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EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

YEAR 3 - QUARTERLY REPORT
JULY 15 – OCTOBER 14, 2012

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

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1. ESTAK QUARTERLY REPORT SUMMARY

ESTAK activities during the first quarter of Year 3 have continued to focus directly on specific tasks according to the work plan and to TAK priorities. The ESTAK program is focused on strengthening capacity of the Tax Administration of Kosovo (TAK) and on increasing taxpayer compliance. The ESTAK team has made good progress in both areas during the reporting quarter as reflected in the progress details below. The main achievements during the quarter, are summarized below:

- Assisting TAK in developing an organization-wide Enforced Collection Plan and with the commencement of implementation of that plan;
- Piloting the “Managing Communications” course, the last of the six courses designed and developed by ESTAK as part of its management training program;
- Developing a tax compliance strategy for the enclaves and presenting the results at a donor workshop in September 2012;
- Designing an initial work plan for TAK’s Intelligence Unit, with a focus on reviewing 3rd party and other information received by TAK;
- Assisting TAK with drafting an Administrative Instruction on the recent amendments to Kosovo’s VAT law;
- Assisting TAK with the implementation of the SIGTAS Stage 2 modules and with developing a collection case management system;
- Further expanding e-filing, including a new mandatory requirement for all registered employers to e-file their monthly wage withholding tax/pension contribution forms – this has seen an increase in the number of e-filing registered taxpayers from 12,500 to 20,000 during the quarter;
- Delivering “Test Writing” and “Presentation and Facilitation Skills” courses to the second intake of internal trainers under TAK’s “train the trainer” program – as a result, the number of TAK internal trainers has increased to 38;
- Completing assistance to the new hire induction program;
- Assisting TAK with the 2013 Budget process – this included a visit by TAK to the Kosovo Customs Budget department, and substantially completing a Resource Management Guide outlining best practices for TAK management;
- Reviewing TAK’s Code of Conduct and its monitoring process;
- Assisting with TAK’s implementation of a simplified Management Information System that covers its key performance indicators.

For most of the quarter, ESTAK assistance was provided by 1 long-term expatriate advisor, 5 local advisors and 1 full-time translator.

As required by the Task Order, other sections of this report provide details on:

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

2. PROJECT PROGRESS

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

(A) SKILLS DEVELOPMENT/TRAINING:

In its first two years the focus of ESTAK training efforts was on re-establishing a functioning Training Department, completing a comprehensive training needs assessment, re-establishing a “train the trainers” (ToT) program, arranging a comprehensive induction program for new hires, and implementing the ISD training methodology in TAK. By the end of Year 2, the responsibility for running induction and other training had largely been handed over to the TAK Training Department. The main remaining training initiatives requiring ESTAK support in Year 3 were management training and completion of an operations manual for the Training Department.

The only tasks relating to training expected to be completed during the second quarter of the Year 3 work plan, were: (1) the piloting of the Managing Information course, being the sixth and final course of ESTAK’s management training program, and (2) supporting the induction program for TAK new hires.

The Managing Information course, renamed as Managing Communications (to better describe its content), was piloted on 11-12 October 2012 with the group of team leaders that had new hires within their team as well as some selected HQ managers. The same group had been the pilot for the five previous management training courses. The course was designed and delivered by ESTAK’s Senior Training Advisor. A TAK senior management representative, who had been selected as management training sponsor, attended the course as an observer. The feedback from participants indicated that the course was well received, which was confirmed by course ratings; program content at 89%, instructors at 97% and logistics at 87% participant satisfaction.

The 12 month induction program that ESTAK helped develop for TAK new hires was completed at the end of August 2012, a few weeks earlier than originally planned. This followed TAK management’s decision to end the probation period for the 35 new hires and to give them on-going employment contracts, with the remaining training to continue outside of the induction program. ESTAK’s support for that induction program also ceased at that time and the temporary induction training program manager was promoted and returned to his TAK regional office, but remains available to assist with future induction training. During the final phases of the program, ESTAK assisted with the TAK test panel’s setting of the pass mark for the final test and with monitoring the delivery of the test. (All 35 participants met the pass mark criteria). As a result of the successful delivery of the one-year induction pilot program, the TAK training department is now institutionalizing it for the core positions of TAK.

The previous ESTAK quarterly report referred to 15 additional “train the trainer” program candidates who had completed the curriculum development course in that quarter. This quarter the same individuals attended the “test writing” and “presentation & facilitation skills” courses on 4 September and 20-21 September respectively. These courses were delivered by the ESTAK Technical Training Advisor jointly with TAK Training Department staff, who will take over this role in the future. (A ToT course is also being planned to be delivered by TAK trainers). 13 of the participants successfully finished the program. As a result, TAK has now expanded its pool of internal trainers from 25 to 38. The trainees, with ESTAK assistance, are developing training materials for induction of enforced collection and taxpayer education staff, using the previous induction course (which focused on taxpayer audit staff) as a model.

Although not yet due for completion, ESTAK commenced planning for tax training for selected judges and prosecutors to be delivered during the next quarter. Initial meetings were held with the Kosovo Judicial Council, the Kosovo Judicial Institute and other stakeholders. It was agreed that the trainees would comprise: (1) the two judges being appointed to the Basic Court in Pristina that will take over tax dispute

hearing work from the Independent Review Board in 2013, (2) two judges from the Appellate Court, (3) selected Judges that could be involved in hearing tax evasion/criminal tax cases, and (4) prosecutors. It is proposed that the duration of such training will be 6 days (8-9 November, 12-13 November and 10-11 December), the training will be held at KJI's premises and delivered by a group including ESTAK advisors and TAK experts. 3 days of this training will be covered from existing courses (with some minor updating) developed and presented during the TAK induction program. Preparation of the remaining training materials has already commenced.

In addition to the work plan tasks, ESTAK has contributed to TAK's training activities during the quarter in the following areas:

- ESTAK advisors reviewed and helped TAK IT management refine their training needs with regard to training offered for TAK and other government organization IT staff through USAID's BEEP project
- TAK's Training Manager who returned to TAK after a 12-month maternity leave absence was provided with a detailed update briefing by the ESTAK team. The interim Training Manager who was providing back-up over those 12 months was promoted and returned to his TAK regional office, but remains available to assist with training initiatives when needed
- The project team attended TAK Training Commission meetings and assisted with the induction of new Training Commission members

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

The Year 3 ESTAK work plan included a number of discrete management effectiveness tasks.

Three linked tasks relating to TAK's organization structure were planned to be completed by now:

- support in the implementation of Phase I (changes at senior management levels and expansion from 2 to 3 regional offices in Pristina) of the restructure,
- assistance with the development of consequential organizational structure changes (Phase II),
- assistance to TAK with updating job descriptions to reflect changes to the organization structure.

Phase I changes came into effect on March 1, 2012. ESTAK considers that these changes have resulted in positive performance improvements. In particular, relationships between TAK HQ and regional offices have improved (including more visibility of HQ staff in the regions), performance in the legal/appeals area has improved, and the new Senior Manager Executive Office position has become embedded and respected by other senior managers. More recently further improvements have taken place, including development of the Modernization, Planning and Analysis area in HQ and of the TAK Intelligence Unit, following the appointment of additional staff in those areas. Following ESTAK's suggestion, the decision to integrate the Human Resources and Training functions has been reversed, while retaining both areas reporting to the same Deputy Director-General.

Changes at the Phase II level have also been largely implemented, but there are two areas where staffing decisions still need to be implemented:

- Additional staffing for the Call Center to enable expansion to handle in-calls that was delayed to coincide with the relocation of the Call Center to its new premises (expected by the end of October 2012). In the meantime ESTAK is assisting with the preparation of an additional job description for Call Center officers, to allow for surplus Processing unit staff transfer to the Call Center;
- Establishment of TAK's International Tax Unit – TAK has decided to locate this unit within the

Senior Executive Office, has appointed a European Integration officer to work alongside TAK's International Liaison officer, and has planned for an additional legal officer to complete the establishment of this unit during the next quarter.

In supporting these organizational changes, there was a need to develop new job descriptions or revise the existing ones. Coincidentally an external initiative led by the Ministry of Public Administration (MPA) aimed at establishing a consistent grading structure across the entire public service also required all Ministries to provide details of their organization structure, job descriptions and gradings. The ESTAK team understood that all TAK units had prepared the requested information; however ESTAK has recently discovered that the Intelligence Unit has not developed their job descriptions.

Another management effectiveness task scheduled for completion this quarter, was the development of consolidated key performance indicator (KPI) reports for management. The reporting format agreed upon with the TAK DG has now been implemented and details distributed to TAK senior managers. The ESTAK team has however suggested that the new consolidated KPI report be formally presented to TAK senior management during their next meeting scheduled for late October, with the intention that reviewing this report will become a regular agenda item for such meetings.

Progress on this quarter's "assessing staff workload, allocation and budget and recommending changes that will achieve better results" task is reported in the related "Determining Resource Needs" section that follows.

Throughout the quarter, ESTAK advisors directly supported the TAK Director-General in performing his duties and maintained a good working relationship with him. While not always following ESTAK advice, the Director-General nonetheless regularly seeks advice from ESTAK.

ESTAK advisors also provided regular assistance to TAK Deputy Directors, HQ managers and the Large Taxpayer Unit Manager (and to a lesser extent the other regional office managers). In addition, the ESTAK team assisted TAK management through regular participation in TAK HQ senior management meetings and TAK regional manager meetings.

(C) DETERMINING RESOURCE NEEDS:

In the Year 3 work plan, the specific resource need tasks relate to the 2013 Budget cycle, covering the provision of assistance in identifying TAK resource needs to feed into 2013 Budget submissions and supporting TAK with the progress on those submissions.

In particular, it was envisaged that during the quarter ESTAK would assist TAK management in determining their resource needs and in the preparation of the 2013 TAK budget submission. While ESTAK's input to this activity commenced with a progressive review of expenditure items, TAK continued to prepare budget bids on the same basis as previous years.

For 2013 TAK initially requested two additional allocations of 3.635m (2m towards SIGTAS replacement, 0.46m for increased wage and salaries, 0.42m for increased goods and services, 0.35m for TAK HQ premises alterations (addition of a new floor on top of the existing building), 0.25m for computer hardware, 0.08m for increased utility costs, 0.05m for completion of Germia building alterations and 0.025m for purchase of vehicles) and 4.2m for MoF (being subsidies required for GoK to pay for 28,000 fiscal cash registers for small businesses with a subsidy of 150 euro per register) on top of the 7.8m euro allocated to TAK for 2012. Such requests assumed a minimal increase in TAK's staffing level from its current 760 to 767. These requests envisaged an effective doubling of the TAK budget in 2013, a level of additional resourcing which ESTAK considered as unrealistic in the current financial environment and thus such requests were seen to be an opening negotiating position.

In the week prior to the Budget hearings for MoF in August 2012, TAK submitted an amended but higher budget request than initially presented which now included an additional 30 staff for TAK as well as additional funding of around 800,000 euro. ESTAK subsequently prepared talking notes for the acting DG

(the DG was on leave) in support of the amended bid at the MoF Budget hearing that highlighted the priority items in the bid (e.g. SIGTAS replacement), and prepared a package of supporting documentation from donors as handouts for the budget hearing. The ESTAK budget advisor also attended the budget hearing where each MoF department was given 5 minutes to present their case but was also told there was no money available for budget increases despite the potential impact on revenues.

Subsequent to the budget hearing and after the issue of a further budget circular, indications from the MoF Budget department were that a small additional allocation of around 80,000 euro would be given to TAK for wages and salaries sufficient to pay existing staff but did not cater for any additional staff or allow any increases in salary during the 2013 year. The TAK response to this was to submit a further resource request even higher than the previous bids which now included 3m euro additional funding for a new building for a combined tax/customs office. TAK also prepared information showing that despite TAK having more staff, budgetary allocations for Kosovo Customs are higher than TAK in most areas.

ESTAK understands that despite these developments in the budget process, there have been one-on-one discussions between the TAK DG and the Minister of Finance regarding TAK resourcing and that there is a possibility of a small increase in TAK staff numbers for 2013. As in previous years, it has become apparent that TAK resourcing decisions are more reliant on personal meetings between the TAK DG and the Minister than on the formal budget process.

In this environment, it is difficult for ESTAK to get TAK senior management to take resource management seriously, despite TAK acknowledgement that the existence of a good relationship between Minister and DG will not last forever. The ESTAK response has been to:

- prepare good practice resource management materials that can be referred to and used by TAK when they decide they need to improve their resource planning process. ESTAK continued developing a “Resource Management Guide” which is expected to be completed in the near future. Compared with current practice, the Guide focuses on:
 - o improvements in the resource bidding process, in particular identifying the revenue impact of different aspects of different requested elements (in the past revenue target decisions have been virtually completed divorced from TAK resourcing decisions) and prioritizing elements of such bids
 - o improvements in expenditure reporting – the TAK Budget department currently prepares comprehensive information on expenditure with little analysis of this information and does not make recommendations to TAK management on actions they should consider taking; in addition there is a need for reporting on expenditures at the regular TAK senior management meetings (this has only happened once during ESTAK existence and at that time comparisons were made about expenditure increases between years rather than actual expenditure compared with planned expenditure)
 - o focusing on better utilization of existing staff and physical resources rather than the tendency to focus only on the easier decision of asking for additional resources
 - o defining distinct roles of the Budget Department and the Strategic Finance Officer in the Modernization, Planning and Analysis area (TAK has to date not filled the latter position)
 - o identifying future long-term improvements, particularly potential decentralization of the budget process within TAK and involving more TAK management in the process (currently this is limited to the TAK DG, the Deputy Director-General (Support) and TAK’s Budget unit manager)
- arrange for the TAK Budget unit staff to meet with their counterparts at Kosovo Customs so that the two units could share experiences – such a meeting was held on September 19 and representatives of both organizations felt the meeting was useful. This confirmed that both organizations have similar processes.

Given the above, ESTAK considers that current resource management processes in TAK need to be improved but has observed a reluctance from TAK management to change old processes. Previous efforts to get TAK to identify discretionary expenditures have been met with comments that all expenditures are necessary and previous recommendations on better use of transport by using taxis or allowing staff to use their own vehicles for business purposes have been rejected in favor of continuing to only use the TAK vehicle fleet. As a result, ESTAK has curtailed its work on further analysing and recommending changes to improve financial management and has restricted its activities in this area to those listed above.

Further complicating the position is that the government budget system is cash based rather than accrual based, which means that at various times, particularly at the end of a financial year, TAK simply delays paying its bills when it has insufficient funds while at other times TAK bills (particularly in the utilities area) have been paid by MoF rather than from the TAK allocation. Additionally, there have been re-allocations of budgetary funding between budget categories (e.g. from subsidies to salary and wages) that MoF has approved that should also have been approved by the Assembly. Resolution of these issues is however a government-wide issue outside the scope of ESTAK.

(D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION:

In the Year 3 work plan, no specific return processing tasks were planned to be completed during the second quarter. An “on-going” requirement in the work plan however relates to the expansion of e-filing.

In the previous quarter e-filing was significantly expanded with the result that by mid-July 2012, over 12,500 taxpayers had registered for e-filing and most of them were e-filing their employer and VAT declarations.

During the current quarter, following a meeting between TAK and KPST management, the decision was made to make it mandatory for all taxpayers who had registered to have to e-file their tax declarations (by blocking them from downloading tax declarations from the TAK website). As a result of this change and of further publicity given to e-filing, the number of taxpayers registered for e-filing increased to over 20,000 by mid-October 2012. This is estimated to be over 90% of current active employers as TAK records indicate there are up to 2,000 additional active employers that have not registered for e-filing and are continuing to file manually.

The number of e-filed tax declarations that have not been able to be correctly processed at any one time is around 50. As a consequence of the e-filing expansion and the small number of processing errors, TAK now considers it has around 10 Processing department staff that are no longer required and most of them are planned to be transferred to the Call Center to support its expansion to handle in-calls. ESTAK has also recommended that the temporary team within the Processing department that deals with taxpayer account maintenance issues be made permanent.

While many taxpayers are now filing their tax declarations electronically, until recently tax payments still had to be physically made at commercial banks. TAK has requested banks to make electronic payments of tax possible to further enhance the attractiveness of e-filing. Most commercial banks have responded positively to this request. During the quarter the number of commercial banks offering such service has doubled so that by mid-October, three commercial banks were offering TAK-developed web e-payment service to their customers and another was using the web service for transferring payment details to TAK in respect of tax payments made by its branch customers. This process works faster for the banks while also ensuring more complete and accurate processing of payments to taxpayer accounts; therefore it is expected that more banks will start offering these services in the next quarter.

The progress made on e-filing/e-payment arrangements is expected to result in improvements in Kosovo's Doing Business ratings for “paying taxes” which are due to be announced in late October 2012. The one remaining initiative that ESTAK has proposed that would further help such ratings is a reduction

in filing frequency of VAT declarations by smaller businesses. This initiative has been included in the TAK IT Operational Plan and may be implemented in late 2012. TAK has referred details of the ESTAK proposal to the SIGTAS supplier to get an indication of the time and cost needed to modify SIGTAS to reflect the proposed change, and has been advised that this is not a major change. The proposed changes would however be expected to be implemented with a business rule that means taxpayers filing monthly or quarterly at the beginning of a tax year will need to continue on that basis for the full tax year before filing frequency can be changed.

In relation to tax registration, this quarter has seen the further bedding down of new combined tax/business registration processes at “one-stop shops” run by the Business Registration Agency of Kosovo (BRAK) at the municipality level. Registration processes are now electronic and allow new businesses to obtain fiscal numbers and business registration numbers (and if necessary VAT certificates and import/export certificates) within 24 hours of submitting an application. This change is expected to significantly improve Kosovo’s Doing Business “starting a business” ratings.

Since their commencement in February 2012, almost 3,000 new businesses have registered at the “one stop shops”. However, while the registration process is much more efficient than previously, new businesses continue to receive both a business registration number and a fiscal number. Both the ESTAK and BEEP projects consider that only one number should be used for registration, but this has been resisted by the World Bank donors assisting BRAK. However, at a recent TAK/BRAK meeting, BRAK agreed to amend their processes such that multiple businesses run by the same individual have only one business registration number (as happens with fiscal numbers) rather than a separate number for each business. Implementation of this change will remove the main obstacle to moving towards a common number for tax/business registration in future.

The only remaining “registration” improvement that ESTAK has identified is a proposal to dispense with the requirement for import/export certificates (following a similar move in Kosovo Customs), but this cannot be progressed until the next opportunity to amend Kosovo’s VAT law arises.

(E) SIGTAS IT SYSTEM:

One specific IT task was expected to be completed during the quarter, namely assisting TAK with the implementation of Stage 2 of the SIGTAS upgrade. Stage 2 comprises three modules that link with the core SIGTAS system. Progress on the implementation of the respective modules has been as follows:

- Audit module – has been implemented in TAK regional offices during the quarter and is being used for all new audits opened. As older audit cases are closed, the module will progressively become the main vehicle for audit case management by taxpayer audit team leaders
- Appeals and objections module – has been implemented in the TAK HQ Appeals department with open and closed appeals case details entered into the module
- Collections module – while the module has been implemented in TAK regional offices, those offices have been advised by TAK IT not to use it. There are two parts to the module – the part that records details of instalment arrangements (this part is not working correctly and changes requested from the SIGTAS supplier have not yet been made) and the collection case management part (earlier TAK/ESTAK review of this part indicated that it does not deliver the functionality desired by TAK and as a result ESTAK has been assisting TAK IT with the redevelopment of this part)

ESTAK advisors visited the Pristina 1 and 2 regional offices and the Pristina-based Enforced Collection Unit and prepared a report confirming the SIGTAS module implementation details noted above. In particular, this report emphasized the priority needed and being given to improving the Collections module. TAK IT recently gave a presentation on their progress on this task during the quarter that revealed that they had departed from the initial specifications and significant additional work with ESTAK’s

IT Advisor will be required during the next quarter in order to complete this module.

Three on-going IT tasks are also expected to be progressed each quarter:

- On-going support for TAK in its efforts to sustain SIGTAS until a replacement system is rolled out. This was achieved during the quarter. ESTAK assistance is continuing with particular emphasis on the implementation of the Stage 2 Collections module. ESTAK has also provided support to TAK IT management in relation to their dealings with the SIGTAS supplier and the SIGTAS support and maintenance contracts
- Support the on-going evolution of e-filing and online taxpayer service support. This was also achieved during the quarter. ESTAK have actively supported the expansion of e-filing. The increased number of e-filers as a result of these efforts is detailed in the previous section of this report. ESTAK also notes that e-filing gives taxpayers direct access to details of their e-filed tax declarations and payments, an additional benefit for those who e-file
- On-going increases in the exchange of information among interested users. There has been no change in information sources during the quarter, but discussions were initiated with the management and staff of TAK's Tax Investigation and Intelligence Units on proposed steps to review the suitability of existing third party and other data already provided to TAK as well as identifying additional sources potentially useful to TAK

A further IT work plan task, assistance with development of a simplified MIS for TAK using key performance indicator information, which was not yet due for completion, has in fact also been completed and this system has been made available to TAK senior managers. ESTAK has however recommended that the system be formally introduced to the senior management team at their next meeting in late October.

ESTAK also continued its participation in IT Operational Plan progress review meetings called by the Senior Manager of the Executive Office. Many tasks in that plan have now been completed, while all other tasks are in progress and expected to be completed in 2012, perhaps with the exception of the VAT filing frequency reduction change which requires TAK management approval to proceed, and which appropriately has a lower priority than collection case management system development.

ESTAK also assisted TAK with the drafting of the terms of reference for an IT security expert that TAK is considering asking EU support for, and has made recommendations on different approaches TAK can take with the team responsible for cleaning taxpayer accounts.

2.2 OBJECTIVE 2 – INCREASE TAXPAYER COMPLIANCE

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

Tax legislation

Following enactment of amendments to most tax laws during the previous quarter, there have been no tax legislative changes pursued by MoF/TAK during the current quarter. However, following the prior legislative amendments, one major task remained to be completed which was the preparation of an Administrative Instruction covering the VAT law amendments. ESTAK assisted with the establishment of a TAK working group to perform this task and recommended that only 11 of the 29 amendments needed further clarification in the Administrative Instruction. ESTAK participated in initial meetings of the group and provided specific input regarding one of the amendments. Progress on this task has however been delayed and following confirmation of EU/TAIEX VAT experts planned work in Kosovo, TAK has agreed for those experts to take over ESTAK's role on the working group (as well as responsibility for subsequently assisting TAK with updating of VAT taxpayer guides and pamphlets).

After meeting with the MoF Tax Policy unit, ESTAK escalated to senior MoF management the need for urgent legislative action regarding VAT agricultural import and irrigation exemptions, and income tax heavy equipment incentive allowances that are all due to expire at the end of December 2012.

The recent IMF mineral taxation mission has also recommended various changes to tax legislation that are currently under consideration by MoF. ESTAK reviewed the recommendations but noted none that had immediate administrative impact other than that relating to double tax treaties (as detailed below).

ESTAK has also continued to assist USAID and TAK with the implementation of revised tax (and customs) exemption procedures for USG/USAID contractors and subcontractors resulting from the revised USG/GoK bilateral agreement that was signed on 29 March 2012. It is expected that new procedures will be implemented during the next quarter.

Double tax treaties

ESTAK has continued to assist a MoF/Ministry of Foreign Affairs working group that has been progressively arranging for about 20 countries to enter into double tax treaties with Kosovo.

During the quarter, a double tax treaty was signed with Turkey. This added to the two previous double tax treaties in force (with Albania (2004) and Macedonia (2011)), as well as 7 past agreements entered into by Yugoslavia which continue to have effect in Kosovo. Negotiations have previously been completed and treaties simply require signing with the Czech Republic, Hungary and Albania (a revised agreement) and negotiations remain close to finalization with the United Kingdom.

A delegation from Albania also visited Kosovo for the signing of a mutual co-operation agreement between the tax offices of Kosovo and Albania. ESTAK advisors assisted the TAK Director-General with his presentations for this event and attended the signing ceremony.

Late in the quarter, an IMF mineral taxation policy mission recommended, amongst other things, that Kosovo “review all tax treaties and consider re-negotiating the most problematical ones. Until the treaties are reviewed and a national policy is set, do not negotiate additional treaties”. The mission’s main concern was with the previous Yugoslav agreements that had been made with the Netherlands, Germany, France and Finland which provide a zero withholding tax rate on interest and which could be used by chains of companies including residents of treaty partner countries to avoid tax on gains from the sale of mining rights in Kosovo. These recommendations will need to be considered at the next Ministry of Finance/Ministry of Foreign Affairs working group meeting.

It should also be noted that the ESTAK role assisting with double tax treaties will probably be assumed by a GIZ funded legal expert who potentially will arrive in Kosovo before the end of 2012 and will be assisting TAK with legal issues for a period of 2 years.

Legal barriers

ESTAK continued to assist TAK with monitoring and identifying legal barriers to TAK collection and enforcement. During the previous quarter Privatization Agency of Kosovo (PAK) management had agreed in principle (subject to confirmation by their Board) that if TAK suspended seizure actions against SOEs, that they would use some of their funds to pay off the tax debts of the remaining SOEs that have not yet commenced privatization action and/or will not be privatized. However, given that none of the PAK Board positions are currently filled, it is unlikely that TAK will receive up to 3m euro in tax debt collections from this source until 2013.

A further problem that has arisen during the quarter, relates to “old debt” particularly that over 6 years old and technically statute-barred (unless dispute actions have extended that timeframe). Earlier this year, the Auditor-General raised concern about the amount of old debt and debt nearing the 6 year statute bar date. Assembly Budget Committee members have raised similar concerns and the impact that non collection of debt is having on the GoK budget. These old debt cases should simply be written off as uncollectable but TAK is reluctant to do so for the fear of being criticized for not taking action on collecting these debts during the previous 6 years, once such cancellation is publicized. If it is not cancelled, then

the amount of old debt will continue to rise. ESTAK is assisting TAK with the resolution of this issue and has identified that the up to 74m euro amount of old debt includes:

- 27 cases of over 1m euro debt that account for 53m euro of the old debt. Some of this old debt relates to budgetary organizations where collection of the debt is simply GoK money going round in circles such that agreement from GoK/Assembly to cancel old debt in those cases would not “harm” the budget
- over 50% of the old debt cases are for amounts of less than 200 euro which should be written off as uneconomic to pursue without having to go through the cancellation/publication process

(B) ROBUST AND FAIR AUDIT FUNCTION:

Three specific “audit” tasks were expected to be completed during the quarter, namely:

- Implementation of the SIGTAS Stage 2 Audit Module – as noted earlier in the “SIGTAS IT System” section of this report, this was implemented during the quarter and is used by all of TAK’s regional offices in their new audits
- Assisting TAK with updating and re-launching of the Code of Conduct and policy regarding corruption allegations – during the quarter ESTAK participated in a TAK working group responsible for reviewing and updating TAK’s Code of Conduct. The working group completed its work and the revised Code has been translated in 3 languages and is due to be submitted to TAK senior management for approval at their management meeting in late October. The revised Code differs from the earlier version in two main aspects:
 - o The Code now includes a set of guiding principles which TAK staff are expected to observe in relation to their duties as well as continuing the rule-based provisions which indicate what staff are not allowed to do
 - o The responsibility for monitoring many of the provisions in the Code is shifted from the Office of Professional Standards to TAK staff team leaders and line managers

Following TAK management approval, the Code of Conduct will be “re-launched” and the training courses regularly delivered by the Office of Professional Standards will be updated.

- Developing a plan to improve taxpayer compliance in the enclaves – following earlier completed analysis of the tax compliance of “enclave taxpayers” and discussions with TAK staff dealing with North Mitrovica and in TAK’s sub-offices in Gracanica and Shterpce, ESTAK completed a proposed TAK compliance strategy for the enclaves which envisages compliance activity at two levels:
 - o for North Mitrovica, the focus for now should be on encouragement of voluntary compliance through taxpayer education and registration since the ability for TAK to take more serious enforcement action there is very limited in the current environment
 - o for other enclave areas in Kosovo, the full range of compliance approaches should be applied (ESTAK recommendations here thus focused on ensuring TAK staff in its sub-offices had the same ability to do this as TAK staff in its regional offices e.g. updating of the TAK website to ensure all material presented there was available in the Serbian language)

These recommendations were approved by TAK management and the plan was provided to the TAK working group updating TAK’s Risk Response Plan (as part of TAK’s 2012-2015 Compliance Strategy) with assistance from the IMF. Copies of the enclaves strategy were also provided to donors at the TAK donor workshop on 20 September 2012 which was attended by USAID, EU, SIDA and the IMF.

ESTAK also completed its work on the remaining audit task (carried forward from the previous quarter) relating to the development of a plan to address 3rd party information and intelligence issues within TAK. Following the appointment of two staff to TAK's Intelligence Unit (in addition to the previously appointed manager of that unit) in September 2012, the time was appropriate for such work to be undertaken. After an initial meeting with TAK's Intelligence Unit staff, ESTAK prepared a proposed plan of activities for the Intelligence Unit in its establishment phase. The plan envisaged that the Intelligence Unit would initially focus on:

- Reviewing existing information provided or available to TAK to determine its usefulness in detecting non-compliers. ESTAK recommended this work initially focus on the information provided to TAK from fiscal cash registers and in relation to the annual reporting on purchase transactions of over 500 euros, the two areas where the collection of information imposes a significant "compliance cost" on taxpayers, particularly those with smaller businesses
- Identifying new information sources for TAK to identify non-compliers
- Establishing an on-going information gathering activity (e.g. creating a library of relevant articles from investigative journalism sources such as Pristina Insight and Preportr)
- Establishing and maintaining liaison with other enforcement agencies in relation to intelligence matters

The proposed plan was presented to and accepted by the Intelligence Unit and its stakeholders (TAK's Tax Investigation and Risk Management Units) at a meeting in October. During the next quarter, ESTAK intends to assist the Intelligence Unit with the implementation of that plan and to hand this responsibility over to the EU/TAIEX funded expert who will assist TAK in this area following their arrival, potentially in late 2012.

In addition, there is one audit area in the Year 3 work plan which requires on-going assistance, namely the building of VAT administration capacity to reduce the turnover threshold for VAT taxpayer registration. It is now clear that the VAT taxpayer registration threshold will not be reduced during the ESTAK timeframe due to a GoK commitment to the IMF not to make such a change. Nevertheless, ESTAK believes that a future reduction in that threshold is desirable and has focused its efforts on a proposal to reduce the filing frequency for VAT declarations from monthly to quarterly for smaller businesses. Such a change is seen as a pre-requisite to VAT registration threshold reduction, while at the same time contributing to a further improvement in Kosovo's "Doing Business" ratings and reducing by half the number of VAT declarations required to be filed and processed each year. This change has been included as an action item in the TAK IT implementation plan for 2012. Following TAK IT confirmation from the SIGTAS supplier that the adoption of this change would not involve a significant time/cost, TAK management approval is now needed so that work on implementation of this change can proceed.

Progress has also been made on the remaining "audit" activity in the Year 3 work plan which relates to the implementation of simplified audit risk criteria. During the quarter TAK management decided to make one change to the audit risk selection criteria (adding an additional comparison between declared turnover and tax actually paid) but not to proceed with the previously recommended simplified formulae in relation to income tax declarations. The change has been implemented and TAK management, particularly the Senior Manager (Operations) is now regularly selecting audit/compliance visit cases for TAK's regional offices using the audit risk selection model. However, while there are no current plans to further amend the selection criteria, ESTAK considers that there remains a need to review the information sources that are used in the audit risk selection model (currently restricted to information from tax declarations, from Kosovo Customs and from MoF Treasury). The proposed initial work of the Intelligence Unit (as noted above) will provide the opportunity to identify if and how additional information (e.g. from fiscal cash registers) can be incorporated into the model.

In addition to these tasks, ESTAK also contributed to TAK's audit activities as described below:

- Supported TAK's audit quality measurement program - ESTAK assisted with briefings for new

personnel assigned to that program;

- Assisted TAK with the data matching process between TAK and Customs that started during the IMF mission in March 2012;
- Assisted a TAK working group in monitoring progress on TAK's 2012 Risk Response Plan and drafting TAK's 2013 Risk Response Plan;
- Assisted TAK HQ Taxpayer Audit management and staff with comments on various technical tax issues – this included reviewing changes to quarterly income tax forms to accommodate the increase in the presumptive tax rate on services from 5 to 9% and a related public ruling that TAK clarifying what “services” are covered.

(C) ROBUST AND FAIR COLLECTIONS FUNCTION:

The following enforced collection activities were scheduled for completion during the quarter, progress on which has been as follows:

- Implementation of SIGTAS stage 2 Collections Module – As indicated above, in the “SIGTAS IT System” section of this report, while the Collection Module has been implemented, it is not being used by TAK regional offices. The “instalment arrangement” payment part has errors that have not yet been fixed by the SIGTAS supplier. Previous ESTAK/TAK analysis showed that the collections case management part of the module had not been properly designed and as a result it was decided that TAK IT would modify this part of the module under ESTAK IT Advisor supervision. While TAK IT staff did complete some of this work, ESTAK found that they had departed from the initial business process specifications and as a result significant further work is needed during the next quarter;
- Implementation of automatic notices to debtors and non/stop-filers AND assisting the Call Center in expanding to deal with in-calls arising from the receipt of such automatic notices. During the quarter, and in preparation for these changes, further accommodation alterations in the Geremia building were completed, this being the site for the “expanded” Call Center. However, the physical shift to the new premises has been delayed until the next quarter to allow for the acquisition of additional furniture. These activities have consequently been delayed until the shift takes place and the Automated Call Distribution (ACD) equipment has been re-installed on those premises.

In response to the statement by the TAK DG about his intention to give greater emphasis to enforced collection, ESTAK worked with TAK managers to draft a specific Enforced Collection plan which would require high-level organization-wide commitments rather than the past tendency by management to leave this responsibility to enforced collection functional staff. The plan included specific sections and activities covering:

- Informing taxpayers
- Implementation of the Collection Module (as above)
- Establishment of a Collection Quality Review position/unit
- Automatic issue of notices (as above)
- Building a career path in Enforced Collection (a future ESTAK work plan task)
- Intensification of enforcement collection activities in TAK regional offices
- Planning and prioritizing collection team work
- Management focus

During the quarter ESTAK took the opportunity, while USAID's external tax reviewer was present, to

discuss the draft plan with Pristina-based enforced collection management and staff. As a result some refinements to the plan were made and it was subsequently approved and signed by TAK top management at a senior management team meeting.

These visits also highlighted adverse working condition issues (mainly relating to humidity and lack of air circulation) for staff in Pristina's Enforced Collection center. A subsequent ESTAK visit showed little action had been taken to resolve these issues but that coincidentally TAK's Deputy Director (Support) had met with the Ministry of Public Administration management about the same issues on the day of the ESTAK visit. ESTAK now understands that progress on resolving the issues has been further delayed by disagreements among the staff working in the premises on what corrective action is needed.

During the external reviewer's visit, the TAK DG also raised his concerns in relation to TAK's "old debt", a topic he was questioned on by both the Auditor-General and members of the Assembly. Much of the "old" debt was now statute-barred and should be cancelled, but cancellation required publication and thus would open TAK to criticism of why it had not timely collected such debts. ESTAK subsequently analysed the "old" debt and identified that over half of the number of cases were for amounts of less than 200 euro which could be written off as "uneconomic to pursue". Of the remainder, 27 cases involving amounts of over 1m euro made up the bulk of the balance – some of these related to budgetary organizations where collection/cancellation of the debt had no budgetary impact as it was simply "government money going around in circles". At the end of the quarter, TAK was still in discussion with the Assembly about further actions.

ESTAK also contributed to TAK's enforced collection activities in the following areas:

- Visited all TAK regional offices with TAK's Deputy Director-General (Operations and Compliance) and/or Manager Enforced Collection emphasizing the need to increase enforced collection efforts, to give priority to the collection of newer debt (about 18m euro of debt relates to the last 12 months) and to discuss instalment agreements, penalty reduction and other collection issues;
- Significantly updated enforced collection forms – taking into account legal changes and current needs there are now 47 different enforced collection forms;
- Assisted in training for taxpayer education staff on how they can assist taxpayers with tax debt enquiries;
- Prepared a memo for TAK regional offices establishing a common practice for the assignment of collection cases to staff (prior to the implementation of the Collections module);
- Provided information to TAK management on the legal status of fines in the Tax Administration & Procedures law.

A key ESTAK initiative, which for now continues to have largely a collection function focus, has been the operation of TAK's Call Center. Progress on this has been as follows:

- The Call Center has continued following up with taxpayers with debts of between 500 and 3,000 euro. During the quarter ended 30 September 2012, Call Center staff collected tax revenues totalling 480,000 euro; and
- Call Center staff followed up with these debt case taxpayers on any delinquent tax declarations.

(D) PUBLIC EDUCATION ON TAX COMPLIANCE:

No specific education tasks were expected to be completed during the second quarter of the Year 3 work plan. There are three education activities in that work plan that require on-going assistance:

- Assistance with publicizing taxpayer service initiatives such as the inauguration of new facilities in Pristina, the progressive expansion of e-filing, and the expansion of the Call Center to include in-call capacity. Activities in the previous quarter focused on the first two of these with the third due

to occur later in Year 3. During this quarter, following a request from the TAK DG, the ESTAK team prepared speaking notes for him to use in his presentation to a visit from a delegation of the top management from the Albanian Tax Office. These highlighted the recent taxpayer education achievements and the visiting delegation was shown the new facilities in Pristina and was given copies of TAK's flyer pamphlets for taxpayers. In relation to e-filing, ESTAK supported the TAK DG and KPST's wish for e-filing to be made mandatory for those taxpayers who had previously registered for e-filing, and assisted TAK in drafting an announcement for taxpayers on this;

- Assistance to TAK with the progressive redevelopment of its taxpayer education function – ESTAK continued to assist TAK with the implementation of its Taxpayer Education Operational Plan. During the quarter, ESTAK reviewed progress on the plan and noted that most planned activities had been implemented and highlighted those that remained to be addressed. One of those remaining areas involves plans for the cessation of most current “tax certificate” issuing work. ESTAK prepared a report for TAK top management which recommends this since ESTAK considers tax certificate work is neither productive for TAK nor for those organizations that have requested the production of such tax certificates from TAK. ESTAK has also assisted with the LTU part of the Operational Plan by facilitating the opening of email addresses for industry sectors and assisting with the planned publicity for taxpayers about this change;
- On-going assistance to TAK in publicizing enforcement actions. The media article that ESTAK prepared based on data obtained from TAK's Tax Investigation and Enforced Collection Units on the number and types of enforcement actions carried out was published by TAK during the quarter. The article was published on the front page of the “Express” newspaper and in several other on-line portals.

The ESTAK team made further progress on the only other “education” activity in the Year 3 work plan, namely the conduct of briefings on tax issues for judges and prosecutors. ESTAK initially facilitated a stakeholder meeting with the Kosovo Judicial Council, Kosovo Judicial Institute, Ministry of Finance and TAK regarding the status of plans for the Courts to take over the role of hearing those tax dispute appeals currently heard by the Independent Review Board from the end of 2012. ESTAK offered to assist with these plans and following stakeholder acceptance, conducted separate meetings with the Kosovo Judicial Council, the Kosovo Judicial Institute and Kosovo Customs. It is envisaged that ESTAK and TAK will between them provide 6 days of training for those members of the justice sector that will in future be involved in hearing tax dispute appeal cases, or that will be involved in hearing any appeals from those initial Court hearings. It is also envisaged that members of the judiciary and prosecutors who could be involved in tax criminal cases would also be able to participate in the training. The training is planned to commence on 8 November and to be completed on 11 December using KJI's training facilities. A training agenda has been prepared for KJI to issue to proposed participants.

In addition to these tasks, ESTAK has also contributed to TAK's education activities in the following areas:

- Identified TAK's Gjilan and Large Taxpayer Unit offices as those with the highest priority for upgrading of their taxpayer service facilities, realizing that funding restraints don't allow TAK to modernize all its taxpayer education facilities simultaneously;
- Supported increases in the number of taxpayers e-filing and the number of banks offering e-payment facilities and has ensured that taxpayers who e-file have ready access to details of recent filing and payment transactions (these details are recorded in the e-filing system “history” tab);
- Prepared a history of e-filing development which was communicated to all TAK staff;
- Monitored progress on the accommodation alterations in the Germia building to allow for the proposed expansion of TAK's Call Center – these alterations are now complete and simply await the acquisition of furniture before the planned relocation of the Call Center to those premises during the next quarter;

- Met with TAK Taxpayer Education management to ensure progress on taxpayer education issues raised in ESTAK's "Compliance Strategy for the Enclaves" report (e.g. updating of the TAK website to include additional Serbian translations, printing of the "Tax Legislation" book in Serbian, and ensuring TAK's completion of previously planned taxpayer education seminars in Gracanica and Shterpce);
- Commenced work on drafting a Customer Relationship Management Software proposal for TAK. After initial discussions with TAK IT, and taking into account higher IT priorities, it was agreed to defer this work until later in Year 3.

While ESTAK's taxpayer education work during the past 18 months has led to a change in the culture of TAK which now recognizes the rights of taxpayers as stakeholders, ESTAK considers that one further package of changes relating to taxpayer contact is needed to complete the modernization of TAK's taxpayer service function. In particular, ESTAK considers that TAK needs to change from its traditional methods of taxpayer contact (namely, most taxpayer contact at regional offices is from taxpayers visiting TAK offices and with written enquiries being referred to TAK HQ) to move towards a position where:

- Taxpayer contact by telephone (Call Center) is encouraged as this is the most efficient way (for TAK and taxpayers) of dealing with taxpayer enquiries
- More outwards taxpayer contact takes place using TAK's IT system (e.g. automatic reminder letters and/or SMS messages for late filers and late payers) with Call Center dealing with responses
- Taxpayers can continue to visit TAK regional offices (providing facilities similar to Pristina e.g. computer terminals for downloading, e-filing, etc) but are discouraged from visiting TAK HQ
- Taxpayers written and electronic enquiries are addressed by TAK regional offices rather than HQ
- TAK HQ retains its "rulings" function (with a focus on public rulings and binding rulings), deals with enquiries from regional offices that are regarded as having national significance and is otherwise able to assist where regional offices who cannot resolve issues
- Regional offices have greater responsibility for conducting local taxpayer seminars with TAK HQ role confined to providing educational information (e.g. details of legislative and process changes) in support of regional office educational activities
- Visiting taxpayers at their premises by TAK staff upon their request (particularly educational visits for new businesses) is promoted
- TAK is responsive to social media contact (e.g. establishment of TAK Facebook page)

The broad objective is to shift responsibility for taxpayer contact from HQ to regional offices so that HQ can concentrate on its policy and program design responsibility. At the same time the changes will give regional office staff more technical work to better match their skills and enhance their future career development (rather than taxpayer education being seen as inferior to being a tax auditor).

To enable these changes, there is a need to reduce the taxpayer service workload in TAK regional offices. Some reductions have already arisen due to BRAK "one stop shops" issuing many fiscal numbers and the impact of e-filing, but there continues to be a need to further reduce administrative work relating to tax certificates. As these changes are made TAK HQ will be able to progressively assign responsibility for responding to taxpayer enquiries to regional offices.

ESTAK has presented the above package of changes to TAK's Director of Taxpayer Service, to TAK's HQ Taxpayer Education and Pensions Managers, to TAK regional office Taxpayer Service team leaders, to TAK's "taxpayer advisors" and to TAK pensions staff and has received positive support for future change in this direction. As a result of this feedback, ESTAK proposes to assist TAK's Director of Taxpayer Service to present these changes to TAK top management during the next quarter.

2.3 OBJECTIVE 3 – DONOR COORDINATION

In the Year 3 work plan, the only donor co-ordination task was the on-going active participation of ESTAK in a donor co-ordination forum.

ESTAK liaison with donors is co-ordinated through TAK-run workshops - held at key times when the need for TAK donor/stakeholder is needed. Such workshops have taken in the past taken place every 6 months or so to coincide with visits by the IMF risk management experts assisting TAK with its Compliance Strategy and Risk Response Plan work.

During the quarter, a further TAK-run workshop was held on 20 September 2012, and was attended by representatives from USAID, EU, SIDA, IMF and MoF. TAK gave presentations on its risk response plan work, its IT developments (including improved registration and e-filing processes) and on future donor needs, while ESTAK also gave a presentation on its compliance strategy in the enclaves work. In preparation for the workshop, ESTAK also updated tables showing current and future confirmed donor assistance for TAK.

Outside these workshops, ESTAK continues its successful cooperation at an operating level with other donor projects assisting TAK:

- ESTAK coordinated activities with EU/TAIEX (in relation to VAT) and EULEX experts (in relation to support for TAK's Tax Investigation Unit). With such VAT assistance being limited to only one week this quarter, ESTAK took on the main role of assisting TAK with VAT matters, but envisages this being passed back to EU/TAIEX experts when they return next quarter;
- ESTAK worked with GIZ-funded experts (in relation to VAT and auditing using indirect methods training assistance with the Bavarian Government);
- ESTAK coordinated efforts with the IMF with regular contact with visiting missions. In preparation for each regular mission visit, ESTAK visits TAK's Large Taxpayer Unit and the MoF Tax Policy unit to obtain the latest information on likely future revenue projections. In addition, during this quarter ESTAK advisors met with and provided assistance to separate IMF missions covering TAK's risk response work, financial sector taxation, and mineral taxation policy.

ESTAK also continued to liaise with other USAID projects. This quarter, assistance was provided to the KEDS project providing them with TAK business information to support their survey of the impact of electricity supply disruptions on businesses in Kosovo, to the BEEP project with Doing Business progress information, to the GFSI project with PEFA pre-assessment tax information and with information on issues raised by their trade advisor, to Tetratex in relation to KEK privatization and tax issues, and to YEP in relation to VAT exemption issues relating to grants.

3. PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

ESTAK has previously 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 three areas:

1. The performance of TAK staff is not adequately managed
2. TAK resource management practices need to be improved
3. Information received by TAK is not used effectively to detect non-compliers

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

(a) The performance of TAK staff is not adequately managed:

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

The problem - Sustained support for performance and human resource management by ESTAK in Years 1 and 2, has not been matched with sufficient tangible support from the TAK leadership team. Comprehensive competency standards were introduced for all key job roles and training has been provided to most managers including all team leaders in the regions. While there was some appetite for the practice to take root in the regional offices, similar traction has not occurred organization-wide due to the absence of TAK HQ leadership commitment, either to sanctioning poor performers or to meaningfully utilizing identified top talent in the organization. This problem is also compounded by the continued reluctance by TAK/MoF to sign Administrative Instructions on "best practice" human resource policies covering (1) recruitment and selection, (2) promotions, (3) discipline, (4) grievance, and (5) performance improvement procedure which includes provision for the termination of serially under-performing employees.

Proposed solution - As a consequence of discussions with USAID, ESTAK has discontinued its support in the performance management area from February 2012 and in the wider human resource management area from June 2012, with the exception of completing management training and a small number of discrete tasks that are included in the Task Order. It is anticipated that the delivery of the ESTAK-developed management training courses to TAK's top management team in the coming months may lead to an improvement in TAK's performance management approach.

(b) TAK resource management practices need to be improved:

The problem – TAK resource management practices need to be improved. During the life of ESTAK, TAK resourcing decisions have largely been confined to 3 individuals (the TAK DG, the TAK Deputy DG (Support) and the Budget Unit manager) and internal reporting on resource management issues is rare and lacks analysis. There has been a tendency to ask for additional resources rather than to review the better use of existing resources and to go outside the Budget process with TAK resourcing ultimately decided on the basis of personal discussions between the TAK DG and the Minister of Finance. In this environment TAK management has shown little interest in improving its resource management practices.

Proposed solution – ESTAK recognizes that TAK reliance for resources on a personal relationship between the DG and the Minister is not sustainable. While this approach may still continue in the current environment, ESTAK is nevertheless pursuing and nearing completion of a "best practice" Resource Management Guide for TAK management in order that future budgetary processes are more rigorous, more consultative, and better prepared, a necessity for the future when personal relationships between the TAK DG and Minister of Finance can no longer be relied upon. ESTAK has also facilitated a meeting between the TAK and Kosovo Customs Budget departments in order to allow them to share practices and

in particular to try and better tie the decisions made on revenue collection targets and revenue agency resourcing which tend to be made in isolation from each other. As with performance management above, it is anticipated that the delivery of the ESTAK-developed management training courses to TAK's top management team in the coming months may lead to an improvement in TAK's resource management approach.

(c) Information received by TAK is not used effectively to detect non-compliers:

The problem – During Years 1 and 2, ESTAK has assisted TAK in obtaining external information from a range of sources. In addition to the previously arranged on-going data exchanges with Kosovo Customs and the Treasury, TAK now also has access to property tax and vehicle registration data. TAK receives significant additional data from taxpayers following the legal requirements to report on annual purchase transactions over 500 euros, and to install fiscal cash registers which report electronic sales data to TAK. While the Customs and Treasury data is used in TAK's risk-based audit selection model, none of the additional data now received is currently used for that purpose or for any other action to identify non-compliers.

Proposed solution – ESTAK recommended that TAK establish an Intelligence Unit with one of its functions being to review the sources of data tax receives and to ensure that such data is useful for identifying non-compliers. In effect, such a review would also serve as a post-implementation review of the over 500 euro purchase transaction and fiscal cash register initiatives to determine whether the benefits TAK gets from such data exceeds the compliance costs that taxpayers incur in providing such data to TAK. TAK appointed an Intelligence Unit manager in early 2012 and has recently appointed two staff to assist him. ESTAK has prepared a proposed initial work plan for that unit and this has been presented to and agreed with by the Intelligence Units main stakeholders (TAK's Investigation and Risk Management Units). ESTAK intends to support the initial implementation of this plan commencing with a review of the usefulness of the data TAK receives from fiscal cash registers, an exercise that TAK has not previously taken while it has continued its focus on getting taxpayers to install and use fiscal cash registers to issue fiscal receipts. The review will also indicate if and how such data could be used in TAK's audit risk selection model. In the longer term, ESTAK responsibility for assisting the Intelligence Unit will be handed over to the EU/TAIEX expert who may arrive in Kosovo during the next quarter.

4. SUCCESS STORIES AND ACHIEVEMENTS

The main success stories of the quarter have been:

- **Development of an organization-wide Enforced Collection Plan** – At the beginning of the quarter the TAK DG indicated that he wanted TAK to give greater emphasis to “enforced collection” following a period of successful implementation of a range of “taxpayer service” initiatives. ESTAK supported this change but wanted to ensure an organization-wide response by TAK, rather than a limited effort left to enforced collection functional staff to follow. While TAK’s 2012 Risk Response Plan had included taking actions against non-filers and non-payers, it was acknowledged that reporting against that plan had only formally recorded enforced collection results with little change in the nature and level of activity from that that had taken place in previous years. ESTAK advisors discussed with TAK Enforced Collection management the development of an “operational plan” for enforced collection activity for the next 6 months. A draft plan was prepared by ESTAK and presented during the USAID external reviewer’s visit. The plan was subsequently tested with Pristina-based enforced collection management and staff. The final version of the plan was presented to TAK’s top management who each subsequently signed their commitment to its implementation. ESTAK has since then provided support to TAK with initial implementation of various aspects of the plan.
- **Management training program development completion** – One of the key training initiatives in the ESTAK project is the development of a management training program. Initially plans were for there to be 7 management training courses, but when it was later determined that the management of finances in TAK was a centralized process which required little management involvement, the program was reduced to 6 courses. The Managing for Results, Managing Performance, Managing Teams, Managing Change, and Managing Operations courses were developed and piloted in previous quarters. This quarter, the remaining Managing Communications course was developed and piloted with the same group of new hire team leaders and selected HQ managers that piloted the previous 5 courses. As a result, one group of TAK “managers” has now completed the full management training program. A second group of TAK regional managers has so far partially completed the program. Most importantly, TAK have selected a sponsor who will take over on-going responsibility for delivery of the management training program. The sponsor attended the latest training and the ESTAK team will continue working with him through to the end of the project. Recognizing that there would be some sensitivity if the sponsor had to present management training to his boss and peers, ESTAK’s Senior Training Advisor will in future quarters present two of the six training courses to TAK’s top management team.
- **Tax compliance strategy for the enclaves finalized** – In earlier quarters, ESTAK had conducted an analysis of the compliance levels of “enclave taxpayers” revealing that their levels of non-compliance were not significantly different from other Kosovo taxpayers. However it was recognized that the full range of TAK compliance strategies could not be applied to North Mitrovica taxpayers due to the lack of effective enforcement and rule of law agencies in that area. Accordingly, ESTAK prepared a compliance strategy for the enclaves that involved a two-tier compliance approach: (1) for North Mitrovica, to focus (for now) on voluntary compliance (taxpayer education and registration) relying on TAK’s 5 Serbian staff living in North Mitrovica to work with those taxpayers; and (2) for other enclave areas, the full range of compliance strategies would be applied. ESTAK also made recommendations focussed on ensuring TAK’s staff in its Gracanica and Shterpece sub-offices could perform these activities in the same way as the staff in TAK’s regional offices. The compliance strategy was completed in time for the TAK working party, with IMF (and ESTAK) support, to update TAK’s Risk Response Plan for 2013 so that those recommendations could be taken into account. A copy of the compliance strategy was also presented at a donor workshop organized by TAK that was held on September 20, 2012.

5. UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT QUARTER

Building upon the work completed to date, the ESTAK team expects to work on the following tasks in the third quarter:

- Assisting TAK with the implementation of its Enforced Collection Plan, in particular:
 - Completing development of a case collection management system and its subsequent implementation;
 - Commencing in-call capability in TAK’s Call Center, initially restricted to enquiries on the automatic issue of reminder letters for late filers and late payers, a process that is also due to be implemented during the next quarter;
 - Designing a career ladder for Enforced Collection staff;

- Completing an analysis of, and recommending corrective action on, TAK’s “old” debt;
- Providing assistance to TAK’s Intelligence Unit in its initial stages in accordance with the plan developed for that unit, and handing over responsibility for this work to the EU/TAIEX expert upon their arrival in Kosovo;
- Providing assistance to TAK with VAT issues, including completing a VAT Administrative Instruction, until EU/TAIEX experts arrive to carry on that work;
- Providing assistance to the MoF/TAK/Ministry of Foreign Affairs working party responsible for progressive implementation of double tax treaties until a GiZ funded legal expert commences to carry on that work;
- Supporting TAK with progress towards a changed taxpayer contact approach, and in particular with the proposed cessation of tax certificate work;
- Seeking TAK management support for reduced frequency filing requirements for smaller VAT payers, and assisting TAK with its implementation;
- Delivering ESTAK designed management training courses for TAK management as part of the transferring of this responsibility to TAK in the future;
- Organizing and co-delivering tax training for selected judges and prosecutors;
- Developing a Standard Operating Procedures Manual for TAK’s Training department;
- Conducting a review of TAK’s functional quality and review functions in conjunction with TAK’s Internal Audit unit.

6. CHANGES TO THE YEAR 3 WORK PLAN

In broad terms the bulk of the proposed Year 3 Work Plan can continue unchanged. While there have been minor changes in project resourcing timeframes, the vast majority of the remaining work plan activities are expected to be completed, or at least substantially completed, by their target dates.

During the quarter, ESTAK has also continued to play a larger role in assisting TAK with VAT issues than previously given the cessation of EU assistance to TAK in that area. EU/TAIEX experts are however due to recommence support for TAK with VAT issues during the next quarter and recently visited Kosovo for a week to get a status update on current VAT issues.

ESTAK work has continued during the quarter with the following additions that are not covered in the Task Order:

- Assistance to the KEDS project to conduct a business survey on the impacts of electricity supply disruption on business activity – ESTAK assistance was needed so that TAK data on businesses could be analysed within the confidentiality requirements of tax legislation;
- Continued reporting to the BEEP project on “Doing Business” tax simplification progress;
- Updating of the “tax” sections of the previous World Bank PEFA assessment of Kosovo conducted in 2009 for the GFSI project in preparation for the next PEFA assessment;
- Following a referral from the BEEP project, reviewing and updating the tax-related sections of a Kosovo Legal Guide that is published by an Austrian legal firm;
- Continued assistance to USG/USAID, TAK, Kosovo Customs and USAID contractors on the provisions covering tax and customs exemptions in the “umbrella” USG/USAID bilateral agreement between the governments of USA and the Republic of Kosovo that was signed on March 29, 2012.