



# Assessment of Tax Compliance Costs for Businesses in the Kyrgyz Republic

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ASSESSMENT OF TAX  
COMPLIANCE COSTS FOR BUSINESSES  
IN THE KYRGYZ REPUBLIC



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## KEY FINDINGS

- The principal outcome of the tax reform implemented in recent years in the Kyrgyz Republic is a reduction of the administrative burden on the private sector associated with compliance with tax legislation. Since 2012, the average time required by taxpayers to maintain their tax records decreased by 40 percent—from 40.4 days in 2012 to 23.6 business days in 2016.
- The positive developments are pervasive: time costs of tax administration were reduced across all types of taxpayers regardless of tax bracket, size of business, and other factors.
- The value of time is directly linked with the tax regime. Taxpayers who operate under the simplified tax regime spend less time on tax records, that is, 8.6 days on average in 2016. The businesses paying value added tax (VAT) incur higher costs (47.1 business days) due to the number of taxes to be managed and a highly complex system of tax record management compared to the uniform tax.
- The most costly stage of the tax accounting procedure is maintenance of tax records in the office, which takes over half of all businesses' expenses on tax administration. The key success of the tax reform was changes in the filing frequency of the tax reports for small and medium businesses in 2015, thus leading to reduction in costs of tax management in the office by nearly one-third.
- Tax reforms that were focused on decreased filing frequency of tax statements, the introduction of a system for e-filing, and cancellation of status of VAT invoice as the high security forms reduced the time costs of taxpayers visiting the tax authority offices by more than two and a half times: from 7.6 days to 2.9 days from 2012 to 2016.
- Following the decrease in time costs, the costs of tax compliance also tended to decline. Average costs of tax administration dropped by two times and amounted to US\$367 in 2016.
- Tax administration costs against the turnover of taxpayers tend to decline. Regarding microbusinesses, the costs of tax accounting against its turnover amounted to 2.2 percent of annual profit, which is comparable by its value with the uniform tax rate and may be viewed as an additional tax.
- Annual savings on the reduction of the administrative burden on the private sector due to the ongoing tax system reforms in the Kyrgyz Republic were estimated at US\$1.8 million in 2014 and US\$2.2 million in 2016. Hence, the overall burden on the national economy associated with tax compliance declined from 0.19 percent to 0.13 percent of the national gross domestic product (GDP).
- Transfer of functions of the social contribution administration from the Social Fund to the State Tax Service in the pilot areas helped substantially reduce the time cost of taxpayers as less time was required for trips to submit reporting. Reforming the procedure for filing reports on one type of mandatory payments reduced the costs to taxpayers by 10 percent of the total time spent.

- Taxpayers in pilot districts gave a positive assessment to all changes related to transfer of functions of the social contribution administration from the Social Fund to the Tax Service.
- The coverage by the tax control declined from 58 percent of inspected entrepreneurs in 2012 to 47 percent of businesses in 2016.
- Medium and large taxpayers, who operate under the general tax regime with VAT payment, are mostly likely to receive tax inspections, and among these, the inspections' decrease is the lowest. Over two-thirds of interviewed entrepreneurs in this group were exposed to tax audits in 2016.
- Businesses' financial costs of tax audits remain the same. Decrease in the percentage of inspected taxpayers is levelled off by an increase in the total number of taxpayers. Thus, the total expenses of all entrepreneurs on inspections changed little, if any.
- Taxpayers' subjective opinion about the administrative burden on the business in the area of tax regulation and the overall tax environment improved, which suggests an emerging positive trend toward a better tax system in the Kyrgyz Republic in the perception of business community.
- Almost one in three taxpayers in the Kyrgyz Republic considers that excessive tax burden is a major constraint for business development, and therefore, they resort to various schemes for understatement of tax base. Most respondents believe that a chance of striking a deal with the tax officials makes it possible to avoid taxes. The scale of tax evasion over the period of reform decreased.
- Tax authorities' image is generally well perceived by entrepreneurs and has changed for the better in recent years. The transparency of information from the tax authorities has improved, and tax-related materials are easily accessible; thus, it has a positive effect on the Tax Service image.
- Though the professional qualities of tax officials were positively assessed, only 15 percent of entrepreneurs agree that they obtain high-quality service from the tax authorities. The more complicated and costly the tax regime is, the more complaints taxpayers have against the performance of the Tax Service employees.

# BACKGROUND

## TASKS AND OBJECTIVES OF THE STUDY

The International Finance Corporation (IFC), a member of the World Bank Group, is the largest global development institute focused on supporting the private sector in emerging economies. Through its work with more than 2,000 companies worldwide, IFC mobilizes capital, expertise, and influence to create markets and opportunities for developing countries.

The objective of the IFC Central Asia Tax Project is to improve compliance with mandatory requirements of tax legislation through increased transparency and simplification of tax administration procedures. Simplification of tax accounting procedures will reduce costs of tax compliance, lessen the administrative burden on small and medium businesses, reduce barriers to entry into the formal economy, and serve as a driver for economic growth in the Kyrgyz Republic.

The key element of reforms is an immediate assessment of their efficiency and possibility for adjustments based on assessment results. With this view, IFC, through its technical assistance tax reforms projects, has conducted a series of studies, which help monitor the tax system reforming processes in the Kyrgyz Republic. The main goal of the studies was a periodic assessment of time and costs to taxpayers in the Kyrgyz Republic in complying with the mandatory requirements of the tax legislation.

The baseline year for assessment of the reforming progress was 2012. As part of the study, three rounds of measurements were performed, where the tax administration costs of the Kyrgyz taxpayers were assessed at a regular time span—in 2012, 2014, and 2016.

Equitable intervals of measurements allowed an immediate assessment of the impact of implemented tax reforms on the cost of taxpayers to comply with tax legislation. In addition, actual data on the tax system status helped elaborate concise recommendations for the Government with the focus on elimination of identified issues and reduction of the tax administration costs to businesses.

This report outlines the results of all three rounds of business environment surveys in the area of tax regulation; it includes the estimates of tax accounting costs of taxpayers in the Kyrgyz Republic in 2012, 2014, and 2016.

## ECONOMY AND BUSINESS ENVIRONMENT IN THE KYRGYZ REPUBLIC

The Kyrgyz Republic, with a population of 6 million people, is one of the few low-income countries in Europe and Central Asia compared with the average-income countries in the region (in 2016, the country's gross national income [GNI] per capita was US\$1,100<sup>1</sup>). The Kyrgyz economy mostly comprises industrial and agricultural sectors. The industrial sector is represented by energy and mining enterprises, which contribute about 60 percent to the total manufacturing output. In 2015, the industrial sector's share in the national gross domestic product (GDP) was 15 percent.<sup>2</sup> Over 400,000 farmholdings are engaged in the agricultural sector, employing more than half of the national labor force. In 2015, the agricultural sector contributed 22 percent to the GDP. The small business contribution to the national economy is negligible. The National Statistic Committee reports that 9,800 of small businesses were registered in 2015, where 2.3 percent of the total labor force was employed. The share of small businesses in GDP is also negligible and makes up as little as 6.9 percent. The Kyrgyz economy has endured unfavorable regional conditions, but the opportunities for growth remain moderate. The real GDP growth was forecasted to exceed 3 percent in 2016 and 2017, which is below historical indicators and the country's capacity.<sup>3</sup> Nevertheless, national economic growth continues to suffer in an adverse external environment. Real GDP growth of 2.7 percent from January to October 2016 was registered (for the same period last year, GDP growth was 4.8 percent). Higher GDP was conditioned by stable indicators in the agriculture, construction, and services sectors. The growth in these sectors was 2.2 percent, 7.6 percent, and 3.2 percent, respectively, and thus, contributed the most to the national economic growth in January–October 2016.

Overall, since the economic crisis caused by the recession in Russia in late 2014, the macroeconomic situation in the Kyrgyz Republic has somewhat improved. For the midterm period, growth is forecasted provided that remittances volume and demand in the foreign markets get recovered. The economic growth in Russia and Kazakhstan should encourage export growth that was passive during the first 10 months of 2016 and an inflow of remittances supporting domestic consumption. Moreover, as Kyrgyz producers progressively adapt to the norms and standards of the Euroasian Economic Union (EEU), access to the common market is likely to improve.

Every year, the World Bank publishes the international ranking of ease of doing business, which covers virtually every country in the world. This ranking defines the ease of doing business in a country based on several indicators, including starting a business, dealing with construction permits, taxation, getting electricity, getting credits, and so on. Based on the 2017 Doing Business report, the Kyrgyz Republic ranked 77 among 190 economies.<sup>4</sup> Meanwhile, the Kyrgyz Republic is an outsider among 24 countries of the Europe and Central Asia Region and was ranked 21<sup>5</sup> by ease of doing business (Table 1).

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<sup>1</sup> <http://russian.doingbusiness.org/data/exploreconomies/kyrgyz-republic>

<sup>2</sup> <http://www.stat.kg/media/publicationarchive/b4e90f85-e3d9-4c3a-8779-d9fe43b2801d.pdf>

<sup>3</sup> <https://openknowledge.worldbank.org/bitstream/handle/10986/25973/112199-WP-Kyrgyz-Republic-Economic-Update-no-4-ADD-SERIES-PUBLIC.pdf?sequence=1&isAllowed=y>

<sup>4</sup> <http://russian.doingbusiness.org/rankings> (Doing Business 2018 ranking based on the data of 2016 fiscal year).

<sup>5</sup> Data do not include all countries of the Europe and Central Asia Region

*Table 1.  
International Ranking of Ease of Doing Business in 2017*

COUNTRY	WORLD RANKING	EUROPE AND CENTRAL ASIA REGION
Georgia	9	1
Lithuania	16	3
Russian Federation	35	4
Kazakhstan	36	5
Belarus	38	6
Moldova	44	10
Armenia	47	12
Azerbaijan	57	16
Uzbekistan	74	19
Ukraine	76	20
Kyrgyz Republic	77	21
Tajikistan	123	24

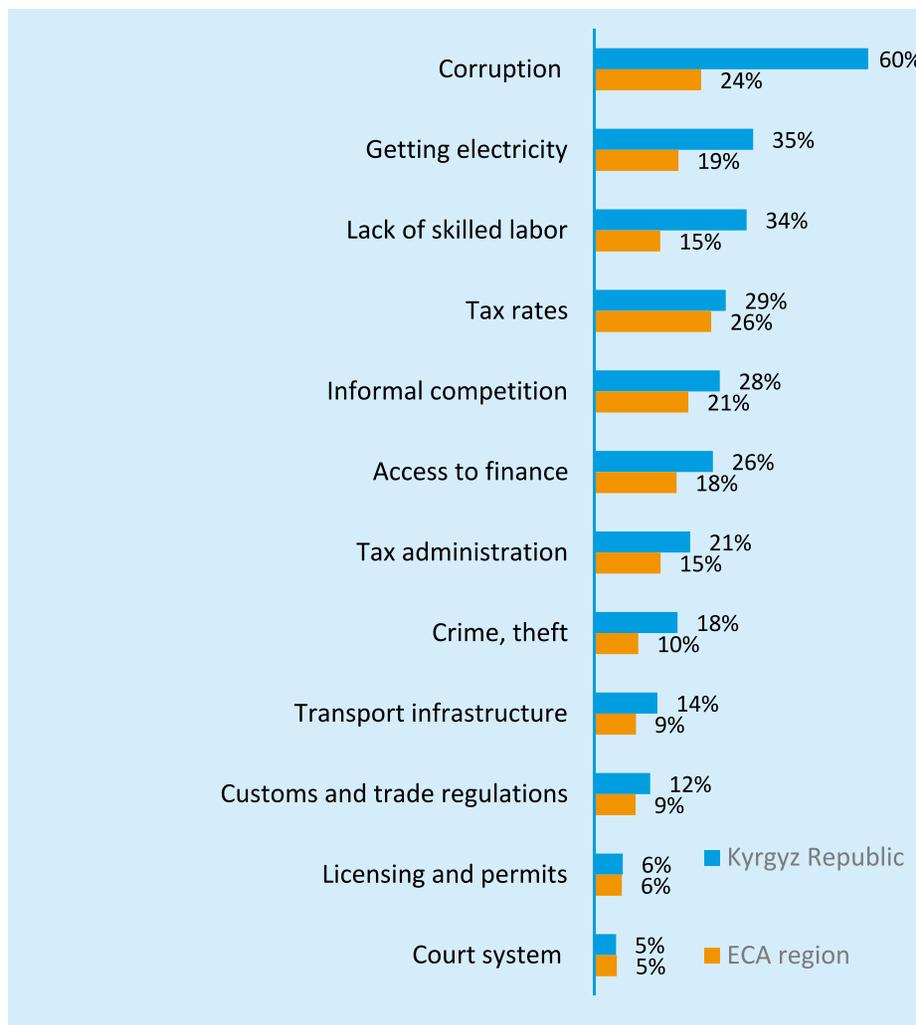
In parallel to the Doing Business ranking, one of the most comprehensive international surveys of business environment is the ‘Enterprise Survey’, which has been regularly conducted by the World Bank since 1990. In this survey, managers and appropriate specialists (if necessary, accountants, human resources specialists, lawyers, and so on) of micro, small, and medium enterprises are interviewed. These surveys cover a broad range of business environment topics, including access to finance, competent labor force, corruption, connections to utilities grids, administrative regulation, and so on. The latest survey in the Kyrgyz Republic was conducted in 2013, where 270 businesses in the country were interviewed.

Most businesses (60 percent of respondents) viewed corruption as a major constraint for their business development (Figure 1). Corruption is viewed in a broader context, without being linked to any particular business activity. Moreover, this indicator in the Kyrgyz Republic was two and a half times higher than an average percentage in the Europe and Central Asia Region. This suggests that corruption is one of the key administrative barriers to business growth in the Kyrgyz Republic.

Among the entrepreneurial aspects reviewed, the business environment survey covers the area of taxation.<sup>6</sup> Historically, businesses view tax rates as one of the major constraints for growth. Every fifth entrepreneur stated that not only the tax amount but also the tax administration procedure was an administrative barrier to business development. By contrast, in the Europe and Central Asia countries, on average, 15 percent of entrepreneurs interviewed pointed to such major constraint. These data once again reaffirm the urgency of reforming the taxation system in the Kyrgyz Republic—in particular, tax administration should be simplified, and businesses costs for compliance with mandatory requirements of tax legislation should be reduced.

<sup>6</sup> <http://www.enterprisesurveys.org/data/exploreeconomies/2013/kyrgyz-republic#regulations-and-taxes>

*Figure 1.  
Major constraints for private sector development in Kyrgyz Republic*



*Note: ECA = Europe and Central Asia Region.*

## METHODOLOGY OF STUDY

This study investigated operational commercial enterprises in the Kyrgyz Republic, including legal entities and individual entrepreneurs, who have been engaged in business and regularly submitted their tax returns in 2012, 2014, and 2016. Agricultural holdings and entrepreneurs operating under the voluntary patent-based taxation system were not covered by this study because of the special tax regime. Thus, to estimate the businesses costs of tax compliance, businesses which have regularly kept tax records during the review period and submitted tax returns for the respective taxation year were selected.

Overall, three rounds of study of business costs in different taxation periods were conducted in the process of implementation of tax reforms:

ROUND 1	ROUND 2	ROUND 3
was held from October 2013 to February 2014 and covered the tax reporting period of 2012	was held from January to April 2015 and covered the tax reporting period of 2014	was held from January to April 2017 and covered the tax reporting period of 2016

The survey was conducted through personal structured interviews with respondents using a questionnaire. This structured questionnaire was developed by IFC experts in line with the international standards applicable for studies of tax reporting costs to enable further international benchmarking. The average duration of the interviews was 45 minutes. The questionnaire consisted of individual blocks, with each block covering a specific topic of tax reporting. The major topics were the following:

- General data on a taxpayer
- Tax accounting
- Conduct of tax audits and inspections by the Social Fund
- Value added tax (VAT) refund procedure
- Tax appeals
- Assessment of performance of tax authorities and perception
- Assessment of taxation environment

The sections covering VAT refund procedures and tax appeals were not included in this analysis because of the small number of respondents who went through such tax procedures for the review period. An insufficient number of observations makes it impossible to conduct statistical analysis, and data received may be processed through the qualitative analysis only.

The respondents represented business owners/individual entrepreneurs, managers of companies/taxpayers, and other competent specialists in the topic of study (finance managers, accountants, and so on). If various specialists of the interviewed company were the most competent respondents, several people were interviewed. The prospective interviewees were initially recruited by phone. Stratified random sampling was used for this study. For the simple random sample, all objects of total population have equal non-zero probability to be selected for sampling, which precludes the need to weigh the results. In case of stratified random sampling, all objects of total population are divided into uniform groups/strata, and then, simple random sampling within each stratum is arranged. This approach obtains statistically significant data with the preset level of error both for each stratum and for the total population, with the use of appropriately computed weighting coefficient.

Study sampling was stratified using the following criteria:

- Tax regime chosen by the taxpayer
- Size of the taxpayer (determined by the business’s annual income)
- Geographic area of taxpayer operations
- Major economic activity

The Tax Service under the Government of the Kyrgyz Republic collected the data on population distribution by the selected strata and performed direct random sampling of taxpayers for the study in accordance with the methodology developed and presented by IFC.

The Tax Service’s data show that the total population of this survey amounted to 19,206 taxpayers in 2012 and 21,981 and 23,620 taxpayers in 2014 and 2016, respectively (Table 2).

During the monitoring, the population distribution by tax regime did not change considerably. More than half of the registered taxpayers followed the general tax regime without VAT registration (Table 2). In 2016, 28 percent of businesses paid VAT and 20 percent of entrepreneurs paid the unified tax.

*Table 2.  
Distribution of total population of taxpayers with breakdown by tax regime*

	2016		2014		2012	
	N	%	N	%	N	%
General regime, VAT registration	6,542	28	6,161	28	5,622	29
General regime, without VAT registration	12,250	52	11,296	51	10,309	54
Simplified regime	4,828	20	4,524	21	3,258	17
Total	23,620	100	21,981	100	19,189	100

Table 3 describes the distribution of interviewed taxpayers based on the tax regime in each round of survey. It is clear that with regard to the criteria of tax regime, the sampling of the total population shifted toward taxpayers who operated under the general regime with VAT registration. Sampling was redistributed to derive a sufficient number of observations in this stratum, which is adequate for further statistical analysis and has the comparable level of permissible error. The computed weighted coefficients reconstruct the pattern of total population by the tax regime in the process of describing an average taxpayer.

*Table 3.  
Distribution of interviewed taxpayers disaggregated by tax regime*

	2016		2014		2012	
	N	%	N	%	N	%
General regime, VAT registration	597	40	583	39	610	40
General regime, without VAT registration	583	39	565	38	567	37
Simplified regime	326	22	358	24	339	22
Total	1,506	100	1,506	100	1,516	100

A similar approach was used for calculating the size of taxpayer, which was identified by its annual income/revenue. Analysis of the total population structure by the size of the taxpayer shows that more than half of all businesses fall under the category of microbusiness, with turnover less than KGS 1 million. Moreover, this category in 2012 constituted two-thirds of the total number of taxpayers in the Kyrgyz Republic (Table 4).

*Table 4  
Distribution of total population of taxpayers, breakdown by size (annual profit)*

	2016		2014		2012	
	N	%	N	%	N	%
Microbusiness (less than KGS 1 million)	13,542	57	13,671	62	12,439	65
Small business (KGS 1–4 million)	4,901	21	4,182	19	3,201	17
Small business (KGS 4–8 million)	1,474	6	2,892	13	2,416	13
Medium business (KGS 8–30 million) <sup>a</sup>	2,138	9				
Large business (more than KGS 30 million) <sup>b</sup>	1,565	7	1,236	6	1,133	6
Total	23,620	100	21,981	100	19,189	100

*Note: a. KGS 8–30 million for legal entities and above KGS 8 million for individual entrepreneurs; b. Only for legal entities.*

Proportional distribution of sampling against the total population would certainly lead to excessive number of microbusinesses in the sampling and poorly represented medium and large taxpayers. Such distribution would make it impossible to perform statistically significant analysis by the size of taxpayer within each stratum. Furthermore, as described in table 5, the size of a business is one of the key parameters that can have a serious effect on tax administration costs. To this end, the share of microbusinesses in the sampling was considerably reduced, and the representation of medium and large taxpayers was adjusted to the statistically acceptable value (Table 5).

*Table 5.  
Distribution of interviewed taxpayers, breakdown by size (annual profit)*

	2016		2014		2012	
	N	%	N	%	N	%
Microbusiness (less than KGS 1 million)	666	44	745	49	759	50
Small business (KGS 1–4 million)	340	23	301	20	283	19
Small business (KGS 4–8 million)	107	7	242	16	241	16
Medium business (KGS 8–30 million)	176	12				
Large business (more than KGS 30 million)	217	14	218	14	233	15
Total	1,506	100	1,506	100	1,516	100

Each round of the study surveyed all the regions of the Kyrgyz Republic, thereby ensuring maximum geographic coverage. Nonetheless, the total population is highly heterogeneous by location. Half of operational and registered taxpayers function in Bishkek (Table 7). Because the location does not have a strong effect on tax accounting costs of businesses, geographic distribution in the sampling was almost equal to the total population (Table 8).

Further, for the regional analysis, all other regions were grouped as the southern region (Osh, Jalal-Abad, and Batken Provinces) and the northern region (Chui, Issyk-Kul, and Talas Provinces). A more detailed breakdown was not appropriate due to the limited number of respondents in each province.

*Table 6.  
Distribution of total population of taxpayers, disaggregated by region*

	2016		2014		2012	
	N	%	N	%	N	%
Bishkek	12,139	51	11,394	52	11,324	59
Other regions	11,481	49	10,587	48	7,865	41
Total	23,620	100	21,981	100	19,189	100

*Table 7.  
Distribution of taxpayers interviewed with breakdown by region*

	2016		2014		2012	
	N	%	N	%	N	%
Bishkek	787	52	746	49	712	47
Other regions	719	48	760	51	804	53
Total	1,506	100	1,506	100	1,516	100

The last sampling stratification parameter was the major economic activity of the registered entrepreneurs. A detailed breakdown of respondents by type of activities was not appropriate and thus, it was agreed to group all business entities into three main sectors—industry, trade, and services. As long as the industrial companies’ share in the total population was as little as 14 percent of the total number of taxpayers (Table 8), the sampling was redistributed in a similar way to increase the share of the industrial sector by reducing the representation of the services sector companies from 56 percent to 43 percent (Table 9).

*Table 8.  
Distribution of total population of taxpayers, by type of economic activities*

	2016		2014		2012	
	N	%	N	%	N	%
Industry	3,260	14	3,177	14	2,615	14
Trade	7,201	30	7,004	32	6,163	32
Services	13,159	56	11,800	54	10,411	54
Total	23,620	100	21,981	100	19,189	100

*Table 9.  
Distribution of taxpayers interviewed, by type of economic activities*

	2016		2014		2012	
	N	%	N	%	N	%
Industry	343	23	367	24	385	25
Trade	511	34	476	32	495	33
Services	652	43	663	44	636	42
Total	1,506	100	1,506	100	1,516	100

# TAX ENVIRONMENT IN THE KYRGYZ REPUBLIC

## TAX ADMINISTRATION REFORM

The Central Asia Tax Project of IFC is part of the regional Investment Climate Advisory Services Program implemented by the World Bank Group. Through the project, IFC actively assists the Tax Service with improvements on the existing tax administration system in the Kyrgyz Republic. In particular, the project supports the following tax reform areas:

- Introduction of tax inspection systems with risk-based assessments of taxpayers
- Transition of tax reporting to electronic submissions
- Simplification of tax reporting forms and decrease in filing time
- Introduction of alternatives for tax payments
- Improvements to VAT administration procedures
- Capacity strengthening of the Tax Service
- Development and conduct of outreach activities for the private sector, including distribution of training materials on taxation matters

During 2012–2016, a series of tax administration reforms was implemented. The objective of these reforms was to strengthen tax compliance by increasing transparency and simplification of tax procedures. These activities have mainly resulted in reduction of tax accounting costs for taxpayers and barriers to entry to the formal economy, thereby incentivizing economic growth. Moreover, these activities were focused on improved performance of the State Tax Service under the Government of the Kyrgyz Republic.

The major outcomes achieved due to reforms in the Kyrgyz Republic include the following:

- 1** Since 2012, a paid service for web-based tax filing using an electronic key purchased from a private operator was implemented. The business community suggested introduction of free-of-charge electronic tax reporting submission as the next stage. In 2014, the State Tax Service introduced the electronic tax reporting filing system for taxpayers whose income is less than the VAT registration threshold (KGS 4 million) through the taxpayer account at the Tax Service's website. As of today, all taxpayers regardless of their revenue levels may make use of this service.
- 2** Since July 1, 2013, field tax audits were planned based on risk assessment of failure to pay tax. Across the country, a field tax audits plan is generated automatically and at the centralized level pursuant to the risk assessment with the use of risk criteria as specified in the Tax Code, and additional criteria as approved by the State Tax Service. Introduction of risk assessment system anticipates achieving the following goals:

- Efficient use of STC resources. Tax control is focused on abusive taxpayers, resulting in higher tax revenues.
- Secure impartiality. A subjective factor in the selection process is avoided because a risk level for all taxpayers is determined based on the same parameters.
- Reduce tax burden on good faith taxpayers. Good faith taxpayers are inspected less often and thus, bona fide tax payment is incentivized.
- Immediate response to emerging schemes of tax legislation violations. Focus on abusive taxpayers allows detection of new tax evasion schemes immediately and in a consistent manner.

3 Persistent efforts are taken to reform the VAT system. The Government of the Kyrgyz Republic approved Resolution No. 569, dated November 4, 2016, 'On Procedure for application and account of certain high security document forms of invoices for electronic filling'. This Resolution proceeds to the next stage of reforms, that is, to cancel VAT invoices as a high security document and assign a range of numbers to taxpayers. The State Tax Service introduced a new VAT invoices administration system, which enables more speedy issuance of VAT invoices to taxpayers and improves the internal controls. The reform helped the taxpayers avoid visits to tax authorities to purchase invoices; instead, taxpayers file an application and obtain VAT invoice numbers electronically.

4 To implement a set of government actions aimed at increasing the cashless payments share, a project on introduction of new options for paying taxes was launched for small and medium companies in 2014. Electronic means of paying taxes through Point of Sale (POS) terminals, ATMs, Internet banking, and mobile communication means are currently available in eight banks and are focused on creating an enabling environment for taxpayers through reduction of their time and costs, elimination of direct contacts between a business and a tax inspector, and better tax transparency as the taxes are paid through bank terminals and payment kiosks. To raise awareness of taxpayers, outreach materials were developed and disseminated.<sup>7</sup> As reported by the State Tax Service, the number of cashless payments has considerably increased from 2012 through 2016. In 2012, there were reports of 186 payments of taxes to the budget using all types of peripheral hardware (payment cards, payment kiosks, web-based cash office, electronic wallet, and Internet banking) to the amount of KGS 374,800, while in 2016, 139,257 payments were recorded for the total amount of KGS 171,721,600. Mobile banking should be adopted at the next stage.

5 The Government invested considerable effort toward reducing time for submission of tax statements by introducing appropriate amendments to the Tax Code.<sup>8</sup> From July 1, 2015, the frequency of reports submission for small and medium businesses has declined from a monthly to a quarterly basis, with the frequency of tax payments also changing to a quarterly basis for small companies with revenues not exceeding KGS 4 million (medium companies with income of less than KGS 30 million have yet to pay taxes every month).

<sup>7</sup> [http://www.vb.kg/doc/315995\\_gns\\_vypystila\\_byklety\\_po\\_yplate\\_nalogov\\_cherez\\_internet\\_banking.html](http://www.vb.kg/doc/315995_gns_vypystila_byklety_po_yplate_nalogov_cherez_internet_banking.html)

<sup>8</sup> [http://www.president.kg/ru/news/zakony/5871\\_vneseniy\\_dopolneniya\\_i\\_izmeneniya\\_v\\_nalogovyy\\_kodeks\\_kyrgyzskoy\\_respubliki/print/](http://www.president.kg/ru/news/zakony/5871_vneseniy_dopolneniya_i_izmeneniya_v_nalogovyy_kodeks_kyrgyzskoy_respubliki/print/)

- 6 In 2015, preparations were made to implement one of the major reforms: transfer the function of social contributions administration from the Social Fund to the Tax Service. Currently, the ongoing pilot project is to implement Resolution No. 763 of the Government of the Kyrgyz Republic, dated November 10, 2015, 'On Piloting administration of social security contributions', which empowers the SCS to collect contributions. The pilot project is ongoing in Oktyabrskiy district of Bishkek City and Sokuluk district of Chui Province. During the pilot project, the Government of the Kyrgyz Republic has identified the issues that should be resolved before proceeding to nationwide reform. Based on these outcomes, the Government of the Kyrgyz Republic prepared legislative amendments related to transfer of the administration of social security contributions to the SCS.

## BUSINESS PERCEPTION OF TAX ENVIRONMENT

- Subjective perception of the tax environment by taxpayers tends to be favorable, implying that from the business community's perspective, there are positive improvements in the Kyrgyz tax system.
- Despite that, the effective total tax is one of the lowest in the region: almost one in three taxpayers in the Kyrgyz Republic believes that tax burden is a major obstacle for business development.
- Hence, businesses have to resort to various schemes of understatement of tax base, because they think that they will strike a deal with the tax authorities. According to respondents, the scale of understatement of tax base has declined in recent years.

The key goal of the study was to provide the best objective assessment of taxpayers' costs of tax compliance. Equally important was to analyze overall business perceptions of the tax environment where they operate. During all three rounds of study, respondents were asked to provide their opinion<sup>9</sup> about various dimensions of business activities, which were directly or indirectly associated with taxation and tax legislation.

The findings demonstrate a steady decrease in the number of taxpayers who think that the number of normative and legal acts in the area of taxation represents an issue (Figure 2). Whereas in 2012, one in three businesses (35 percent) perceived an excessive number of legislative acts as an obstacle for doing business, by the time of Round 3 (2016), the share of such businesses declined by 18 percent.

The coherent reforms of the tax system were bound to be reflected in the taxpayers' assessment of frequent changes in the tax legislation. Whereas the share of taxpayers, who viewed such changes as obstacles for doing business, declined in 2014 from 39 percent to 23 percent, in 2016, a slight increase was noticed again. In absolute terms, this factor is not so critical: only one-fourth of the interviewed entrepreneurs mentioned this issue. It can be concluded that for the large majority of taxpayers, the volatile taxation system does not present a specific concern. Meanwhile, to continue tax reforms, it is equally important to ensure stability and introduce changes to the tax legislation at certain intervals (once a year) and provide all necessary informational support to the business community to help mitigate negative perceptions of innovations in the taxation arena.

Another equally important feature of the tax system is not only the number of regulatory normative acts but their inconsistency. Overall, this factor is slightly more challenging for businesses as compared to the issue of the total number of legislative acts. However, the survey findings point to positive dynamics in the matter of the legislative framework inconsistencies. The share of taxpayers who referred to the inconsistent legislative framework is persistently reducing, having reached 23 percent of respondents in 2016 (Figure 2). In other words, though the legislative changes had been frequently incorporated, the transparency and coherence of laws improved. However, inconsistencies in the normative acts should be identified and removed on a systematic basis.

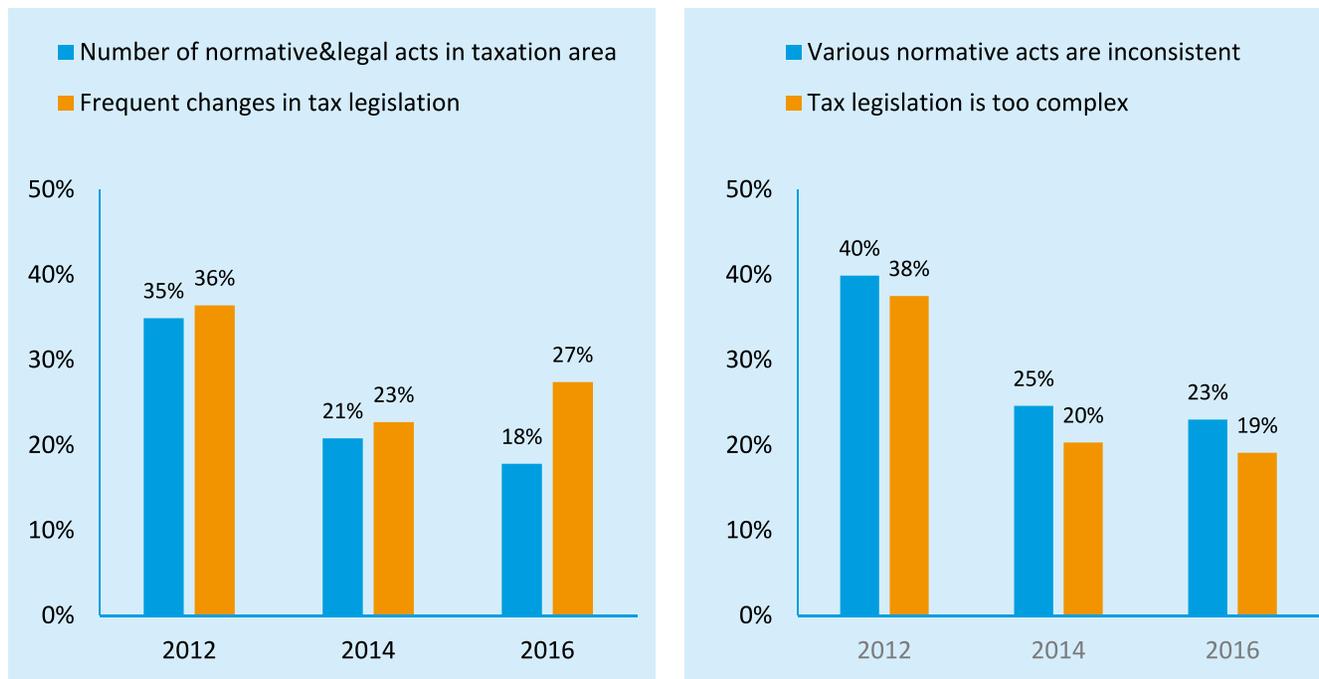
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<sup>9</sup> Assessment was given on a five-point scale, with criteria varying from 'not a problem' to 'serious problem'

A direct consequence of the situation described earlier is improved perception of tax legislation in terms of its complexity. During Round 1 of the survey in 2012, about 40 percent of respondents noted that they found it difficult to understand the current tax system. In 2016, the share of such respondents decreased twofold (Figure 2). Moreover, not only the tax legislation but also the tax procedures became less complicated. In 2012, one in three entrepreneurs replied that tax procedures are challenging for doing business, but in 2016, only one out of five entrepreneurs shared this opinion (21 percent).

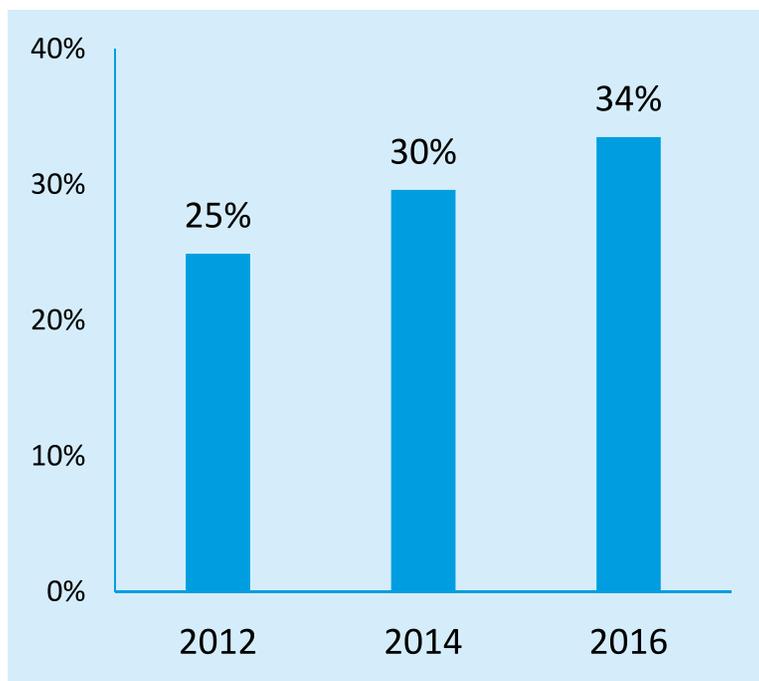
Based on the subjective opinions of entrepreneurs about the tax environment, an improved perception of the tax system among taxpayers may be noted, as demonstrated by the decreased number of normative and legal acts, fewer inconsistencies, and as a result, better understanding of tax legislation. Overall, the survey suggests positive improvements to the tax system of the Kyrgyz Republic from the perspective of the business community.

*Figure 2.*  
*Share of taxpayers who think that the laws are a problem for business*



Traditionally, a heavy tax burden is one of the major constraints for small and medium business development. Data of the business environment survey held by the World Bank in 2013 shows that high tax rates constrained the business development of 29 percent of entrepreneurs in the Kyrgyz Republic. Despite this, during the tax reform process in recent years, one more positive trend was observed—more taxpayers think that paying taxes has its benefits. At the start of the monitoring process, only one in four taxpayers shared this view; during Round 3 of the survey, one in three businesses supported this view (Figure 3).

Figure 3.  
Share of taxpayers who think that there are many benefits of paying taxes



Note: \*Share of respondents, who 'fully agree' or 'rather agree' that there are many benefits for the businesses in paying taxes.

The large majority of entrepreneurs, nonetheless, still do not notice any advantages of paying taxes for their businesses. One of the key reasons could be the tax rate. Based on the results of the last round of the survey, 34 percent of taxpayers in 2016 hold the view that extremely high tax rates are applicable to the peer companies. This indicator has been steady, and it does not correspond to the type of taxpayer, size, or tax regime.

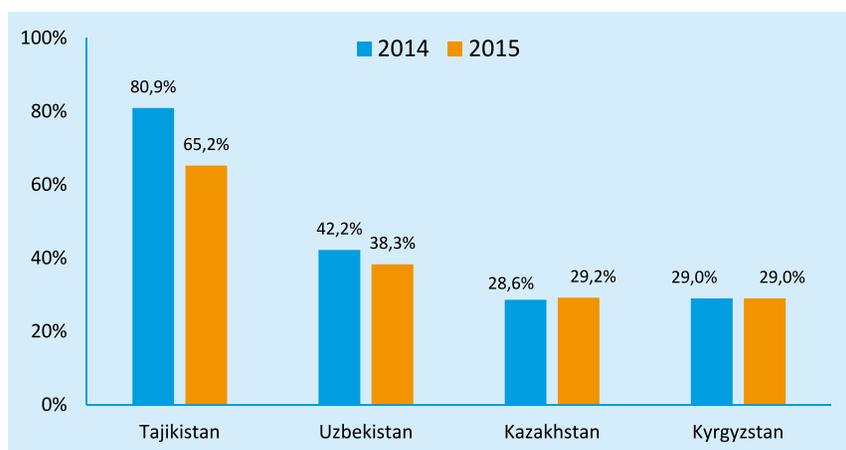
The level of subjectivity in the entrepreneurs' assessment of tax burden on a business should be kept in mind while analyzing the survey. The World Bank Group conducts a large-scale worldwide survey on the Ease of Doing Business in different economies<sup>10</sup> and publishes its data on a regular basis. More than 180 countries participate in this survey; the survey considers various dimensions of business operations, including taxation and tax administration matters.

One of the evaluated parameters is the total tax, which consists of a tax rate and mandatory contributions that should pay a company in the second year of its operations; the total tax is expressed as the share of income. This survey shows that the overall tax burden on the private sector in the Kyrgyz Republic is moderate compared to other countries in the Central Asia region (Figure 4). A medium-size taxpayer<sup>11</sup> in the Kyrgyz Republic pays 29 percent of its revenue as the total tax. This indicator is one of the lowest in the region. To compare, in Tajikistan, the overall tax burden on the private sector exceeds 50 percent of earnings.

<sup>10</sup> Doing Business, <http://russian.doingbusiness.org/rankings>

<sup>11</sup> Definition of a "medium-size" entrepreneur is available at: [http://russian.doingbusiness.org/Methodology/paying-taxes#Общая налоговая ставка \(% от прибыли\)](http://russian.doingbusiness.org/Methodology/paying-taxes#Общая_налоговая_ставка_(%_от_прибыли))

*Figure 4.*  
*Total tax (percentage of profit) paid by businesses in Central Asia region as reported in Doing Business for 2014–2015*

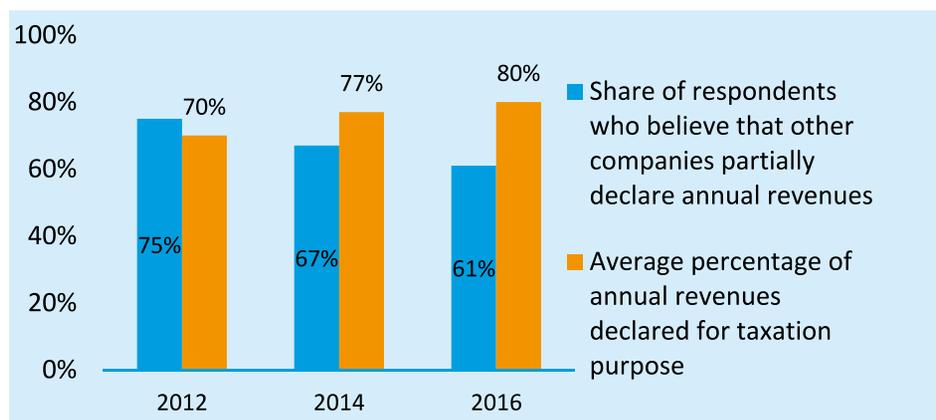


Because of a relatively high tax burden, entrepreneurs have to resort to various schemes for understatement of the tax base. One of the most widely used practices is an informal salary (its portion or full amount) paid by an employer to a company’s employees. About one-third of respondents (74 percent in 2016) mentioned that some companies operating in the same sector followed this practice.

Understatement of formally declared payroll fund is a firmly rooted practice, which has not substantially changed over the last few years of monitoring.

The second most frequently used method is under-declaration of annual income of a company for taxation purposes. More than 60 percent of respondents in 2016 assumed that peer companies in the same sector did not declare their annual income in full amount (Figure 5). The survey data present a higher number of positive answers. In 2012, the share of such respondents was higher (75 percent of total number of businesses surveyed). Because this practice is commonly used, the scale of income concealment is also high. Businesses believe that a company may conceal one-fifth of its total annual turnover. During Round 3 of the survey, a gradual reduction of this share was noted and, respectively, an increase in average taxable turnover of taxpayers.

*Figure 5.*  
*Assessment of scale of under declared annual profit to reduce tax base*

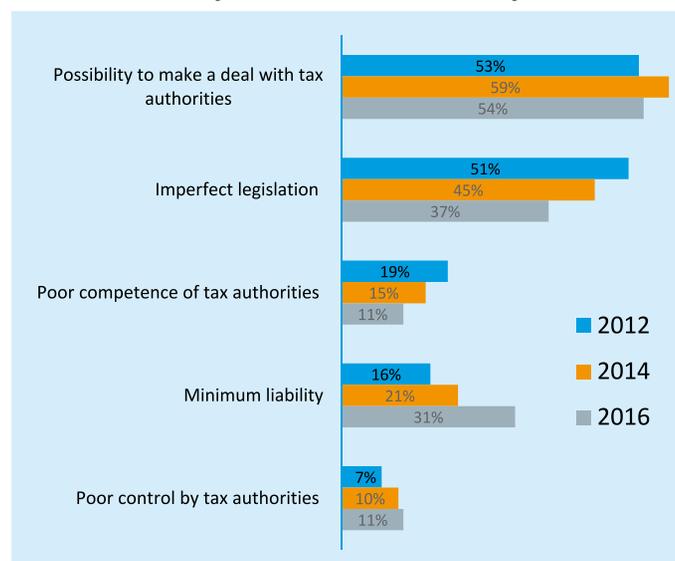


It was impossible during a survey to explicitly ask and receive an open answer about whether a company declares its profit in full or partially. Therefore, indirect evaluations were used, whereby a respondent was asked to give an answer about other companies operating in the same sector rather than about his/her company. This approach enables an implicit assessment of the extent of the problem in question. Thereby, assessing the scale of a reduced tax base should be considered as a conservative estimate, understanding that there is a high probability that the real situation differs from the simulated state and the situation on the ground could be even worse.

What makes it possible for businesses to evade taxation? The common reason given by taxpayers is the possibility to strike a deal with the tax authorities. More than half of the respondents stated this reason, and this practice remained prevalent during all three rounds of the survey. No prerequisites for changes in this situation were identified thus far.

Third in the list of possibilities for tax evasion is an imperfect tax legislation. Unlike the previous case, a clearly positive trend was reported. The share of businesses who think that gaps in legislation facilitate tax evasion has steadily declined—from 51 percent to 37 percent—during the monitoring period (Figure 6). This situation corresponds to the trend for fewer inconsistencies of normative and legal acts noted by the respondents and as described earlier. A similar trend is reported in the assessments of tax authorities’ competencies. The share of businesses which believe that low competence of tax officials is one of the factors in tax evasion has reduced by half in recent years. In the 2016 survey, only 11 percent of respondents shared this opinion.

*Figure 6.  
Possibilities for understatement of tax base*



It is worth noting that the minimum liability of taxpayers, as mentioned by the respondents, also enables understatement of the tax base. During the survey, the share of respondents who replied that taxpayers hold minimum liability for violations of tax legislation has nearly doubled—from 16 percent in 2012 to 31 percent in 2016. This is the only factor that has increased in recent years. To sum up, the problem of tax evasion is not associated with the normative and legal environment but with the human factor, including the possibility of striking a deal with tax officials and a minimum liability held by the businesses for failure to comply with tax legislation.

## BUSINESS COSTS OF COMPLIANCE WITH TAX LEGISLATION

The primary purpose of this study was to assess and monitor the costs incurred by the taxpayers to comply with mandatory requirements of tax legislation. All reforms carried out by the Government and the State Tax Service, with the support of the World Bank Group and IFC, were designed to simplify tax procedures, thereby reducing the administrative burden on businesses in the tax administration arena. The latter should become an added incentive for economic support and growth and for higher tax collections due to decreased tax administration costs.

Generally, the same employees (accountants) in a company are engaged in both accounting and tax accounting, perceiving their role to be an integrated process. Hence, to ensure accuracy of assessments, it was important that the respondents were presented with formulations that make a distinction between accounting and tax accounting in a clear and understandable way. Finally, the following definitions were used:

- Accounting is the accounting of the income and expenses of a company but not associated with taxation. It is an activity that a company would perform even if it did not have to pay any taxes.
- Tax accounting is the accounting of income and expenses of a company associated with taxation and the Social Fund, production and storage of source documents, accounts maintenance, calculation of taxes and social contributions, filling out tax forms and the Social Fund's forms, submission of tax forms, payment of taxes, any interaction with tax authorities, and the Social Fund units, and so on. This is the activity of a company connected to tax legislation compliance.

Tax administration costs of taxpayers being assessed in the course of this study include labor costs (salaries paid to tax accountants on staff) and indirect costs, such as payment for services of outsourcing companies, acquisition of specialized software for tax accounting, purchase and maintenance of cash registers, invoices, forms, and so on. The principal indicator describing the success of ongoing reforms in the tax policy and tax administration areas is the time costs of taxpayers because such costs fairly represent the changes that happen.

## TIME COSTS

- In recent years, time costs of taxpayers for tax administration reduced by 40 percent and took 23.6 days in 2016, which is the principal outcome of the tax reform carried out in the country.
- Reduced administrative burden in the area of tax regulation was reported for all types of taxpayers regardless of the tax regime, the size of business, and so on.
- Taxpayers operating under the simplified regime spent the least time for tax accounting, and VAT payers incurred the highest time costs. This situation is caused by the number of administrative taxes and extremely complex system of tax record maintenance compared to the uniform tax system.
- Maintenance of tax records in the office takes over half of all tax administration costs of entrepreneurs.
- Decreased frequency of submission of tax reporting for small and medium businesses in 2015 resulted in reduced time costs of tax records in the office and visits of tax authorities to submit tax returns in 2016.
- Implemented reforms of administration of VAT invoices and introduction of alternatives for paying taxes also contributed to a decrease in administrative costs of entrepreneurs for tax administration due to less time spent for visits and a reduction in direct expenses on purchase of invoice forms.
- The logical consequence of a reduced administrative burden for tax compliance is a better perception among taxpayers about the level of complexity of tax administration.

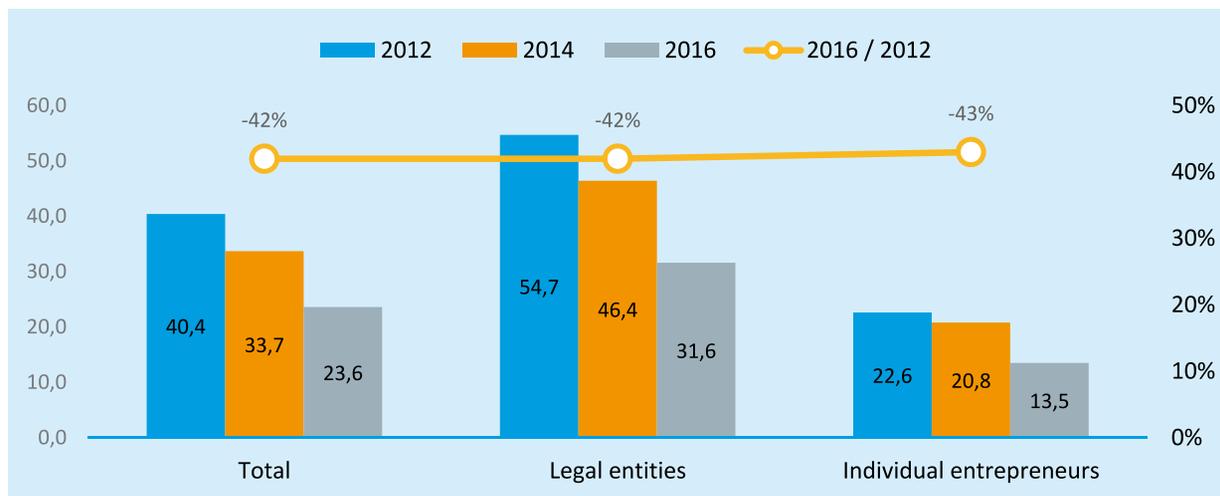
Time costs of tax accounting consist of the total time within a year spent by all employees in a company-taxpayer, who deal with the tax administration process, and expressed as person-days per year. Tax record maintenance by the accountant of an enterprise is the commonly used tax administration practice in the Kyrgyz Republic. Over 90 percent of taxpayers maintain tax records in-house, without engaging third-party specialists. The data of all rounds of the study indicate that this practice has not changed for the past years. Thus, expenses on labor remuneration of employees are a major component in the company's cost structure for tax accounting.

Between 2012 and 2016, time costs of tax administration of one average taxpayer in the Kyrgyz Republic contracted by more than 40 percent: from 40.4 days in 2012 to 23.6 days in 2016 (Figure 7). A decrease in time costs was reported across all types of taxpayers, regardless of the size of company, area of operations, or the tax regime. This is a principal outcome of the reforms implemented in the tax policy and tax administration areas, with the focus on simplified tax system, taxation procedures, and reduced administrative burden on businesses.

Historically, legal entities spend more business time for tax records compared to individual entrepreneurs. One individual entrepreneur in 2016 spent on average 13.5 business days for tax records, which is two and a half times less than time costs of legal entities for the same operations (31.6 working days). In the beginning of regular monitoring of time costs in 2012, a legal entity would need over 50 working days per year on average to comply with all requirements of tax legislation (Figure 7).

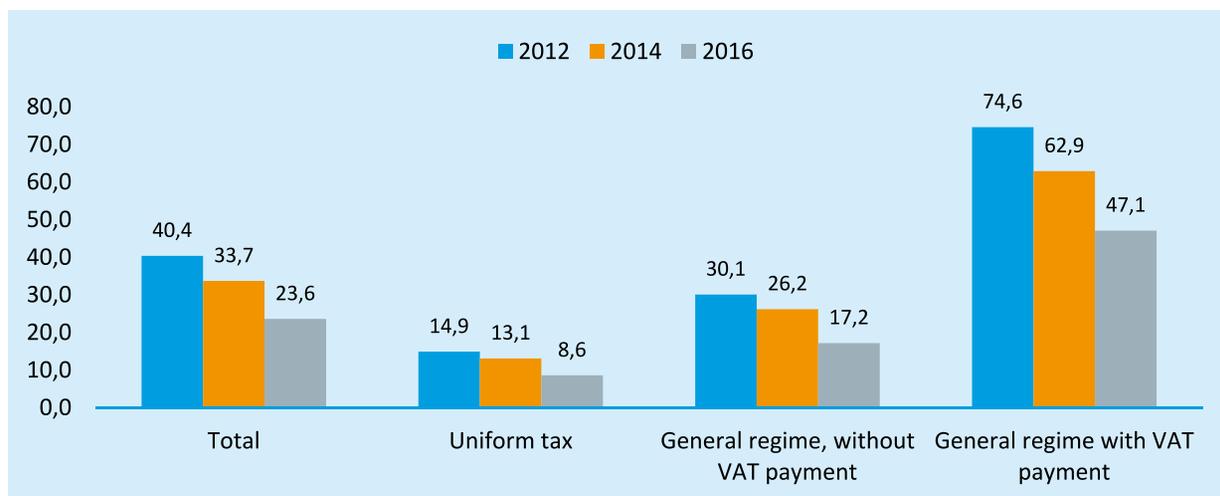
It should be noted that reduced time costs, in 2016 against 2012, in percentage terms were observed regardless of whether a taxpayer was a legal entity or an individual entrepreneur. The same applies to the different tax regimes. This suggests integrity of the tax reforms pursued, applying to all types of taxpayers.

**Figure 7.**  
Dynamics of time costs of tax records by type of taxpayer, in person-days per year



It is natural that the time needed to maintain tax records largely depends on the tax regime under which a taxpayer operates. The payers of the uniform tax incur less time costs compared to taxpayers following other tax regimes. In 2016, the companies which follow the simplified tax regime spent less than nine working days on average to maintain their tax records. The most costly tax administration operations were in the companies which operated under the general tax regime with VAT; they spent about 47 business days in 2016 for such operations (Figure 8).

**Figure 8.**  
Dynamics of time costs of tax accounting by type of tax regime, in person-days per year



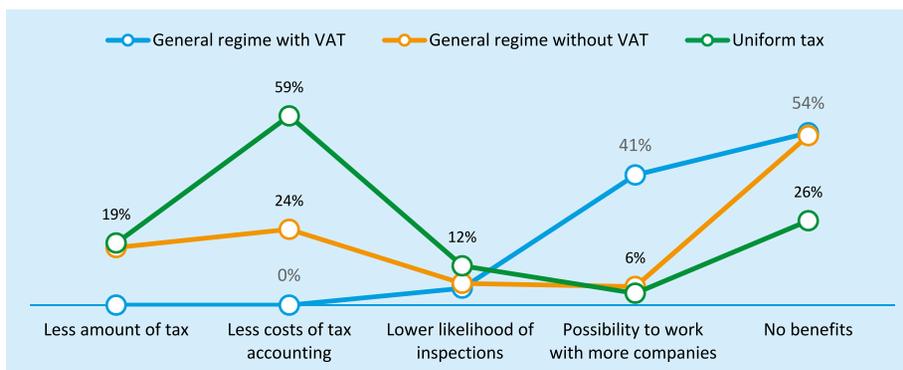
The substantial cost of tax record maintenance may represent one more administrative barrier to enterprises making the transition from the simplified tax regime to the general tax regime. Even for businesses with comparable income (less than KGS 8 million per year), the time costs of operating under the simplified tax regime are half as much as those businesses following the general regime. If a business intends to be registered as a VAT payer, the time costs for tax accounting will increase by more than four times against the costs of the uniform tax payers. The study findings confirm this assumption: about one in four VAT payers responded that an artificial separation of businesses is one of the commonly used practices for understatement of tax base.

The benefits operating under the simplified tax regime are supported by the generally held opinion of entrepreneurs that their tax regime has no advantages. Over half of the entrepreneurs operating under the general regime shared this opinion (Figure 9). For reference, this indicator among businesses operating under the simplified regime is as low as 26 percent.

In addition, if compared to the general tax regime, a higher share of uniform tax payers think that one of the benefits of this tax regime is less cost of tax accounting. Fifty-nine percent of respondents among entrepreneurs operating under the simplified regime hold this view. It is worth mentioning that savings on tax administration costs is one of the common benefits, and it outranks even a critical factor such as a reduced amount of taxes to be paid, which was referred by as little as 24 percent of payers of uniform tax (Figure 9).

It is assumed that VAT payers have to operate under this tax regime due to a high volume of turnover but they see no advantages in being VAT payers. The only good thing in the general regime with VAT payment is an opportunity to work with more companies.

*Figure 9.  
Benefits of tax regime, which was followed by a business in 2016*



Entrepreneurs’ desire to remain under the simplified regime to minimize their administrative costs of tax accounting and the amount of taxes to be paid indicates that they are discouraged from increased development within the formal economy and from transitioning to the general tax regime as their businesses grow. This situation may have an adverse effect both on the enterprises’ development and on the overall economic growth.

Round 1 of the study dedicated to the tax records practice in 2012 was the baseline, and its primary purpose was to set the baseline point, against which the monitoring of further reforms should be measured. If the dynamics of reduced time costs for tax compliance is analyzed, it is clear that the main reduction took place in the period between Round 2 and Round 3 of the study, both in absolute terms and in percentage terms. The time costs of one taxpayer contracted by 17 percent in 2014 against the level of 2012: from 40.4 business days in 2012 to 33.7 days in 2014. The results of Round 3 of monitoring point to higher dynamics. In 2016, administrative burden on one taxpayer reduced by more than 10 business days or by 30 percent of the similar time costs reported in 2014 (Figure 8). Two major reasons can be identified which affected the uneven reduction of time for tax administration. First, tax reform produces a cumulative effect. No innovation immediately generates a tangible outcome; time is needed. In 2014, the introduction of alternative methods of tax payments through ATMs and payment kiosks was launched. But the 2014 survey identified no quick outcomes. As described in the following paragraphs, the meaningful savings of time spent for tax payment was reported only in 2016.

Second, the ongoing tax administration reforms have had varying degrees of impact on businesses. Between Round 2 and Round 3 of the study, the filing frequency of tax reporting by small and medium businesses was changed from monthly to quarterly filings. The reduction in filing frequency (by three times) reduced the time costs of tax accounting and thus, was reflected in the study findings in 2016. IFC-led surveys allow both the monitoring of changes in time costs of tax administration and analysis of the possible causes for detected trends. The most time costly tax-related activity was the office work of a taxpayer, which includes accounting of tax base, calculation of tax amounts, filling in tax forms, including Single Tax Return, filling reporting forms of the Social Fund, and so on. In 2016, such type of work took 13.3 business days on average and amounted to more than half of all time costs of tax compliance (53 percent) (Figure 10).

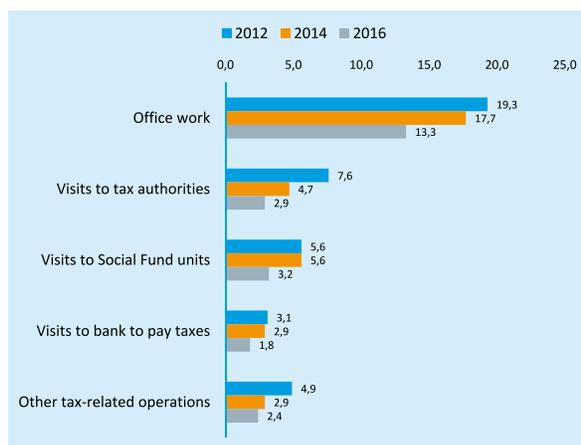
On July 1, 2015, the amendments to the Tax Code were designed to regulate filing frequency of tax reporting for small and medium businesses. The frequency of tax reporting for taxpayers with income of less than KGS 30 million was reduced by three times, due to the transition from the monthly to the quarterly period. Moreover, small companies with turnover not exceeding KGS 4 million (KGS 8 million as effective from January 1, 2016), also saw changes in the frequency of tax payments; currently, such businesses pay tax on a quarterly basis. It is worth mentioning that the reform is wide-reaching because it touches more than 90 percent of taxpayers in the Kyrgyz Republic.

Alongside the reforms outlined earlier, the monitoring results suggested a sharp decrease in time costs of tax records related to the office work of taxpayers. In 2014, the time spent in an office decreased insignificantly (by 8 percent against the level of 2012), but two years later, a positive dynamic was reported at 25 percent, decreasing from 17.7 days in 2014 to 13.3 days in 2016 (Figure 10). In absolute terms, such savings were the highest among all tax administration costs.

For the same period, a significant decline was observed in the share of entrepreneurs to whom the filing frequency of tax returns was challenging in their business operations. In 2012, one in six respondents (16 percent) evaluated the frequency of filings of tax returns as ‘a problem’ or ‘a big problem’. The results of Round 2 did not identify any substantial changes in this indicator, but once the tax code was amended and the filing frequency of tax statements changed in 2015, the scale of the perceived problem declined by a minor level at 6 percent. It could be argued that the reforms helped simplify a costly stage of tax administration in terms of time, to the largest possible extent.

*Figure 10.*

*Time costs structure of tax accounting by type of activities over time, in person-days per year*



Office-based tax management takes many forms depending on various features of the taxpayer. Primarily, it depends on the tax regime followed, influenced by the number of paid taxes and time for their administration.

Uniform regime taxpayers typically incur the minimum time costs, that is, 2.9 working days. This indicator is 10 times less than the indicator of companies following the general regime and paying VAT. Such companies spend 30 working days on average for tax accounting purposes. Maximum time is required for accounting of VAT and filling the Single Tax Return, which takes 8 and 7.4 days, respectively.

The degree of difficulty of accounting of these two types of taxes, which are the most costly by administration time, was assessed in various ways. Where the time costs are the highest, VAT accounting is not an issue for its payers. Unlike VAT, the Single Tax Return is the most challenging aspect—one in five VAT payers consider its administration to be ‘complicated’ or ‘extremely complicated’. Among taxpayers who operate under the general regime but do not pay VAT, the Single Tax Return is an issue for one in three interviewed entrepreneurs.

*Table 10.  
Time costs of office work of tax accounting by major types of taxes in 2016  
and percentage of taxpayers who consider tax accounting to be complicated*

	Standart regime with VAT		Standart regime without VAT		Uniform tax	
	person / days	complicated	person / days	complicated	person / days	complicated
Income tax	2,2	0,19%	0,7	3%	0,4	0%
Corporate profit tax	5,6	13%	2,5	8%		
Sales tax	1,8	0%	0,9	0%		
VAT	8	11%				
Uniform tax					0,8	0%
Social contributions	3,6	2%	1,6	5%	0,6	2%
Property tax	1,1	2%	0,6	1%	0,5	1%
Land tax	1	1%	0,5	1%	0,4	1%
Single Tax Return	7,4	22%	2,7	31%	1,2	20%

In the baseline analysis conducted on the data of 2012, the following conclusions were made: the second most costly stage was visits to tax authorities for various purposes, with the primary purpose being the submission of tax statements. In addition to changes in the filing frequency of tax reporting, a series of reforms was carried out to simplify the procedure of tax return submission.

Since 2012, taxpayers may submit tax returns through the Internet using electronic digital signature, through a privately operated commercial service. Two years later, for taxpayers with turnover not exceeding the VAT registration threshold, electronic tax return filing through the Tax Service website was integrated. Based on survey data, in 2016, one in ten entrepreneurs submitted tax returns through the Internet, and one in three large taxpayers utilized this service. Therefore, the average time of visits to the tax authorities among all businesses decreased during the reform period by more than half: from 4.3 days in 2012 to 1.9 days in 2016 (Figure 11).

The key reason taxpayers do not use the existing web-based service of tax return submission is a lack of opportunity or lack of need because of the small amount of tax returns. These reasons were true for 29 percent and 26 percent of interviewed businesses, respectively (Table 11).

It should be emphasized that one in six respondents (16 percent) did not file tax returns through the Internet because he/she did not trust electronic document management and considered it to be insecure. The State Tax Service should consider conducting an outreach campaign to explain the issues of security of electronic declaration. These activities would considerably increase the number of users of remote filing of tax returns and take a step toward reducing the administrative burden on businesses in the area of tax regulation.

Data suggest that 15 percent of entrepreneurs surveyed would be willing to submit tax returns through the web portal of tax authorities but consider the cost of electronic declaration and the digital signature to be too expensive for their businesses. Promoting competition in the electronic services market of and incentivizing businesses would lead to a reduced cost of electronic declaration and expand the number of users.

*Table 11.  
Reasons why taxpayers did not submit tax returns through the Internet in 2016*

No possibility, computers, Internet connection	29%
Unnecessary, because of low volume of tax returns	26%
No trust to electronic document management; it could be unsafe	16%
Electronic declaration and digital signature are too expensive	15%
Employees do not know how to use the electronic declaration system	6%
Tax inspector forces to submit hardcopy return	5%
I was not aware about such possibility	5%
It is convenient and handy	4%
Tax Inspector usually helps to fill out tax returns	3%
The system operates with failures; no feedback mechanism	3%
Other reason	6%

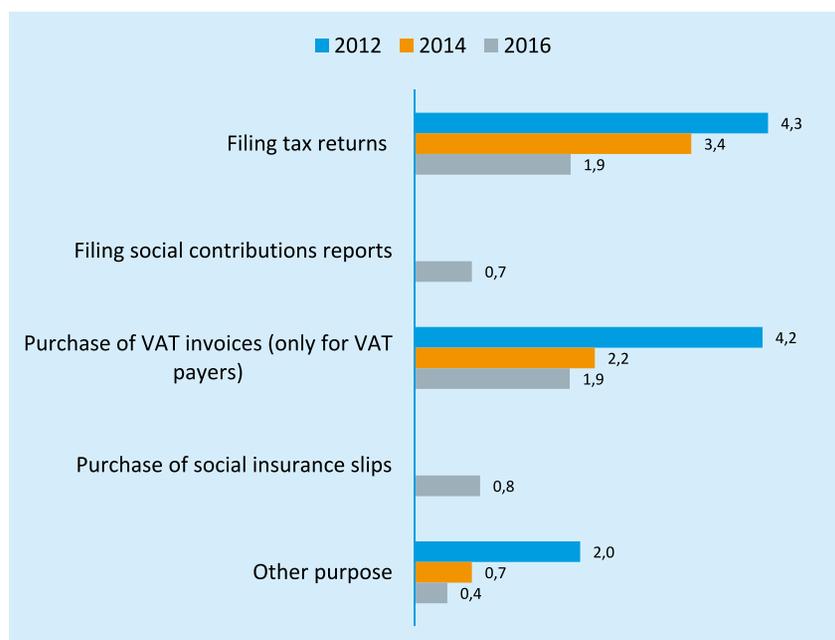
The VAT system is another key area where reforms to reduce the cost of compliance with tax legislation and introducing simplified tax accounting are being implemented by the State Tax Service with IFC support.

During the monitoring period in 2014, a new system of administration of VAT invoices in real-time mode was adopted. This system issued and controlled VAT invoices online. In 2016, another system was implemented allowing cancellation of such invoices as high security documents, and assigning taxpayers the range of invoice numbers. Before the latter reform, entrepreneurs had to come personally to the tax authority and purchase VAT invoice forms. Once the new system was adopted, taxpayers filed an application without the need to visit a tax office and get a decision on assigning the range of VAT invoice numbers both in hardcopy and electronically.

These activities had a favorable effect on time costs of taxpayers associated with visits to the tax authorities' offices. Round 2 of the study identified a 50 percent decrease in average costs to the taxpayers for visits to the Tax Service office to purchase VAT invoices. In 2012, VAT payers had to spend about four business days for visits to buy invoices; in 2014, this indicator accounts to 2.2 working days (Figure 11).

Along with the reduction in time costs, the cancellation of paper-based VAT invoice forms reduced the direct financial costs to entrepreneurs. In 2012, one taxpayer operating under general regime with VAT spent KGS 3,048 per year on average to purchase various forms, invoices, book of records, and other tax forms. Round 3 data<sup>12</sup> show that this item of expenses decreased by three times and amounted to KGS 1,159 in 2016.

*Figure 11.  
Time costs of visits to tax authorities' offices for various purposes, in person-days per year*



<sup>12</sup> Though the reform was implemented in 2016, Round 3 was held in 2017, and taxpayers were able to evaluate the changes.

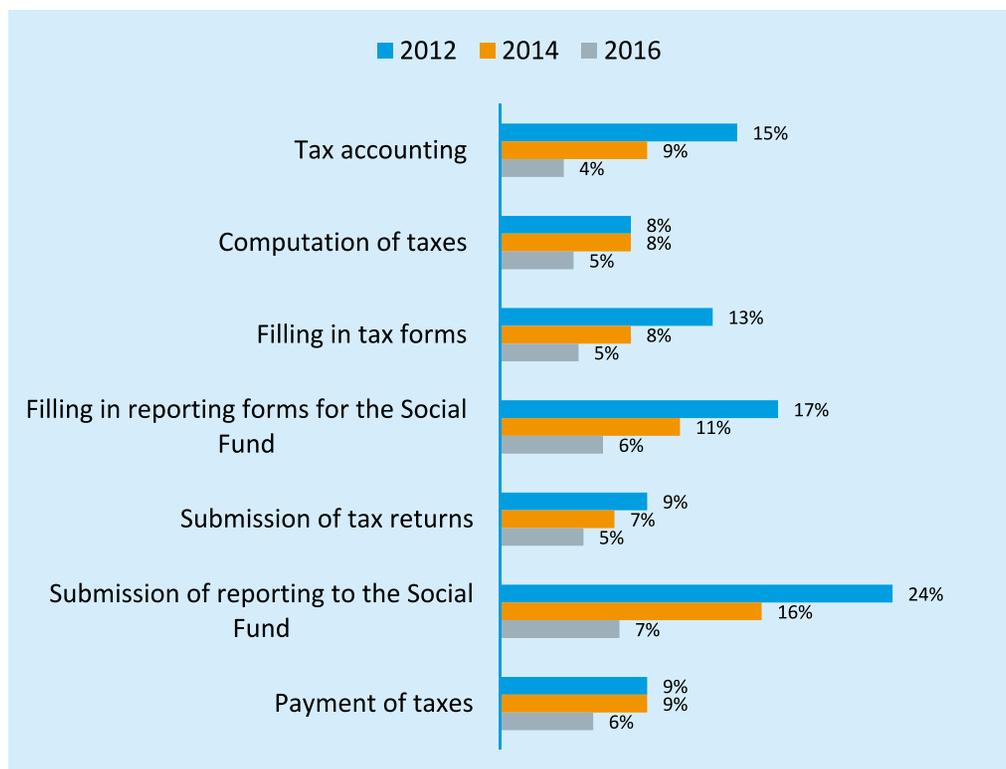
As already mentioned earlier, in 2014, a project was initiated to introduce the options of paying taxes through bank and payment terminals and paying taxes through Internet-banking. Along with changes in the frequency of paying taxes by small companies — from a monthly to quarterly basis — this project succeeded in reducing the time for visits to banks to pay taxes from 3.1 business days in 2012 to 1.8 days in 2016 (Figure 10). Mobile banking should be integrated at the next stage of reforming the tax payment procedure.

Every step of ongoing reform makes a specific contribution toward decreasing taxpayers’ costs for compliance with tax requirements. The reform of the taxation system and tax administration implemented in the Kyrgyz Republic leads to a reduced administrative burden on businesses, and thereby, nurtures conditions for overall national economic development.

The logical consequence of reduced administrative burdens related to tax compliance is an improved perception of the complexity of tax administration among taxpayers. In 2012, one in six interviewed entrepreneurs (15 percent) stated that keeping tax records is challenging for his/her business. In 2016, after the reforms were implemented, the share of respondents who supported this view dropped by 4 percent (Figure 12).

Office work on computation of tax base and filling out various tax reporting forms is the most costly given the time required. However, tax accounting in the office is not challenging for taxpayers. The share of businesses who think that this stage of tax administration is ‘complicated’ or ‘extremely complicated’ is insignificant and made only 5 percent of interviewed entrepreneurs in 2016 (Figure 12).

*Figure 12.  
Share of taxpayers who believe that certain tax-related activities  
are complicated or extremely complicated*



## ADMINISTRATION OF SOCIAL TRANSFERS

- At the start of monitoring activities, taxpayers identified the interaction with the Social Fund as the most challenging stage of all tax administration stages; meanwhile, for one in four entrepreneurs, reporting to the Social Fund was an issue. Round 3 of the study demonstrated positive changes in the respondents' assessments.
- On the areas of the pilot project on transfer of the function of social payments to the tax authorities, time costs of taxpayers for administration of social payments reduced, because less time was required for visits to submit reporting.
- Reforming the filing process for one type of mandatory payment decreased the total time cost to taxpayers by 10 percent. Once the Tax Service takes over the function of receipt of social contribution reports from all types of taxpayers, about US\$0.87 million would be saved in administration of such contributions.
- Taxpayers in pilot districts provided a positive assessment of all changes associated with transfer of the function of social payment administration from the Social Fund to tax authorities.

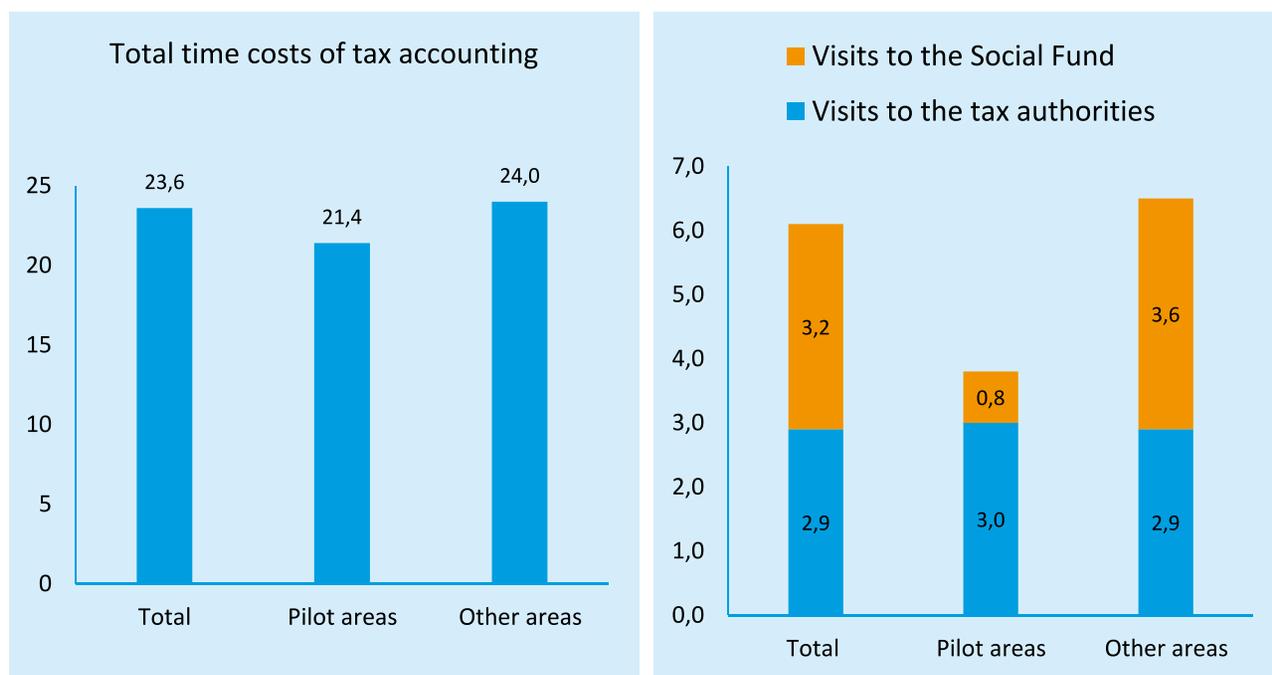
Administration of payments to the Social Fund is mandatory for legal compliance. Filling out statements of the Social Fund and their delivery incur only time costs, but in the course of monitoring, these procedures represented a serious issue for taxpayers. Many entrepreneurs assessed interaction with the Social Fund as the most problematic among all stages of tax administration. During Round 1 of the survey in 2012, delivery of statements to the Social Fund was the most challenging for one in four taxpayers (Figure 12).

This suggested the need to reform the existing practice of social contributions administration. To that end, in late 2015, the Government of the Kyrgyz Republic made the decision to transfer functions of social contributions administration from the Social Fund to the State Tax Service. Since 2016, with the IFC support, a pilot project has been launched to empower the Tax Service in their social contributions collection. Pilot projects were implemented in Oktyabrskiy district in Bishkek City and Sokulukskiy district in Chui Province.

During Round 3 of the survey, an attempt was made to track the administration of social payments in 2016. The sampling was redistributed to focus on two pilot districts. Though the pilot project was implemented on a step-by-step basis throughout 2016, and the majority of taxpayers have started making social payment reports to the tax authorities only since August 1, 2016, the results of this study point to positive trends in the social payments administration.

Average time costs of taxpayers in the districts where the pilot project was implemented to allow social contributions administration by the tax authorities are lower than in other areas of the Kyrgyz Republic, where the entrepreneurs still make social contribution reports to the Social Fund. It should be noted that the changes in administration of one tax only generated considerable savings of taxpayers' working time. Average total time for tax accounting in pilot areas was 21.4 days, whereas in other districts, it amounted to 24 working days (Figure 13).

*Figure 13.  
Time costs of tax administration and visits to the tax authorities and Social Fund  
by the taxpayers in pilot areas in 2016, in person-days per year*



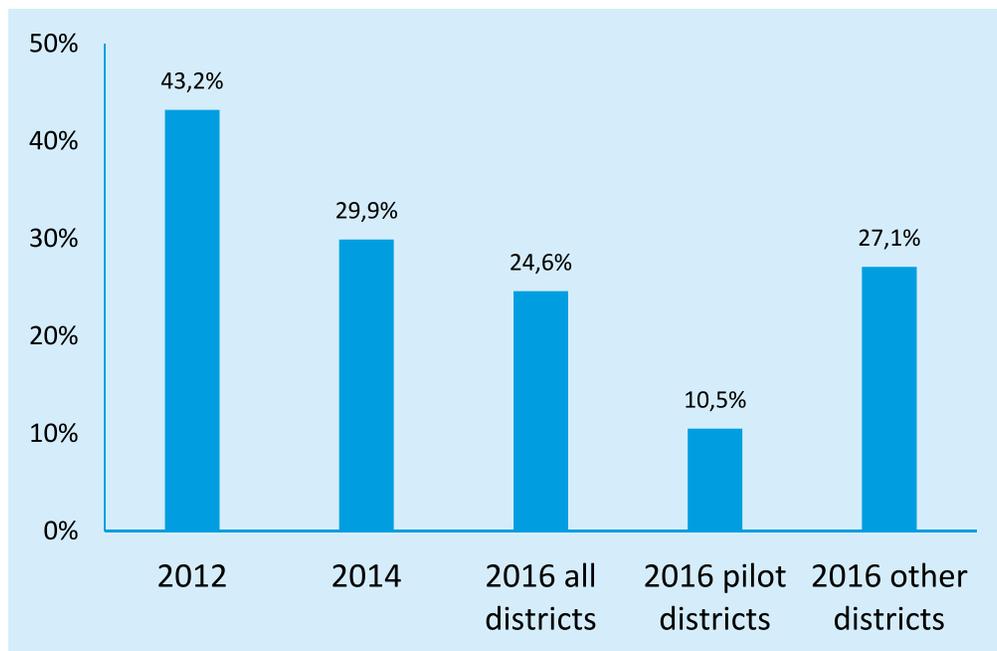
In this context, no critical difference in the time spent for calculation of social contributions and filling in respective forms was observed during the survey. The major savings were achieved through decreased time in visits to submit reports, because instead of going to two different bodies, it was enough to visit only the tax authorities' office to deliver all statements. Figure 13 clearly shows that the travel time of entrepreneurs to the tax offices in pilot areas does not vary from the time spent by other taxpayers. However, time costs of visiting the Social Fund for the selected months of 2016 had drastically dropped from 3.6 to 0.8 working days. Hence, reform of the reporting process for one of the types of mandatory payments helped reduce the costs to taxpayers by 10 percent of total time spent.

Apart from decreased time costs of social contribution administration, the survey results point to a downward trend in coverage of inspections by the Social Fund. Several years ago, the coverage of inspections conducted by the Social Fund was extensive. In 2012, 43 percent of surveyed taxpayers reported that they had to be inspected for payment of social security contributions (Figure 14, which indicated that the social contributions administration system needed reform).

During the monitoring period, the share of entrepreneurs inspected by the Social Fund decreased by half. Based on results of Round 3 of the survey, only one in four taxpayers had been inspected by the Social Fund in 2016. In areas where the pilot project on transfer of the function of social payments administration to the tax authorities was implemented, the inspections covered only 10 percent of respondents<sup>13</sup> (Figure 14).

<sup>13</sup> It should be noted that under the pilot project, the normative and legal framework related to the functions and authorities of the STC and the Social Fund in the area of inspections of social contributions payments was not clearly elaborated.

*Figure 14.  
Dynamics of coverage with the Social Fund's inspections*

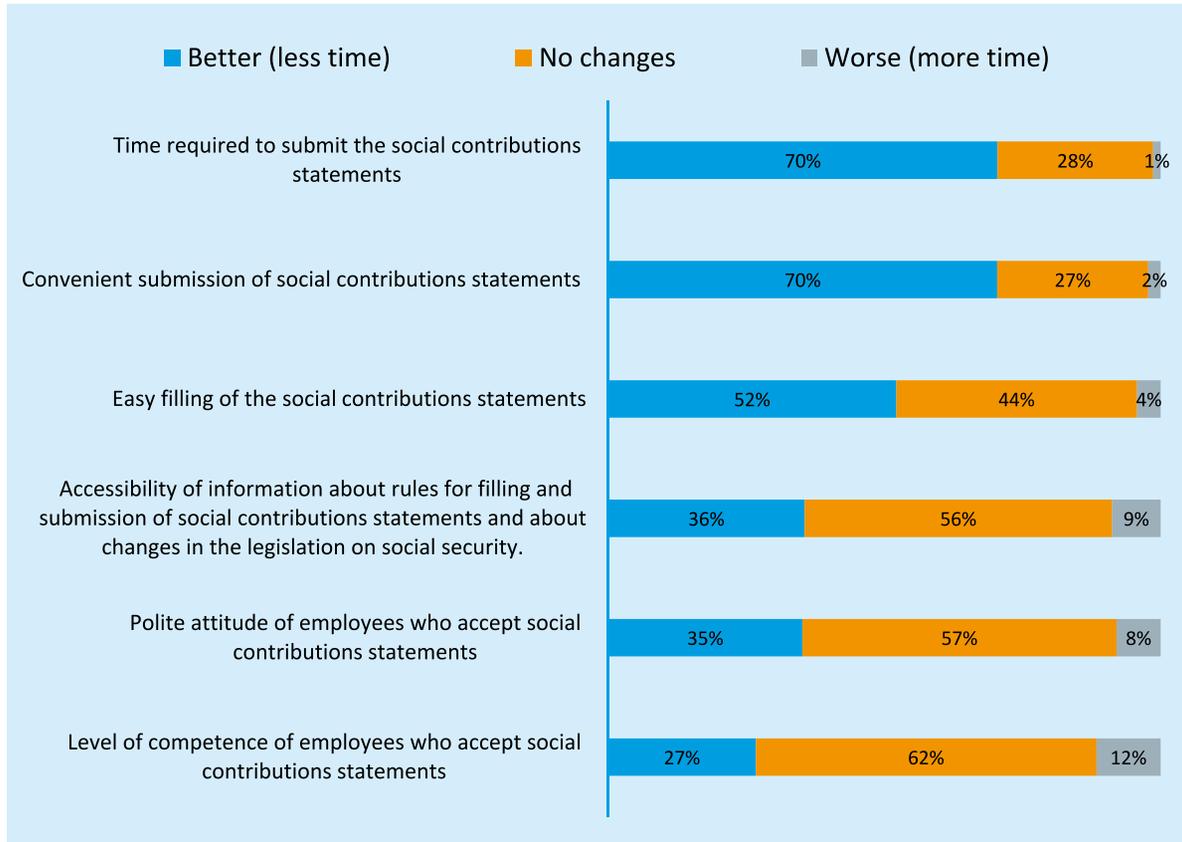


Along with the analysis of actual time costs of different tax procedures, during the survey, the taxpayers in the pilot areas were asked to provide qualitative assessments regarding the extent of changes in keeping tax records following the transfer of social payments administration from the Social Fund to the tax authorities. The overwhelming majority of respondents in pilot areas (70 percent) confirmed that they spent less time delivering social security reporting (Figure 15). The same share of taxpayers (70 percent) replied that the process of submission of social security reporting became more convenient as compared to the former filings to the Social Fund. It is suggested that such positive assessments were related to the upgraded and modern premises of the Tax Service of Oktyabrskiy district of Bishkek City.

The following essential features were well perceived: convenience in filling the social security reporting forms (more than 50 percent of positive views), accessibility of information about rules for filling and submission of reporting, and the polite attitude of employees who accept statements. It should be noted that the respondents provided no negative views: no respondent reported that the situation changed for the worse. The only parameter that received more than one-tenth of negative assessments (12 percent) was the competence of employees accepting social contribution reports (Figure 15). This is probably due to the new type of mandatory payments that Tax Service specialists must process. This issue should be resolved as the practices of payment administration become well established and the competence level of the Tax Service employees improves.

In pilot areas, the actual time savings of taxpayers administering social contributions and highly subjective assessments of respondents indicate the need for large-scale use of the tried and tested practices. The Government of the Kyrgyz Republic intends to continue the pilot project until July 1, 2017, to prepare for a full-scale transfer of the social payment administration function from the Social Fund to the tax authorities.

**Figure 15.**  
*Changes in administration of social payments reported by respondents in pilot areas*



## COST OF COMPLIANCE WITH TAX LEGISLATION

- Alongside the reduction of time costs, the costs of compliance with tax legislation also tended to decline. Because of inflation and exchange rate differences, the decrease in financial expenses in the national currency is not significant. The expenses of tax accounting reduced by half if denominated in U.S. dollars equivalent, that is, US\$367 in 2016.
- Businesses costs of tax administration are heavily dependent on the size of taxpayer and its tax regime. Compared with VAT payers, the average costs of tax accounting for companies following the general tax regime without VAT payment decreased by more than three times.
- Tax administration costs against turnover of taxpayers tended to decline. With regard to microbusinesses, the costs of tax accounting remain high and, in essence, this is a sort of additional tax with its amount comparable to the uniform tax rate.
- The overall burden on the national economy associated with compliance of tax legislation during the reform period reduced from 0.19 percent to 0.13 percent of GDP.
- Annual economic impact of the tax system reform and the reduction of the administrative burden on businesses were estimated at US\$1.8 million in 2014 and US\$2.2 million in 2016.

Tax system reforms pursued in the Kyrgyz Republic are focused on accelerating and simplifying tax accounting for taxpayers. A reduction in time costs of tax compliance should ultimately result in financial savings. The release of additional funds for businesses is the ultimate goal of tax reforms, because these savings could then be reinvested, with the amount of taxes increasing accordingly. Reducing the administrative burden related to tax legislation compliance will facilitate economic growth in the country.

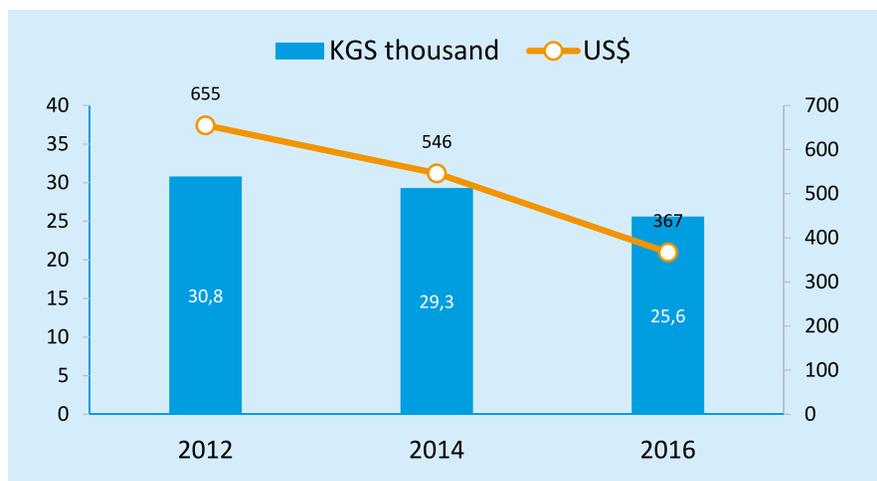
The financial cost of maintaining tax records includes the labor costs of all employees of companies taxpayers, who are involved in the tax administration process, as well as the payment for services of third-party specialists, if such functions are outsourced in part or in whole. In addition, to calculate the total financial costs, the following direct expenses should be accounted:

- Purchase of forms, invoices, book of records, and other tax forms
- Acquisition and maintenance of cash registers and other associated expenses
- Obtaining of tax-related information (specialized materials, database, learning and teaching aids, participation in workshops, and so on)
- Purchase and maintenance of dedicated software for bookkeeping and tax accounting

The expenses reviewed do not include costs of businesses for paying such taxes because the objective of the surveys was not an assessment of tax burden on the businesses but the monitoring of efficiency of ongoing reforms in terms of assessment of tax administration costs.

Average costs to one taxpayer for the administration of all taxes in 2012 were above KGS 30,000 per year (Figure 16). Unlike the working time spent, which declined substantially, the money costs have not demonstrated significant movement. Based on the results of Round 2 of the survey in 2014, the financial costs of surveyed entrepreneurs was KGS 29,300 which is equivalent to a 5 percent reduction against the level of 2012. In 2016, this indicator decreased considerably to KGS 25,600, or 13 percent against the indicator of 2014.

Figure 16.  
Dynamics of financial costs of one taxpayer for compliance with requirements of tax legislation



The World Bank's data show that the formal inflation level in 2013–2015 varied between 6.5 percent and 7.5 percent in per year terms.<sup>14</sup> Any savings of time costs of tax accounting maintenance are affected by a devaluation of national currency and increase in average salary of specialists involved into the tax administration process. Hence, if in 2012, the weighted average exchange rate of the U.S. dollar to Kyrgyz som was US\$1/KGS 47, in 2016, the rate was US\$1/KGS 69.9. If the financial costs of tax accounting based on the U.S. dollar are considered, their dynamics would correlate with a descending trend in the assessments of time spent. In 2012, one taxpayer paid US\$655 to comply with all requirements of tax legislation; in 2014, this amount dropped to US\$546, and the data of 2016 show that financial costs amounted to US\$367 (Figure 16). Therefore, financial costs over the period of reform decreased by half and resulted in a 44 percent reduction in time costs compared to 42 percent.

It is understood that the assessments provided earlier are conservative and represent the lower threshold against the actual costs of tax accounting. This is because during the survey, the entrepreneurs mostly referred to the formal salary of their employees, based on which the financial costs were estimated. Given that the actual level of labor costs exceed the formally declared salary, the taxpayers incur higher costs of tax accounting compared to estimated costs, but it is impossible to prepare adequate calculations.

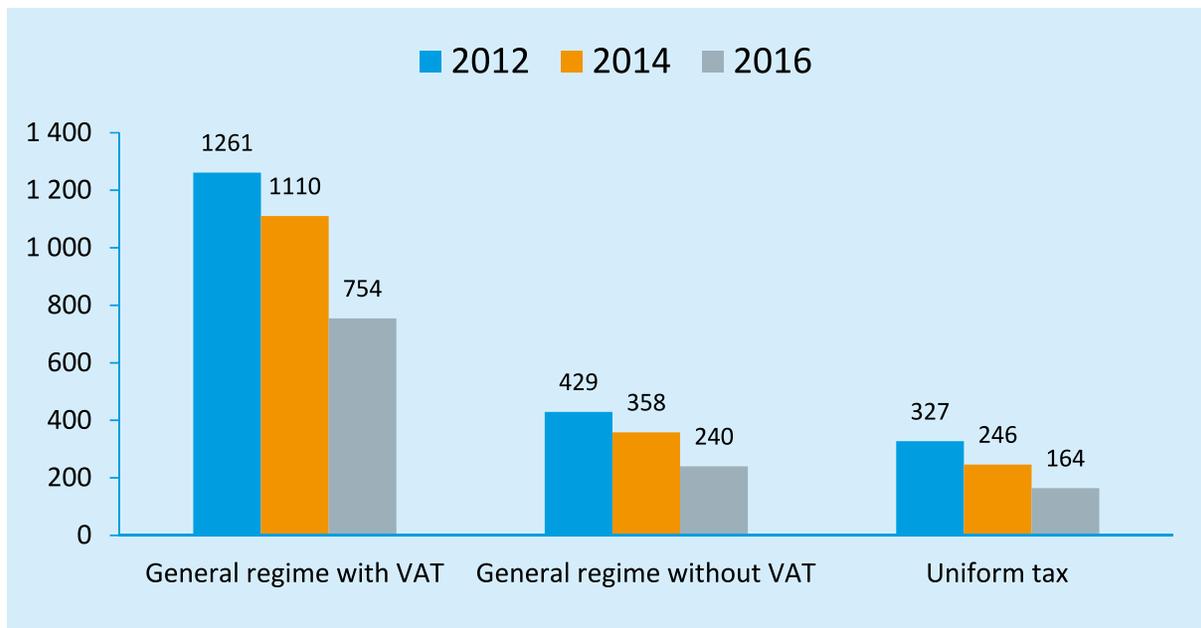
The entrepreneurs' tax administration costs and the time costs vary heavily based on the tax regime under which a business operates. The highest financial costs are incurred by taxpayers operating under the general regime with VAT. At the start of monitoring, these expenses reached US\$1,261 and dropped to US\$754 in 2016.

The data support the fact that VAT is the most costly tax in terms of administration. Companies operating under the general regime and paid VAT had to pay the maximum number of taxes compared to companies operating under other tax regimes. Accounting of the maximum number of taxes requires more highly qualified accountants, whose average salary is the maximum among all tax regimes under review.

<sup>14</sup> <https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?end=2016&locations=KG&start=2013&view=chart>

The study findings demonstrate that the transition from payment of VAT to the general tax regime without VAT decreases the average costs of tax accounting by more than three times. Consequently, the simplified tax regime incurs the least costs. Compared to other tax regimes, the payers of uniform tax are released from payment of VAT, income tax, and sales tax. As a result, average costs of payers of uniform tax in 2016 amounted to US\$164 (Figure 17).

*Figure 17.  
Dynamics of financial costs of tax administration depending on tax regime, in U.S. dollars*

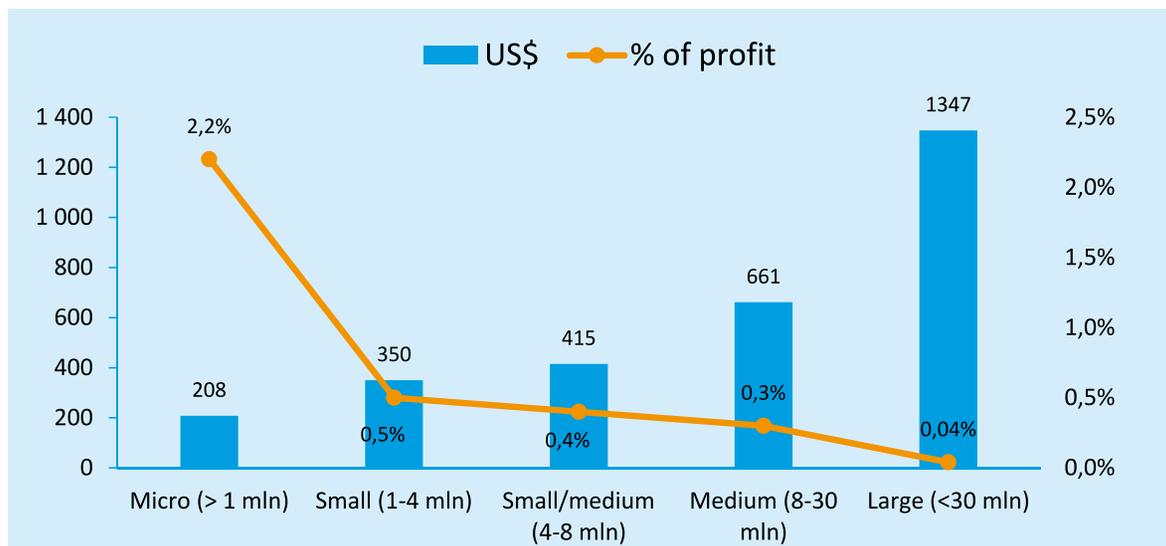


Business features such as the size and tax regime correlate with each other. This is because a business’s size is defined by its annual turnover, and the latter has an effect on the tax regime that a business may choose. Medium and large businesses have to work under the general regime with VAT because their annual turnover exceeds the threshold of mandatory registration of VAT, and microbusinesses and small businesses choose the simplified tax regime. Besides, a company’s size is directly connected with the staff number of the company, which varies between 3.4 people in a microcompany (with turnover less than KGS 1 million) to 55.5 people in a large company (with turnover above KGS 30 million). Staff numbers have an immediate effect on the scope of tax accounting in a company.

Microbusinesses with profit less than KGS 1 million spent about US\$200 for tax administration purposes in 2016 (Figure 18). This segment mainly consists of individual entrepreneurs (61 percent of all group) with three employees on average. Moreover, microbusinesses hold nearly 80 percent of all taxpayers who operate under the simplified taxation regime.

As the size of a taxpayer increases, its costs of tax accounting rise intermittently. Small companies with profit varying from KGS 1 million to KGS 4 million per year spent twice as much as microbusinesses, that is, US\$350 per year. The costs of compliance with tax requirements incurred by large companies were the highest among all segments reviewed, and accounted for US\$1,347 per year—twice as much compared to the costs of medium taxpayers.

*Figure 18.  
Financial costs of tax accounting and share of profits by size of taxpayer, in 2016*



With the minimum sum of tax administration expenses, microbusinesses with profit less than KGS 1 million bear the maximum relative financial burden. Average costs of such taxpayers exceed 2 percent of value of the annual profit (Figure 18). Given the fact that most microcompanies operate based on the simplified tax regime, it is suggested that tax administration is an additional tax comparable by its value with the uniform tax rate (from 2 percent in case of cashless payment to 6 percent of annual profit). This is a serious barrier to microbusiness development and to operating in the legitimate economy sector because in this context, predominantly highly profitable companies remain competitive after they pay and administer all taxes. A taxpayer who cannot ensure a highly profitable business at the beginning either has to go into liquidation or operate to some extent in the shadow sector.

Large companies incurring the maximum tax administration costs do not face a serious financial burden associated with tax record maintenance because of their scale. Regarding the annual profit of large taxpayers, the tax accounting costs are negligible—a tenth or a basis point of percentage of total annual profit (Figure 18).

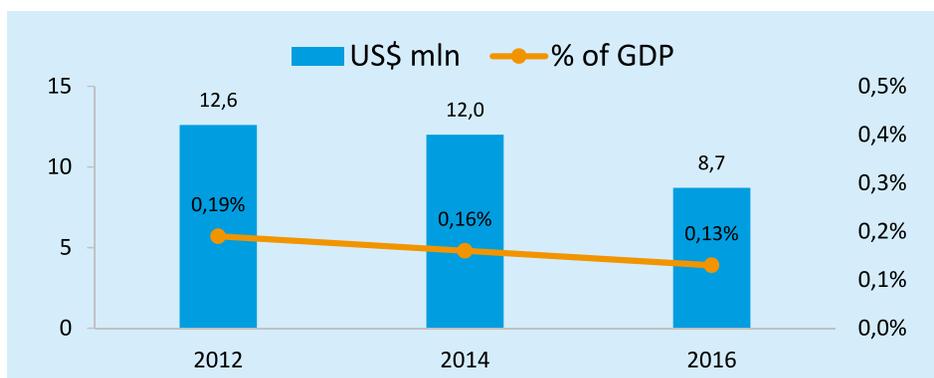
Favorable developments in a reduction to the financial burden on businesses relating to tax administration are good for the national economy. As reported by the State Tax Service in 2012, 19,206 legal entities and individual entrepreneurs were engaged in economic activities and submitted tax returns (this survey did not cover entrepreneurs, who operated under patent-based tax and farmholdings). If the data are extrapolated on average costs of one taxpayer across all private enterprises and individual entrepreneurs of the country (except entrepreneurs, who operate under patent-based tax and farmholdings), the total cost of all taxpayers to comply with mandatory requirements of tax legislation in 2012 would amount to KGS 592 million, which is equivalent of US\$12.6 million<sup>15</sup> (Figure 19).

<sup>15</sup> Average weighted exchange rate of U.S. dollar to Kyrgyz som in 2012 was US\$1/KGS 47.0

By 2016, the total number of taxpayers covered by this survey increased by one-fourth, and based on the SCS data, 23,620 business entities operated. There was reduction of tax accounting costs to individual average taxpayers in 2016; however, total expenses in the national currency remained at the level of 2012 with KGS 605 million. However, because of changes in the exchange rate of the U.S. dollar to the Kyrgyz som over the monitoring period,<sup>16</sup> total costs of all taxpayers in U.S. dollars decreased substantially. The total financial costs of tax administration in 2016 was US\$8.7 million.

The same trend is observed while analyzing the costs of tax administration in relation to the national GDP. Whereas, according to data of Round 1 of the survey conducted in 2012, compliance with all mandatory requirements of the tax legislation was at 0.19 percent of the national GDP, by the end of 2016, this indicator fell by almost one and a half times to the level of 0.13 percent of GDP. Because the total costs in Kyrgyz som, as already mentioned, remained approximately at the same level as in 2012, this decrease was due to the GDP growth. In 2012, the GDP of the Kyrgyz Republic was KGS 310,471 million,<sup>17</sup> and four years later, the country's GDP increased by almost one and a half times, reaching KGS 458,027 million<sup>18</sup> in 2016.

*Figure 19.  
Dynamics of cumulative financial costs of tax accounting and share of GDP*



When assessing the economic impact of the reforms, it is necessary to consider the following factors: changes in the average time costs and, as a result, the financial costs of each taxpayer; dynamics of the total number of taxpayers for the reviewed period; the exchange rate difference with respect to the U.S. dollar; inflation rate, the rate of one or another tax; and so on. In other words, to get a true picture of the savings from the implemented reforms, it is necessary to project the existing costs of one taxpayer for the situation of the past years (the baseline year of monitoring), which is measured by the progress of the ongoing reforms. That is, we should assess the total expenditures of the national economy with the current costs of maintaining tax records.

Based on the official statistics on the level of inflation, total number of taxpayers, weighted average rate of the national currency, and so on, annual savings of US\$1.8 million is estimated from reducing the tax administration costs in 2014 as compared to 2012. The same computations for 2016 show that as a result of the tax system reforms, the administrative burden on taxpayers would have been US\$2.2 million less in 2014.

<sup>16</sup> Average weighted exchange rate of U.S. dollar to Kyrgyz som in 2016 was US\$1/KGS 69.9

<sup>17</sup> <http://www.stat.kg/media/publicationarchive/f2ea7c53-8222-41f6-bc05-368614890b41.pdf>

<sup>18</sup> <http://www.stat.kg/media/publicationarchive/47a55d1e-b665-4384-9a2c-0b79d9dfb3529.pdf>

## INSPECTIONS OF COMPLIANCE WITH TAX LEGISLATION

- The introduction of the risk assessment system in the selection of taxpayers for tax audits has made it possible to scale down the coverage of the tax control to 47 percent of inspected taxpayers in 2016.
- The overall trend of scaled-down coverage of tax audits is noted for all types of taxpayers but varies by the type of entrepreneurs.
- Medium and large businesses operating under the general tax regime with VAT come under the scrutiny of the tax authorities. The coverage of inspections in this segment was reduced the least; over two-thirds of the interviewed entrepreneurs passed tax audits in 2016.
- There are salient regional differences in the scope and dynamics of coverage of inspections: the minimum coverage and dramatic drop are observed in Bishkek, while in the southern regions, there are practically no changes in the coverage of inspections.
- Against the background of scale-down coverage of tax inspections and decreased time costs to pass an inspection, the total costs of all taxpayers remain unchanged due to inflation and an increase in the total number of businesses.
- The taxpayers' perception of the administrative burden on the private sector associated with the tax control procedure tends to improve.

The state-level control over compliance with mandatory requirements of the tax legislation by business entities could be a sizeable administrative burden on entrepreneurs, and the financial expenses on passing the tax control procedures (tax audits, office audit, and raid tax control) may contribute heavily to the total tax administration costs of entrepreneurs.

IFC provides assistance to the State Tax Service in improving tax administration, including the reforming of the tax audit system through introduction of the risk assessment system for selection of payers to be inspected. From July 1, 2013, the field inspections are planned based on analysis of the level of risk that a taxpayer fails to meet his/her tax obligations. Thus, only those taxpayers who are likely to violate the requirements should be inspected. The main purpose of the risk assessment system is to improve the performance of the tax authorities by ensuring better objectivity in the selection of taxpayers to be inspected, increasing tax collections, and reducing the administrative burden on good faith taxpayers.

In the course of the survey, entrepreneurs were asked about their experience of passing tax inspections and inspections implied any forms of tax control such as:

- Scheduled documentary inspections of all types of taxes;
- Thematic inspection of certain types of taxes;
- Counter audit (in case of verifying contractors of an entrepreneur);
- Raid audit (checking cash accounting, cash registers, tax patents, permits, and so on); and
- Desk audit at the tax office.

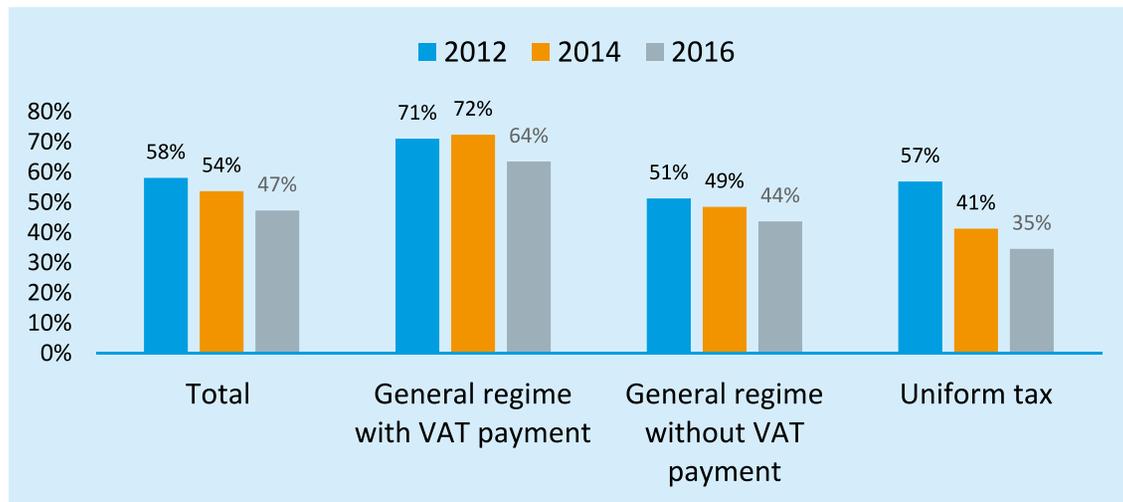
Time costs of going through the tax control were also assessed, if a respondent was sure that he/she was a subject of tax audit but he/she could not specify a type of tax control and if a respondent believed that an inspection was unauthorized.

The monitoring data demonstrates a steady trend in scaling down the coverage of entrepreneurs by tax inspections. The new risk assessment system introduced between Round 1 and Round 2 of the survey had consistently reduced the percentage of inspected taxpayers. According to the monitoring, before the tax system reform in 2012, 58 percent of taxpayers were subject to tax inspections (Figure 20). In recent years, the scope of entrepreneurs' tax audits had been steadily declining every year, reaching 47 percent of all taxpayers in 2016.

The percentage of entrepreneurs inspected by the tax authorities was uneven and varied heavily depending on the tax regime under which the taxpayer operated. So, the tax authorities paid close attention to the companies who pay VAT. With the overall trend to scale down the coverage of inspections, two out of three taxpayers working under the general tax regime and paying VAT were inspected in 2016 (Figure 20).

But the scaling down of coverage by tax audits was uneven. Though the risk assessment system was adopted in 2013, taxpayers working on the general tax regime did not notice any practical changes in 2014. The share of inspected entrepreneurs remained at the level of 2012. A significant decrease in the tax control coverage was recorded only in respect of companies operating under the simplified tax regime. The reduction of such coverage among payers of uniform tax inspected was quite drastic—from 57 percent in 2012 to 41 percent in 2016. Only in 2016, the survey findings identified a descending trend in the number of inspected entrepreneurs who operated under all applicable tax regimes.

*Figure 20.  
Dynamics of coverage of tax inspections, breakdown by tax regime*



Despite positive trends, the share of entrepreneurs inspected over the year remains very high. For example, in Uzbekistan, this indicator was only 14 percent in 2009.<sup>19</sup> At the same time, international practice shows that efficient integration of the risk assessment system in the tax audits planning allows to reduce further the number of inspected taxpayers. An example of the best international experience in the scope of inspections is South Africa, where tax inspections coverage did not exceed 2 percent for income tax payers and 3 percent for VAT payers.<sup>20</sup>

<sup>19</sup> Based on IFC survey 'Tax Compliance and Reporting Costs for Businesses in Uzbekistan'

<sup>20</sup> Based on data of the World Bank Foreign Investment Advisory Service, 2006

As mentioned earlier, one of the most extensive global studies of the business environment is the Enterprise Survey, which is regularly conducted by the World Bank and covers 139 countries around the world. State regulation and taxation is considered in this survey. One of the key indicators is ‘Percentage of firms visited or required to meet with tax official’.

Although the latest survey of enterprises was carried out by the World Bank in 2013, the data clearly shows the position of the Kyrgyz Republic against other countries of Eastern Europe and the Central Asia region. According to published data,<sup>21</sup> the overwhelming majority of entrepreneurs in the Kyrgyz Republic in 2013 had to somehow deal with tax authorities (Table 12). This figure is one of the highest in the region. These data point not only to the urgency of reforming the tax control area but also to the fact that it is too early to be satisfied with what has already been achieved.

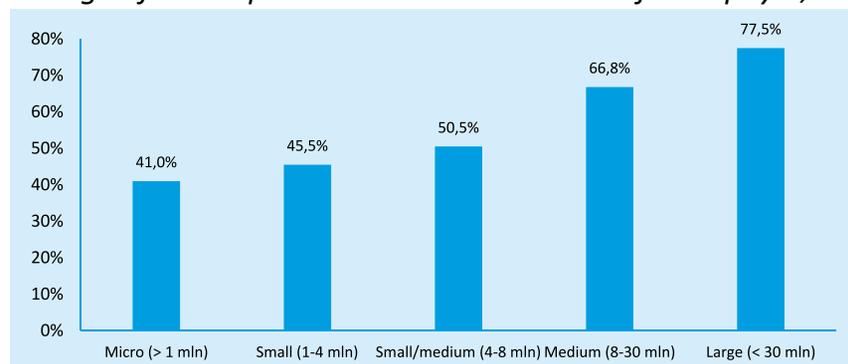
*Table 12.  
Percentage of enterprises who were inspected or had to meet with tax authorities in 2013*

COUNTRY	PERCENTAGE OF ENTERPRISES
Kosovo	93.8%
Kyrgyz Republic	91.2%
Azerbaijan	84.2%
Armenia	76.7%
Montenegro	74.8%
Tajikistan	73.9%
Macedonia	70.2%
Moldova	70.2%
Bosnia and Herzegovina	69.1%
Bulgaria	62.6%
Ukraine	61.6%
Romania	58.2%
Turkey	54.9%
Serbia	50.9%
Russian Federation	48.1%
Belarus	36.6%
Kazakhstan	32.4%
Uzbekistan	30.2%
Georgia	24.8%

The coverage of inspections depends not only on the tax regime but also on the size of a taxpayer. The larger the annual turnover of a business, the higher the probability of inspection. Thus, among large-scale enterprises, whose turnover exceeded KGS 30 million, more than three-fourths of the surveyed respondents were inspected in 2016 (Figure 21).

<sup>21</sup> <http://www.enterprisesurveys.org/data/exploretopics/regulations-and-taxes#europe-central-asia--1>

*Figure 21.  
Coverage of tax inspections based on the size of a taxpayer, 2016*



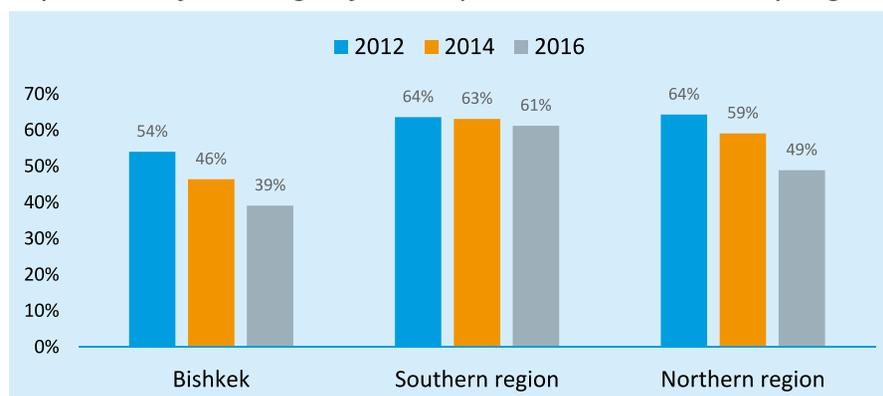
The relationship of the coverage of inspections with the size of a company is nonlinear and drastically increases when a company moves to the segment of medium taxpayers with a turnover of more than KGS 8 million. The coverage of tax inspections does not exceed half of the total number of taxpayers in the microentrepreneurs and small entrepreneurs segment; however, this indicator reaches two-thirds of the respondents in the segment of medium-size enterprises.

Given that the majority of medium and large enterprises are VAT payers, it may be stated that this group attracts a high interest of controlling bodies.

Coverage of tax inspections is uneven with important regional differences. In the southern region of the Kyrgyz Republic including Osh, Jalal-Abad, and Batken Provinces, the percentage of taxpayers audited remained virtually unchanged during the study. At the same time, this region is characterized by the highest coverage of tax control. According to respondents, during 2012, almost two-thirds of all operational entrepreneurs were inspected in the southern region (Figure 22). During three rounds of the survey, this indicator changed little and remained at the same high level as compared to other regions.

At the very beginning of the study in 2012, the same high level of coverage of tax inspections was identified in the northern regions of the country (Chui, Issyk-Kul, Naryn, and Talas Provinces). However, by Round 3 of the survey in 2016, the percentage of inspected taxpayers declined significantly and amounted to less than half of the surveyed entrepreneurs.

*Figure 22.  
Dynamics of coverage of tax inspections, breakdown by region*

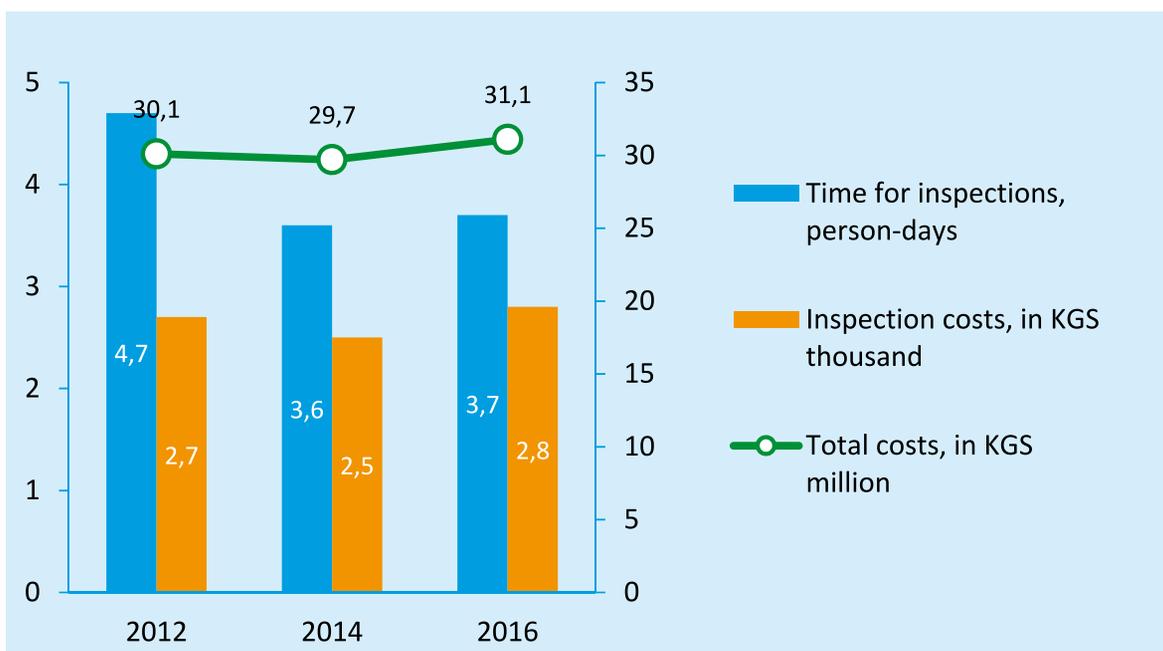


In Bishkek City, the percentage of entrepreneurs inspected by tax authorities is traditionally the lowest. This could be due to the large number of taxpayers doing business in the capital. As the State Tax Service reported in 2016, more than half of all economic entities of the country (12,139 taxpayers) were registered in Bishkek.

The findings of the 2014 survey show a slight decrease in the number of hours taxpayers have to spend on tax inspections. At the same time, inflation factors mitigated the effect of reduced time costs, and financial costs were kept at the same level throughout the period of reforming and monitoring of changes (Figure 23). On average, one taxpayer being inspected spent about four working days a year in all inspections, and the financial expenses in 2016 amounted to KGS 2,800.

Although the tax inspections coverage scaled down in percentage terms, the number of taxpayers being inspected in absolute terms remained practically the same. This is due to the annual growth in the total number of taxpayers comprising total population of the study. In 2012, according to the SCS, 19,200 operational enterprises were registered, and by 2016, the total number of businesses reached 23,600. As a consequence, the total costs of entrepreneurs for passing tax audits remain almost unchanged (Figure 23).

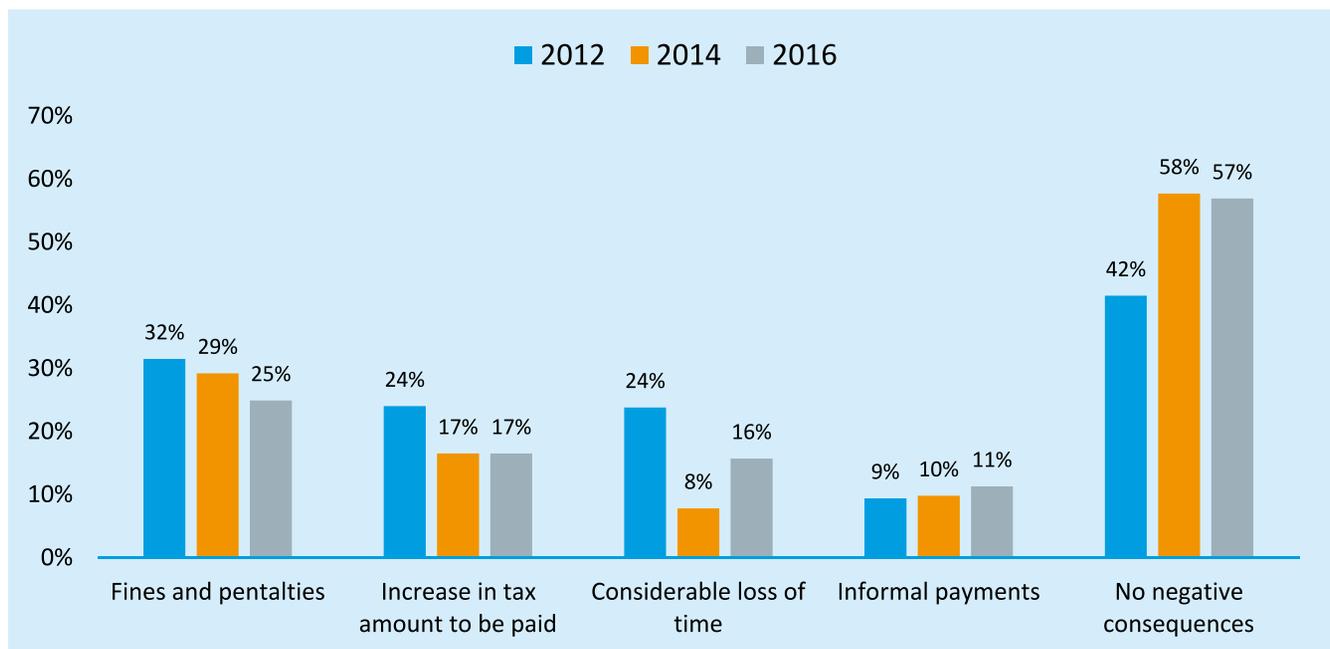
*Figure 23.  
Dynamics of costs of passing inspections of the Tax Service*



These estimates do not account for the government agencies’ costs of organization and conduct of tax control, which could also be quite high. According to the estimates of inspected entrepreneurs in 2016, a tax inspector spent about 17 hours in an office during one inspection and this indicator varies heavily depending on the size of the taxpayer: 8 hours for microbusinesses and 38 hours for large enterprises. At the same time, during 2016, every business was inspected by the tax authorities 1.7 times on average. Thus, the actual expenditures of the country’s economy on controlling activities to check compliance with tax legislation could be significantly higher than the estimates presented in this study. This once again highlights the need to continue the reforms—in particular, introducing a risk-based approach in the selection of taxpayers to be inspected—and reduce the large-scale coverage of entrepreneurs by tax inspections.

Reducing the administrative burden on the private sector by decreasing the tax administration costs should certainly have a favorable effect on entrepreneurs’ compliance with mandatory requirements of tax legislation. The tax authorities control detects a much smaller number of tax violations as compared to the situation at the onset of the tax reforms. In 2012, less than half of the inspected taxpayers (42 percent) reported no negative consequences of the results of the latest tax audit, but the subsequent rounds of the survey recorded a drastic drop of the share of respondents who faced negative consequences after an inspection (Figure 24).

*Figure 24.  
Dynamics of consequences of the recent tax inspection*

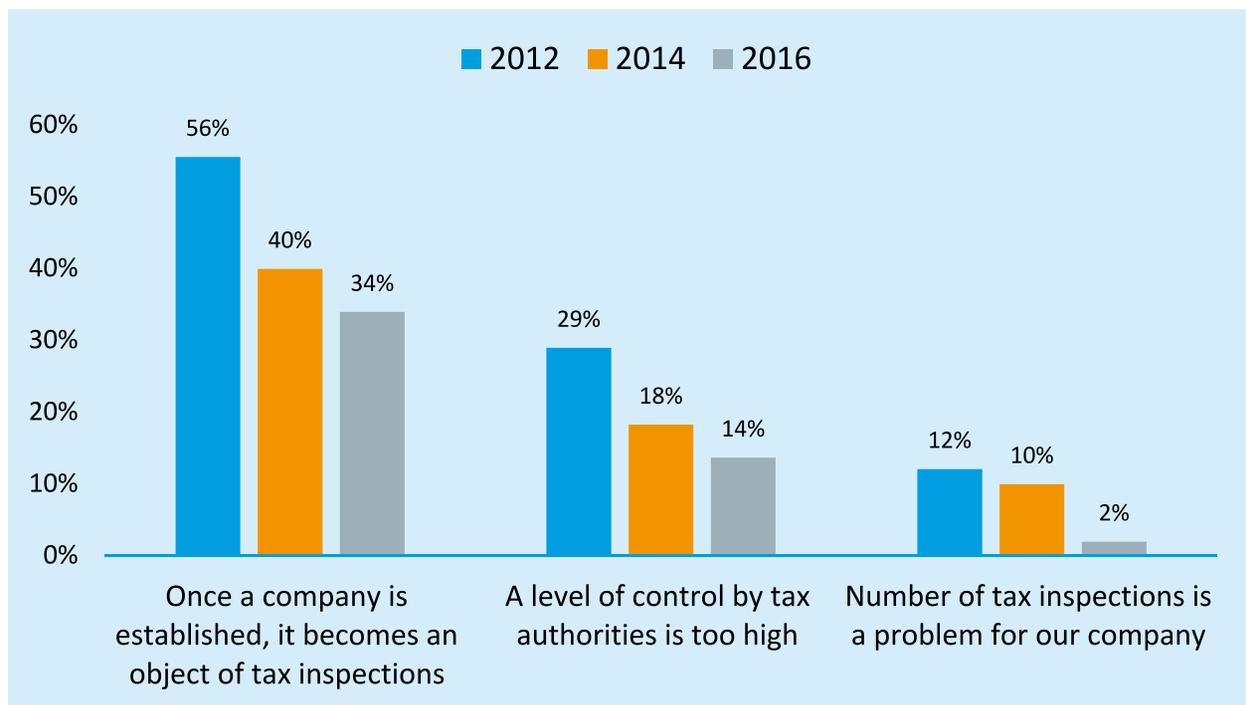


If during tax inspection, any violations by a taxpayer are detected, in most cases, sanctions will be imposed against an entrepreneur. Every fourth respondent stated that in 2016, based on the inspection findings the fine and/or penalty was imposed against his/her business. The second most common negative consequence was an increase in computed tax amount, experienced by 17 percent of taxpayers (Figure 25).

The survey findings demonstrate not only the actual reduction in the coverage of entrepreneurs by tax audits but also a better subjective opinion about tax control. At the first round of monitoring in 2012, over half of the respondents were convinced that once a company is registered, it immediately becomes an object of tax audits. Such a widespread opinion could not but affect negatively the willingness of a start-up business to be formally registered.

Reforms of the tax inspections system had a positive impact on the taxpayers' perception of the controlling bodies. In 2016, only one-third of the respondents agreed that a new business is always a target for tax inspection. Moreover, the share of entrepreneurs who believed that the level of tax control is excessive dropped to 14 percent (Figure 25). As already noted, during 2016, one entrepreneur was inspected less than two times on average. This frequency of tax inspections was not a problem for taxpayers.

*Figure 25.*  
*Share of taxpayers who agree with the following statements*



## ASSESSMENT OF PERFORMANCE AND ATTITUDE TO TAX AUTHORITIES

- Overall, taxpayers gave a positive assessment to the bulk of tax authority activities. During the reform period, the entrepreneurs' subjective perception of the SCS' image changed for the better.
- Tax officials scored high for their professionalism; however, their personal qualities were assessed to be at a much lower level.
- Entrepreneurs did not think they received high-quality services from the tax authorities. The more complicated and costly a tax regime, the more complaints taxpayers have against the work of the SCS officials.
- Transparency of tax authorities increased and the accessibility of tax-related information grew; these developments improved the image of the Tax Service.

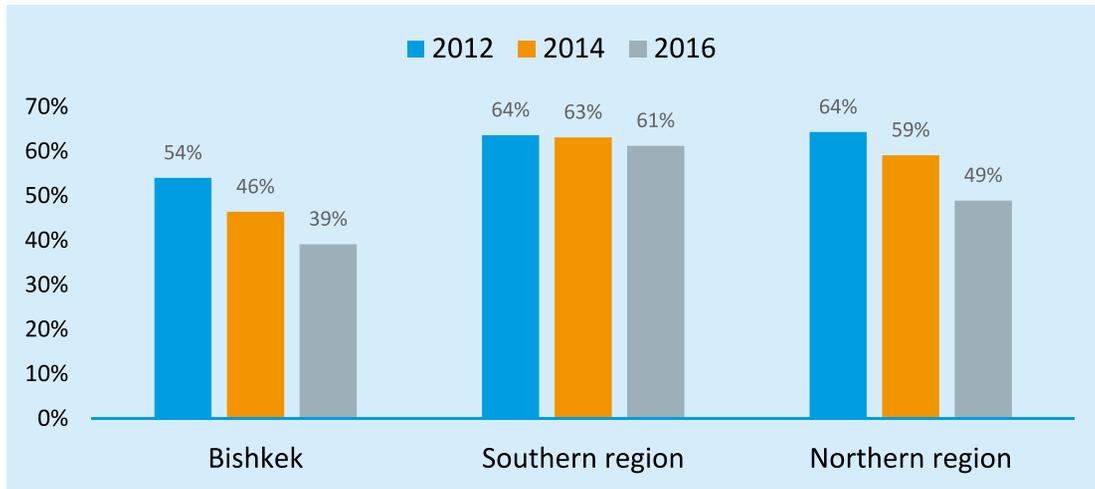
It is clear that taxpayers do not keep track of the time they spend on tax accounting. Reduction of costs over a year may not be so crucial for a business that it would be noted by entrepreneurs. Thus, it was equally important to identify a perception of tax authorities in qualitative terms, because an emotional component may affect the efficiency of interaction between entrepreneurs and officials. During the survey, the taxpayers were requested to provide a subjective view of various aspects of tax officials' operations and share their opinion on the overall image of Tax Service. Figure 26 outlines average values on a scale from 0 percent to 100 percent, where 100 percent implies full compliance with the parameter being assessed.

Overall, every aspect of tax officials' performances reviewed were evaluated positively by taxpayers. In 2016, no indicator fell below two-thirds of 100 percent of performance efficiency. The maximum score was assigned to the business qualities of the SCS officials. According to taxpayers, the competence and skills of tax officials and overall performance was above the 70 percent threshold scale of public services quality.

The personal qualities of tax officials were poorly assessed. The minimum score of all reviewed qualities was assigned to honesty and impartiality of tax officials (Figure 26).

Meanwhile, the favorable dynamics in the perception of tax authorities by taxpayers should be noted. The favorable dynamics was particularly clear in 2014 regarding the assessments provided in Round 1 of monitoring in 2012. In the course of the study, it is not possible to identify what factors improved the perception of the tax authority image among taxpayers. However, it is assumed that a reduction in the overall burden of tax administration on the businesses and overall better quality of public service rendered by tax officials contributed to the improved perception. These factors could certainly be interlinked.

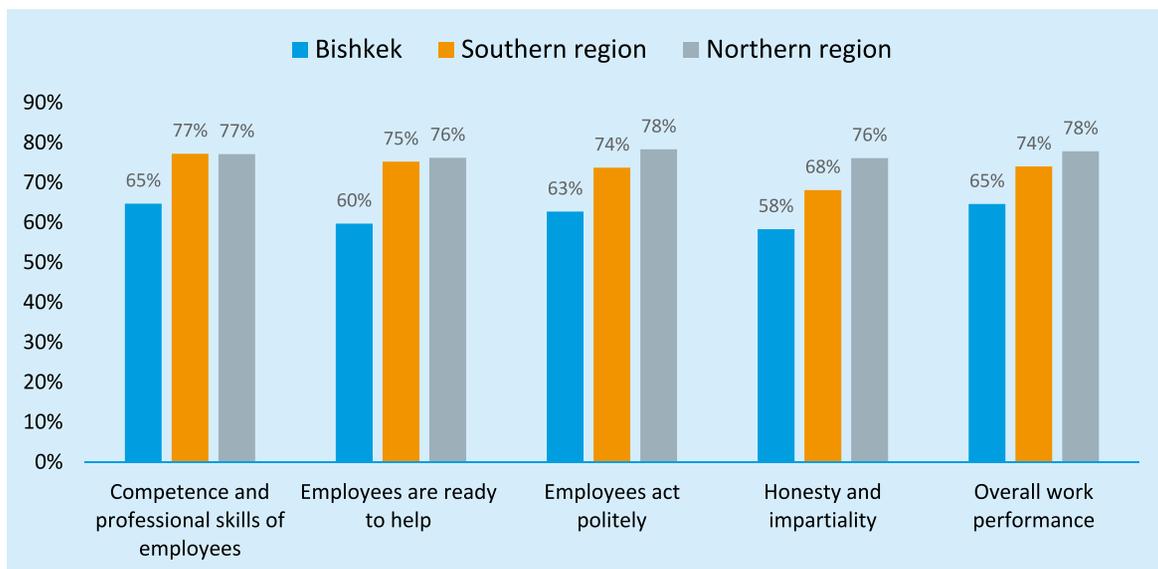
**Figure 26.**  
*Dynamics of tax authorities' performance assessment*



The perception and attitude to the work of tax authorities does not depend on the size of the taxpayer. The study identified considerable regional differences in perception of tax authorities by entrepreneurs. Taxpayers in Bishkek City provided the lowest assessments of the parameters compared to other regions (Figure 27). It is assumed that the smaller the size of a municipal area, the closer the informal ties between public officials and the business community will be, thus ensuring better support from the tax officials to taxpayers in maintaining compliance as compared to a big city.

Entrepreneurs operating in the northern region of the Kyrgyz Republic provided more positive assessments to the politeness, honesty, and overall performance of tax authorities compared to the businesses in the southern region. The best practice of public services in tax administration should be analyzed and introduced throughout the country.

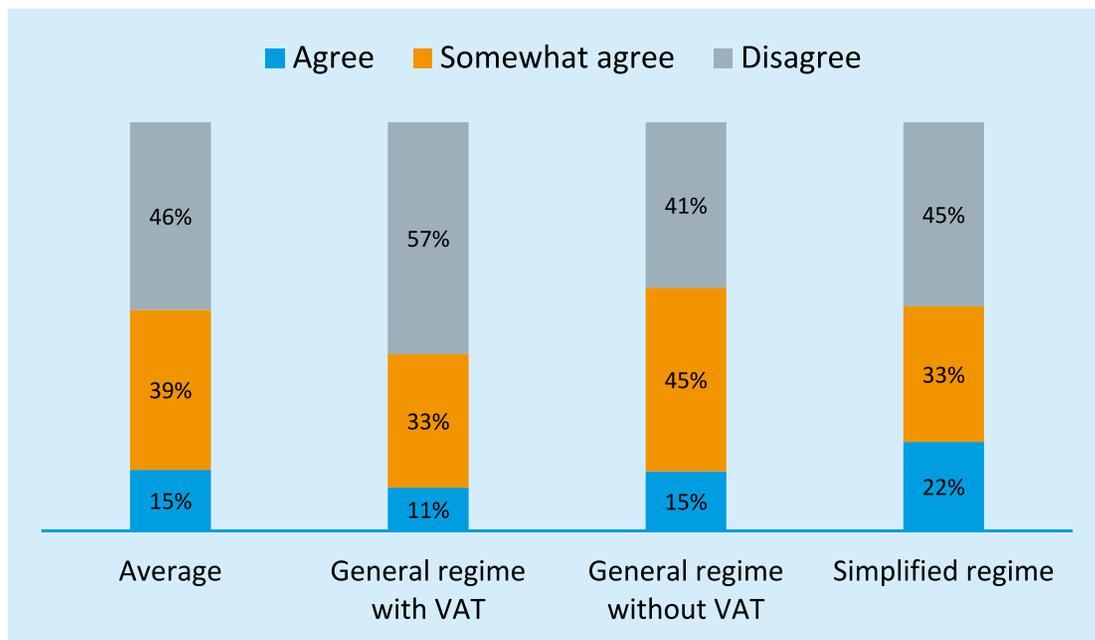
**Figure 27.**  
*Regional differences in performance assessment of tax authorities, 2016*



Although many positive trends in the reduction of tax administration costs and attitude of tax authorities were identified during the monitoring, it is impossible to argue explicitly that taxpayers are satisfied with the quality of public services received from the tax administration. The share of respondents who agree that the tax authorities render high-quality services was insignificant and accounted for as little as 15 percent of the total number of interviewed taxpayers (Figure 28). The majority of taxpayers hold the opposite view. Over half of the interviewed entrepreneurs in 2016 believed that the quality of public services rendered by the tax officials was far from satisfactory and needed improvement.

The respondents’ opinions vary strongly depending on the tax regime followed by the taxpayer. It is suggested that the more complicated the tax regime is, the more critically the entrepreneurs assess the quality of work of the Tax Service. As noted earlier, general tax regime with VAT payment is the most costly and most challenging to administer. This is due to the regime comprising the maximum number of taxes along with complex maintenance of tax records (principal taxes, including VAT). Hence, to administer such a system, both the taxpayers and tax authorities’ specialists should have appropriate qualifications. Over half of the interviewed companies—VAT payers (57 percent) pointed to the moderate level of quality of services rendered by tax authorities.

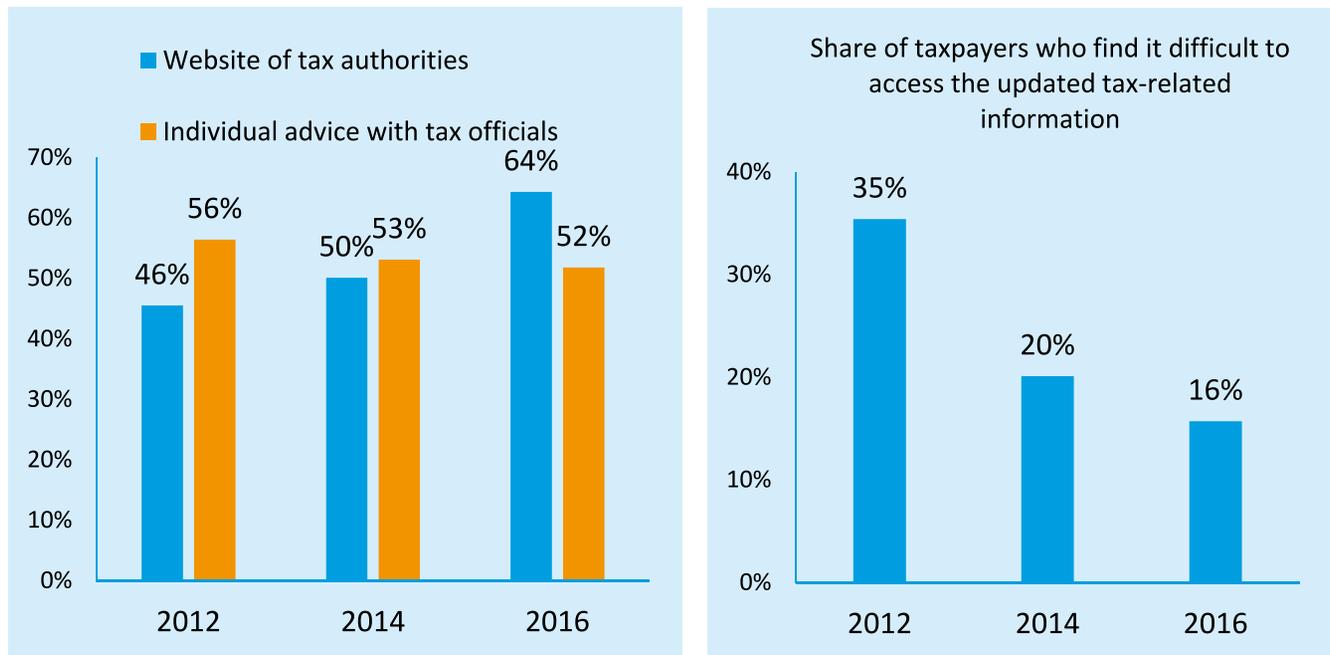
*Figure 28.*  
*Share of taxpayers who agreed that tax authorities render high-quality services, breakdown by tax regime, 2016*



Ongoing reforms, accompanied by changes in the tax legislation, should include adequate outreach support for taxpayers. The results of the study show positive movement in this area. One of the most convenient and increasingly popular sources of information about tax legislation is the website of the State Tax Service. In 2012, entrepreneurs more often approached the tax officials directly for advice on taxes and tax legislation, though in 2016, the situation changed. During the monitoring period, the share of users of the SCS’ website as the key source of tax-related information increased from 46 percent in 2012 to 64 percent in 2016 (Figure 29).

The logical consequence is a decline in the share of entrepreneurs who believed that access to tax-related information was problematic. In 2012, the search for updated tax-related information was challenging for one in three taxpayers (33 percent), while in 2014, only one in five taxpayers (20 percent) found it difficult, and in 2016, this indicator dropped to 16 percent of respondents (Figure 29).

*Figure 29.  
Sources of information and difficulty of access to tax-related information*



Historically, one expense to entrepreneurs has been the purchase of tax-related information (specialized materials, learning and teaching aids, and so on). Of those taxpayers who use the tax authority website, all respondents stated that they visited it to search for information about changes in tax legislation. As a result, costs to taxpayers for purchase of tax-related information fell from KGS 1,331 in 2012 to KGS 790 in 2016.

More accessible tax-related information and transparency of tax authorities could have an effect on shaping a positive image of the State Tax Service as perceived by the business community in the Kyrgyz Republic.

## COSTS OF TAX COMPLIANCE: INTERNATIONAL BENCHMARKING

- Positive trends helped the Kyrgyz Republic improve its ranking considerably in the countries where IFC surveyed costs of tax compliance and made the top three for the time of tax accounting.
- The position of the country in a wider assessment of taxation system by Doing Business international ranking indicates a need to continue reforms of the national tax system.

In recent years, the World Bank Group, together with IFC, conducted more than 10 studies of businesses costs of tax compliance in developing and transition economies and have accumulated a vast collection of empirical data for international benchmarking.

It is impossible to make a full comparison of the results of tax administration costs studies in different countries because every single study was adapted to the specific and particular countries where they took place. However, such studies help with direct comparative analysis of key indicators, primarily analysis of the indicators related to time costs of compliance with tax legislation.

The studies' findings are not representative for all developing economies and may not be extrapolated to represent transition countries in the world or in a region. In most cases, the government of a country where a study of costs of tax compliance was held asked IFC to conduct the study on the assumption that there was a certain burden related to tax administration.

To ensure comparability, only those taxpayers who maintain tax records on their own and engage staff for this work (to exclude costs of outsourcing services) were selected. The comparative analysis was feasible with the use of the standard methodology of surveying and sampling used for such studies worldwide, and a common definition of accounting and tax accounting was used in the questionnaires.

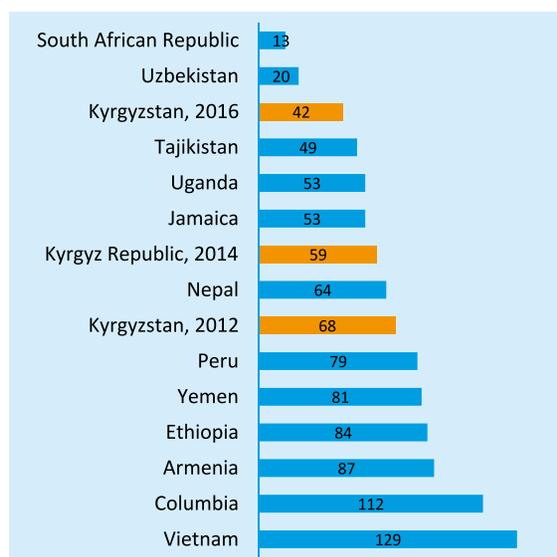
Moreover, the amount of tax administration costs depends strongly on the size of a taxpayer. For the purpose of comparison, usually 'medium' companies were selected. An assumption is that there is no cross-country definition available for a small, medium, and large business. Definition of the 'medium' size of taxpayer varies in each country. In the Kyrgyz Republic, this group includes taxpayers with turnover from KGS 4 million to KGS 30 million per year (US\$57,000–429,000).<sup>22</sup> By contrast, in Tajikistan, this group is represented by taxpayers with turnover ranged from TJS 800,000 to TJS 5 million per year (US\$103,000–641,000).<sup>23</sup>

These positive trends for overall reduction of tax administration costs help the Kyrgyz Republic compete effectively with other developing economies. Out of 13 countries where a similar study was held at different times, the Kyrgyz Republic is among the best (Figure 30).

<sup>22</sup> Annual average exchange rate US\$1/KGS 69.9

<sup>23</sup> Annual average exchange rate US\$1/TJS 7.8

*Figure 30.  
Time costs of tax accounting of 'medium' taxpayers based on studies held  
by IFC in different countries, \* in person-days per year*



*Source: Coolidge, Jacqueline. 2012. "Findings of Tax Compliance Cost Surveys in Developing Countries." eJournal of Taxation 10 (2): 250–287.*

*Note: \*These figures present survey data of costs of tax compliance conducted by the World Bank Group in various economies over the last eight years.*

Based on the results of the 2017 Doing Business international ranking, the Kyrgyz Republic ranked 77, which is a good indicator given the strong competition among countries.

Nevertheless, by the taxation parameters, the Kyrgyz Republic was ranked only 151 of 190 countries surveyed.<sup>24</sup> The Doing Business survey analyzes the taxes and mandatory contributions which a medium-size company has to pay in a respective year and the administrative burden associated with payments of taxes and contributions, as well as the necessary post-filing procedures and tax payment. To ensure international benchmarking, a company with specific profile is considered: the company has to be a medium-size business, with 60 staff employees, the ownership form is a limited liability company, it manufactures and sells consumer goods, and so on.

The Doing Business report shows that time costs of tax accounting in the Kyrgyz Republic amount to 225 hours per year, which is an equivalent of 28 business days. Generally, this figure corresponds well to the results of the survey of costs of tax compliance, because the time span includes only preparation and filing of reporting and payment of three major types of taxes and contributions, namely the corporate income tax, VAT or sales tax, and labor taxes, including payroll taxes and social contributions.

The Kyrgyz Republic is competitive according to the total tax burden figure, which accounts for 29 percent of profit in the Kyrgyz Republic and the time of tax administration. However, the country scores poorly based on the other two indicators reviewed (number of payments per year and index of post-filing procedures). Since the final ranking is computed as the simple average of four indicators, the country has a low international ranking.

<sup>24</sup> <http://russian.doingbusiness.org/rankings>.

The post-filing index procedures describes the time taken to comply with the VAT refund procedure and waiting time to receive a VAT refund, along with other costs for inspections of profit tax. These indicators were not in the scope of this study and may not be comparable. The primary factor preventing the Kyrgyz Republic from improving its rank is the high number of tax payments, amounting to 51 payments per year, as reported in the Doing Business survey. Thus, the Kyrgyz Republic was assigned one of the lowest ranks among the countries in the region (Table 13). This is a direct effect of the limited use of electronic reporting in the Kyrgyz Republic.

Since the Doing Business report accounts for taxes and contributions paid in the second year of operation (calendar year 2016), the reforms of frequency of tax payments by small businesses held in 2015, which reduced such frequency by four times, open the door for a better position of the Kyrgyz Republic in the international ranking by the indicator of the number of tax payments and taxation. Introduction and full-scale use of electronic filing of reporting should considerably reduce the number of required payments and improve the Kyrgyz Republic's position in the final international ranking of Doing Business, thereby improving the image of the country on the international stage.

*Table 13.  
International ranking of ease of tax administration, 2017*

COUNTRY	RANKING OF TAXATION	PAYMENTS (NUMBER PER YEAR)	TIME (HOURS PER YEAR)
Azerbaijan	35	6	195
Armenia	87	14	313
Belarus	96	7	184
Georgia	22	5	269
Kazakhstan	50	7	178
Kyrgyz Republic	151	51	225
Latvia	13	7	169
Lithuania	18	11	109
Moldova	32	10	181
Russian Federation	52	7	168
Tajikistan	132	6	224
Uzbekistan	78	10	181
Ukraine	43	5	328
Uzbekistan	30.2%		
Georgia	24.8%		

This suggests that the tax reforms instituted in the Kyrgyz Republic several years ago helped substantially reduce the administrative burden on businesses in the area of tax regulation, thereby creating more opportunities for the development of the national real economy sector. However, the analysis of the best international practice points to the need to continue tax reform and further reduce the costs of businesses for compliance with mandatory requirements of the tax legislation.

# ANNEX 1.

## KEY INDICATORS OF TIME COSTS FOR TAX ACCOUNTING

			Legal Entity	IE	General Regime with VAT Registration	General Regime without VAT Registration	Simplified Regime (Uniform Tax)	Micro-businesses (>1 million)	Small businesses (1–4 million)	Small/medium businesses (4–8 million)	Medium businesses (8–30 million)	Large businesses (<30 million)
Time costs of tax accounting in working days per year												
1. Office work	2012	19.3	27.8	8.6	39.9	13.0	3.9	11.5	21.1		36.1	67.7
	2014	17.7	26.7	8.5	37.8	12.3	3.9	10.3	17.4		35.3	59.4
	2016	13.3	19.3	5.8	30.0	8.7	2.9	7.2	12.4	18.3	26.0	47.2
2. Visits to tax authorities	2012	7.6	9.7	4.9	13.3	5.7	3.8	5.3	8.9		12.8	19.1
	2014	4.7	5.8	3.6	7.6	4.0	2.7	3.7	4.8		7.1	10.5
	2016	2.9	3.7	2.0	5.6	2.1	1.4	2.1	2.7	4.1	5.5	6.0
3. Visits to the Social Fund	2012	5.6	6.8	4.2	7.3	5.5	3.3	4.9	6.2		6.7	10.1
	2014	5.6	6.5	4.7	7.3	5.7	3.1	4.9	5.7		6.7	10.0
	2016	3.2	3.1	3.2	3.4	3.3	2.4	3.1	3.0	3.0	3.3	3.9
4. Visits to banks	2012	3.1	3.6	2.5	4.0	3.0	1.8	2.6	3.4		4.4	4.5
	2014	2.9	3.1	2.7	3.4	2.8	2.5	2.6	3.1		3.4	4.0
	2016	1.8	2.0	1.7	2.3	1.8	1.2	1.7	1.9	2.1	2.1	2.2
5. Other activities	2012	4.9	6.8	2.4	10.1	2.9	2.1	2.8	4.7		8.2	22.2
	2014	2.9	4.4	1.4	6.9	1.6	0.9	1.4	3.2		6.4	11.2
	2016	2.4	3.6	1.0	5.7	1.4	0.7	1.1	2.3	4.1	5.3	9.2
Time costs of tax accounting for doing office work to deal with various taxes, in working days per year												
Income tax	2012	2.6	3.3	1.5	4.2	1.9	1.1	1.8	2.4		3.6	8.9
	2014	2.3	3.0	1.4	3.7	1.9	0.9	1.7	2.1		3.2	6.9
	2016	1.1	1.5	0.6	2.2	0.7	0.4	0.6	0.8	0.9	1.8	5.3
Profit tax	2012	3.8	4.8	2.1	6.3	2.5	X	2.9	3.5		5.5	9.0
	2014	3.7	4.7	2.2	6.0	2.4	X	2.7	3.4		5.7	8.1
	2016	3.6	4.3	2.3	5.6	2.5	X	2.7	3.4	3.8	5.3	7.5
Uniform tax return	2012	4.1	6.0	1.7	8.0	3.0	0.7	2.5	5.2		7.0	12.4
	2014	3.8	5.6	1.9	7.4	2.9	1.1	2.3	4.4		6.8	11.4
	2016	3.7	5.2	1.8	7.4	2.7	1.2	2.1	4.0	5.3	6.7	10.7
Sales tax	2012	4.3	5.1	2.7	6.2	3.2	X	2.9	4.0		6.9	11.1
	2014	4.1	5.0	2.6	6.2	3.0	X	2.7	3.8		6.7	9.9
	2016	1.2	1.4	0.8	1.8	0.9	X	0.8	1.0	1.3	1.6	3.0

			Legal Entity	IE	General Regime with VAT Registration	General Regime without VAT Registration	Simplified Regime (Uniform Tax)	Micro-businesses (>1 million)	Small businesses (1–4 million)	Small/medium businesses (4–8 million)	Medium businesses (8–30 million)	Large businesses (<30 million)
VAT	2012	8.6	9.1	4.5	8.6	X	X	6.9	6.5		8.4	13.2
	2014	8.4	8.9	3.8	8.4	X	X	6.6	6.5		8.3	12.1
	2016	8.0	8.3	3.7	8.0	X	X	6.2	6.4	6.6	7.9	11.9
Uniform tax	2012	1.2	1.9	1.1	X	X	1.2	1.2	1.3		0.1	1.1
	2014	1.1	1.3	1.1	X	X	1.1	1.1	1.2		0.8	
	2016	0.8	0.9	0.7	X	X	0.8	0.7	0.8	1.6	0.5	
Social Fund contributions	2012	2.8	3.7	1.5	5.0	2.1	1.2	1.8	2.9		4.3	9.8
	2014	2.6	3.6	1.5	4.7	2.0	1.0	1.7	2.6		4.1	8.2
	2016	2.0	2.7	0.9	3.6	1.6	0.6	1.2	1.8	2.3	3.1	6.8
Property tax	2012	1.0	1.4	0.4	1.7	0.6	0.2	0.6	0.7		1.9	2.1
	2014	1.0	1.3	0.5	1.6	0.6	0.5	0.6	0.7		1.6	2.3
	2016	0.8	1.0	0.5	1.1	0.6	0.5	0.6	0.6	0.8	0.9	1.9
Land tax	2012	0.8	1.0	0.5	1.3	0.6	0.2	0.6	0.7		1.2	2.0
	2014	0.8	1.1	0.5	1.3	0.6	0.5	0.6	0.6		1.1	2.1
	2016	0.7	0.8	0.4	1.0	0.5	0.4	0.5	0.5	0.7	0.8	1.7
Time costs for visits to tax authorities, in working days per year												
Submission of tax statements	2012	4.3	5.0	3.4	5.6	4.2	2.4	3.6	4.8		5.8	7.4
	2014	3.4	3.7	3.1	4.0	3.5	2.2	3.1	3.5		3.8	5.0
	2016	1.9	2.1	1.6	2.8	1.8	1.0	1.6	1.8	2.2	2.9	3.0
Submission of social insurance statements	2012	X	X	X	X	X	X	X	X	X	X	X
	2014	X	X	X	X	X	X	X	X	X	X	X
	2016	0.7	0.8	0.5	0.6	1.0	0.4	0.6	0.8	0.7	0.8	0.5
Purchase of VAT invoices and excise forms	2012	4.2	4.3	3.5	4.3	0.4	X	2.2	4.3		4.5	5.9
	2014	2.2	2.3	1.2	2.2	2.0	X	1.9	2.1		2.1	2.8
	2016	1.9	1.9	1.6	1.9	X	X	1.9	1.6	1.6	2.0	2.2
Purchase of social insurance slips	2012	X	X	X	X	X	X	X	X	X	X	X
	2014	X	X	X	X	X	X	X	X	X	X	X
	2016	0.8	X	0.8	1.0	1.0	0.8	0.9	0.8	0.8	1.1	X
Other purposes	2012	2.0	2.7	1.2	3.5	1.5	1.4	1.4	2.3		3.0	5.8
	2014	0.7	1.0	0.5	1.4	0.5	0.5	0.5	0.7		1.3	2.7
	2016	0.4	0.5	0.2	0.8	0.2	0.2	0.2	0.3	0.7	0.8	1.0

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