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**BUSINESS CLIMATE
REFORM**

GEORGIAN TAX ADMINISTRATION SURVEY ANALYSIS

January 4, 2008

This publication was produced for review by the United States Agency for International Development. It was prepared by Andrew Sidamon-Eristoff, Tax Specialist, contract No AFP-I-00-04-00002-00, TO 3, managed by Chemonics International Inc. and submitted to USAID /Caucasus cognizant Technical officer Nino Kumsishvili.

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Date: 4 January, 2008

To: Nato Beruashvili, Fiscal Reform Team Leader

From: Andrew Sidamon-Eristoff, Tax Specialist

CC: Olin McGill, Chief of Party

Re: Georgian Tax Administration Survey Analysis

Background

In July 2007, the Georgian Ministry of Finance asked the USAID Business Climate Reform (BCR) Project to draft a survey to identify the Georgian business community's principal concerns and priorities for improving tax administration. The BCR Project developed a survey and, with the Ministry's assistance, has received 118 complete and/or partial survey responses. You have asked me review and analyze the results.

Data Issues

The reported data contains certain important inconsistencies. For instance, the number of taxpayers (herein "respondents") reporting that they had undergone an audit (47) did not match the number who offered feedback on their audit experience (47 to 59, depending on the question). Similar inconsistencies pertain to other results, including those with respect to collection actions and criminal enforcement proceedings. Finally, the number of respondents with respect to each question rarely approached 118.

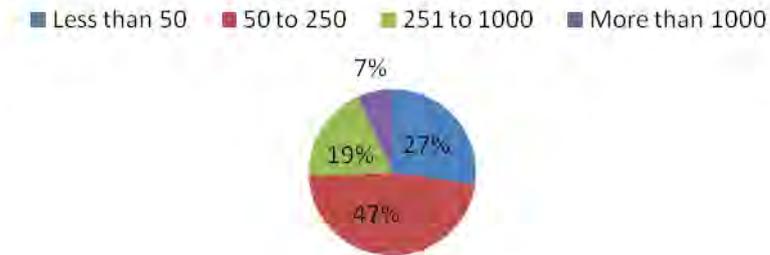
Who Responded?

The respondents represented a variety of industries as classified by the Georgian Ministry of Finance. Trade (17 percent), construction (11 percent), food product processing (10 percent), communications (8 percent), and electricity generation and distribution (4 percent) together accounted for more than half of the responses. This is consistent with informal expectations. However, the relatively large "other" percentage --- 39 percent --- suggests that the Ministry should consider adopting a more precise classification system.

71 percent of respondents classified themselves as limited liability companies. 26 percent were joint stock companies. Three entities described themselves as an alternative form of legal organization: a "judicial face of public service", a "non-commercial entity", and a "branch/representative office of foreign legal entity".

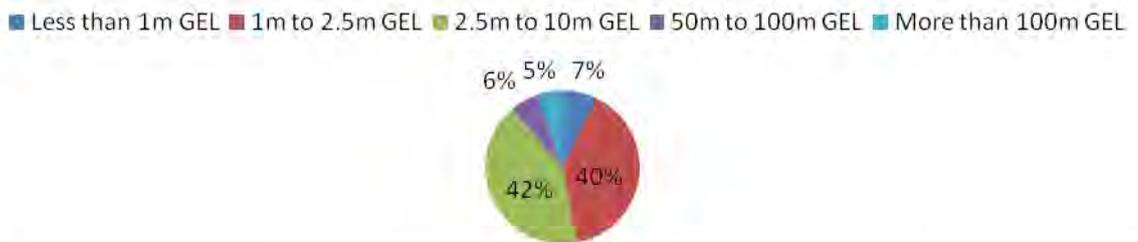
A plurality (47 percent) of respondents reported having between 50 and 250 employees. 7 percent reported having more than 1000 employees, while 27 percent reported having less than 50. Again, this met informal expectations for the data sample.

Number of Employees



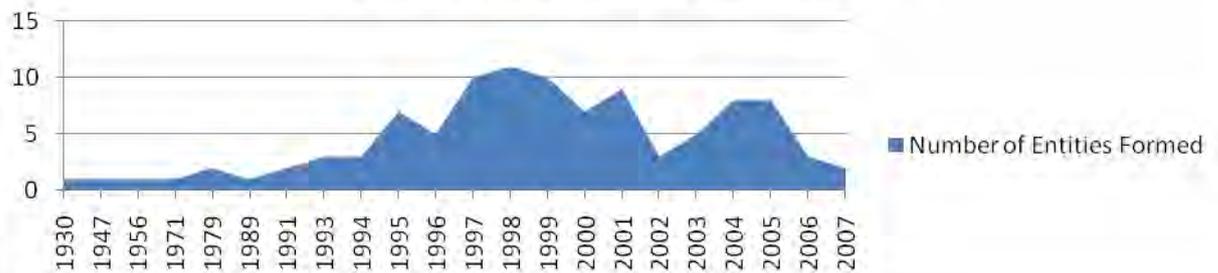
More than 80 percent of respondents reported 2006 gross income between 1,000,000 and 10,000,000 GEL, indicating a solid sample of medium-sized business operations.

2006 Gross Income



The median year for business formation was 1999, although the average was 1997.

Date of Business Formation



Taxes Paid and Cost of Compliance

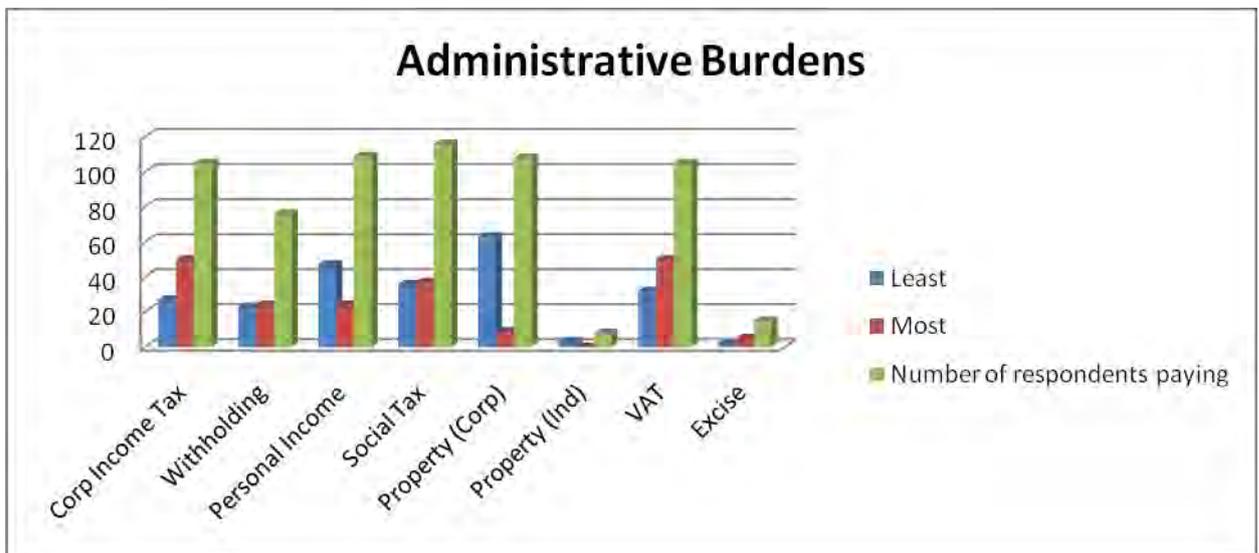
Nearly all respondents reported paying corporate income tax, personal income tax, social tax, corporate property tax, and the value-added tax (VAT). Comparatively few reported paying individual property tax (8) or an excise tax (15).

Only three respondents reported a cost of compliance; the median was 4 percent.

Most respondents reported using internal booking and/or accounting staff to prepare and file their tax forms. Only six reported using outside professional services.¹ None relied on a general business manager.

Administrative Burdens

Respondents were asked to identify up to three taxes that imposed the least and most administrative (as distinct from financial) burden on their business, respectively. The chart below presents the distribution of 233 “votes” for least burdensome and 199 votes for most burdensome, alongside the number of respondents who reported paying each tax.



Judging from the ratio between votes for “most” and “least” burdensome, and setting aside taxes with few responses, respondents ranked the corporate income tax as most burdensome, followed by the VAT. Conversely, the corporate property tax was ranked as least burdensome, followed by the personal income tax. The negative attitude toward the corporate income tax was largely consistent across gross income levels, although the few respondents at the very highest level were more negative. Similarly, the 18 respondents reporting gross incomes between 1m and 2.5m GEL were most likely to rank the VAT as most burdensome (55 percent). Although the data sample was tiny, it is interesting that 100 percent of the agriculture and transportation respondents ranked the VAT as most burdensome, as did 64 percent of food processors.

¹ Unfortunately, it appears that respondents were confused by questions asking whether they had used outside professional services in the audit, collections, and/or criminal investigation context. The data were unusable for purposes of this analysis.

The survey solicited reaction to a series of statements regarding the administrative burden of the tax or taxes identified as most burdensome. The table below summarizes the results on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

The tax imposes an administrative burden because:	Median Score
Forms are in paper rather than electronic format.	5
The Tax Law is unclear or ambiguous.	4
The relevant normative act is unclear or ambiguous.	4
Forms and instructions are unclear or ambiguous.	4
Forms require redundant data compilation and/or entry.	4
There are no official sources of interpretation or explanation.	4
A relevant normative act does not exist.	3.5
Appropriate forms and instructions do not exist.	3
Filling in forms requires an excessive amount of time.	3
Forms require manual data entry.	3
Forms require excessive amounts of supporting documentation.	3
Tax officials are <u>unable</u> to answer questions and provide help in filling out forms and related documents.	3
Tax officials are <u>unwilling</u> to answer questions and provide help in filling out forms and related documents.	2

In general, these results suggest that providing tax forms in electronic format and clearing up ambiguities in the Tax Law and related guidance (including regulations and instructions) would help reduce the administrative burden of tax compliance in Georgia. On a positive note, respondents did not embrace the assertion that tax officials are unwilling to answer questions or provide help in filling out forms and related documents.

Audits and Enforced Collections

The survey asked whether taxpayers had undergone audits or been subject to enforced collections within the last three years. 47 respondents reported that they had undergone an audit, 19 reported that had been subject to a collection action, and six reported that they had been subject to a criminal tax investigation. The survey then presented a series of qualitative questions regarding the taxpayers' experience. Unfortunately, as noted above, substantially more respondents answered the qualitative questions than had indicated that they had undergone an audit, collection action, or criminal investigation, respectively. This renders the results statistically suspect. Nonetheless, the results are at least suggestive of the business community's overall experience with, and perspective on, audits and enforced collections.

The table below summarizes the results of respondents' reported experience with audits on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

The Tax Department/Revenue Service auditors...	Median Score
Explained the purpose, process, and scope of the audit prior to commencing the audit.	5
Explained your business' procedural rights during the course of the audit.	5

Explained your business' rights to dispute the audit's findings and conclusions.	5
Were courteous and professional	5
Gave you an appropriate opportunity to explain your position and, if necessary, retrieve and produce relevant documentation.	5
Made reasonable demands for documents and additional information.	5
Gave you an opportunity to review their preliminary audit findings and conclusions.	5
Explained the legal basis for proposed adjustments or assessments clearly	4
Conducted the audit in an efficient manner.	4
Conducted the audit according to a clear audit plan or protocol.	4
Were respectful of the competing demands for your staff's time.	4
Were flexible and creative in solving problems that arose during the audit.	4
Were willing to work cooperatively with your staff with regard to scheduling, document production, time limits, etc.	4
Were willing and able to make decisions to resolve minor issues that arose during the course of the audit.	4
Focused on major issues rather than minor technical issues and violations.	4
Were willing to amend their preliminary audit findings and conclusions after you offered additional explanation and/or evidence.	4
Were willing and able to refer more difficult decisions to a supervisor for quick resolution.	3
Had no clear audit plan and, instead, conducted an unfocused "fishing expedition".	2
Were rigid and inflexible after reaching their preliminary conclusions.	2
Indicated that they could not be flexible due to possibility that the Financial Police or Inspector General might review their work and conclusions.	2
Had obviously reached a conclusion as to the amount of money your business should be assessed prior to commencing the audit.	1.5
Seemed to be working toward a revenue quota or goal rather than checking for noncompliance with the Tax Code.	1
Were rigid and mechanical in interpreting the Tax Code.	1
Complained of political pressure during the course of the audit.	1
Hinted to you or your staff that they might accept a bribe in exchange for adjusting their conclusions.	1

These results are almost "too good to be true". Contrary to my expectations based on anecdotal evidence, respondents gave auditors and the audit process high marks for professionalism and strongly disagreed that auditors were rigid, focused on revenue, or craven in the face of political pressure and outside oversight. Although it is possible that the questions were misunderstood, the scoring appears consistent across a range of questions.

The table below summarizes the results of taxpayers' reported experience with collection actions on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

The Tax Department/Revenue Service...	Median Score
Gave you fair and adequate notice of the collection action.	4
Explained the underlying basis for the collection action prior to taking	4

action.	
Explained your business' rights in relation to the collection action.	4
Made reasonable demands for documents and other information.	4
Were respectful of the competing demands for your staff's time.	4
Were willing to work cooperatively with your staff to resolve issues and problems that arose during, or as a consequence of, the collection action.	3
Were willing and able to make decisions and resolve minor issues that arose during the course of the collection action.	3
Indicated that they could not be flexible in resolving issues or problems due to possibility that the Financial Police or Inspector General might review their work and conclusions.	3
Were courteous and professional	1
Conducted the action in an efficient manner.	1
Conducted the action according to a clear plan or protocol.	1
Indicated that political pressure may have played a role in commencing the collection action.	1
Hinted to you or your staff that they might accept a bribe in exchange for lifting or adjusting the collection action.	1

These results are both less consistent and less favorable to Georgian tax administration. Although respondents gave high marks to some aspects of the process --- fair notice, explanations, etc. --- they also indicated that the tax agents were discourteous, unprofessional, and unorganized. However, significantly, they also eschewed complaints regarding corruption and political pressure.

The table below presents summarizes the results of taxpayers' reported experience with criminal investigations on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

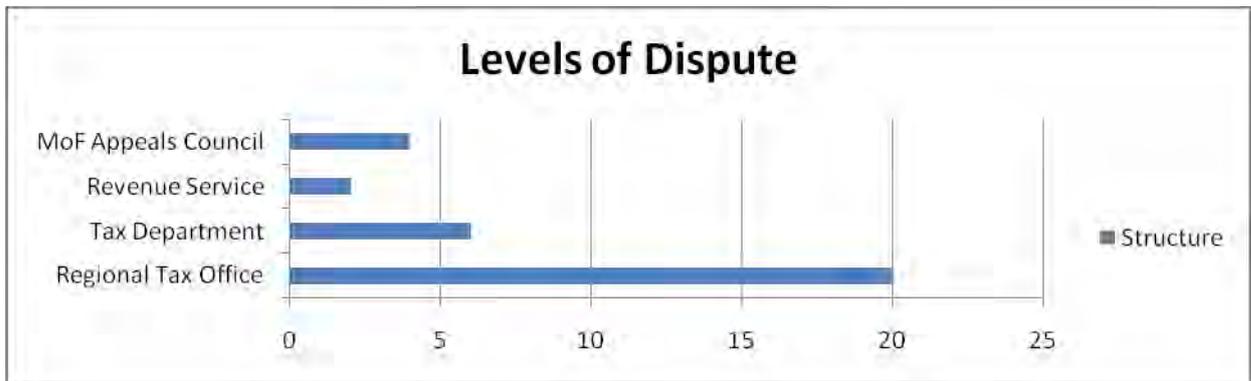
The Financial Police...	Median Score
Gave you notice of the investigation.	5
Explained your business' rights in relation to the investigation.	5
Explained the underlying basis for the investigation prior to taking action.	4
Were courteous and professional	4
Made reasonable demands for documents and other information.	4
Conducted the investigation in an efficient manner.	3
Conducted the investigation according to a clear plan or protocol.	3
Were respectful of the competing demands for your staff's time.	3
Were willing to work cooperatively with your staff to resolve issues and problems that arose during, or as a consequence of, the investigation.	3
Were willing and able to make decisions and resolve minor issues that arose during the course of the investigation.	3
Indicated that political pressure played a role in the decision to commence the investigation.	1
Hinted to you or your staff that they might accept a bribe in exchange for terminating or adjusting the collection action.	1

Once again, even in light of the small sample, these results defy expectations. Respondents rejected the notion that political pressure and bribery play a role in criminal investigations and indicated that the Financial Police conducted investigations with courtesy and

professionalism. Various “neutral” ratings suggest that extra procedural training is advised and that management might consider ways to empower staff to resolve issues and make decisions in the field.

Tax Disputes

A total of 32 respondents (27 percent) reported that they had disputed or contested a tax assessment within the past three years. This seems high, but may reflect the manner in which the survey was distributed among taxpayers. The reported median annual number of disputes was between one and two disputes. As one might expect, respondents reporting between 2.5m and 50m GEL in gross income were more likely to have a higher annual number of disputes. The chart summarizes the highest structures of administrative dispute resolution reached.



Given the small sample, this distribution makes some sense. (Note: the Revenue Service and the Tax Department are functionally equivalent because the former absorbed the latter in 2006).

Even though no taxpayers reported using the courts, a few dozen answered questions probing their reason for choosing the courts over the administrative dispute resolution process. Setting aside the obvious data validity problem for a moment, it is interesting to note that most of these respondents agreed that the administrative dispute resolution process is “a waste of time” but were neutral with respect to comparative considerations of fairness, efficiency, political pressure, and openness.

The table below summarizes the results of taxpayers’ reported experience with the administrative dispute resolution process on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

	Median Score
We entered the process with a reasonable expectation that it would result in a fair and just decision.	5
Overall, the process was biased in favor of the Government.	5
The process prior to reaching the Tax Department Chairman and/or the Revenue Services Dispute Resolution Board was pointless because no one would make a controversial decision in favor of a taxpayer.	4
The process prior to reaching the Minister of Finance and/or the Ministry of Finance Dispute Resolution Board was pointless because no one would make a controversial decision in favor of a taxpayer.	4
The dispute should never have arisen in the first place. It came about	4

because Tax Department officials refused to take responsibility for agreeing with the taxpayers.	
We had a full and fair opportunity to argue our position.	4
The final decision favored the Government on most important issues.	3.5
The dispute should never have arisen in the first place. It came about because Tax Department officials wanted, or were under pressure, to collect more money.	3
The final decision favored our (the taxpayer's) position on most important issues.	3
The final decision favored each side in part.	3
Regardless of which side "won," the final decision was fair and just.	3
We had a full and fair opportunity to contest or challenge the Government's position.	3
The decision-makers acted with courtesy and professionalism.	3
The decision-makers were well informed regarding the Tax Code and the technical tax issues involved in the dispute.	3
The decision-makers asked informed questions.	3
For future disputes, if any, we will use the administrative dispute resolution process again rather than the court system.	3
The process was reasonably efficient and timely.	2.5
Overall, the process was biased in favor of the taxpayer.	2

These results suggest several observations. First, respondents generally felt that the system is biased in favor of the government's position. This is not surprising, nor would it be unique to the Georgian taxpayer experience.

Second, however, respondents expressed some confidence in the process itself, agreeing that they had a full and fair opportunity to argue their position. Respondents were neutral with respect to a range of questions regarding fairness, ability to challenge the Government's position, professionalism, and the quality of the decision-makers' inquiries. In this context --- involving admittedly aggrieved taxpayers --- I am inclined to view a "neutral" rating as somewhat positive.

Third, respondents expressed frustration and impatience with lower and intermediate levels of appeal. Again, this is not surprising, but suggests that some extra effort might be made to infuse these levels of appeal with greater credibility. Similarly, respondents expressed some displeasure with the process' inefficiency and lack of timeliness.

Finally, respondents generally agreed that disputes arise because tax officials refused to take responsibility for agreeing the taxpayers. Interestingly, the respondents were neutral with respect to the hypothesis that disputes arise because tax officials wanted, or were under pressure, to collect more money.

Reform Options

The survey asked respondents to prioritize various options for improving and reforming Georgian tax administration. The tables below present the results in order of respondents' priority rankings (Table 1) and by category (Table 2).

Table 1 Reform by Priority Ranking

Priority	Category	Reform
Highest	Politics and Process	Building confidence in the administrative dispute resolution process
		Creating an independent Tax Appeals Board that is free from political influence

High-to-Medium	Tax Code	Lower tax rates	
		Clarifying amendments to the Tax Code	
	Customer Services and Technical	Development of Normative Acts to clarify and explain the Tax Code	
		Development of official explanations for taxpayers	
		Development of on-line research resources (placing copies of the Tax Code, decisions, opinions, instructions, etc. on the World Wide Web)	
		Better forms and instructions	
		Development of electronic services (electronic filing, electronic payment)	
		Publication of dispute resolution decisions	
	Politics and Process	Restricting political influence in tax administration	
		Eliminating official corruption in tax administration	
	Training	Training for Revenue Service auditors	
		Training for Revenue Service tax collectors	
		Training for Revenue Service customer service staff	
Training for Financial Police staff			
Medium	Tax Code	Consolidation of taxes	
	Customer Services and Technical	Upgrading Revenue Service offices and other facilities	
		Developing a telephone customer service center	
		More technological support for Revenue Service managers and staff	
	Training	Training for Revenue Service managers	

Table 2 Reforms by Category

Category	Priority	Reform
Customer Services and Technical	High-to-Medium	Development of Normative Acts to clarify and explain the Tax Code
		Development of official explanations for taxpayers
		Development of on-line research resources (placing copies of the Tax Code, decisions, opinions, instructions, etc. on the World Wide Web)
		Better forms and instructions
		Development of electronic services (electronic filing, electronic payment)
		Publication of dispute resolution decisions
	Medium	Upgrading Revenue Service offices and other facilities
		Developing a telephone customer service center
More technological support for Revenue Service managers and staff		
Politics and Process	Highest	Building confidence in the administrative dispute resolution process
		Creating an independent Tax Appeals Board that is free from political influence
	High-to-Medium	Restricting political influence in tax administration
		Eliminating official corruption in tax administration
Tax Code	High-to-Medium	Lower tax rates
		Clarifying amendments to the Tax Code
	Medium	Consolidation of taxes
Training	High-to-Medium	Training for Revenue Service auditors
		Training for Revenue Service tax collectors
		Training for Revenue Service customer service staff

		Training for Financial Police staff
	Medium	Training for Revenue Service managers

Surprisingly, respondents’ highest priorities related to the administrative dispute resolution process, notwithstanding their somewhat positive reaction to the current process in previous sections of the survey. They specifically embraced the idea of creating an independent Tax Appeals Tribunal. Interestingly, however, 64 percent of the 22 respondents who both reported they had been through a dispute and responded to the idea of creating an independent Tax Appeals Tribunal, were negative. Also significant was the fact that reducing tax rates did not win a “highest priority” rating.

Respondents’ high-to-medium priorities were predictable and appropriate. Clearly, the Ministry of Finance and the Revenue Service have a range of popular reform options to choose from.

Respondents ranked consolidating taxes, upgrading the Revenue Service’s facilities and technological support, developing a telephone service center, and training for Revenue Service managers as medium priorities. Interestingly, respondents were more supportive of extra training for Revenue Service and Financial Police staff than they were of extra training for Revenue Service managers.

The survey then asked for respondents’ reaction to a “catchall” range of statements that touched on reform issues. The table below summarizes the results on the following scale: 5 – Strongly Agree, 4 – Somewhat Agree, 3 – Neutral, 2 – Somewhat Disagree, 1 – Strongly Disagree.

	Median Score
Reforming tax administration (the system of administration rather than the Tax Code itself) is critical to improving Georgia’s business climate.	5
Reforming the Tax Code is critical to improving Georgia’s business climate.	5
Fear of being accused of corruption inhibits tax officials from making difficult decisions.	4
Georgian tax administration has improved over the last three years.	4
Mid-level tax officials should have more discretion to resolve issues.	4
Official corruption is no longer a serious problem.	4
The Georgian Tax Code has improved over the last three years.	4
The Government of Georgia is committed to further reform of the Tax Code and tax administration.	4
The Government should replace the Ministry of Finance Tax Dispute Resolution Board with a system of binding arbitration in which all arbitrators would be Georgian.	4
The Government should replace the Ministry of Finance Tax Dispute Resolution Board with a system of binding arbitration in which arbitrators would include representatives of the International Arbitration Association or a similar international organization.	4
The participation of foreigners is critical to the credibility of any system of tax dispute resolution.	4
Parliamentarians should serve on the Ministry of Finance Tax Dispute Resolution Board.	3
The creation of the State Revenue Service has improved tax administration.	3

The Government should replace the Ministry of Finance Tax Dispute Resolution Board with an independent Tax Appeals Tribunal with trained board members appointed by the President to a fixed term.	3
The system of administrative tax dispute resolution has improved over the past three years.	3
Training of tax officials has improved over the last three years.	3

The Government of Georgia should find these results generally encouraging. Significantly, respondents agreed that Georgian tax administration has improved over the last three years, that official corruption is no longer a serious problem, and that the Government is committed to further reform of the Tax Code and tax administration. In general, respondents with higher reported gross incomes were slightly more favorable.

That said, issues remain. Respondents were neutral as to both whether the creation of the Revenue Service has improved tax administration and as to whether training of tax officials has improved. They still feel that tax officials are inhibited by accusations of corruption and need more discretion to resolve issues.

Attitudes toward the dispute resolution system were nuanced. Respondents were neutral as to whether the system has improved over the past three years and embraced the idea of replacing the Ministry of Finance Tax Dispute Resolution Board with a system of binding arbitration involving the participation of foreigners for the sake of credibility. They were neutral as to whether Parliamentarians should serve on the Ministry of Finance Tax Dispute Resolution Board and as to the idea of creating an independent Tax Appeals Tribunal with trained board members appointed by the President to a fixed term. In view of the fact the respondents had earlier ranked creating an Independent Tax Appeals Tribunal as a “highest” priority, one may draw the conclusion that respondents supported creating a Tribunal but questioned the idea of Presidential appointment.

Conclusions

The small sample and data inconsistencies militate against reaching broad conclusions. Nonetheless, the results do contain some discrete observations and suggestions for the future direction of Georgian tax administration:

- The Ministry of Finance should consider a more precise industry classification system.
- It is likely that the use of professional services firms for tax compliance will grow in the coming years as the tax system becomes more complex and sophisticated.
- Providing tax forms in electronic format and clearing up ambiguities in the Tax Law and related guidance, particularly with respect to the corporate tax and the VAT, should be top priorities for reducing the administrative burden on Georgian taxpayers. In general, the business community wants better forms and instructions, more and better publicly-available guidance, and the development of electronic services.
- The Revenue Service can take credit for improving the conduct of audits. It should leverage that achievement to make similar improvements to the conduct of collection actions. In particular, the results suggest that tax collection agents need more customer service-related training.
- The Financial Police should consider ways to empower staff to resolve issues and make decisions in the field, where appropriate.

- Corruption and political pressure are less of a current issue in Georgian tax administration than one might have supposed, given recent history. However, restricting political influence and eliminating corruption remain high priorities for business, and thus these issues should remain part of the public-private dialogue.
- There appears to be at least some “buy-in” to, or acceptance of, the process of administrative dispute resolution. This is a substantial achievement, because it marks a rising level of confidence in institutions and process.
- Although there is generalized support for creating an independent Tax Appeals Tribunal, many respondents are not sure what “independence” really means or what institutional structures are required to secure it.
- The Ministry of Finance should look for ways to enhance the credibility of lower and intermediate levels of administrative dispute resolution.
- Respondents did not appear to focus on tax rates as a major issue.
- The business community is aware of and supports the Government’s efforts to improve tax administration.