

## Introduction

After the Republic of Azerbaijan gained its independence the policy pursued under the leadership of the national leader Haydar Aliyev has ensured implementation of large-scale reforms in all the spheres of the economy. The introduction of an adequate tax policy into the market relations has also its own significant share among other reforms such as improvement of administration, privatization of state property, structural reforms carried out in the economy etc. During recent years much work has been done with respect to formulating an efficient tax system, improving its legislative basis, raising the level of professionalism of tax body employees, creating an efficient tax environment and tax culture. Since 1999 the works carried out in terms of structural changes in tax authorities enabled to achieve a systematic, robust structure which is also easy to coordinate.

The set of reforms conducted in the tax system has ensured the growth of tax receipts within a short period and stimulated the development of entrepreneurship. The budget receipts have increased from 6.1 billion AZM in 1992 up to 4.963 billion in 2004. The number of legal entities engaged in entrepreneurial activities is more that 67.000 and the number of individual entrepreneurs operating without establishing a legal entity has exceeded 185.000.

The dynamic development of the domestic economy requires the continuation of works related to formulation of a civil tax service in Azerbaijan. The State Program on Improvement of the Tax Administration of the Azerbaijan Republic is the next stage of reforms to be conducted in this area. The State Program has been developed in accordance with the "State Program (for the years 2004-2008) on social-economic development of the regions of the Azerbaijan Republic", the Presidential Decrees on "Additional measures to be taken for the development of entrepreneurship in the Azerbaijan Republic under the state protection", dated September 10, 2002, "Prevention of interferences impeding the development of entrepreneurship", dated September 28, 2002, "Measures to be taken for stimulation of the social-economic development of the Azerbaijan Republic", dated November 24, 2003 and "Enforcement of anti-inflation measures in the Azerbaijan Republic", dated May 31, 2005.

## The Objectives and Duties of the State Program

The main objective of the State Program is to achieve efficient tax administration and ensure the growth of tax receipts, which stimulates acceleration of social-economic development, on a regular basis through bringing the tax system in line with international standards.

In order to achieve this main objective the following duties will be fulfilled within 2005-2007:

- improve taxpayer service of the Ministry of Taxes;
- establish private consulting services for small and medium entrepreneurs at the regions;
- establish an improved appeal system for the protection of taxpayer rights;
- accelerate the preparatory works for shifting to self-declaration system;
- improve the taxpayer registration system, including registration for VAT purposes;

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- organize audit planning within the framework of the MOT computer database;
- reinforce technological and administrative means in the field of enforced collection;
- raise the level of professionalism of the tax body employees;
- automate the functional activities of the tax authorities within a single computer system;
- transfer to an electronic correspondence between tax authorities and taxpayers.

### **The main principles of improvement of tax administration**

The improvement of tax administration is based on the following main principles:

- increase of efficiency of tax administration should have a positive impact upon the economic development;
- the bureaucratic obstacles hindering the payment of taxes should be eliminated, the number of reports should be reduced;
- tax receipts should exceed the enforced collection costs in significant amounts;
- the normative legal base should be improved in order to prevent tax evasions;
- taxpayer's insolvency should be prevented and their rights be protected.

### **Main directions of improving tax administration**

The modern tax policy requires establishment and development of a balanced tax legislation and tax system. It is a known fact that the core of the tax legislation of the Azerbaijan Republic is the Tax Code, adopted in the year 2000 and entered into force on January 1, 2001. During previous years some changes and amendments were made to the Tax Code by taking into account the experiences of the developed countries. In general, the current Tax Code reflects enlargement of tax base, application of tax control and conduction of improved tax audits.

In parallel with tax legislation much work has been done in improvement of the tax system management. The establishment of the MOT, replacement of tax authorities in the administrative rayons with the territorial tax departments and other structural reforms in the tax system has had a positive impact upon the decrease in the number of tax evasions and increase in the amount of budget receipts. However, it should be mentioned that there are still unused resources in this area. Taking into account this fact the improvement of the tax administration under the following directions is considered to be reasonable:

- improve a system for voluntary payment of taxes and ensuring reliable protection of taxpayer rights;
- enforce measures against tax fraud and tax evasion cases, formulating the tax administration as a system with low risks;
- improve the enforced collection system and preventing occurrence of tax debts;
- bring the management system of the tax bodies in conformity with international standards;
- develop a database system in line with modern standards.

The following actions are planned for the coming years to develop a system for voluntary payment of taxes and ensure reliable protection of taxpayer rights in the Azerbaijan Republic:

- develop taxpayer enlightenment;
- implement programs aimed at raising the awareness of tax culture;
- conduct private consulting services regarding tax issues;

- protect taxpayer rights, establish an improved appeal system with the purpose of impartial administration of complaints.

Increasing voluntary compliance in terms of tax payments necessitates conduction of measures regarding introduction of tax returns for overall incomes of physical persons through benefiting from international experience. The enlightenment activities are of great significance for correct and proper reflection of income sources by the physical persons on their returns.

All the measures to be taken in order to prevent and combat tax evasions are aimed to treat all taxpayers under equal principles and ensure the growth of tax receipts. The tax evasions by the legal entities and physical persons in most of the cases are related to cash transactions, offsetting VAT by using false tax invoices and other factors.

Measures such as toughening the registration process for the prevention of VAT evasion, detecting the taxpayers who are inclined to evasion in advance through introduction of a staged examination mechanism for the registration process and refusing to register such taxpayers voluntarily should be widely used.

Improvement of tax audit, making it a system with low risks is of great significance for increasing the efficiency of the tax administration. With this purpose in view, the integration of legal and analytical database about the taxpayers into the MOT database, automation of taxpayer selection process for on-site audit purposes and evaluation of the audit results based on the special criteria is planned.

The following actions should be taken in order to improve the enforced collection system and minimize tax arrears:

- to group the tax arrears through the MOT database by the dates of their occurrence, automate the delivery of notifications to taxpayers regarding their debts;
- to improve voluntary registration procedure for the VAT purposes and prevent occurrence of tax debts by toughening the interest rates for the debts.

The tax administration should be strengthened in order to increase the efficiency of the enforced collection process. In connection with this, technological, economic and legal aspects of the enforced collection mechanism should be developed and introduced.

The improvement of management system at the tax authorities and bringing it in conformity with the principles of market economy is aimed at a proper transfer of receipts to the state budget in a timely manner through efficient use of human resources, raising the level of professionalism of the employees, and improving the relations with the taxpayers.

The improvement of evaluation system for the activities of structural divisions of the MOT is also planned. With the purpose of optimizing the tactical planning and decision-making capacity of the MOT, establishment of Management Information System (MIS) and its integration into the computer database will be ensured. The transparency of the existing procedures at the MOT will be increased and the activities of the internal security system will be reinforced with the purpose of detecting the risks of corruption and reinforcing the struggle with such cases.

The following should be done to train personnel in order to raise their level of professionalism:

- to increase the material and technical basis of the Training Center, introduce modern training conceptions and methods;
- to organize an on-line long distance training for both the MOT employees and taxpayers and develop necessary training appliances.

One of the main directions of improving the tax administration of the Azerbaijan Republic is the development of a computer information system meeting the modern requirements. The automation of all type of activities of the MOT and its regional offices within a single computer information system and replacing the direct contacts with taxpayers with non-contact ones are one of the main goals set forth in the State Program. In connection with this, in the coming years it is planned to establish a single electronic state registration of taxpayers and collection of all the necessary data on taxpayers. At the same time, electronic filing and processing of tax returns shall be considered as an important element of MOT strategic plan.

Collection of tax returns into the MOT computer database, tax payments checking, selection of taxpayers for desk and field audits, and conduction of audits will be automated.

In parallel with this, other directions of the MOT activities, including paperwork pipeline, personnel management and training, planning and measurement of individual and collective performance based on the key balanced criteria, different taxes revenue forecasting, which are important elements of management, will be automated and integrated into the single computer information system of the MOT.

### **Expected Results**

The following will be achieved as a result of modernization activities to be conducted during 2005-2007 under the "The State Program on Improvement of the Tax Administration of the Azerbaijan Republic":

- the level of voluntary compliance will increase;
- robust and improved taxpayer service will be achieved;
- the number of risks will be minimized;
- the impartiality and effectiveness of tax audits will increase;
- the increase of tax receipts will be ensured with low administrative costs;
- more realistic database will be developed for revenue forecasting;
- the preparatory works for the self tax declaration system for all the citizens will be completed;
- the protection of taxpayer rights will be reinforced;
- effective legal and economic mechanisms and technology will be applied with the purpose of early determination of tax arrears and ensuring of tax compliance ;
- tax returns will be received and processed electronically;
- non-contact relationships with taxpayers in terms of electronic filing tax returns and payment of taxes will be ensured;
- modern, robust and improved management system will be implemented with respect to managing human resources and activities of tax authorities;
- the standards of service etiquette will be ensured;
- mechanisms and procedures detecting corruption risks will be introduced.

**MEASURES to be taken under the State Program (2005-2007)  
on Improvement of Tax Administration of the Azerbaijan Republic**

No	Main Directions	Measure	Executive Body	Duration	
1	<b>Improvement of a system of voluntary tax payments and ensuring a reliable protection of taxpayer rights</b>	1	Establishment of a modern Call Center within the MOT	Ministry of Communication and Information Technology, Ministry of Taxes	2005-2006
		2	Establishment of computer terminals for taxpayers at the regional tax agencies	Ministry of Taxes	2005-2006
		3	Enabling taxpayers to get access to the computer database of the MOT through their own passwords and check their personal account sheets of liabilities & payments	Ministry of Taxes	2005-2006
		4	Teaching the "Tax Culture" courses in the secondary schools	Ministry of Education, Ministry of Taxes	2005-2007
		5	Establishment of specially equipped rooms at secondary schools for teaching issues concerning taxes	Ministry of Education, Ministry of Taxes	2005-2007
		6	Organization of meetings between taxpayers and MOT employees on a regular basis	Ministry of Taxes	2005-2007
		7	Organization of TV and radio broadcasts concerning the MOT activities and tax education issues	Ministry of Taxes, "Television and Radio Broadcasting" Joint Stock Company	2005-2007
		8	Improvement of the "Taxes" newspaper issued and the web-site launched by the MOT	Ministry of Taxes	2005-2007
		9	Study & application of modern international experience in the field of taxpayer service	Ministry of Taxes	2005-2007
		10	Development of an organizational and normative legal base for rendering private tax consulting services to small business	Ministry of Taxes, Ministry of Economic Development	2006-2007
		11	Development of curriculum for private tax practitioners on tax issues and conducting special training courses at the MOT Training Center	Ministry of Taxes	2006-2007
		12	Allowing taxpayers to file a complaint to the superior tax body (official) through the official web-site of the MOT	Ministry of Taxes	2006
		13	Developing proposals regarding establishment of a more advanced appeal system for taxpayers	Ministry of Taxes, Ministry of Justice	2006-2007
		14	Study of international experience regarding tax amnesty with respect	Ministry of Taxes, Ministry of	2006

			to property legalization and developing proposals	Justice	
		15	Study of international experience on management, technical support and software supply in order to shift to self declaration system for all citizens of the country and evaluation of required human, technical and financial resources	Ministry of Taxes, Ministry of Finance, Ministry of Justice, Ministry of Communication and Information Technology	2006
		16	Developing a draft of the State Program on transfer to self declaration system for all citizens of the country	Ministry of Taxes, Ministry of Finance	2007
2	<b>Reinforcing the struggle against tax fraud and tax evasions, strengthening the tax administration as an low risks system</b>	1	Improving the registration system of VAT payers	Ministry of Taxes, Ministry of Finance	2005-2006
		2	Actions to be taken to detect those who are inclined to evasions before registration: - developing diagnostic criteria regarding suspicious economic transactions, tax fraud and evasion features; - development of a computer database between the MOT and third parties and integration thereof into the MOT database; - simplification of information exchange between the MOT and third party based on the appropriate criteria	Ministry of Taxes, Ministry of Finance, State Customs Committee, National Bank, Ministry of Interior, Ministry of Transportaion, Ministry of Justice, State Statistics Committee	2006
		3	Development of proposals regarding application of financial sanctions for violation of tax legislation with respect to VAT	Cabinet of Ministers, Ministry of Justice, Ministry of Finance, Ministry of Taxes	2005
		4	Improvement of legal and economic analytic database for audit planning under the MOT and integration of this database into the MOT database	Ministry of Taxes	2005-2006
		5	Automation of taxpayer selection process for field inspection purposes in order to increase the efficiency of field tax audits and eliminate subjectivity of the process of selection process	Ministry of Taxes	2005-2006
		6	Ensuring impartiality of on-site tax audits through evaluation of their effectiveness based on the key performance balanced criteria	Ministry of Taxes	2005
3	<b>Improvement of enforced collection system and prevention of</b>	1	Grouping tax debts according to maturity within the MOT database and automation of notifications to non-complying taxpayers	Ministry of Taxes	2006-2007
		2	Prevent increase of tax arrears through improvement of VAT registration process	Ministry of Taxes	2005-2007
		3	Development of proposals regarding new interests rates accrued for	Ministry of Taxes	2006-

	<b>occurrence of tax arrears</b>		unpaid debts balances		2007
4	<b>Meeting the MOT management system to international standards</b>	1	Implementing a performance measurement system for all kinds of activities of structural divisions of the MOT and local tax offices	Ministry of Taxes	2005-2006
		2	Reinforcement of Management Information System (MIS) for optimizing the tactical planning and decision-making capacity of the MOT	Ministry of Taxes	2005-2006
		3	Improving procedures related to the MOT activities and reinforcement of internal security system in order to detect corruption risks and prevent them	Ministry of Taxes	2006-2007
		4	Implementing individual performance measurement system for the MOT employees	Ministry of Taxes	2006-2007
		5	Improving the skills and knowledge of the MOT managers in business planning, monitoring and performance measurement of activity of interest	Ministry of Taxes	2005-2006
		6	Establishing a human resources management computer database system for the MOT employees	Ministry of Taxes	2005-2007
		7	Creating a system of material incentive and awarding the MOT employees based on the results achieved	Ministry of Taxes	2005-2007
		8	Introduction of modern training conceptions and methods and increasing the material and technical basis of the MOT Training Center	Ministry of Taxes	2005-2007
		9	Organization of a long distance computer training for both the MOT employees and taxpayers and develop necessary training materials and software	Ministry of Taxes	2005-2007
5	<b>Development of a computer database system that meets the modern requirements</b>	1	Development of software for all necessary sub-systems of the MOT computer information system and application thereof	Ministry of Taxes	2005-2006
		2	Meeting the management and administrative processes to those of technological ones at all structural divisions of the MOT	Ministry of Taxes	2005-2006
		3	Creating a single electronic registration system for taxpayers	Ministry of Taxes	2005-2006
		4	Ensuring transfer to electronic filing tax returns	Ministry of Taxes	2006-2007
		5	Exchange of electronic data registries regarding payment documents among taxpayers, tax agencies, banks and treasury	Ministry of Taxes	2006-2007