

**REVENUE POLICY AND ADMINISTRATION IN THE CIS-7:
RECENT TRENDS AND FUTURE CHALLENGES**

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Summary

All views expressed are those of the authors, and do not necessarily represent the views or positions of the International Monetary Fund

Introduction

During the last 5 to 7 years, most of the CIS-7 countries¹ have undertaken ambitious tax policy reforms with a view to establishing more modern and market-friendly tax systems. They have also, to varying degrees, aimed to reform their tax administrations and increase their effectiveness. As of the end of 2002, tax policy reform in the CIS-7 countries has advanced further toward the goal of developing a tax system characteristic of a modern, market oriented economy than have the respective tax administrations. This paper identifies areas where major progress has been made, and highlights the challenges that remain in order to consolidate the gains made thus far and to continue improvements in both the tax policy framework and tax administration.

Tax Policy Reforms

The tax laws and the policies reflected in the laws of most of the countries are now quite good. All of the CIS-7 countries have enacted a second, fundamental round of tax legislation since their independence was achieved in 1992. In some cases, this legislation has taken the form of comprehensive “Tax Codes,” similar to but generally predating the Russian strategy. While the Russian Ministry of Finance began a very ambitious project of drafting a new Tax Code as early as 1995, thus perhaps setting the stage for similar actions by other CIS countries, ultimately in Russia Part I of the new Code was not adopted until July 1998, coming into effect in 1999. (Most of the remaining sections on the major tax laws came into effect in the following year, and the new profits tax only became effective for 2002.) Kazakhstan was the first of the CIS countries as a whole to adopt a new, modern Tax Code, in 1995. The Kyrgyz Republic undertook a quite comprehensive reform of its tax laws in 1995, effective in 1996. Georgia enacted its new Code effective January 1, 1997. Tajikistan adopted a similar model Code though somewhat more detailed, which became effective in quick stages between July 1, 1998, and January 1, 1999. Both of these latter sets of laws were good by international standards, laying the foundations for a modern, and fairly simple and straightforward, tax system.

Revenue trends

Over the past five years, revenue performance has been mixed: three of the seven countries have achieved slight to moderate increases in tax revenues, expressed as a percentage increase in the tax revenue to GDP ratio (Tables 1 and 2), while the other four countries have experienced tax revenue decreases. In all of the countries the VAT is by far the most important source of revenue—in most cases producing at least one-third of total tax revenues. The individual income tax in most cases has declined in significance, or remained stagnant as

¹ The “CIS-7” countries refer to 7 of the smallest and/or poorest members of the Commonwealth of Independent States: Moldova, Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Uzbekistan, and Tajikistan.

a revenue producer. And unsurprisingly, in many cases the importance of customs duties as a revenue source has declined somewhat as trade barriers have been lowered.

Tax Rates

Considerable evolution has taken place in regard to the setting of tax rates over the past five years, in the individual income tax (PIT) and profits tax (EPT). Table 3 shows the trend in income and profits tax rates for the CIS-7 countries over the period 1997-2001. This general evolution mirrors that occurring elsewhere in the CIS—notably in Russia—as well as in the world more broadly. The trend has clearly been to consolidate the number of brackets in the PIT and lower the top marginal rate; and to unify the rate of the EPT. By world standards, income tax rates in the CIS-7 countries are now rather modest, with almost all countries using a top PIT rate of 20 to 25 percent—a factor which may serve to explain in part at least the decline or lack of increase in the revenue outturns from this tax—and an EPT rate between 20 and 30 percent (with the great majority falling in the lower end of that range).

Since Russia adopted its flat 13 percent PIT rate at the beginning of 2001, there has been intense interest among some CIS countries in following suit. None have (as yet) adopted such a radical rate cut, however, largely it appears out of a well-founded fear of the revenue consequences, and the rather greater uncertainty of the potential benefits which such a rate reduction could produce. Evidence on the impact of the consolidation of the Russian PIT rate at 13 percent (from a progressive rate schedule of 12, 20 and 30 percent) is not conclusive. Prior to this change, the effective personal income tax rate is estimated to have been 14 percent. Revenues from the PIT in fact increased over 2001 as a percentage of GDP. However, this effect was even more marked for the other major taxes than the PIT.

Specific areas of progress

An earlier study identified as of the end of 1997 a few main areas that generally still needed to be changed throughout the CIS countries, for each of the major taxes. In many of these areas, progress has in fact been made since that time:

- ***Destination basis for VAT***--As of July, 2001, Russia adopted the destination basis for CIS trade (except with Belarus) for all commodities other than Russia's two major exports—crude oil and natural gas. Originally, all trade within the CIS countries themselves was taxed on the origin basis. Prior to the Russian change, most of the other CIS countries had partially moved toward the destination basis, in some cases retaining origin based trade only with Russia. With the Russian shift, the entire CIS (other than Belarus) is now on the destination basis with respect to VAT, for all trade except for trade with Russia in crude oil and natural gas.
- ***Accounting laws***--Almost all the CIS-7 countries have made significant progress in reforming their accounting laws, with some—including for example Tajikistan (effective January, 2003); Georgia (law passed February 1999); Armenia—having

officially adopted international accounting standards (IAS) as the basis for their national accounting standards, and others having moved some way in this direction.

- **Excise taxes--** Several countries have made considerable progress in restricting the coverage of their excise taxes more nearly to the traditional excisable goods—petroleum products, alcoholic beverages, and tobacco products—though certain “luxury” items still pervade the excise tax coverage in some cases. Progress has been *mixed* in attaining symmetric treatment of imported and domestically produced excisable goods.
- **VAT thresholds**—As of 1997, the thresholds for VAT registration were too low, or non-existent, throughout the CIS. Over the period the thresholds have generally increased. There can be no doubt that setting a sufficiently high threshold for registration is of very great practical importance in implementing a VAT successfully.
- **Portfolio income--** In many of the countries, most or all interest income is now subject to the personal income tax rather than being exempted, as was frequently the case previously. In most cases, this income is taxed at a fixed, lower, rate of final withholding. While this might seem at variance with the conventional tax policy wisdom pointing toward a “global” system of taxation of income on economic efficiency grounds, in fact such a system of final withholding has been proven necessary and most useful in bringing such income into the tax net at all.

Lingering problem areas

Despite this general progress in tax law reform, substantial problems remain, or have recurred, first, through subsequent regression toward distortionary provisions of various sorts, and second, through failure to *implement* the laws as written. The impairments of the new laws themselves have come in two principle forms—a reintroduction of tax incentives and exemptions; and the introduction (or in some cases, retention) of provisions designed to counteract problems that should more properly be corrected through improved administration. For example, a common technique intended to combat VAT fraud through the misstatement of transaction values has been to include “minimum price” provisions, allowing the authorities to restate transaction prices to reflect “market values.”

Certain specific areas of policy weakness also remain:

- **Agricultural taxes--**Special regimes under either or all the income tax, VAT, and land taxes continue to apply to agriculture and farmers in at least 6 of the 7 CIS countries, and indeed in several cases new ones have been introduced relatively recently.
- **Small enterprises--** Similarly, in most countries, special regimes apply to small enterprises. One of the most serious problems, certainly in terms of the equity of the tax system, if not revenue, is the great difficulty in these countries (as elsewhere,

including the developed countries) of properly assessing and collecting tax from entrepreneurs and small businesses.

- ***Tax and investment incentives***--One of the most serious problems in the CIS, including the CIS-7 countries, is the widespread use of tax incentives, holidays, and especially special “zones,” of various sorts, designed to encourage investment, particularly foreign investment. In almost all the countries, there has not only been lack of progress, but actual regression, in getting rid of such sectoral or geographic incentives.
- ***VAT refunds***-- One of the most intractable problems in administering the VAT all over the world is the need to grant refunds of excess credits to businesses whose taxable input value exceeds the value of taxable output.

Tax Administration Reform

During the second half of the 1990s and early 2000s, most of the CIS-7 countries have aimed to reform tax administration and increase its effectiveness, to varying degrees. The main elements of these reform programs have consisted of establishing closer links between the tax, customs, and social security administrations with a view to improving compliance control, reorganizing the tax administration along functional lines, consolidating or reducing the number of local tax offices, modernizing core tax administration procedures such as taxpayer registration and returns filing and payment processing, improving the quality of taxpayer services, and increasing the degree of computerization of the tax administration.

At the outset of the reform process, most tax administrations in the region lacked a modern organizational structure and were under-resourced. Moreover, several faced the challenge of implementing a new tax code, with tax officials having received relatively little training in the contents of the new code and having a weak understanding of the new code’s provisions. During this period, moreover, the number of registered taxpayers continued to increase significantly. Against this background, progress has been positive, but much remains to be done. Of the many obstacles that remain, two major ones that will determine the future direction of the reform efforts under way are the weak capacity of tax department staff and the lack of effective management of reforms. The main challenges to tax administration reform in this region are therefore to improve tax administration staff skills in a range of areas, and to strengthen managers’ capacity to plan and implement reform programs. These initiatives, in turn, will require the commitment and continuous support of senior government officials to improving tax compliance and the effectiveness of tax administration. The remainder of this section describes in greater detail the problems that remain to be addressed.

The legal framework

The modernization of the tax laws and the incorporation of new tax administration laws into the tax code represent a major step in the direction of improving these countries’ legal framework for taxation, but there are nevertheless a number of challenges that lie ahead in

implementing the new legislation. In almost all the countries, the regulatory framework is weak. In most cases, extensive regulations have been developed in accordance with specific directions in the tax code. However, the drafting of these regulations is poor and they often add little to the substantive provisions in the tax code. There are a number of areas where regulations would be useful but have not yet been prepared. Strengthening the regulatory framework for tax administration should be a priority for the tax authorities in the next few years.

Capacity and management

The weak capacity of tax department staff, the lack of effective management, and the existence of corrupt practices continue to be major obstacles to improved tax administration effectiveness throughout the region. Although several countries have made efforts to train tax department staff in different areas (e.g., technical skills related to returns processing, audit, enforcement), training is still insufficient, the staff's general technical capacity is weak, and there is a lack of professionalism. Salaries continue to be low by local and international standards, contributing to corruption. In most of the countries, the tax administration has a relatively small headquarters staff, and because of this there is considerable pressure on a relatively few skilled people to carry out work that is required. Although most tax administrations have undertaken a range of training courses for their staff in different aspects of tax administration, staff, and in particular managers, have received little or no training focused exclusively on management issues.

Enforcement agencies outside the tax administration

Several of the CIS-7 countries continue to have separate tax enforcement agencies. The work that these agencies perform often duplicates the tax department's audit and collection enforcement activities, and has prevented the tax administration from consolidating and modernizing these two critical tax administration functions. The continued existence of separate enforcement agencies outside the tax administration poses particularly important challenges to establishing effective tax administrations in the region, as: (i) staff of these enforcement agencies lack the required skills in revenue administration; (ii) this model is incompatible with a modern tax administration based on self-assessment, which focuses on encouraging taxpayers to comply with their obligations on a voluntary basis, and not on "policing" taxpayers; and (iii) the lack of specialized skills in tax administration and close contact with taxpayers that characterizes these enforcement agencies greatly increases the risk of corrupt practices and gives the wrong signals to the taxpayer community.

Functional organization

Most of the tax administrations have been reorganized, at least in principle, along functional lines, with separate departments for the main tax administration functions (returns filing and payment, audit, collection enforcement, appeals, etc.) This is a positive step that should enable the tax administrations to focus their attention on planning and monitoring operations and defining procedures in each of the critical tax administration functions. In some countries,

however, separate departments still exist for administering the direct and indirect taxes, which inevitably leads to duplicating functions and complicates management. In most of the CIS-7 countries, although the local offices often have taxpayer service units, there is no separate *headquarters* department devoted exclusively to planning and overseeing the provision of services to taxpayers.

Establishment of large taxpayer units (LTUs)

A major organizational change that several tax administrations introduced during the 1990s and more recently has been the establishment of a separate unit within the tax administration to ensure effective monitoring of compliance for the large taxpayers. The performance of the LTUs in this region has been mixed. In some of the countries that have established LTUs (Azerbaijan, Georgia, Moldova), this effort has resulted in some improved monitoring of the largest taxpayers and in the provision of better taxpayer services. In most of the countries where efforts have been made to establish such units, the local tax offices have resisted transfer of the large taxpayers under their jurisdiction to specialized offices charged with administering the largest taxpayers. Government support for establishing large taxpayer operations, providing them with appropriate staffing and resources, and giving them the political backing needed to enforce compliance from the largest taxpayers, has been weak. As a result, the LTUs in these countries have not been as effective as they could have been with the proper organization, procedures, staffing, and government support for their operations.

Systems and procedures

The following section discusses selected issues concerning key systems and procedures in tax administration.

- ***Planning and monitoring--*** During the 1990s, the tax administration in several countries (Armenia, Azerbaijan, Georgia, Moldova) made some progress in improving the planning of the tax administration's main activities. Several administrations now identify the organization's strategic objectives. However, considerable work is still required to translate these objectives into annual national work plans.
- ***Taxpayer identification numbers (TINs)--*** Several countries now have TINs which are better structured and have improved the process of TIN issuance. Other countries are initiating, on a pilot basis, programs to issue proper TINs to new legal entities registering for tax purposes. Azerbaijan, Georgia, and Moldova, have begun to use or will soon require use of the same TIN by both the tax and customs administrations.
- ***Self-assessment--*** The tax laws in most of the CIS-7 countries stipulate that taxpayers are to determine their own tax liabilities based on their understanding of these laws (e.g., that they are to self-assess their tax liabilities). However, although the tax administrations have been moving, to varying degrees, in the direction of such a self-

assessment system, in practice none of the countries has been able to introduce all of the elements required for a modern self-assessment system. Taxpayers in all of the CIS-7 countries still have significant contact with tax officials for purposes of preparing and submitting their tax returns.

- ***Taxpayer services--*** Some countries have established specialized units in the tax administration (particularly at the local office level) exclusively devoted to providing taxpayer services. There is now greater availability of published material on tax-related matters and printed tax forms as compared to the early 1990s, when taxpayers generally had to hand-copy the format of various tax forms posted on the walls of local tax offices. Despite these advances, considerable work is still required to develop the concept of taxpayer services as a major tool to encourage taxpayers' voluntary compliance.
- ***The audit function--*** In general, relatively little work has been done to modernize the audit process, and the tax administrations in the CIS-7 countries still face major difficulties in convincing taxpayers of their ability to take immediate action against delinquent taxpayers. The approach to audit continues to be on comprehensive audits of all tax types, and there has been a reluctance to follow advice to move to a tax type audit programs focusing on VAT and income tax. VAT refund audits are often carried out for purposes other than verifying the refund, regular exporters are often subject to repeated audits for refund claims resulting from zero rated sales, and refund audits are not given the required priority.

Table 1. General Government Revenue, 1997-2001 1/
(in percent of GDP)

	1997	1998	1999	2000	2001
Armenia					
total revenue 2/	18.3	19.7	21.2	18.9	18.5
o/w tax revenue	16.3	16.9	19.3	17.7	17.1
Azerbaijan					
total revenue 2/	19.1	19.6	18.5	21.2	21.5
o/w tax revenue	15.6	14.0	14.2	14.5	14.6
Georgia					
total revenue	14.4	15.6	15.4	15.2	16.3
o/w tax revenue	12.7	12.8	13.8	14.2	14.3
Kyrgyz Republic					
total revenue	22.0	24.1	22.9	18.5	20.4
o/w tax revenue	17.9	19.4	16.6	15.1	15.8
Moldova					
total revenue	38.5	37.6	30.4	30.7	29.1
o/w tax revenue	34.0	32.1	24.8	24.8	24.4
Tajikistan					
total revenue	13.7	12.0	13.5	13.6	15.2
o/w tax revenue	11.8	11.7	12.8	12.9	14.1
Uzbekistan					
total revenue	30.1	31.1	29.3	28.0	25.9
o/w tax revenue	27.7	29.4	27.9	26.2	23.4

Source: IMF data as of 2002 unless otherwise indicated, country authorities

1/ Including grants unless otherwise indicated

2/ Excluding grants

Table 2. Tax Revenue, 1997-2001
(in percent of GDP)

	1997	1998	1999	2000	2001
Armenia					
Total tax revenue	16.3	16.9	19.3	17.7	17.1
o/w enterprise profits tax	2.0	1.3	2.2	2.0	1.4
income tax	1.8	1.6	1.9	1.4	1.0
VAT	4.9	6.2	6.9	6.5	6.8
excise taxes	2.3	2.0	2.2	2.5	2.6
customs duties	1.3	1.1	0.8	0.8	0.8
Azerbaijan					
Total tax revenue	15.6	14.0	14.2	14.5	14.6
o/w enterprise profits tax	2.9	2.0	1.9	2.7	2.2
income tax	2.1	2.4	2.4	2.0	1.8
VAT	4.1	4.2	4.2	4.1	4.8
excise taxes	1.4	0.6	0.6	0.5	2.1
customs duties	1.9	1.7	1.7	2.1	1.1
Georgia					
Total tax revenue	12.7	12.8	13.8	14.2	14.3
o/w enterprise profits tax	0.8	1.0	1.0	1.3	1.0
income tax	1.0	1.7	1.9	1.8	2.0
VAT	4.4	4.4	4.4	4.8	5.4
excise taxes	1.1	0.8	2.1	1.5	1.4
customs duties	1.3	1.3	0.6	0.9	0.8
Kyrgyz Republic					
Total tax revenue	17.9	19.4	16.6	15.1	15.8
o/w enterprise profits tax	1.1	1.3	1.2	0.9	1.3
income tax	1.0	1.2	1.1	1.2	1.3
VAT	5.6	5.8	4.1	4.6	5.7
excise taxes	1.5	2.1	2.6	2.3	1.5
customs duties	0.8	1.1	0.6	0.4	0.4
Moldova					
Total tax revenue	34.0	32.1	24.8	24.8	24.4
o/w enterprise profits tax	2.7	2.0	1.9	1.7	1.8
income tax	3.2	2.5	1.8	1.7	1.8
VAT	10.6	12.3	7.6	8.3	7.9
excise taxes	5.7	4.1	3.6	4.1	3.6
customs duties	1.4	1.2	1.9	1.4	1.2
Tajikistan					
Total tax revenue	11.8	11.7	12.8	12.9	14.1
o/w enterprise profits tax	1.1	1.1	2.3	1.8	1.9
income tax	1.2	1.0	1/	1/	1/
VAT	1.5	1.9	2.3	2.5	3.4
excise taxes	0.5	0.1	0.6	0.5	0.6
customs duties	1.7	1.2	1.3	1.3	1.7
sales tax (cotton and aluminum)		3.9	3.5	3.3	2.5
Uzbekistan					
Total tax revenue	27.7	29.4	27.9	26.2	23.4
o/w enterprise profits tax	7.2	5.9	4.4	3.6	2.9
income tax	4.0	3.9	4.2	3.7	3.9
VAT	7.5	9.4	7.3	7.5	6.5
excise taxes	6.0	5.9	8.1	7.7	6.2
customs duties	0.6	0.7	0.4	0.7	0.6

Source: IMF data as of 2002 unless otherwise indicated; country authorities

1/ Figure for enterprise profits tax includes both EPT and PIT for these years

Table 3. Rates of Enterprise Profits Tax and Individual Income Tax, 1996-2003
(in percent unless otherwise indicated)

	1996 2/	2002	2003
Armenia			
EPT	12/18/25/30 3/	20	
PIT	12/18/25/30	10//20	
PIT threshold 1/		4 times MW	
Azerbaijan			
EPT	25/35/45 4/	27	8/
PIT	12/15/20/30/40/55 3/	35	8/
PIT threshold 1/	none	5 times MW	
Georgia			
EPT	20/35 4/	20	
PIT		15/17//20	
PIT threshold 1/	6 times MW	0.5 times MW	
Kyrgyz Republic			
EPT	10/15/30/45/50 4/	20	
PIT	5/10/15/20/30/40	10//20	
PIT threshold 1/		6.5 times MW	
Moldova			
EPT	32	25	proposed to reduce to 22
PIT	10/20/30/40/50	10/15//25	
PIT threshold 1/	1 times MW	25 times MW	proposed to increase to 36
Tajikistan			
EPT	32/40/55 4/	30	
PIT	10/15/20/25/40	10/15//20	
PIT threshold 1/		0.5 times MW	
Uzbekistan			
EPT	31 6/	24	
PIT	40 7/	13/23/33	3/,5/
PIT threshold 1/			

Source: country authorities; published sources

1/ expressed in terms of monthly minimum wage

2/ in some cases, initial rates are for 1995

3/ progressive

4/ by category of activity

5/ 13 percent bracket below 4 MMW

6/ 31 percent rate in effect as of 1/1/2000

7/ 40 was highest bracket as of 1/1/2000

8/ As of 1/1/2001; 35 percent was the highest bracket in the PIT as of that date

