be in doubt. TAK and ESTAK have consistently advised Government decision-makers and other stakeholders (including the IMF) that TAK's ability to reach the higher revenue target was conditional on TAK receiving sufficient resourcing and support from the Government. Until recently, it appeared that the Government was going to meet most of these requirements but the latest decisions now show that this is not the case.

Coincidentally coming to TAK's assistance, has been a recent proposal to release between 5 and 10 vehicles to TAK from EULEX as that mission downsizes. This will partially reinstate TAK's previous request for additional/replacement vehicles but will in turn require additional goods and services costs for vehicle running and maintenance. With the likelihood of there being no mid-year budget review this year, there will be little opportunity to obtain additional funding unless funds can be released from other department's allocations within MoF's total budget as might be the case with salaries.

As a consequence of the above, TAK has started to look at whether it can postpone or reduce some of its approved capital items (which are mostly IT project related and includes funding for photocopiers and printers) in order to recreate a pool for funding some replacement computers. (There is an ability to make shifts in the TAK budgetary allocations of up to 15% between components, with MoF approval, provided the salary and wage component is not amended). As a result of this work ESTAK has been advised that reallocations of capital may allow sufficient funding for up to 300 new laptop computers to be funded - however it seems clear that some of that released funding in the capital allocation would be needed to increase goods and services and utilities allocations just to allow TAK to carry out its normal operations, let alone to try and find funding for new initiatives, particularly those being proposed by ESTAK.

The ability for ESTAK to deliver on some of its initiatives must accordingly now also be in doubt. For example, TAK management is showing reluctance to implement some of the changes that ESTAK has recommended in relation to consolidating tax forms and reducing VAT return filing frequency that would support improvements in "Doing Business" rankings, simply because of the cost implications of making such changes. Indeed, this is now seen as the most serious problem facing ESTAK going forward.

The TAK DG is nevertheless continuing to aim to collect tax revenues of 270m euro in 2011 despite the budgetary limitations now imposed. This can be expected to result in an even greater focus from MoF and TAK senior management on short term revenue gain initiatives, potentially at the expense of longer term more sustainable initiatives which ESTAK is trying to introduce.

5 VARIANCES FROM THE YEAR 1 WORK PLAN

ESTAK work has broadly continued in line with the Year 1 Work Plan but with the following additions:

- the requirement to assist TAK (in conjunction with EUCTA) with the preparation of an updated Administrative Instruction for the new Tax Administration and Procedures law
- the requirement to provide more HR assistance to TAK in developing its own pay scale and disciplinary procedures in line with provisions in the updated Tax Administration and Procedures law
- the addition of a local advisor to assist the Director-General of TAK in his public relations activities and the related development of a Communications Strategy for TAK
- assisting TAK management with the production of monthly bulletins to brief all staff on current and upcoming issues
- the initial development of tax simplification proposals to assist Kosovo to elevate its "Doing Business" rankings

6 UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT YEAR

Following on from the work completed to date, details of ESTAK activities in Year 2 are listed in a separate ESTAK Year 2 Work Plan document.