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EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

QUARTERLY REPORT
JULY 15 – OCTOBER 14, 2010

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

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1 ESTAK QUARTERLY REPORT SUMMARY

Following a first quarter which included introduction of the ESTAK program to stakeholders, finalization of the Year 1 ESTAK workplan and the confirmation of long-term resident advisors, activities during the second quarter focused directly on specific tasks according to the workplan and to TAK priorities. The ESTAK program is now fully staffed, with 5 short and long-term international advisors (and 2 others due to commence in the third quarter), 3 local advisors and 3 translators and administrative support.

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 by increasing voluntary compliance and bringing non-compliant taxpayers into the formal economy. ESTAK has made good progress in both areas during the second quarter and this is reflected in the progress details below.

The main achievements during the second quarter, and the areas which have dominated ESTAK input during the quarter, have been:

- SIGTAS upgrade implementation (stage 1)
- Substantive completion of ESTAK work on sub-legal acts covering the income tax laws and the law on tax administration and procedures
- Completion of a comprehensive training needs analysis for TAK
- Review and revision of TAK resource bid for 2011 Budget with particular input on designing a revised salary structure for the future
- Drafting of proposed HR policies and procedures for TAK in areas including recruitment, disciplinary actions and grievances
- Commencement of work on improving TAK's public relations activities

Some progress has been made on resolving the problems and barriers to achievement identified in the previous quarterly report, but many of those that remain arise from a lack of support to TAK from the highest levels of the Ministry of Economy and Finance.

As required by the Task Order, the balance of this report provides details on:

1. Project progress (activities, benchmarks and performance standards achieved)
2. Problems encountered and proposed solutions
3. Success stories and notable accomplishments
4. List of upcoming events and activities to be carried out in the next quarter
5. Updates to the Year 1 Work Plan

2 PROJECT PROGRESS

2.1 OBJECTIVE 1 – STRENGTHEN THE CAPACITY OF TAK TO ADMINISTER ITS RESPONSIBILITIES

(A) SKILLS DEVELOPMENT/TRAINING:

In the Year 1 workplan, several skills development/training tasks were expected to be completed during the first two quarters. Significant progress on those tasks has been accomplished and all are still expected to be completed during Year 1.

The main emphasis to date has been placed on the completion of a comprehensive training needs analysis (TNA), the first stage of the proposed introduction of ISD training methodology in TAK. In particular, the following steps have been 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 & procedures, education & training, career potential, management & senior management, communications and equipment & working conditions was also 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 latest individual work plans (which had been completed by 614 staff at the beginning of the year)
- Earlier completed analysis work (quarter 1) in relation to the ability and capacity of the TAK Training Unit and of external training providers (KCPED, KIPA, LSE, MDA and SCAAK)

All of the above data is currently being analyzed and it is expected that a final TNA report ready for discussion with TAK senior management will be completed by the end of October.

The other initially planned skills development/training tasks, and progress against them to date, are:

- Explaining the ISD methodology process to TAK management (June 2010) – process has been explained to Deputy Directors Corporate Services and the recently appointed Manager Training. For the Director-General and other Deputy Directors this will be covered as part of the proposed presentation on the results of the TNA
- Identifying trainers and subject matter reviewers for training material development and delivery (July to October 2010) – work on this has been delayed until after completion of the training needs analysis – in hindsight timing for completion of this task should have followed completion of that analysis
- Training strategy developed and actualized in annual funded training program (by 30 September 2010) – a draft strategy is proposed to be included in the final TNA report. In the interim annual funding for training included in 2011 Budget resource bid has followed 2010 levels except for an increased amount for internal travel costs to allow for more visits between TAK offices for training purposes
- Internal training program development for key occupations and managers (by 31 August 2010) - work has commenced in relation to key occupations (curricula course outlines drafted for tax audit,

collection and education functions – a total of 77 course outlines have been drafted as part of the proposed multi-year training strategy)

- On-line training material library established (by 30 September 2010) – under action with the TAK Training Unit having requested and received copies of training materials from TAK operational units – these materials are yet to be evaluated to determine the value of including them in a proposed electronic course catalogue
- “Train the trainers” trainers selected and trained and conducting training (31 October 2010) – under action – past “train the trainer” materials have been reviewed and it has been decided to design and implement a new program with three courses (curriculum development, test writing, and presentation & facilitation skills)

During the second quarter, the following has also been achieved:

- Developed a training policy addendum with three training forms (Training Department Support Request, Equipment Request and Program Evaluation) which have subsequently been approved by TAK senior management, have been loaded on to the SharePoint portal and are now in use
- Discussed the TAK 2010-2015 Strategic Plan's ten training performance indicators with TAK training staff and prepared an action plan to define the tasks necessary to achieve each of those indicators
- Conducted some initial work on the feasibility of developing computer-based training - it is envisaged that the proposed training strategy will include e-learning as a viable strategy for some training needs

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 drafting the Administrative Instruction in relation to that law)
- “Collection” aspects of the Tax Administration and Procedures Law (for regional Enforced Collection Team Leaders), including on computation of collection statutory period
- The Personal and Corporate Income Tax Laws (as part of the working party discussions on the Administrative Instructions being prepared 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)

(B) IMPROVING MANAGEMENT EFFECTIVENESS:

In the Year 1 workplan, a number of discrete management effectiveness tasks were required to be completed during the first two quarters. The following tasks were completed as planned:

- Preparation of Staffing Plan in preparation for TAK's 2011 Budget submissions (June to October 2010) – An interim staffing plan envisaging 50 additional TAK staff was developed in time for TAK to present at its Budget hearing on 31 August
- Assistance with EU tender for new integrated computer system for TAK (up to July 2010) - ESTAK assisted TAK and an EU contractor with the development of specifications for the tender that was advertised in July 2010 (bids closed in early October 2010 and these are now being evaluated)
- KPIs developed and implemented (by 31 August 2010) – KPIs have been identified and approved by TAK management and have been implemented through a special report that has been developed on the SharePoint portal on which training has been provided for TAK HQ and regional office managers

A key management effectiveness task, which has not yet been completed but is currently being worked on, is a review of the TAK organization structure with recommendations on changes to TAK management (by 31 October 2010). As most of the previous IMF mission recommended changes at HQ level have already been implemented (with ESTAK support, for example, in drafting new or revised job descriptions), the focus of this work is on reviewing the organizational structure of TAK's regional offices and modelling the most optimal structure which can be applied across TAK. One remaining change at HQ level supported by ESTAK during the quarter was providing TAK with a concept of operations for the IMF-recommended Risk Management Unit which is now in the process of being implemented in the Office of Modernization and Strategic Planning with a team leader for that unit having been selected and an ESTAK advisor proposed to give support during November. (During the same period EUCTA has been assisting TAK with establishment of the IMF-recommended Tax (Fraud) Investigation Unit).

In terms of TAK's regional offices, the TAK regional office structure has not been revised for many years, and the current review is taking into account the workload change impacts of the recent SIGTAS upgrade as well as ESTAK proposals to introduce a Call Center during 2011. Work on this has been delayed while priority was given to other human resource management tasks (following the unexpected early passing of the Law on Tax Administration and Procedures which included a provision to allow TAK to establish its own salary structure and recruitment and disciplinary policies), and this is now expected to be completed by 31 December 2010.

In relation to the Law on Tax Administration & Procedures impact and the resultant requirement to prepare an Administrative Instruction covering these human resource management issues, ESTAK has drafted procedures in relation to:

- recruitment and selection
- promotions
- discipline
- grievance
- performance improvement procedure (which includes provision for the termination of substantially/serially under-performing employees)

and these have been submitted to TAK management for consideration.

As part of the TAK resource bid preparations under the 2011 Budget process, ESTAK has proposed amendments to staff remuneration which reflect:

- provision for the introduction of a variable pay element based on employee performance;
- adjustments to base pay for a number of roles, which would facilitate a more sensible decompression of pay rates and create more meaningful differentiation between jobs based on their actual size, complexity and organizational value. (The existing degree of compression prohibits meaningful incentives for employees to develop and seek promotion to a more senior role as the financial incentives to do so are very limited).

A final fully costed reward proposal, taking into account any revisions to the structure and/or to specific jobs within the structure (once existing jobs have been re-evaluated on a consistent basis) will be submitted to MEF before the end of 2010 once greater clarity is achieved regarding TAK's 2011 Budget allocation. The intention is to adopt an approach that can be safely piloted in 2011 with appropriate safety measures included in order to build confidence, particularly with MEF and with internal stakeholders. As such, if implemented appropriately, the approach could represent a sustainable approach to incentivizing employees to optimize organizational performance. Moreover, it is hoped that a meaningful precedent could be created whereby other civil service institutions could consider adapting or applying a similar approach beyond TAK.

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 on this 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 half-year and 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. A revised year-end performance self-assessment process and approach was proposed and agreed and workshops are ongoing with Regional Managers to support them through this. In the event that this is successful, the year end should enable a proper performance calibration exercise to be undertaken alongside an inaugural Regional Manager talent review. This may help support the Director General's consideration of a potential redeployment of a number of current Regional Managers in the first quarter of 2011. The appetite for modern performance management practices in the regions appears encouragingly strong and a paced approach to introducing Performance Management capability layer by layer throughout 2011 is suggested as the one most likely to produce sustainable impact once any revisions to the field structure have been implemented.

Throughout the quarter, 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 taking our advice, nor necessarily as a matter of course seeking it ahead of important decisions, particularly on staffing deployment, the Director-General nonetheless regularly seeks advice from ESTAK advisors. TAK Deputy Directors, HQ managers and the Large Taxpayer Unit Manager (and to a lesser extent the other regional office managers) 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 finalization of TAK's 5-year Strategic Plans, and through drafting for the Director-General of monthly information bulletins for all staff (3 of which have been drafted and issued to all staff so far).

In order to further assist the Director-General and TAK management, a decision was made during the Year 1 workplan 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 a publicity campaign covering the changed fiscal number requirements related to the SIGTAS upgrade
- preparing the Director-General for his recently held quarterly TAK performance and results media conference (for example, the preparation of a media kit) and analysing how future media conferences could be improved
- the redesign of TAK's website, which has now been updated and includes an initial listing of Frequently Asked Questions (after TAK offices were canvassed regarding their 10 most common taxpayer questions)
- reviewing various aspects of how TAK currently manages its relationship with the media with a view to recommending changes to TAK management

(C) DETERMINING RESOURCE NEEDS:

In the Year 1 workplan, the only specific resource need task required to be completed during the first two quarters was that of providing assistance in identifying TAK resource needs to feed into 2011 Budget submissions (July to October 2010). In this area, the initial TAK Budget submissions were reviewed and corrected in conjunction with TAK management in time for the August 31 Budget hearing.

While time did not allow ESTAK advisors to complete a full staffing review, the original TAK proposal for additional 50 staff positions was supported due to a combination of:

- allowing 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 22 staff)
- allowing 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)
- a proposal to re-open the TAK sub-office in North Mitrovica, following expressions of interest from former staff in that office to return to work (an initial 4 positions have been advertised and this may increase to its former level of 12 staff in future)
- 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

In relation to TAK's financial bid, ESTAK completed a review of all items initially submitted and succeeded in ensuring that there was an operational rationale for everything reflected in the bid and more realistic figures included as part of the budget request. As a result, the final consolidated submission 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 bids 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 the first quarter of 2011)

With the completion of this task, most of the ESTAK requirement for this objective has now been met. Once final resourcing decisions under the 2011 Budget process are known, ESTAK will assist with its implementation 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. In order to consolidate this, it is proposed that, once the field structure review has taken place, 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 thought 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 necessarily ever having been asked what their requirements are. There has therefore been a substantial disconnect between this and what the regional office network is being required to deliver, operationally and strategically.

(D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION:

In the Year 1 workplan, the only return processing/taxpayer re-registration task required to be completed during the first two quarters was the requirement that there be a taxpayer registration system supported by SIGTAS (by 31 July 2010). Progress on this outcome has been delayed by the deferral of SIGTAS upgrade implementation until early October but has now been substantially completed as the new taxroll module has now been implemented with the “go-live” of the first stage of the SIGTAS upgrade.

In particular, ESTAK played a major role in assisting TAK “business owners” in preparing 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 had decided to automatically issue fiscal numbers to active taxpayers who did not have one. 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 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 above 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 has allocated just over 60,000 fiscal numbers to taxpayers in Kosovo. During October and November the number of active taxpayers will be confirmed as those active taxpayers who have not yet obtained a fiscal number will need to do so in order to be able to download their tax declaration forms from the TAK website. It is expected 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 (which does not have an active de-registration process) and is matched by the 35,000 “passive” taxpayers TAK now has recorded on its database.

In relation to returns processing, delays in return processing while taxpayer data was converted from “old” to “new” SIGTAS resulted in a return processing backlog of about 30,000 declarations. 10,000 of these have since been processed but a backlog of about 20,000 currently remains, mostly being 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 resolved in coming weeks, 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 requirement recently introduced that requires taxpayers to download their tax forms from the TAK website which contain various fields of pre-populated data.

As will be clear from the above, progress is being made on improving the accuracy and timeliness of TAK data for both TAK staff and taxpayers and while the SIGTAS upgrade process has introduced some temporary processing problems, further improvements can be expected as the second stage of the SIGTAS upgrade and e-filing are implemented in coming months.

(E) SIGTAS IT SYSTEM:

In the Year 1 workplan, the main SIGTAS IT task expected to be completed during the first two quarters was to provide assistance with SIGTAS upgrade implementation during July to September 2010. It was originally envisaged that SIGTAS upgrade implementation would take place in two stages during that period but commencement of the first stage of implementation was deferred several times until the first week of October 2010.

ESTAK played a key role in ensuring that 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 were working towards the same go live date. Assistance provided to the “business owner” is described under objective 1(d) above. Assistance to IT management and staff was provided in relation to:

- ensuring that “new” SIGTAS would process payments and apply penalties and interest in accordance with Kosovo laws
- ensuring that assessments and re-assessments can 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 can be printed from new SIGTAS
- mediation between TAK management and the SIGTAS vendor on matters relating to acceptance of the new system, contract payments, development versus support changes, etc.
- 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

The upgrade of SIGTAS represents one of the most significant achievements in TAK that will occur during the lifetime of ESTAK but the implementation process remains in the early stages. While the first phase of implementation has been completed and taxpayer data has been successfully converted for the vast majority of taxpayers, some new processes are not yet fully implemented throughout TAK. Following successful resolution of these issues, the second stage of SIGTAS implementation (introduction of audit, collection and objection modules) will take place. At this stage this is planned to take place during November.

Following the completion of the SIGTAS upgrade and activities related to it, IT focus will shift to the implementation of E-filing and on-line taxpayer service support. While the Year 1 workplan envisaged this implementation taking place in August 2010, due to delays with the SIGTAS upgrade, this implementation is not now due to commence until December 2010. ESTAK advisors have and will continue to support the introduction of this initiative. E-filing is expected to be phased in over the next 6 months, beginning with Large Taxpayer Unit taxpayers 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 workplan, and progress on them, are as follows:

- TAK IT maintenance agreement in place (by 30 September 2010) – Completed - A support agreement with the SIGTAS vendor is in place – additional support has now come into effect following implementation of the systems upgrade
- Business modernization system function established (by 31 October 2010) – Partially completed - a TAK Modernization Unit has been established and this has focussed 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 has not yet been established. Work on the Modernization Steering Committee will be followed up in the third quarter in conjunction with TAK's new Risk Management Unit, the proposed team leader of which has been managing the SIGTAS upgrade business analyst team and who will report to the manager of planning and analysis in the office of the Director of Modernization.

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.

2.2 OBJECTIVE 2 – INCREASE TAXPAYER COMPLIANCE

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

Income Tax laws

In the Year 1 workplan, the only tax legislation task expected to be completed during the first two quarters 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 on these laws (covering the more urgent monthly and quarterly provisions) were completed by TAK with ESTAK assistance and referred to MEF in May 2010 and were subsequently signed off by the Minister. During the second quarter, ESTAK 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 on these laws (covering the annual income tax provisions) have largely been completed. There have been several meetings to finalize the last two provisions (covering the taxation of long-term construction contracts and the taxation of the commercial of income of NGOs) and it is expected that ESTAK input on these instructions will largely be completed by the end of October. The Instructions will then be ready for referral to MEF.

Tax Administration & Procedures law

In addition to the income tax sub-legal act Administrative Instructions, the earlier than expected passing of a consolidated and amended Tax Administration & Procedures law (which came into effect from 18 August 2010) has 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, the draft of which exceeds 150 pages, has required a significant time commitment from TAK and its advisors, but is now about 75% completed. ESTAK's technical input in this area is expected to be largely completed during November.

VAT law

As indicated in the Year 1 workplan, 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.

With no future plans to amend the tax laws (other than the VAT law which is being managed under the EUCTA project), ESTAK's sub-legal act work requirements are now expected to be largely completed during the next quarter.

Double tax treaties

In relation to double tax treaties, Kosovo currently has only one treaty in effect (with Albania). Initial discussions have taken place on such treaties with Macedonia, Turkey, Belgium and Germany and in each case responses are awaited from those countries. ESTAK has followed up with MEF officials to in turn follow up with the Ministry of Foreign Affairs but there have been no further developments with those potential agreements. Discussions then commenced with Montenegro (a Government working party was being established to which ESTAK was to provide advisory assistance) and there was some contact with Hungary, but again nothing further has developed with these countries. More recently, an approach was made to finalize an agreement with the Czech Republic. ESTAK advisors participated in a working group to comment on this proposal with a view to a formal agreement being ready in time for it to be signed when their authorized representative visits Kosovo in November.

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. Unfortunately a late change by MEF Legal without TAK consultation to the recently approved Law on Tax Administration & Procedures may have impacted on TAK's ability to collect interest and penalties in such cases.

(B) ROBUST AND FAIR AUDIT FUNCTION:

In the Year 1 workplan, the only specific audit function task expected to be completed during the first two quarters was audit risk model updating and training work during the June to August 2010 period. Due to medical problems faced by the advisor who was planned to do this work, this work has been delayed and is now due to take place in November with a new advisor appointed for that purpose. Although refinement and training work has not yet been completed, ESTAK advisors have nevertheless continued to provide assistance with TAK's continued use of the Audit Risk Model encouraging TAK HQ to use the information provided by it (rather than continuing to rely on their own subjective methods) in their decisions on the tax audit cases being selected by HQ during 2010.

ESTAK advisors also continue to give support to 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 Director-General regarding staffing of the audit quality unit which is expected to be implemented in November. Due to difficulty is encouraging staff to move into HQ positions, Audit Team Leaders will be rotated through the audit quality review team on a 6-month basis. This will 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 required 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 was to improve the quality and effectiveness of taxpayer visits by ensuring visits were 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.

During the second quarter, plans have also been made to jointly co-ordinate TAK audit assistance work with the EUCTA project with the result that:

- the EUCTA project expect to have a new taxpayer audit advisor arrive in Kosovo in late October for a period of 6 months – their advisor has a background in VAT auditing and will focus on preparation of a tax audit manual and providing training on that manual
- the ESTAK project plan to have a short-term advisor due to commence work in November who will focus on audit risk model work, assist with the development of TAK's new Risk Management Unit and who will assist, along with ESTAK's DCoP, the EUCTA advisor with tax audit manual work, the ESTAK advisor having a background in income tax auditing

In preparation for this work, the DCoP has accumulated all existing and past TAK audit materials, has prepared a proposed table of contents for the new tax audit manual, and has commenced drafting the first parts of that manual.

In relation to tax activity in the enclaves, TAK has re-established sub-offices in Gracanica and in Shterpcë but continues to have no presence in North Mitrovica since Kosovo's declaration of independence in 2008. However, during the second quarter, past TAK North Mitrovica staff indicated their willingness to return to work. As a result TAK is planning to re-open its North Mitrovica office and has advertised 4 staff positions. ESTAK has actively supported this development and assisted TAK in its preparation of a request to MEF (which was subsequently discussed with the Deputy Minister) for special approval to temporarily fill these positions given that TAK had already reached its maximum authorized staff ceiling level – this MEF approval is still awaited and as a result no further progress is being made on re-opening the North Mitrovica office. Late in the reporting period, ESTAK advisors became involved in considering the best means by which TAK could leverage a northern initiative being initiated through a joint USAID and Government of Kosovo project.

In relation to North Mitrovica, TAK is also now regularly receiving reports from Customs of imports that come through the EULEX border post in North Mitrovica but then subsequently do not come through the Customs post in Mitrovica city. Furthermore, TAK has now 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).

(C) ROBUST AND FAIR COLLECTIONS FUNCTION:

In the Year 1 workplan, the only specific collections function task expected to be completed during the first two quarters was that automated notices would be issued for non-filers and non-payers (by 31 August 2010). The issue of automated notices was planned to commence as the SIGTAS upgrade was progressively implemented. Following the initial stage of SIGTAS implementation, it is now proposed that taxpayers with tax assessments with tax to pay will start to get final notices before enforcement action is taken from the second half of October 2010. Non-filers will start to get automated notices from December 2010 after the second stage of the SIGTAS upgrade is implemented.

ESTAK advisors have regularly recommended to TAK management the need for regional offices to place a focus on non-filers and stop-filers and to place a focus on segmenting their tax debts between statute-barred debt (which needs to be written off), larger debts (which they should focus their action on) and smaller debts. Despite this, progress to date continues to be slow, although in preparation for the SIGTAS upgrade over 47 million euro of debt has been placed in the 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 (via the PTK postal system) to these taxpayers following the SIGTAS upgrade.

In the meantime, ESTAK advisors continued to assist the TAK Director-General with his review of tax debt cases of over 1m euro. ESTAK has also assisted TAK with the government agreed further period of amnesty from tax penalties in relation to 2008 and prior year tax debts where outstanding tax and interest is paid in one lump sum prior to 30 November 2010. Assistance has also been provided in development

of procedures for collecting tax debts of budget organizations, with an effort scheduled for late November to take advantage of expected budget surpluses of these organizations resulting from under-spending in their authorized budgets.

As previously noted, ESTAK advisors have provided 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). In addition, ESTAK advisors have visited several regional offices to meet with the manager and team leader in an effort to identify systemic issues that are causing collection problems. As a result of these meetings and visits, three new forms and instructions have been issued: request for adjustment of tax account; request for payment transfer; and request for credit transfer.

ESTAK has also liaised with the USAID-funded SEAD project in relation to how tax administration laws and practices impact on caseloads in the Courts and has recently commenced discussions with the USAID-funded BEEP project regarding the development of credit registries in Kosovo.

(D) PUBLIC EDUCATION ON TAX COMPLIANCE:

In the Year 1 workplan, no specific public education function tasks were required to be completed during the early quarters as most taxpayer education outcomes are not planned to be achieved until the last quarter. This recognized the priority in other areas of the workplan and envisaged a short-term Taxpayer Education Advisor commencing in November 2010.

It is now proposed to delay the commencement of the Taxpayer Education Advisor until January/February 2011 due to:

- delays in the completion of Administrative Instructions which contain numerous examples and which can form the basis for development of a range of taxpayer education materials
- prior emphasis being given to the development of a TAK communication strategy during November by ESTAK's Public Relations Advisor with assistance from a subcontracted expert

It is envisaged that the Taxpayer Education Advisor would initially focus on the provision of assistance to income taxpayers with the preparation of their 2010 annual tax returns (required to be filed by 31 March 2011) but would then progressively assist TAK with the development of various other taxpayer education focused guides and pamphlets rather than expecting taxpayers to read and understand lengthy laws and administrative instructions.

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 has been described above under Objective 1(b) and while focused on the needs of the Director-General to date, will increasingly have an impact on TAK's taxpayer education function.

ESTAK advisors have continued to assist with the establishment of the Taxpayer Advocate position. Following earlier development of the criteria relating to the types of taxpayer cases that the incumbent could deal with in effect representing the taxpayer, the opportunity was taken to publish this role internally in the monthly all staff bulletin. The incumbent of this position has successfully resolved a number of cases in which taxpayers had previously been unable to obtain relief from inappropriate tax assessments.

As ESTAK moves towards giving taxpayer education a focus in 2011 in conjunction with its proposals to introduce a Call Center during that year, initial briefings have been provided to TAK regional managers on future proposals regarding the proposed Call Center. Future progress on this initiative awaits 2011 Budget resourcing decisions regarding staffing for this center and resolution of TAK accommodation shortages in Pristina (given plans to locate the Call Center in Pristina).

2.3 OBJECTIVE 3 – DONOR COORDINATION

In the Year 1 workplan, the only donor co-ordination task expected to be completed to date was the establishment of a donor co-ordination forum. It had been planned that a donor meeting at the end of May 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 and a replacement has not yet been scheduled or taken place.

In the meantime, the ESTAK project has continued to work constructively with the EUCTA project at a working level in jointly providing assistance across most areas of TAKs operations.

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

- the European Union, in relation to the proposed funding of a replacement IT system
- the Bavarian Government – following an EUCTA-organized study visit, a delegation from Bavaria is due to visit Kosovo in November to confirm future assistance needs
- the USAID funded World Learning facilitated study visit to USA in 2011 in examine operational Call Centers

3 PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

The previous quarterly report outlined six problem areas, namely:

1. TAK accommodation in Pristina
2. TAK salary levels
3. Fiscal registers
4. Replacement computer system
5. Relationship between HQ and regional offices
6. TAK Training Unit

At this stage, progress is being made on four of these areas. In particular:

- ESTAK has continued to advance proposals for resolving TAK's accommodation issues (but a result from these efforts continues to remain outstanding). 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 (this lack of space not only prevents the recruitment of staff needed to address the continued growth of Pristina and surrounding communities, but also impacts on compliance levels and revenue). TAK has obtained additional space in the old Rilindja building occupied by the Large Taxpayer Office which is now the base for TAK's new Tax (Fraud) Investigation Unit and which provides TAK with a conference/training room albeit in a remote location. The other additional building being used to handle the overflow from TAK HQ is being used to accommodate some of the EUCTA project advisors and it now seems likely our future ESTAK Taxpayer Audit Advisor and his translator will also need to be accommodated in that building which is undesirable from a capacity building perspective given our preference to co-locate our advisors with their TAK counterparts. There is little more that ESTAK can do on this issue which may also impact on ESTAK plans to establish a Call Center in Pristina
- ESTAK has proposed an indicative new salary/performance incentive structure for TAK for 2011 but the extent to which this is able to be achieved depends on the final results of 2011 Budget submissions
- ESTAK has taken some initiatives to improve the relationship between HQ and regional offices by drafting monthly update bulletins by all staff and by working to ensure that information obtained from third parties is adjusted in HQ so that it usable at regional office level – this work will continue as work such as a review of the organization structure at regional office level continues
- ESTAK is assisting in the re-establishment of a functional Training Unit in TAK – progress to date has begun to develop momentum following the recent appointment of a substantive Training Manager

ESTAK is continuing to distance itself from the Government's fiscal register initiative, given the potential eventual risk of failure of this initiative, which has proceeded on a basis inconsistent with previous USAID advisor advice.

ESTAK also remains concerned about the potential impact of a replacement computer system for TAK dependent on the results of the current tender process. This has not impacted on the ESTAK second quarter work plan but may impact in the third and fourth quarters.

One factor that has contributed to some of the above problems and which has hindered progress on resolving them has been the limited support provided to TAK from the highest management levels of the Ministry of Economy and Finance (MEF). The TAK Director-General is becoming increasingly frustrated

that his attempts to make progress in a number of areas are being hampered by a lack of action within TAK's own Ministry. The following is a list of current outstanding issues where MEF support is needed by TAK:

- the accommodation shortage in Pristina mentioned above (the Customs Department also has a similar problem)
- the lack of progress on any salary initiatives including the lack of TAK (and Customs) access to the "brain fund" in the interim pending the approval of proposed TAK salary structure and bonus concept – indeed the situation could get worse before it gets better given the moves to abolish various allowances that are currently paid to TAK staff over their basic level salaries
- the lack of a decision on the request to temporarily appoint additional TAK staff to enable TAK to re-open its sub-office in North Mitrovica (despite this lack of response, the Director-General has authorized the continuation of this initiative)
- the lack of any follow-up work on the previous communications and work that has taken place on double tax treaties with other countries (although MEF has recently appointed a person to work in this area)
- the 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 – as a result the Government has since July 2010 been receiving little revenue from the gambling industry
- the lack of support to address the resourcing problems of the Independent Review Board – while that Board reports to the Assembly the Ministry has a vested interest and influence over its operations but has to date taken no steps to address the ever increasing backlog of tax (and customs) dispute cases that are waiting to be heard – this now includes a substantial dispute regarding KEK which could easily be given priority if MEF takes some action in that regard

These issues not only impact on TAK directly but also impact on ESTAK's ability to deliver on several action points in its workplan. In addition to the Director-General's attempts, ESTAK's next step is to raise these issues with the GFSI project CoP Matthew Smith to see what additional influence he might be able to bring on addressing these issues.

Conversely, one area where MEF is now offering assistance to TAK (and Customs) is in the management of its public relations and publicity activities. Owing to limited funding from its own budget for such purposes, TAK has always had to work with MEF on such activities. The recent TAK Director-General's media conference provided the first opportunity for all parties to work together and the input from MEF was not as timely as TAK desired. ESTAK has prepared a lessons learned paper as a result of that conference and this will soon be discussed with TAK and MEF management. (In the meantime, ESTAK is continuing with its plans to assist TAK in developing a communications strategy during November rather than allowing MEF to do this on TAK's behalf).

4 SUCCESS STORIES AND ACHIEVEMENTS

The main success stories of the second quarter, and the areas which have dominated ESTAK input during the quarter, have been:

- SIGTAS upgrade implementation (stage 1) – as indicated earlier in this report, many of ESTAK's planned actions were dependent on this and have been impacted by the delays with the initial implementation of the upgrade
- Substantive completion of ESTAK work on sub-legal acts covering the income tax laws and the law on tax administration and procedures
- Completion of a comprehensive training needs analysis for TAK
- Review and revision of TAK resource bid for 2011 Budget with particular input on designing a revised salary structure for the future
- Drafting of proposed HR policies and procedures for TAK in areas including recruitment, disciplinary actions and grievances
- Commencement of work on improving TAK's public relations activities
- Drafting of new monthly update bulletins for all TAK staff
- Assistance towards the re-opening of a TAK sub-office in North Mitrovica

5 UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT QUARTER

Following on from the work completed to date, the third quarter is expected to see the final stages of SIGTAS upgrade implementation, sub-legal act finalization, completion of a review of the TAK organization structure and TAK management consideration of the recently completed Training Needs Analysis and HR policy and procedure drafts.

As 2011 Budget resourcing decisions are made, further work on developing a new salary structure in TAK will also proceed. Following recent momentum in re-establishing the Training Unit, focus will be given to building a policy on managing employee training and development.

Following implementation of the second stage of the SIGTAS upgrade, IT focus will shift to implementation of TAK's e-filing initiative.

One new area of focus will be further refinement and training on TAK's audit risk model and working with EUCTA on the development of an Audit Manual.

Another new area of emphasis following the appointment of ESTAK's Public Relations Advisor, and with the assistance of a communications expert, will be the development of a comprehensive communications strategy for TAK. This is expected to form the basis for a focus on Taxpayer Education during 2011 alongside plans to introduce a Call Center in TAK.

6 CHANGES TO THE YEAR 1 WORK PLAN

In broad terms the bulk of the previously approved Year 1 Work Plan can continue unchanged. Changes have been needed to the timing of the planned audit risk model work (following medical problems of the initially planned advisor), to training initiatives (following the late appointment of a TAK Training Manager) and to those activities that were dependent on an earlier implementation of the SIGTAS upgrade – but the vast bulk of these activities are still expected to be completed during Year 1.

ESTAK work has also continued 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
- a proposal to assist TAK management with the production of monthly bulletins to brief all staff on current and upcoming issues
- the need to monitor and assist TAK with dealing with the results of the EC-funded IT system tender (currently under consideration)