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# EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

QUARTERLY REPORT

OCTOBER 15, 2010 – JANUARY 14, 2011

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

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# 1 ESTAK QUARTERLY REPORT SUMMARY

ESTAK activities during the third quarter have continued to focus directly on specific tasks according to the work plan and to TAK priorities. The ESTAK program has been operating at its peak level, with 8 short and long-term expatriate advisors, 3 local advisors and 4 translators.

The Task Order for the ESTAK program envisages a dual focus on strengthening capacities of the Tax Administration of Kosovo (TAK) and on increasing taxpayer compliance. ESTAK has made good progress in both areas during the third quarter as reflected in the progress details below. The main achievements during the third quarter, and the areas which have dominated ESTAK input during the quarter, have been the following:

- SIGTAS upgrade – assisting with the resolution of all problems that arose as a result of the implementation (stage 1) which occurred just prior to the beginning of the quarter
- Completion of ESTAK work on sub-legal acts covering the income tax laws and the law on tax administration and procedures
- Updating of Kosovo's annual income tax declarations alongside a revision of the formulae used in TAK's audit risk assessment model
- Assistance with the proposed introduction of e-filing and with other compliance cost saving proposals designed to assist with elevating Kosovo's "Doing Business" rankings
- Reporting on the comprehensive training needs assessment previously completed for TAK and re-establishment of a functional Training Department in TAK
- Design of a revised TAK salary structure including a variable bonus pay element
- Completion of a high-level review of TAK's organization structure
- Completion of a TAK communications strategy alongside continued assistance with TAK's public relations activities
- Assistance with the development of TAK's 2011 Business/Operational Plan and with reports on how TAK can achieve a higher tax collection target than previously planned

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

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

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

Although only required to be reported on annually, this report also details progress made in implementing the ESTAK Performance-Based Monitoring Plan and on progress being made in respect of the key performance indicators.

## 2 PROJECT PROGRESS

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

#### (A) SKILLS DEVELOPMENT/TRAINING:

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

The main emphasis to date has been placed on the completion of a comprehensive training needs assessment (TNA), the first stage of the proposed introduction of ISD training methodology in TAK. The TNA report was completed during the third quarter. Briefings on the findings and recommendations in this report were presented and discussed with TAK HQ senior managers and TAK regional office managers during December and subsequently with individual managers in relation to the areas that affected them directly. The institutional capacity survey part of the TNA provided TAK's senior managers with a significant amount of information on employee satisfaction and this will form the basis of ongoing employee satisfaction surveys proposed to be introduced with ESTAK assistance from 2011.

A key TNA report recommendation that has been accepted by TAK senior management was the proposal to re-establish a Training Commission to oversee TAK training activities and the Commission has since had its initial meeting. The TNA report included a recommended future training strategy/plan for TAK and this has been approved in principle (some aspects of the plan will require funding from the Kosovo Government and/or donors, the prospects for which will become clearer during the next quarter) by the Training Commission.

In the interim period prior to the completion of the TNA report, ESTAK has been successful in re-establishing an operational Training Department within TAK HQ (a Department that when ESTAK started had no active manager and was only managing the administrative aspects of training opportunities outside Kosovo while each area of TAK looked after its own training needs). A new Training Manager was appointed, training support and training equipment request forms and training course evaluation procedures were developed and TAK's previously approved "Training Policy" of 2006 was re-introduced in TAK's operational areas in practice.

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

- Explaining the ISD methodology process to TAK management – this was initially explained to Deputy Directors Corporate Services and the Manager Training and subsequently to the Director-General and other Deputy Directors as part of the presentations on the results of the TNA, and most recently to the re-established Training Commission – now complete
- Identifying trainers and subject matter reviewers for training material development and delivery - work on this was delayed until after completion of the training needs assessment – it is now proposed to commence this work during the fourth quarter and this will continue into Year 2
- Internal training program development for key occupations and managers –
  - a) in relation to key occupations, curricula course outlines have been completed for tax audit, collection and education functions and these are included in the TNA report – a total of 76 course topics have been identified – the Training Commission is going to review these

outlines and training covering them will be developed in Year 2 building on various material including the policy and procedure manuals which are currently being developed for each of TAK's functional areas

- b) in relation to management training, this was deferred while ESTAK's Training and HR experts worked on higher priority areas – work on this has recently commenced with initial training proposed to be delivered in June 2011
- On-line training material library established – the TAK Training Unit have received copies of training materials from TAK operational units and reviewed them for suitability for inclusion in a proposed electronic course catalogue, but unfortunately most are outdated and not suitable for that purpose – in the interim the training course catalogue and selected training course material will be made available to staff on TAK's SharePoint portal during the fourth quarter but further work on this will be needed during Year 2
- “Train the trainers” trainers selected and trained and conducting training – work on this was delayed until after completion of the training needs assessment – as per the TNA report, it is proposed to re-establish the “train the trainers” program during the fourth quarter and to deliver three training courses (on curriculum development, test writing, and presentation & facilitation skills) to the selected trainers under that program during March & April 2011. By year end the train the trainers program will have been established but actual training by those trainers will not commence until Year 2

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

- Implementation of a training policy addendum covering three training forms (Training Department Support Request, Equipment Request and Program Evaluation) which are now being used by TAK operational areas
- Implementation of a monthly Program Evaluation Report that summarizes the results of completed training evaluation reports completed by participants
- Continued work on TAK's 2010-2015 Strategic Plan's training performance indicators
- Continued work on the feasibility of installing a Learning Management System and on developing computer-based training
- Establishment of procedures for the booking of TAK's two “training” rooms in Pristina
- Facilitation of extensive EUCTA-funded training courses on VAT and for TAK's newly established Tax Investigation Unit that required the establishment of several administrative training procedures and forms
- Approval to re-establish TAK's Training Commission, and following this Training Commission approval of: Training Commission Roles and Responsibilities, and TNA Recommendations Work Plan (or Training Strategy)

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

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

- Adult learning theories, Instructional Systems Design (ISD) and the ADDIE Model (for Training Department staff)

#### (B) IMPROVING MANAGEMENT EFFECTIVENESS:

In the Year 1 workplan, a number of discrete management effectiveness tasks were required to be completed. The following tasks were substantially completed during the quarter:

- Assistance with EU tender for new integrated computer system for TAK - ESTAK assisted TAK and an EU contractor with the development of specifications for the tender that was advertised in July 2010 – ultimately the tender process for this system was however cancelled after TAK raised concerns about the risks involved with likely suppliers and about the impact on TAK's future operations of developing a replacement system with apparently few additional benefits over TAK's existing computer system following its upgrade
- – during the third quarter the previously developed ESTAK performance indicators were reviewed in conjunction with USAID – changes being made as a result of that review will also have a similar impact on TAK's performance indicators

A key management effectiveness task, which has not yet been completed but is currently being worked on, is a review of the TAK organization structure with recommendations on changes to TAK management. As most of the previous IMF mission recommended changes at HQ level have already been implemented (with ESTAK support, for example, in drafting new or revised job descriptions), the focus of this work has been on reviewing the organizational structure of TAK's regional offices and modelling the most optimal structure which can be applied across TAK.

In terms of TAK's regional offices, the TAK regional office structure has not been revised for many years, and the current review has taken into account the workload change impacts of the recent SIGTAS upgrade as well as ESTAK proposals to introduce a Call Center during 2011. Work on this was delayed while priority was given to other human resource management tasks (following the unexpected early passing of the Law on Tax Administration and Procedures which included a provision to allow TAK to establish its own salary structure and recruitment and disciplinary policies). A comprehensive high-level organization structure review report has recently been completed for TAK senior management consideration and this is expected to be presented to the TAK Director-General in January 2011. This review will be followed by a supplementary more detailed report the content of which is dependent on the decisions TAK makes on the initial report. It is expected that the supplementary report will be completed during the next quarter in time for progressive implementation during ESTAK Year 2.

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

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

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

These draft procedures have been approved by TAK senior management for referral to the Ministry of Economy & Finance in Administrative Instruction format during the next quarter. Assuming that these are approved by MEF, ESTAK will support the process of communication and implementation of the changes later in 2011.

In December, the government announced its intentions towards enhancing base salaries for civil servants (which includes TAK employees) by 30%. The government announcement is setting an expectation that all employees will receive a non-performance related salary increase which runs contrary to TAK/ESTAK plans to introduce a performance-based salary structure with a variable component of salary based on performance. Complicating this issue is how to treat the allowance part of TAK employees pay which is not covered by the 30% increase but which most employees currently think will be.

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

A revised year-end performance self-assessment process and approach was proposed and agreed and workshops are ongoing with Regional Managers to support them through this new process. A similar approach has recently commenced with Deputy Director-Generals and Directors who report directly to the TAK Director-General. The appetite for modern performance management practices in the regions appears encouragingly strong and a phased approach to introducing Performance Management capability layer by layer throughout 2011 is suggested as the one most likely to produce sustainable impact once any revisions to the field structure have been implemented.

A revised performance appraisal form with new guidance was issued to all TAK staff in November and, for the first time, with a proposed normal distribution of performance ratings. An analysis is currently being undertaken by ESTAK advisors into the outputs from that exercise with a view to any revisions to the 2011 process being proposed. The identification of development needs for all staff in 2011 is entirely different from the past and a menu-driven approach is being adopted which supports the findings of the TNA exercise and effectively asks employees to identify which of a pre-populated menu of development needs they most require. This will ensure that the learning, training and development proposition being designed supports the needs of the staff as articulated. In order to support necessary behavioral change among managers and staff, two new competency frameworks have been developed by ESTAK team (one for managers, one for non-managerial staff). The management training program being designed by ESTAK will support this and it is hoped that this competency framework will apply to all staff and be used to comprise up to 50% of their performance rating in 2011 (and thus inform any bonus payable in January 2012).

In addition, in light of the pending finalization of TAKs' operational business plans for 2011, ESTAK will in the next quarter help support the process whereby the team and individual objectives set for TAK staff adhere to best practice and support the achievement of the operational business plans.

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

ESTAK's recently completed organizational structure review acknowledges that the quality of the engagement between the Director-General and at least some of his direct reports is not ideal presently, due to a variety of factors, and proposes that the DG considers a facilitated session – the facilitation being undertaken by ESTAK - with his team in early 2011 to address existing uncertainties and frustrations and

results in some form of informal contract between them on what they need from one another in 2011 in order to be effective as a team in order to meet the significant challenges ahead.

TAK Deputy Directors, HQ managers and the Large Taxpayer Unit Manager (and to a lesser extent the other regional office managers) have also received regular assistance from ESTAK advisors. In addition, ESTAK advisors assisted TAK management through their regular attendance at TAK HQ senior management meetings and TAK regional manager meetings, through assistance with the initial implementation of TAK's 5-year Strategic Plans and through the development of a 2011 Business/Operational Plan, and through continued drafting for the Director-General of monthly information bulletins for all staff.

The other task remaining to be completed during Year 1 is the development of an operational review capacity within TAK to be developed in conjunction with TAK's Internal Audit Unit. Initial discussions have taken place with the TAK Director-General and the Internal Audit Unit and this work will continue in the next quarter.

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

- developing and implementing publicity campaigns and preparing responses to media enquiries
- preparing the Director-General for his quarterly TAK performance and results media conferences (for example, the preparation of a media kit) and analysing how future media conferences could be improved (for example, by making modifications to TAK's "conference" room)
- the redesign and progressive updating of TAK's website – indeed the ESTAK advisor has been asked to temporarily take over the role of managing TAK's website until a counterpart for the ESTAK advisor has been appointed (the position has been advertised) and can take over that role
- identifying how TAK's image can be improved (e.g. setting up a design competition with graphic design university students to design a future logo for TAK to use – 26 proposals were made and these are being evaluated by a TAK committee with ESTAK support)
- reviewing various other aspects of how TAK currently manages its relationship with the media

Furthermore, during the third quarter, ESTAK developed and proposed a comprehensive Communication Strategy for TAK which has been accepted by TAK senior management. This strategy commences with an initial focus on developing taxpayer education and publicity materials during the first half of 2011 before increasing publicity efforts. The ESTAK advisor will assist her counterpart, once appointed, with the implementation of this strategy.

### (C) DETERMINING RESOURCE NEEDS:

In the Year 1 workplan, the specific resource need tasks relate to the 2011 Budget cycle, covering the provision of assistance in identifying TAK resource needs to feed into 2011 Budget submissions and supporting TAK with the progress on those submissions and their eventual implementation.

While initial Budget cycle timeframes did not allow ESTAK advisors to complete a full staffing review, the original TAK proposal for an additional 50 staff positions was supported by:

- allowing backfilling of the vacancies in TAK resulting from internal appointments to TAK's new Tax (Fraud) Investigation Unit (an IMF requirement – that unit now has 22 staff)
- allowing backfilling of the vacancies in TAK resulting from internal appointments to TAK's new Risk Management Unit (an IMF requirement – that unit now has 2 staff)

- a proposal to re-open the TAK sub-office in North Mitrovica, following expressions of interest from former staff in that office to return to work (an initial 5 appointments have been made (although the appointees have not yet commenced) and an additional 3 positions have been advertised)
- additional staffing of about 10 positions being half of those needed for the proposed establishment of a Call Center in TAK during 2011 (the other half will be resourced from positions no longer needed from the setting up of the Call Center) taking into account the additional workload requirements arising from the SIGTAS upgrade

ESTAK's organizational structure review includes a recommendation that a full resource planning exercise be undertaken in 2011 in relation to the 2012 budget submission and ESTAK would provide significant advice to this activity. This would be the first time that TAK has undertaken such an exercise and would take into account the likelihood of continued resourcing constraints in terms of the budget restrictions upon MEF. In addition, this would enable the field structure in particular to fully reflect its requirements in light of a number of organizational change initiatives such as the implications of the SIGTAS upgrade, new audit and other field strategies and the substantially revised revenue target for 2011.

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

Key recommendations included higher bids for:

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

With the completion of these tasks, most of the ESTAK requirements for this objective were expected to have been met by now. A complicating factor has however been the early holding of government elections in Kosovo which has meant that progress on finalizing the 2011 Budget has been temporarily stalled. While it is not yet known how the budget cycle will progress, it is expected it will resume from where it left off. However, of particular relevance to TAK is a succession of political promises (involving both greater government expenditure and greater tax exemptions) which if implemented will require greater revenue collection to be achieved which would in turn likely necessitate a higher resource bid for TAK for 2011 than that previously submitted. Given this issue, it is likely ESTAK will now be playing a role in assisting TAK prepare a revised 2011 Budget submission in ESTAK's fourth quarter.

Once final resourcing decisions under the 2011 Budget process are known, ESTAK will also assist with its implementation in TAK. Following this year's involvement, it is expected that TAK will better be able to determine their own resource requirements in future years. In order to consolidate this, it is proposed that, once the field structure review has been completed, ESTAK will support workforce planning and

resource modelling techniques to enable a more three dimensional resource planning approach to be taken in 2011 in respect of the 2012 (and beyond) budget planning process. This is thought necessary as it is clear that to date there has been a significant lack of meaningful engagement between HQ and the field on resource requirements (human, technical etc) with at least a feeling that the regions are often in effect told by the center what they will receive without necessarily ever having been asked what their requirements are. There has therefore been a disconnect between regional resourcing decisions and what the regional office network is being required to deliver, operationally and strategically.

#### (D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION:

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

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

Together with the automatically allocated fiscal numbers, TAK has now allocated just over 60,000 fiscal numbers to taxpayers in Kosovo. During October and November the number of active taxpayers has increased further as the remaining active taxpayers who had not yet obtained a fiscal number needed to do so in order to be able to download their tax declaration forms from the TAK website. It is estimated that there are about 65,000 active non-employee taxpayers in Kosovo. This is substantially less than the numbers maintained by the Ministry of Trade and Industry's Business Registration Unit (which does not have an active de-registration process) and is matched by the 35,000 “passive” taxpayers TAK now has recorded on its database.

During the third quarter, ESTAK has also played an active role together with USAID's Business Enabling Environment Project in responding to stakeholder desires for Kosovo to lift its “Doing Business” rankings. This has included a particular focus on the processes used to apply for a fiscal number and looking at ways in which to reduce the time for such processes and/or amalgamating them with other registration processes for new businesses, work on which will continue in the next quarter. At the same time, ESTAK has also been promoting other changes that will improve Kosovo's “paying taxes” part of such rankings, namely the proposed introduction of e-filing (discussed further under (e) below) and reductions in the frequency of filing tax declarations, particularly VAT declarations.

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

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

Progress is being made on improving the accuracy and timeliness of TAK data for both TAK staff and taxpayers, and further improvements can be expected following the implementation of the second stage of the SIGTAS upgrade during the next quarter. In particular, the accuracy of the taxpayer registration

database will improve once non-filers are actively followed up once they start receiving and responding to reminder letters. It is thus expected that the TAK database will become increasingly more reliable throughout 2011 and result in this ESTAK objective being substantially achieved by the end of 2011.

#### (E) SIGTAS IT SYSTEM:

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

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

- resolution of issues that had held up TAK being able to input into SIGTAS details of tax assessments made as a result of taxpayer audits by TAK’s tax auditors
- resolution of issues related to the issuance of new certificates for VAT filers
- mediation between TAK management and the SIGTAS vendor on matters relating to acceptance of the new system, contract payments, development versus support changes, etc. - in this regard ESTAK notes that TAK IT have already expended a significant part of their “support” budget and consider that more funding will be needed to maintain the SIGTAS system in future

The upgrade of SIGTAS represents one of the most significant achievements in TAK that will occur during the lifetime of ESTAK but the implementation process remains only partly completed. While the first phase of implementation has been completed and taxpayer data has been successfully converted for the vast majority of taxpayers, the second stage of SIGTAS implementation (introduction of audit, collection and objection modules) has not yet taken place. While the second stage is expected to involve significantly fewer system implementation issues, more emphasis is needed on user training, which is scheduled to commence in the near future.

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

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

- TAK IT maintenance agreement in place – Completed. A support agreement with the SIGTAS vendor is in place – additional support has now come into effect following implementation of the systems upgrade
- Business modernization system function established – Substantially completed. A TAK Modernization Unit has been established and this has focused on two projects (the management of business analysts conducting testing for the SIGTAS upgrade and the introduction of fiscal cash registers) but a Modernization Steering Committee to support and oversee the operation of

that unit, as originally proposed by the IMF, has not yet been established. Work on the Modernization Steering Committee will be followed up in the next quarter in conjunction with TAK's new Risk Management Unit.

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

## 2.2 OBJECTIVE 2 – INCREASE TAXPAYER COMPLIANCE

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

#### *Income Tax laws*

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

The first two Administrative Instructions, covering the more urgent monthly and quarterly provisions were completed by TAK with ESTAK assistance and referred to MEF in May 2010 and were subsequently signed off by the Minister. ESTAK subsequently assisted with preparation of the training material and supported TAK trainers who provided training on these instructions to TAK team leaders in September 2010.

The second two Administrative Instructions on these laws, covering the annual income tax provisions, have now also been completed and these were signed off by the Minister in November. ESTAK facilitated the TAK working groups that considered these Instructions.

During the next quarter, ESTAK will assist TAK with preparation of taxpayer guides that use many of the examples that are included in the Instructions but are written in taxpayer-friendly language and that taxpayers can use to complete their annual 2010 tax year income tax declarations which are due to be filed by 31 March 2011. (As noted in (b) below, these guides will also take into account the proposed changes to the format of these annual tax declarations that were identified during the third quarter).

#### *Tax Administration & Procedures law*

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

During the next quarter, ESTAK will assist with the training of staff on the changes made in this (and the income tax law) Administrative Instruction. This will then complete all of the sub-legal act work envisaged under ESTAK as there are no current proposals to further amend any of the above laws.

#### *VAT law*

As indicated in the Year 1 workplan, the VAT legislation aspects are being led by the EUCTA project team, including work on the Administrative Instruction relating to the new EU-compliant VAT law which came into

effect on 1 July 2010. That Administrative Instruction has also been completed and signed off by the Minister.

A proposed amendment to the VAT law is in progress and is being managed under the EUCTA project. ESTAK has proposed some additional changes to the EUCTA team (e.g. a proposal to reduce the filing frequency of VAT declarations from monthly to quarterly for smaller businesses). Recent promises made in the lead-up to the government elections which proposed expanding VAT exemptions might also have an impact on the current amendment. Ultimately a sub-legal act will also be required for this amendment. While the EUCTA project is managing this work, ESTAK will still have a review role, but the time commitment is expected to be minor.

#### *Double tax treaties*

In relation to double tax treaties, Kosovo currently has only one treaty in effect (with Albania). Initial work on potential treaties has also taken place with Macedonia, Turkey, Belgium, Germany, Montenegro, Czech Republic and Hungary but in each case further work is needed. ESTAK assisted MEF/TAK with formal negotiations with Turkey during the third quarter and a final agreement for a treaty with Turkey is expected to be signed off during 2011. With the exception of Turkey, ESTAK is concerned with the lack of progress on this work and in particular is not aware of any recording system which keeps up to date progress on this work – for example, a government working party was set up to deal with the Montenegro proposal but then nothing, and similarly there was a proposal to finalize an agreement with the Czech Republic prior to a visit with their representative in November but nothing happened. As a result, it is not known to what extent delays are due to awaiting responses from the other countries or are being held up by lack of response from Kosovo's own Ministries of Foreign Affairs and Economy & Finance. ESTAK intends to follow up on this during the next quarter.

#### *Legal barriers*

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

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

#### **(B) ROBUST AND FAIR AUDIT FUNCTION:**

During Year 1, plans have been made to jointly co-ordinate TAK audit assistance work with the EUCTA project with the result that:

- the EUCTA project had a new taxpayer audit advisor arrive in Kosovo in November for a period of 6 to 7 months – their advisor has a background in VAT auditing and will focus on preparation of a tax audit manual and providing training on that manual
- the ESTAK project had a short-term advisor commence work at the same time, who focussed on audit risk model work (including reviewing the format of annual income tax declarations), assisting with the development of TAK's new Risk Management Unit and assisting, along with ESTAK's DCoP, the EUCTA advisor with tax audit manual work, the ESTAK advisor having a background in income tax auditing

Prior to this and in preparation for that work, the DCoP had accumulated all existing and past TAK audit materials, had prepared a proposed outline for the new tax audit manual, and had commenced drafting the first parts of that manual.

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

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

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

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

In relation to tax activity in the enclaves, TAK has re-established sub-offices in Gracanica and in Shterpece but continues to have no presence in North Mitrovica since Kosovo's declaration of independence in 2008. However, during the last few months, past TAK North Mitrovica staff indicated their willingness to return to work. As a result TAK is planning to re-open its North Mitrovica office and has advertised and appointed 5 staff (but they have yet to take up their positions) and has advertised some additional positions. ESTAK has actively supported this development which is now expected to proceed in the next quarter, once there is some certainty about the new Kosovo government.

In relation to North Mitrovica, TAK is also regularly receiving reports from Customs of imports that come through the EULEX border post in North Mitrovica but then subsequently do not come through the Customs post in Mitrovica city. Furthermore, TAK has placed a staff member at the Customs post in Mitrovica city, on a pilot basis, to assist in the blockage of imports from importers with tax due and in the identification of "goods without origin" (undocumented goods).

However, until TAK re-opens its sub-office in North Mitrovica, TAK's revenue collection activities in the North are severely limited. It is envisaged that once that sub-office is reopened, initial emphasis will be given to ensuring that North Mitrovica taxpayers are registered and are made aware of their tax obligations. It is envisaged that discussions would take place with the appointed TAK staff with a view to

determine how best to proceed with this and it is probable that ESTAK will assist with the preparation of a submission to support a funding request to USAID to utilise some of the funding recently provided by the Kosovo Government for pursuing initiatives in the north.

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

### (C) ROBUST AND FAIR COLLECTIONS FUNCTION:

In the Year 1 workplan, the initial collections specific task expected to be completed was that automated notices would be issued for non-filers and non-payers. This issue of automated notices was planned to commence as the SIGTAS upgrade was progressively implemented. Following the delays with SIGTAS upgrade implementation, it is now expected that taxpayers with tax assessments with tax to pay will start to get final notices before enforcement action is taken during the next quarter. Non-filers will also start to get automated notices, a process that was originally proposed to take place after the second stage of the SIGTAS upgrade is implemented, but which may now take place sooner given the expected positive revenue impact of this initiative and current stakeholder demands for significantly increased tax revenue in the immediate future.

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

In the meantime, ESTAK advisors continued to assist the TAK Director-General with his review of tax debt cases of over 1m euro. ESTAK also assisted TAK with the government agreed period of amnesty from tax penalties in relation to 2008 and prior year tax debts where outstanding tax and interest is paid in one lump sum prior to the end of November 2010 (or where, due to SIGTAS upgrade implementation issues, an audit had been completed by the end of November and payment was made by the end of December). ESTAK also provided assistance in the development of procedures for collecting tax debts of budget organizations, to take advantage of expected budget surpluses of these organizations resulting from under-spending of their authorized budgets.

The ESTAK Compliance Advisor continued to provide informational seminars for Enforced Collection regional team leaders in new capabilities resulting from the amended Law on Tax Administration and Procedures and for processing statute-barred collection cases (cases in which more than 6 years has passed since the tax debt was assessed). In addition, the ESTAK advisor continued to visit TAK regional offices to meet with the manager and team leader in an effort to identify systemic collection issues.

During this quarter, the ESTAK Compliance Advisor also commenced work on updating a Collections Procedural Manual. While the ESTAK advisor will co-ordinate this work, much of the content is being drafted by experienced TAK collectors and segments have been allocated to such staff to work on during the next quarter.

ESTAK has also continued to liaise with the USAID-funded SEAD project in relation to how tax administration laws and practices impact on caseloads in the Courts and worked with that project and the USAID-funded BEEP project regarding the further development of credit registries, including the pledge register, in Kosovo.

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

#### (D) PUBLIC EDUCATION ON TAX COMPLIANCE:

In the Year 1 workplan, no specific public education function tasks were required to be completed during the early quarters as most taxpayer education outcomes are not planned to be achieved until the last quarter. This recognized the priority in other areas of the workplan and allowed for the prior completion of Administrative Instructions (which contain numerous examples and which can form the basis for development of a range of taxpayer education materials) and prior emphasis being given to the development of TAK's communication strategy.

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

In the interim and as detailed under (b) above, during the third quarter, ESTAK's Audit Advisor assisted TAK with the identification of changes needed to the existing annual income tax declarations and with the development of a new income tax declaration for partnerships and ensured the changes were approved by TAK management and advised to TAK IT to ensure the changed forms will be able to be processed. The Publications Advisor will prepare tax form completion guides based on the changed forms and on the laws/administrative instructions.

In terms of the other Year 1 workplan taxpayer education tasks, progress to date has been as follows:

- FAQ material developed. An initial set of FAQ questions and their answers was included on the TAK website – this set is being increasingly expanded as more FAQs are identified by TAK staff and through monitoring of a facility on the TAK website which allows taxpayers to directly seek answers to their questions. ESTAK is also exploring how it can record the number of “hits” on taxpayer education parts of the website
- publicity spots regarding Taxpayer Advocate and Taxpayer Charter. In line with the TAK Communication Strategy developed during the third quarter greater emphasis on this is now proposed in the second half of 2011. ESTAK has proposed that TAK “relaunch” the Taxpayer Charter in 2011 but only after TAK staff have been fully briefed on the expectations of those staff in terms of standard response times taxpayers can expect to their enquiries
- publication of enforcement actions. To date, publicity has focussed on general enforcement messages rather than also including results of enforcement in specific cases – focus on the latter is dependent on the identification of appropriate cases to publicize which has been limited in recent times but is expected to increase in the near future following finalization of the updated Tax Administration & Procedures law and its related Administrative Instruction, and following a recent Government initiative to follow up, with Police assistance, the most “risky” taxpayers as identified by TAK on the basis of TAK and Customs data
- briefings on tax issues for judges and prosecutors. ESTAK has been involved in initial discussions with the EUCTA project regarding this, given that project has been liaising with judges and prosecutors in relation to their Tax Investigation Unit work

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

During the third quarter, emphasis was also given to the development of taxpayer satisfaction surveys with these due to be used from 2011 and designed to be returned to TAK's Taxpayer Advocate. ESTAK advisors also continued to assist with the operation of the Taxpayer Advocate position and the incumbent successfully resolved a number of cases in which taxpayers had previously been unable to obtain relief from inappropriate tax assessments.

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

### 2.3 OBJECTIVE 3 – DONOR COORDINATION

In the Year 1 workplan, the only donor co-ordination task not yet completed has been the establishment of a donor co-ordination forum. It had been planned that a donor meeting at the end of May would also confirm the continuation of that group as a regular forum. However, the planned donor meeting was cancelled due to the inability of one of the donors to participate at that time and a replacement has not yet been scheduled or taken place (although there is the possibility of such a meeting hosted by the IMF may be held in January 2011). In the meantime, the ESTAK project continued to work constructively with the EUCTA project at a working level in jointly providing assistance across most areas of TAKs operations.

Following a change of IMF resident representative, ESTAK also met with the IMF during the third quarter to re-establish reporting and working relationships with the IMF particularly in regard to revenue collection target progress and future revenue forecasts. Work on this will be finalized during the next quarter.

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

- the European Union, in relation to the “Blueprints” exercise that was undertaken during December 2010 and is likely to result in the determination of future EU assistance provision following the completion of the EUCTA project in September 2011
- the Bavarian Government – following an EUCTA-organized study visit, a delegation from Bavaria visited Kosovo in November to further define future assistance needs
- a USAID funded World Learning facilitated study visit to USA which is proposed to take place in March 2011 for selected TAK senior managers to examine operational Call Centers

### 3 PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

Previous quarterly reports have outlined ten problem areas, namely:

1. TAK accommodation in Pristina
2. TAK salary levels
3. Fiscal registers
4. Replacement computer system
5. Relationship between HQ and regional offices
6. TAK Training Unit
7. Delays in proposed reopening of suboffice in North Mitrovica
8. Double tax treaty delays
9. Delays in passing revised Law on Games of Chance
10. Independent Review Board backlog

Of these, items 4 and 6 have now effectively been resolved. Concerns about a replacement computer system have now evaporated after the EU withdrew its funding after TAK could not confirm its support for introducing a replacement computer system given that it became apparent that a new system was unlikely to deliver any significant benefits to TAK above its existing (upgraded) computer system. Also, TAK's Training Unit is now functional again.

Of the other eight problem areas, ESTAK is making progress with four as follows:

- ESTAK has continued to refine its proposed new salary/performance incentive structure for TAK for 2011 but the extent to which this is able to be achieved depends on the final results of 2011 Budget submissions (which have been delayed due to government elections)
- ESTAK has taken some initiatives to improve the relationship between HQ and regional offices by drafting monthly update bulletins for all staff, by working closely with regional managers in establishing a more effective performance management process, and by ensuring regional managers are more directly involved in TAK's annual planning processes. In addition ESTAK is undertaking a comprehensive review of TAK's organization structure at regional office level
- ESTAK has continued to support TAK in its efforts to re-open its sub-office in North Mitrovica. While MEF did not approve TAK's previous request to employ additional staff at that location such that TAK would temporarily exceed its authorized staffing level in 2010, that year has now finished and instead final decisions are now awaited on TAK's authorized staffing level for 2011. Despite this TAK proceeded to appoint staff to positions at that location, but their commencement has also been delayed at their request due to uncertainty regarding the outcome of the government elections
- ESTAK successfully participated in double tax treaty negotiations with Turkey during the third quarter and a formal agreement is expected to be signed in 2011. Nevertheless ESTAK remains concerned about the apparent lack of any reporting processes within MEF on the progress of double tax treaty discussions with a range of other countries where double tax treaty work has commenced but does not appear to be routinely followed up via the Ministry of Foreign Affairs

In relation to the four remaining problem areas, which are largely outside ESTAK's control:

- TAK's accommodation issues in Pristina remains outstanding particularly in the short term (proposals for a longer term public/private partnership construction of a building have recently commenced although there are still concerns regarding its possible location). In the meantime, TAK's accommodation problems in Pristina continue to deteriorate – no more staff can be recruited in the Germia building occupied by the Pristina 1 and 2 regional offices (this lack of

space not only prevents the recruitment of staff needed to address the continued growth of Pristina and surrounding communities, but also impacts on compliance levels and revenue which ESTAK has recently estimated at between 4 and 6m euro in revenue for every 10 additional staff not able to be accommodated in Pristina). Furthermore, it is noted that MEF has relocated its Property Tax (which used to be in the same building as TAK's Large Taxpayer Unit), Tax Policy and other units to a modern privately rented building and has not addressed TAK's (and Customs) accommodation concerns in Pristina. There is little more that ESTAK can do on this issue which may also impact on ESTAK's 2011 plans to establish a Call Center in Pristina.

- ESTAK is continuing to distance itself from the Government's fiscal register initiative, given the potential eventual risk of failure of this initiative, which has proceeded on a basis inconsistent with previous USAID advisor advice
- There has been lack of progress on the revised Law on Games of Chance – it had been the intention that the licenses that operators would pay under that law would compensate for the exemption of VAT now provided to gambling operators – and as a result the Government has since July 2010 been receiving little revenue from the gambling industry
- There has been lack of support to address the backlog problems of the Independent Review Board. While the Board reports to the Assembly the Ministry has a vested interest and influence over its operations but its resourcing decisions have to date have not addressed the ever increasing backlog of tax (and customs) dispute cases that are waiting to be heard. This continues to include a substantial dispute regarding KEK which could easily be given priority but this has not happened despite KEK and TAK requests for the IRB to do so. USAID/ESTAK believes that the IRB will never operate successfully in its current format and as a result of USAID/ESTAK request the next IMF tax mission due to arrive early in 2011 has agreed to specifically review this issue

An emerging challenge for ESTAK is the increasing amount of stakeholder pressure being imposed on TAK to significantly increase its tax revenue collection levels in 2011 to fund some of the government commitments made during the recent election process. This can be expected to result in an even greater focus from MEF and TAK senior management on short term revenue gain initiatives, potentially at the expense of longer term more sustainable initiatives which ESTAK is trying to introduce. Proposals to temporarily focus tax audit staff on TAK database accuracy initiatives (as envisaged in TAK's 2011 business/operational plan) and for tax officials to assist with training course development and subsequently participation (rather than being out in the field) could be at risk.

## 4 SUCCESS STORIES AND ACHIEVEMENTS

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

- SIGTAS upgrade – assisting with the resolution of all problems that arose as a result of the implementation (stage 1) which occurred just prior to the beginning of the quarter
- Completion of ESTAK work on sub-legal acts covering the income tax laws and the law on tax administration and procedures
- Updating of Kosovo's annual income tax declarations alongside a revision of the formulae used in TAK's audit risk assessment model
- Assistance with the proposed introduction of e-filing and with other compliance cost saving proposals designed to assist with elevating Kosovo's "Doing Business" rankings
- Reporting on the comprehensive training needs assessment previously completed for TAK and re-establishment of a functional Training Department in TAK
- Design of a revised TAK salary structure including a variable bonus pay element
- Completion of a high-level review of TAK's organization structure
- Completion of a TAK communications strategy alongside continued assistance with TAK's public relations activities
- Assistance with the development of TAK's 2011 Business/Operational Plan and with reports on how TAK can achieve a higher tax collection target than previously planned

## 5 UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT QUARTER

Following on from the work completed to date, the fourth quarter is expected to see the final stages of SIGTAS upgrade implementation, implementation of e-filing in TAK's Large Taxpayer Unit, completion of a review of the TAK organization structure and the completion of tax guides to assist taxpayers with the completion of annual 2010 income tax declarations.

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

Work will continue on refining TAK's audit risk model and working with EUCTA on the completion of an Audit Manual. Work will also continue on the development of a Collections Procedural Manual.

In line with TAK's communications strategy, emphasis will initially be placed on the development of taxpayer education materials to avoid the need for staff and taxpayers to have to refer to laws and administrative instructions for their tax information. This is an initial step in giving a focus to Taxpayer Education during 2011 which later includes plans to introduce a Call Center in TAK.

## 6 CHANGES TO THE YEAR 1 WORK PLAN

In broad terms the bulk of the previously approved Year 1 Work Plan can continue unchanged. Changes have been needed to the timing of training initiatives (which in hindsight have proved too ambitious) and to those activities that were dependent on an earlier implementation of the SIGTAS upgrade – but the vast bulk of these activities are still expected to be completed, or at least substantially completed, during Year 1.

ESTAK work has also continued with the following additions:

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

## 7 FINANCIAL STATUS OF CONTRACT

The table below summarized financial status of the ESTAK program as of the end of Quarter 2, and includes: (1) budgeted amounts by line item, (2) amounts committed, disbursed and expended (with disbursements plus accrued amounts shown separately) and (3) estimated costs to complete the contract)

Budget Cost Elements	Budgeted Amounts	Disbursed Amount	Accrual Amount	Expended Amount (Disbursed + Accrual)	Remaining Budget to Complete
Fixed Daily Rate - Labor	\$ 2,462,680.12	\$ 517,907.19	\$ 81,170.31	\$ 599,077.50	\$ 1,863,602.62
TCN - Labor	\$ 1,090,881.00	\$ 272,050.34	\$ 28,916.58	\$ 300,966.92	\$ 789,914.08
CCN - Labor	\$ 593,652.00	\$ 108,851.24	\$ 25,155.90	\$ 134,007.14	\$ 459,644.86
Other Direct Costs	\$ 1,173,541.00	\$ 236,646.73	\$ 31,847.96	\$ 268,494.69	\$ 905,046.31
Subcontractors -ODC	\$ 27,271.81	\$ 1,247.60	\$ 5,048.45	\$ 6,296.05	\$ 20,975.76
G&A	\$ 349,166.00	\$ 56,632.42	\$ 8,748.14	\$ 65,380.56	\$ 283,785.44
<b>Total</b>	<b>\$ 5,697,191.93</b>	<b>\$ 1,193,335.52</b>	<b>\$ 180,887.35</b>	<b>\$ 1,374,222.87</b>	<b>\$ 4,322,969.07</b>

## 8 PERFORMANCE-BASED MANAGEMENT PLAN PROGRESS

The Year 1 workplan includes a Performance-based Management Plan (PMP) which lists a series of performance indicators against which ESTAK program progress can be measured. Although these indicators are annual ones and are not required to be formally reported on in annual ESTAK reports, it is appropriate to report on general progress made in implementing this plan.

ESTAK advisors have worked closely with TAK's Strategic Planning and Analysis Unit to identify performance indicators for each TAK organizational unit and to set up reporting processes for these indicators. In several cases where information was not readily available in respect of 2009, there has been the need to establish initial measurements as baselines during Year 1 against which to measure ESTAK progress in subsequent years.

During the third quarter, the results of the performance indicator work, of the Training Needs Assessment work (particularly the Institutional Capacity Survey and the staff satisfaction information) and of the taxpayer satisfaction survey with TAK's Taxpayer Advocate were reviewed. This exercise has revealed areas where information deficiencies remained enabling this to be addressed before ESTAK's first annual progress report against the PMP needs to be presented in its first Annual Report. The review also considered the ESTAK approach alongside the approach being taken under USAID's GFSI project and in particular, in conjunction with the COTR, has looked at reducing the number of performance indicators against which reporting is necessary. The results of this review will be finalized during the next quarter.

As with previous quarterly reports, while not reporting against all indicators in this report, it is however appropriate to present progress against the general high-level result indicators that were included in the PMP.

### (A) TAK TAX REVENUE COLLECTIONS:

A key outcome of the ESTAK program is to increase TAK tax revenue collections by at least 50% over the program's 3-year timeframe. Compared with a base of 206.5m euro collected in 2009, the PMP indicated that 235m euro was the target to be collected in 2010, a target which matched that originally expected by the Kosovo Government and which remained unchanged despite the Kosovo Government reducing its tax revenue collection target to 216.5m euro earlier in the year.

TAK tax revenue collections for 2010 reached 221.6m euro, representing 94.3% of the ESTAK annual revenue target. ESTAK notes that the 2011 tax revenue collection target has preliminarily been significantly raised to 270m euro, a target which is consistent with ESTAK's original projections and one that keeps the 3-year ESTAK revenue collection target on track. As the breakdown data becomes available, we will further analyze the reasons for not achieving revenue target and focus on eliminating a similar risk in 2011 and out years.

### (B) ACTIVE INDIVIDUAL ACCOUNTS AT KPST:

A second key outcome of ESTAK is to increase the number of active individual accounts at KPST. To a large extent as tax compliance increases, KPST compliance is also expected to increase as some tax declaration forms double as pension contribution collection forms.

Compared with the 31 December 2009 baseline of 218,000 active individual accounts at KPST, that number has now risen to 227,000 exceeding the expected 2010 annual target of 225,000 due to a combination of better compliance and pension contributor follow-up where some past contributions had not been able to be allocated to specific individuals.

It should be noted that following the appointment of person to TAK's vacant Manager Pensions position and the resultant recommencement of monthly TAK/KPST meetings, that ESTAK now regularly attends and provides input at such meetings.

#### (C) ANNUAL COST OF TAK:

For 2010, TAK's budgetary allocation, after MEF review, was 6.68m euro (comprising 3.97m personnel costs, 1.77m operating costs and 0.93m capital costs). For 2010 TAK actually spent 6.52m euro (comprising 3.94 personnel costs, 1.74m operating costs and 0.84m capital costs) representing 97% of the annual budget.

Taken together with revenue collection information, the cost of collection per 100 units of revenue in respect of 2010 dropped from the 2009 baseline of 3.73 to 2.95 marginally above the expected annual 2010 result of 2.83. (It should be noted that TAK is currently considering changing the measurement of the cost of collection to not only include tax revenues collected but also pension contributions).

#### (D) TAK STAFFING:

By the end of 2010, TAK staff numbers had increased from its 2009 base of 679 to 711 marginally below its authorized maximum 2010 staffing level of 712.

One area of note is that the gender balance has shifted from 468 male and 211 female in 2009 to 494 male and 217 female. Thus, of the net increase of 32 positions, only 6 of this related to females. It should however be noted that TAK has also appointed (although they have not yet started) 5 additional staff at its proposed reopened North Mitrovica sub-office, 4 of which are female and all of which represent ethnic minorities.

Taking these latest appointments into account, TAK will have 495 male and 221 female staff and their ethnic mix is 692 Albanian, 15 Serb, 2 Turkish 7 from other ethnic minorities.