

New challenges facing the tax service – towards reforms, changes, and transformation

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Introduction

As a result of successful and wise economic policy, economy of Azerbaijan has seen a fast growth in recent years and gained economic diversification by virtue of effective allocation of oil revenues together with enormous achievements obtained in the non-oil sector. By turning into a rapidly developing country, Azerbaijan is recognized as a country with high growth rates, both regionally and globally.

More recently, the world economy has encountered stagnation, subdued economic growth, and decreasing demand due to global transformations and current socio-economic situation. In such a sensitive period of time, in the context of globalization that challenges national economies, we witness more and more political and economic factors influencing economic development. We should admit that despite the economic growth rate, the crisis and its consequences, to some extent, have adverse effects on all the countries.

Azerbaijan has always reacted to economic challenges immediately, therefore, over the last years, implications of such global crises have been successfully minimized as a result of preventive socio-economic policy.

The measures for generating alternative sources of income from non-oil sector by investing the oil revenues, involving foreign investments, and creating more favourable conditions for business have contributed to development of sustainable national economy able to withstand long-term impacts of various crises. All these steps have led to a rising international ranking of the country within a short period of time. **According to 2016 Global Competitiveness Report by the World Economic Forum, Azerbaijan ranked 37th (1st among CIS countries) among 138 countries.** “Doing Business 2017” Report by World Bank, which assesses the business climate in 190 countries, ranked Azerbaijan 65th. Simplification of business registration allowed Azerbaijan to be among the world’s top five countries as per the “starting a business” indicator and become recognized as a country with the best experience.

New model of economic growth – road maps of national economy

New global economic order and significant drop in international oil prices in the world energy market have negatively affected all oil-exporting countries, including Azerbaijan. Taking that into account, President of the Republic of Azerbaijan Ilham Aliyev assigned certain new tasks to the government. These tasks include: building a new model of economic development, implementing advanced, sustainable, and consistent reforms to restructure and foster the liberalization of the economy, increasing competitiveness, reducing the dependence on import, improving export-oriented non-oil sector, and using the human resources in a more effective manner. Accordingly, the need for advanced economic strategy, and implementation of relevant institutional and conceptual reforms has emerged as a serious concern.

One of the important steps towards resolving the issues facing our country and obtaining sustainable growth in the new period of development was a Decree on “**Main directions of strategic road map on national economy and major sectors of economy**” signed by the President Ilham Aliyev. This map, as well as approved strategic roadmaps on 11 leading sectors of the economy, being a fundamental document for

defining short-term development goals and priorities in Azerbaijan, form the backbone of new national economic model. The strategic road maps reflect economic development strategy and the action plan for 2016-2020, long-term vision by 2025, and the targeted vision for post-2015 timespan. Based on an in-depth analysis of current economic situation, these documents outline the development tendencies of different sectors, enhancement of economic competitiveness, encouragement of investments, competitive environment, access to global markets, human capital development, as well as strengthening Azerbaijan's position and the image of a reliable partner in the world economy.

Economic priorities of Azerbaijan in the rise of new challenges, the ways of applying these priorities, including the key issues intended for 2017 are extensively interpreted in the article by Mr President Ilham Aliyev published on the website of the Davos Forum. Enhancement of diversification of non-oil sector, recovery of financial system, and promotion of population's income and employment rates are among primary national goals defined for the new era. Currently, structural and institutional reforms are underway in the country; the government, in order to strengthen the economic potential, expands national transit and logistics, strongly supports production of exportable products, establishment of agricultural parks and large farms, industrial parks and zones. Similarly, the public administration system is being improved, as well as the transparency ensured in all the spheres, including tax and customs.

Toward a Tax System Open to Challenges and Changes

The national tax authority functioning as a vital state institution in supporting the reforms, always reacts to economic changes in a prompt and adequate manner. Notwithstanding substantial achievements of the tax system in improving tax legislation and administration, as well as institutional capacity in recent years, new trends in national economy and the need for building a knowledge-based modern economy has set a new agenda for tax authorities. To this end, enhancement of regulatory role of tax policy, creation of affordable, transparent, and attractive tax environment, upgrading the tax administration, improvement of services for entrepreneurs and establishment of

modern corporate governance system which are considered significant factors in economic policy, as well as effective tools in regulating the business activity come first.

Year of intensive reforms

Commencement of a new era in the economy made the fundamental reforms in the tax system inevitable, in 2016. The roadmap on "Main directions of the strategic roadmap on national economy and major sectors of economy", as well as "Strategic Road Map on production of consumer goods in Azerbaijan at the level of small and medium enterprises" outline important tasks encountered by the tax system in the new era. These are increasing the mutual trust between taxpayers and tax authorities, boosting the transparency, creating favourable conditions for entrepreneurs, continuing the reforms of tax system in order to determine real potential of tax in conformity with the country's economic growth, focusing on effects of tax incentives, and improving the tax administration. "Directions of Tax Reforms in 2016" approved by the Presidential Decree on the 4th of August 2016 has outlined the actions carried out last year. We can list the "Risk management" system which is successfully applied to identify tax risks and uncover the tax evasion. Likewise, increasing scope of e-audit for large taxpayers, expansion of e-services provided to taxpayers, and regulations on all forms of tax inspections have also been improved. Launch of the "Tax Free" system opened the gate for considerable tourist influx into the country. **In 2016, OECD Global Forum on Transparency and Exchange of Information for Tax Purposes rated Azerbaijan as largely compliant which means the transparency and exchange of tax information meet the international standards to a great extent.** Moreover, the preparatory work on individual and fast innovative technology-based services for disciplined taxpayers based on "Green corridor" principle has been completed. All the aforesaid served to increase transparency of the tax system and develop a new stage of relationship between tax authorities and businesses.

Liberalization of tax legislation

At the end of 2016, in a short period of time, after close and constructive dialogue with international organizations, financial institutions, public associations of entrepreneurs, and business representatives, the Tax Code and relevant legal

documents were seriously and considerably changed in terms of both, the scale and concept. Primary goals of these amendments are to create more favourable conditions for the development of SMEs, increase mutual trust between tax authorities and business entities, optimize tax burden, protect taxpayers' rights, facilitate implementation of tax obligations, prevent the time loss, provide the social equity by defining the tax benefits for some taxpayers, stimulate non-cash operations, extend tax base, regulate money circulation, encourage investment in the economy by rising banks' liquidity and attractiveness of tax climate, stimulate the exports, and ensure accuracy and transparency of accounting.

Further, a number of provisions have been added to the Tax Code based on the best international practices. They comprise advance tax ruling, system of "voluntary tax disclosure" that protect taxpayers' rights, application of transfer pricing oversight and CFC rules, development of digital economy, and particularly the tax mechanisms on e-commerce. Establishment of tax procedures on e-commerce is among the complex problems encountered by tax administrations worldwide. Azerbaijan has studied the practices of various countries, particularly the EU member states for establishing a tax mechanism in related field, thus the most effective and specific settlement of this issue among the CIS countries is applied in tax legislation of the Republic of Azerbaijan.

Obviously, the amendments made to respective legislation define multi-sided targets which, in its turn, also necessitate tax authorities' compliance with modern management requirements. In recent years, large-scale projects have been performed for improving the tax legislation and tax administration. New targets require formation of a dynamic administration which is more flexible, adaptable to new requirements, capable to immediately and adequately balance its duties with the challenges of time, and rests upon the principles of modern corporate governance.

The top management of the tax administration has taken practical steps for the implementation of these targets. Thus, the Ministry of Taxes has established Administration Centre in order to coordinate the reforms for improving both, the legislation and tax administration. At present, this Centre executes intensive work to

ensure flexible and rapid implementation of tasks specified in the Action Plan adopted by the Supreme boards held in the Ministry of Taxes.

Transformation into a taxpayer-oriented administration

Logical continuation of reforms in the tax system makes improvement of administration and transformation of organizational structure inevitable.

The Ministry of Taxes being a vibrant and dynamic organization built up its administrative resources and organizational structure flexible to a rapid changing economic environment, whilst conducting reforms in tax administration and management as necessary. However, recent changes in national tax administration are more extensive, both in terms of essence and coverage. Following the reforms of 2002 in realization of tax management on the basis of regional principles at the initiative of nationwide leader Heydar Aliyev, it is the second such fundamental and conceptual transformation aiming to change whole management spheres of tax service and envisages transformation of national tax service into a taxpayer-oriented administration.

A new perspective on the tax system, is first of all, based on two main principles. The first and foremost is "**individual approach**" principle. Until now, the tax service has mainly focused on taxpayers with the largest turnover and all taxpayers (large, medium and small) have been subjected to the same administrative mechanisms, regardless of their turnovers. The primary task of the tax administration in the new period is to shift this approach and shape relevant approaches per taxpayer category. To this end, by using the **principle of "turnover intervals", which is widely applicable in international practice**, it is considered to differentiate the approach with respect to taxpayers in all areas of tax administration and shape a more efficient, flexible, and transparent administration. The key objective of this approach is to separate working principles concerning SMEs, large enterprises and those with special regime, provide an individual approach to each business group, and ensure proper distribution of fiscal and administrative burdens.

The second important principle is "**building and deepening the partnership with business entities**". Although Ministry of Taxes has embarked on building partnership

bonds with business entities for several years now, the new approach stipulates the transformation of these relations into what will focus more on clarification of taxpayer obligations and delivering innovative and modern services to them. Due to international practices, it was decided to introduce an innovative system of targeted individual and rapid services based on "Green corridor" for disciplined taxpayers.

Transformation of the organizational structure

Consequently these major principles were adopted as the basis for building a new organizational structure of tax authorities and reconstruction of the Ministry of Taxes in line with modern requirements.

As an important element of organizational structure, the Department of Taxpayer Service and Transparent Tax Partnership has been established at the Ministry's central office. Immediate functions of the Department include the work with taxpayers on the grounds of constructive dialogue, mutual trust, and partnership, information sharing, delivery of individual trainings for taxpayers, extensive structural and administrative measures for these purposes, thus finally achieving a progressive tax culture and awareness among society and taxpayers.

It should be noted that as of January, this new structure ensures organizational and administrative control over the provision of individual and prompt targeted services to disciplined taxpayers within traditional and innovative methods of "Green corridor" principle. In addition to traditional services, such taxpayers receive latest ICT-based innovative services. These services include video calls, delivery of time-effective service to partner taxpayers at Call and Service centres, round tables at partner taxpayer's request, seminars and conferences, preparation of workshops and so forth. For the purpose of organizing coordination activities, each partner taxpayer has been assigned a supervisor by associated tax structure. The supervisors provide targeted services to partner taxpayers at their request. All of the abovementioned stimulates disciplined taxpayers and convenient operation of entrepreneurs. It also stands as a model for other taxpayers and definitely will incentivise them by demonstrating the advantages of a disciplined taxpayer.

The Risk Management Department has been established to analyse the taxpayers' activities across risk modules, identify cases of tax evasion based on modern technology, select the methods of tax inspection based on the analysed data, assess tax potential more accurately, implement risk management mechanism through the use of advanced means of ICT, as well as to ensure the processing of data received from integrated e-databases of numerous state agencies.

As a result of further changes carried out within the Ministry, Monitoring Execution of Tax Legislation Department and Monitoring Tax Liabilities Department have been established to coordinate the activities of tax authorities under fiscal functions and improve the managerial functions, including increasing the efficiency in the field of tax control, audit, and collection of tax debts.

Also, two new Centres have been created in the Ministry of Taxes. The Information Technology Centre of the Ministry of Taxes deals with ensuring more widespread use of IT within the tax system, effective implementation of ICT strategy of the Ministry and providing unified management in the respective field. The main duties of the Centre include supporting analytical activities, achieving creation of accurate HQ information of in the field of tax control and strengthening analytical capacity by ensuring data processing, as well as contributing to improvement of tax administration through building modern IT infrastructure.

The Media and Communications Centre has been set up for providing the taxpayers and all other groups of society with relevant information on a regular basis, properly communicating the tax reforms and changes to tax legislation through the use of social networks, shaping innovative approaches and uniform communication policy in the relevant sphere, reorganizing and expanding the scope of work with the media on different platforms and social aspects.

Restructuring took place not only in the capital but also in the regions. Consequently, on the basis of functioning capital tax departments, the National Revenues Department, Baku Local Revenues Department, and Small Entrepreneurs Department were established under the Ministry of Taxes. Establishment of these Departments namely rests upon the principle of "turnover intervals" and is used to differentiate working

approaches with taxpayers, and engage with SMEs and large businesses on the basis of individual approach. All necessary legal grounds regarding operating principles and conducts with taxpayers had been approved.

Another important aspect of realized structural and personnel reforms is establishment of the institute of directors and chief directors in newly set up departments. By increasing the liability and accountability in performing the activities and functions, the institute of directors will allow effective implementation of horizontal and vertical control in administration, as well as enable more efficient, accurate, and rational management of newly established Departments.

Best international practices give rise to new approaches

The restructured tax administration contributes to performing more quality work for large taxpayers, establishing partnership-based relations with medium-sized businesses, and taking more simplified and efficient approach in dealing with tax matters of small businesses. Application of “principle of individual approach” to taxpayers from different sectors with different turnover enables to render more efficient service to such taxpayers, minimize tax control measures, and fulfil taxpayer-related activities by a single tax authority, through “one stop shop”.

- When treating large companies and special regime taxpayers, the Ministry of Taxes will pursue a policy that builds upon extensive analysis and risk assessment. Overarching priority will be given to assessment of available risks and introduction of e-audit. Risks of tax evasion by such taxpayers will be assessed on individual and thorough basis, predictions will be made through economic analysis, whereas tax control measures, including field tax inspections will be carried out more comprehensively.
- Middle-income local businesses and disciplined taxpayers will be communicated under the principle of transparent partnership. The cases of tax evasion will be identified in consideration of features related to the field of activity and such taxpayers will be subjected to optimum measures of tax control.

- Totally new approaches will be applied with respect to small businesses. As prescribed in the “Strategic Roadmap on production of consumer goods in Azerbaijan at the level of small and medium-sized enterprises”, in order to improve the business climate in Azerbaijan, the main focus will be put on small and medium enterprises (SMEs) during the tax reforms. The Ministry of Taxes will determine optimum tax rates and carry out consultations with business associations and public organizations for supporting dynamic development of SMEs, and the tax policy will cover the issues of wages, as well as incentivise SMEs to legalize their turnover. As regards small businesses, all communication will be established on the feedback principle, targeting increase in the level of voluntary compliance by raising efficiency in data transmission, accountability and range of services, as well as reducing tax and administrative burdens on businesses.

The Ministry of Taxes will make changes to reporting and submission systems of tax returns, thus tax return and statement forms intended for SMEs will be simplified. **One of the key objectives before the tax authorities, nowadays, is to give comprehensive support to low-risk taxpayers and minimize tax risks under the partnership agreements;** hence the reporting by large companies and special regime taxpayers will be improved in the manner allowing due analysis.

This very approach has been applied at local tax authorities, therefore separate departments dealing with small businesses, as well as taxpayer service and transparent partnership units have also been established at local tax authorities.

Major concerns of entrepreneurs, such as tax inspections, especially the off-site tax inspections, problems related to prompt control measures, including incessant calls by tax officials, frequent restrictions on bank accounts and etc. have been eliminated. It is worth mentioning, that new administrative approach monitors the impracticability of inspection in the absence of tax authorities’ analysis and due justification. Risk assessment system will automatically process, analyse and group taxpayers based on risk criteria, whereas tax liabilities and tax capacity will be assessed according to risk modules. Overall, local authorities will not implement measures of tax control on their

own decisions. Restrictions on low-risk taxpayers' accounts and limitations on leaving the country will be lessened, whereas inspections at SMEs will be developed; first and foremost, use of ratio-based inspections at SMEs will be extended; number of inspections will be optimized; quantity of on-site inspections at SMEs will diminish; the method of electronic inspections will apply; as well as real-time tax control will improve and gain efficiency under new regulations. It should be noted that innovative technologies in the field of ICT accelerated the VAT refund process per se. The performance of the Call Centre of the Ministry of Tax which has been functioning as of 2011 under approved European standards (certified by "Austrian Standards plus") will be further improved, whereas all responses provided by the Call Centre are legally binding.

All these changes, in accordance with current structuring of the economy, serve to focusing basic fiscal burden on large taxpayers, and further stimulating the performance of SMEs by reducing tax and administrative burdens in the near future. Sustainability of tax reforms will further increase competitiveness of the SMEs, in particular, positively impact permanence of newly-built enterprises, stimulate opening of representative offices of foreign companies, and create more favourable conditions for investments in the non-oil sector.

Thus, as stated in Mr President's article published on the website of the Davos Forum, serious steps have been taken towards ensuring greater transparency in tax and customs system. Indeed, both the state and tax authorities are confident that all the innovations will be accordingly accepted by taxpayers, who, in turn, will responsibly fulfil their tax compliance on time and in full. As the transparency is built on bilateral basis; we expect the entrepreneurs to act transparently as well. Tax authorities are constantly expanding their technological capabilities to carry out fiscal functions. Thus we strongly believe that entrepreneurs will properly assess reduction of tax burden and control measures, simplification of accountability, and potential contribution of reforms to the national economic development.

Knowledge management-based human resources

Alongside the above, Ministry of Taxes will carry on reforms aimed at successful implementation of its functions, build technological and administrative capacity for effective execution of such functions, as well as increase the role of knowledge management and technology in present-day tax administration. Currently, introduction of a knowledge management in various areas of tax administration by using the latest achievements of information and communication technologies is essential in terms of effectiveness of the tax system in any country. Knowledge management generates new opportunities for assessing and managing the risks threatening the taxpayers and tax authorities.

The knowledge management is the most advanced field that enables transformation of assets into → values → information → data → knowledge and skills, hence allowing an effective decision-making process. As a result of introduction of innovations and IT-based knowledge management, intellectual and technological capital of agency goes up, skills and knowledge, corporate culture, activities of the structures and technologies efficiently co-act, which, in its turn, leads to mitigation of risks. Therefore, compliance with tax obligations becomes more affordable.

The Ministry of Taxes greatly values improving qualification of its HR through high-level training sessions. Skilled and analytically capable staff members, being the major driving force for reaching targets and goals, will remain a main focus in the national tax system for 2017.

With the goal of HR capital investment and further capacity building, Twinning project on **"Support to Ministry of Taxes of the Republic of Azerbaijan in the field of investing in HR capital"** in the framework of Neighbourhood Policy of the European Union has been successfully fulfilled. With our Spanish and French colleagues, we have organized forward-looking manager groups who play an important role in realization of the new tax policy.

Certification programs further improve qualification of tax officers, with programs consisting of training sessions and tests for obtaining certificates that serve as an incentive for continuous improvement of tax officials' skills and knowledge. These will

be considered as primary requirements in appointing the staff to vacant positions and promoting them in the years to come.

The Training Centre of the Ministry of Taxes plays an important role in improving the qualification of the HR. According to the Memorandum of Understanding signed with the International Anti-Corruption Academy, the Training Centre of the Ministry of Taxes, being the regional centre for fighting corruption, organizes several improvement courses for hundreds of tax officials for acquiring new skills and expertise.

Additionally, I would like to touch upon our relations with the Intra-European Organization of Tax Administrations (IOTA). As a full-fledged member of the organization since 2002 whilst its sequentially elected Executive Council and Strategic group member, Azerbaijan has always attached a great importance to deepening ties with IOTA, studying progressive practices of tax administrations of member countries and their application in national tax system. At the moment, we learn the best practices of member countries' tax administrations and their application for training purposes, as well as e-learning processes. Training of tax officers is part of our priority activities identified for 2017. European countries apply specific long-term programs designed to raise taxpayers' awareness and achieve compliance through education programs. Ministry of Taxes of Azerbaijan that has set a goal of studying the practice of developed countries and using the latest innovations in the field of e-learning, places enormous emphasis on existing productive and constructive cooperation with IOTA.

To conclude, I am absolutely confident that on-going fundamental reforms in tax services, liberalization of tax legislation, measures for making tax climate more attractive, considerable reduction in tax burden, formation of information technologies and knowledge management-based tax administration, as well as the new tax management system that meets economic demands will considerably contribute to growth of the national economy, development of the entrepreneurship, as well as effective cooperation between businesses and tax authorities for the sake of national progress.