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**BUSINESS CLIMATE  
REFORM**



# BUSINESS EFFECTIVENESS BY TECHNOLOGY DRIVEN CHANGES

IMPLEMENT ONLINE TAX SERVICES,  
STREAMLINE APPEALS PROCESSES &  
COMMENCE AUTOMATIC AUDIT SELECTION

**CONTRACT NO. AFP-1-00-04-0002-00 TO:03**

**7 September, 2007**

This publication was produced for review by the United States Agency for International Development and the Government of Georgia. It was prepared by USAID Business Climate Reform, managed by Chemonics International Inc. The author is Neli Baeva, Tax and Customs Specialist. The views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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## EXECUTIVE SUMMARY

The approved SOW as per contract includes the following tasks:

1. Implement Tax Online Services System (TOSS)
  - a. Work with the Revenue Services to evaluate & rank bidders' proposals for TOSS development;
  - b. Provide input to drafting a contract;
  - c. Plan implementation of TOSS.
  
2. Design MOF Appeals Case Management System
  - a. Work with the Ministry of Finance to design business processes;
  - b. Draft requirements to the software;
  - c. Draft development & implementation plan.
  
3. Improve RS Collection Function
  - a. Work with the RS to develop and adopt methodology on provisional assessments;
  - b. Work with the RS to implement VAT return non-filers business process and relevant software facilitating it.

These tasks were carried out in two trips. The first trip was from 15 July, 2007 to 27 July, 2007. The second was from August 19, 2007 to September 7, 2007. Activities and deliverables during the second trip are the subject of this report.

All deliverables related to task 1 were submitted.

Regarding task 2, technical support was provided to the drafting of an Order defining the business process for appeals and addressed to the MOF Council. The Order is still not finalized. Also, based on meetings with the SRS Legal Division, a high-level description of the existing practices is provided. More details have to be collected before the business process re-design can commence and requirements to the software that will facilitate entire appeals processing can be developed.

With regard to task 3, after agreeing on a modified business process to be implemented, I reached agreement with SRS on an acceptable methodology for the provisional assessment for all monthly taxes, but a MOF decision stopped the implementation process. I engaged the Tax Policy Deputy Minister to review the issue, providing him with more information about the proposed business process, meaning and purpose of provisional assessment, and the importance of establishing non-filers business process in order to encourage resumption of implementation. Due to ongoing changes in the Government and the short period, certain specific results have not been achieved except a promise that the non-filers issue, especially a provision for a "zero" tax declaration in the Tax Code, will be carefully reviewed again.

Activities and deliverables on other subjects, not included in the SOW, were carried out during the trip and are described in details in this report.

## ACTIVITIES & RESULTS DURING THE TRIP AS PER THE SOW

#	Activities / Achievements	Reference to attachments	Effect
1	TOSS Plan implementation of TOSS	Attachment 1: Implementation Plan – Microsoft project file	Proper implementation will guarantee successful launching of TOSS and clients satisfaction.
2	Appeals Case Management System	Attachment 2: High-level description of Current appeals processes.	Aimed at Business process re-designing ensuring a fair, repeatable & controllable dispute resolutions and timely and accurate case, statistics and management information.

### OTHER ACTIVITIES:

1. Activities related to audit selection software
  - Multiple meetings with working group on: Methodology, business process and algorithms for calculating taxpayers risk scores using set of Indicators (Attachment 3: Memos dates August 20 and August 22, and description of the risk score calculation)
  - Provided written notes to selected indicators and adopted approach.
2. Activities related to contract management for Tax Online Services System:
  - Interim Review of already developed software (Attachment 4: Memo dated 28 August)
  - Provide recommendations and supplementary documents: Examples of contract to be incorporated in the system for testing purpose and clarifications on “Contract” statuses (customized, printed, signed, rejected).
  - Identify equipment needs and commence hardware procurement (Attachment 4: Memo dated September 03).
3. Activities related to contract management for developing Non-payers Case Management software:
  - Interim review of already developed software
  - Drafted Implementation Plan(Attachment 5: Non\_payersSoftwareImplementation.mpp)
4. Review the progress on implementation of non-filers business process.(Attachment 6: Memo dated August 21, 2007)

**NOTE:** All attachments are incorporated in the report document. Original plans in mpp formats are attached to the report.



## Attachment 1 - TOSS Interim Review and Status: Meeting with contracted software company for TOSS

### MEMO

**Date:** 28 August, 2007  
**To:** Olin McGill, USAID Business Climate Reform, COP  
**From:** Neli Baeva, Tax Administration & IT Advisor  
**CC:** Nato Beruashvili, USAID Business Climate Reform, Fiscal Team Leader  
Maia Tevzadze, USAID BCR, Regulatory Team Leader  
**Re:** Meeting with contracted software company for Tax Online Services System.

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#### Attendees:

**Contractor:** Givi Utmelidze – Team Leader  
John Partsvania – software developer  
**SRS:** Andrei Gorbushkin – Head of SRS IT Division  
**BCR:** Neli Baeva- Tax Administration & IT Advisor

Meeting was organized by Andrei Gorbushkin and took place at the old Tax Department building on 27 August 2007 at 3:00pm.

#### I. Purpose

The purpose of the meeting was for the contractor to demonstrate what is already developed.

##### 1. What was shown?

The main functionalities as per requirements are designed, specifically the capacity to fill in and submit an application for Tax Online Services.

##### 2. What was missing?

- Control of eligibility for services (contractor complained that they are not given eligibility criteria in order to implement that); and
- Implementation of the concept for Activation Code (it is in the requirements document)

##### 3. Further assessment and suggestions, provided by me as follows:

- a. Log in to the system, after successful processing and activation of taxpayer's online account, and visualization of services taxpayer is subscribed for is completed.
- b. Access to taxpayer's card is integrated.

- c. Request for password help – main screen for requesting help works. Automatic generation of one time password and e-mailing it to taxpayer is still missing.
- d. Invoking VAT tax declaration for completion and submission. All pages of the VAT form are designed and can be invoked and navigate through; controls are still not embedded and the submission controls are not incorporated. Work on that will be completed by September 15. Also, an option for completing tax declarations through multiple sessions is not yet developed.
- e. Processing an application for Tax Online Services at the tax office. This part is developed using Oracle forms as per SRS's request. The general design is in place. Functionalities have to be elaborated as per requirements.

## **II. Further next steps**

- a. Any messages that have to be issued by the system are missing. We agreed that the development team will include messages, the most reasonable according to them, and the SRS staff will propose changes at testing.
- b. We talked about creating a users' guide that will be published on the site and be accessible for each taxpayer. The guide will provide instructions to the taxpayer on how to subscribe and use Tax Online Services.
- c. Also SRS insists on utilizing a Microsoft class model for authentication. The contractor agreed to consider this request and is looking for Oracle solutions close to this requirement.
- d. The incorporation of taxpayer experience and input perhaps through a focus group was discussed. We reached an agreement to organize and hold a taxpayers' conference during which enough information could be gathered to clarify their exact needs of such a software package.

## **III. Implementation Plan**

The plan is prepared using Microsoft Project software. It includes tasks, start date and duration of the task, links between tasks, and responsible resources for task execution. The plan timeframe was coordinated with timeframe for TOSS development. The plan was presented to the SRS IT Manager and was adopted by him.

Here is an extract of it. The GANT chart can be seen in the mpp file.

#		TASK	Duration	START	END		RESOURCE
1	1	<b>UsersTesting &amp; System's Tuning before launching</b>	<b>28 days</b>	<b>9/24/07</b>	<b>10/31/07</b>		
2	1.1.	Prepare users' guide	5 days	9/24/07	9/28/07		contractor
3	1.2.	Nominate few taxpayers to complete users testing	3 days	10/1/07	10/3/07	2	SRS
4	1.3.	Create testing scenarios	8 days	9/24/07	10/3/07		contractor & SRS IT Division
5	1.4.	Execute users testing and Document testing results.	7 days	10/4/07	10/12/07	3	Selected taxpayers & SRS IT
6	2	Make amendments to the system based on testing results	7 days	10/15/07	10/23/07	5	contractor
7	3	Repeat the testing to be sure that needed changes have been done and problems are resolved.	6 days	10/24/07	10/31/07	6	SRS IT Manager
8	4	Prepare materials to make taxpayers aware of the existence of the Tax Online System. Advertise the system. Public Notices /announcements. Leaflets.	20 days	9/24/07	10/19/07		SRS
9	5	Ensure equipment capacity for stable implementation	28 days	9/10/07	10/17/07		
10	5.1.	Evaluate the capacity of existing equipment and needs of upgrade / procurement of equipment for proper implementation	3 days	9/10/07	9/12/07		SRS IT Manager
11	5.2.	Estimate the cost of needs	3 days	9/13/07	9/17/07	10	SRS Systems Administrator
12	5.3.	Ensure funding for equipment needs	10 days	9/18/07	10/1/07	11	SRS Managers & Donor's Projects
13	5.4.	Procure equipment / elements and install them	12 days	10/2/07	10/17/07	12	SRS & Donor's projects
14	6	Launch the system	1 day	11/1/07	11/1/07	7	SRS
15	7	Monitor and control.	21 days	11/2/07	11/30/07	14	contractor & SRS IT Division
16	8	Train system administrator how to maintain the system.	10 days	11/12/07	11/23/07		contractor (during their last 10 days of monitoring)
17	9	Administrate the system	1 day	12/3/07	12/3/07	15	SRS System Administrator

It was identified that some of the existing hardware doesn't have capacity to handle expected load of requests with the implementation of TOSS.

The below memo is a justification of the Web Server need and technical specification of it.

## Attachment 2 - TOSS Interim Review and Status: Equipment needs

### MEMO

**Date:** 03 September, 2007  
**To:** Olin McGill, USAID Business Climate Reform, COP  
**From:** Neli Baeva, Tax Administration & IT Advisor  
**CC:** Nato Beruashvili, USAID Business Climate Reform, Fiscal Team Leader  
Maia Tevzadze, USAID BCR, Regulatory Team Leader  
Irakli Gvenetadze, IT Implementation Expert  
**Re:** Equipment necessary for implementation of Tax Online Services System.

Dear Olin,

One of my tasks, as per the SOW, is to create an implementation plan for Tax Online Services System (TOSS).

Among all, two main critical tasks are included in it: (1) users testing of the system, and (2) ensuring equipment capacity for proper performance.

#### 1. Users testing of the system

The completion of this first task includes organizational and administrative actions to engage a group of taxpayers in the process of testing. Andrei Gorbushkin, the SRS IT Manager, is taking the lead on that. With the authority of the SRS Director, Mr. Gadaev, and good testing plan and scenarios developed by the software company and the SRS IT team, users' testing will be implemented to confirm the capabilities and usability of the software.

In regards to the equipment capacity, in a conversation with Andrei and the Tax System Administrator, it became clear to me that the current web server does not have the capacity to implement TOSS. The current server is a simple PC with very low technical characteristics: one (1) CPU - Intel Pentium IV 2.8, RAM of 512 MB, and a HD with 40 GB.

It is critical to have a web server that can ensure fast and accurate handling of all user requests with good performance. While the current server deals only with the load of clients accessing the Tax website to obtain information about their balances by type of tax or to download a property tax declaration, the implementation of TOSS will increase the requirements of the server dramatically. Taking into consideration not only planned implementation of VAT e-filing, but future enhancements of TOSS (adding more online services for all types and groups of taxpayers), Andrei and I determined the following technical specifications for a web server:

IBM x3950 Server2XCPU 2x3.50 GHz Dual-Core Processor MP,  
667MHz/4MB/16MB ECC L2/L3 Dynamic ECC cache,  
4 GB PC2-3200 ECC DDRAM (up to 512 GB),

Dual channel SAS Controller,  
O/Bay SAS (up to 440.4GB),  
with RAID 0,1,Opt.,  
IBM Remote Supervisor Adapter II (RSAIL),  
2XEthernet 1000Mb,  
4XUSB Ports,  
IBM Integrated Baseboard Management Controller (BMC),  
Diagnostics: Drop down Light Path Diagnostics panel,  
2x1350W HS p/s and 3U Rack  
Additional 2 CPU (same spec as above),  
IBM 2GB (2x1GB) PC2-3200 ECC DDR2 Upgr SDRAM RDIMM,  
IBM 146.4 GB 10K-rpm SAS SFF HS 2.5" (SFF tray) HDD,  
Windows Srv Std 2003 R2a English DSP 1-4CPU 5 Clt.

Our initial estimation of the cost of the web server, based on previous experience, is around \$40,000 (forty thousand US dollars).

The SRS does not have any budget planned for this piece of equipment. It will be worthy, if the project budget allows, to provide financial assistance in this regard. As the project is already supporting development of the system, and a proper web server is a precondition for its successful implementation.

**Note:** The IBM brand was selected for consistence with already existing equipment and for easier maintenance. (The main server for the Tax IS is IBM.)

## **Attachment 3: Appeals Business Processes**

### **I. Status on MOF Order on Appeals**

The second draft of the Order for processing appeals by the MOF Council has been prepared. While it is better than its predecessor, additional items require elaboration before adoption and implementation can occur.

The initial screening of a submitted appeal includes confirming compliance with the requirements of Article 149 and two paragraphs of Article 147. This was a significant issue during discussion as it became apparent that there are differing understandings among the parties about when and by whom the initial screening is to be completed.

The MOF representatives and the Deputy Head of the SRS Legal Division posit that an appeal's initial screening must be carried out by the Legal Division or MOF Board of Appeals staff. However, both parties acknowledge that accurate completion of the initial screening does not require special expertise. It is my professional opinion that the initial screening should be executed at the front desk, where the appeal is delivered. It is at the point of acceptance or non-acceptance at the front desk that an individual should accept the appeal if it matches the requirements of Articles 149 and 147, or refuse the appeal because it does not meet the requirements of the Articles. Both MOF and SRS officials replied that front desk operators do not have the legal right to make any appeal decision, even the right to determine the completeness of the submission. In fact, they posit, this is forbidden by law.

Who performs the initial screening will define whether the submitted appeal has to be processed or not (as per Article 146). It is not clear. According to the MOF representatives, since acceptance of the submission has to be completed by SRS experts, it is not included in the Order because the order's purpose is to regulate business process for appeals at the Board of Appeals of the MOF.

The MOF representative stated that our suggestion for designing and adopting standard forms for appeal, notice for appeal submitted to court, and the appeal's decision are accepted and will be included in Taxpayer's Appeal Leaflet in the future.

A high-level description of the existing business processes for processing tax appeals is presented below, based on information collected from SRS Legal Division. It can be used for business process re-engineering and developing relevant software.

### **II. Current Business Processes**

The Tax Code allows a taxpayer to appeal assessed tax liabilities by the tax authority. The appeal can be addressed to and processed by: (1) the Court; (2) the SRS; or (3) the MOF Board of Appeals.

#### **1. Appeals submitted for processing by Court.**

##### *1.1. A taxpayer submits a tax appeal to the Court.*

According to the Tax Code, the taxpayer is obligated to submit a notice to the relevant Tax office informing the tax authority about incoming appeal at the Court. A Tax

appeal submitted to the Court should match all requirements included in Article 149 and applicable requirements included in Article 147.

*1.2. The Court sends a copy of the entire tax appeal package to the SRS Legal Division or to the relevant Inspectorate.*

The appeal package shall have as its cover a cover notice with a request for review.

The cover notice shall include a deadline by which the Tax Authority must respond.

*1.3. The SRS Legal Division or the relevant Inspectorate drafts a motion document on the appeal case.*

*1.4. The SRS Legal Division submits the motion document to the Head of the Legal Department for review.*

*1.5. The Director of the SRS signs the motion document and mails it to the Court.*

*1.6. The Court schedules a hearing and informs the taxpayer and Tax Authority of the date and time.*

*1.7. The hearing is conducted.*

More than one Court session can be carried out before a decision on the case is made.

For each session, the Court can request additional information from the taxpayer or from the Tax Authority. The Court must make a decision on a tax appeal case within one month from the date the appeal is submitted to the Court.

*1.8 The Court decision is mailed to the taxpayer and Tax Authority.*

The taxpayer has a right to appeal a Court decision to the second Court Appeals Level. The taxpayer does not have a right to appeal a Court decision to SRS or to the MOF Board of Appeals.

*i. The Tax Authority enters the relevant records into the appeals register and into the taxpayer's ledger as required.*

## 2. Appeals submitted for processing by the SRS

*2.1 A taxpayer submits a tax appeal to the SRS Legal Division at SRS headquarters or to the relevant Inspectorate.*

If the taxpayer submits a tax appeal to the relevant Inspectorate, the appeal is accepted and forwarded to the SRS Legal Division Appeals Unit. Only the Legal Division Appeals Unit at the SRS headquarters has the authority to process an appeal.

*2.2 The Head of the SRS Legal Division assigns the case to a legal officer.*

*2.3 The appointed legal officer executes the initial screening of the appeal.*

*2.4 The appointed legal officer analyzes the case and, if necessary, requests additional information from taxpayer through the relevant Inspectorate or from the Inspectorate itself.*

*2.5 The appointed legal officer prepares a Draft Decision and presents it to the Head of the Legal Division.*

*2.6 The Head of the Legal Division reviews the case and drafts a decision.*

*2.7 The Head of the Legal Division submits the decision to the Director of SRS for review and signature.*

*2.8 The signed decision is mailed via registered mail to the taxpayer and copy of it is forwarded to the relevant Inspectorate, where it is recorded into the taxpayer's ledger as required.*

The Head of the Legal Division has the authority to select cases for processing by the SRS Legal Division. Usually, these are complex cases. In such cases, the Legal Division prepares all necessary documents and submits the package to the MOF Board of Appeals. The MOF Board of Appeals makes a decision on the case. The Head of the SRS signs the decision and mails it to the taxpayer and copy of it is forwarded to relevant Inspectorate.

Utilizing this process, the taxpayer does not physically attend any step in the appeal's processing. Communication between the taxpayer and SRS occurs via the relevant Inspectorate and registered mail.

### 3. Appeals submitted for processing by the Ministry of Finance Board of Appeals

#### *3.1. A taxpayer submits a tax appeal to the MOF Board of Appeals*

When a taxpayer addresses an appeal to the MOF Appeals Council, s/he submits it at the taxpayer's registration tax office or at the MOF administrative office. When an appeal is submitted at the taxpayer's registration tax office, the tax office forwards it to the MOF administrative office.

#### *3.2. The MOF administrative office forwards the appeal to the MOF Board of Appeals.*

#### *3.3. A MOF Board of Appeals member is appointed to a case, who executes the initial screening of the appeal and prepares a written request to the SRS Legal Division for any supplementary documents required for the hearing.*

#### *3.4. The SRS Legal Division prepares and returns to the MOF Board of Appeals member all requested documents.*

#### *3.5. The appeal is presented to the MOF Board of Appeals during a scheduled session. The taxpayer and SRS representatives attend the MOF Board of Appeals session. More than one session can be carried out on a case.*

#### *3.6 The MOF Board of Appeals decision is mailed via registered mail to the taxpayer and copy of it is forwarded to the relevant Inspectorate, where it is recorded into the taxpayer's ledger as required.*

## Attachment 4: AUTOMATIC AUDIT SELECTION

Each modern tax administration has software facilitating selection of taxpayers for audit. It is based on data accumulated during at least a five year period, knowledge and expertise of auditors, profiling of taxpayers based on their compliance, and many financial indicators and criteria.

A working group, including representatives of the Audit Division, Risk Management Unit and IT Division, has been established to undertake the planning and guide implementation. The Project provides technical support mainly in software development, but inevitably I was involved in discussions related to the selected indicators, methodology of using indicators and algorithms for calculating risk score.

The below memos and notes outline my input during my trip. Also I am providing some recommendations to the working group that were not formally presented to it despite some of them have been discussed.

### 1. RISK SCORE CALCULATION

#### 1.1 Methodology & Algorithms

The following methodology and algorithms for risk score calculation is proposed:

- Risk indicators are divided into 2 groups:
  - Group 1: Indicators for which average values by business sectors will be calculated and used in scoring process, and
  - Group 2: Indicators to which points will be assigned.
- The users (audit Division and Risk Management staff) will assign weights (coefficients) to each group that will be used to calculate the final risk score of each taxpayer. For simplicity of description let us name those coefficients **K1** and **K2**. The priority weight of each indicator within a group will be determined as well. For indicator ‘I’ let assume that the relevant weight is **Ci**.

**Group 1** (includes Indicators 1, 2 and 4 as per the attached list of indicators):

<b>Step 1</b>	Calculate the average values of indicators 1, 2, and 4 per business sectors from profit tax declarations about taxpayers belonging to the business sectors used for the calculations.) For simplicity let consider that p1, p2 and p4 are the calculated average value for business sector “x”.
<b>Step 2</b>	Calculate the risk value per business sector using the weights g1, g2, and g4 the formula: $\text{Risk value business sector (paverage)} = p1 * c1 + p2 * c2 + p4 * c4$
<b>Step 3</b>	Calculate values of indicators 1, 2 and 4 for each taxpayer. Let us consider taxpayer – “a” and his indicators’ values are g1, g2, and g4
<b>Step 4</b>	Calculate the risk value for taxpayer “x” based on indicators 1,2 and 4. Let us name the risk value for taxpayer “x” – g $G = g1 * c1 + g2 * c2 + g4 * c4$

<b>Step 5</b>	Calculate how the taxpayer's risk value (g) stands to the business sector risk v (paverage). $R1 = \text{abs} [(g - \text{paverage}) / \text{paverage}]$ This is the taxpayer's risk score for the indicators from group 1.
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**Group 2** (includes Indicators 3, 5, 6, 7, 8, 9, 10, 11 and 12 as per the attached list of indicators):

**Step 1:** Determine range of values for each of the Group 2 indicators, as follows:

Calculate taxpayer a risk score for Group 2 indicators so that each taxpayer will receive relevant points for each of the Group 2 indicators, as follows:

For each indicator a range of values is determined based on indicator values calculated for all taxpayers. The user (auditor) divides the range on sub-ranges and assigns points (score) to each range.

*For example*, for indicator 3 it was determined that the range of values is [0; 0.5]. The user divided it on 4 sub-ranges and assigned points to each range as described below.

- [0; 0.1] → 2 points,
- (0.1; 0.2] → 5 points,
- (0.2; 0.3] → 7 points,
- (0.3; 0.5] → 20 points

For indicators 5 and 10, which requires a “YES” or “NO” value, the taxpayer will receive 0 points in case of “NO” and a big number of points in case of “YES” (auditors have to determine).

**Step 2:** Determine weight for each indicator from Group 2, as follows:

The weights (C3, C5, C6, C7, C8, C9, C10, C11, and C12) allocated by the auditor to each indicator determine the importance of the indicator in risk score calculation.

**Step 3:** Calculate the risk value for taxpayer “X”

*For example on Steps 1 and 2*, for taxpayer “X” we might have the following calculations related to indicators from Group 2:

Indicator	3	5	6	7	8	9	10	11	12
Indicator Value	0.23		47	17	0.5	132		0.7	8,789
Allocated points (PInd <sub>j</sub> )	3	50	2	5	4	7	0	6	2
Weight of Indicator(C <sub>j</sub> )	0.02	0.5	0.03	0.05	0.15	0.1	0.04	0.08	0.03

Then the risk score for taxpayer “X” for Group 2 would be:

$$R2 = \sum (P\text{Ind}_j * C_j) \text{ where } j = 3,5,6,7,8,9,10,11, \text{ and } 12$$

Using the exact number from the table above it will be:

$$R2 = 3*0.02 + 50*0.5 + 2*0.03 + 5*0.05 + 4*0.15 + 7*0.1 + 1*0.04 + 6*0.08 + 2*0.03 = 27.25$$

The final risk score for a taxpayer will be calculated as follows:

$$R = R1 * K1 + R2 * K2$$

## 2. SOFTWARE

Software implementing above methodology and algorithms for the following indicators determined by the Audit Division:

1	(Turnover -Expenditures. Stock of Goods)/Turnover
2	Profit/Turnover
3	Interest paid on Credit/ (Turnover -Expenditures. Stock of Goods)
4	Expenditures/Turnover
5	VAT taxpayers
6	Import , purchased inventory holdings (through Customs Declaration)
7	Salaries Assessed/Salaries Paid
8	VAT Turnover according to the declaration/overall profit from economic activities
9	VAT amount to be deducted (Input VAT)/VAT actual amount
10	Excise amount to be deducted
11	Revenues – 2006 year/Revenues – 2005 year Expenditures – 2006 year/Expenditures 2005 year
12	Frequent change of the place of registration

The software is already developed and was presented to the Audit Division. It is a tool that the Audit Division can use to explore different scenarios (different indicators and different weights). The software allows user to add new indicators, deactivate existing, assign weights to indicators and look at the final result produced by the software – a list of taxpayer selected for audit. The software also offers functionalities for filtering the list by business sectors, by regions (inspectorates) and other criteria.

## 3. RECOMMENDATIONS TO THE WORKING GROUP

### 1. It is a rule of thumb to analyze and evaluate a taxpayer within a relevant group of taxpayers.

Taxpayers are usually divided in three groups: large, medium, and small business entities. In different countries different indicators are used for dividing taxpayers in groups and in different countries same indicators have different threshold values to execute the division.

In Georgia, a large taxpayer is defined based on turnover (revenue /total income).

- a. If the annual turnover is bigger than 2.5 mln GEL, the taxpayer is classified as a large taxpayer.
- b. If a taxpayer does not meet that criterion, but is an excise tax payer and its turnover is bigger than 1.0 mln GEL it is also a large tax payer.

Thresholds of 2.5 mln and 1.0 mln GEL are very reasonable for the current economic situation in Georgia. With changes in the overall country economy, those thresholds will have to be changed.

Currently, there are no criteria defined for determining groups of medium and small taxpayers.

### **Suggestions:**

1. Medium size taxpayers: entities with an annual turnover between 0.5 to 2.5 mln GEL. This group can be divided in two subgroups based on whether taxpayer is registered as VAT taxpayer or not:
  - a. Medium 1 –all taxpayers classified as medium size, registered for VAT
  - b. Medium 2 –all medium size, not registered for VAT.As a rule medium size business entities is a taxpayers' group with the biggest compliance risk, so most audit resources have to be spent on that group of taxpayers. Also, it is a well-known rule that compliance risk is bigger for taxpayers from Medium 1 group compared to risk for taxpayers from Medium 2 group.
2. Small size taxpayers: entities with annual turnover less than 0.5 mln GEL. It is admitted that this group is not worthy to audit when the audit resources are very limited. Still, it does not mean that random selections of cases for audit among taxpayers from this group are not recommended, quite opposite. However, here so called "third party information" might be used to select a taxpayer for audit.

Compliance risk for different business sectors is different or the same indicator has different weight / strength in determining the risk. Also, scoring systems are designed and applied by groups of taxpayers and per business sectors. You cannot compare scores among taxpayers belonging to different sizes.

In some countries there is a practice of selecting taxpayers for audit on one type of tax using data only from tax declarations for the type of tax that will be audited. For business entities, it is usually Profit Tax.

To create a scoring system we must first identify the criteria which can predict the potential audit result; or errors, or misreporting by the taxpayer. This usually translates into unreported income and exaggerated expenses, which leads to a lower tax base and lower taxes.

Each criterion is judged on importance in comparison to other criteria and is given a weight. Higher weight means more impact on the final score of taxpayer.

It is critical what indicators are taken into consideration and how they are interpreted. Unfortunately the SRS Working Group (WG) rejected to discuss the indicators and what is their meaning at that stage. Below I am providing few comments that aimed at ringing a bell to the WG that it must review and clarify the list of indicators and how they will be used.

### **2. Some comments of selected indicators**

#### **Indicator # 11: [Revenue 2006 / Revenue 2005] – [Expenses 2006/Expenses 2005]**

What this ratio "Trend of revenue minus trend of expenses." indicates? What is its interpretation?

According to Auditors if the ratio value is different than zero, revenue and expenses are changing with the same trend, no need for audit otherwise taxpayer has to be selected for audit.

According to me this is a wrong conclusion from economic / financial point of view, because each enterprise works hard to decrease its expenses and increase its revenue, which inevitably leads to profit increasing.

### **Indicator #7: Salaries Assessed (accounted) / Salaries Paid**

This indicator shows that the enterprise failed to pay salaries due. It indicates that the enterprise failed to fulfill its obligations, but what is the reason for that: a) just using salary money for other purpose or b) the enterprise is in very bad financial condition. To really make a right conclusion it is necessary to have a look at other financial ratios discovering taxpayer's financial status and liquidity.

It is more valuable, according to me, to compare the average salary paid by a taxpayer with the average salary paid within the business sector and taxpayer's group (large, medium, or small). A deviation more than X% (let say 15%) is an indication that taxpayer probably underreports salaries, relevant withholdings.

It is important to include indicators disclosing taxpayer's compliance:

- filing compliance;
- payment compliance; and
- compliance related to the accuracy of reporting (information about previous audits).

These are indicators based on which taxpayers' profiling is usually done. These are the major risk compliance areas also.

## **Attachment 5: Non-Payers Software**

### **STATUS**

The development of non-payers software package is ongoing. The next contract review is scheduled for September 15, when the contractor suppose to demonstrate execution of some functionalities as described in the design review document dated 24 July 2007 and included in my trip report dated July 27, 2007.

One element of non-payers software is computerization of “Blocking taxpayers’ bank accounts” enforce collection measure. This measure ensures taxpayer’s bank accounts to be blocked for any outgoing transaction and debt to be collected by withdrawing the debt amounts from bank accounts if money are available or are deposited to.

Up to now a manually prepared order was delivered to each bank branch, where taxpayer has accounts along with instruction how much money for each type of tax to be collected. With the new software component, that is integral part of the non-payer software package, information about imposed “blocking of taxpayer’s bank accounts” will be send electronically to banks’ headquarters from where it will be distributed to relevant branch offices.

When an internal software procedure identifies that the debt is collected an order for annulling the order for blocking taxpayer’s bank accounts will be issued automatically and information about that will be sent to commercial banks headquarters electronically. Up to now unblocking of taxpayer’s bank accounts was executed on paper order, issued by tax authority, upon taxpayer’s request and delivered to bank’s branch by taxpayer.

The developed software component will also enable banks electronically to inform tax authority about new opened bank accounts.

Since September 3, 2007, software component for electronic communication between banks and the SRS is operational. After a transitional period of 1-2 months, during which flow of paper orders duplicating the electronically sent information to banks will continue, contracts between banks and the SRS for only electronic information exchange will be signed and paper orders will be abolished.

### **IMPLEMENTATION PLAN**

The implementation plan was developed and was presented to the IT Division, which will implement it in close cooperation with Collection Division. Below is an Excel version of the proposed implementation plan.

#	TASK	Duration	START	END	RESOURCE
1	<b>1 Users' testing</b>	<b>12 days</b>	<b>10/1/07</b>	<b>10/16/07</b>	
2	1.1 Select a Inspectorate to complete user testing of the developed software	2 days	10/1/07	10/2/07	Head of Collection Division
3	1.2 Train the selected staff for the testing	5 days	10/3/07	10/9/07	2 IT team / Software Developers
4	1.3 Plan the testing - crete testing scenarios	5 days	10/1/07	10/5/07	SoftwareDevelopers
5	1.4 Complete the testing and document testing results	5 days	10/10/07	10/16/07	3 Collection Officers from selected Inspectorate
6	<b>2 Analyze testing results</b>	<b>3 days</b>	<b>10/17/07</b>	<b>10/19/07</b>	<b>5 Software Developers</b>
7	<b>3 Plan software changed based on testing results</b>	<b>2 days</b>	<b>10/22/07</b>	<b>10/23/07</b>	<b>6 IT Manager</b>
8	<b>4 Complete changes to the software</b>	<b>5 days</b>	<b>10/24/07</b>	<b>10/30/07</b>	<b>7 Software Developers</b>
9	<b>5 Repeat the users testing to ensute that mistakes were fixed</b>	<b>3 days</b>	<b>10/31/07</b>	<b>11/2/07</b>	<b>8 Users</b>
10	<b>6 Develop user guides (if needed, because the software has online help features)</b>	<b>10 days</b>	<b>10/1/07</b>	<b>10/12/07</b>	<b>Software Developers</b>
11	<b>7 Develop a plan for training all people that are going to use the sosftware.</b>	<b>2 days</b>	<b>10/19/07</b>	<b>10/22/07</b>	<b>IT manager &amp; Head of Collection Division</b>
12	<b>8 Complete the training.</b>	<b>5 days</b>	<b>11/5/07</b>	<b>11/9/07</b>	<b>9 Software Developers &amp; Collection Officers executed the users testing</b>
13	<b>9 Evaluate the technical availability allowing all people from collection working on non-payer cases to use the software (if necessary request and install additional computers)</b>	<b>4 days</b>	<b>10/1/07</b>	<b>10/4/07</b>	<b>IT manager &amp; Head of Collection Division</b>
14	<b>10 Launch the software for non-payers</b>	<b>1 day</b>	<b>11/12/07</b>	<b>11/12/07</b>	<b>12 IT Division</b>
15	<b>11 Monitoring &amp; Fine tunning</b>	<b>21 days</b>	<b>11/13/07</b>	<b>12/11/07</b>	<b>14 Software Developers</b>
16	<b>12 Administrating &amp; maintenance</b>	<b>0 days</b>	<b>12/11/07</b>	<b>12/11/07</b>	<b>15 IT team &amp; Collection Division</b>

## Attachment 6: Non-Filers Business Process Implementation

To follow up on non-filer business process implementation, after achieving an agreement with the SRS on business process and algorithms for provisional assessments, I met with the SRS Deputy Director Irakli Siradze, to discuss the implementation. The memo below depicts main moments of our meeting.

**Date:** 22 August, 2007  
**To:** Olin McGill, USAID Business Climate Reform, COP  
**From:** Neli Baeva, Tax Administration & IT Advisor  
**CC:** Nato Beruashvili, USAID Business Climate Reform, Fiscal Team Leader  
Maia Tevzadze, USAID BCR, Regulatory Team Leader  
**Re:** Status of non-filers business process implementation.

### Attendees

**SRS:** Irakli Siradze – Deputy Head of the SRS, and  
Tamaz Modebadze – Head of Collection Division

**BCR:** Neli Baeva- Tax Administration & IT Advisor,  
Nata Goderdzishvili – Fiscal Reform Attorney  
George Esakia – Fiscal Reform Specialist  
Maia Pirtskhalaishvili – Translator / Interpreter

The meeting took place at the SRS building on 21 August 2007 at 5:00 PM.

The main purpose of the meeting was to understand the progress on non-filers business process implementation. During my previous visit to Georgia, we developed acceptable all business process and provisional assessment algorithms and agreed that the SRS experts will describe both in details and prepare all necessary documents for approval by the MOF.

Mr. Siradze informed us that all documents were prepared, as we agreed, and a presentation to the MOF was hold.

Unfortunately, the Minister and his Tax Policy Deputy decided that it is not a right time to implement non-filers business process and introduce provisional assessment to taxpayers failed to submit monthly tax declarations (declarations on VAT, Excise, and Withholdings). So the implementation is stopped. The decision also states that non-filers business process will be implemented for annual tax declarations first, but without provisional assessment. That means the implementation of non-filers process will happen earliest in January next year. Such decision is unexpected and shows inconsistency. The decision to implement non-filers business process for monthly tax declarations was made by the Tax Department in December 2006. Since then many efforts were made to come up with acceptable business process and methodology for provisional assessment and many efforts were spent to design and develop software facilitating the process.

One of the arguments presented to us was that the SRS is working on implementation of so many new software packages: ASYCUDA World, Tax Online Services System and Risk Analysis & Audit selection.

To my professional opinion, such argument reveals lack of consistency, because proper implementation of risk analysis and audit case selection is based on information about taxpayers' compliance that includes filing compliance. To some extent, existing of non-filers business process is a precondition of proper implementation of risk analysis & audit case selection.

Another subject discussed was the Order, final form of VAT declaration and contract to be signed between taxpayer and SRS for using online services.

Mr. Siradze confirmed that the Order and VAT declaration are finalized and he expects them to be approved by the MOF by the end of following week. Regarding the contract, he promised to check what is its status and to take any necessary measures to have it ready.

Later, I had a chance to meet with Mr. Vaza Petriashvili, Deputy Minister at the MOF and responsible for Tax Policy. During the meeting, I re-addressed the issue with non-filers business process. Mr. Petriashvili promised that his team will work on so called "Zero" declaration provision in the tax code and find decisions that will overcome problems this provision causes to proper identification of non-payers.