

How to create a world-class taxation system from scratch: the story of tax reform in Azerbaijan

Since its independence and transition to market economy in 1991, Azerbaijan has been one of the fastest-growing economies in the world, spurred by investment in the country's oil and gas sector. But while the country was enjoying a massive inflow of revenue from oil and gas exports, its tax authorities were facing serious challenges: the country's tax system was a legacy of the Soviet Union and was not up to the challenges and requirements of the fast-growing economy that Azerbaijan had become.

At the onset of the 21st century, the country started addressing its inefficiencies head on. First, it created the Ministry of Taxes in 2000. The country's first tax code followed soon after; it was passed by Parliament in 2000 and entered into force in January 2001. Still, something was missing. Though the ministry and the code were new, Azerbaijan's tax compliance system was not fully established. In view of this shortcoming, the country's then-president, Haidar Aliyev, called for the development of a new, simplified, tax administration system in 2003.

The Minister of Taxes, Fazil Mammadov, took on the challenge of creating, from scratch, a transparent tax administration system, as was necessary. In fact, Mammadov was a key player in the reform process from the very beginning to its successful implementation. Under Mammadov's leadership, the Ministry of Taxes revolutionized Azerbaijan's tax administration by creating a state-of-the-art online system. The 2009 edition of the *Doing Business* report acknowledged the Ministry's progress and named the country "top reformer" globally—with business-friendly reforms in 7 areas, including the "paying taxes" indicator.

Starting with a clear mandate

What triggered the reform at the Ministry of Taxes was in fact a wider agenda of transition into technology-enabled "e-government" at the national level. Realizing the importance of information and communication technologies (ICT) for government, former President Heydar Aliyev unveiled the "National Strategy on Information and Communication Technologies for the development of the Republic of Azerbaijan" in February 2003.¹ This document created the foundations of "e-government" in Azerbaijan and called for:

- Extensive application and development of ICT at the government level;
- Increased tech-savvy among state officials;
- Greater use of electronic documents in government agencies; and
- New, public, automated data systems providing services to citizens.

¹ Decree #1146 of the President of the Republic of Azerbaijan, February 17, 2003.

Mammadov's task was to apply this strategy to the country's tax administration system. He was to help create a modern, efficient and transparent taxation system backed by modern ICT, in line with European Union and even global standards.

As many people are risk-averse and resistant to change, institutional reform is bound to encounter opposition. Some people tend to think reforms are gambles—and that they eventually lead to wasted time and resources. “But if you want to reform and you know you can do it... my advice is not to let anybody stop you and be ready to face criticism along the way,” says Mammadov. “The result that you will achieve will be worth your efforts,” he adds.

With this in mind, Mammadov took a first bold step towards overhauling the tax administration in Azerbaijan. He was ready to face opposition. In February 2004, he called his staff to work on designing a fast, flexible and efficient tax administration system consistent with international standards.

In May 2004, Natig Amirov, then Head of the Economic Analysis Department at the Ministry of Taxes, came up with a proposal. The system he proposed would:

- Computerize document exchanges within the Ministry of Taxes;
- Create an online database through which taxpayers would be able to file and pay their taxes; and
- Provide the basis for integrating the activities of the Ministry of Taxes with other ministries.

Mammadov was happy with the proposal and, in December 2004, issued a decree announcing the Ministry's plan to computerize the tax administration system. He asked Amirov to set up and lead a working group within the Ministry responsible for the implementation of the proposal. “I had known Amirov for many years and was very pleased with his work as the Head of the Economic Analysis Department,” says Mammadov. “I was confident that he and his colleagues would be able to achieve the desired results,” he adds. Within a few weeks of the decree, the working group was up and running.

The importance of learning from international best practices

“We engaged international partners from the beginning because we wanted to benefit from their experience,” explains Amirov. Indeed, as early as December 2004, the Ministry of Taxes invited representatives from the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) to Azerbaijan for consultations. “They provided us with invaluable information on the various tax administration systems around the world and advised us to study international best practices that we could easily replicate in Azerbaijan,” says Amirov.

Based on these recommendations, the working group visited the United States and Turkey to learn from their successful use of IT-based tax systems. The United States was chosen because its tax administration system employed particularly advanced technologies. And Turkey was chosen because “it was the most developed of our neighbors and because of our cultural and

linguistic affinity, we thought their example would be the easiest to apply in Azerbaijan,” explains Amirov.

Members of the working group paid several visits to Turkey. During one of these visits, in May 2004, they discovered a Turkish company called Cybersoft, which was under contract to develop a similar program for the Turkish Ministry of Finance. The working group decided to contract Cybersoft for its own project because they thought that the company’s experience would bring a lot to the project. “The company did in fact bring a lot of good ideas in terms of what had worked and what hadn’t in previous projects and this helped us set a realistic goal that could be achieved given our objectives and time frame,” says Amirov. “The fact that we had no language barrier with the company was also an important aspect facilitating our cooperation,” he adds.

The year 2005 was a very busy year for Amirov and his team. They conducted intensive meetings and spent 18-hour workdays developing the system with Cybersoft. The working group was made up of 30 members who were individually responsible for different aspects of the project. Amirov met with members of this team every day.

But as work progressed, the members of the working group realized that they did not have the regulatory base that would support the development and implementation of the program once it was ready. “We knew that without greater financial support from the President’s Office, we wouldn’t be able to achieve our goal,” says Mammadov. “I therefore approached President Aliyev and asked him to personally back our project,” he adds.

President Aliyev welcomed Mammadov’s request and issued a decree calling for the facilitation of Azerbaijan’s tax administration by 2007.² His decree set guidelines, objectives and deadlines for the reform project. Most importantly, it gave the Ministry of Taxes greater authority and a bigger budget to conduct its work. That turned out to be critical to the success the project.

Amirov’s team had clear goals, yet nobody quite knew what the end result should look like. What was the fast, flexible and modern tax administration system that they sought? “Our approach to this was to build the new system while addressing the problems and inefficiencies of the old one,” Says Amirov. With this in mind, the team decided on the following principles:

1. Get rid of paper declaration and facilitate document exchange in electronic format;
2. Centralize registration and administration by using one single database for taxpayer services;
3. Integrate the system with other state agencies and private banks.

With these objectives in mind during a year of hard work, the team was able to put together a system that moved tax return declarations to an electronic format. Features of the new system included:

- An online filing and payment option for taxpayers with no hard-copy requirement;
- A software application to offer information and help taxpayers manage tax debts; and
- An electronic archive of tax returns and other relevant information.

² Decree # 992 of the President of the Republic of Azerbaijan, September 12, 2005

“For us, the benefits of ATIS [that is, Automated Taxation Information System] were immense,” says Mammadov. “Not only did we attain our objective of developing a unique tax administration system in line with international standards, but we also expanded our tax base and increased our revenues.” he adds. As of September 2008, about 43% (85,000) of 200,000 active VAT payers use the Automated Taxation Information Service to file and pay their taxes. The Ministry hopes this number will keep rising.

A quick success, but not without obstacles

While the project delivered its result successfully and relatively quickly, Mammadov and Amirov admit that the process was not without its problems. “One of the major obstacles for us occurred during the testing stage of the project in mid-2005,” Amirov says. He had proposed testing one of the sub-databases of the system, but the results were disappointing and the database processed information too slowly. Halfway through the project, only a couple of months from the projected launch date, the team feared it would fail to meet the deadline.

“The failure of the test generated a lot talk in the Ministry about the feasibility and future of the project,” recalls Amirov. “As the test revealed the project’s weaknesses, our critics—who disliked the project from the outset—tried to convince us to stop our work.” Amirov feared that the failure seemed to confirm critics’ perception that “we were resource-wasting risk-takers.”

Mammadov recalls his experience:

As the Minister, it is my duty to listen to all my staff and take their opinions into consideration. So I convened my staff and listened to the criticisms. In response, I told them that the President and the Ministry had set the clear objective of creating a taxation system in line with EU and global standards. “We will reach this goal,” I said. “Whether you will be with us when we get there is your choice, but we will be there.”

The Minister’s clear stance and backing for the project sent a strong signal to those opposed and encouraged Amirov’s team to keep up the work.

“I must admit, this time was probably the most challenging for the project,” says Amirov. “Did I have doubts about the outcome of our work during this period? Yes, of course. But I didn’t lose my spirit and certainly didn’t let my staff be discouraged.”

Shortly after the meeting, the Minister summoned Amirov and his deputy on the working group, Zaur Fatizadeh, to encourage them to continue their hard work. He told them he knew that they were working on a very important task and that they were doing everything possible. He said that he would understand if the outcome wasn’t achieved in time. Most importantly, he told them that they had his full support and asked them to continue pushing forward. Finally, on August 16, 2006, Amirov was promoted to the position of Deputy Tax Minister and Fatizadeh was promoted to Amirov’s former position, Head of the Economic Analysis Department.

Preparing everybody for the results

As the new system was slowly becoming a reality, the Ministry of Taxes started preparing for the launch with early 2006 in mind. As the launch date approached, the Minister wanted everybody to be informed of the scope and features of the new system. So, from July 2005 to January 2006, the Ministry trained its entire staff on the new system. In addition, the Ministry—with the assistance of the Azerbaijan Entrepreneur Association—set up computer terminals in 12 provincial offices to facilitate training. Today, the Ministry has terminals in 15 offices—with 20 more to be set up in 2009. And after the launch, in January 2006, the Ministry kept a help desk operational within the Ministry to make sure staff's questions were addressed.

The public was educated, too. “As of July 2005, we started conducting training sessions for taxpayers,” says Amirov. In Baku, Azerbaijan's capital, the Ministry invited major taxpayers to learn about the changes and advantages of the new system. Ministry staff travelled outside the capital to hold additional informational sessions for taxpayers in other regions. In addition, a toll-free number was set up for taxpayers to call with questions about the new system. Furthermore, the Ministry's website, www.taxes.gov.az, offered a variety of new services for taxpayers—including the possibility to contact the Minister directly, participate in online discussion forums, get questions answered, read related legislation and access the latest news and statistics.

A few words of wisdom...

“Those who want to undertake a similar reform in this (or any other field) should know that resources alone are not enough to do the trick,” says Mammadov. In his view, a reformer's main asset is human capital, no matter how much financial and technical resources may help. “Every single person involved, from the bottom to the top, has to be ready to work hard,” he says. “When undertaking ambitious reform agendas, you don't want to be surrounded with staff that will tell you that the results of all tests are perfect: You are better off with people who are honest... so you can work together to address [problems] and perfect the system.”