PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: AB4969

Project Name	Tax Administration Reform Project
Region	EUROPE AND CENTRAL ASIA
Sector	Central government administration (100%)
Project ID	P116696
Borrower(s)	REPUBLIC OF KAZAKHSTAN
Implementing Agency	
	Tax Committee of the Ministry of Finance of the Republic of Kazakhstan
Environment Category	[ ] A [ ] B [X] C [ ] FI [ ] TBD (to be determined)
Date PID Prepared	December 31, 2008
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1. Key development issues and rationale for Bank involvement

The Government of Kazakhstan is currently implementing tax administration reform in pursuit of the objectives of improving Kazakhstan's competitiveness and business climate by reducing the burden of tax compliance through state-of-the art procedures and processes while combating tax evasion and corruption. The Government has asked the Bank for assistance in implementing the tax administration reform by providing support to the Tax Committee (TC) to further develop a strategy for increased efficiency and effectiveness of operation.

Meanwhile, the TC has formulated the Strategy for the Development of the Tax Service, dated October 12, 2007 which lays down the mission and vision of the Tax Service and its strategic aims toward its expected role of tax administration in a modern market economy. This role is geared towards: (i) ensuring the completeness of tax collection through improvement of voluntary compliance, simplification of tax legislation, and increased efficiency of the tax collection; (ii) ensuring taxpayer satisfaction through increased awareness and taxpayer education, reduced administrative burden, and improved quality of taxpayer service; (iii) formation of a highly effective tax service through reengineering of business processes, introduction of risk management system, improvement in the use of information and communication technologies, (iv) strengthening of the enforcement function; and (v) improving transparency and the motivation and orientation of staff towards achievement of results.

Previously, many of the key tax policy and administration issues were identified in Volume II of the Tax Strategy Paper prepared under JERP and disseminated in June 2008. Volume II of the Paper examines several areas of tax administration reforms including: (i) institutional issues such as the organizational structure, management, and human resource management and training; (ii) operational issues such as taxpayer services, audit, collection, large taxpayer matters, IT and appeal system; and (iii) technology issues relating to information infrastructure capabilities and

requirements. During discussion of the aforementioned Tax Strategy Paper in November 2009, Deputy Prime Minister Yerbol Orynbayev mentioned that following the reform of the Tax Code, the Government was keen to move as fast as possible with the tax administration reform, based on the recommendations in the Strategy Paper and using internationally accepted standards. A brainstorming seminar was held on December 19, 2008 under the auspices of the Prime Minister's Office to which all internal and external stakeholders were invited to discuss the proposed reforms in tax administration. The seminar endorsed the areas of tax administration reform identified during the identification mission and proposed in this concept note.

Significant improvements have been made in Kazakhstan in IT development following the implementation of the Bank financed Tax Administration Computerization component of the Financial Enterprises Development Project (Loan. 3867-KZ) prepared in 1998 and completed in 2002. This project supported the implementation of a decentralized tax processing environment, consistent with the telecommunications infrastructure available at the time. E-filing has reached an impressive 65 percent of all taxpayers. Most taxpayer-firms file return electronically. However, at peak times processing on this system can be slow, and there is no guarantee of timely delivery of notifications. Projected growth in online transactions for registration and tax filing will clog the traffic on the already saturated communication lines and stress the database capacity throughout the entire process. The IT department is aware of these shortcomings and has developed an action plan and a concept paper for the modernized system.

The tax policy framework is quickly evolving. TC has already proposed several amendments to the Tax Code, based on the recommendations in Volume II of the Strategy Paper, especially with respect to the headquarters organizational structure and appellate system.

However several weaknesses still exist. The size of the tax bureaucracy (11,000) is large relative to the amount of tax collected and the number of taxpayers compared to most modern tax administrations. Instead of a modern, functional focus, the tax administration still has the old geographical focus with more than 200 tax offices located in all rayons. Unofficial payments to tax officials still remain a problem, there being constant close contact between the taxpayers and tax officials. These are likely responsible for the fact that while Kazakhstan ranks 44th in the overall ranking for the Doing Business – Paying Taxes 2008 it ranks a poor 105th with respect to the time it takes taxpayers to comply with tax obligations.

The taxpayer services are underutilized, the audit system is weak, and the appeal mechanism lacks taxpayer confidence. For instance, only less than 50 appeals were filed in the City of Almaty through May 2008 which taxpayers mentioned was the result of the perception that the departmental appellate system was not fair or impartial. Self assessment and risk management systems are fragile. Even in terms of IT, the systems are fragmented at rayon and oblast levels and by taxes and functions and not integrated as a modern administration should be. The system is not flexible enough to withstand modifications required with changes in legislation and is gradually becoming outdated and unable to support a modern risk management approach, inter-agency connectivity and wider use of e-government.

In terms of the effectiveness of the tax administration, the VAT productivity of Kazakhstan is the sixth lowest (at about 0.3%) among the countries of Europe and Central Asia.[1] On the other hand, the corporate income tax (CIT) productivity is impressive, being the second highest in the region (at about 0.3%). This shows that while CIT is performing well, there are serious problems with VAT administration.

The Government's proposal to introduce universal declaration of personal income tax starting 2012 will considerably expand the requirements for return processing and the capacity of the data management system. There is also a proposal to create a customs union among Russia, Kazakhstan and Belarus. This will need harmonization of the VAT registration codes of the three countries and the creation of a VAT information exchange system between them.

Lastly, property tax and other municipal taxes and fees are still collected by the TC on behalf of the municipalities, which is not in accordance with international practice in many countries, and stretches the resources and dilutes managerial attention of the TC in an area where it typically does not have a comparative advantage.

Responding to the Government's request, a World Bank mission visited Astana between November 3 and 14, 2008 to work with the Tax Committee (TC) for identifying the key areas of assistance, and determining the project components, outcomes, outputs results framework, risks and mitigating factors for the Tax Administration Reform Project (TARP). The project proposes to complement and broaden the Government's current tax administration reform program. The project design reflects the results of intensive discussions with key stakeholders.

The following lessons have been incorporated into the design of the project: (i) clear evidence of sustained political commitment and support for the reform; (ii) clear vision of the organizations development needs; (iii) all elements of the reform are being addressed in an integrated and comprehensive way; and (iv) assistance is targeted to achieve development objectives as well as specific project goals.

2. Proposed objective(s)

The development objective of the proposed project is to reform and strengthen the tax administration in order to improve the level of voluntary compliance, enhance effectiveness to fight tax evasion, increase administrative efficiency, and reduce the potential for corruption. The project would have a positive impact on the business climate by improving client services, strengthening institutional and human capacity in the tax administration, and reducing the burden of taxpayer compliance.

3. Preliminary description

It is envisaged that the project would consist of four basic components, the implementation of which would be possibly managed by different units of the TC:

(a) An ***Institutional Development*** component that would finance the following activities: (a) a comprehensive review and redesign of the organizational structure at headquarters and regional offices; (b) reorganization and consolidations of local offices based on rationalization; (c) analysis and reform of the managerial structure and decision-making

[1] "Assessing overall fiscal effort in ECA 1995-2004," Emilia Skrok and Aristomene Varoudakis, World Bank Regional Study, 2007.

modalities; (d) comprehensive review of HR policies, civil service legislative framework and development of reformed workforce planning and strategy; (e) review of the HRMIS and its integration with the TC IT system and the e-government gateway; (f) HRMIS hardware and licenses; (g) development of training strategy and curriculum; (h) feasibility study for a training institute; (i) equipments for training institute and distance learning system; and (j) study tour, managerial/HR training, and language training.

(b) An ***Operational Development*** component that would finance the following activities: (a) review and redesign of the business processes; (b) development of an integrated database for taxpayers; (c) streamlining of data/information exchange procedures with relevant government bodies; (d) development of universal filing methodology; (e) development of a risk-based audit selection methodology; (f) development of analytical methods in market intelligence, non-compliance trends, risk perception of risk, and use of feedback from current audits; (g) development of a cameral audit information system; (h) development of protocol for information exchange with other agencies and procedures for use of third party information and indirect methods; (i) development of modalities possible transfer of local taxes to municipalities; (j) improvement in enforced collection and arrear management; (k) design of a modern call center; knowledge database, web-based access to taxpayer account and single-client software; (l) review and reform of the departmental appeal system; (m) proposed development of a specialized tax court (m) redesign of the VAT registration system in accordance with the harmonization protocol under the customs union; (n) development of a VAT information exchange system for the customs union; (o) design of an automated VAT refund system; (p) review and reform of the excise taxation procedure; (q) improve in non-resident taxation, including automated enquiry and economic monitoring; (r) study tour and training for the above activities, including training for tax court judges; (s) software for process reengineering; (t) specialized field audit software; (u) laptops for field audits.

(c) An ***IT Infrastructure Development*** component that would finance: (a) capacity building in organization and management of the IT modernization; (b) design and software development for integrated tax management system and related hardware; (c) design and development of data management software and related hardware/equipments; (d) development of concept, architecture and applications for data processing centers (DPC); (e) hardware/equipments for central and 4 regional DPCs, including printing and mailing systems; (f) development of voice and data networks; (g) equipments/hardware for call center; (h) video-conferencing facilities; (i) risk management system hardware and licenses; and (j) hardware and licenses for subsystems.

(d) A ***Project Management*** component that would finance: (a) tax reform advisor; (b) change management advisor; (c) procurement consultants including IT procurement consultants; (d) monitoring and evaluation of project including taxpayer surveys; (e) translation services; (f) project audit; and (g) project management operations.

4. Safeguard policies that might apply

The project will not have any civil works or land acquisition, only minor refurbishment of rooms for IT connections to support information technology. Should any additional needs be identified

during project preparation the project team will contact the safeguards team for possible reclassification.

5. Tentative financing

Source:		($m.)
BORROWER		39.50
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT		31.30
	Total	71.00

6. Contact point

Contact: Munawer Sultan Khwaja
Title: Senior Public Sector Specialist & Revenue Reforms Coordinator
Tel: (202) 458- 5110
Email: mkhwaja@worldbank.org