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FINAL REPORT

REGULATORY IMPACT ASSESSMENT

TAX PAYMENT SIMPLIFICATION

FINAL

Friday, September 12, 2014

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TAX PAYMENT SIMPLIFICATION

Final

USAID ECONOMIC PROSPERITY INITIATIVE (EPI)

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I. EXECUTIVE SUMMARY

The complexity of the treasury code and tax payment system of Georgia has been recognized as highly bureaucratic, time-consuming, and costly, creating the basis for errors and mistakes that adversely affect tax compliance and contribute to administrative and enforcement costs. The Revenue Service (RS) has to sort through excessive number of non-compliance cases and, unless one is willing to punish honest taxpayers, the RS must invest significant resources on distinguishing between mischief and error. Beyond the direct costs of noncompliance that can be measured quantitatively (e.g., time and revenue losses), these complexities have created a tremendous source of frustration for Georgia taxpayers. Furthermore, they reduce the system's transparency and undermine the trust in its fair application.

While direct costs have been recognized as important, these complexities have also impeded opportunities for successful tax planning and analysis for the government, which results in an uncoordinated, ineffective, and inefficient allocation of resources. Moreover, they create distortions and confusion amongst taxpayers, and enforcement becomes increasingly more difficult, more costly, and less successful.

The objective of the proposed regulation encompasses an overall simplification and reengineering of the current tax system, designed to achieve clear, streamlined, fair, and efficient operations within the RS. The forecast results for the RS include improved taxpayer compliance, higher revenues, and sufficient and timely internal operations.

The technical team's analysis demonstrates clear and measurable costs and benefits that the Georgian government can use to compare the given options. Specifically, the team analyzed two options of possible action, and the related potential opportunities and requirements:

- Option 1: Doing nothing. This option covers "as-Is" state of current regulation, and outlines the challenges related to present legislation and practices.

- Option 2: Analyzes the introduction of a single treasury code payment process for taxpayers, with an emphasis on the potential benefits and costs related to the reform.

As demonstrated in the following table, the PV (present value) of Option 1 is assumed to be zero, and the PV for Option 2 is estimated at GEL 27,880,923 based upon a 10-year time horizon and 7% long-term discount rate.

Table 1 – PV and NPV Calculation for RIA Options

	OPTION 1	OPTION 2
Benefits (PV)	0	GEL 28,638,296
Costs (PV)	0	GEL 757,372
Benefits - costs (NPV)	**0**	**GEL 27,880,923**

Table 2 – List of Annual Costs Related to RIA Options

	OPTION 1 (ANNUAL)	OPTION 2 (ANNUAL)
Salaries and bonuses of IT specialists	0	GEL 33,600
Salaries and bonuses of other stakeholder Departments	0	GEL 33,600
Maintenance cost of the IT system	0	GEL 33,600
System Development Consulting Services (Year 1 only)	0	GEL 52,853

Table 3 – List of Annual Benefits Related to RIA Options

	OPTION 1 (Annual)	OPTION 2 (Annual)
Reduced Hours of manual work of RS officers (working on Tax Record Cards)	0	11,200 hours
Reduced Number of transactions for shifting paid funds from one treasury code to another (by RS)	0	5 098 transactions
Reduced Cost of transactions for the taxpayers for shifting funds from one treasury code to another	0	GEL 50-1,000 per transaction. Equal to GEL 2,549,000
Reduced Number of Income Tax transactions conducted by the taxpayers	0	588 transactions
Reduced Cost of Income Tax transactions for the taxpayers	0	Reduced by GEL 414 to GEL 6 (on average)
Correct Allocation of funds among state and local budgets	GEL2,309,272[1]	GEL 12 809 272[2]
Reduced VAT Refund Time	0	156 days
Efficiently Imposed Funds	0	GEL 300 million
No Reverse Charge VAT	0	GEL 948 050

The analysis above was derived from a review of the practices of a representative size and segment-based cross-section of companies (taxpayers), as well as from consultations with government officials and stakeholders that generally represent the consensus opinion for an effective and efficiently managed process when the new treasury system will be introduced.

[1] 2013 figure
[2] Calculated as 2 309 272 GEL + 10 500 000 GEL. GEL 10,5 is annual average of lost revenue for the local budgets accumulated in 2005-2013.

II. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

A. ORGANISATION AND TIMING

In March 2014, the USAID Economic Prosperity Initiative (EPI) selected Policy and Management Consulting Group to conduct a Pilot RIA on the Tax Payment Simplification Reform proposed by Ministry of Finance of Georgia (MoF). The work on the RIA began in early April with preliminary meetings aimed at developing the RIA action plan, deadline, and meetings schedule. The team met weekly to discuss the progress of the project. Additionally, there have been exchanges of documents and comments by e-mail. The team worked according to the RIA action plan developed at the beginning of the project, which was submitted on the April 23. The final report template was developed by April 30, and the team conducted the following activities from April 15 to June 13:

- Collect data and organize meetings with relevant stakeholders;
- Define the problem and objectives;
- Measure the impact of the regulatory proposal;
- Perform a cost-benefit analysis.

The project team included representatives from the Analytical Department of the MoF, policy analysts from PMCG, and an EPI representative.

B. CONSULTATION AND EXPERTISE

By 10 May, consultation was conducted with:

- Mr. Irakli Siradze, Tax Expert and EPI consultant, one of the authors of the regulatory proposal;
- Mr. Vazha Petriashvili, Advisor to the Head of the RS
- IT Specialists of the RS

The goals of the consultations were to develop a comprehensive description of the current situation, to define the problem, and to analyze the impact on various stakeholders.

On May 23, PMCG organized focus group involving various stakeholders. Large companies and SMEs were invited to participate to study the potential impact of the reform on each type of business.

The purpose of the focus group discussions was to:

- Assess the opinion of relevant stakeholders about the current situation;
- Analyze the status quo;
- Analyze the potential impact of the proposed regulation.

The following participants took part in the focus group:

- Mr. Levan Dgebuadze – Deputy Head of the Service Department of the RS
- Mr. Tengiz Gvelesiani – Head of the Analytical Department of Ministry of Finance
- Mr. Merab Narmania – Advisor to the Analytical Department of Ministry of Finance
- Ms. Thea Goginashvili – Advisor to the Analytical Department of Ministry of Finance
- Representatives of private companies (e.g., Nikora JSC (retail trade – grocery), Rakia Georgia (Free Industrial Zone), TBC Bank (commercial banking), and Financial Management Group (consulting /audit and business services).

The public consultation process was limited because of the time constraints for preparing a pilot Regulatory Impact Analysis.

Table 4 - Summary of Stakeholder Consultations

STAKEHOLDER	METHOD OF CONSULTATION	SUMMARY OF RESPONSES	COMMENT
Mr. Irakli Siradze (Tax Expert)	Interview	• Current situation and problems associated with tax payments in Georgia • Objectives of government intervention • Impact of regulatory proposal • Groups of society affected by regulatory proposal	• Responses were incorporated into the analysis
Mr. Vazha Petriashvili (RS)	Interview	• Potential impact on taxpayers • Simplification of VAT Refund process • Impact on commercial banks • Correct allocation of state and local revenues	• Responses were incorporated into the analysis

IT Specialists (RS)	Interview	• Work already done by IT department • Simplification of tax administration for the RS	• Responses were incorporated into the analysis
Large businesses and SMEs	Focus Group	• Average time to complete tax payment • Reduction of number of monthly transactions for Income Tax • Changes in number of transactions for banks • Changes in bank's internal IT system	• Responses were incorporated into the analysis

III. PROBLEM DEFINITION

A. POLICY CONTEXT

One of the primary goals of the RS is to collect taxes and duties in accordance with the acting laws and regulations, in due time, and to accomplish this in a way that will sustain confidence and a perception of fairness among stakeholders. The actions of taxpayers, whether due to ignorance, carelessness, recklessness, or deliberate evasion — in addition to weaknesses in a tax administration – mean that instances of failure to comply with the law are inevitable.

For this purpose, revenue administrations are appropriated a finite level of resources, which requires careful decisions as to how and in what ways those resources are to be allocated to achieve the best possible outcome in terms of improved compliance.

A numbers of factors influence the diversity of taxpayers' compliance behaviors (e.g., a lack of knowledge concerning the nature and types of responsibilities, complexity of tax affairs, vague regulations, burdensome procedures, etc.). As such, the RS requires a systematic process for identifying and implementing approaches and tools to ensure smooth, timely and adequate compliance among the taxpayers.

In this respect, revenue administrations around the world play a key role in ensuring that taxpayers clearly and precisely understand their obligations under revenue laws.

Even though the exact obligations imposed on taxpayers vary from one tax liability to another and from one jurisdiction to the next, there is one obligation that applies to all taxpayers: the obligation to pay tax liabilities correctly and on time. If taxpayers fail to meet this responsibility, then they are considered non-compliant. However, there are clearly various degrees of non-compliance. For example, non-compliance may be due to unintentional error as well as intentional fraud and might include an overpayment of tax. Additionally, a taxpayer may technically meet their obligations, but compliance may be in question due to interpretational differences of the law. The reasons causing these violations as well as possible solutions to the above-mentioned challenges are discussed further in the report.

According to Georgia tax legislation, taxpayers pay taxes and duties, identifying specific treasury codes for each liability (e.g., VAT, Income tax). There are 164 treasury codes; each code identifies a specific type of tax liability, beneficiaries, region, etc. Taxpayers are expected to provide a specific treasury code in a payment document for each tax liability to fulfill their payment and to proceed with covering liabilities at the RS.

The extensive number of treasury codes tempts taxpayers to mistakenly transfer payable funds to the wrong account, which causes a number of complications for taxpayers and for tax authorities, such as uncovered tax liabilities, unclear tax statistical data, etc. (details are provided in the Problem Definition section of the report).

The RS has analyzed the extent and scope of the setback of the existing system and has initiated a change to simplify and streamline the acting payment process for taxpayers. The initiative includes a change within the internal IT system of tax administration, which encompasses uniting 164 treasury codes into a single treasury code. According to the initiative, taxpayers will be obliged to provide only one treasury code in payment documents for all taxes and duties. The IT software at the RS will then allocate the transferred payments automatically to specific accounts (according to the taxpayers' specific liabilities) with no manual intervention in the process. Information about liabilities and specific tax accounts will be selected by the software according to declarations filed by the taxpayers.

The RS has already developed the software internally and has tested it among potential stakeholders in a pilot project. All required changes identified during the pilot project have been updated and incorporated into the system.

Finally, the RS's Legal Department has already drafted the legislative amendments required to launch the new system, and the RS is ready for further implementation.

B. PROBLEM DEFINITION

The complicated, non-transparent tax payment system is leading to mistakes, additional costs, and other undesirable consequences (e.g., penalties, incorrect allocation of tax revenues among local and central budgets):

1. Due to an extensive number of treasury codes, taxpayers frequently provide wrong treasury codes in the payment document, which causes a number of complications for taxpayers and the tax administration. Mistakenly transferred payments cause **inaccurate data about tax liabilities, tax compliance, statistics, and macro-economic analysis**. According to the existing system, taxpayers have an opportunity to transfer payments to a specific liability account of their own choice in spite of the fact that they may be facing a specific liability (i.e., account payable) to cover a specific tax. Taxpayers liabilities are recognized as covered as long as there is no negative balance on the personal record card (taxpayers' accounts) at the RS. For example, in frequent cases, taxpayers tend to choose transferring payments to the VAT account (on the VAT treasury code) as an overpaid VAT account exempts taxpayers from paying property tax. Ultimately, tax authorities have inaccurate and misleading figures for further analysis.

   Access to sufficient, accurate, and timely data is vital to the RS's ability to successfully administer the taxation system. In order to avoid an erroneous analysis, the assessment must be as accurate as possible, and any available data should be cleansed as close to its source as possible. This ensures that different users of the data are not led to misinterpreted or mistaken results.

2. **Inaccurate allocation of state and local budgets**: According to Georgia's tax legislation, a taxpayer is exempt from Property Tax (this is a type of tax for local budgets) in case of overpaid VAT on the taxpayer's account. In most of these cases, taxpayers do not pay any property taxes, as their liabilities are recognized as covered when overpaid VAT is in place. Therefore, local (and regional) budgets do not receive the tax payments and are left without potential income. According to the data provided by the RS, a total of GEL 95 million accumulated from 2005 to 2013, which was mistakenly distributed to the central budget instead of local budgets.

3. **Additional Service Fees faced by the taxpayers**: For mistakenly transferred payments, taxpayers have to pay GEL 50-1,000 for each transaction to shift paid liabilities from one liability account to another. Shifting payments from one tax account to another is done manually by RS officers. A taxpayer first submits an application to the RS requesting amendments between the accounts, with required documents attached. RS officers then begin the process by studying and shifting requested funds from one tax record card to another manually, which may take up to 3-4 days. However, as practices have shown, the provided documents are frequently insufficient and require additional clarifications and information. RS officers assist companies with accumulating the required documents; nonetheless, these barriers prolong this preliminary stage by up to 10-15 days. Consequently, the total time to complete the operation may be up to 20 days.

4. **Disputed liabilities** are not separated from current liabilities (i.e., recognized liabilities of the taxpayer). Taxpayers' record cards currently show the overall, united liabilities of the taxpayer and includes liabilities (e.g., accounts payables to the tax authority) which may be going through the appeal system and thus are not yet recognized as "debt" to the RS. The system does not enable the tax authority to separate the amounts of disputed liabilities on each taxpayer's record card. In this case, the RS continues imposing taxes on the Taxpayer's record card in spite of the fact that the liabilities could have been finally recognized as covered due to the appeal process. According to the data provided by the Audit Department of the RS, a total of GEL 300 million was imposed on the taxpayers' accounts in 2013 before final resolution of disputes. Additionally, the inability to differentiate between recognized and disputed liabilities within a tax record card forces the tax authorities to impose penalties and/or sanctions arisen because of audit inspections on an entire liability of taxpayers account. Penalties and sanctions in these cases are not assessed on the disputed liabilities individually, which ultimately impedes companies' overall operations by demonstrating an unreliable tax history and a hampered image due to imposed penalties and "frozen" tax accounts. This causes a number of difficulties for the business community, such as participating in various tenders where companies are questioned on terms related to security and reliability of the company's tax history.

5. One of the greatest burdens faced by the taxpayers appears to **be a method of imposing Income Tax on the taxpayer's record card**. Namely, Income Tax is not imposed according to the filed return (declaration) of the taxpayer; rather, it is imposed based on the previous actual payment of the taxpayer. Specifically, 20% Income Tax is being withheld from salaries by the Tax Agent (employer) and is liable to payment at the time of distributing salaries. Based on the amount paid previously as Income Tax, an estimated Income Tax for the next accounting period is imposed on the taxpayer's record card. In frequent cases, this kind of estimation does not coincide with declared data and, thus, results in unrecognized liabilities of the taxpayers. It is further required to conduct additional corrections and comparisons between filled declarations and imposed duties that result in extended time and resources for both the taxpayer and RS officials. Moreover, if the Income Tax is paid at the end of the month (e.g., on the 30th or 31st of the month), the existing treasury system does not indicate a payment on the taxpayers account for 2-3 days. Finally, every bank transaction (payment) of the Income Tax costs GEL 0.50 per transaction.

6. **Natural Persons** face difficulty with the extensive number of treasury codes. According to data provided by the RS, 11,000 Natural Persons have conducted payments totaling GEL 15 million without submitting declarations in 2013. Consequently, the RS has no information about the purpose of these payments since the treasury codes have also been mistakenly provided in the payment document.

These barriers highly influence large taxpayers as well as small and medium sized entities. Even though large taxpayers represent about 10-15% of all taxpayers, they represent the largest revenue contributors to the budget. Consequently, resolving the above-mentioned drawbacks will profoundly affect the degree of tax compliance the overall well-being of business community.

C. BASELINE SCENARIO

The baseline scenario consists of maintaining the "As-Is" situation; namely, taxpayers will have to pay their liabilities identifying various treasury codes according to specific tax liabilities, those are 164 now. A detailed description of a current system follows.

Internal Procedures:

Administration of this system is burdensome and time-consuming, as most of the calculations and transactions are done manually by the RS officials.

For example, shifting payments from one tax account to another is done manually by RS officers. A taxpayer first submits an application to the RS requesting changes between the accounts. Then, RS officers analyze the taxpayers' record card manually and prepare a "Conclusion" (a decision act) which is further sent to the treasury to shift liabilities from one treasury code to another. Depending on the difficulty of a specific case, a process may take up to 20 days. Moreover, this kind of transaction is fee-based, where taxpayers pay a service fee of GEL 50-1,000 per transaction. Finally, any transactions to the treasury accounts require 25 types of internal forms and registrations prepared by authorities.

70 employees are responsible for operating personal record cards of taxpayers.

Penalties/Fines:

Tax penalties and fines are imposed on the overall, lump sum liability of a taxpayer, rather than by each type of liability.

State and Local Budgets:

The state budget transfers funds to local budgets on a daily basis. Local budgets are provided with information about taxes paid by each taxpayer manually (i.e., registries are sent to local budgets).

Tax Accounts (Tax Record Cards)

Paid taxes are illustrated on the tax account (tax record card) of the taxpayer. The types of tax record cards are as follows:

- Tax record card for each types of tax;
- Tax penalties;
- Penalties imposed for customs violations;
- Eliminated taxes.

All of the above-mentioned cards are analyzed for calculating the lump sum obligations of the taxpayer.

As for the cards given below, they are not included in overall, lump sum calculations. These include:

- Reverse charge VAT card;
- Excise stamps card;
- Temporary cards – these cards present information about temporarily imposed taxes for questionable liabilities that need to be resolved within the tax administration;
- Card for taxes paid at Customs before 2011 (due to re-engineering of internal business processes after 2011; precisely – uniting Tax and Customs Record Cards – some information derived before 2011 was kept separate for tracking reasons).

Income Tax

Income tax is imposed on the taxpayer's card before the actual tax return on income tax has been submitted to the tax authority. This results in an estimated, "pre-imposed" income tax liability. Income Tax is imposed for:

- Income tax withheld by employer;
- Income tax of employees of diplomatic corps and equivalent organizations;
- Income tax of employees of free industrial zone;
- Non-commercial natural persons, who did not file a tax return (declaration) but have practically paid Income Tax within the time-frame of the liability (declaration due time).

A specific problem arises for large taxpayers when withholding Income Tax, due to the extensive number of transactions, such as withholdings (e.g. Bank of Georgia, Georgian Railway, etc.).

VAT Offset Document

In some cases, a proof of payment to the budget (invoice, payment bill) may serve as basis for offsetting VAT:

- Reverse charge VAT (specific treasury code is applied);
- VAT paid for Temporary Admission (Customs);
- VAT charged on a difference for goods supplied to the warehouse.

Overpaid VAT

Profit Tax, Income Tax, and Property Tax declarations (returns) may be subject to re-scheduling (delaying) on the request of the taxpayer, though the payment dates remain unchanged. As a rule, no overpaid VAT is recognized until the declaration is filed.

In the remaining cases, claimed overpaid VAT is subject to a refund three months from the submission time. However, exceptions are as follows:

- Overpaid VAT is refundable within one month if occurred as a result of purchase/import or export of fixed assets;
- If the offset VAT resulting from a purchase exceeds the amount of imposed VAT, then the right to claim a refund occurs within 3 months and will be refunded within the following 3 months;

Overpaid VAT is transferred to a special Overpaid VAT Account opened within the treasury. Tax-free services are refunded from this specific account as well.

Fines

According to an existing system, fines are levied on an overall, lump sum balance of the taxpayers account (tax record card) rather than on specific types of taxes. Nonetheless, some exceptions are applied:

- In cases of a Tax Restructuring process within a company, fines are levied according to the tax authority's pre-determined schedule;
- Fines are applied on Customs Duties if liabilities are not covered within 3 days after the customs operation.

Tax Agreements (Tax Debt Negotiations)

Tax agreements (tax debt) negotiations are imposed on taxpayer's record cards, including:

- Adjustments (reductions) on the debt balance of the taxpayer's record card are performed manually once the negotiated amount of debt has been covered;
- If a tax agreement has been reached within the debt negotiation process concerning liabilities to be declared, the negotiated amounts are corrected manually on the card;

A failure to pay negotiated debt within the time frame of the agreement results in an imposed fine of 0.5% of the negotiated amount.

Summary and Expected Trends

Along with the barriers and challenges described above, the number of mistakes, burdensome internal procedures at the RS, and unclear statistical data on current liabilities will persist. All stakeholders have confirmed the expected evolution of the problem during consultations, which consists of:

- Data for tax analysis and forecasting will be inaccurate, causing resources to be inefficiently allocated and the budget to be planned mistakenly;
- Local budgets will lose total of GEL 10,5 million in potential revenues each year;
- Taxpayers will face service costs for shifting payments from one account to another of GEL 50-1,000 per transaction;
- Additional (estimated) taxes will be imposed on disputed taxpayers liabilities in spite of the fact that, at the end of the appeal process, the liability of a specific tax may not even be recognized by the Tax Authority;
- Estimated 20% Income tax will be imposed "estimatedly" on the taxpayers record card based on previously conducted payments;

- The VAT refund process will take up to 6 months, and the internal process of the tax authorities will take up to 20 days;
- Natural Persons will continue to mistakenly transfer payments to the wrong accounts, leaving a substantial number of funds uncoordinated and inefficiently allocated.

IV. OBJECTIVES

A. GENERAL OBJECTIVES

According to the problem elaborated in the previous section, the general objective of the initiative is the simplification of the treasury codes system to:

- Increase the accuracy of the data available;
- Enable an accurate allocation of funds between central and local budgets;
- Reduce service costs and time for the taxpayers (as well as operating costs and time for RS);
- Provide a fair and transparent tax administration system;
- Improve the quality of service delivery.

B. SPECIFIC AND OPERATIONAL OBJECTIVES

The following table presents the summary of objectives.

Table 5 – Summary of Objectives

OBJECTIVE	INDICATOR	RESPONSIBILITY	TIMING
Reduce operation time for tax authorities (for internal transactions among treasury codes)	Operations time - 0 hours	RS	2015
Re-allocate funds between central and local budgets	Received local revenues (for the first year after introducing new system only): GEL 97,309,272	RS	2015
Reduce number of monthly transactions for Income Tax	Number of Income Tax Transactions to 1	RS	2015
Monthly payment cost for Income Tax	Cost of monthly Income tax Transactions to GEL 0.50	RS	2015
Eliminate Service fees for the taxpayers	Amount of Service Fees GEL 0	RS	2015

V. POLICY OPTIONS

The RS has come up with an ambitious plan for streamlining the treasury code system and simplifying payment processes for the taxpayers. For these purposes, RS has introduced a regulation according to which 164 treasury codes will be united into one treasury code. The technical implementation of a new regulation is supported by internally developed software. As the IT system has already been developed and tested, and the required legal amendments have already been drafted, there are only two options to analyze.

These two policy options are presented herein with appreciation of the challenges and objectives provided in the above-mentioned sections:

- A “Do Nothing” policy - which anticipates no changes to an existing system
- “Regulation and IT System” policy – developing united treasury code system for all types of taxes backed up by IT system

A. POLICY OPTION 1 – DO NOTHING

If no changes are applied to the current “As-Is” state, challenges faced by the taxpayers as well as tax authorities will remain unchanged.

We assume the trends to remain unchanged in terms of following major drawbacks of the currently acting system:

- Data for tax analysis and forecasting will be inaccurate, causing resources to be inefficiently allocated and the budget to be planned mistakenly;
- Local budgets will lose about GEL 10,5 million in potential revenues each year;[3]
- Taxpayers will face service costs for shifting payments from one account to another of GEL 50-1,000 per transaction;
- Additional (estimated) taxes will be imposed on disputed taxpayers liabilities in spite of the fact that, at the end of the appeal process, the liability of a specific tax may not even be recognized by the Tax Authority;
- Estimated 20% Income tax will be imposed “estimatedly” on the taxpayers record card based on previously conducted payments;

[3] The annual average of lost revenue for the local budgets for 2005-2013 is GEL 10,5 million (GEL 95 million/9 years).

- The VAT refund process will take up to 6 months, and the internal process of the tax authorities will take up to 20 days;
- Natural Persons will continue to mistakenly transfer payments to the wrong accounts, leaving a substantial number of funds uncoordinated and inefficiently allocated.

B. POLICY OPTION 2 – REGULATION AND DEVELOPING IT SYSTEM

According to Option 2, the proposed change in a treasury system, 164 treasury codes will be substituted by one single code. Additionally, internally developed software within the RS will enable tax authorities to re-allocate all taxes and duties of taxpayers accurately and precisely based on the liabilities provided in taxpayers' declarations.

The essential elements of the changes, as well as Option 2's specific solutions and opportunities, are laid out below.

While 164 treasury codes will be replaced by a single treasury code, it is essential to highlight that the internal diversification of taxes (according to types of the taxes, regional allocation, etc.) will still be in place for internal processing (administration) only.

Internal Procedures will be Automated

Taxpayers will enter a single treasury code within the tax payment document. The system will then automatically re-direct the payments to their specific liabilities derived from the declarations filed by these taxpayers.

Any changes within the account (i.e., shifts from one liability account to another) will be automated with no human intervention or manual operations required.

The sequence of paid liabilities will be covered according to the Tax Code regulations. The base of the liabilities come first, followed by sanctions and fees. This means that taxpayers will not be able to manipulate transferred payments based on their own perceptions.

In case of multiple liabilities (accounts payables) on the taxpayer's record card, for example, if there are liabilities to pay two types of taxes, then the payments will be first re-directed to the liabilities imposed on the earliest accounts (first incurred liabilities).

"Other Payments" Account

Sanctions and fines will be allocated and generally covered in the record card under the "other payments" account with no diversification of sanctions and/or fines, based on the specific type of tax.

Extra payments by the taxpayers*:* If overpayment occurs while there are no liabilities on the record card, then the payment will be allocated to the “other payment” account until any liability appears on a record card. A payable amount will then be automatically transmitted from the “other payment” account to the new liability account of the taxpayer.

State and Local Budgets

Based on the proposed change within the IT system, property taxes will be automatically allocated to local budgets. The information will be derived from declarations filed by taxpayers. If a taxpayer possesses land in Georgia, he/she is obliged to provide information on all relevant land plots and their location. In this case, conducted payments will be disseminated among the territorial units proportionally. The relevant payment information will be automatically sent to the treasury.

Taxpayer’s Account (Tax Record Cards)

1. Taxpayer’s Record Card - A taxpayer’s liabilities for various tax types, as well as sanction and/or fines, will be imposed on one record card.

The following data will be included on *separately managed record cards* of the taxpayers:

2. “Temporary Card” which includes:
   - Additionally imposed liabilities, which are going through the appeal system and are not yet recognized;
   - Negotiated amount of liabilities (debt) imposed on the record card as a result of a Tax Agreement.
3. Cards for Deferred Payments – this card includes deferred (postponed) payments and liabilities of the taxpayers in the following cases:
   - Liabilities undergoing Restructuring and Rehabilitation processes;
   - Deferred Liabilities negotiated with the RS;
   - Liabilities to be declared by the taxpayer, based on a tax agreement.
4. A separate record card will be maintained for unjustified overpayment.
5. All data from tax record cards and temporary cards will be incorporated in the balance sheet of the taxpayer.
6. A separate record card will be opened for local budget operations.

Additionally Imposed Liabilities will be transferred from the Temporary Account to taxpayer’s record card by a special unit after the recognition of this liability. No fines will be imposed on the Additionally Imposed Liability account until transferred to the basic record card. A summary card (account) will be designed for presenting the taxpayer's balance sheet.

Tax Withholding and Estimated Levy

Income tax will be imposed on the taxpayer only after the declaration about withholding is submitted by the taxpayer. The withheld tax should be paid in the month after declaration.

Taxpayers who are employed by companies not liable to withhold tax (i.e., Diplomatic Corps, Free Industrial Zones) will be levied an estimated tax before declaration.

The proposed initiative encompasses a single monthly transaction for Income Tax. The introduction of a single treasury code system enables taxpayers to transfer Income Tax once a month in accordance to the provided information in the tax declaration. No "pre-imposed" Income Taxes will be in place.

Offset VAT and Deferred Declaration

Imposing Offset VAT and Reverse Charge VAT

No Reverse Charge VAT procedure will be in place for VAT registered taxpayers. VAT registered taxpayers will file a reverse charge amount in the VAT declaration, which will serve as the basis for the offset. Non-VAT registered taxpayers will file the reverse charge VAT for the relevant reporting period. Regarding customs procedures, a payment schedule provided by the taxpayer for Temporary Admission (a customs procedure for temporarily importing goods to a country) will serve as basis for VAT offset.

Currently, a company must pay VAT despite that it will eventually be refunded to the company as a reverse charge VAT. A proposed change within the system will thus decrease the Cash Outflows for companies and will enable efficient use and availability of funds. Based on the statistical data provided by the RS, the total amount of Reverse Charge VAT for the year 2013 was GEL 118,506,287, which represents a benefit of GEL 948,050 by introducing renewed IT system.

Refunding Overpaid Amounts

Amounts overpaid by taxpayer will be subject to a refund within one month, based on a taxpayer's claim.

- Overpaid amounts will be refunded from the "Other Payments' account;
- Taxes levied incorrectly will be refunded within 30 days.

Other changes required for the system

- Changes in Revenue Classification will be required with corresponding modifications to specific fields on the declaration form;
- Updates on Types of Businesses will be required based on the data available at the National Statistics Office of Georgia to enhance the quality of analysis within the system;
- The balance sheets of tax record cards should be prepared during a transition period to ensure a smooth startup of the system. A Balance Sheet represents the overall assessment of accounts payables as well as accounts receivables on the taxpayers' record card. This operation is done internally by the current RS system and does not require any additional resources;
- Although the proposed system enables automatic distribution of taxes among liabilities, manual transactions will still be possible on the taxpayer's request;
- As the new system imposes taxes based on the submitted declaration only, with no anticipated and/or probable assessments, additional fields will be introduced on the Tax Declaration form. Specifically, fields denoting Excise, Dividends, and Adjara Regional duties will be added;

Recommendations on System Rollout

- It is highly recommended to startup the project at the beginning of the year to ensure a smooth transitional phase from the old treasury system to the new system;
- An additional pilot project is recommended for Large and Medium-Sized Taxpayers to identify required changes and/or adjustments to the proposed system. In fact, the system had been tested in 2013 to assess its reliability and accuracy; nonetheless, due to the quickly developing processes and legislation, launching a pilot project with several interested companies to ensure a smooth and flawless product introduction to the final market is recommended.

VI. ANALYSIS OF IMPACTS

A. METHODOLOGY

Both qualitative and quantitative methods for analyzing the two options, including baseline studies, precise identification of baseline conditions, clarification of objectives, target setting, performance evaluation, and outcome measurement. A Cost Benefit Analysis was conducted to compare relative costs with related benefits of each option. A Net Present Value calculation was conducted based on a 10-year time horizon for and a 7% discount rate.

B. ANALYSIS OF IMPACTS

The analysis above was derived from a review of the practices of a representative size and segment-based cross-section of companies (taxpayers), as well as from consultations with government officials and stakeholders that generally represent the consensus opinion for an effective and efficiently managed process when the new treasury system will be introduced.

Table 6 – Summary of Impact of RIA Options

IMPACT	OPTION 1	OPTION 2
Administrative: RS - Business Processes	• Burdensome, time consuming internal processes	• Simplified internal processes, reduced time
Fiscal: RS – Local Budgets	• Lost annual revenues	• Increased annual revenues
Public financing	• Inaccurate statistics • Inaccurate allocation of state and local revenues	• Accurate statistics • Accurate allocation of state and local revenues
Fiscal: Taxpayers	• Service fees for taxpayers	• No service fees
	• Additional taxes assessed on disputed liabilities	• Fair and realistic assessment of taxes during ongoing dispute processes
	• Extensive number of Income Tax transactions	• Reduced number of Income Tax transactions
Banks	• Existing IT system	• Changes to the internal IT system requiring additional costs
Micro taxpayers	• No direct impact	• No direct impact
Natural persons paying property tax	• Inaccuracy of payments	• Accuracy of payments

High impact **Medium impact** **Low impact**

C. COST AND BENEFITS ANALYSIS

As demonstrated in the following table, the PV (present value) of Option 1 is assumed to be zero, and the PV for Option 2 is estimated at GEL 27,880,923 based upon a 10-year time horizon and 7% long-term discount rate.

COSTS

Option 1, PV = GEL 0

Because Option 1 anticipates leaving the current system in an "As-Is" state, no additional costs are assumed.

Option 2, PV = GEL 757,372

Based on consultations with stakeholders and statistics obtained from the RS for the analysis, the amount of the implied costs have been identified. These costs mainly include the RS's design and maintenance costs related to the new system. Detailed figures and comparison of the options are presented in a Comparison Matrix given in the final section of the report.

Table 7 – List of Annual Costs Related to RIA Options

	OPTION 1 (ANNUAL)	OPTION 2 (ANNUAL)
Salaries and bonuses of IT specialists	0	GEL 33,600
Salaries and bonuses of other stakeholder Departments	0	GEL 33,600
Maintenance cost of the IT system	0	GEL 33,600
System Development Consulting Services (Year 1 only)	0	GEL 52,853

BENEFITS

Option 1, PV = GEL 0

Because Option 1 anticipates leaving the current system in an "As-Is" state, no additional benefits are assumed.

Option 2, GEL 28,638,296

The technical analysis team strived to translate the benefits of the project into specific and precise figures and to express these calculations clearly. The major benefits resulting from the newly introduced system lie in the simplified procedures; specifically, the benefits result from the decreased numbers of transactions and working hours of the RS employees, as well as from reduced costs for taxpayers. The introduction of the new system envisages some benefits (i.e., quality of statistics) that could not be presented in precise. Nonetheless, from the perspective of a well-functioning system with effective governance procedures, obtaining accurate, timely, and detailed statistics are of paramount importance for the respective authorities. Detailed figures for the comparison have been presented further in the report.

Allocation of Local Budgets: According to the figures provided by the RS, the annual total revenue for local budgets represented GEL 2,309,272. Nonetheless, the conducted analysis has identified that the introduction of the new system will result in additional GEL 10,5 million of potential annual revenues for the local budgets for a consecutive year. This figure has accumulated in the state account, because taxpayers have transferred payments to only one account instead of diversifying them according to the various liabilities. As previously stated, Georgia legislation assesses liabilities according to the overall, lump-sum liability of the taxpayer, and, therefore, any types of the taxes are recognized as covered, as long as no overall “debt” to the tax authority exists. Given Option 2’s innovative approach and the introduction of an automated IT system, local budgets will receive additional funding that was previously allocated to the state account in error. Based on these figures, local budgets will receive GEL 97,309,272. Furthermore, this new allocation procedure will better enable the MoF to support local governments with funds and to ensure balanced development of the central and regional jurisdictions.

Reduced Labor Requirements for RS Staff: Based on the information provided by RS, each operation for tax record cards may require up to 20 day, depending on the difficulty and specifications of an operation. There are currently 70 employees working on the manual operations of the taxpayers’ record cards, who could be freed up from this task for other activities. Based on an 8-hour working day per employee, the introduction of the automated system will provide savings of up to 11,200 hours of administrative processes a year.

The automated system will enable taxpayers to **easily and accurately analyze their obligations,** as the Tax Record Card will provide precise information about on-going liabilities with no “estimated” assessments of Income Tax or “additional” charges for Disputed Funds and Transactions from the RS.

Moreover, it will **decrease the number of transaction** from an annual average of 600 to 12 and will reduce costs of transferring Income Tax payments from GEL 420 to GEL 6 annually. The monetary value for these changes has been presented in the PV calculation.

Based on the 2013 figures provided by the RS, the total number of transactions for shifting from one treasury code to another was 5,098. Consequently, taxpayers will save GEL 50-1,000 per transaction.

The amount of additionally imposed taxes, which are now imposed on the taxpayers' **disputed accounts,** will be re-distributed across specific liabilities. This amount is estimated at GEL 300 million. This amount will be re-allocated partially according to the results of dispute resolution, and, for future processes, no additional and "estimated" taxes will be imposed for securing the revenues of an authority.

The VAT refund process will decrease from 186 to 30 days. By creating an easier system for both taxpayers and administrations, the VAT Refund can provide additional financial resources for the companies, which will enable re-investment and can stimulate business growth. The monetary value for these changes has been estimated at GEL 2,227,186, which is calculated as: GEL 53,028,228 (the amount of VAT refunded in 2013) x (5/12) x 0.10 (bank interest rate).

Saving related to elimination of reverse charge VAT: as demonstrated in the table below, the annual benefit for the elimination of reverse charge VAT is estimated at GEL 948,050, which is calculated as: GEL 120,000,000 (reverse charge VAT in 2013) x (1/12) x 0.10 (bank interest rate). More importantly, public finance figures for analyses will be accurate and reliable for the effective management of the funds.

Table 8 – List of Annual Benefits Related to RIA Options

	OPTION 1 (Annual)	OPTION 2 (Annual)
Reduced Hours of manual work of RS officers (working on Tax Record Cards)	0	11,200 hours
Reduced Number of transactions for shifting paid funds from one treasury code to another (by RS)	0	5 098 transactions
Reduced Cost of transactions for the taxpayers for shifting funds from one treasury code to another	0	GEL 50-1,000 per transaction. Equal to GEL 2,549,000
Reduced Number of Income Tax transactions conducted by the taxpayers	0	588 transactions
Reduced Cost of Income Tax transactions for the taxpayers	0	Reduced by GEL 414 to GEL 6 (on average)
Correct Allocation of funds among state and local budgets	GEL2,309,272[4]	GEL 12 809 272[5]
Reduced VAT Refund Time	0	156 days
Efficiently Imposed Funds	0	GEL 300 million
No Reverse Charge VAT	0	948 050 GEL

[4] 2013 figure
[5] Calculated as 2 309 272 GEL + 10 500 000 GEL; estimation is made that the amount for 2015 would be the same as 2013.

Option 1 is assumed to have no costs or benefits, and, therefore, we present the costs and benefits for option 2 only. These costs mainly represent spending for the development and maintenance of the newly designed IT system.

Due to the distribution and/or overall type of benefit effects, the technical team has assessed some benefits against the weighting scale rather than calculating them within the PV calculation, including:

- Correction of previously inaccurately assessed Income Tax, which has been named as one of the most troubling challenges for stakeholders;
- Accurately allocate local and state budgets to ensure the balanced development of municipalities and to improve statistical data of the RS, which will ultimately influence the reliability and accuracy of the entire budget planning process and corresponding spending activities;
- Increase the quality of statistical data, whereas access to sufficient, accurate, and timely data is vital to the RS's ability to successfully administer the taxation system. In order to avoid an erroneous analysis, the assessment must be as accurate as possible, and any available data should be cleansed as close to its source as possible. This ensures that different users of the data are not led to misinterpreted or mistaken results.

Considering projected costs and benefits, the calculated NPV for Option 2 is shown in the following table:

Table 9 - NPV Calculation for RIA Options

	OPTION 1	OPTION 2
Benefits (NPV)	0	28 638 296 GEL
Costs (NPV)	0	757 372 GEL
Benefits - costs (NPV)	**0**	**27 880 923 GEL**

VII. COMPARISON OF OPTIONS

The table below presents the comparison of Option 1 and Option 2, including the calculated NPV and the evaluation of the non-monetary benefits.

Table 10 - Summary Comparision of RIA Options

EVALUATION CRITERIA	OPTION 1	OPTION 2
Benefits – costs (NPV)	0 GEL	**27 880 923 GEL**
Correct Allocation of funds among state and local budgets*	1	5
Efficiently Imposed Funds*	1	5
Public statistical data*	1	5
SUMMARY	**1**	**5**

The NPVs for Option 1 and Option 2 are GEL 0 and GEL 27,880,923, respectively. Additionally, Option 2's qualitative benefits have been ranked in a weight scale from 1 to 5, with 1 as the lowest rank and 5 as the highest.

Based on these calculations and qualitative weighting indicator analysis, Option 2 is recommended for implementation.

VIII. MONITORING AND EVALUATION PLAN

Ex-post evaluation can be conducted if required and/or appreciated by the RS to determine the actual impact and to demonstrate accountability for the project. If conducted, the ex-post evaluation should address performance, quality, and relevance of the project using a blend of interviews, observations, and available reports and/or data of the RS and other stakeholders. This evaluation will assist the RS to summarize the lessons learned and to provide a firm foundation for future planning, implementation, and project updates.

In fact, each benefit and challenge of the system has been broadly analyzed by the RS while developing the IT system and designing its internal business processes. The RS demonstrates the full capacity, the required expertise, and the willingness to manage the initiative accordingly.

Table 11 - Indicators of Progress towards Meeting the Objectives

INDICATOR	FREQUENCY OF EVALUATION	RESPONSIBILITY FOR MONITORING
Reduce operation time for tax authorities (for internal transactions among treasury codes) - automatic	End of year 2015	The RS
Reduce number of monthly transactions for Income Tax	End of year 2015	The RS
Monthly payment cost for Income Tax	End of year 2015	The RS
Eliminate Service fees for the taxpayers	End of year 2015	The RS
Overall feedback from the customers	End of year 2015	The RS

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