REPORT

THE COSTS OF TAX COMPLIANCE IN ARMENIA

Yerevan 2011

Investment Climate Advisory Services | World Bank Group

In partnership with
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PREAMBLE

Tax compliance costs in many countries, including Armenia, have a significant impact on the business environment and represent one of the main obstacles to business development, especially for small and medium enterprises (SMEs) and individual entrepreneurs.

According to the World Bank’s Doing Business 2011 ranking, Armenia is rated 159 among 183 countries across the world in terms of its environment for paying taxes\(^1\). This is the lowest ranking among all 10 of the country’s DB indicators, and greatly influenced Armenia’s overall ranking, of 48.

A key tax environment indicator is the amount of time businesses spend performing mandatory tax procedures - such as tax accounting, preparing and filing tax returns, paying taxes, and related activities. Ultimately, such tasks constitute the great majority of any business’s "tax compliance costs." To estimate compliance costs related to the payment of taxes and duties, we have carried out a study of such costs for private sector companies and individual entrepreneurs in Armenia. This report presents the study’s main results.

Tax compliance cost surveys are designed for the primary purpose of providing detailed information about topics of interest in individual countries, usually to provide inputs for a specific tax reform agenda. The World Bank Group’s Tax Compliance Cost Surveys all follow a similar methodology and employ a similar questionnaire.

This report presents results of the tax compliance cost survey for private sector companies and individual entrepreneurs in Armenia. The survey’s findings evaluate the cost of accounting of specific taxes and duties and of realizing specific tax procedures, such as accounting, preparation and submission of required tax reporting, undergoing inspections, and so on.

The study’s results identify the areas in which private companies and individual entrepreneurs suffer from unnecessarily heavy burdens, and could thus provide a solid basis for reforming Armenia’s tax administration system with an eye towards reducing costs related to tax compliance. Study data represent the views and experiences of a sample of 750 private companies and 250 individual entrepreneurs in Armenia, all active for tax year 2009. The study was organized and carried out by the Investment Climate Advisory Services of the World Bank Group upon request of the Ministry of Economy and State Revenue Committee of Republic of Armenia.

\(^1\) The World Bank Group, *Doing Business 2011* (also see 2006 - 2010).
THE COSTS OF TAX COMPLIANCE IN ARMENIA

Glossary

AMA Armenian Marketing Association
AMD Armenian Dram
DB Doing Business
FP Fixed Payment
GDP Gross Domestic Product
IE Individual Entrepreneur
IFC International Finance Corporation
LT Large Taxpayer
LTU Large Taxpayers Unit
LE Legal Entities
MSME Micro, Small and Medium Enterprise
OECD Organization for Economic Co-operation and Development
PIT Personal Income Tax
PT Profit Tax
RA Republic of Armenia
RBA Risk Based Audit
SSP Social Security Payment
SRC State Revenue Committee of the Republic of Armenia
TIN Tax Identification Number
TSC Taxpayers Services Center of the State Revenue Committee of the Republic of Armenia
VAT Value Added Tax
WB World Bank

Average official exchange rate for 2009
Armenia Dram to US Dollar: 1 USD = 363.28 AMD
Executive Summary

The Report represents the main results of IFC’s 2010 survey of private sector companies and individual entrepreneurs in Armenia. Its findings evaluate the cost of compliance with tax legislation and supervisory bodies to fulfill tax liabilities by legal entities (companies) and individual entrepreneurs in 2009. This study does not estimate the cost of tax administration for the state (tax authority or local authority). The following tax compliance costs were surveyed:

- **Tax accounting procedures**: such as keeping tax accounting; maintaining book of registration of revenues\(^2\) and book of shipment of inventory holdings\(^3\); researching, learning and analyzing tax legislation; filling tax reports;
- **Submission of tax reports** to tax authority and local authority; payment of taxes; preparation of additional information on requests of tax authority;
- **Tax inspections**, including unofficial visits related to inspections of taxpayers; filing appeals;
- **Other costs** related to compliance with tax, such as purchasing blank tax reports, printed and electronic tax publications, and accounting software, participating in tax workshops and training events, payment of tax consultations, etc.

The survey report examines the cost of tax compliance in terms of time and money. The number of man hours spent working on tax compliance can also be expressed in terms of money, as the cost to businesses includes staff wages as well as any lost productivity. Thus, from the business’ perspective, the time required to comply with tax regulation is an additional cost associated with paying taxes.

The study shows that tax compliance in Armenia is a burden on private businesses, especially for small companies and individual entrepreneurs, which spend an additional 10 percent of income on tax administration\(^4\).

Despite the fact that most survey respondents reported that the quantity of taxes is the main concern for Armenian businesses (39%), other characteristics of the tax system - such as tax inspections, corruption associated with paying taxes, tax accounting procedures, tax reports and frequency of filing - are also worrisome for a lot of taxpayers (see chart 1).

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4. For companies that had annual turnover up to 5mln AMD.
Therefore, the survey focused on assessment costs of tax compliance and particularly on those that are the most costly and problematic for Armenian business, such as maintaining book of registration of revenues, tax inspections and book of shipment of inventory holdings.

**Businesses Spent 2.5 Staff Months Per Year to Comply with Tax Procedures**

The survey shows that, on average, a company accountant spent about 50 working days (400 hours) carrying out the three main tax procedures - tax accounting, filing reports and supporting tax inspections - in 2009 (see table 1). Individual entrepreneurs spent much less time, 118 hours, as a result of more simple requirements (number of taxes, accounting, reporting and payment requirements, etc.). Yet taking into account the relatively small size of most individual entrepreneur firms, this total is also too high.

**International comparison. Tax compliance costs.**

Small and midsized businesses in New Zealand spend 76.7 hours on tax compliance each year. The amount of time spent on tax activities is strongly related to business size (from 51.3 hours for businesses without employees, to 204.5 hours for businesses with at least 20 employees). The survey data show that even micro-sized Armenian business, represented by individual entrepreneurs, spent more than twice as much time (118 hours) than even the smallest New Zealand businesses.

The most costly tax procedure for both companies and individual entrepreneurs was tax accounting, which took up 80 percent of tax compliance work time for companies and about 66 percent for individual entrepreneurs. The average company spent 333 hours, while the average individual entrepreneur spent about 78 hours on tax accounting, filling tax reports, maintaining book of registration of revenues and book of shipment of inventory holdings.

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5. Figures were calculated as % of respondents who marked particular issue as medium or big problem for a company.
7. About 50 % of individual entrepreneurs did not have employees at all and about 30 % had one employee in 2009.
holdings and analysis of tax legislation in 2009. The main reason tax accounting procedures were so costly for businesses is the necessity to maintain special tax books - namely, book of registration of revenues and book of shipment of inventory holdings - and the time required to find, learn and analyze tax legislation. Maintaining these book is their most time consuming procedure - companies spent, on average, 149 hours on these tasks, while tax accounting took about 108 hours per year. Finding, learning and analyzing tax legislation took 82 hours on average in 2009. The same can be said for individual entrepreneurs, since the maintaining of book of registration of revenues and book of shipment of inventory holdings (below, often referred to as "maintaining books") took the most time among their tax procedures as well - about 37 hours on average in 2009.

Thus, maintaining book of registration of revenues and book of shipment of inventory holdings and researching tax legislation significantly increase the costs of compliance and remain sizable hurdles for Armenian businesses.

| Table 1: Annual Cost of Compliance with All Tax Procedures per Average Company and Individual Entrepreneur in 2009.* |
|--------------------------------------------------|--------------------------------------------------|
| **Tax procedures**                                | **Companies**                                    | **Individual entrepreneurs**                |
|                                                  | **TIME** | **COST** | **TIME** | **COST** |
|                                                  | **hours**| **AMD**  | **hours**| **AMD**  |
| Tax accounting, filling tax reports, maintaining book of registration of revenues and book of shipment of inventory holdings, learning and analyzing tax legislation | 333      | 357,600  | 78       | 49,100   |
| Submission of tax reports to tax authority and local authority, tax payments and preparation of additional information on requests of tax authority | 50       | 52,800   | 36       | 22,700   |
| Inspections including unofficial visits and filling appeals | 17       | 18,300   | 4        | 2,500    |
| Other costs related to tax compliance | -        | 66,300   | -        | 3,200    |
| Total average:                                  | 400      | 495,000  | 118      | 77,500   |

The reporting and payment system is also time consuming. As the study shows, about 94 percent of companies and 96 percent of individual entrepreneurs visited a tax authority to submit tax reports, as well as for other reasons, in 2009. Some taxpayers also visited a local authority to submit tax reports. The number of taxes and the need to frequently file tax

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8. All figures in the table represent the mean for all companies and individual entrepreneurs. The averages for companies or individual entrepreneurs who spent time for particular activity only (for example inspections) differ from the mean for all companies and individual entrepreneurs because of for example about 44% of companies was inspected and that is why spent time on this.

reports costs businesses considerably. But the most costly aspect of these procedures is the physical filing and paying of taxes in person. This means time spent on travel, waiting in lines, preparing additional information or doing additional actions to file reports and pay taxes. Consequently, companies spent an average of about 50 hours filing reports and paying taxes in 2009. Despite fewer taxes and a lower frequency of filings, individual entrepreneurs spent about 36 hours on average to fulfill reporting and payment requirements.

Tax inspections represent another cost for Armenian businesses. Inspections mean time lost to support the inspector’s visit, as well as repeated visits during the year. As survey data shows, more than 44 percent of companies and 34 percent of individual entrepreneurs were inspected by the tax authority in 2009. The most inspected taxpayers faced two or more different kinds of inspections during the year. Tax inspections are used to force businesses to pay more or make unofficial payments, survey respondents reported. Further, some 10 percent of companies and individual entrepreneurs were visited unofficially by tax officials in 2009, since taxpayers were not properly informed of their legal grounds on such visits.

**Small Businesses Bear the Highest Relative Compliance Costs**

Tax compliance costs hinge on business size - the larger the company, the greater the costs. While the smallest companies spent about 221 hours, or AMD 296,150, on average, in 2009 to comply with all tax procedures, large companies spent an average of 1,145 hours, or AMD 1,848,830, on compliance (see charts 2, 3). Size matters for individual entrepreneurs as well, though not as much because of smaller income discrepancies.

**Chart 2: Time Spent on Compliance with All Tax Procedures per Average Company and Individual Entrepreneurs Depending on Turnover in 2009.**

<table>
<thead>
<tr>
<th>Turnover, AMD</th>
<th>Time, hours</th>
<th>Average of all</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 5 million</td>
<td>221</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>5 - 29.99 million</td>
<td>291</td>
<td>58.35</td>
<td></td>
</tr>
<tr>
<td>30 - 58.35 million</td>
<td>444</td>
<td>More than 58.35 million</td>
<td></td>
</tr>
<tr>
<td>More than 58.35 million</td>
<td>669</td>
<td>Large taxpayers</td>
<td></td>
</tr>
<tr>
<td>Average of all</td>
<td>1,145</td>
<td>Average of all companies</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Turnover, AMD</th>
<th>Time, hours</th>
<th>Average of all individual entrepreneurs</th>
<th>Individual entrepreneurs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 1 million</td>
<td>82</td>
<td>118</td>
<td></td>
</tr>
<tr>
<td>1 - 5 million</td>
<td>106</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 5 million</td>
<td>218</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average of all</td>
<td>118</td>
<td></td>
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</tbody>
</table>
It is important to understand how tax administration costs are burdensome for particular businesses. Despite the fact that large businesses spend more on compliance, small businesses are ultimately more adversely affected because their costs represent a greater percentage of business turnover. Chart 3, below, shows tax compliance costs represented as a percentage of turnover for Armenian businesses.

The survey suggests that smaller companies and smaller individual entrepreneurs bear the greatest relative tax compliance burden. The smallest individual entrepreneurs spent 8.6 percent and the smallest companies 17.5 percent of their incomes to comply with tax legislation in 2009. These are extremely high tax administration burdens that should be seen as an additional tax. Regressive tax compliance cost patterns are common throughout the world, but they are more severe in Armenia, as the survey data shows. Similarly high tax compliance costs exist wherever tax legislation, accounting procedures, reporting and payment requirements are as complicated as they are in Armenia (see international comparison in box below).

10. Should be considered possible differences in relative compliance cost for various companies in different countries as well as different methodologies that had been applied.
International comparison: relative cost of tax compliance

The studies of tax compliance costs that were carried out for other countries show that they are relatively fixed and therefore regressive. SMEs usually carry much higher relative compliance costs in comparison with large businesses.

As table 2 shows, compliance costs for Armenian companies are more regressive than those in other countries - except in countries where tax administration is complicated and very costly for businesses, especially for small ones.

<table>
<thead>
<tr>
<th>Country</th>
<th>Relative costs of tax compliance</th>
</tr>
</thead>
</table>
| EU               | - 2.6% is the estimated cost-sales ratio for SMEs (up to 250 employees)  
                  | - 0.2% is the estimated cost-sales ratio for large business12 |
| New Zealand      | - 0.03% for companies with turnover of 10 million-50 million NZD;  
                  | - 0.09% for companies with turnover above 50 million NZD13 |
| United Kingdom   | - 0.05% for VAT compliance costs and 0.04% for corporation compliance costs for companies with turnover above 1 million GBP14 |
| The Netherlands  | - 0.02% for companies with turnover between 100 million-500 million NLG;  
                  | - 0.006% for companies with turnover above 500 million NLG15 |
| Canada           | - 0.10% for companies with turnover between 0.5 million-1 million CAD;  
                  | - 0.06% for companies with turnover above 1 million CAD16 |
| Ukraine          | - 8.2% for companies with turnover less than UAH 300,000 ($60,000);  
                  | - 1.86% for companies with turnover of UAH 300,000-1 million;  
                  | - 0.78% for companies with turnover of UAH 1 million-5 million;  
                  | - 0.21% for companies with turnover of UAH 5 million-35 million;  
                  | - 0.07% for companies with turnover over UAH 35 million ($6.9 million).17 |
| Uzbekistan       | - 15.6% for companies with turnover less than UZS5 million ($3,776)  
                  | - 2.1% for companies with turnover of UZS 5-50 million  
                  | - 0.8% for companies with turnover of UZS 50-100 million  
                  | - 0.3% for companies with turnover of UZS 100 million - 1 billion  
                  | - 0.1% for companies with turnover over UZS 1 billion |
| South Africa     | - 4.8% for companies with turnover up to R 300,000 ($50,000);  
                  | - 1.2% for those between R300,000 - R 1 million;  
                  | - 0.2% for those between R 1 - 6 million;  
                  | - 0.08% for those between R 6 - 14 million.18 |
| Armenia          | - 17.5% for companies with turnover up to AMD 5 million ($13,765);  
                  | - 2.4% for companies with turnover of AMD 5 - 29.99 million;  
                  | - 1.3% for companies with turnover of AMD 30 - 58.35 million;  
                  | - 0.4% for companies with turnover over AMD 58.35 million;  
                  | - 0.2% for large taxpayers.  
                  | - 4.6% for individual entrepreneurs on average. |

11. All data in the table based on different surveys so the differences in the figures might be also related to different methodological approaches in particular surveys.
Tax Compliance Costs Represented 0.3% of the Country’s GDP in 2009

On average, companies spent six times more on tax compliance than individual entrepreneurs. In 2009, total tax compliance costs for all Armenian companies was nearly AMD 9 billion, while for individual entrepreneurs the total was AMD 1.27 billion (see chart 4). In total, the tax compliance burden, for companies and individual entrepreneurs combined, amounted to AMD 10.24 billion (USD 28.2 million) in 2009, or 0.3 percent of Armenia’s GDP.

As the data shows, tax accounting is the most costly procedure, representing some 73 percent of total tax compliance costs for companies and 63 percent of costs for individual entrepreneurs (see chart 4). About 13 percent of total tax compliance costs among companies were a result of other costs, such as the purchase of blank tax reports, specialized printed and electronic tax publications, accounting software, participation in tax workshops and training.

19. The study represents the cost of tax compliance for active private companies and individual entrepreneurs who operated in 2009. (See Annex “Survey Methodology”).
20. According to survey results, only half of the respondents were inspected during 2009, so the cost was borne by “only” half the businesses.
events, and payment of tax consultations. These costs represent only 4 percent of individual entrepreneurs’ costs because many simply did not need these items, while others needed considerably less than most companies. Filing reports and tax payments are the second greatest cost for individual entrepreneurs (30 percent of total costs), but third for companies. The least costly procedure for both companies and individual entrepreneurs is tax inspection, which represents just over 3 percent for companies and individual entrepreneurs. But this share does not reflect the real impact of tax administration on businesses. Tax inspections are one of the problems of Armenia’s tax system, according to survey respondents and inspections coverage (more detailed information is presented in the chapter "Inspections").

The Major Component of Tax Accounting Cost is Time Spent on Maintaining Book of Registration of Revenues and Book of Shipment of Inventory Holdings

Maintaining the book of registration of revenues and book of shipment of inventory holdings is the most time consuming and burdensome tax compliance procedure for businesses, survey data shows. A company that kept at least one of these books in 2009 spent an average of 255.8 hours maintaining it, while individual entrepreneurs spent an average of about 102.7 hours maintaining these books in 2009. Most importantly, an analysis of accounting practices reveals that the data from these books duplicates some data from accounting registers. Thus, even though some of the work is redundant, taxpayers are obliged to perform the most costly of tax compliance procedures in order to meet legal requirements.

The second issue related to keeping tax accounting is the time that taxpayers spent dealing with tax legislation. Companies spent on average 81.8 hours on finding, studying and analyzing tax legislation in 2009, which represents about 40 percent of the total time companies spent on tax accounting, analysis of tax legislation, and filling in reporting forms. This time cost is directly linked to the complexity of taxes and tax accounting. As survey data suggests, the main reason companies spend so much time on researching and analyzing tax legislation is that the tax system often changes. Accountants are forced to get the most up-to-date and correct information and must also consult specialized publications, attend seminars and workshops and information sessions.

International comparison. Analysis of legislation

Small and midsized businesses in New Zealand spend five hours per year learning tax legislation, which is 10 times less than the smallest Armenian companies spend.

Tax accounting also requires a great deal of time - the average company spent about 108.2 hours on accounting, while individual entrepreneurs spent 20.4 hours calculating taxes and maintain-

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21. These figures are relevant for companies and individual entrepreneurs who maintained books in 2009.
22. Time spent on searching, studying and analysis of tax legislation was high due to last “big” changes, that entered into force in 2009. However such legislative amendments are undergoing every year.
23. Measuring the tax compliance costs of small and medium-sized businesses - a benchmark survey, New Zealand (Prue Oxley et al. 2005)
ing record books. The difference in time cost is primarily related to taxes that companies and individual entrepreneurs pay. Some 87 percent of companies paid from 3 to 6 taxes in 2009, while about 85 percent of individual entrepreneurs paid between 1 and 4 taxes. Further, most companies paid Profit tax (90%) and VAT (48%), which require much more time than the two main taxes paid by individual entrepreneurs, Personal income tax and Fixed payment (60%) (further details in the chapter "Cost of tax accounting").

Companies spent an average of about one employee’s working day (8.9 hours) to calculate and fill in by name return for employees (PIT) in 2009. The time cost on this report varies depending on the number of employees - from an average of 3.5 hours for companies employing up to 5 employees, to 23.7 hours for companies employing more than 50 employees.

Submission of Tax Reports and Paying Taxes are Time Consuming Procedures

The survey data shows that visits to the tax authority and local authority take a lot of time and represent a significant burden for taxpayers. As the study shows, about 94 percent of companies and 96 percent of individual entrepreneurs visited the tax authority at least once to submit reports and/or other reasons in 2009. Also, about 46 percent of companies and 33 percent of individual entrepreneurs visited a local authority at least once.

International comparison. Visits to supervisory bodies

In South Africa, barely half of small and midsized enterprises don’t visit a tax office at all during the year, and of those who do, almost three quarters make four or fewer visits per year.24 Even small companies and individual entrepreneurs in Armenia have to visit the tax authority and local authority at least 9 - 11 times per year25: that is a difference of more than 2-3 times. This is more evidence that Armenia’s reporting system requires significant change.

Another time consuming and costly procedure associated with taxation is payment of taxes, which also requires a great deal of time to fulfill tax obligations.

On average, companies spent about 27.4 hours making tax payments in 2009, while individual entrepreneurs spent about 23.1 hours. This means that businesses spent an average of about 2 hours each month to pay taxes. Making tax payments thus takes even more time than filing tax reports - companies spent about 20.8 hours and individual entrepreneurs spent about 12.8 hours to file reports.

The main reason businesses had to pay so many visits to the tax authorities was the lack of an e-filing system. The survey data shows that there are only several cases when companies and individual entrepreneurs reported that they submitted tax reports electronically in 2009. This means that the electronic filing system, for the most part, failed to work in 2009. Though the e-filing system was not working properly in 2009 (due to a lack of technical capacity within the SRC, a lack of public awareness, and other reasons), businesses could still submit tax reports via postal services starting in 2006. Yet only 20 percent of companies and 7 percent

24. RA Law on Personal Income tax adopted 27.12.1997, article 37, paragraph 1
of individual entrepreneurs did so. One of the main reason here is accountants’ diffidence due to a lack of appropriate knowledge. Focus group participants who prefer to file in person stated that this method gave them more confidence in the accuracy of their reports and less worry that the tax authority might call the director to receive clarification.

**Tax Inspections** are a Heavy Burden - More Than 44 Percent of Companies were Inspected in 2009

Regardless of the fact that tax administration has improved in recent years, as the Enterprise survey shows, the tax compliance survey reveals that the current tax administration system remains far from modern and requires significant improvements.

The risk-based approach is dysfunctional. According to the survey data, more than 44 percent of companies and 34 percent of individual entrepreneurs were inspected at least once in 2009. These figures highlight how burdensome the current tax administration system remains. The survey data takes into account all types of inspections and examinations businesses faced in 2009.

Another issue related to tax inspections is the different kind of inspections a particular company or individual entrepreneur may face. Some 53 percent of inspected companies were inspected once in 2009. This means that about 46 percent of all inspected companies were inspected more than once. Such companies had to spend considerable time supporting and dealing with some sort of inspection. Among the companies and individual entrepreneurs that were inspected, the average number of inspections was 2.2 and 2.6 respectively.

Finally, businesses regularly face unofficial visits. About 10 percent of companies and individual entrepreneurs faced unofficial visits of tax inspectorates in 2009. Businesses were not properly informed regarding legal grounds of such inspections and often had to make unofficial payments, provide goods and services free or use other approaches to resolve the problems related to such inspections.

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26. See chapter ‘Inspections’
27. Source: www.enterprisesurveys.org
Complying with Taxes Creates Additional Costs for Business

In addition to the cost of staff time related to tax accounting procedures, filing reports and supporting inspections, taxpayers have to purchase tax reporting forms and spend additional financial resources to fulfill tax obligations properly with the use of specialized software for keeping financial and tax accounting, specialized printed and electronic publications, and attending educational and training events. As survey data shows, about 80 percent of companies and 93 percent of individual entrepreneurs bought blank tax reports in 2009, spending on average AMD 8,280 and AMD 2,467, respectively. In all, Armenian business spent AMD 1.25 billion for these purposes in 2009.

The survey data shows the extent of businesses’ tax compliance expenses and also reveals other issues related to tax legislation and practice. According to survey respondents, the main issues with tax laws and by-laws are their complexity and the way they often change unpredictably, necessitating constant updates of tax information and additional learning of new and difficult tax codes. Thus, taxpayers are regularly obliged to spend money on special tax literature, training events and consultations.

Further, the majority of taxpayers must periodically buy new tax forms since they change frequently. Also, the frequency of filing tax reports adds to the overall cost of forms. Still, the main issue in this regard is the lack of an electronic filing system in 2009, as the survey data shows (more detailed information regarding e-filing is presented in the Chapter “Submission of tax reports and tax payment”).

International practice. Simplified Tax Compliance Procedures for SMEs in EU\textsuperscript{28}

On the basis of the discussion of the numerous best practice cases presented in the Report "Simplified Tax Compliance Procedures for SMEs", the experts have formulated some more general lessons that could be taken up by the Member States, who of course have sovereignty regarding tax matters:

1) A stable and predictable regulatory environment is one way to implement the "think small first" principle in taxation.
2) The integration of registration for tax purposes within general business registration and one-stop shops can help reduce information and compliance costs.
3) Tailor-made information on taxation can reduce compliance costs for small businesses.
4) Small businesses need information and assistance on changes in tax laws.
5) Binding interpretations of existing tax laws and rulings reduce uncertainty.
6) Simplified methods for tax accounting and for establishing the tax base can reduce compliance costs for small businesses.
7) Tax forms and reporting requirements can be adjusted to the business reality of small enterprises.
8) The electronic filing of tax returns can speed up procedures and reduce compliance costs.
9) Payment reminders and individual tax accounts can speed up payment and refund procedures.
10) Penalty procedures can be avoided or reduced by special information for young enterprises.

General Conclusion

Tax compliance costs in Armenia represent a considerable burden on companies and individual entrepreneurs, and especially small businesses, for which such costs may be the equivalent of 17 percent of turnover. Such costs amount to an extra tax, which undermines competitiveness and hinders further expansion. Small businesses are thus put at a competitive disadvantage, even within the Armenian market. This deters investment as well as the creation of new SMEs. Reforms aimed at lowering tax compliance costs for private businesses, especially small businesses, should therefore be a high priority.

During 2010 and 2011, the Government of Armenia implemented a number of reforms aimed at simplifying and improving tax administration and taxpayer services. Some of the reforms were implemented based on IFC recommendations that had resulted from initial survey findings29. These reforms include:

- Reduction of the number of the tax reports/returns by 53;
- Reduction of the number of the tax payments by 14;
- Adoption of the new Law on Patent fee, according to which IEs also may choose the Patent fee taxation regime, and the Patent fee taxation regime threshold was increased from AMD 2.5 million (USD 6750) to AMD 6.0 million (USD 16210);
- VAT payers have a right to issue electronic tax invoices. In addition, it is defined that those VAT payers who issue only electronic tax invoices are exempted from filling in the book of shipment;
- Approval of the procedure of calculation, set off and/or payment of fines by the GoA for delays in paying back of overpayments or amounts other than overpayments;
- Approval of criteria for considering tax payer as a risky taxpayer in relation to offsetting or refunding VAT and Excise Tax without study or inspection;
- Approval of the procedure on providing commentary related to implementation of provisions of the tax legislation;
- Publication of the Guidelines on Tax Inspections in several areas (construction, transportation, health, education, tourism, fixed payments, maintaining books of shipment of inventory holding and registration of revenues, real estate transactions, and use of cash registers);
- Establishment of the Interdepartmental Board of Appeal and the procedure of discussing decisions of appeal (both tax and customs) committees of the SRC;
- Regulatory and administrative measures to improve taxpayer service (e.g. to exclude cases when taxpayers are required to submit documents or data not envisaged in the tax legislation and procedures, to promote the submission of tax reports (calculations, statements, data) by taxpayers via postal services and especially electronically (by encouraging them through explanatory activities), to exclude unnecessary contacts with taxpayers visiting the tax officials, to invite taxpayers to the tax authority exclusively within the scope of jurisdictions provided by the Law on Inspections and tax legislation);

29. The field stage (face-to-face interviews) of the survey was conducted during May-July 2010, hence the questions of the questionnaires and answers are related to year 2009.
Launch of three special taxpayer service centers (two in Yerevan and one in Vanadzor), which are designed to minimize taxpayers’ contacts with tax officers. It is anticipated that in 2011, three additional service centers will be established;

Introduction of 27 types of tax reports out of around 40 that can be submitted electronically starting Jan. 1, 2011.

General Recommendations

<table>
<thead>
<tr>
<th>SHORT TERM RECOMMENDATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Simplification of Tax Accounting</td>
</tr>
<tr>
<td>1.1 Elimination of Requirements for Maintaining Special Tax Books</td>
</tr>
</tbody>
</table>

**Survey findings**

The survey data suggests that businesses spend an extraordinary amount of time maintaining their book of revenue registration and book of shipment of inventory holdings. Companies spent about 149.3 hours on average maintaining books in 2009, and 117.4 hours tax accounting and filing all reporting forms. The same goes for individual entrepreneurs, who spent 38.1 hours maintaining books and 27.7 hours on tax accounting, on average.

Analysis of accounting practice shows the books’ data duplicates some data from accounting registers. As focus group participants reported, tax authorities carry out intensive inspections to control how books are maintained and enact penalties even for minor violations.

Accountants reported that there are many cases when the tax authority “urges” taxpayers to maintain these books even if they are not obliged to do so in the legislation. In particular, despite the fact that non-VAT payers are exempted from maintaining book of registration of revenues, as well as from book of shipment of inventory holdings, if they obliged by law to use cash machines, many of these businesses do so anyway.

**Recommendations**

2. Also, the elimination of the book of registration of revenue should be considered after implementing the following actions:

   - Define in legislation that the taxpayers who use cash control machines that enable analytical sales reporting during execution will not be required to keep book of revenue registration.
   - Set a timetable to free entities occupied in retail sales from the mandatory requirement of revenue book keeping, or to present them with an alternative.

Elimination of these books will cut tax compliance costs by one-third.
## 1.2 Simplification of Tax Accounting, Including Special Simplified Accounting Schemes for SMEs

The time costs of tax accounting (including, analysis of tax legislation, filling in tax reports forms and maintaining book of registration of revenues and book of shipment of inventory holdings) strongly correlate with business size, in terms of turnover. While companies spent an average of about 333.5 hours on all tax accounting operations, smaller businesses (annual turnover up to AMD 5 million) spent on average 177 hours in 2009.

VAT and Profit tax are the most time consuming taxes. It takes about 53.1 hours for VAT accounting and about 50.5 hours for Profit tax accounting. As practice and tax compliance costs for small business show, simple tax accounting is not as simple as it should be. Further simplification of accounting, and in particular accounting for small businesses, is key to reducing compliance costs. The government should consider the following:

- Harmonize tax and financial accounting requirements for SMEs, in order to have less dissimilarity between tax and financial accounting.
- Define the criteria according to which business entities can be classified as micro, small and medium, both for financial and tax accounting purposes.
- Develop and put into use the special tax accounting regulation for companies with revenue up to AMD 100 million.
- Tax legislation should be simplified and unified to reduce time spent on compliance with the most complicated taxes, such as Profit tax and VAT.

## 1.3 Reduction of Costs of Access to Tax Information and Improvement of Compliance with Tax

Companies spent on average 81.8 hours on searching, studying and analyzing tax legislation in 2009, about 40% of the total time they spent on tax accounting, analysis of tax legislation and filling in reports. Individual entrepreneurs spent about 13 hours, or 28% of the time they spent on tax accounting, analysis of tax legislation, filling in all reports.

The main reason companies spend so much time researching and analyzing tax legislation is that the tax system is always changing. Another problem is the complexity of tax legislation and filling in reports. Amendments to the tax legislation should be consolidated and reduced to a maximum of one set of changes per year. Ensure adequate time is provided between the publication of the new provisions and their coming into effect, allowing taxpayers to adapt.

- Simplify and unify provisions of the tax legislation and the relevant bylaws. This should make applying the present law simpler and make it easier for taxpayers to understand it and fulfill its provisions.
- Develop an article-by-article commentary for all tax legislation. This document should
Executive Summary

Focus group participants reported the following weaknesses in Armenia’s current tax legislation:

- There is a lack of information regarding new legislation;
- Laws come into force post factum;
- The tax legislation is changed frequently;
- The tax legislation is complex - in some cases it is impossible to follow tax rules and fulfill the tax obligation as the law requires (tax rules often do not correlate with the real economic activities of business);
- The tax authority fails to adequately explain the tax legislation;
- Too much time is required to find answers regarding tax legislation (e.g. on how to pay taxes properly).

To simplify the reporting process, the following recommendations are made:

- Provide essential explanations for the provisions of the tax laws and the special features of its application by taxpayers and should be published before respective provisions come into force.
- Introduce advance ruling practice (explanations), where taxpayers upon request may obtain binding individual rulings from tax authorities related to future transactions. Thus, businesses will be secure from future mistakes and possible penalties.
- Improve consultative support to taxpayers. It is recommended to improve tax consulting services under the tax authority call center. Free help desks within each office of the tax authority should be established, whose sole objective is to provide free consultations to taxpayers and to assist them in understanding and applying tax legislation. These help desks should be set up in an "open workspace" manner. Also, the quality of the advisory services of the tax authority should be enhanced with improved training for tax officers.
- Continue to make the tax legislation and regular updates available free of charge on the web site of the tax authority.

Simplification of Reporting

2.1 Revising Reporting Forms and Reporting Periods

Companies filled in about 22 tax reports on average in 2009 and even small companies had to fill in about 19 reporting forms during the year. The main issue is the frequency of filing taxes - primarily fixed payment and social security payments which are filed on a monthly basis by the most of taxpayers.

The tax laws establish different deadlines for submission of different taxes. For example, fixed payment for some activities should be filed within 15 days, after the end of the reporting period, but the SSP report should be filed within 20 days after the end of the reporting period.

Revising and streamlining reporting forms, reducing the frequency of filing should make it possible to curtail the time it takes to fill out returns.

Establishing a longer reporting period for all taxes (except VAT) should cut the time costs of reporting.
Survey shows that on average companies had 10 visits in 2009. The number of visits that companies/individual entrepreneurs must make directly depends on the frequency of filing tax reports.

- Non-VAT payers submit at least 2 tax reports per quarter (PIT and SSP) if they employ up to 5 employees, and 4 if they employ more than 5 employees.
- VAT payers (previous year turnover up to 100 million AMD) submit at least 3 tax reports per quarter (VAT, PIT and SSP) if they employ up to 5 employees, and 5 if they employ more than 5 employees.
- VAT payers (previous year turnover over 100 million AMD) submit at least 5 tax reports per quarter (VAT, PIT and SSP) if they employ up to 5 employees, and 7 if they employ more than 5 employees.

Companies had to wait in line about 40 minutes on average to meet with tax officials in order to submit tax reports. Improving the system for receiving taxpayers should reduce the time spent in lines and in the office of supervisory authorities.

According to accountants, the main reason tax officials prefer the submission of reports in person is because it allows them the chance to oblige taxpayers to pay taxes even if they have losses, advance payments or VAT for refund. Taxpayers indicated numerous issues associated with reports filing in person, and the reasons tax officials invented to refuse tax reports include:

- Company has not checked amount of taxes paid;

Further improvement of the regulatory framework on reporting and increased control of compliance with legislation at the stage of receipt of reports by tax officials. It is necessary to develop and introduce detailed staff rules (job descriptions) for each department within the tax authority, especially for those in direct interaction with taxpayers.

According to tax legislation, tax reports should be accepted by tax officers without

30. See table 15.
Company has losses;
Company has even small amount of tax indebtedness;
Company declares red ink of VAT;
Company does not pay some amount of taxes in advance upon request of tax officials.

2.4 Reduction of Grounds for Other Visits

In 2009, two out of three companies visited the tax authority five times and about 11 percent of companies visited the local authority four times for reasons not associated with reports filing.

The main reasons companies and individual entrepreneurs have to visit supervisory bodies, as accountants indicated are to obtain information regarding taxation and gain the consent from the tax authority on the amount of taxes to be paid.

Since a significant share of Armenian taxpayers visit tax authorities and local authorities for non-reporting related purposes, tax legislation as a whole needs to be revised to simplify it, eliminate conflicts and contradictions, foster stability, and generate unambiguous comments and interpretations. Also, the reduction of requirements and the requests for additional information/documents/actions could further reduce time spent on visits to supervisory bodies.

3 Improvement of Tax Administration

3.1 Development of Internal Audit Guides

The average inspection lasted 40 hours in 2009.

To address the lack of formal internal reference guides, the tax authority should develop audit guides (for internal use) for each industry. This would include not only the general methodology for conducting tax audits, but also comparative industry data, e.g., average sales, profitability, average number of employees in the industry. To improve the audit process, the tax authority should set up a systemized database of tax inspections acts, which would help, make the tax inspectors’ approach to similar cases consistent.

3.2 Unofficial Visits

Approximately 10 percent of companies and individual entrepreneurs faced unofficial visits from tax inspectors in 2009. These visits were not official since businesses were not informed regarding the legal grounds of preliminary control or discussion of its content or request of additional information or actions. Strict control over compliance with legislation at the local level is necessary to prevent the practice of asking for reports/information/data/actions for which there are no legislative requirements or asking for them more often than required by law.

Strengthening internal control over the actions of public officials within the supervisory authorities is necessary to eliminate the pressuring of businesses. Internal audit trails of revenue collection and detailed internal
such inspections and often had to pay unofficial payments, to provide free of charge goods/services or use other approaches to resolve problems that resulted from the visit.

Performance monitoring should be introduced and conducted on a regular basis. Periodical Performance Management Personal Reports should be made with a view of evaluating staff performance, including audit activities. The roles and responsibilities of each function and of employees of the tax authority working at all levels within each function should be clearly defined (staff rules).

Improving tax legislation, particularly cutting down the reasons for carrying out unscheduled inspections, and implementation of a risk-based system for planning supervisory and inspection activities should make it possible to reduce both the overall number of inspections and the share of unscheduled supervisory measures.

In order to protect taxpayers’ rights and increase compliance with tax legislation by both taxpayers and tax officials, the tax authority should ensure the following:

- Define and publicize taxpayers’ rights and obligations so that taxpayers have confidence in the fairness and equity of the tax system and are aware of the implications of non-compliance.

- Comprehensive and clear information should be provided to audited taxpayers about the extent of audit procedures before the audit begins.

- Taxpayers should be able to refer any serious difficulty in their relations with the tax authority to a mediator within or outside the tax authority.

- The tax authority must maintain clear rules and procedures regarding the prompt and accurate recording of all tax audits undertaken.
# Executive Summary

Some 60 percent of companies maintain tax accounting using a personal computer, although only 34 percent of companies do this using specialized accounting software. At the same time, more than 40 percent of companies keep tax accounting manually. A smaller share of individual entrepreneurs maintains tax accounting electronically (about 8%) and only 3 percent use specialized accounting software.

Keeping tax accounting electronically, particularly with specialized accounting software, improves efficiency considerably.

## Simplification of Tax Accounting

### Providing Incentives to Keep Accounting Electronically

Encourage businesses to maintain tax accounting electronically by distributing simple accounting software free of charge and providing training on electronic accounting to SMEs.

This software should enable fill in forms and submit them electronically directly to the tax authority.

## Streamlining VAT Invoices System

VAT was the most time consuming of all taxes paid in 2009. It took about 53.1 hours for companies and about 13.6 hours for individual entrepreneurs. It takes the most time because of the obligation to keep the VAT invoices for each taxable transaction and maintain special registers of them. As survey data shows, companies and individual entrepreneurs spent significant additional time dealing with VAT invoices.

Introduction of the electronic system for preparing and exchanging VAT invoices may drastically reduce the time costs of procedures related to VAT invoices.

Streamline the VAT invoice procedures based on best international practices: cancel the requirement to have the VAT invoice signed and stamped; cancel the requirement to use the mandatory template for VAT invoices (any template should be accepted if it contains required information).

## Improvement of VAT Refund System

About 14 percent of respondents reported that the largest drawback of being a VAT-payer is the difficulty or inability of receiving the VAT refund.

The survey data also confirms the existence of some issues with the VAT refund, since only 17 percent of companies eligible for the refund submitted a refund application to the tax authority in 2009.

The core principle should be implemented in practice - introduce an automated system for VAT refund. The special risk-based system should be introduced for rapid checking of applications for VAT refund. Also, the introduction of a penalty should be considered in the case of a late VAT refund from the tax authority. Since many company representatives do not know how to apply for...
Nearly 17 percent of companies did not apply for the VAT refund because the procedure is too complicated and too expensive and could lead to additional inspections. 11 percent indicated that they did not submit the application because they knew they wouldn’t receive the refund and some 22 percent of companies did not know how to apply for the VAT refund at all.

### 3 Improvement of Filing and Payment of Taxes

#### 3.1 E-filing is a Key to Reduce Time for Submission of Tax Reports

- **Very few companies and individual entrepreneurs submitted tax reports electronically in 2009.** Thus, about 94 percent of companies and 96 percent of individual entrepreneurs visited the tax authority at least once for submission of reports and/or other reasons in 2009.

- **Some 44 percent of companies that submitted reports via post indicated that the main reason they did so was because they felt that submitting their reports via post was the fastest way to fulfill reporting obligations.** Moreover, one out of three companies that filed reports via post indicated that the main reason was to avoid interaction with tax officials in person.

- **As focus group participants reported, electronic filing is not popular.** It could be due to several reasons:
  - Businesses are not aware of new e-filing system;
  - Among taxpayers who are aware, many do not know how to file electronically;
  - E-filing software is complex and sometimes fails;
  - E-filing software is expensive for some small and micro-companies and individual entrepreneurs;
  - Some taxpayers, especially in

- **VAT refund, the tax authority’s awareness program needs to better raise awareness on applying for VAT refund, including the distribution of informational materials and regular updates to the website of the tax authority.**

- **Accelerating electronic filing of all tax reports (including reports which are submitted to local authority) on-line or by e-mail should considerably reduce time costs and the overall costs of tax compliance for Armenian businesses.**

- **Businesses should be encouraged to file electronically or at least via the postal system.** Legal protections for businesses that submit required documents by registered post and through the Internet should be strengthened and well-publicized.

- **Authorities should refine the software for the electronic tax filing system to prevent filing mistakes and make it compatible with the accounting software most widely used by taxpayers.** Also, the registration of electronic signatures should be free of charge and the validity term of electronic signatures should be unlimited. Distribution among small businesses of software for basic tax accounting and e-filing free of charge will encourage them to keep accounting and file reports electronically, further reducing the costs of tax compliance.

31. Among those who were eligible for a VAT refund in 2009.
3.2 Reduction of Costs of Tax Payments

The payment of taxes requires a lot of time. Companies spent about 27.4 hours on average to pay taxes and individual entrepreneurs spent about 23.1 hours to make tax payments in 2009. This means that businesses had to spend about 2 hours each month on average to pay taxes. The tax payment takes even more time than filing tax reports.

Reduce the number of payments of taxes: advance payments of Profit tax should be reduced to a quarterly basis for VAT payers and twice a year for non-VAT payers.

Social security payments should be made on a quarterly basis for businesses that have more than five employees. 32

In order to promote online banking that could significantly reduce the costs of the payment procedure, it is necessary to conduct consistent public awareness campaigns by tax authorities together with the Central bank and other banks.

There are different deadlines to pay different taxes - one of the reasons business spent so much time on tax payments.

Unification of deadlines for payment of all taxes is needed to reduce costs of tax payments.

3.3 Reduction of Time to Prepare Additional Information

19 percent of companies and 8 percent of individual entrepreneurs were requested by the tax authority to provide additional information regarding taxation in 2009. It was mostly related to the verification of tax data in reporting forms and inspections, focus groups participants reported.

Strengthening the tax authority by making available the automated flow of third party information and providing electronic information-matching capability will help remove the need to obtain volumes of information from the taxpayers themselves. This will reduce the compliance cost of submitting information routinely, improve the inspection planning system, and reduce the number of inspections/audits.

4 Improving the Tax Administration System

4.1 RBA Needs to be Implemented

44 percent of companies and 34 percent of individual entrepreneurs were inspected at least once in 2009. These figures explicitly show how burdensome the current tax audit system.

Further steps towards implementation of a risk-based system for the tax inspections, one based on best international practices for selecting taxpayers for inspection, is the main pre-condition for improving the effec-

32. Businesses that have up to 5 employees submit report on social security payments on quarterly basis regardless the company is VAT payer or not.
Among the companies and individual entrepreneurs that were inspected, the average number of inspections was 2.2 and 2.6 respectively.

The underreporting of incomes varies across different regions and sectors. Companies underreport more in the south region (39 percent of real turnover) and least in the central region and Yerevan city (30 percent of real turnover). Individual entrepreneurs from the central and north regions (37 percent and 36 percent, respectively) underreport more than entrepreneurs from Yerevan city and the south (31 percent and 32 percent, respectively).

Businesses operating in production (both companies and individual entrepreneurs) evade reporting requirements more than business from other sectors of the economy.

The correlations between the levels of unreported incomes/audit outcomes in different regions and sectors could serve as an indicator in the development of "risk-based audit" selection systems.

Also, the most popular schemes to evade taxes, as shown in this report, could be used to develop risk criteria in the RBA system. As survey data shows, the three most popular ways to evade taxes are:

- Declare only part of revenue
- Pay salaries unofficially
- Overstate costs

However, evidence that a certain proportion
tiveness and efficiency of supervisory and inspection work. It will also cut down time and financial costs for businesses.

Planning inspections should be done more systematically, and should be based on risk analysis, as mentioned above. The goal is to reduce the planned inspection rate for low-risk taxpayers, many of which are small and medium enterprises. Other types of "control" (such as unplanned inspections) should be minimized as much as possible, especially for small and medium enterprises.

Accelerating the introduction of a computerized risk analysis system within the tax authority is key.

Developing criteria for assessing the quality of inspections instead of the tax amount collected - the level of tax compliance - is another key.

Establishing an effective grievance mechanism for obtaining feedback on inspections from taxpayers, e.g., via a web portal, would also help cut down on ineffective and unlawful inspections.

The quality of the supervision work of the Tax authority should be enhanced through better trainings of tax officers.

### 4.2 Development of Risk Criteria

The costs of tax compliance in Armenia

Among the companies and individual entrepreneurs that were inspected, the average number of inspections was 2.2 and 2.6 respectively.
5 Appeal System Needs Further Improvement

Very few taxpayers use official means of dispute resolution with the tax authority, such as the appeal procedure. Among respondents who indicated "solving issues" in relations with the tax authority, about 45 percent used connections with friends, colleagues or relatives, 22 percent paid "voluntary" contributions to different funds and 7 percent filed appeals.\

Many decisions of the Tax Appeal Committee operating within SRC are posted on the SRC official website. However, the analysis is often not sufficiently detailed to identify a clear statutory basis for the decision.

Despite the fact that the revised appeal system (according to the Government decision #1361-N) is an improvement on the previous system in that it introduces non-SRC officials into the appeals process (making it more independent) and publicizes decisions, further reforms are necessary.

In order to further improve the tax appeal process, the government should consider the following recommendations:

- Creating a tax Ombudsmen's office. The tax Ombudsman can provide smaller taxpayers with an avenue for redressing non-monetary complaints, bolster confidence in the tax system (which could arguably improve compliance), place pressure on tax officials to improve conduct and show taxpayers (especially SMEs) that the government is committed to making the tax system more balanced and taxpayer-friendly.

- Drafting and disseminating among businesses (especially SMEs) a taxpayers' charter as a clear description of taxpayers' rights.

- Additional reforms to the SRC Appeals Committee process must also be pursued to ensure that monetary appeals are addressed in an independent, transparent manner that is grounded in tax laws. The Appeals Council should have the authority to render a decision; the Appeals Council should not include SRC officials; written reasons for a decision should be provided to taxpayers; a feedback loop to auditors should be maintained.

- Improve outreach on overall taxpayers' rights, including appeals.

33. Four % of companies also filed appeals into court and other share of companies used other ways to 'solve issues'. There is no data regarding individual entrepreneurs because of lack appropriate data.

34. Operating within Ministry of Finance.
6 Reduction of Other Costs Related to Taxation

Companies spent on average AMD 287,055 on tax consultations, AMD 69,614 on tax workshops and training events and about AMD 43,226 specialized printed and electronic publications in 2009.

The supervisory authority should carry out ongoing consulting and public awareness campaigns among taxpayers aimed at making tax legislation easier to understand and apply. It should also try to cut down the cost to businesses of purchasing specialized publications, legal and consulting databases, and educational, training, and methodological materials, and of paying for seminars, workshops and other training events.

7 Reduction of Tax Evasion

Based on the survey, about one third of all company turnover is hidden for taxation purposes. These indicators may be used as benchmarks for understanding the possible scope of tax evasion in the country, with some cautions.

On average, companies pay one out of three staff salaries unofficially. Individual entrepreneurs hide a greater share of total salary, paying unofficially about 40 percent of wages.

Most taxpayers indicated that the fallibility of tax legislation and the possibility of unofficial agreements with supervisory authorities are the main causes of tax evasion.

The tax system of Armenia needs reform in order to reduce the share of unreported income. At the same time, formal changes to the tax law alone will not eradicate hidden income, though it may reduce the size of the country’s shadow economy.

All recommendations indicated in the report and elaborated based on survey data may promote reducing the extent of underreporting and increasing the level of tax compliance. Efforts to improve the efficiency and fairness of tax administration based on the report’s recommendations may do more to encourage voluntary tax compliance and reduce tax compliance costs.
Introduction

General Overview of Economy

Gross Domestic Product

Armenia saw strong economic growth during the 2000’s. However, the global economic crisis hit the Armenian economy hard, resulting in a deep recession in 2009. Instead of the World Bank-projected 11 percent decline of real GDP, a 14.2 percent downturn was observed followed by a slow recovery since January 2010. In 2009, almost all sectors of the Armenian economy reported an economic decline, especially in the industrial sector: 7.8 percent construction: 42.3 percent; and electricity production: 13.5 percent. External trade-circulation has shrunk 27 percent, with export down 34 percent and import 29.3 percent. Table 4 shows the GDP of Armenia for 2005-2010.

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP, million USD</td>
<td>4,929.3</td>
<td>6,550.0</td>
<td>9,351.6</td>
<td>11,686.0</td>
<td>8,445.2</td>
<td>9,392.5</td>
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<tr>
<td>GDP, million AMD</td>
<td>2,242,881</td>
<td>2,656,190</td>
<td>3,149,283</td>
<td>3,568,228</td>
<td>3,102,815</td>
<td>3,516,185</td>
</tr>
<tr>
<td>Real GDP growth, %</td>
<td>13.9</td>
<td>13.2</td>
<td>13.7</td>
<td>6.8</td>
<td>-14.2</td>
<td>4.5</td>
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</tbody>
</table>

State budget revenues

From 2005 to 2008, state budget revenues increased alongside stable economic growth. However, the 2009 recession brought about instability in budget revenue inflows. The amount of collected taxes, the taxes surplus growth pace and Taxes/GDP indicator for 2007-2010 are presented in table 5. According to the official data obtained from the RA National Statistics Service, the Taxes/GDP indicators in Armenia from 2008-2010 were 20.3 percent, 20.2 percent, and 19.9 percent, respectively. In comparison, in 2009 the highest Taxes/GDP indicator in CIS countries was in Ukraine, at 36.9 percent, in the Russian Federation, at 34.6 percent, and in Georgia, at 21.6 percent, while the lowest wages were in Tajikistan, at 17.8 percent. In Armenia the collected taxes in 2009 decreased by 15.9 percent, or AMD 98.7 billion. Social security payments fell by AMD 2.1 billion, or 2 percent, mainly due to the decline in the economy’s higher taxation sectors.

35. All the data presented in the given section were obtained from the official websites of the National Statistical Service of the RA (www.armstat.am) and State Revenue Committee (www.taxservice.am).
The RA State budget for 2009 had estimated the collection of AMD 727.5 billion tax incomes and state fees, but less than 625.3 billion AMD were collected - 28.2 percent below expectations.

In 2010, state budget revenues were AMD 755.8 billion, an increase of 11.7 percent from 2009. Tax revenues were AMD 699.4 billion in 2010, up 11.9 percent compared to 2009.

As shown in table 5, the highest inflows in tax revenues are provided by VAT. Its weight in the GDP was 8.6 percent, up 0.4 percent compared to 2009. In state budget revenues VAT represents 39.9 percent, up 2.3 percent compared to 2009.

In 2010, the income tax inflows made nearly AMD 74 billion, an increase of more than AMD 13.7 billion from 2009. Profit tax inflows declined from AMD 80.8 billion in 2009 to AMD 77.8 billion in 2010. Thus its weight in the GDP declined by 0.4 percent. The revenues from different taxes and their specific weight in GDP and total state budget revenues for 2009-2010 are shown in the table below.

<p>| Table 5: Tax revenues and their specific weight in the GDP formation for 2009-2010 |
|-------------------------------------------------|-----------------|-----------------|-----------------|
|                              | 2008            | 2009            | 2010            |
| Total State budget revenues* | 759189.9        | 676416.0        | 755833.0        |
| Inflows in million USD       | 2481,2          | 1862.0          | 2022,7          |
| Specific weight in state budget revenues, % | 100             | 100             | 100             |
| Specific weight in GDP, %    | 20.8            | 21.8            | 21.5            |
| Tax revenues                 | 726098.3        | 625265.3        | 699437.2        |
| Inflows in million USD       | 2373.0          | 1721.2          | 1871.8          |
| Specific weight in state budget revenues, % | 95.6            | 92.4            | 92.5            |
| Specific weight in GDP, %    | 20.3            | 20.2            | 19.9            |
| Including Value Added Tax    | 318313.0        | 254158.1        | 301730.5        |
| Inflows in million USD       | 1040,3          | 699.6           | 807.5           |
| Specific weight in state budget revenues, % | 41.9            | 37.6            | 39.9            |
| Specific weight in GDP, %    | 8.7             | 8.2             | 8.6             |
| Profit tax                   | 86212.2         | 80800.5         | 77813.1         |
| Inflows in million USD       | 281.8           | 222.4           | 208.2           |
| Specific weight in state budget revenues, % | 11.4            | 11.9            | 10.3            |
| Specific weight in GDP, %    | 2.4             | 2.6             | 2.2             |
| Income tax                   | 53748.6         | 60204.7         | 73939.8         |
| Inflows in million USD       | 175.7           | 165.7           | 197.9           |</p>
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<thead>
<tr>
<th>Category</th>
<th>Inflows in million AMD</th>
<th>Inflows in million USD</th>
<th>Inflows in million USD</th>
<th>Specific weight in state budget revenues, %</th>
<th>Specific weight in state budget revenues, %</th>
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<td><strong>Social Security Payment</strong></td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>48140.5</td>
<td>128.8</td>
<td>6.4</td>
</tr>
<tr>
<td><strong>Property tax</strong></td>
<td>2.8</td>
<td>0.009</td>
<td>0.0</td>
<td>1.7</td>
<td>0.005</td>
<td>0.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.4</td>
<td>0.004</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Land tax</strong></td>
<td>15.6</td>
<td>0.051</td>
<td>0.0</td>
<td>19.5</td>
<td>0.054</td>
<td>0.029</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>10.9</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Customs duties</strong></td>
<td>37289.9</td>
<td>121.9</td>
<td>4.9</td>
<td>25111.3</td>
<td>69.1</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29366.7</td>
<td>78.6</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>Fixed payment</strong></td>
<td>20341.2</td>
<td>66.5</td>
<td>2.7</td>
<td>23815.6</td>
<td>65.6</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>21976.4</td>
<td>58.8</td>
<td>2.9</td>
</tr>
</tbody>
</table>

36. Including taxes, duties, social payments, Government grants and other revenues
37. Including the fixed payments collected for petrol and diesel fuels, as well as cigarettes production.
Characteristics of Businesses

The Law "On providing state assistance to small and medium sized enterprises" of the Republic of Armenia, adopted in 2000, established the MSME classification indicators. According to it, the MSMEs (legal entities (LE) and individual entrepreneurs (IE)) classification is based on number of employees and certain sector indicators (see table 6).

Table 6: MSME classification indicators in Armenia

<table>
<thead>
<tr>
<th>Classification</th>
<th>Economy sectors</th>
<th>MSME (number of employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Micro</td>
<td>Small</td>
</tr>
<tr>
<td>Industry</td>
<td>5</td>
<td>50</td>
</tr>
<tr>
<td>Construction and energy</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>Science and education</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>Transport, trade and services</td>
<td>5</td>
<td>15</td>
</tr>
</tbody>
</table>

The table below shows new classification indicators for MSMEs will be enforced starting from 2011, in particular, the LEs and IE will be classified as micro, small and medium based on the number of employees\(^{38}\) and the revenue obtained in the course of previous year or the net value of assets as of the previous year\(^{39}\).

Table 7: MSME classification, new indicators in Armenia

<table>
<thead>
<tr>
<th>Indicators</th>
<th>MSME</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Micro</td>
</tr>
<tr>
<td>Number of employees</td>
<td>10</td>
</tr>
<tr>
<td>Revenue of previous year (million AMD)</td>
<td>100</td>
</tr>
<tr>
<td>Net value of assets by the end of the year (million AMD)</td>
<td>100</td>
</tr>
</tbody>
</table>

---

\(^{38}\) Without field diversification.  
\(^{39}\) Accepted indicators in EU states.
There are no defined criteria according to which business entities can be classified as micro, small or medium for tax purposes. However, in business frames, non-VAT payers are considered SME entities.

MSMEs represented 42.5 percent of GDP in 2009, or AMD 968.7 billion, and 41.7 percent, or AMD 1,110.3 billion, in 2008 - reflecting an increase of 0.8 percent. However, the absolute value decreased by AMD 141.6 billion. Table 8 demonstrates 2007-2009 GDP structure by sector and according to MSMEs and large companies.

### Table 8: MSMEs and large companies' share in GDP by sector of economy.

<table>
<thead>
<tr>
<th>Economy sector</th>
<th>2007 (%)</th>
<th>2008 (%)</th>
<th>2009 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MSMEs</td>
<td>Large</td>
<td>MSMEs</td>
</tr>
<tr>
<td>Industry</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>27.9</td>
<td>72.1</td>
<td>22.3</td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>41.2</td>
<td>58.8</td>
<td>48.5</td>
</tr>
<tr>
<td>Trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>47.3</td>
<td>52.7</td>
<td>51.4</td>
</tr>
<tr>
<td>Transport and communication</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>28.6</td>
<td>71.4</td>
<td>20.8</td>
</tr>
<tr>
<td>Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>42.3</td>
<td>57.7</td>
<td>45.0</td>
</tr>
<tr>
<td>Total GDP 42</td>
<td>41.0</td>
<td>59.0</td>
<td>41.7</td>
</tr>
</tbody>
</table>

According to the survey results, the heaviest burden of tax compliance falls on micro-businesses, which represent up to 17.5 percent for companies and 8.6 percent for individual entrepreneurs. Micro-businesses see this as their main obstacle, which hinders competitiveness and expansion.

Table 9 presents the distribution of business entities according to micro, small, medium and large, as of 2007-2009.

### Table 9: Distribution of businesses by micro, small, medium and large

<table>
<thead>
<tr>
<th>Year</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Total (% of Large)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>82.6</td>
<td>12.7</td>
<td>2.5</td>
<td>2.2</td>
</tr>
<tr>
<td>2008</td>
<td>74.0</td>
<td>18.3</td>
<td>5.4</td>
<td>2.3</td>
</tr>
<tr>
<td>2009</td>
<td>75.9</td>
<td>16.8</td>
<td>5.0</td>
<td>2.3</td>
</tr>
</tbody>
</table>

According to the data presented in the Table 10, large entities represented 2.3 percent of Armenia’s registered businesses in 2009, though they provided more than 50 percent of tax revenue as well as the largest share of the labor force. The table below demonstrates MSMEs’ and large companies’ specific weight by the economy sectors as of 2007-2009.

---

40. The data is brought from 2007-2009 Guide Book on Small and Medium Entrepreneurship in Armenia.
41. The data is brought from 2007-2009 Guide Book on Small and Medium Entrepreneurship in Armenia.
42. Without agriculture and net taxes.
Table 10: MSMEs’ and large companies’ specific weight by economic sector as of 2007-2009.

<table>
<thead>
<tr>
<th>Economy sector</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SME entities (%)</td>
<td>Large (%)</td>
<td>SME entities (%)</td>
</tr>
<tr>
<td>Industry</td>
<td>91.6</td>
<td>8.4</td>
<td>94.6</td>
</tr>
<tr>
<td>Agriculture^4</td>
<td>92.8</td>
<td>7.2</td>
<td>93.7</td>
</tr>
<tr>
<td>Construction</td>
<td>90.1</td>
<td>9.9</td>
<td>89.6</td>
</tr>
<tr>
<td>Trade</td>
<td>99.3</td>
<td>0.7</td>
<td>98.8</td>
</tr>
<tr>
<td>Transportation and communication</td>
<td>87.0</td>
<td>13.0</td>
<td>85.4</td>
</tr>
<tr>
<td>Services</td>
<td>89.6</td>
<td>10.4</td>
<td>89.9</td>
</tr>
<tr>
<td>Total in RA</td>
<td>97.8</td>
<td>2.2</td>
<td>97.7</td>
</tr>
</tbody>
</table>

As the figures demonstrate, the specific weight of large companies in the course of the mentioned three years was highest in the sector of transportation and communication. For MSMEs, the top sectors were trade, industry and agriculture.

Characteristics of Tax System

The RA tax relations are regulated by:

- Tax legislation, which includes the "Law on Taxes", separate Laws on different taxes;
- RA Government decisions;
- RA State Revenue Committee legal acts, as well as, in cases defined by the law, additional acts approved by other authorized state bodies.

The "Law on Taxes" of the RA, has defined the following types of taxes and payments:

1. Profit Tax
2. Personal Income Tax
3. Value Added Tax
4. Excise Tax
5. Property Tax
6. Land Tax
7. Patent fee
8. Fixed Payment

^4 Businesses involved in agricultural industry.
Annex 1 presents the rates for main taxes and payments, as well as periodicity for submission of reports and making payments.

The RA "Law on Simplified Tax" was introduced in Armenia in 2000, substituting value added tax and (or) profit tax (income tax), levied on taxpayers whose previous year’s turnover did not exceed AMD 50 million (without VAT). The "Law on Simplified Tax" was declared invalid, in two phases. Starting from January 2008, it was provided that simplified tax regimes can be applied only by taxpayers with certain types of activity more typical to micro-businesses. Starting in 2009, the given tax was completely taken out of the system. The amendment to the RA Law "On Value Added Tax" has been adopted partially to ensure proper taxation of taxpayers left out of the field of simplified taxation and business entities with small turnover, as well as to create relatively simple conditions for tax accounting. The amendment introduced, for the first time in RA, a maximum threshold of sales turnover (VAT threshold) of AMD 58.35 million. If revenue remained below this number, the business could be considered non-VAT payers. The aforementioned VAT threshold applies to both legal entities and IEs. For non-VAT payers, a number of amendments were introduced in the RA Law "On Profit Tax" and in other relevant government decisions.

In particular, due to amendments to the RA Law "On Profit Tax", the taxpayers of this group are not required to file a balance sheet (statement of financial position) and income statement. Instead, they file a simplified calculation of the profit tax and maintain simplified accounting of the profit tax. It is worth mentioning that the necessity to maintain book of registration of revenue and book of shipment of inventory holdings was removed for this group of taxpayers.

Still, the Law provides an opportunity for taxpayers not exceeding the VAT threshold to be voluntarily deemed VAT payers. Despite simplified accounting privileges effective for non-VAT payers, a rather large number of taxpayers have chosen to return to the general field of taxation. Among the advantages of being considered a VAT-taxpayer is the opportunity to trade with a larger number of companies, according to 19.8 percent of respondents, and the possibility of a VAT refund, according to 14.4 percent.

The patent fee system was introduced in 2009, as a result, the 15000-16000 taxpayers exempted from submitting tax returns during the year, instead of that they just pay a lump sum for each quarter. Patent fee payers could be considered individuals engaged in certain types of activity defined by the Law that have not hired labor and whose turnover from the previous year has not exceeded AMD 2.5 million. IEs, at this time, were not allowed to become patent fee payers. Starting from 2011, the new Law "On Patent Fees" is enforced; expanding the circle of patent fee payers to include IEs who satisfy these conditions:

- had turnover less than AMD 6 million AMD during previous year
- have not hired employees
- engaged in certain types of activity defined by the Law

44. Domestic electric appliances, watches/clocks and clothing repair, etc.
45. Effective since 2009
46. A number of other conditions should be satisfied on parallel basis, particularly related party cannot be considered as VAT non-payers.
47. This privilege applies solely to non-VAT payers, which are required by law to have a Cash Machine.
48. Clothing, shoes, hats, carpet manufacture, renovation, etc.
49. At the same time a number of other conditions have to be satisfied, for example it is not subject of joint activity contract party or a product manufacturer is not subject to excise tax, at some point during previous and (or) current year has not implemented importing by the means of RA "import for free circulation" customs regime.
50. Different types of activity are defined for IE (only 7) and for natural persons (14).
Based on survey results, the heaviest burden of tax compliance (8.6%) for individual entrepreneurs is on those whose turnover is under 5 million. Some 96 percent of respondents of this turnover group has not hired employees. If assumed that other conditions for being considered patent fee payers will be satisfied, then it can be assumed that the new patent fee law will release most IE’s from this heavy burden of tax compliance and enable them to focus on further business development.

In April 2010, as a result of amendments to the Law "On Taxes," the taxes were divided into two groups: state and local. The state taxes are profit tax, income tax, excise tax, value added tax, and the local taxes are property tax, land tax, hotel tax, and parking tax.

For each separate tax type, the taxation bodies declare an official commentary, which regulates the calculation and payment orders for that type. For example, there are two official commentaries in use for profit tax law, one of which regulates residents’ profit tax calculation and payment order, while the other one covers profit tax calculation and payment for non-residents. While referring to profit tax, it is worth mentioning the RA Government decision that defines the maximum allowable size for certain types of deductions from gross income. The same mechanism is also applied for. Personal income tax calculation. It should be stated that most provisions of the above mentioned decision are not extended to non-VAT payers.

Another important Government decision defines the requirements for documents justifying expenditures. The decision sets all necessary data the documents have to contain and makes possible expenditures reduction in terms of profit and personal income taxes calculations.

51. RA Government decision 753 adopted 27.11.1998.
52. RA Government decision 525 adopted 25.08.1998.
CHAPTER I

COSTS OF TAX ACCOUNTING

KEY FINDINGS

- The survey data suggests that businesses spend an extraordinary amount of time maintaining book of revenue of registrations and book of shipment of inventory holdings. Companies spent about 149.3 hours on average maintaining books and 117.4 hours on tax accounting and forms filling in 2009. The same goes for individual entrepreneurs, who spent an average of 38.1 hours maintaining books and 27.7 hours on tax accounting.

- VAT and Profit tax are the most time consuming taxes among all taxes companies paid in 2009. Business spent about 53.1 hours for VAT accounting and about 50.5 hours for accounting Profit tax.

- Nearly 60 percent of companies perform tax accounting on a personal computer, while 34 percent of companies that use PCs use specialized accounting software. More than 40 percent of companies keep tax accounting manually. Meanwhile, only 8 percent of individual entrepreneurs maintain tax accounting electronically, with only 3 percent using specialized accounting software.

- About 14 percent of respondents reported that the largest drawback of being a VAT-payer is the difficulty of obtaining a VAT refund. The survey data also confirms the existence of problems with the VAT refund process - since only 17 percent of eligible companies applied to receive it in 2009.

- Companies filled in about 22 tax reports on average in 2009. Even small companies had to fill in about 19 reporting forms in the year.

- Companies spent on average 81.8 hours searching, studying and analyzing tax legislation. This represents 40 percent of the total time companies spent on tax accounting, analysis of tax legislation, and filling in reports. Individual entrepreneurs spent about 13 hours, or 28 percent of their legislation analysis, tax accounting and reports filing time.
Every business has to keep tax accounting on a regular basis, including several operations to meet legal requirements, such as:

- Finding, learning and analyzing tax legislation;
- Keeping tax accounting for particular taxes and payments;
- Maintaining book of registration of revenues and book of shipment of inventory holdings;
- Filling in tax reporting forms.

Each of these steps requires a certain amount of time spent by taxpayers. The survey estimated the cost in terms of time and money of tax accounting and filling in reporting forms for the main taxes that business paid as follows:

- Profit tax;
- VAT;
- Personal income tax (on individual entrepreneurs incomes and on wages);
- Social security payments;
- Fixed payments;
- Excise tax;
- Property and/or Land tax;
- Payment for using of natural resources and/or pollution of environment;
- Local duties and fees;
- State duties.

The survey data shows that maintaining books was the most time consuming procedure for both companies and individual entrepreneurs in 2009. The average company spent about 255.8 hours maintaining books, while individual entrepreneurs spent an average of about 102.7 hours (see charts 5, 6). Thus, maintaining these books is a burdensome requirement for businesses in Armenia.

53. These figures are relevant for companies and individual entrepreneurs who maintained books in 2009. The more detailed information is presented below in this chapter of the report.
Keeping accounting of all taxes also requires considerable time. On average, a company spent about 108.2 hours on tax accounting in 2009. Individual entrepreneurs, meanwhile, spent about 20.4 hours on average to calculate all taxes. The difference in time cost is primarily related to the difference in the number of taxes paid by companies and individual entrepreneurs. Companies paid on average 5 taxes, and 87 percent of companies paid from 3 to 6 taxes in 2009. Individual entrepreneurs, on the other hand, paid 3 taxes on average, and about 85 percent paid between 1 and 4 taxes in the year. More importantly, most companies paid Profit tax (90%) and VAT (48%), which requires much more time than the two main taxes paid by individual entrepreneurs - Personal income tax and Fixed payment (60%) (further details shown later in the chapter).
The third most time-consuming operation, especially for companies, is researching, learning and analyzing tax legislation. Companies spent about 81.8 hours and individual entrepreneurs about 13.2 hours on average on this procedure in 2009. This time cost directly depends on the complexity of tax legislation and tax accounting. As survey data suggests, the main reason companies spend so much time on researching and analyzing tax legislation is the frequent changes of tax legislation. Also, accountants have to search out up-to-date and accurate filing information and must also consult specialized publications, attend seminars and workshops, and so on. All of these activities require additional time and financial resources and significantly increase tax compliance costs. These costs could be reduced significantly if tax legislation was improved and the tax authorities improved their consultancy function (discussed further in this chapter).

The time cost of tax accounting (including, analysis of tax legislation, filling in tax reports and maintaining books) strongly correlates with business size. While companies spent about 333.5 hours on average on all tax accounting operations in 2009, the smallest companies (annual turnover up to AMD 5 million) spent an average of about 176.9 hours. Large taxpayers spent more than 5 times more time to fulfill tax accounting procedures—about 996.5 hours in 2009 (see chart 7). The same trend applies for individual entrepreneurs: those with up to AMD 1 million in annual turnover spent four times less time keeping tax accounting, filling reports, analyzing legislation, etc, than individual entrepreneurs with annual turnover exceeding AMD 5 million—44.6 hours and 164.5 hours per year, respectively (see chart 8).

55. All indicators were calculated among individual entrepreneurs who spent time on particular operations.
The cost of tax accounting procedures is obviously regressive due to several factors such as the type and number of taxes businesses pay, the number of taxable operations, and so on. This tendency is not an Armenian phenomenon, but worldwide. More important is the finding that small business have much greater difficulty meeting all accounting requirements because they are forced to spend so much more time and money, in relative terms, (as shown in the previous chapter). Tax compliance costs are very regressive when comparing the relative tax compliance costs for small, medium and large businesses. Thus, the current tax system does not encourage businesses to grow, nor does it foster high compliance because of all
the complex tax rules and frequent changes to tax law. The high cost of tax accounting procedures explicitly suggests that tax accounting needs to be simplified for all business, but such reform is especially crucial for small companies and individual entrepreneurs. Also, eliminating book of registration of revenues and book of shipment of inventory holdings and improving tax legislation and streamlining consulting services to taxpayers could significantly reduce tax compliance costs and encourage 1) small businesses to grow 2) incorporation of businesses by individual entrepreneurs.

1.1 VAT Accounting is Most Time-Consuming for Businesses

The study shows that VAT and Profit tax are the most time-consuming taxes among all taxes companies paid in 2009. Companies require an average of about 53.1 hours for VAT accounting and about 50.5 hours for accounting Profit tax (see chart 9). Almost the same situation existed for individual entrepreneurs, who spent an average of about 13.6 hours on VAT accounting and about 9.2 hours on Personal income tax (see chart 10).

Chart 9: Time spent by companies on tax accounting of selected taxes.\(^{56}\)

<table>
<thead>
<tr>
<th>Taxes</th>
<th>Time, hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total time on all taxes</td>
<td>108.2</td>
</tr>
<tr>
<td>VAT</td>
<td>53.1</td>
</tr>
<tr>
<td>Profit Tax</td>
<td>50.5</td>
</tr>
<tr>
<td>Personal Income Tax</td>
<td>16.0</td>
</tr>
<tr>
<td>Social Security payment</td>
<td>17.2</td>
</tr>
<tr>
<td>Fixed payment</td>
<td>10.0</td>
</tr>
<tr>
<td>Property and/or Land tax</td>
<td>3.7</td>
</tr>
<tr>
<td>Payments for using of natural resources</td>
<td>3.7</td>
</tr>
<tr>
<td>and/or pollution of environment</td>
<td></td>
</tr>
<tr>
<td>Local duties and fees</td>
<td>0.9</td>
</tr>
<tr>
<td>State duties</td>
<td>0.8</td>
</tr>
</tbody>
</table>

56. The total average for all taxes is not the sum of average of particular taxes because different companies paid different taxes in 2009.
According to charts 9 and 10, VAT is the most costly tax for both companies and individual entrepreneurs. It takes the most time because this tax requires special accounting for each taxable operation (which is the usual practice) as well as the requirement of keeping the VAT invoices for each taxable transaction and keeping special registers of them. The data shows the significant additional time companies and individual entrepreneurs spend dealing with VAT invoices.

**International comparison. VAT invoices**

EU and other OECD countries have specific requirements regarding the form and maintenance of VAT invoices. VAT invoices are compulsory elements of the VAT control system in other countries, but Armenian companies spend much more time dealing with them. The procedure needs to be simplified and aligned with international best practice. There are at least three major differences:

1. There is no special VAT form in EU countries (any documents that contain mandatory elements are considered VAT invoices);
2. VAT invoices may be submitted to the contractor by e-mail or a special exchange system;\(^{58}\)
3. There is no requirement to submit any VAT invoice registers or VAT invoices to the tax authority.\(^{59}\)

To reduce the time costs of maintaining VAT invoices, therefore, the VAT invoice form should be simplified in Armenia and an electronic system for exchanging VAT invoices between VAT-payers should be established.

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\(^{57}\) The total average for all taxes is not the sum of average of particular taxes because of different individual entrepreneurs paid different taxes in 2009.


\(^{59}\) For control purposes, however, the taxable person in EU countries may decide the storage place provided that he makes the VAT invoices there available without undue delay to the competent authorities whenever they so request.
The main reason companies incur significant costs in paying the Profit tax is that tax accounting of incomes differs from financial accounting and record keeping, as taxable income does not correspond fully to financial results calculated on the basis of financial accounting and record keeping data. The time costs of complying with Profit tax legislation are related to a special procedure for taxing and including specific transactions in income and expenditures, and calculating advance payments. Also, problems associated with tax accounting are due to ambiguous tax legislation and the absence of clear and useful explanations and instructions from the tax authority. Accountants spend a lot of time simply understanding the rules on how to tax particular operations, in particular how to tax certain expenditures, obtaining consultations from tax consultants or colleagues and checking all data numerous times to ensure that particular operations have been properly taxed according to the letter of the law.

Considering the significant time cost on tax accounting, the procedures for calculating taxes should further simplify what is most crucial for SMEs. The current tax legislation has no definitions for general and simplified bookkeeping as such, and the privileges for VAT payers and non-VAT payers are prescribed only by the laws on separate tax types. The main differences are presented in Table 11 below.

Table 11: Tax accounting procedures for VAT and non-VAT payers.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Tax accounting depending on the status of taxpayer</th>
<th>Non-VAT payers</th>
</tr>
</thead>
</table>
| Profit Tax                               | 1. The Government decision defines the maximum thresholds for calculation of profit tax on some types of expenses. When the threshold is exceeded, expenses are no longer included in the calculation. For example, staff training, advertisement, etc.  
2. Together with the profit tax calculation, the accounting balance sheet and financial statements are also submitted. | 1. The specified limitations (maximum thresholds for some expenses) are not acting. The accrued expenses are fully recognized in the reporting period.  
2. Only a simplified calculation of the profit tax is submitted.  
3. The maximum and minimum profit tax thresholds were set, only for 2009, at 2 percent and 10 percent, respectively. |
| Personal Income Tax                      | Calculations of annual incomes are submitted.     | Calculations of simplified annual incomes are submitted. |
| Social Security Payment                  | Annual tax is calculated by the acting tariffs (15%, 5% regressive), but no less than AMD 60 thousand (165 USD) per annum. | Annual tax is calculated by 3 percent tariff, but no less than AMD 60 thousand (165 USD) per annum. |

60. Starting from 2011 VAT payers also will not submit balance sheet and income statement.
The fixed payment may also be deemed a simplified tax regime. The size of amount subject to payment is defined by the product of relevant coefficients. The taxpayers maintain financial accounting and submit an annual accounting balance sheet and financial statements. If payers carry out activity subject only to the fixed payment they do not submit any calculations for VAT and profit tax.

Starting from 2011, the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) has been in force to regulate accounting for SMEs.

From the taxation perspective, a proper definition of SME is needed. In the framework of the business environment, an SME is assumed to be a non-VAT payer. According to the Law of the Republic of Armenia, "On state support to small and medium-sized entrepreneurship," new classification indicators for SME entities are being executed starting from 2011 that mostly conform to European indicators.

### 1.2 VAT Refund Procedure is Long and Complicated and Many Have Difficulty Obtaining Refund

Despite the fact that almost half of all respondents reported that there are no drawbacks to being registered as a VAT-payer, more than 60 percent answered that neither are there any benefits (see Chart 11). About 20 percent responded that the greatest benefit of being VAT payer is their ability to trade with a large number of business entities. About 15 percent of respondents indicated that the largest drawback of VAT-payer status is the higher tax burden in terms of accounting, refund and administration. Notably, one of the largest drawbacks to being a VAT payer is the cost of labor-intensive tax accounting procedures. Because of complicated accounting, the survey data also confirms that this tax is the most time consuming of all, as shows chart 9 (companies spent about 53 hours on accounting of VAT on average in 2009).
Ironically, more than 14 percent of respondents think the possibility of obtaining a VAT refund is the greatest benefit of being a VAT-payer, while nearly the same share of respondents (14%) reported that the largest drawback to being a VAT-payer is the difficulty of obtaining a VAT refund. Indeed, only 17 percent of refund-eligible companies applied for one in 2009. The main reason was that the amount of tax for refund was very low (47 percent of respondents marked this as the main reason). Some 11 percent of companies\textsuperscript{62} indicated that they did not submit an application because they did not expect to receive a refund and nearly 18 percent reported that the procedure is too complicated and too expensive and could lead to additional inspections. Finally, some 22 percent of companies failed to apply for the refund because they did not know how.

Therefore, the above-mentioned figures confirm the necessity of improving the practices and internal procedures of VAT refund within the tax authority. The core principle should be the introduction of an automated system for VAT refund. It is worth to mention, that:

\begin{itemize}
  \item By the Government decision adopted on December 30, 2010, was defined the criteria for considering taxpayers’ eligibility for tax refund (VAT and excise) without carrying out required inspection or examination.
  \item By another Government decision approving Government Action plan, it is specified that SRC should implement risk-based inspections starting May 1, 2011.
  \item By the Government decision adopted February 10, 2011, was approved the procedure for calculating and paying penalties in case of refund delays of more than 90 days.
\end{itemize}

Since many company representatives do not know how to apply for a VAT refund, the tax authority's awareness program needs to include appropriate actions regarding raising taxpayer awareness on filing for the VAT refund, including distribution of appropriate information materials among VAT payers and updating the information on the website.

\textsuperscript{61} The figures show the share of respondents that indicated particular benefit/drawback of being VAT-payer.

\textsuperscript{62} Among those who were eligible for a VAT refund in 2009.
1.3 Accounting Software is not Properly Used; Companies Spend More Time Keeping Accounting Manually

Nearly 60 percent of companies maintain tax accounting using a personal computer, although only 34 percent of companies do this using specialized accounting software (see chart 12). Still, more than 40 percent of companies keep tax accounting manually. Meanwhile, about 8 percent of individual entrepreneurs maintain tax accounting electronically, and only 3 percent do so with specialized accounting software (see chart 12).

More than 60 percent of Profit tax and VAT payers among companies maintain tax accounting electronically (using non-specialized or specialized software), while less than half of fixed payment payers and non-VAT payers do so. The main reasons companies do not keep tax accounting electronically are a relatively small number of operations and less complex tax accounting.

As chart 13 shows, the less turnover company has, the less inclined it is to maintain tax accounting electronically. About 45 percent of the smallest companies (with annual turnover less than AMD 5 million) use computers, but more than 90 percent of large taxpayers prefer keeping tax accounting electronically. Large companies, of course, have a greater number of taxable operations, pay more taxes and have more complex tax accounting that requires using more sophisticated accounting systems. Also, tax accounting of fixed payment is less complex than tax accounting of Profit tax or VAT. Since 32 percent of the smallest companies (turnover less than AMD 5 million) paid Fixed payment and 70 percent did not pay VAT, most have little need for electronic accounting.
Chart 13: The share of companies which kept tax accounting manually (without using PC), using non-specialized software (such as MS Excel) or specialized accounting software, depending on turnover, in 2009.

According to respondents, additional hurdles to the implementation of electronic tax accounting include a lack of computers, especially in remote regions, and low competence in electronic devices and the use of accounting software, especially for small companies.

The majority of individual entrepreneurs maintain tax accounting manually (see chart 12), due to their relatively small number of taxable operations.

Chart 14: Time spent on tax accounting and filling in all reporting forms depending on way of keeping tax accounting - manually (without using PC), using non-specialized software (such as MS Excel) or using specialized accounting software (among companies with annual turnover over AMD 58.35 million and which operate in Yerevan).
Keeping tax accounting electronically, especially using specialized accounting software, is very efficient. Among companies with a turnover greater than AMD 58.35 million operating in Yerevan, those using specialized accounting software required over 25 percent fewer hours to maintain their accounting than those doing the work manually in 2009 (203 hours to 271, respectively, see chart 14).

It is necessary to ensure that taxpayers, especially small companies and individual entrepreneurs, are able to maintain accounting electronically through the distribution, free of charge, of simple accounting software and the encouragement of business to file electronically, as discussed in detail in the Chapter "Submission of tax reports and tax payments" below.

1.4 Profit Tax Report Form Requires the Most Time to Fill Out; Social Security Payment Forms Take the Most Time Annually

As charts 15, 16 shows, Social security payment forms require more time than other taxes, primarily because all companies have to file Social security payment reports on a monthly basis, except small companies that had five or fewer employees in the previous quarter. Filling VAT reports also takes a lot of time in comparison with other taxes due to both the complex reporting form and the number of reports that companies have to file in a year.

Chart 15: Time spent by companies on filling in reporting forms of selected taxes in 2009.

Most companies filed VAT reports on a quarterly basis, but some companies filed them each month, as the Law on VAT defines monthly reporting period, if a company’s turnover exceeds AMD 100 million in the previous year.
Companies submitted about 22 tax reports on average in 2009. Chart 17 shows that even small companies have to fill in about 19 reporting forms in a year.

At the same time individual entrepreneurs filed about 14 tax reports on average in 2009, confirming that reporting requirements for small business are too high and require too much time to fulfill.
International practices. Simple tax reporting forms.

Tax reporting for small businesses could be significantly simplified, reduced to several lines in the report. For instance, the whole report of a micro-firm could contain one figure indicating tax base and another indicating tax due. In some cases this could also contain the amount of fine.63

This is the approach used, for example, in Singapore. There, the annual report on income tax for small businesses was significantly condensed. Individual entrepreneurs and partnerships with a turnover of less than $340,000 file a report that has only four lines: turnover, gross profit (loss), allowed deductions and corrected profits (loss). These businesses do not have to file financial statements unless specifically requested.64 The principle is followed by many countries (e.g., by Ukraine for the unified tax reporting form for IEs;65 by South Africa, and many others).

1.5 Tax Legislation is Complex and Ambiguous - Analysis of Tax Legislation Annually Takes 82 hours

Companies spent on average 81.8 hours searching, studying and analyzing tax legislation in 2009 - about 40 percent of the total time companies spent on tax accounting, analysis of tax legislation, calculation and filling in tax reports and forms (see chart 18). Individual entrepreneurs, meanwhile, took much less time on this work, needing only 13 hours on average, or 28 percent of their total time spent on tax accounting, analysis of tax legislation, calculation and filling in reports and forms in 2009. The main reason individual entrepreneurs keep very basic tax accounting is that they pay fewer taxes and have fewer taxable operations, and thus need less time to analyze tax legislation.

Chart 18: Time spent on tax accounting, analysis of tax legislation, calculation and filling in annual by name return for employees (PIT) and filling in all reporting forms in 2009.

64. OECD, 2008. Programs to reduce the administrative burden of tax regulations in selected countries. Information note, Forum on tax administration: taxpayer services sub-group. www.oecd.org
The time cost for analyzing tax legislation depends on a company’s turnover and varies from 49.7 hours for the smallest companies to 141.3 hours for the largest companies (see chart 19). The larger the company, the greater its number of taxes paid and its number of taxable operations, necessitating more time spent studying various tax laws.

Chart 19 shows that even the smallest companies spend a lot of time dealing with tax legislation in order to properly fulfill their tax obligations. One key problem is that the tax system is always changing. Another problem is the complexity of tax legislation and tax accounting. To identify whether tax accounting is correct, accountants not only have to refer to provisions of the current legislation and bylaws, but also search out the current tax bodies to get the most up-to-date and accurate information. They must also consult specialized publications, attend seminars and workshops, and so on.

International comparison. Analysis of legislation

Small and midsized businesses in New Zealand spend five hours per year learning tax legislation, which is 10 times less time than the time spent by the smallest Armenian companies.

Time cost on analysis of tax legislation depends on annual turnover of companies as well as on the total number of taxes companies pay. It varies depending on the tax regime company’s use and whether they pay VAT. Looking at only companies with annual turnover between AMD 5 million to 58.35 million, chart 20 shows that companies that pay profit tax spend more than twice as much time analyzing tax legislation as companies paying fixed payments - 88.9 hours vs. 39.1 hours, respectively. This highlights the complexity of the Profit tax, one of the most time consuming of Armenia’s taxes.

66. Measuring the tax compliance costs of small and medium-sized businesses - a benchmark survey, New Zealand (Prue Oxley et al. 2005)
The tax legislation is ambiguous and contradictory

The RA tax legislation lacks precise definitions of concepts, often resulting in misunderstanding as well as misapplication. In particular:

- The 2nd article of legislation of RA law on "Value added tax" states that periodically implemented economic activities for obtaining profit are considered business activities. The legislation, however, never defines the word "periodically."

- The RA law on "Value added tax" defines a set of parameters that when satisfied establish the person or business as a non-VAT payer. However, in practice, when applied for non-residents of RA, the tax agent has a lot of trouble identifying whether the non-resident meets the mentioned parameters. The main problem is that it is necessary to consider information regarding the activities of that non-resident in other countries.

Another time consuming tax is VAT, as mentioned above. Chart 20 also confirms this, showing that VAT payers spent almost twice as much time analyzing legislation as the non-VAT payers - 108.1 hours vs. 64.3 hours, respectively.

Chart 20: Time spent searching, studying and analyzing tax legislation by companies depending on taxes paid in 2009 among companies with annual turnover from 5 million to 58.35 million AMD.

Despite the fact that companies that pay fixed payments and do not pay VAT spend less time analyzing tax legislation, this procedure is still time consuming for small businesses due to the complexity of tax legislation and tax accounting.
Chart 21 also confirms that businesses faced numerous hurdles related to tax compliance work, most related to tax legislation. In particular, about 65 percent of respondents indicated that the frequency of changes in tax legislation has been a significant problem for companies. Also, about half of the respondents think there is a lack of adequate instruction and explanation from the tax authority and that the tax legislation is very complex and filled with contradictions.

**Tax legislation: business opinion**
Focus group participants reported the following weaknesses in the current tax legislation in Armenia:

- A lack of information regarding new legislation;
- Laws take into the force *post factum*;
- The tax legislation change frequently;
- Tax legislation is complex and in some cases impossible to follow (tax rules do not correlate with real economic activities of business);
- A lack of explanation of the tax legislation from the tax authority;
- Too much time required to find answers for questions about tax legislation (on how to pay taxes properly).

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67. The chart shows opinion of respondents regarding extend the some characteristics of tax compliance work. The data is calculated based on share of respondents who indicated that particular issues are big or medium problem for companies.
1.6 Advance Tax Rulings

Based on the experience of developing countries, and according to the survey data (see chart 21), many taxpayers face significant uncertainty due to ambiguous tax laws, frequent amendments and a lack of public explanatory guidance. This uncertainty can increase the monetary and non-monetary compliance costs incurred by taxpayers as they are forced to navigate through an administratively weak tax system that offers insufficient guidance. An advance tax ruling system is one critical tool to achieve this certainty and to establish a well-functioning self-assessment tax system.

In two widely publicized studies, The International Fiscal Association defines an advance ruling as "a more or less binding statement from the Revenue authorities upon the voluntary request of a private person, concerning the treatment and consequences of one or a series of contemplated future actions or transactions," and, similarly, "a statement issued, upon request, to a (potential) taxpayer indicating the tax administration’s view of the tax treatment of a particular set of facts and circumstances contemplated, in the process of completion, or completed but not yet assessed."

The success of an advance tax rulings procedure will depend on how it is perceived by taxpayers. That is, if rulings are not binding on the tax authorities, taxpayers will not be confident in entering into a transaction in reliance upon a ruling, since it could be reversed at a later stage.

When designing an advance (private) rulings system, there are several advantages and disadvantages that need to be weighed, especially because of competing interests of domestic taxpayers, potential foreign investors, legislators and the tax authority.

As this table illustrates, many of the advantages have corresponding disadvantages, although it is possible to minimize these through appropriate system design.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributes to the <em>effectiveness of a self-assessment system</em></td>
<td>Requires resources (or reallocation) to establish a rulings function in the administration.</td>
</tr>
<tr>
<td>Greater certainty for taxpayers who can decide whether to proceed with certain activities/arrangements.</td>
<td>Requires procedures to <em>ensure rulings are made consistently</em>, particularly where the function is decentralized.</td>
</tr>
<tr>
<td>Minimizes appeal volumes by resolving tax issues before a transaction occurs.</td>
<td>Could potentially increase volumes if rulings are appealable, or rendered void because assessments are contrary to the ruling pronouncement.</td>
</tr>
</tbody>
</table>

68. Note on Advance Tax Rulings, prepared by Komal Mohindra, WBG IC department, Global Tax Team, page 58.
| **Enhances confidence of foreign investors.** | Depending on the type of legislation in place, substantial amendments may be required to ensure "Greenfield" foreign investors (who are not "taxpayers" and not "subject to tax" in a country) can apply for a ruling. |
| **Builds capacity within the administration to address complex technical issues.** | Requires high level of in-house, legal expertise. |
| **Identifies areas of confusion for further legislative clarification.** | Utility of rulings diminished in countries with frequent "overriding" legislative amendments and jurisprudence. |
1.7 Personal Income Tax Report - Companies Spent About 9 hours annually on Calculation and Filling in Annual by Name Return for Employees (PIT)\textsuperscript{71}

Companies spent an average of about one employee’s workday (8.9 hours) to calculate and fill in by name return for employees in 2009 (Chart 22). The time cost for this report varies depending on the number of employees - from 3.5 hours for companies employing up to 5 employees, to an average of 23.7 hours for companies employing more than 50 employees. On average, IE’s spent less time on this task (2.8 hours, in 2009) than companies due to their relatively small number of employees (the average individual entrepreneur employs 2 employees while the average company employs 23).

\textbf{Chart 22: Time spent on annual by name return for employees (PIT) in 2009}

\begin{center}
\begin{tabular}{|c|c|}
\hline
\textbf{Number of employees} & \textbf{Time, hours per year} \\
\hline
Up to 5 & 3.5 \\
6 - 15 & 8.5 \\
16 - 50 & 12.9 \\
Over 50 & 23.7 \\
Average of all companies & 8.9 \\
\hline
\end{tabular}
\end{center}

\textsuperscript{71}RA Law on “Personal Income Tax” adopted 27.12.1997, article 37, paragraph 1.
1.8 Businesses Spend Too Much Time Maintaining Books, an Unnecessary Tax Compliance Burden

The survey data suggests that businesses spend an extraordinary amount of time maintaining book of revenue registrations and book of shipment of inventory holdings.

Legal requirements to maintain book of revenue registrations and book of shipment of inventory holdings

**Book of shipment of inventory holdings**

In this book, only payment invoice sales are registered for both legal and physical entities. That can include retail and wholesale. No purchase records are kept in the book.

The book is to be kept wherever the shipment or transport of products takes place, in other words, in the stock. When products are released from the stock, a record is made in the book (see table 12 below). Then, in the corner of the payment invoice, a note is made recording the page and line on which the record was made. Finally the product is released.

**Table 12. A blank book of shipment of inventory holdings**

<table>
<thead>
<tr>
<th>NN</th>
<th>Name of the group of product type</th>
<th>Payment invoice number and date</th>
<th>Total sum including value added tax (in AMD)</th>
<th>Shipment (the start of product release, transportation) day, time/hour</th>
<th>Way and location of transportation (address)</th>
<th>Name, surname, number of power of attorney document (passport number) of accompanying person (recipient) of the product</th>
<th>Name of buyer (recipient) and TIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

**Book of registration of revenue**

The book of registration of revenue is used only by companies conducting retail sales. Both the purchase price and number of items bought are registered in the book, as well as the selling price. Moreover, in the case of any price changes, the balance of each item to be sold at the modified price must be registered. In case the price noted in the book and that on the price tag do not coincide, a penalty of 25 percent of the difference is applied. After inspection, if the error re-occurs within a year the penalty goes up to 50 percent.

**Table 13. A blank book of registration of revenue**

<table>
<thead>
<tr>
<th>NN</th>
<th>Date of receiving the item</th>
<th>Purchase invoice</th>
<th>Item registration</th>
<th>Item Sale price registration</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Date</td>
<td>Number and date</td>
<td>Total sum (in AMD)</td>
<td>Name of the item</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>10</td>
<td>12</td>
<td>13</td>
<td>14</td>
<td></td>
</tr>
</tbody>
</table>
Chart 23 shows that maintaining books requires much more time than keeping tax accounting and filling reporting forms. Companies spent about 149.3 hours on average maintaining books and only 117.4 hours on keeping tax accounting and filling reporting forms in 2009. The same goes for individual entrepreneurs, who spent an average of 38.1 hours and 27.7 hours on these tasks, respectively (see chart 23).

The figures suggest that maintaining books takes twice as much time as tax accounting and filling all reporting forms - an average of 255.4 hours (see chart 24) to 124.1 hours, respectively. It also confirms how book of registration of revenues and book of shipment of inventory holdings are time-consuming and burdensome for businesses.
The data also shows that even individual entrepreneurs who usually have relatively low incomes in comparison with legal entities must spend a great deal of time maintaining books. On average, an individual entrepreneur spent about 102.7 hours\(^{72}\) in 2009 to maintain these books (see chart 24). Those who maintained book of registration of revenues required an average of about 97.5 hours to do so, while those who maintained book of shipment of inventory holdings needed an average of 72.6 hours. Meanwhile, individual entrepreneurs spent an average of 20.4 hours keeping tax accounting and only three hours filling in reporting forms.

In 2009, one out of three companies had to maintain book of registration of revenues while about 44 percent of companies had to maintain book of shipment of inventory holdings (see chart 25).

72. The figure is calculated among individual entrepreneurs who maintained at least one type of books in 2009.
At the same time, only about 29 percent of IE's maintained book of registration of revenues in 2009, and about 20 percent maintained book of shipment of inventory holdings (see chart 26).

Trade companies suffered more than companies from other sectors due to the necessity of maintaining books - they spent an average of about 407 hours dealing with books, nearly twice as much time as production companies and companies from other sectors (see chart 27).

<table>
<thead>
<tr>
<th>Type of Activity</th>
<th>Time, Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average of all companies</td>
<td>255.8</td>
</tr>
<tr>
<td>Trade</td>
<td>407.0</td>
</tr>
<tr>
<td>Production</td>
<td>223.2</td>
</tr>
<tr>
<td>Services</td>
<td>196.3</td>
</tr>
<tr>
<td>Other</td>
<td>188.0</td>
</tr>
</tbody>
</table>

* The figures in the chart above are calculated among companies that maintained these books in 2009.

The survey data shows how burdensome, in terms of time cost, book maintenance is for both IEs and LEs. The main question regarding these books is whether they are indeed necessary, either for control purposes or in order to accurately record financial and tax accounting.

It’s worth mentioning that inspections connected with book of shipment of inventory holdings are the most undesirable for businesses, as the check-ups are often made without prior notice. Further, whenever a discrepancy is found between the registered and actual present products, a penalty of 25 percent of the difference is applied. If the error re-occurs on a subsequent inspection within a year, the penalty is increased to 50 percent. Naturally, discrepancies can be either deliberate or accidental.

According to focus group participants, most businesses collect invoices or other accounting documents during the day, and only at the end of that day do their recording. Recording invoices and accounting documents in the course of a working day is very inconvenient. To carry out that work as required by the government decision, in fact, would require one employee devoting his or her entire day to the task.

In addition to the VAT report, VAT payers also submit a register of the VAT invoices they have written out and received, if the amount of the invoice exceeds AMD 100,000 (app. 280 USD) without VAT. In other words, tax authorities receive information from VAT payers about transactions exceeding AMD 100,000.
As was already mentioned, non-VAT payers are freed from maintaining these books if they obliged by the law to maintain cash-control machines. Starting in 2011, VAT payers who write out their "tax invoices" in electronic form also need not keep this book.

Therefore, the government should consider completely eliminating book of shipment of inventory holdings, as the recent developments in this field have exempted many businesses from the obligatory requirement of keeping these records.

The book of registration of revenue is maintained only by companies conducting retail sales. Both the purchase price and the number of items are registered in the book, as well as the selling price. Moreover, in case of any price changes (usually discounts) the balance of each item to be sold out at the modified price must be noted.

If the prices noted in the book and on the price tag do not match, a penalty of 25 percent of the difference is applied. If the error re-occurs on a subsequent inspection within a year, the penalty is increased to 50 percent.

Usually, businesses that intentionally hide their revenue register the items in the book at a price below the actual sale price. In accounting, there is no other tax inspection-approved document on which wholesale prices are recorded. However, a contrary situation is also present: companies have little flexibility regarding their price policy. If a shop wishes to offer a discount to a regular customer, it has to reduce the value of the whole group of items. The price can then be increased for the remaining quantity of items in stock.

Another option that again does not favor the business is selling by discounted price but paying taxes at the higher, registered value. Naturally, both alternatives are unacceptable and time consuming, and highlight the problems with regard to these books.

In other mandatory accounting documents the retail sale price of products or materials is not registered. Thus, when the books are missing, the tax authorities cannot obtain the sale prices from other documents. But the issue can be solved, if the businesses involved in the retail sales use cash control machines with specially designed software that provides analytical reporting. Such machines can record and report the quantity and prices of all items sold. At present, only a small number of major super-markets use these advanced cash control machines.

As focus group participants reported, the tax authority carries out intensive inspections of taxpayers to control how books are maintained. The survey data also shows that many such inspections are associated with checking these books. Companies received an average of 1.7 inspections related to books of registration of revenues and shipment of inventory in 2009, and spent about 23 hours supporting these inspections (more detailed information is presented in the Chapter "Inspections" below).

Yet as focus group participants indicated, these books do not fully prevent tax evasion, since taxpayers can easily manipulate the data even in filed books. Thus, taking into account all the constraints related to maintaining books - the amount of time required for book maintenance, the intensive inspections and the potential for abuse - the need to eliminate these books is clear. It will mean a significant reduction in tax compliance costs, which is crucial for fostering growth and improving the competitiveness of Armenia's small business and trade.
1.9 Personal Reports for Employees (Social Security Payment) Require Considerable Time

Companies filed an average of about 25 personal reports for employees (SSP) in 2009, one for each employee. Thus, the number of reports filed increases with the number of employees. Reporting requirements are very burdensome for business, especially for businesses that have more employees.

Chart 28: Average number of personal reports for employees (SSP) filed in 2009

The smallest companies, by number of employees (up to 5), spent an average of about 1.7 hours filling in personal reports for employees (SSP) in 2009, while companies with more than 50 employees spent about 80 hours (see chart 29). In all, companies averaged about 11.5 hours spent filling in mentioned report.

Chart 29: Time spent by companies on filling in personal reports for employees (SSP) in 2009

Though the filling in and submitting of those reports is not stipulated by tax legislation and is thus not included in tax compliance costs, this report form should be simplified, particularly in light of the time companies must spend on them.

73. RA Government decision  N 938-N, adopted 12.05.2005
## 1.10 Recommendations

<table>
<thead>
<tr>
<th>Survey findings</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> Elimination of Requirements for Maintaining Special Tax Books</td>
<td>1. Completely remove from circulation book of shipment of inventory registration.&lt;br&gt;2. Also, the elimination of the book of registration of revenue should be considered after implementing the following actions: &lt;ul&gt;&lt;li&gt;Define in legislation that the taxpayers who use cash control machines that enable analytical sales reporting during execution will not be required to keep these revenue books.&lt;/li&gt;&lt;li&gt;Set a timetable to free entities occupied in retail sales from the mandatory requirement of revenue book keeping, or to present them with an alternative.&lt;/li&gt;&lt;/ul&gt;Eliminating of these books will cut tax compliance costs by one-third.</td>
</tr>
</tbody>
</table>

The survey data suggests that businesses spend an extraordinary amount of time maintaining their book of revenue registrations and book of shipment of inventory holdings. Companies spent about 149.3 hours on average maintaining books in 2009, and 117.4 hours on keeping tax accounting and filing all reporting forms. The same goes for individual entrepreneurs, who spent 38.1 hours maintaining books and 27.7 hours on tax accounting on average in 2009.

Analysis of accounting practice shows the books' data duplicates some data from accounting registers. As focus group participants reported, tax authorities carry out intensive inspections to control how books are maintained and enact penalties even for minor violations.

Accountants reported that there are many cases when the tax authority "urges" taxpayers to maintain these books even if they are not obliged to do so according to legislation. In particular, despite the fact that non-VAT payers are exempted from maintaining book of registration of revenues, as well as from book of shipment of inventory holdings, if they obliged by law to use cash machines, many of these businesses do so anyway.

| **2** Simplification of Tax Accounting Including Special Simplified Accounting Schemes for SMEs | The time cost of tax accounting (including analyzing tax legislation, filling in tax reports forms and maintaining books) strongly correlates to business size (in terms of turnover). Overall, companies spent an average of 333.5 hours on all tax accounting operations in 2009. The smallest businesses (annual turnover up to AMD 5 million), meanwhile, spent an average of 177 hours fulfilling tax requirements. |

As practice and tax compliance costs for small business show, simple tax accounting is not as simple as it should be. Further simplification of accounting, and in particular accounting for small businesses, is key to reducing compliance costs. The government should consider the following: <ul><li>Harmonize tax and financial accounting requirements for SMEs, in order to have less dissimilarity</li></ul>
VAT and Profit tax are the most time-consuming - companies required an average of 53.1 hours for VAT accounting in 2009, and about 50.5 hours for Profit tax accounting.

CHAPTER I. COSTS OF TAX ACCOUNTING

VAT and Profit tax are the most time-consuming - companies required an average of 53.1 hours for VAT accounting in 2009, and about 50.5 hours for Profit tax accounting.

CHAPTER I. COSTS OF TAX ACCOUNTING

Some 60 percent of companies maintain tax accounting using a personal computer, although only 34 percent of companies do this using specialized accounting software. At the same time, more than 40 percent of companies keep tax accounting manually. A smaller share of individual entrepreneurs maintains tax accounting electronically (about 8%) and only 3 percent use specialized accounting software.

Keeping tax accounting electronically, particularly with specialized accounting software, improves efficiency considerably.

Some 60 percent of companies maintain tax accounting using a personal computer, although only 34 percent of companies do this using specialized accounting software. At the same time, more than 40 percent of companies keep tax accounting manually. A smaller share of individual entrepreneurs maintains tax accounting electronically (about 8%) and only 3 percent use specialized accounting software.

Encourage businesses to maintain tax accounting electronically by distributing simple accounting software free of charge and providing training on electronic accounting to SMEs.

This software should enable to fill in forms and submit them electronically directly to the tax authority.

Encourage businesses to maintain tax accounting electronically by distributing simple accounting software free of charge and providing training on electronic accounting to SMEs.

3 Providing Incentives to Keep Accounting Electronically

Some 60 percent of companies maintain tax accounting using a personal computer, although only 34 percent of companies do this using specialized accounting software. At the same time, more than 40 percent of companies keep tax accounting manually. A smaller share of individual entrepreneurs maintains tax accounting electronically (about 8%) and only 3 percent use specialized accounting software.

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5 Improvement of Vat Refund System

About 14 percent of respondents reported that the largest drawback to being a VAT-payer is the difficulty or inability of receiving the VAT refund.

The survey data also confirms the existence of some issues with the VAT refund, since only 17 percent of companies eligible for the refund submitted a refund application to the tax authority in 2009.

Nearly 17 percent of companies did not apply for the VAT refund because the procedure is too complicated and too expensive and could lead to additional inspections, 11 percent indicated that they did not submit the application because they knew they wouldn’t receive the refund and some 22 percent of companies did not know how to apply for the VAT refund at all.

The core principle should be implemented in practice - introduce an automated system for VAT refund. The special risk-based system should be introduced for rapid checking of applications for VAT refund.

Also, the introduction of a penalty should be considered in the case of a late VAT refund from the tax authority. Since many company representatives do not know how to apply for VAT refund, the tax authority’s awareness program needs to better raise awareness on applying for VAT refund, including the distribution of informational materials and regular updates to the website of the tax authority.

6 Simplification of Reporting

Companies filled in about 22 tax reports on average in 2009 and even small companies had to fill in about 19 reporting forms during the year. The main issue is the frequency of filing taxes - primarily fixed payment and social payments, which are filed on a monthly basis by most taxpayers.

The tax laws establish different deadlines for submission of different taxes, in particular, fixed payments for some activities should be filed within 15 days but social payments reports should be filed within 20 days.

Revising and streamlining reporting forms and reducing the number of appendices, especially for the profit tax return, and reducing the frequency of filing should curtail time costs.

Establishing longer reporting periods and unifying deadlines for all taxes (except VAT) and payments should further cut the time costs of reporting.

7 Reduction of Costs for Access to Tax Information and Improvement of Compliance with Tax

Companies spent an average of 81.8 hours on searching, studying and analyzing tax legislation in 2009 - about 40 percent of the...
total time companies spent on tax accounting, analyzing tax legislation, and filling in all reports. Individual entrepreneurs spent about 13 hours—about 28 percent of their total time spent on tax accounting, analyzing tax legislation, filling in all reports.

The main reasons companies spend so much time researching and analyzing tax legislation: the tax system is too complex and always changing. To identify whether tax accounting is correct, accountants not only have to refer to the provisions of the current legislation and bylaws, but also search out tax bodies to get the up-to-date and accurate information.

Focus group participants reported the following weaknesses in the current tax legislation:

- A lack of information regarding new legislation;
- Laws come into force post factum;
- The tax legislation is changed frequently;
- The tax legislation is complex and in some cases impossible to follow (tax rules do not correlate with real economic activities of business);
- A lack of explanation and instruction from the tax authority;
- Too much time is required to find answers regarding tax legislation (e.g. on how to pay taxes properly).

Simplify and unify provisions of the tax legislation and the relevant bylaws and introduce a moratorium on amendments to tax legislation. This should make applying the present law simpler and make it easier for taxpayers to understand it and fulfill its provisions.

Develop an article-by-article commentary for the all tax legislation. This document should provide an essential explanation of the provisions of the tax laws and the special features of its application and should be published before the respective provisions come into force.

Introduce advance ruling practices, where taxpayers upon request may obtain binding individual rulings from the tax authorities related to future transactions. Thus businesses will be secure from future mistakes and possible penalties.

Improve consultative support to taxpayers by improving tax consulting and call center services under the tax authority. Also, establish free help desks within each office of the tax authority to provide free consultations to taxpayers and assist them in understanding and applying tax legislation. These help desks should be set up in an "open workspace" manner. Also, the quality of the advisory services of the tax authority should be enhanced with improved training for tax officers.

Continue to make the tax legislation and regular updates available free of charge on the web site of the tax authority.
CHAPTER II

SUBMISSION OF TAX REPORTS AND TAX PAYMENTS

KEY FINDINGS

- Very few companies and individual entrepreneurs submitted their tax reports electronically in 2009. Thus, about 94 percent of companies and 96 percent of individual entrepreneurs visited the tax authority at least once during the year.

- Some taxpayers visited the tax authority at least once a month. The survey shows that companies averaged 10 visits in 2009.

- Two out of three companies visited the tax authority five times, and about 11 percent visited the local authority four times - for reasons not associated with reports filing.

- Payment of taxes requires a lot of time - companies spent an average of about 27.4 hours paying taxes, while individual entrepreneurs spent about 23.1 hours making tax payments, in 2009. This means that all businesses spent about 2 hours each month, on average, to pay taxes. There are many different deadlines for different taxes - just one reason businesses spent so much time on tax payments.

- Companies spent an average of about 40 minutes, each visit to the tax authority, waiting to meet with tax officials.

- Some 19 percent of companies and 8 percent of individual entrepreneurs were requested by the tax authority to provide additional information regarding taxation in 2009.
The survey data shows that visits to the tax authority and local authority for various tax-related purposes take a lot of time and place a significant burden on taxpayers. Another time-consuming and costly procedure associated with taxation is the payment of taxes.

According to Doing Business 2011, Armenia ranks 159 out of 183 economies worldwide in paying taxes. One of the three indicators which influence this rating is the number of payments. A mid-sized Armenian manufacturing company operating in Yerevan, for example, has to make 50 payments per year.

**How the number of tax payments are calculated, according to Doing Business methodology**

The tax payments indicator reflects the total number of taxes and contributions paid, the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved for this standardized case study company during the second year of operation. It includes consumption taxes paid by the company, such as sales tax or value added tax. These taxes are traditionally collected from the consumer on behalf of the tax agencies. Although they do not affect the income statements of the company, they add to the administrative burden of complying with the tax system and so are included in the tax payments measure.

The number of payments takes into account electronic filing. Where full electronic filing and payment is used by the majority of medium-size businesses, the tax is counted as paid once a year even if filings and payments are more frequent. For payments made through third parties, such as tax on interest paid by a financial institution or fuel tax paid by a fuel distributor, only one payment is included even if payments are more frequent.

Where two or more taxes or contributions are filed for and paid jointly using the same form, each of these joint payments is counted once. For example, if mandatory health insurance contributions and mandatory pension contributions are filed for and paid together, only one of these contributions would be included in the number of payments.

Source: www.doingbusiness.org

Chart 30 shows that, on average, Armenian companies pay taxes more frequently (50 payments) than companies from Eastern Europe and Central Asia countries (41.7 payments) and much more frequently than companies from OECD countries.

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75. According to Doing Business methodology the typical midsize company had annual turnover about AMD 780 million that generally corresponds to turnover of large companies in the country.
According to Doing Business methodology, the above-mentioned indicator depends on the number of taxes, frequency of payments, and frequency of filing taxes (see box Doing Business methodology). Also the number of payments takes into account electronic filing. Therefore, improving the filing and payment system is key to improving the Doing Business rating and for reducing tax compliance costs.

Each Company is Requested to Submit a Number of Reports on an Annual Basis - Average Company Visited the Tax Authority about 10 Times and The Local Authority about 5 Times to Submit Reports in 2009.

About 94 percent of companies and 96 percent of individual entrepreneurs visited the tax authority at least once for submission of reports and/or other reasons in 2009 (see chart 31). Also about 46 percent of companies and 33 percent of individual entrepreneurs visited the local authority at least once to submit reports or for other reasons in 2009.

This means that almost all taxpayers have to visit the tax authority for one reason or another.

The survey data also shows that about 80 percent of companies and 92 percent of individual entrepreneurs visited the tax authority to submit tax reports. This means that the majority of taxpayers did not or could not file reports via registered post or electronically, as will be discussed later within this chapter. Moreover, the data suggests that individual entrepreneurs visited more frequently than companies despite the fact that individual entrepreneurs pay fewer taxes and have softer reporting obligations.

Among companies that visited the authorities in 2009, the average was 13 visits to the tax authority and five to the local authority (see chart 32). Individual entrepreneurs, meanwhile, visited the tax authority eight times on average and the local authority three times.

International comparison. Visits to supervisory bodies

In South Africa, barely half of all small and mid-sized enterprises visit a tax office during the year, and of those who do, almost three-quarters make four or fewer visits per year. Even small companies and individual entrepreneurs in Armenia have to visit the tax authority and local authority at least 9 - 11 times per year: that is a difference of more than 2-3 times. This is more evidence that Armenia’s reporting system requires significant change.

Overall, a company visited the tax authority an average of ten times and the local authority five times, to submit tax reports. Individual entrepreneurs averaged six visits to the tax authority and two to the local authority.

The number of visits that companies/individual entrepreneurs have to make depends on the frequency of filings and tax payments. An analysis of tax legislation and practice show that:

- Non-VAT payers submit a minimum of 2 tax reports per quarter · PIT and SSP (up to 5 employees) · and 4 if the business has more than 5 employees.

77. The total number of visits to tax authority/local authority is not equal to the sum of the number of visits to submit tax reports and for other tax-related reasons because some companies/individual entrepreneurs failed to make certain visits (for submitting reports or other reasons) in 2009.
- VAT payers (previous year turnover up to AMD 100 mln) submit a minimum of 3 tax reports per quarter - VAT, PIT and SSP (up to 5 employees) - and 5 if the business has more than 5 employees.

- VAT payers (previous year turnover over AMD 100 mln) submit a minimum of 5 tax reports per quarter - VAT, PIT and SSP (up to 5 employees) - and 7 if the business has more than 5 employees.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Report filing</th>
<th>Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT</td>
<td>• Monthly (turnover for the previous year exceeded AMD 100 million)</td>
<td>• Monthly (turnover in previous year exceeded AMD 100 million)</td>
</tr>
<tr>
<td></td>
<td>• Quarterly (turnover for the previous year did not exceed AMD 100 million)</td>
<td>• Quarterly (turnover in previous year did not exceed AMD 100 million)</td>
</tr>
<tr>
<td>Social security payments</td>
<td>• Monthly (more than five employees in previous quarter)</td>
<td>• Quarterly (five or fewer employees in previous quarter) Monthly</td>
</tr>
<tr>
<td>Profit tax</td>
<td>Annually</td>
<td>Monthly+ one more additional payment for the year (based on report data)</td>
</tr>
<tr>
<td>Personal income tax (wages)</td>
<td>Quarterly and one report annually</td>
<td>Monthly</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>Annually</td>
<td>Monthly+ one more additional payment for the year (based on report data)</td>
</tr>
<tr>
<td>(individual entrepreneurs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property tax</td>
<td>Quarterly</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Land tax</td>
<td>Annually</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Fixed tax</td>
<td>Depending on type of activity:</td>
<td>Monthly</td>
</tr>
<tr>
<td></td>
<td>• monthly;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• quarterly;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• biannually;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• annually.</td>
<td></td>
</tr>
</tbody>
</table>

Report filing deadlines also result in additional visits to supervisory bodies. If a taxpayer has to file two reports in a particular month but there is a difference in deadlines, that business might visit a supervisory body twice in a month. Armenia’s tax legislation establishes different deadlines for different taxes. The report on Social payments, for example, should be filed within 20 days of the end of the quarter (if the taxpayer employs five or fewer employees). But Personal income tax reports (on wages) should be filed before the first day of the second month of the following quarter. This causes many taxpayers to file tax reports separately, which again adds another visit to the tax authority, and additional time spent dealing with reporting obligations.
The survey data shows that the more turnover a company has, the more visits that company makes to file reports and other reasons. The smallest by turnover companies visited the tax authority and local authority about 11 times on average in 2009 (see chart 33). Large taxpayers79 visited those bodies about 26 times on average. Larger companies tend to pay more taxes and thus need more frequent visits to the supervisory bodies, not only to pay and file taxes but also for consultation and other reasons. Also, visit frequency for VAT returns also hinges on turnover. For example, VAT returns are filed on a monthly or quarterly basis depending on the taxpayer’s turnover: if turnover exceeded AMD 100 million in the previous year, the VAT return is filed monthly; if not, it’s filed quarterly.

<table>
<thead>
<tr>
<th>Annual turnover, AMD</th>
<th>Number of visits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 5 million</td>
<td>11</td>
</tr>
<tr>
<td>5 - 29.99 million</td>
<td>14</td>
</tr>
<tr>
<td>50 - 58.35 million</td>
<td>17</td>
</tr>
<tr>
<td>More than 58.35 million</td>
<td>21</td>
</tr>
<tr>
<td>Large taxpayers</td>
<td>26</td>
</tr>
<tr>
<td>Average of all companies</td>
<td>15</td>
</tr>
</tbody>
</table>

There is a difference in the number of visits among individual entrepreneurs of varying turnover, but it’s insignificant. (see chart 34).

79. Companies registered in Large Taxpayers Unit.
More burdensome for businesses are that visits to the tax authority and local authority require spending a lot of man hours and money.\textsuperscript{80} The time cost consists of time spent traveling to the supervisory body office using regular means of transportation (round trip), time spent waiting in line to meet with officials to submit tax reports, receive consultation or provide documents or information to supervisory officials.

The survey data shows that even the smallest companies and individual entrepreneurs spent a considerable amount of time visiting supervisory bodies (tax authority and local authority). Companies with an annual turnover below 5 million AMD spent an average of about 15 hours (see chart 35), while individual entrepreneurs spent about 13 hours visiting supervisory bodies in 2009 (see chart 36). Moreover, large taxpayers spent an average of about 42 hours or about 3.5 hours each month visiting supervisory bodies.

\textbf{Chart 35: Time spent by companies on visits to the tax and local authority in 2009.}\textsuperscript{81}

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\textsuperscript{80} Cost of transportations (e.g. tickets) was not taken into account in the survey.

\textsuperscript{81} The time cost was calculated among all companies both which visited and did not visit to supervisory bodies in 2009.
The most time-consuming of their visits to supervisory bodies for both companies and individual entrepreneurs are their visits to the tax authority to submit tax reports. Companies spent 59 percent of their supervisory body-visit time on this task, while individual entrepreneurs spent 65 percent (see chart 37). The second most time-consuming are their visits to tax authority for other purposes - 29 percent of total visit time for companies, and 26 percent for individual entrepreneurs.

The survey data shows that taxpayers make a lot of visits to the tax authority and local authority. Businesses are ultimately forced to spend too much time dealing with reporting obligations and visiting supervisory bodies for other non-reporting purposes. Clearly, the reporting system needs reform.

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82. The time cost was calculated among all individual entrepreneurs both who visited and did not visit to supervisory bodies in 2009.
Several approaches could reduce both the number of visits and time spent visiting:

- Trimming the filing frequency of some taxes (in particular, Social payments, Fixed tax can be filed on a quarterly basis instead of monthly; all other taxes (except VAT) can be filed annually);
- Establishing joint filing for some taxes (in particular, all property taxes can be filed jointly using the one form; Social tax report can be merged with Personal income tax reports);
- Unify filing deadlines for all taxes with the same periodicity of filing;
- Develop and improve the electronic filing system (this is discussed in detail below);
- Encourage taxpayers to file reports via post instead of in person;
- Eliminate need for non-filing related visits (this is discussed in detail below);
- Eliminate need to visit local authority (only one government body is necessary - the tax authority).

**Best international practices. Reporting simplification program**

In order to reduce the costs and inconvenience for taxpayers related to compliance to the numerous tax requirements, tax administrations in some countries (e.g. Australia, Denmark and Sweden) have taken steps to unify tax calculation, filing and payments for all or most of the taxes paid by businesses with a certain frequency. In order to do that, the legislative acts defining requirements for filing and paying these taxes were harmonized. The businesses in these countries now calculate their taxes and file reports on them at the same time, within one process (which is usually done at the time the enterprise carries out accounting for internal purposes), and make a single payment of all taxes. One of the most successful examples of this approach can be found in Australia. Under the integrated tax reform undertaken there in 2000, all reporting forms were replaced with a single form titled Business Activity Statement. Before 2000, all enterprises in Australia had to fill numerous tax forms and pay each tax separately. Under this approach, information about taxpayers was duplicated and for each tax there were specific deadlines and established frequencies for filing and paying. After the reform, a single tax form was introduced which can be filled in and filed electronically; in this case, there is no duplication of information. During the reporting period, the enterprises make a single payment that covers all their obligations.  

2.1 Companies Spent more than 27 Hours Making Tax Payments in 2009

According to the survey data, paying taxes requires a lot of time - companies spent an average of about 27.4 hours paying taxes in 2009, while individual entrepreneurs spent about 23.1 hours. This means that businesses spent an average of about two hours each month to pay taxes. The tax payment takes even more time than filing tax reports. As shown above, companies spent an average of about 20.8 hours and individual entrepreneurs about 12.8 hours to file reports in 2009.

83. OECD, 2008. Programs to reduce the administrative burden of tax regulations in selected countries. Information note, Forum on tax administration: taxpayer services sub-group. www.oecd.org
Required procedures for payment of taxes

Businesses, in order to pay taxes at a bank in person, must prepare a tax payment order, print it out, have a manager sign the document, travel to the bank, wait in line for a bank official and finally submit the document and finalize the transaction. All of these require time, while if a company uses an electronic payment system, paying taxes requires much less time and is much more efficient.

The number of payments made depends on the number of taxes a company or individual entrepreneur pays, as well as the frequency of tax payments, the means of payments (electronically or in person in a bank office) and the payment deadlines for different taxes.

An analysis of tax legislation suggests that companies must process payments each month for at least three taxes: Social payments, Personal income tax on wages and Minimum profit tax (see table 14 above). Individual entrepreneurs (if they have employees) have at least two monthly payments: Social payments, and Personal income tax on wages. VAT payers whose turnover exceeded AMD 100 million (the previous year), were obliged to pay VAT on a monthly basis as well. Fixed payments must also be made on a monthly basis.

Another issue is different deadlines for different taxes. In particular, the Fixed tax should be paid within 15 days of the end of the month, while minimum profit tax should be paid by the 25th day of each month. Such staggered payments do not promote joint payments and create additional time costs for taxpayers.

According to Doing Business 2011, manufacturing companies’ process 50 tax payments per year (see table 15). The most time consuming taxes are Social payments, Profit tax (including minimum income tax) and VAT.

### Table 15: Number of payments, according to Doing Business 2011

<table>
<thead>
<tr>
<th>Tax or mandatory contribution</th>
<th>Payments (number)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social security contributions</td>
<td>12</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>13</td>
</tr>
<tr>
<td>Land Tax</td>
<td>4</td>
</tr>
<tr>
<td>Property tax on Building</td>
<td>4</td>
</tr>
<tr>
<td>Vehicle tax</td>
<td>4</td>
</tr>
<tr>
<td>Environmental pollution charge for vehicles</td>
<td>1</td>
</tr>
<tr>
<td>Value added tax (VAT)</td>
<td>12</td>
</tr>
<tr>
<td><strong>Totals:</strong></td>
<td><strong>50</strong></td>
</tr>
</tbody>
</table>

The Doing Business methodology takes into account electronic filing. Where full electronic filing and payment is available and used by the majority of medium-size businesses, the tax is counted as paid once a year even if filings and payments are more frequent. Also, wherever two or more taxes or contributions are filed for and paid jointly using the same form, each of these joint payments is counted once.

84. See Doing Business 2011 Report. [www.doingbusiness.org](http://www.doingbusiness.org)
Therefore, in order to reduce the number tax payments and the total time costs it is necessary to encourage businesses to pay taxes electronically and establish joint payments for some taxes (in particular Social payments and Personal income tax on wages).

Of course, paying taxes electronically requires appropriate equipment, as well as an Internet connection and software. This might be difficult for some taxpayers because of the cost and accessibility. But introducing joint payments and filing some taxes together will help all businesses reduce costs.

Making payments are rather time consuming, since, in Armenia, the payments are mostly made in person, at a bank. Customers at these banks are often not served quickly, in part because customers often visit the bank without the payment order but rather present preliminary bookkeeping documents to the bank employee. This inevitably doubles the time needed to serve such customers. Online banking still has very limited coverage in Armenia. Some reasons are as follows:

- Minimal technical saturation of businesses;
- Limited availability and affordability of Internet connection;
- Limited public awareness about online banking;
- Lack of confidence in online banking system, and personal capabilities.

As seen from the research, 60 percent of companies have computers and most of them have access to the Internet. Yet only a small percent of corporate customers use online banking services, even though banks offer incentives for embracing the online system (for instance, certain transactions on applied tariffs are usually lower when made online). As banks realize, in order to promote online banking among business customers it is necessary to conduct consistent public awareness campaign.

The same goes for electronic filing - greater public awareness is crucial, as is clearer instruction and better explanations of the electronic system. Both should be conducted on a regular basis. In the case of individual entrepreneurs, some 83 percent don’t use computers, according to the survey.

Other measures that might reduce payment compliance costs include: reducing the number of taxes for small businesses, limiting payment frequency for some taxes (for example, minimum income tax, Social payments, Personal income tax on wages, property taxes), and unifying payment deadlines for all taxes.

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85. Of course, the described phenomenon is more typical for small business, the majority of which has no an accountant or the accountant has second job and usually is not involved in routine works, as well as low level of technical saturation.
2.2 Taxpayers Spent Too Much Time in Tax Offices

On each visit to the tax authority, companies spent an average of about 40 minutes waiting in line to meet with tax officials and submit tax reports. At the same time, about 23 percent of companies spent no time waiting in line to meet with tax officials in 2009. Also, companies spent an average of about 15 minutes waiting in line to meet with officials on each visit to the local authority in 2009, although about 50 percent of companies spent no time doing so.

Overall, companies spent a total of about 6.2 hours, on average, waiting to meet with tax officials in order to submit tax reports in 2009, and about 1.2 hours at the office of the local authority.

Chart 38: Time spent by companies on waiting in line at the tax office in 2009 by region.

<table>
<thead>
<tr>
<th>Region</th>
<th>Time, minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central</td>
<td>47</td>
</tr>
<tr>
<td>Yerevan</td>
<td>42</td>
</tr>
<tr>
<td>Large taxpayers</td>
<td>35</td>
</tr>
<tr>
<td>North</td>
<td>28</td>
</tr>
<tr>
<td>South</td>
<td>23</td>
</tr>
</tbody>
</table>

Chart 38 shows that, in 2009, companies in Yerevan and the Central region spent more time waiting to meet with tax officials in comparison with companies from the North and South. Also, the large taxpayers spent a bit less time than other companies from Yerevan because they submit tax reports to a special, large taxpayers department set up to service such firms.

Why do companies in Yerevan and the Central region spend so much more time waiting? Focus groups participants from Yerevan blamed the huge number of queries in their tax offices during the reporting period. In addition, tax offices are rather inefficient in regards to filing reports, mainly because of inadequate staffing. Also, accountants indicated that they had to spend time explaining some of the data, such as why a company had losses, or the total amount of tax paid. If a company was unable to provide all the necessary information/data/explanations, the tax official would not accept the reports. Such actions are not required by law, in particular the explanation as to why a company has losses. Further, they require time costs on the part of both the taxpayer and the tax authority. Therefore, the tax authority should consider all possibilities to reduce time costs by improving the system of tax report submissions and ensuring tax officials abide by the law. Also, the tax authority should encourage businesses to file reports remotely – either electronically or by registered post. This will increase efficiency and reduce the demand on the limited staff of tax offices.

86. Among companies which visited to tax authority in 2009.
87. Divisions are conditional. For details see Annex "Survey Methodology".
2.3 Taxpayers Must Repeatedly Visit Supervisory Bodies for Reasons Unrelated to Reporting Requirements

Two out of three companies (over 66%) visited the tax authority an average of five times in 2009, and about 11 percent of companies visited the local authority four times, all for reasons unrelated to reports filing. Individual entrepreneurs also had to visit supervisory bodies for reasons unrelated to submission of reports. 42 percent of them visited the tax authority two times and eight percent visited the local authority once on average in 2009.

According to focus groups, the main reasons companies and individual entrepreneurs visit supervisory bodies are to obtain information regarding taxation, consult with tax officials, obtain and sign inspection statements, gain the consent from the tax authority on the amount of taxes to be paid or to check accuracy of data contained in VAT invoices.

Companies spent a total of about 9.3 hours visiting the tax authority, on average, and about 4 hours on visits to the local authority. Individual entrepreneurs spent about 7.7 hours visiting the tax authority and about 6.2 hours at the local authority. Such visits represent an additional tax compliance burden on businesses that is not fully considered by the legislation. Businesses often visit the tax authority, for example, to receive explanation and instruction because of another change to tax laws, or the complexity of tax legislation etc. If the government ensures stable and predictable tax legislation and the tax authority provides appropriate guidelines and consultations via a hot-line call center, businesses would have less need to visit the tax authority. It is not necessary to visit the tax authority to obtain and sign tax inspection statements, since it can be done via post or by secured e-mail if the system exists and works properly. Neither is it necessary for taxpayers to confirm the amount of tax payments if the payment system is transparent and well-maintained.

2.4 About 19 percent of Companies were Requested to Submit Additional Info

As survey data shows, about 19 percent of companies and 8 percent of individual entrepreneurs were requested by the tax authority to provide additional information regarding taxation in 2009. Most requests were related to verifying tax data in reporting forms and inspections, according to focus groups participants. Among the companies and individual entrepreneurs that submitted additional information to the tax authority, companies did this 3.5 times on average and individual entrepreneurs an average of 2.4 times. Among those who did this, more than 20 percent of companies submitted five or more times. Some companies submitted additional info at least once a month.

The companies that did submit additional info spent about 5.5 hours on average on the procedure in 2009, while individual entrepreneurs spent about 2.6 hours. These operations add to total tax compliance costs.

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88. The time costs are calculated among companies and individual entrepreneurs who had particular visits in 2009.
89. Time cost of dealing with preparation and submission of additional information to the tax authority was calculated among companies and individual entrepreneurs who prepared and submitted this information in 2009.
2.5 E-Filing System is Not Fully Functional

Companies and individual entrepreneurs were asked which means of tax reports submission they used in 2009, among the three most common - on paper in person, on paper via post or electronically via the Internet.

More than half of all companies submitted tax reports on paper in person (52 percent) in 2009, while about 27 percent did this both personally and via post and about 20 percent only via post (see chart 39). Among individual entrepreneurs, three out of four filed reports on paper in person, and 19 percent did this both personally and via post. A scant few companies submitted tax reports electronically in 2009.

In fact, only a statistically negligible number of companies and individual entrepreneurs filed tax reports electronically in 2009. This means that, in essence, the electronic filing system failed to work in 2009 and businesses were unable to use it due to a lack of means and understanding.

As international practice shows, e-filing systems are commonly used worldwide (see box below) and are the most efficient way to strengthen a tax reporting system, reduce tax compliance burdens for businesses and streamline tax administrative procedures. Both taxpayers and tax authorities benefit from e-filing. It is not only about reducing the time cost for businesses, but also about promoting better tax compliance. Moreover, the tax authority could use its resources more efficiently since e-filing systems require much less staff involvement, reduce mistakes and aggregate taxpayer data for download into tax authority databases.
International practice. E-filing

According to the Report of the Expert Group for European Commission, electronic filing of personal income tax returns is possible in all reporting European countries. In Italy, electronic filing of personal income (entrepreneurs) and corporate tax returns is mandatory. Help with filling in income tax declarations electronically is provided by special software, explanations on websites, call centers, and other materials. Analysts have identified improvement potential in the following areas: the pre-registration of data by the tax department and the sending out of pre-filled tax returns, the introduction of electronic signatures, better presentation and handling of electronic filing, electronic tax assessment notices, electronic tax accounts, automatic tax computation and the development of tax accounts and linking accounting software with electronic filing.

Despite all the benefits of e-filing, Armenian businesses could only begin to use such a system in 2010. Recently, the situation has improved noticeably, and as of May 2011, about 4200 taxpayers submit tax reports electronically.

As focus groups participants reported, the electronic filing is not as popular as it should be due to several reasons, as follows:

- Businesses remain unaware of the new e-filing system;
- Among taxpayers who are aware, many do not know how to file reports electronically;
- E-filing is time-consuming (system failures, technical errors);
- E-filing system is expensive for smaller companies and IE’s;
- In remote regions, lack of computers and Internet access.

Due to the absence of a reliable electronic filing system, taxpayers filed either through registered post or in person at the tax authority in 2009. Companies that filed in person spent almost twice as much time submitting tax reports as companies that filed via post - 15.3 hours to 7.7 hours, respectively (see chart 40).

---

91. Taxpayers pay license (about $ 42) for the first year of registration and then $14 for each subsequent year (service fee).
Some 44 percent of companies that filed reports via post indicated that the main reason they did so was that it was the fastest way to fulfill their reporting obligations. One out of three companies that filed reports via post, meanwhile, indicated that they did so to avoid personal interaction with tax officials.

Tax officials often force taxpayers to submit reports in person, rather than encouraging them to file reports via post or even electronically.

The main reason tax officials do this, according to focus groups participants, is to force taxpayers to pay taxes even if they have losses or overpayments. Taxpayers indicated numerous problems with reports filing in person, including several excuses tax officials use to refuse tax reports:

- The company failed to gain consent from the tax authority on the amount of taxes to be paid
- The company has losses;
- The company has some tax indebtedness, even a very small amount;
- The company declares red ink of VAT (company can either claims for VAT refund or off-set against future VAT payments);
- The company failed to pay some amount of taxes in advance, as requested by tax officials.

None of these reasons are included in Armenian tax law, and in fact some of them contradict the law. Still, tax officials often force taxpayers to prepare additional information or change tax reports data during in-person submission of reports.

Therefore, it is necessary to minimize contact between taxpayers and tax officials. The most efficient way to do so is to develop and improve the electronic filing system and encourage taxpayers to file reports electronically.

Survey findings suggest that electronic tax filing has great potential and would likely be widely embraced by taxpayers if the system were efficient, effective and widely available. About 75 percent of companies and 17 percent of individual entrepreneurs have an Internet connection. Among companies that do not have an Internet connection, three out of four have the appropriate infrastructure for Internet access.
International practices. Promotion of e-filing

Tax administration bodies in a number of countries take specific measures to encourage their taxpayers to use electronic reporting. In Australia and Ireland, companies using the remote electronic system for tax calculation and payment are entitled to extended tax filing and payment deadlines. In 2007, South Africa cancelled sanctions for minor reporting delays in cases when electronic reporting systems are used. Some countries (Australia, Ireland, Taiwan, United Kingdom, and USA) promise to process the reports and refund the taxes of e-taxpayers at an increased speed. Furthermore, in Denmark, starting from 2005, all newly established companies are granted the special Start-up Electronic Package which includes an electronic signature and user data.

Taking into account the problems associated with report filing, the amount of time taxpayers spend to file taxes and the huge potential of electronic filing, it is necessary to introduce an electronic filing system in all regions and all tax and local offices and to encourage and train businesses to use it.

2.6 Recommendation for Reducing Reporting and Payment Burden

International practices. Recommendations by the European Union - general principles of administrative burden reduction

Compliance with the following principles may significantly reduce the administrative burden for businesses:

1. Reduction of reporting frequency to the minimum necessary level and harmonizing frequency and deadlines for different types of reports.
2. Prevention of cases when the same information has to be provided several times as well as duplication of requirements for providing the same information to several public bodies.
3. Moving from reporting in hard copy to filing reports through email and special websites.
4. Establishing thresholds for information requirements, reducing the requirements for small and medium enterprises as much as possible or using a sample reporting system.
5. Replacing the universal reporting requirements applied to all enterprises with a risk analysis-based approach when only certain companies functioning in high risk areas are obliged to submit their reports.
6. Canceling requirement to submit types of reports that are no longer necessary due to the cancellation of their respective legislative requirements (for instance, permits).
7. Dissemination of official explanations for complicated legislative acts that may hinder business activities or require deep legal knowledge.

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92. OECD, 2008. Programs to reduce the administrative burden of tax regulations in selected countries. Information note, Forum on tax administration: taxpayer services sub-group. www.oecd.org
94. OECD, 2008. Programs to reduce the administrative burden of tax regulations in selected countries. Information note, Forum on tax administration: taxpayer services sub-group. www.oecd.org
### 2.7 Recommendations

<table>
<thead>
<tr>
<th>Survey findings</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> E-Filing is Key to Reducing Time for Submission of Tax Reports</td>
<td>Accelerating implementation of electronic filing system for all tax reports (including reports submitted to the local authority) should considerably reduce time costs and the overall costs of tax compliance for Armenian businesses.</td>
</tr>
<tr>
<td>Neither companies nor individual entrepreneurs submitted tax reports electronically in 2009. Thus, about 94 percent of companies and 96 percent of individual entrepreneurs visited the tax authority at least once for submission of reports and/or other reasons in 2009.</td>
<td>Businesses should be encouraged to file electronically, or at least via post, and should be interested in doing so. Legal protections for businesses that submit required documents by registered post and through the Internet should be strengthened and well-publicized.</td>
</tr>
<tr>
<td>Some 44 percent of companies that submitted reports via post indicated that the main reason they did so was because it is the fastest way to fulfill reporting obligations. One out of three companies that filed via post indicated that they did so to avoid direct contact with tax officials. As accountants reported, tax officials often force taxpayers to submit reports in person and therefore do not encourage businesses to file reports via post or electronically.</td>
<td>Authorities should refine the software for the electronic tax filing system to prevent filing mistakes and make it compatible with the accounting software most widely used by taxpayers. Also, the registration of electronic signatures should be free of charge and the validity term of electronic signatures should be unlimited. Distribution among small businesses of software for basic tax accounting and e-filing free of charge will encourage them to keep accounting and file reports electronically, further reducing the costs of tax compliance.</td>
</tr>
<tr>
<td>As focus groups participants reported, electronic filing is not popular. It could be due to several reasons:</td>
<td>Revising and streamlining reporting forms, reducing filing frequencies and establishing a longer reporting period for all taxes (except VAT) should cut reporting time costs.</td>
</tr>
<tr>
<td>▪ Businesses are unaware of the e-filing system;</td>
<td></td>
</tr>
<tr>
<td>▪ Among taxpayers who are aware, many do not know how to file electronically;</td>
<td></td>
</tr>
<tr>
<td>▪ E-filing software is complex and sometimes fails;</td>
<td></td>
</tr>
<tr>
<td>▪ E-filing software is expensive for smaller companies and individual entrepreneurs;</td>
<td></td>
</tr>
<tr>
<td>▪ In remote regions, there is a lack of computers and Internet access.</td>
<td></td>
</tr>
<tr>
<td>Most taxpayers must visit the tax authority at least once a month, and the survey shows that the average company paid 10 visits in 2009. The number of visits that companies/individual entrepreneurs must make directly depends on the filing frequency.</td>
<td></td>
</tr>
</tbody>
</table>
CHAPTER II. SUBMISSION OF TAX REPORTS AND TAX PAYMENTS

2 Reduction of Grounds for Other Visits

Two out of three companies visited the tax authority five times and about 11 percent of companies visited the local authority four times for reasons unrelated to reports filing in 2009. The main reasons companies and individual entrepreneurs have to visit supervisory bodies, as accountants indicated, are to obtain information regarding taxation, and gain the consent from the tax authority on the amount of taxes to be paid.

Since a significant share of Armenian taxpayers visit the tax authorities and local authority for non-reporting related purposes, tax legislation as a whole needs to be revised and simplified, eliminating complexity and contradictions. It should also be stable and allow for unambiguous and uniform interpretations.

3 Reduction of Costs of Tax Payments

Payment of taxes requires a lot of time: companies spent about 27.4 hours on average to pay taxes and individual entrepreneurs spent about 23.1 hours in 2009. This means that businesses had to spend about 2 hours each month on average to pay taxes. The tax payment takes even more time than filing tax reports.

Reduce the number of payments of taxes: especially advance payments of Profit tax should be reduced to a quarterly basis for VAT payers and twice a year for non-VAT payers.

Social security payments should be made on a quarterly basis for businesses that have more than five employees.96

In order to promote online banking, which could significantly reduce costs of payment procedure, it is necessary to conduct consistent public awareness campaigns by the tax authority together with the Central bank and other banks.

There are different deadlines to pay different taxes: thus, businesses spent additional time on tax payments.

Unification of deadlines for payment of all taxes is needed to reduce costs of tax payments.

4 Improvement of Services for Taxpayers

Companies had to spend about 40 minutes waiting to meet with tax officials on average per visit to the tax authority.

Improve the system for receiving taxpayers to reduce the time spent in lines and in the offices of supervisory authorities.

5 Reduction of Time to Prepare Additional Information

19 percent of companies and 8 percent of individual entrepreneurs were requested by the tax authority to provide additional information regarding taxation in 2009. It was

Strengthening the tax authority by making available the automated flow of third party information and adding electronic information-matching capabilities will reduce the

96. Businesses that have up to 5 employees submit reports on social security payments and pay it on a quarterly basis regardless of whether the organization is a VAT-payer.
mostly related to verifying tax data in reporting forms and inspections. need to obtain information from the taxpayers themselves. This will reduce the compliance cost of submitting information, improve the inspection planning system, and reduce the number of inspections.

6 Eliminate Current Practice Requesting Additional Information/Data/Advance Payments to Submit Reports

The main reason tax officials prefer submission of reports in person is to "oblige" taxpayers to pay taxes even if they have losses, advance payments or VAT for refund. Taxpayers indicated numerous issues associated with reports filing in person, particularly excuses created by tax officials to refuse reports, include:

- Company has not checked amount of taxes paid;
- Company has losses;
- Company has even a small amount of tax indebtedness;
- Company declares red ink of VAT;
- Company does not pay some amount of taxes in advance upon request of tax officials.

Further improvement of the regulatory framework and increased control of compliance with legislation by tax officials is needed. Authorities must develop and introduce detailed staff rules (job descriptions) for each department within the tax authority, particularly for those who interact directly with taxpayers.

According to tax legislation, tax reports should be accepted by tax officers without preliminary control or discussion of content or request of additional information or actions.

Strict control over compliance with legislation at the local level is necessary to prevent the practice of making requests for which there is no legislative support.
CHAPTER III

INSPECTIONS

KEY FINDINGS

There is a lack of an effective risk-based approach in the tax audit system. 44 percent of companies and 34 percent of individual entrepreneurs were inspected by tax authorities at least once in 2009.

Among all inspected companies, about 53 percent were inspected once and 23 percent two times. Thus, 24 percent were inspected three or more times. On average, companies were inspected about two times in 2009.

Individual entrepreneurs were inspected even more intensively than companies - they were inspected an average about three times in 2009.

Approximately 10 percent of companies and individual entrepreneurs faced unofficial visits in 2009.

Very few taxpayers used any official means to resolve disputes with the tax authority, such as the official appeal procedure. Among respondents who indicated attempts to "solve issues" with the tax authority, about 45 percent used connections with friends, colleagues or relatives, 22 percent paid "voluntary" contributions and 7 percent filed appeals.97

The World Bank's Enterprise Surveys project, which compares the perceived difficulty of tax administration for small and mid-sized companies worldwide and in particular across the Eastern Europe and Central Asia region, shows that in 2009, Armenian businesses suffered less from tax administration than businesses in other selected countries. (see chart 41).

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97. Four % of companies also filed appeals into court and other share of companies used other ways to "solve issues". There is no data regarding individual entrepreneurs because of lack of appropriate data.
In 2005, some 46 percent of Armenian companies considered tax administration a significant obstacle to doing business, but this had fallen by more than half, to 21 percent, by 2009. Accordingly, one can conclude there has been significant improvement in administering taxes in the country. This also confirms that some strategic measures in reforming tax administration have been implemented in practice and that taxpayer opinions regarding tax administration have improved. The strategic goals to implement a new tax audit policy suggest further appreciation for modern approaches to tax administration, which may significantly improve the system and create efficient and effective tax administration based on best international practices (see box below).

**A new policy of tax audits**

The existing practice of mistrust towards the taxpayers and treating the taxpayers as potential tax evaders will change to a selective audit of the taxpayers based on analysis and risk-based criteria. With this in view, structural, human resource and training activities will be performed; the piloting of the new system and dissemination of the results will take place. Procedures for auditing by separate sectors and types of taxpayers will be established. Starting from 2009, an on-going monitoring of risk sectors, major types of goods and separate taxpayers will be introduced. In 2010, a large selection of taxpayers with good tax records will introduce and implement a streamlined mechanism of simplified tax administration.

The Council for a new revenue administration culture development (RAC).

- **a)** Tax audit strategy. Special sub-programs will be created for the construction, electricity, gas, mining, water, trade and other main sectors of economy;
- **b)** Measures aimed at reducing tax credits, huge tax losses and arrears;
- **c)** Working program on administrative cooperation and mutual assistance with competitive bodies.

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The activities of the SRC operative intelligence, investigation, and inquiry departments will be revised, and put on a program target and grounded in law. As a result of the aforementioned measures, a system of risk-based selection of taxpayers for audits will be put in place. The system will ensure transparency of tax control and improve overall tax compliance.

The following policies will be implemented within this program:

1. Implement a system of risk-based selection of taxpayers for audit;
2. Restructure offsite audits on the basis of automated data processing software and a state-of-the-art database;
3. Implement a system of automatic refunds of tax credits, including VAT credits, and implement measures with a view to reducing tax arrears;
4. Improve the efficiency of intelligence, investigation, and inquiry functions of the tax agency, and define an optimal scheme of interaction with other functions within the Tax Service;
5. Tighten sanctions for intentional violations of the tax legislation, and enact regulations to differentiate between such violations and legitimate tax planning.

Regardless of the fact that tax administration has been improved in recent years, as the Enterprise survey shows, the current tax administration system remains far from modern. Ineffective and inefficient practices still require significant improvement.

### 3.1 Risk-Based Selection Approach for Tax Audit Purposes was Dysfunctional in 2009

According to the survey data, about 44 percent of companies and 34 percent of individual entrepreneurs were inspected at least once in 2009 (see chart 42). These figures explicitly show how burdensome the current tax audit system remains. The survey data takes into account all type of inspections businesses faced in 2009, including inspections of book of registration of revenues and book of shipment of inventory holdings and other types of examinations (see box below). It should be mentioned that, for most taxpayers, verifications of cash registers’ fiscal memory was perceived as a type of examination, though tax legislation does not provide for a definition of such a procedure. Therefore, this type of examination has not been included in the list of inspections. Verification of cash registers’ fiscal memory is conducted by tax officials during personal visits to a taxpayer’s office.

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99. It is worth to mention that according Government decision N 511, adopted on April 14, 2011, taxpayers on a monthly basis, will submit a report on total cash transactions recorded by cash registers, electronically or by post.
Type of inspections business faced in 2009

Inspection is a tool to monitor business activity and help the government ensure taxpayer compliance with legal requirements, including the complete and timely observance of tax obligations. Business faced the following types of inspections in 2009:

- Tax inspection;
- Inspections of books of registration of revenues and of shipment of inventory holdings;
- Cameral examination (desk audit);
- Other types of examination;

Chart 42: Share of companies and individual entrepreneurs inspected by tax authority in 2009.100

Audits are a critical and important component of revenue authorities’ compliance activities in countries around the world. Faced with limited resources and a large numbers of taxpayers (especially in the SME sector), revenue authorities most often use a systematic risk-based approach to identify which taxpayers to audit.

Best international practice makes evident that there are two key elements involved in improving overall compliance with taxes and reducing the number of audits, especially of SMEs:

1. Build an appropriate tax administration system based on risk assessment101;
2. Improve voluntary compliance with tax regulations102.

100. The share of businesses inspected by the tax authority (all type of inspections/examinations) is calculated based on answers of respondents who represent only private active business. All type of inspections are calculated among businesses that have at least one type of particular inspection/examination in 2009.
According to survey data, about 44 companies were audited at least once in 2009, and more than 27 percent of companies with turnover up to AMD 5 million were inspected (see chart 43). More notably, more than 34 percent of individual entrepreneurs were inspected in 2009. This suggests that the system of choosing taxpayers for audit based on risk criteria failed or did not apply in 2009.

The risk-based approach to tax administration helps focus tax authority audit capacity on the most high-risk taxpayers, e.g. taxpayers whose risk of non-compliance is high. The risk-based system also takes into account the potential amount of taxes that the taxpayer might avoid paying. As a result, smaller businesses, including IEs, are rarely high risk due to their low turnover and less paid in taxes. This does not mean small businesses should not be inspected at all. Rather, a few select small businesses should be inspected in order to prevent non-compliance.

Chart 43 shows that small businesses were inspected less often than larger ones, but the system still has yet to incorporate best international practices and understand the lesser need to inspect small business. SME audits must follow the conventional view that it is costly (both for business and the state) and unnecessary to examine all taxpayers and their records in a given audit cycle. The so-called "100-percent inspections" concept must be replaced with sampling techniques that involve profiling, stratification, and risk analysis.

Best international practice suggests that where a risk-based approach is implemented only a very small percentage of small businesses are inspected - and yet the overall efficiency of tax audits remains high.

In France, for example, less than 2 percent of businesses are inspected each year.103 In Latvia, the number of controls that the State Revenue Service (SRS) carries out is quite limited. In the first quarter of 2009, Latvia’s SRS carried out 8,999 tax controls104 on 6,416 legal entities.105 That is, it controlled an average of 4 percent of the total number of registered businesses (151,560) in a quarter. In a year, this means Latvia audits about 16 percent of all businesses - much higher than France, but still much lower than Armenia.

The audit system for medium and large taxpayers should also be significantly improved in

104. SRS tax inspectors implement four main types of tax control: inspection, thematic check, tax audit, and observation.
Armenia. About four out of five large taxpayers were audited in 2009, a much higher rate than in other OECD countries. For example, in France only a third of large taxpayers faced audit from 2002-2005.\textsuperscript{106}

International practices also suggest a number of reform options to improve the efficiency of tax administration and reduce the burden on taxpayers of a small business audit program. A primary requirement is to move from a comprehensive to a targeted, risk-based audit selection of small business. As tax audit resources are generally scarce, priorities for tax audit (large and midsized taxpayers) need to be clearly defined. The audit coverage and audit frequency of small and micro-businesses should be much lower than that of large and mid-sized businesses. Table 16 illuminates the situation in Germany:

Table 16: Tax Audits in Germany (2000).\textsuperscript{107}

<table>
<thead>
<tr>
<th>Business size</th>
<th>Number of registered businesses</th>
<th>Number of tax audits conducted</th>
<th>Average audit frequency</th>
<th>Coverage of audited taxpayers in the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>167,164</td>
<td>38,115</td>
<td>Every 4.3. years</td>
<td>22.3%</td>
</tr>
<tr>
<td>Midsized</td>
<td>755,061</td>
<td>67,457</td>
<td>Every 11.1 years</td>
<td>8.9%</td>
</tr>
<tr>
<td>Small</td>
<td>1,169,364</td>
<td>119,111</td>
<td></td>
<td>Risk-based selection of a small number of small and micro businesses for audit (2% of businesses were audited)</td>
</tr>
<tr>
<td>Micro</td>
<td>4,394,539</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Also, thanks to a well-designed risk-based audit system in South Africa, less than 5 percent of that country’s SMEs are subject to any kind of tax inspection or audit in a given year. Nevertheless, tax revenues in South Africa are considered healthy.

International practice. The core principles of good tax administration system

Role of audit

- Detect and redress individual cases of non-compliance with tax law
- Promote voluntary compliance
- Focus on high-risk taxpayers
- Attempt to close the ’tax gap’

Methods of audit

- Manual screening - by local officers
  - Auditors decide on cases: high risk of corruption
  - Not a systematic method, hence some non-compliance can be missed
  - Only internal data and local knowledge is used for selection
- Random selection
  - Stratified sampling, better representation of taxpayer strata
  - No bias in audit selection
  - High opportunity cost of auditing - "go errors"

\textsuperscript{106} General Direct Directorate. France. 2009.
Risk-based selection
- Identify those taxpayers who are most likely to be non-compliant
- Use of ‘risk-scoring’ techniques and taxpayer profiling

Core Principles of Risk Based Audit
- Trust, but verify
- Self-assessment of taxes
- Equity – honest, compliant taxpayers treated with respect, non-compliant taxpayers treated with severity
- Taxpayer service orientation
- Promote a tax culture of voluntary compliance
  a. tax system is based on trust
  b. taxpayers self-assess their taxes

Table 17 shows the level of implementation and short characteristics of a risk-based audit system in selected countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Risk-based selection approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>Extensive data matching and data mining techniques (incl. decision trees and neural networks). Score-based risk assessment (estimation method unknown); 35% of the audits; Regression analysis for VAT returns</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Centralized, based on manually designed risk criteria</td>
</tr>
<tr>
<td>India</td>
<td>Audit selection based on risk profiling developed through external data sources, various techniques</td>
</tr>
<tr>
<td>USA</td>
<td>Discriminate function (DIF score), based on prior random samples</td>
</tr>
<tr>
<td>Canada</td>
<td>Macro-level analysis using time series econometrics. Audit selection based on data mining techniques</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Audit selection based on data mining since 2007</td>
</tr>
</tbody>
</table>

The latest example of implementation of risk based audit system is in Kyrgyz Republic where the State Tax Service pilot offices in the third quarter of 2010 started conducting tax inspections based on risk assessment. A recent IFC survey of the investment climate in the Kyrgyz Republic found a high rate of tax inspections that is the same in Armenia as tax compliance costs survey shows. Kyrgyz businesses were covered by routine and extraordinary tax controls, which were not cost-effective for either companies or the state. Since the audit selection was not based on reliable risk criteria, compliant taxpayers faced additional burdens while many evaders remained undetected. Thus, introduction of the risk based system in tax administration will significantly reduce compliance and administrative costs while optimizing efficiency of tax inspections. The core steps to implement the system in Kyrgyz Republic are as follows:
- Development of IT system and support;
- Development of core parameters (risk criteria) of the system

108. WBG. Tax training. 2010.
Businesses also faced other types of examinations carried out by the tax authority in 2009. About 6 percent of companies and 2 percent of individual entrepreneurs (see chart 42) had specific examinations, such as, cameral examinations, inventory, etc. The survey data shows that more than 67 percent of companies had cameral examinations109.

### 3.2 Tax Audit Takes a Lot of Time for Both Taxpayers and Tax Authority

Some 53 percent of all inspected companies were inspected once in 2009. At the same time, 23 percent of companies faced two inspections, and 10 percent faced three inspections during the year. The average company was audited 2.2 times and an individual entrepreneur 2.6 times in 2009. These figures confirm that the system of appointment for inspections has serious flaws, including the selection process and vague legal grounds for each audit.

According to the Law On Inspections of the Republic of Armenia, the same state body is allowed to audit the same business no more than once a year, except in cases specified by this law or cases wherein the audit is implemented to offset this requirement in some way. Only in such special cases does the auditing body have legal grounds to carry out a double audit within the same year.

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109. These figures were calculated among companies and individual entrepreneurs who had other type examinations according to the chart 42
Another type of frequent inspection that requires a lot of time is the audit of book of registration of revenues and book of shipment of inventory holdings. On average, companies’ books were audited 1.7 times, costing business about 23 hours for supporting this type of inspection in 2009. As discussed in the chapter “Cost of tax accounting,” maintaining these books already requires a great deal of time. If these books are eliminated, as proposed above, taxpayers will save time and money related to both maintaining the books and supporting inspections of them.

To deal with frequent and various types of tax inspections, taxpayers must prepare documents, provide explanations and visit the tax authority to learn more about the inspection and/or to lodge appeals.

The tax authority too must spend time carrying out inspections and conducting post-inspection procedures such as filing documents, gaining internal approval of results, and dealing with any appeals. Taking into account the total number of inspections made, one can only conclude that the tax inspectors spend a great deal of time working on inspection activities.

Therefore, monitoring and control functions of the tax authority needs to be improved, and should focus on inspecting only the most at-risk taxpayers. Implementation of a risk-based system is key to building an effective and efficient tax administration system. Also, improving the tax inspection appointment system must include changes to laws and the creation of procedures aimed at optimizing the current inspections structure and reducing the number of inspections and the time it takes to carry them out. Businesses will also benefit if the tax authority modernizes its inspections system and focuses on the most at-risk taxpayers, rather than "disturbing" smaller businesses with unnecessary audits.

110. The number and time cost of all types of inspections were calculated among businesses that had at least one particular inspection in 2009.
3.3 Unofficial Visits Remain a Problem

Based on the World Bank’s Enterprise survey data, about 13 percent of Armenian firms expected to give gifts to tax officials during meetings with them in 2009. This number reveals a significant drop since 2005, when 69 percent expected to give gifts. As chart 45 shows, the situation has improved in recent years, and the 2009 figure is smaller than it is for many of Armenia’s neighbors. Yet still this number remains high as it reveals continued corruption within the tax authority.

The order of tax inspection appointment

Before starting the audit, the Head of (deputy) the SRC shall issue an order on carrying out the audit. This order shall state the name of the Body carrying out the audit, the full name of the business entity under audit, the position, name, and surname of official(s) carrying out audit, the time period of the audit as well as the aim, terms and legal bases for carrying out the audit. Officials not mentioned in the order shall not be entitled to take part in the inspection. The copy of the order is then given to the head of the business to be audited, or to the official replacing him, no less than three working days before the start of the audit, with a few exceptions.

Without the above-mentioned documents and steps, a tax inspector is not permitted to carry out an inspection. But as survey respondents reported, several of these steps were often not taken or ignored, officials unauthorized to carry out audits did so, and unofficial visits regularly took place.

According to the survey data, about 10 percent of companies and individual entrepreneurs faced unofficial visits in 2009. (Visits from tax officials are considered unofficial when the business has not been informed of the legal grounds for the inspection and when officials request payment or other goods or services free of charge, or suggest extra-legal resolutions.
Among companies that faced unofficial visits, about 20 percent used connections of friends, colleagues or relatives to "solve issues" that resulted.

Some measures to protect taxpayers’ rights and eliminate unofficial visits

In order to protect taxpayers’ rights and increase compliance with tax legislation by both taxpayers and tax officials, the tax authority should ensure following:

- Define and publicize taxpayers’ rights and obligations so that taxpayers have confidence in the fairness and equity of the tax system but are also aware of the implications of non-compliance.
- The rights and obligations of tax officials and taxpayers, tax penalties and appeal procedures should be contained in guides available to businesses, advisors, tax officials and to the public and updated regularly.
- Comprehensive and clear information should be provided to audited taxpayers about the extent of audit procedures before the audit begins.
- Taxpayers should have the right to refer any serious difficulty in their relations with the tax authority to a mediator within or outside the tax authority.
- The roles and responsibilities of each function and of employees of the tax authority working at all levels within each function should be clearly defined (staff rules).
- Periodical Performance Management Reports should be made with a view to evaluating staff performance, including audit activities.
- Internal audit trails of revenue collection and audits conducted to facilitate internal financial audits and performance management should be introduced and conducted on a regular basis.
- Regulation of tax audits should be more detailed, thus the law on tax inspections should be specified separately.
- The tax authority needs clear rules and procedures to ensure the prompt and accurate recording of all tax audits it performs.

3.4 The Appeal System is Not Commonly Used

According to tax legislation and current practice, taxpayers faced several possible consequences as a result of tax inspections and visits of tax officials in 2009, including repeated inspection, payment of penalties, "frozen" accounts, and suspension or interruption of economic activity. About 49 percent of companies had no consequences as a result of tax inspections. But another 49 percent reported that they had to pay penalties as a result of inspections. Thus, one can conclude that many companies might wish to file an appeal with the tax authority or lodge an appeal with the court. Yet only 7 percent of companies reported that they filed appeals in 2009.

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111. These figures were calculated among companies who answered on this question. The %age does not reflect the share of companies which paid penalties in 2009.
Survey respondents were asked how they usually "solve issues" that arose in relations with the tax authority. About 80 percent said they had "no issues" with the tax authority. This could mean that these companies truly had no problems with the tax authority, or that they preferred to avoid responding to such a sensitive question. Either way, among those who indicated methods for resolving any issues with the tax authority, some 22 percent paid "voluntary" contributions and 7 percent filed appeals.112 This means that very few taxpayers used the official means of resolving disputes with the tax authority, likely because they were forced to do so by tax officials or because they lack faith in the system.

The tax process mapping study (conducted in 2009) confirms several concerns regarding appeal procedures that might further explain their low popularity and usage among taxpayers (see box below).

Box. Observations on appeals system based on tax process mapping study113

Based on the process outlined in Head of SRC Order No. 07-N, the following issues could be explored further:

- Taxation is a technical issue. It is difficult to understand how the type of issues that arise in appeals cases can be addressed effectively if no individual is tasked with preparing a written opinion for review by other members of the Committee. Potentially, this could also reduce the amount of time required in actual Committee meetings (as less time would be required to brief members on the issues).

- There are mixed signals concerning whether meetings are open or not. If the transparency of the Committee is meant to address corruption concerns indicated in the Government’s Tax Administration Strategy Program for 2008-2011, the perceived transparency needs to be real. Steps could be taken to encourage greater public involvement in sessions.

- Many decisions of the Committee are posted on the tax service’s official website. However, the analysis is often not sufficiently detailed to identify a clear statutory basis for the decisions. By preparing more technically focused analyses of issues and decisions, the Appeals Committee could contribute significantly to the understanding of taxpayers and tax officials on the application of the law.

However, the current tax appeals system in Armenia was revised in October 2010. The Government decision114 created the Appeal Council and established the order for discussing decisions of tax customs with superior authorities and appeals committees. The peculiarities of the newly established appeal procedures are characterized in the box below.

112. Four percent of companies also filed appeals into court, while other companies used other means to "solve issues." There is no data regarding individual entrepreneurs because of a lack of appropriate data.
Box. Characteristic of the new appeal procedures based on the Government decision #1361-N

The revised system has the following features:

- Taxpayers appeal to the State Revenue Committee’s Appeals Committee ("SRC Committee").
- The SRC Committee considers the case and, if the case is decided in favor of the taxpayer, a decision is issued.
- If the decision is against the taxpayer, the case is automatically referred to the newly established Appeals Council, an inter-ministerial 9 member council headed by the Deputy Minister of Finance, with additional members from Ministry of Justice (1), the SRC (3), Ministry of Economy (1), financial-economic head of government staff (1), Ministry of Finance, including legal department (2).
- The Appeals Council reviews the case and formulates a technical opinion that is referred to the SRC Committee.
- The SRC Committee then decides whether to accept the Appeals Council's decision or not. If not, the case is referred to the Prime Minister’s office for further consideration. To date, no cases have been referred to the PM’s office.
- The SRC Committee issues a written decision with the facts and the finding to the taxpayer. These (as of recently) are posted on the SRC’s website.
- Further appeals are conducted via a three-stage court process, though no specialized tax or commercial court exists.

The revised system (based on Government decision #1361-N) is an improvement on the previous system in that it introduces non-SRC officials into the appeals process (making it more independent) and publicizes decisions. However, further reforms are recommended (see Recommendations below).
### 3.5 Recommendations

<table>
<thead>
<tr>
<th>Survey findings</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1 RBA Needs to be Implemented</strong></td>
<td>Further steps towards implementation of a risk-based system for tax inspections, one based on best international practices for selecting taxpayers for inspection, is the main pre-condition for improving the effectiveness and efficiency of supervisory and inspection work and reducing time and financial costs for businesses. Planning inspections/audits should be done more systematically, and should be based on risk analysis, as mentioned above. The goal is to reduce the planned inspection rate for low-risk taxpayers, many of which are small and medium enterprises. Other types of &quot;control&quot; (such as unplanned inspections) should be minimized as much as possible, especially for small and medium enterprises. Acceleration of the introduction of a computerized risk analysis system within the tax authority is key. Developing criteria for assessing the quality of inspections instead of tax amount collected - the level of tax compliance is a key. Establish a grievance mechanism for obtaining feedback on inspections from taxpayers, i.e. an SRC web portal. The quality of the advisory services of the Tax authority should be enhanced through better and more frequent trainings of tax officers.</td>
</tr>
</tbody>
</table>

| **2 Unofficial Visits** | Strengthening internal control over the actions of the public officials of the supervisory authorities is necessary to eliminate pressuring of businesses. Internal audit trails of revenue collection and audits conducted to enhance performance management should be introduced and conducted |

44 percent of companies and 34 percent of individual entrepreneurs were inspected at least once in 2009. These figures explicitly show how burdensome the current tax audit system remains.

53 percent of companies among all inspected companies were inspected once. At the same time, 23 percent of companies faced two inspections and 10 percent faced three inspections during the year. The average company was audited about two times and individual entrepreneurs about three times in 2009.

Approximately 10 percent of companies and individual entrepreneurs faced unofficial visits from tax inspectors in 2009. Visits from tax inspectors are considered unofficial when the business has not been informed of the legal grounds for the inspection and when officials request payment or other
goods or services free of charge, or suggest extra-legal resolutions to problems.

Periodical Performance Management
Personal Reports should be made with a view of evaluating staff performance, including audit activities. The roles and responsibilities of each function and of employees of the tax authority working at all levels within each function should be clearly defined (staff rules).

Improving tax legislation, particularly cutting down the reasons for carrying out unscheduled inspections, and implementation of a risk-based system for planning supervisory and inspection activities should make it possible to reduce both the overall number of inspections and the share of unscheduled supervisory measures.

In order to protect taxpayers' rights and increase compliance with tax legislation by both taxpayers and tax officials, the tax authority should ensure the following:

- Define and publicize taxpayers' rights and obligations so that taxpayers have confidence in the fairness and equity of the tax system and are aware of the implications of non-compliance.
- Comprehensive and clear information should be provided to audited taxpayers about the extent of audit procedures before the audit begins.
- Taxpayers should have the right to refer any serious difficulty in their relations with the tax authority to a mediator within or outside the tax authority.
- The tax authority must have clear rules and procedures to ensure the prompt and accurate recording of all tax audits performed.
## 3 Development of Internal Audit Guides

The average inspection lasted 40 hours in 2009.

To address the lack of formal internal reference guides, the tax authority should develop audit guides (for internal use) for each industry. This would include not only the general methodology for conducting tax audits, but also comparative industry data, e.g., average sales, profitability, average number of employees in the industry, and other relevant info. To improve the audit process, the tax authority should set up a systemized database of tax inspections acts. This would help make the tax inspectors' approach to similar cases consistent.

## 4 Appeal System Needs Further Improvement

Very few taxpayers use official means for resolving disputes with the tax authority, such as the appeals procedure. Among respondents who indicated "solving issues" in some way, about 45 percent used connections with friends, colleagues or relatives, 22 percent paid "voluntary" contributions to different funds and 7 percent filed appeals.\(^{116}\)

Many decisions of the Tax Appeal Committee are posted on the SRC official website. However, the analysis is often not sufficiently detailed to identify a clear statutory basis for the decisions.

Despite the fact that the revised appeal system (according to the Government decision #1361-N) that is an improvement on the previous system in that it introduces non-SRC officials into the appeals process (making it more independent) and publicizes decisions, further reforms are necessary.

In order to further improve the tax appeal process, the government should consider the following recommendations:

- **Creation of a tax Ombudsmen's office.** The tax Ombudsman’s office can provide smaller taxpayers with an avenue for redressing non-monetary complaints, bolster confidence in the tax system (which could arguably improve compliance), place pressure on tax officials to improve conduct, and show taxpayers (especially SMEs) that the government is committed to making the tax system more balanced and taxpayer-friendly.

- **Drafting and disseminating among businesses (especially SMEs) a taxpayers’ charter, presenting a clear description of taxpayers’ rights.**

- **Additional reforms to the SRC Appeals Committee process must also be pursued to ensure that monetary appeals are addressed in an independent, transparent man-

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\(^{116}\) Four percent of companies also filed appeals and another companies used other ways to "solve issues". There is no data regarding individual entrepreneurs because of a lack of appropriate data.
ner grounded in tax laws. In particular, the Appeals Council should have the authority to render a decision; the Appeals Council should not include SRC officials; written reasons for a decision should be provided to taxpayers; and feedback loop to auditors should be developed.

- Better taxpayer (especially SMEs) outreach on overall taxpayers’ rights, including appeals. The SRC should provide awareness campaigns among taxpayers on a regular basis and offer guidelines on how to efficiently resolve issues related to taxation within the tax authority with the help of a tax Ombudsman.

- Partnering with NGOs and regional SME development centers should be considered.
KEY FINDINGS

Companies spent an average of about AMD 66,333 purchasing tax reports forms, specialized accounting software and publications, participating in tax related workshops and training events, getting tax consultations from tax professionals and other costs directly related to fulfilling tax obligations in 2009.

The average individual entrepreneur spent much less than companies on the same purposes - about AMD 3,220 in 2009.

As survey data shows, about 80 percent of companies and 93 percent of individual entrepreneurs bought blank tax reports in 2009, spending on average AMD 8,280 and AMD 2,467, respectively.

Companies spent about AMD 287,055 on tax consultations and an average of about AMD 170,296 purchasing and maintaining specialized accounting software.117

In addition to the man hours’ costs related to tax accounting, filing reports and supporting inspections, taxpayers have to purchase paper forms of tax reports to file reports and spend further financial resources to fulfill their tax obligations properly.

Financial and tax accounting requires that business commit additional expenses to support these activities, beyond staff expenses as follows:

such expenses are for, in particular, the purchase and support of specialized software for keeping financial and tax accounting (for example, the “1-C” series software);

117. Among companies which incurred these costs.
also, businesses spend money on supporting accountants with the legal information they need to accurately calculate and pay taxes and duties. Such sources of information include specialized printed and electronic publications; educational, training events and methodological materials; legal and consulting databases; specialized seminars and workshops dealing with tax accounting issues etc.;

in supporting tax accounting and submitting mandatory tax reporting, businesses incur fixed costs - for example, for purchase of forms, books, and other paper items for mandatory tax reporting;

Methodology note.
A certain portion of the other tax-related costs are treated as costs paid out for purposes of keeping both tax and general accounting (the costs of purchasing specialized software for keeping general and tax accounting, for example). Businesses, however, find it extremely difficult to divide these costs between general accounting and tax accounting. In addition, a certain portion of these costs (those that go for purchases of specialized software for keeping general and tax accounting, for information and legal databases, and so on) is subject to depreciation according to the legislation and is partly treated as the cost of doing business in compliance with depreciation rates. However, these costs are fixed if we examine the Armenian economy as a whole - as an aggregate of all companies - and calculate the average indicator.

4.1 Business Spent an Additional AMD 66,333 on Other Costs Related to Tax Compliance

In 2009, companies spent about AMD 66,333 purchasing tax reports forms, specialized accounting software, and publications, participating in tax related workshops and training events, getting tax consultations from tax professionals and other costs directly related to fulfilling tax obligations. Individual entrepreneurs spent much less on the same purposes - about AMD 3,220 for the year.

In order to file reports, taxpayers have to fill reporting forms whether electronically or on paper. As survey data shows, about 80 percent of companies and 93 percent of IEs bought tax reports blanks in 2009, spending an average of AMD 8,280 and AMD 2,467, respectively (see Table 18). A smaller share of companies spent money on blank reports because they had better access to electronic equipment and software and were thus able to print out reports themselves. At the same time, companies spent much more in total on blank reports due to the greater number of taxes they paid and greater frequency of filing.

In several cases, individual entrepreneurs bore other costs related to compliance - about AMD 287,055 for purchasing and maintaining specialized accounting software in 2009, for instance. While companies spent about AMD 170,296 on tax consultations only a relatively small number of companies incurred these costs (see Table 18). It is obvious that tax consultations and accounting software are very costly and only a small share of businesses is able to
afford them. As focus groups participants reported, the main reason small companies do not use accounting software is that it is very costly. The same goes for tax consultation - it is very expensive to consult with professionals, survey data shows. Thus, tax training events and workshops were popular because they are much cheaper than personal consultations.

Table 18. Average business costs related to tax accounting and compliance with tax in 2009.

<table>
<thead>
<tr>
<th>Type of other tax related expenses</th>
<th>The share of companies that incurred particular costs</th>
<th>Average costs per company(^{118}), AMD</th>
<th>The share of individual entrepreneurs who incurred particular costs</th>
<th>Average costs per individual entrepreneur, AMD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax reports blanks, accounting books, other paper forms for tax accounting</td>
<td>79%</td>
<td>8,280</td>
<td>93%</td>
<td>2,467(^{119})</td>
</tr>
<tr>
<td>Specialized printed and electronic publications</td>
<td>22%</td>
<td>43,226</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Specialized accounting software</td>
<td>14%</td>
<td>170,296</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Tax workshops, training events</td>
<td>10%</td>
<td>69,614</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Tax consultations</td>
<td>6.5%</td>
<td>287,055</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total average:</td>
<td>-</td>
<td>66,333(^{120})</td>
<td>-</td>
<td>3,220(^{121})</td>
</tr>
</tbody>
</table>

The survey data shows the extent of business expenses required to comply with tax but also reveals problems related to both tax legislation and practice. As survey respondents reported, the main issues regarding tax legislations (both laws and by-laws) are their complexity and regular changes, which make it difficult to have the most updated tax information and to understand how to pay taxes properly. Thus, taxpayers are often obliged to spend money on special tax literature, training events and consultations.

Another problem related to changing tax regulations is that most taxpayers have to regularly buy tax reports blanks because the forms are changed frequently. Also, the high frequency of reports filings means additional costs. But the main problem in 2009, according to the survey data, was the lack of an electronic filing system (more detailed information regarding e-filing is presented in the Chapter “Submission of tax reports and tax payments”).

Therefore, ensuring stability and simplicity of tax legislation is likely to reduce business costs.

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118. The figures are calculated among companies that incurred particular expenses in 2009.
119. The figures are calculated among individual entrepreneurs who incurred particular expenses in 2009.
120. The total amount is not sum of cost of particular expenses, since the total amount represents average cost for all companies regardless whether they bore such costs or not.
121. The total amount includes all type of expenses and is calculated among all individual entrepreneurs regardless whether they bore such costs or not.
Also, the tax authority must work better to help businesses understand how to pay taxes properly. Thus, the tax authority should consult taxpayers using all available means - tax call center, official website, the dissemination of free publications, guidelines, and detailed instructions. The general principles of administrative burden reduction in the EU further suggest to consider the above-mentioned approaches to reduce compliance costs (see box below).

International practices. Selected recommendations by the European Union - general principles of administrative burden reduction

Compliance with the following principles may significantly contribute to reduction of the administrative burden, including additional costs related to compliance with tax for businesses:

1. Reduction of reporting frequency to the minimum necessary level and harmonizing frequency and deadlines for different types of reports.
2. Moving from reporting in hard copy to filing reports through email and special websites.
3. Establishing thresholds for information requirements, reducing the requirements for small and medium enterprises as much as possible or using sample reporting system.
4. Dissemination of official explanations for complicated legislative acts which may hinder business activities or require deep legal knowledge.

The key approach to seriously reducing these costs is the introduction and development of an electronic filing system, which will allow for streamlining, simplifying and improving compliance and significantly cutting down the costs of tax filing. At the same time, Armenia’s e-filing system became operational in 2010, but focus group participants report many problems with this system. One is the incompatibility of e-filing software with other accounting programs. Thus, it would be very helpful for businesses, especially smaller ones, if the tax authority could provide free, simple accounting software that includes a special program for e-filing. This will reduce all business costs associated with the calculation of taxes and filing reports.

4.2 Outsourcing May Help Businesses to Reduce Costs Related to Tax Compliance

There is another opportunity to reduce costs related to tax compliance - making outsourcing fully, or at least partially.

There are a number of consulting companies operating in the SME Accounting Center (Accounting Center) that selected on competitive basis. The Accounting Center provides considerably affordable packages to SME entities including financial accounting, and other services related to tax accounting procedures. SME Development National Center reimburses to SME entities the share of consultancy services costs. For registered companies in marzes the reimbursement can reach up to 80%, and in Yerevan up to 50%. The reimbursement sum can-

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not exceed AMD 1 million in the course of one year for single company. According to survey results, only 58.5% of the respondents are aware of Accounting Center’s existence and only 12.6% out of them have benefited from the provided services, and for individual entrepreneurs these figures are 37.3% and 5.6%, respectively. For instance, companies with turnover up to AMD 5 million outsourcing tax compliance work spent on average AMD 67,738 and those who did it by internal resources spent on average AMD 296,151. It is obvious, that outsourcing tax compliance work is several times more affordable. Taking into account, that the micro businesses bear the heaviest burden of tax compliance outsourcing tax compliance works will drastically reduce the cost of tax compliance of SMEs. As survey data show only 4.9 percent of companies and 2.6 percent of individual entrepreneurs outsource all tax compliance work.

In order to encourage the use of its services by SMEs the Accounting Center should conduct consistent public awareness campaigns. Definitely, it is necessary to consider the fact, that there could be companies that despite of obvious advantages will not choose this option, as involvement of external parties supposes also "transparent" accounting, that is still unacceptable for some companies, as well as some businessmen in spite of the quality of the provided services do not trust and rely on external resources.

International comparison. Other costs related to taxes and outsourcing.

At least three quarters of all European countries surveyed\textsuperscript{125} outsourced at least one tax-related function. In South Africa, a middle-income country, about 44 percent of SMEs outsource all or part of their tax compliance work.\textsuperscript{124} In New Zealand, 80 percent of small and midsized businesses used external tax advisor services.\textsuperscript{125}

Outsourcing is particularly cost-effective for small and midsized businesses. Businesses that outsource may, for example, save money on acquiring or paying for accounting software, specialized printed and electronic publications, educational training, legal and consulting databases, specialized seminars and workshops dealing with tax accounting issues, and the like. A tax consultant/accountant carries all the above-mentioned costs and at the same time provides tax services for numerous businesses. Businesses often think they save money by doing their taxes "in house" but if they run into any difficulties, a professional tax practitioner will usually have to re-do much of the same work to correct mistakes. Thus, small businesses that outsource all their tax preparation work usually have lower costs than those who only outsource some.\textsuperscript{126}

\textsuperscript{123} Ernst & Young 2008 European outsourcing survey.
\textsuperscript{124} USAID (2008) "Formal SMME Tax Compliance Survey Report for South Africa."
\textsuperscript{125} Measuring the tax compliance costs of small and medium-sized businesses - a benchmark survey, New Zealand. 2005.
### 4.3 Recommendations

<table>
<thead>
<tr>
<th>Survey findings</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies spent on average AMD 287,055 on tax consultations, AMD 69,614 on tax workshops and training events and about AMD 43,226 on specialized printed and electronic publications in 2009.</td>
<td>The supervisory authority should carry out consulting and public awareness campaigns among taxpayers aimed at making tax legislation easier to understand and apply. It should also try to cut down the cost to businesses of purchasing specialized publications, legal and consulting databases, and educational, training, and methodological materials, and of paying for the cost of consultations, seminars, workshops and so on.</td>
</tr>
<tr>
<td>80 percent of companies and 93 percent of individual entrepreneurs bought tax reports blanks in 2009, spending on average AMD 8,280 and AMD 2,467, respectively.</td>
<td>Encourage electronic filing to reduce the costs related to the purchase of blank tax reports. Tax filing forms should be provided free of charge to taxpayers.</td>
</tr>
</tbody>
</table>
CHAPTER V

TAX EVASION

KEY FINDINGS

More than half of all companies (51 percent) and individual entrepreneurs (55 percent) believe those working in their field do not hide turnover for tax purposes.\(^\text{127}\) However, these figures may be inaccurate as some respondents refused to answer (6 percent at companies; 4 percent at individual entrepreneurs) or answered that they did not know (33 percent and 29 percent, respectively).

Based on survey results, about 16 percent of companies’ turnover and about 15 percent of individual entrepreneurs’ turnover is hidden for taxation purposes. These indicators may be used as benchmarks for understanding the possible scope of tax evasion in the country, with some cautions.

On average, companies pay 16 percent of all salary payments unofficially. Individual entrepreneurs hide less - about 12 percent of total salary payments.

Comparing underreporting between companies with different turnover shows that the more money a company makes, the less it is inclined to hide turnover for taxation purposes. There is an opposite trend among individual entrepreneurs - the more an individual entrepreneur makes, the more incomes he or she hides for taxation.

Most taxpayers indicated that the fallibility of tax legislation and the possibility of collusion from tax officials are the main circumstances that allow for tax evasion.

There is also a difference in underreporting incomes in the different regions and sectors. Companies underreport more in the north region and least in the south region and Yerevan\(^\text{128}\), while businesses involved in production evade more than businesses from other sectors of the economy.

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127. These figures were calculated as a proportion of the respondents who answered '0' on a question regarding the share of hidden turnover for tax purposes and total number of respondents who answered on this question (indicated particular share of hidden turnover from '0' to "100" percents) excluding respondents who refused to answer or did not know.

128. Divisions are conditional. For details see Annex "Survey Methodology".
General data regarding respondents’ answers on question regarding underreported turnover and unofficial salaries.

Answers on the question "Please tell me what, in your opinion, share of turnover enterprises working in your field hide from taxation?"

<table>
<thead>
<tr>
<th></th>
<th>Companies (%)</th>
<th>Individual entrepreneurs (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent of respondents who indicated figures from &quot;1&quot; to &quot;100&quot;</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Percent of respondents who indicated &quot;0&quot; (zero)</td>
<td>31</td>
<td>37</td>
</tr>
<tr>
<td>Percent of respondents who refused to answer</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Percent of respondents who did not know</td>
<td>33</td>
<td>29</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Answers on the question "Please tell me what share of workers’ salaries, in your opinion, enterprises in your field hide from taxation (pay informally)?"

<table>
<thead>
<tr>
<th></th>
<th>Companies</th>
<th>Individual entrepreneurs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent of respondents who indicated figures from &quot;1&quot; to &quot;100&quot;</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Percent of respondents who indicated &quot;0&quot; (zero)</td>
<td>31</td>
<td>37</td>
</tr>
<tr>
<td>Percent of respondents who refused to answer</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Percent of respondents who did not know</td>
<td>33</td>
<td>29</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The survey data shows that more than half of companies and individual entrepreneurs do not hide their turnover for taxation purposes and pay full salary officially (more than 70 percent of individual entrepreneurs pay full salary officially).\(^{129}\) This could mean that a significant part of businesses do try to work transparently - paying taxes in full and complying fully with tax legislation.

\(^{129}\) The data shows the percentage of respondents who reported that companies (individual entrepreneurs) working in their field hide from taxation "zero" percent of turnover/"zero" percent of salary. Respondents who refused to answer or did not an answer were excluded from the total number of respondents to calculate above-mentioned indicator.
Methodology note

To improve the response level, tax evasion questions were formulated in such a manner as to get respondents to assess, for example, the share of hidden turnover among enterprises working in his or her field (based on the respondent’s perception of common behavior, which is likely to reflect his/her own behavior). The international literature on tax evasion, much of it based on surveys, supports the idea that "those individuals who said they personally knew others who practiced tax fraud is considered to have a better-than-average chance of evasion".\(^{130}\)

While survey data on tax evasion should be viewed with caution, the involvement of a certain number of respondents may be sufficient that rough estimates can be made for specified factors related to the shadow economy. The data below is based on several questions about the relationship between officially reported turnover and actual turnover (share of hidden turnover), about official wages (salaries) compared to real payouts (share of hidden salary).

Yet about 16 percent of companies’ turnover and about 15 percent of individual entrepreneurs’ turnover is hidden for taxation purposes (see chart 46). These indicators may be used as benchmarks for understanding the possible scope of tax evasion in the country, with some cautions.

First, these figures are calculated among companies and individual entrepreneurs who answered on particular questions (indicated figures from "0" to "100") but some respondents refused to answer or reported that they "did not know". Second, the figures are based on self-reporting, i.e., respondents were asked about their perceptions of the behavior of businesses "like yours, operating in your field”. Third, some respondents may not have been fully sincere in their answers, perhaps worrying that an answer could reflect negatively on their own practices.

Chart 46: The share of officially reported and underreported turnover/salary by companies and individual entrepreneurs.\(^{131}\)

Companies pay about 16 percent of salaries unofficially, individual entrepreneurs about 12 percent.


\(^{131}\) The share of underreported turnover/salary was calculated as a mean among companies/individual entrepreneurs who indicated the share of underreported turnover/salary including "zero" answers (indicated figures from "0" to 100%).
Comparing underreporting between companies with different turnover shows that the more money a company makes, the less it is inclined to hide its turnover for taxation purposes. The share of underreported income varies from 16 to 20 percent for companies with turnover up to AMD 58.35 million. Among larger taxpayers the share of underreported turnover is less than 11 percent (see chart 47).

There are numerous explanations for this, including different response rates, but the most important might be as follows:

- Small and midsized businesses commit more non-banking transactions (cash or barter).
- Considering the significant and often distorted competition in many markets, small and midsized enterprises can find it hard to compete, especially with larger companies, when paying full taxes.

132. The share of underreported turnover was calculated as a mean among companies/individual entrepreneurs who indicated the share of underreported turnover including “zero” answers (indicated figures from “0” to “100”).
Larger businesses may have more difficulty hiding their incomes (because of the scope of their operations and the government supervision).

Many large companies engage additional capital through credit and investment markets, which requires high transparency on the part of their business operations and financial statements.

A company is obliged to register as a VAT payer if its turnover exceeds AMD 58.35 million. This may encourage businesses under the VAT threshold to hide some of their revenues so that they can avoid being pushed out of the more favorable tax regimes, taking into account the additional tax burden, burdensome tax compliance costs associated with VAT and numerous disadvantages being registered as VAT payers, as survey data shows (see the chapter "Cost of tax accounting").

At the same time, there is an opposite trend among individual entrepreneurs - the more money an individual entrepreneur makes, the more income he or she hides from taxation (see chart 47). This is probably explained by the progressive nature of the income tax. If an individual entrepreneur’s annual income exceeds AMD 960,000, the tax rate increases twice. Thus, the huge difference between individual entrepreneurs below AMD 1 million and those above this threshold, as chart 47 shows, is a significant tax burden.

5.1 Producers and Northern\textsuperscript{133} Companies Might Evade More than Business from Other Sectors and Regions

According to the survey results, businesses working in production (both companies and individual entrepreneurs) evade taxes more than businesses in other sectors of the economy (see chart 48). The share of underreported turnover varies a bit from sector to sector, as survey data shows, but in the main, companies and individual entrepreneurs who provide services and operate in other sectors underreported less than producers and trade businesses. This might be explained by the high tax burden on the production sector.

\textbf{Chart 48: The share of underreported turnover by companies and individual entrepreneurs operating in different sectors.\textsuperscript{134}}

\begin{tabular}{|c|c|c|}
\hline
\textbf{Type of activity} & \textbf{Companies} & \textbf{Individual entrepreneurs} \\
\hline
Production & 18\% & 19\% \\
Trade & 18\% & 15\% \\
Service & 14\% & 12\% \\
Other & 13\% & \\
\hline
\end{tabular}

\textsuperscript{133} For details see Annex "Survey Methodology".

\textsuperscript{134} The share of underreported turnover was calculated as a mean among companies/individual entrepreneurs who indicated the share of underreported turnover including "zero" answers (indicated figures from "0" to 100"). There is no figure for individual entrepreneurs from "other" sectors due to lack of data.
There is also a difference in underreporting incomes in different regions of the country. Companies underreport more in the north (23 percent of real turnover) and least in the south region and Yerevan city (14 percent of real turnover) (see chart 49). Individual entrepreneurs from different regions underreported almost the same share of their turnover, with minor differences.

<table>
<thead>
<tr>
<th>Region</th>
<th>Companies</th>
<th>Individual entrepreneurs</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>23%</td>
<td>16%</td>
</tr>
<tr>
<td>Central</td>
<td>16%</td>
<td>14%</td>
</tr>
<tr>
<td>Yerevan</td>
<td>14%</td>
<td>15%</td>
</tr>
<tr>
<td>South</td>
<td>14%</td>
<td>14%</td>
</tr>
</tbody>
</table>

There is no evidence in the data regarding why there is a difference in underreporting in various regions. Deeper analysis is necessary to gauge the extent and reasons for underreporting among different regions, sectors and businesses. However, one reason may be related to the fact that those less inclined to underreport (upper middled companies and large ones) are predominantly registered and operating in Yerevan city and the central region of the country. Or the amount of underreporting among the difference between regions, sectors and businesses might be related to inefficient and ineffective tax administration systems, as seen in the chapter "Inspections," above. The oversight system does not take into account a risk-based approach that results in frequent and unjustified tax inspections every year.

The survey data shows that 47 percent of companies that may underreport their incomes were inspected in 2009, which means 53 percent of these companies were not inspected (see chart 50). Meanwhile, some 42 percent of companies that reported the real turnover were inspected in 2009. This likely means that the tax authority does not take into account the risk of underreporting from a particular taxpayer - firms that paid taxes in full and firms that evaded taxes were inspected almost at the same level.

135. The share of underreported turnover was calculated as a mean among companies/individual entrepreneurs who indicated the share of underreported turnover except "zero" answers.
136. See "Methodology note" of this chapter.
5.2 Underreporting is the Most Popular Way to Evade Taxes

There are many different ways to evade taxes, but the most popular are declaring only a portion of real income, or underreporting (52 percent of respondents reported this)\textsuperscript{137} and payment of unofficial salary (26 percent of companies and 16.5 percent of individual entrepreneurs did this) (see chart 51). There are also other schemes such as overstating costs, using fictional firms or abusing tax privileges. Very few respondents believe there is no way to evade taxes. The tax authority and other supervisory bodies should focus primarily on the most popular methods - underreporting, unofficial salaries and using fictional firms.

Chart 51: Most popular ways of tax evasion among companies and individual entrepreneurs.\textsuperscript{138}

\begin{itemize}
\item **Companies**
  \begin{itemize}
  \item Fraudulent abuse of tax privileges; 4.8%
  \item Overstate of costs; 9.8%
  \item Payment of unofficial salary; 16.5%
  \item No ways; 2.5%
  \end{itemize}
\item **Individual entrepreneurs**
  \begin{itemize}
  \item Fraudulent abuse of tax privileges; 4.8%
  \item Overstate of costs; 9.8%
  \item Use of fiction firm; 15.0%
  \item Payment of unofficial salary; 26.0%
  \item Declare only part of the revenue; 53.7%
  \end{itemize}
\end{itemize}

\textsuperscript{137} Among respondents who indicated at least one way of tax evasion. This is also relevant for all figures which are represented in the paragraph. 13 percent of respondents from companies did not know an answer on the question regarding ways of tax evasion and 1.5 percent refused to answer.

\textsuperscript{138} The figures reflect the percentage of respondents who indicated particular way of tax evasion in the field of operation of respondents’ business.
In addition, the government and the tax authority should consider a strategy to reform tax legislation and the tax administration system to reduce circumstances that allow tax evasion and promote compliance. Most taxpayers indicated that the fallibility of tax legislation and the possibility of collusion from the tax authorities are the main circumstances that allow for tax evasion (see chart 52).

Thus, tax legislation, in particular the penalty system, should be changed in order to prevent tax evasion. Also, strict and systematic supervision measures on tax staff should be implemented to prevent unofficial agreement between taxpayers and tax officials. As discussed above (in particular in the chapter "Inspections"), the current control system allows tax evasion and incompetency among the controlling authorities allows taxpayers to evade taxes. The system requires improved human resources management, including training of tax officials and regular performance evaluations of all tax staff to increase competency.

Effective tax optimization schemes affect, first and foremost, state and local budget revenues. Consequently, tax evasion has a discernible impact on the tax burden of the official economy and on the resources available for state spending. On the other hand, poor tax optimization directly affects the size of the shadow (unofficial) economy. Underreporting and overstating enterprise costs (by engaging fictional firms, for example) not only cuts taxable income (and therefore budget revenues) but also misrepresents the real cost of goods, works, and services in the national economy. As a result, a portion of income flows from the official economy into the shadow one. Naturally, some money will return to the official sector (through the purchase of goods, works, and services by people who received unofficial wages and salaries, for example). Much of it will, however, stay in the shadows, servicing unofficial commodity and money circulation.

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138. Chart 52: The main circumstances that allow tax evasion among companies and individual entrepreneurs.

139. The figures reflect the percentage of respondents who indicated particular circumstances which allow evading taxes. The figures were calculated among respondents who indicated at least one reason that allow evade taxes. Nine percent of respondents from companies did not know an answer on the question regarding reasons that allow tax evasion and 1.5 percent refused to answer.
Although the existence and "accessibility" of tax evasion schemes may promote unofficial income, they are only "tools." The real reasons for tax evasion and the shadow economy lie much deeper. Widespread failure to report income for taxation purposes is in large part the result of a faulty tax system. That is, it is the result of a burdensome tax system that motivates taxpayers to find ways to avoid taxes. High tax rates, the high number of taxes and payments, the complexity of tax law in general, and the peculiarities of tax administration are some of the issues that make avoidance common. However, the existing tax system is not the only thing that motivates businesses to hide income. Other reasons may include excessive regulation of the economy (the permit and license system is both complicated and weak), a poor pension and social security system (an additional burden on the payroll), the low quality of government services (enterprises and employees see no point in paying taxes in full, because it does not ensure good government services), bureaucracy and corruption (bribes are demanded), and so on. In the international compliance literature, Alm et al. suggest that government can increase compliance by providing goods that their citizens appreciate, by providing goods in a more efficient manner, or by more effectively emphasizing that "taxes are necessary for receipt of government services."\(^\text{140}\)

In other words, while it is clear that some degree of enforcement (including audits and sanctions) is indeed necessary, increasingly rigorous and harsh enforcement methods tend to give rise to stiffer resistance among taxpayers. On the other hand, efforts to improve government efficiency, fairness, and service quality tend to encourage higher "tax morale" and thus higher levels of voluntary tax compliance.

Measuring the impacts made by particular factors and identifying the real reasons for failures to report income and for staying in the shadows are outside the scope of this report and require special research.

### 5.3 Recommendations

<table>
<thead>
<tr>
<th>Survey findings</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on the survey, about 16 percent of companies' turnover and about 15 percent of individual entrepreneurs' turnover is hidden for taxation purposes. These indicators may be used as benchmarks for understanding the possible scope of tax evasion in the country, with some cautions. Companies pay about 16 percent of salaries companies unofficially, individual entrepreneurs about 12 percent. Most taxpayers indicated that the fallibility of tax legislation and the possibility of conclusion unofficial agreement with the tax</td>
<td>The tax system of Armenia needs to undergo reforms in order to reduce the share of unreported income. At the same time, formal changes of tax law alone will not help eradicate the grounds for hidden incomes nor eliminate the country's sizable shadow economy. All recommendations indicated in the report and elaborated based on survey data may reduce underreporting and increase the level of compliance with tax. Also, efforts to improve the efficiency and fairness of tax administration based on recommendations</td>
</tr>
</tbody>
</table>
authorities are the main circumstances that allow tax evasion.

There are also differences in underreporting among various regions, sectors and business sizes.

Business operating in production (both companies and individual entrepreneurs) evade more than businesses in other sectors of the economy. The share of underreported turnover varies a bit from sector to sector. Companies and individual entrepreneurs who provide services and operated in other sectors underreported less than producers and trade business.

Comparing underreporting between companies with different turnover shows that the more a company makes, the less inclined it is to hide its turnover for taxation purposes. The opposite is true for individual entrepreneurs.

of this report %may do more to encourage voluntary tax compliance and reduce tax compliance costs.

The correlations between the levels of unreported incomes in different regions and sectors could serve as an indicator in the development of "risk-based audit" selection systems.

Also, the most popular schemes to evade taxes could be used to develop risk criteria in the RBA system.

However, evidence that a certain proportion of business income is underreported should not generate pressure on any individual company to increase its reported taxable income. The selection of a particular taxpayer for audit should be made only on an individual basis.
6.1 International Comparisons of Tax Compliance Costs

While there is growing interest in measurement of tax compliance costs in various jurisdictions around the world, there is always a problem of comparison. Differing definitions and methodologies can lead to comparisons between apples and oranges.

Probably the most comprehensive database on tax compliance costs that is explicitly designed for the purpose of international comparison is the World Bank Group’s annual Doing Business report, which includes time estimates for tax compliance for three main sets of taxes: corporate income or profit tax, VAT/sales taxes, and payroll taxes. The Doing Business estimate is based on a hypothetical, medium-sized manufacturing business located in the largest city of each country. It is assumed to have 60 employees and a turnover of approximately 1000 times the per-capita income of the country.

Chart 53 below presents Doing Business data for the time required for tax compliance in selected countries, including Armenia, which is 15th worst in the world in this indicator.
The Costs of Tax Compliance in Armenia

While the Doing Business methodology allows for international comparisons based on a standard set of assumptions and methodology, it is not necessarily representative of the tax compliance cost burden of the majority of actual companies in any particular country. Individual countries have carried out surveys of businesses and/or tax accountants to get an estimate of the average compliance costs of businesses in actual practice, which are very useful to get a more detailed and accurate picture of the situation within each country. Cross-country comparisons, for the reasons noted above, are still difficult.

The World Bank Group’s Tax Compliance Cost Surveys all follow a similar methodology and employ a similar questionnaire, but cross-country comparisons still remain a challenge. In all cases, we aim for a representative sample of business experiences to estimate the time required for a company to complete all necessary tax compliance tasks, above and beyond basic bookkeeping (which should be done by businesses in any event for the sake of their own financial management). The resulting survey data can be broken down by:

- The type of tax (e.g., CIT, VAT, payroll taxes, other taxes),
- The relevant tasks (pre-filing tasks such as data collection and tax calculations, filing tax returns and paying taxes, and post-filing tasks such as refunds, inspections, objections and appeals)
- The type of company (e.g., by size, by sector, or by region)

One of the other main differences across countries is the degree of dependence on external tax advisors to prepare tax returns. For countries where the majority of businesses outsource their tax compliance tasks, details are often only available by surveying such advisors about their work for their clients. In other countries, such as Ukraine and Armenia, the majority of businesses carry out tax tasks "in house" with their own staff.
Since tax compliance cost surveys are designed for the primary purpose of providing detailed information about topics of interest in individual countries, (e.g., usually to provide inputs for a specific tax reform agenda), the resulting survey data do not lend themselves easily to cross-country comparisons. For example, in South Africa, which was preparing to design a new "small business tax" regime, the survey focused on SMEs. In Ukraine, by contrast, the survey was based on a representative sample of all tax-paying legal entities, with a separate survey for "sole proprietors."

Taking these kinds of variations into account, we can compare data for, e.g., "medium" sized firms in each country. In the case of Armenia, the survey data appeared to be somewhat higher than the Doing Business estimate for 2010 (578 hours), based on data from respondents for medium sized businesses, which spent an average of 636 hours per year (see table 19). Some of the discrepancy may be accounted for by the legal requirements in Armenia to maintain books of registration of revenues and of shipments of inventory holdings, which are excluded from the Doing Business methodology because they are a rare requirement.

**Table 19*. Hours per year required for Tax Compliance (Medium sized businesses)**

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Time</th>
<th>CIT</th>
<th>Payroll</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peru</td>
<td>632</td>
<td>42</td>
<td>18</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>S. Africa</td>
<td>105</td>
<td>470</td>
<td>250</td>
<td>1150</td>
<td></td>
</tr>
<tr>
<td>Armenia142</td>
<td>636*</td>
<td>266</td>
<td>108</td>
<td>262</td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>158</td>
<td>79</td>
<td>24</td>
<td>55</td>
<td></td>
</tr>
<tr>
<td>Vietnam</td>
<td>1030</td>
<td>200</td>
<td>107</td>
<td>723</td>
<td></td>
</tr>
<tr>
<td>Yemen</td>
<td>649</td>
<td>229</td>
<td>155</td>
<td>365</td>
<td></td>
</tr>
</tbody>
</table>

Sources: WBG Tax Compliance Cost Surveys

* The time for Armenia includes time for tax accounting, filling reports, submission of tax reports, payment of taxes, analysis of tax legislation, and maintaining books (registration of revenue and shipment of inventory).

The South Africa survey data represents "good practice" for business tax, even though a "small business tax regime" was only introduced in 2009. The South African tax regime relies heavily on self-assessment of tax liabilities by businesses and risk-based audits, with less than 5 percent of SMEs subject to any kind of tax inspection or audit in a given year. Nevertheless, tax

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141. "Medium" is defined relatively in each country: for South Africa, businesses with turnover between about US$1 - 2 million; for Peru over $1 million; for Ukraine between $0.7 - 5 million; for Vietnam between $0.5 - 15 million; for Yemen between $100,000 to $1 million; for Armenia between AMD 58.35 million - 500 million

142. The time cost for Armenia was calculated as time spent on tax accounting, filling reports, submission tax reports, payment of taxes, analysis of tax legislation, and maintaining books. The time spent on submission tax reports, payment of taxes, analysis of tax legislation for particular taxes (CIT, VAT, Payroll taxes) was calculated taking proportion time spent on accounting and filling particular tax to total spent on accounting and filling all taxes that company paid. The time spent on maintaining books was distributed between CIT and VAT in proportion 50/50 take into account that these books are maintained for the purpose of accounting both CIT and VAT.
revenues in South Africa are considered healthy. The South Africa Revenue Service is anxious to encourage more informal businesses in the country to register for tax, but neither tax evasion on the part of SMEs nor corruption in the tax administration are considered serious problems.

Similar surveys carried out in OECD countries tend to focus on costs (including, in particular, the cost to businesses of outsourcing tax compliance to professional tax practitioners). A study by Statistics Canada in 2005 concluded that tax compliance costs for businesses averaged $1171 for basic income tax filing and $514 for Federal/provincial sales tax.143

A similar survey in New Zealand estimated an overall average of 77 hours for SMEs, and 205 hours for businesses with at least 20 employees. In terms of cost, they found average internal tax compliance costs (i.e., excluding companies who outsource to tax professionals) for SMEs of NZ$ 1224 (about US$ 783) for income tax, NZ$1852 (US$1185) for General Sales Tax, and NZ$ 937 (US$600) for payroll taxes.144

An analysis for the United Kingdom estimated average annual compliance costs for (quarterly) VAT returns of L 667, (about $1266), and "per incident" costs of issuing VAT invoices of about L 1.58 each (about $3). A corporate tax return bore an average compliance cost of about L 318.145 For the United States, a study in 1993 estimated average compliance costs of $6080.146

While Armenia’s tax compliance costs of an average of 495,000 AMD or US$ 1363 does not seem too bad in comparison with OECD countries, it must be considered in light of Armenia’s lower per capita GDP (roughly 10 times lower than most OECD countries) and the average salary of accountants.

**International practice. Relative costs of tax compliance.**

As in Armenia, the studies of tax compliance costs that were carried out in other countries around the world show that they are relatively fixed and therefore regressive. SMEs usually carry much higher compliance costs in comparison with large business.

The following table shows the international evidence on cost-sales ratio

<table>
<thead>
<tr>
<th>Country</th>
<th>Relative costs of tax compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>- 2.6% is the estimated cost-sales ratio for SMEs (up to 250 employees)</td>
</tr>
<tr>
<td></td>
<td>- 0.2% is the estimated cost-sales ratio for large business147</td>
</tr>
<tr>
<td>New Zealand</td>
<td>- 0.03% for companies with turnover of 10 million-50 million NZD;</td>
</tr>
<tr>
<td></td>
<td>- 0.09% for companies with turnover above 50 million NZD148</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>- 0.05% for VAT compliance costs and 0.04% for corporation compliance costs for companies with turnover above 1 million GBP149</td>
</tr>
</tbody>
</table>

143. Statistics Canada, Survey of Regulatory Compliance Costs
144. Colmar Brunton, "Measuring the tax compliance costs of small and medium-sized businesses - a benchmark survey" (2005), Exchange rate (as of June 2009): NZ$1 = US$0.64.
<table>
<thead>
<tr>
<th>Country</th>
<th>Tax Rates for Turnover Ranges</th>
</tr>
</thead>
</table>
| The Netherlands | - 0.02% for companies with turnover between 100 million-500 million NLG;  
                      - 0.006% for companies with turnover above 500 million NLG150  |
| Canada      | - 0.10% for companies with turnover between 0.5 million-1 million CAD;  
                      - 0.06% for companies with turnover above 1 million CAD151  |
| Ukraine     | - 8.2% for companies with turnover less than UAH 300,000 ($60,000);  
                      - 1.86% for companies with turnover of UAH 300,000-1 million;  
                      - 0.78% for companies with turnover of UAH 1 million-5 million;  
                      - 0.21% for companies with turnover of UAH 5 million-35 million;  
                      - 0.07% for companies with turnover over UAH 35 million ($6.9 million).  |
| Uzbekistan  | - 15.6% for companies with turnover less than UZS5 million ($3,776)  
                      - 2.1% for companies with turnover of UZS 5-50 million  
                      - 0.8% for companies with turnover of UZS 50-100 million  
                      - 0.3% for companies with turnover of UZS 100 million - 1 billion  
                      - 0.1% for companies with turnover over UZS 1 billion  |
| Armenia     | - 17.5% for companies with turnover up to AMD 5 million ($13,765);  
                      - 2.4% for companies with turnover of AMD 5 - 29.99 million;  
                      - 1.3% for companies with turnover of AMD 30 - 58.35 million;  
                      - 0.4% for companies with turnover over AMD 58.35 million;  
                      - 0.2% for large taxpayers.  
                      - 4.6% for individual on average.  |
| South Africa | - 4.8% for companies with turnover under R 300,000 (about US$50,000)  
                      - 1.2% for companies with turnover R 0.3 to 1 million  
                      - 0.2% for companies with turnover R 1 to 6 million  
                      - 0.08 for companies with turnover R 6 to 14 million152  |

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6.2 Efficiency of Tax Administration

Another useful topic for international comparison is the efficiency of tax administration. There are several useful indicators for assessing the efficiency of tax administration. The following data is from the USAID Fiscal Reform and Economic Governance program. Charter 54 below shows the VATY indicator and the level of net VAT collections as a percentage of GDP. When looking at VATY we can see that Armenia appears slightly above the world average.

Chart 54: VATY international comparison

As in many developing and transitional countries, VAT is the most important source of revenue for the Government of Armenia, composing 8.3 percent and 7.9 percent of GDP (VATY) for 2009 and 2008, respectively. When we compare this indicator across CIS countries (see table 20), classified as lower-to-middle-income economies, we see that Armenia has the lowest VATY indicator. It is worth mentioning that Armenia is not significantly lower than the average of the Central Europe and Central Asia region, 8.62 percent, while the average of the CIS lower-middle-income economies is 7.27 percent.

In 2009, a higher VAT threshold was introduced - AMD 58.3 million ($151,748), which is one reason the VATY indicator declined in 2009. As shown in table 20, Armenia has the highest VAT threshold among lower-middle-income economies of CIS.

There are two widely used indicators to assess the VAT collection efficiency, namely VAT productivity ratio (VATPROD) and VAT gross compliance ratio (VATGCR). They are helpful for assessing country performance within a certain period of time (see table 21) and making

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154. Level of Value-Added Tax collections as % of GDP
156. VATPROD is calculated by the formula VATY/VAT standard rate
157. VATGCR is calculated by dividing net VAT revenues by total private consumption and then dividing by VAT standard rate
cross-country comparisons (see table 20). Both VATPROD and VATGCR show how well the VAT produces revenue for the government, given the prevailing VAT rate 158.

VAT productivity ratio may be misleading, since, in principle, VAT taxes consumption, not production, and GDP measures production, not consumption 159. Thus, VATGCR can be considered a trustier indicator, as it takes into account national consumption. The higher the figure, the more efficient the VAT system is likely to be. As the data shows, Armenia has average figures.

However, if we take into account the relatively high VAT rate in Armenia, then the VAT productivity (VATPROD) indicator appears somewhat under the world average, as shown in chart 55 below.

![Chart 55: VATprod international comparison](image)

---


159. VAT collection efficiency in Poland before and after accession to the European Union - A comparative analysis, Maïgorzata Magdalena Hybka
### Table 20: Cross country comparison

<table>
<thead>
<tr>
<th>Country / Economy / Region</th>
<th>VATy</th>
<th>VAT threshold USD</th>
<th>VATprod</th>
<th>VATgcr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CIS countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Armenia</td>
<td>8.3</td>
<td>151,748</td>
<td>0.42</td>
<td>56.4</td>
</tr>
<tr>
<td>Moldova</td>
<td>12.7</td>
<td>24,520</td>
<td>0.63</td>
<td>67.6</td>
</tr>
<tr>
<td>Georgia</td>
<td>11.5</td>
<td>59,087</td>
<td>0.64</td>
<td>101.7</td>
</tr>
<tr>
<td>Ukraine</td>
<td>9.2</td>
<td>36,837</td>
<td>0.46</td>
<td>75.2</td>
</tr>
<tr>
<td>Belarus</td>
<td>8.8</td>
<td>-</td>
<td>0.49</td>
<td>94.4</td>
</tr>
<tr>
<td>Central Europe and Central Asia region</td>
<td>8.62</td>
<td>43,805</td>
<td>0.46</td>
<td>69.53</td>
</tr>
<tr>
<td><strong>Lower-middle-income economies group</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>6.8</td>
<td>14,400</td>
<td>0.33</td>
<td>50.6</td>
</tr>
<tr>
<td>Italy</td>
<td>7.7</td>
<td>0</td>
<td>0.38</td>
<td>65.0</td>
</tr>
<tr>
<td>New Zealand</td>
<td>5.6</td>
<td>43,648</td>
<td>0.45</td>
<td>54.6</td>
</tr>
<tr>
<td>Romania</td>
<td>7.9</td>
<td>50,421</td>
<td>0.42</td>
<td>65.2</td>
</tr>
<tr>
<td>Turkey</td>
<td>4.9</td>
<td>0</td>
<td>0.27</td>
<td>39.4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>5.6</td>
<td>108,682</td>
<td>0.32</td>
<td>49.9</td>
</tr>
</tbody>
</table>

160. With the same economy group and region

### Table 21: VATprod and VATgcr for Armenia for the years 2007-2009

<table>
<thead>
<tr>
<th>Year</th>
<th>VATprod</th>
<th>VATgcr</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>0.33</td>
<td>43.32</td>
</tr>
<tr>
<td>2008</td>
<td>0.39</td>
<td>56</td>
</tr>
<tr>
<td>2009</td>
<td>0.42</td>
<td>56.4</td>
</tr>
</tbody>
</table>
The Rates for Main Taxes and Payments, as well as Periodicity for Submission of Reports and Making Payments

<table>
<thead>
<tr>
<th>Type of taxes and payments</th>
<th>Taxed object</th>
<th>Rate</th>
<th>Periodicity</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit tax</td>
<td>1. Residents The obtained taxed profit on the RA territory and outside its borders</td>
<td>20% 5% or 10%</td>
<td>Monthly - prepayment or minimum profit tax payment</td>
<td>Taxing of non-residents realizes tax agent by income payment source. 5% is applied for insurance reimbursement, and the incomes obtained from freight. 10% is applied for profit-shares, interest rates, royalties and other passive incomes.</td>
</tr>
<tr>
<td></td>
<td>2. Non-residents Taxed profit obtained from Armenian sources</td>
<td></td>
<td>Annual-VAT paysers submit profit tax return and non-VAT payers profit tax simplified return to the Tax Authorities</td>
<td></td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>The total value of the following operations implemented by VAT payers on the RA territory.</td>
<td>20% 16.67%</td>
<td>Monthly or quarterly</td>
<td>20% is applied to taxed circulation. VAT sum is determined to be 16.67%, total value is being reimbursed. The export of goods and the supply of services that is ancillary to the export of goods and zero-rated.</td>
</tr>
<tr>
<td></td>
<td>Product supply</td>
<td></td>
<td>On monthly or quarterly bases, submitted to Tax Authorities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service provision</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>&quot;Import for free circulation&quot; custom regime products' import</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Tax</td>
<td>Residents The obtained taxed profit on the RA territory and outside its borders</td>
<td>1.10% - taxed income till 80 thousand AMD 20% - taxed income in case of exceeding 80 thousand AMD 2.10% - taxed income till 960 thousand AMD 20% - taxed income in case of exceeding 960 thousand AMD</td>
<td>Employers - monthly SP quarterly prepayment or minimum income tax payment</td>
<td>According to income law, for each month of receiving income it is envisaged to implement individual reduction by 30000 thousand AMD. Other types of income, e.g. royalties, real estate fees, interests, are taxed at a 10% rate without considering the determined reductions.</td>
</tr>
<tr>
<td></td>
<td>Non-residents Taxed income obtained from Armenian sources</td>
<td></td>
<td>Employers on quarterly and SP on annual bases submit reports to Tax Authorities.</td>
<td></td>
</tr>
</tbody>
</table>

161. For those tax payers whose revenue exceeded 100 million AMD during the previous calendar year, a reporting period for implementing payments and presenting reports is considered to be a year.
162. The noted rates apply when calculating the income tax by a tax agent.
163. The noted rates are applied by tax agent when calculating income tax from non taxed income.
## THE COSTS OF TAX COMPLIANCE IN ARMENIA

<table>
<thead>
<tr>
<th><strong>Social Security Payment</strong></th>
<th><strong>Fixed payment</strong></th>
<th><strong>Property tax</strong></th>
<th><strong>Land tax</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Means directed to labor fee inflows (salary payment) by the employer and incomes equaled to the latter, 2. IEs annual gross incomes. 3.</td>
<td>17 types of activities are subject to taxation. For example, the organization of activities realized in food sector, hair-dressing salons, transportation, maintenance services, casinos, as well as auctions, slot machines, computer games, etc.</td>
<td>1. Buildings and facilities 2. Transportation means</td>
<td>1. Agricultural lands 2. Non Agricultural lands</td>
</tr>
<tr>
<td><strong>Fixed payment</strong></td>
<td><strong>Monthly</strong></td>
<td><strong>Quarterly</strong></td>
<td><strong>Quarterly</strong></td>
</tr>
<tr>
<td>A base for taxation is considered the product of baseline data and justifying indicators of specific type of activity expressed in monetary value.</td>
<td>Report on baseline data and justifying indicators is submitted to Tax Authorities on monthly, quarterly, biannual or annual bases depending on type of activity.</td>
<td>On quarterly basis submitted to the Local Authorities.</td>
<td>On Annual basis submitted to the Local Authorities</td>
</tr>
<tr>
<td><strong>Property tax</strong></td>
<td><strong>Employers - monthly or quarterly</strong></td>
<td><strong>Employers on monthly or quarterly and SP on annual basis submit reports to Tax Authorities.</strong></td>
<td><strong>Employers on monthly or quarterly and SP on annual basis submit reports to Tax Authorities.</strong></td>
</tr>
<tr>
<td><strong>Land tax</strong></td>
<td><strong>SP - payment of minimum social security payment of 5000 AMD each month and one more, clarifying, final payment.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Income below 20,000 AMD - 7,000 AMD, 2. Income from 20,000 - 100,000 - 7,000 AMD plus 15% 3. Income above 100,000 AMD - 19,000 AMD plus 5%</td>
<td>SP - payment of minimum social security payment of 5000 AMD each month and one more, clarifying, final payment.</td>
<td>While implementing activity exceptionally in the frames of the given law, no calculations of profit (income) tax and VAT are being presented.</td>
<td>While implementing activity exceptionally in the frames of the given law, no calculations of profit (income) tax and VAT are being presented.</td>
</tr>
</tbody>
</table>

### Social Security Payment
1. Means directed to labor fee inflows (salary payment) by the employer and incomes equaled to the latter, 2. IEs annual gross incomes. 3.

### Fixed payment
17 types of activities are subject to taxation. For example, the organization of activities realized in food sector, hair-dressing salons, transportation, maintenance services, casinos, as well as auctions, slot machines, computer games, etc.

### Property tax
1. Buildings and facilities 2. Transportation means

### Land tax
1. Agricultural lands 2. Non Agricultural lands
Survey Methodology

1. Overview of the Methodology

Tax compliance cost survey among Armenian enterprises and individual entrepreneurs conducted by following steps. More detailed explanation follows below.

| Preparatory stage |  
|-------------------|---
| Questionnaires design |  
| Sampling design |  

| Pilot questionnaires |  
|----------------------|---
| Data collection |  
| Field work |  
| Quality control (visual, logical) |  
| Data input |  

Checking databases and data cleaning
Data analysis

2. Target Population

The population under study for the tax compliance cost survey of Armenia covered all active officially registered legal enterprises and sole proprietors that met the following criteria.

- Active during the reference period, submitting tax reports and working during at least one quarter of calendar year 2009;
- Political parties, religious, professional associations, NGOs, state non-trade organizations and the like were excluded.

The population was stratified based on three key parameters:

| 1. Turnover (for enterprises) |  
|-------------------------------|---
| a. Less than 5000 AMD |  
| b. 5 000 001 - 29 999 999 AMD |  
| c. 30 000 000 - 58 350 000 AMD |  
| d. More than 58 350 001 AMD |  

| Turnover (for sole proprietors) |  
|---------------------------------|---
| less than 5 000 000 AMD |  
| More than 5 000 000 AMD |  

| 2. Sector of economic activity |  
|-------------------------------|---
| a. Production |  
| b. Trade |  
| c. Services |  
| d. Other |
3. Sample Construction

AMA developed a sample design according to suggestions and guidance of World Bank specialists. Sample size was 1000 active private businesses, which included 750 companies and 250 IEs. This was a quota sample. A somewhat lower variability was expected among IEs (because it was assumed they are more similar to each other than companies), and a higher variability for companies. We were focused more on companies (due to their higher tax contribution) than IEs. AMA made a multi-stage cluster sampling, stratifying proportionally by location, sector, and turnover. During the negotiation with the tax committee of RA, IFC specialists received and provided an AMA database, which consisted of around 4000 entities including enterprises and IEs. The provided database was multiplied four times from the sample size.

Sample structure for enterprises.

Proportional random sampling was done for companies.

<table>
<thead>
<tr>
<th>The structure by sector</th>
<th>Production</th>
<th>21.05</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Other</td>
<td>13.81</td>
</tr>
<tr>
<td></td>
<td>Services</td>
<td>44.48</td>
</tr>
<tr>
<td></td>
<td>Trade</td>
<td>20.65</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The structure by turnover</th>
<th>Up to 5 million</th>
<th>34.8</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5 - 29.99 million</td>
<td>32.8</td>
</tr>
<tr>
<td></td>
<td>30 - 58.35 million</td>
<td>10.9</td>
</tr>
<tr>
<td></td>
<td>More than 58.35 million</td>
<td>21.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The structure by region</th>
<th>North</th>
<th>14.5</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Central</td>
<td>21.4</td>
</tr>
<tr>
<td></td>
<td>South</td>
<td>6.0</td>
</tr>
<tr>
<td></td>
<td>Yerevan</td>
<td>56.3</td>
</tr>
<tr>
<td></td>
<td>Large taxpayers</td>
<td>1.8</td>
</tr>
</tbody>
</table>
The next step was to go back to the projected sample and identify potential sampling points (represented by tax offices). Any location with less than 10 respondents was considered cost ineffective, and this input was taken into consideration when deciding from which tax offices data would be required this. This was done through several steps:

- Within each region group (North, South, Central, and Yerevan) respondents were split into regions proportional to the number of businesses under each region.
- Within each region, respondents were split into tax offices (also proportionally) to which they "belonged."
- A check was done to see if some locations (tax offices) were inappropriate (meaning less than 10 respondents) - these locations were dropped from the sampling point list, and not replaced.
- After identifying tax offices, a split was done by sector and size.

The structure for individual entrepreneurs.

The situation is different for IE’s. Trade represents about 60 percent of their population, which indicates that the final sample structure needs to be adjusted to secure sufficient representation of other sectors. The structure is as follows:

<table>
<thead>
<tr>
<th>First figures</th>
<th>Quantity</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>9.50</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>3.63</td>
<td></td>
</tr>
<tr>
<td>Service</td>
<td>26.95</td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td>59.91</td>
<td></td>
</tr>
</tbody>
</table>

The trade proportion would be truncated at 40 percent and boosters added proportionally to other sectors. Adjusted sampling structure was as follows:

<table>
<thead>
<tr>
<th>Final figures</th>
<th>Quantity</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>24.00</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>9.20</td>
<td></td>
</tr>
<tr>
<td>Service</td>
<td>26.40</td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td>40.40</td>
<td></td>
</tr>
</tbody>
</table>

After the table was designed it became clear that the two largest turnover groups contained negligible numbers of potential respondents. So, for sampling reasons, turnover was re-organized into only two groups: above and below 5 million. Since it is reasonable to assume that there will be combined field work for both enterprises and IE’s, the same regions and tax offices were left in the selection.

Finally, the samples were:
The sample for enterprises; their number is 750.

<table>
<thead>
<tr>
<th>Region group</th>
<th>Regions</th>
<th>Tax office as a population for random selection</th>
<th>Turnover</th>
<th>Sector</th>
<th>Nopr&lt;sup&gt;164&lt;/sup&gt;</th>
<th>Noecn&lt;sup&gt;165&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>Shirak, Lori, Tavush</td>
<td>Gyumri, Venadzor, Spitak, Ijevan, Berd, Dilijan</td>
<td>&lt; 5 Production</td>
<td>9</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Other</td>
<td>7</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Services</td>
<td>18</td>
<td>72</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Trade</td>
<td>7</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Production</td>
<td>8</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Other</td>
<td>6</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Services</td>
<td>19</td>
<td>76</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Trade</td>
<td>4</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Production</td>
<td>3</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Other</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Services</td>
<td>8</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Trade</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Production</td>
<td>6</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Other</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Services</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Trade</td>
<td>3</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Central</td>
<td>Aragatzotn, Ararat, Armavir, Gegharkunik, Kotayk</td>
<td>Ashtarak, Masis, Armavir, Echmiadzin, Sevan, Abovyan</td>
<td>&lt; 5 Production</td>
<td>15</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Other</td>
<td>9</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Services</td>
<td>22</td>
<td>88</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Trade</td>
<td>10</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Production</td>
<td>14</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Other</td>
<td>10</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Services</td>
<td>23</td>
<td>92</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Trade</td>
<td>8</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Production</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Other</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Services</td>
<td>6</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Trade</td>
<td>3</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Production</td>
<td>13</td>
<td>52</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Other</td>
<td>4</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Services</td>
<td>8</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35 Trade</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>South</td>
<td>Syunik, Vayoth Dzor</td>
<td>Kapan, Eghegenadzor, Vayq, Jermuk</td>
<td>&lt; 5 Production</td>
<td>4</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Other</td>
<td>3</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Services</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>&lt; 5 Trade</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Production</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Other</td>
<td>4</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Services</td>
<td>5</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 - 29.99 Trade</td>
<td>3</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Production</td>
<td>1</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Other</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30 - 58.35 Services</td>
<td>1</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

164. Number of potential respondents.
165. Number of enterprise contact needed.
At the beginning, the number of enterprises in LTU was 13 (6 in production sector, 4 in service sector and 3 in trade sector). But as this group represents more than half of the total turnover in Armenia (according to World Bank specialists), their number was increased three times to increase their representation. Accordingly, the sample size for LTU was increased to 39 questionnaires - 18 questionnaires in production, 12 in services and 9 in trade). Necessary adjustments of sample size were made by reducing 26 questionnaires proportionally from Yerevan, as the sample in Yerevan is larger and companies under LTU are mostly located there. Reductions were made according to the table below.

<table>
<thead>
<tr>
<th>South</th>
<th>Syunik, Vayoth Dzor</th>
<th>Kapan, Eghenadzor, Vayq, Jermuk</th>
<th>LTU</th>
<th>LTU</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>&gt; 58.35</td>
<td>&gt; 58.35</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Production</td>
<td>Production</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6</td>
<td>6</td>
</tr>
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The sample of individual entrepreneurs is 250.

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<tr>
<th>Region group</th>
<th>Regions</th>
<th>Tax office as a population for random selection</th>
<th>Turnover</th>
<th>Sector</th>
<th>Nopt&lt;sup&gt;166&lt;/sup&gt;</th>
<th>Noecn&lt;sup&gt;167&lt;/sup&gt;</th>
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<td>Production</td>
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<td>Central</td>
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<td>Ashtarak, Masis, Armavir, Echmiadzin, Sevan, Kotayk</td>
<td>&lt; 5</td>
<td>Production</td>
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<td>&gt; 5</td>
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166. Number of potential respondents.
167. Number of sole proprietors contact needed.
4. Data Collection

Survey field work was conducted by the AMA. IFC closely monitored all stages of the survey.

Data Collection Method

Survey data were collected through face-to-face interviews with the most knowledgeable person regarding the general accounting and Tax compliance work at enterprises.

The average duration of the interview was 30 minutes with individual entrepreneurs and 40 minutes with enterprises. Interviews were conducted by a team of 20 interviewers all over Armenia. Field supervisors oversaw their work.

The field supervisors did the following:

- Each field supervisor supervised 5-6 interviewers.
- Every evening, field supervisors met with interviewers to review their day and go over the following day’s schedule.
- Field supervisors provided interviewers contacts, submitted by the recruit supervisor, describing location, transportation, etc.
- Supervisors provided questionnaires, pens, and letters of support to interviewers. Letters of support were given to respondents.
- Before each interview, supervisors called respondents to confirm interview and appointment
- After receiving completed questionnaires, field supervisors added page number zero to all questionnaires to perform quality control. Page zero included information presented from the tax committee, as well as the business’s activities, turnover, region, and contacts. This information was not made available to the respondents.
Timeframe

The survey was conducted from February-August, 2010. The reference period of all questions was the calendar year 2009. Field work was conducted between May and July 2010 and included two pilot phases (of 41 and 12 interviews, respectively) that improved the questionnaire (mainly questions regarding time spent on various tax compliance procedures).

Pilot phase.

Briefing of Interviewers and Supervisors

The first briefing was held on 22.02.2010 and continued for 7 hours. Nearly 30 interviewers, 5 supervisors and sociologists from AMA took part in the briefing. The briefing was held by World Bank group and IFC members. They described each question of the questionnaire, received feedback from the interviewers and supervisors, and answered their questions. During the briefing, all members found some problems connected with numeration, or incorrect translations from English into Armenian. These incorrect translations in some cases changed the meaning of questions to the extent that interviewers couldn’t understand them. Towards the end of the briefing, an IFC official described some of the main categories from the questionnaire, especially the differences between general accounting and tax compliance work. After the first briefing, IFC members changed the questionnaire according to concerns and comments brought forth during the briefing.

Pilot Survey

The main objectives of the pre-test were test questionnaires (2 versions for enterprises, 1 for IE’s) and an evaluation of interviewers’ and supervisors’ work.

Interviewers from AMA performed 41 interviews in 4 days (23.02.2010-26.02.2010):

- b. 19 interviews with enterprises with first version of questionnaire
- c. 12 interviews with enterprises with second version of questionnaire
- d. 10 interviews with IE’s

All interviews were conducted with supervisors or the IFC/World Bank group specialists. At first AMA was informed that respondents could be either directors or accountants. During the pilot survey we learned that, especially in larger firms, accountants were better placed to answer our questions. Once the AMA recruiters had the questionnaires they could better explain the focus of the survey and as a result had more successful appointments.

After each interview, supervisors walked interviewers through their mistakes - but did not alter the completed questionnaires. All questionnaires were received by the World Bank specialist for examination.

Briefing after Pilot Survey

After pilot interviews, the second briefing was held on 27.10.2010, for which AMA’s specialists selected only the best 22 interviewers. During that meeting, all interviewers, supervisors, AMA staff members and IFC/World Bank group specialists discussed their problems and con-
cerns. During the first couple hours the interviewers asked questions of the World Bank specialist, shared their experiences from the pilot interviews and described their main problems. The World Bank specialist explained to the interviewers the mistakes they had made and offered suggestions to improve their performance. Finally, the IFC member went over some parts of the questionnaire in detail, particularly those related to taxes, to better prepare the interviewers for their field work.

**Control procedures**

Supervisors exercised constant quality control over completed questionnaires, in particular:

1. Supervision and checking of completed questionnaires: follow up on missing information, mistakes or contradictions; ensure questionnaires completed in accordance with the instructions i.e. filters/skips are done correctly, open-ended questions are filled in correctly, percentage of "no response" and "do not know" is not too large (maximum 1.5%).

2. Supervision and checking of sample procedures’ implementation by interviewers (checking of routing cards).

3. Calling respondents and requesting confirmation of any vague or suspicious answers.

4. Calling some respondents (approximately 20%) to confirm that interviewers actually conducted the interviews and asked all questions, and recording confirmation phone call.

5. Going with interviewer to the interview once or twice a week to review their work on site.

6. Passing completed questionnaires to the data input specialist.

**Recruitment plan**

Taking into consideration the importance of the program and difficulties of recruiting respondents, AMA involved many professional recruiters - 5 recruiters for enterprises, 2 for IE’s, and a supervisor. Recruiters worked toward a target number of respondent firms, using a database that often lacked company contact numbers. Recruiters found contacts:

- From the yellow pages
- From AMA’s own database
- From regional business centers and chambers of commerce
- From local Governmental institutions

During the survey, AMA prepared a report regarding individual entrepreneurs. In addition, IFC staffers found and passed on to AMA several key contacts from the Tax Committee.

**Description of working plan**

AMA divided work into several regions (North, Center, South, and Yerevan), and kept LTU as a unique group during field work.
At first, AMA started from enterprises in Yerevan. But after the first week AMA set up very few appointments and interviews. But in the following weeks several problems were solved and the work went more smoothly. In the end we had the following recruitment results:

**Response rate** (percent of productive interviews among all companies with whom AMA attempted to establish contact) - 12%

**Cooperation rate** (percent of productive interviews from all companies contacted) - 25%

**Contact rate** (percent of companies AMA successfully contacted) - 51%

**Recruit weekly report.**
On Friday evenings, AMA received a recruitment report from the recruitment supervisor and an interviews report from the field supervisors to help prepare a weekly report for IFC and World Bank specialists. Every Monday AMA sent a weekly recruit report to IFC and World Bank. The report included:

- The number of contacts recruited
- The number of appointments set up
- The number of unachievable contacts and their causes
- The number of effective interviews
- The number of ineffective interviews and their causes
- Percentage of working plan achieved

**The functions of recruit supervisor and recruiters**
Recruit supervisors:

- Prepared the recruitment report form, under the guidance of AMA’s survey and field supervisors. During recruitment, recruiters mentioned all the necessary information about companies, such as:
  - Region
  - Activity
  - Turnover
  - Address (description of address)
  - Name of respondents, their position
  - Day of interview
  - Any reasons for refusal
  - Reasons for unachievable contacts

- Gave necessary contacts of enterprises to recruiters. The supervisor cut part of contacts from provided database according to the working plan and gave it to recruiters. The database of enterprises had 100 percent of contact phone numbers. If any were incorrect the recruiter gave this contact to the recruit supervisor to search for the correct info:
The recruiters:

- Made calls using databases
- Described goals of survey, sought out and contacted the most well-informed employee regarding taxes, most likely an accountant or head of enterprise.
- Made appointment with this official and received directions to the business
- Tried again to contact the enterprises that were unresponsive during the first round of calls - recruiters called contacts until they received either an appointment or a reasonable refusal. If respondent refused, recruiter tried after a few days or a week. If database contact info was incorrect, the recruit supervisor attempted to find the correct contact information using above-mentioned sources.

5. Data Integrity Verification

Data Input

Coding and data input during all field work was done by a data input specialist. Open-ended questions of the questionnaire were coded starting from the 4th day of interviews. The specialist performed coding information for data input. Parallel with the interview, responses were entered into the Excel program, and data was entered with suitable quality control.

Database check and cleaning. After the input of all questionnaires, the entire database was cleaned. As this area is crucial, 100 percent of all databases were double checked by AMA’s specialists. The cleaned databases were also passed on to the World Bank Group specialists and double-checked and cleaned again according to their specifications.

6. Data Analysis

The "segmented" generalization approach was used to estimate time and cost expenditures incurred by the whole target population. The procedure was performed in several stages:

- Weight the sample;
Excluding outliers;
Split the sample into homogeneous segments;
Calculate averages within each segment and run an imputation procedure for missing data;
Data within segments;
Make final adjustments;
Results and generalization.
WEIGHT THE DATABASES

Before data analysis, AMA specialists weighted the samples to get representative information. AMA weighted those categories that had automatically increased or reduced by regions, turnover and sector for enterprises, and by sectors for IEs. The following tables show how the weight coefficients were achieved:

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<thead>
<tr>
<th>Region</th>
<th>Turnover</th>
<th>Sector</th>
<th>n, factual (LTU increased)</th>
<th>n, factual, %</th>
<th>N, %</th>
<th>Weight coefficients (N_{168}/n_{169})</th>
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<td>1.2</td>
<td>1.3</td>
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168. Universe.
169. Sample.
### THE COSTS OF TAX COMPLIANCE IN ARMENIA

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| Total             | 750      | 100      | 100      |
Reduce Outliers

After weighting the databases, AMA’s specialists reduced outliers from the database through the SPSS program function. Those outliers were unique for all databases and could alter the calculations and result in inaccuracies. The outliers were reduced this way: in SPSS, in the window Analyze-Descriptive Statistics-Explore, questions were added regarding where outliers (connected with time, cost, and number) might be. Then the program showed the extreme values for that question (5 highest and 5 lowest) and graphics revealed the number of observations of these extreme values. These outliers were checked and if in database entry the values were correct, they were reduced.

Imputation Procedures

For several questions, missing values were input with mean values calculated within this segment according to average group turnover. Those procedures were done especially for questions about turnover, average official gross salary, the cost of outsourcing and time spent on tax accounting and filling forms.

Data calculation procedures

Sample Segmentation

In order to calculate the received information, disaggregation parameters were selected. The list of parameters for enterprises is below:

- Turnover (5 groups);
- Turnover (4 group);
- Sector
- Region
- Number of employees
- Type of person who does accounting
- Number of accountants
- Type of accountant (certified and non-certified)
- Type of employment of accountants (full time vs. part time)
- Computerization of accounting
- Type of tax regime (Profit tax payers, Fixed tax payers, Profit+Fixed tax payers)
- Type of tax regime (Profit tax payers, Fixed tax payers, Profit+Fixed tax payers) (from 5 to 58.35 million AMD)
- VAT payers and Non-VAT payers among companies with turnover from 5 to 58.35 million AMD

The parameters for **sole proprietors** are below:

1. Turnover (3 groups)
2. Turnover (4 groups)
3. Sector
4. Region
5. Number of employees (including IE)
6. Type of person who does accounting
7. Type of accountant (certified, non-certified)
8. Type of tax regime (Personal income tax payers, Fixed tax payers, Personal income + Fixed tax payers)
9. VAT and Non-VAT payers

We made a table with these parameters as a header and calculated all the questions from questionnaires (whenever possible). For questions about time and cost (except the number of observation and Valid N%), we also calculated mean, median, mode, and standard deviation. For other questions (with multiple choice answers) we calculated numbers of observation and valid n%.

It’s important to mention that turnover groups for analysis developed according to respondents’ answers about official turnover. This information often failed to match information received from the Tax Committee of RA, as the data of the Committee covered three quarters, rather than the entire fiscal year. AMA’s specialists used the turnover cited by respondents to get more complete information for each turnover group.

For the different turnover groups, AMA determined the average costs for one enterprise and sole proprietor. To get information for all of Armenia, AMA’s specialists extrapolated these results.

To calculate totals for tax compliance cost and time, some formulas were created for the aggregates mentioned below. All aggregates were calculated according to the selected disaggregation parameters.

Finally, the total cost of tax compliance for all enterprises in Armenia by different parameters (accounting and filling, submitting reports, VAT refunds, and inspections, studying tax legislation and other additional costs and time) was calculated. That information was calculated for enterprises by their turnover (two selected turnover groups).
4. Conclusions

This section summarizes the key challenges faced during the implementation of the survey and data analysis, and offers possible solutions to the problems that arose during the field work:

🤔 Sometimes respondents failed to understand the meaning of our questions, especially during IE interviews. In such cases, our interviewers tried to be very careful, read the question several times and provided explanation if needed.

🤔 Respondents had difficulties trying to separate and define the amounts of time spent on different compliance procedures. To solve this problem AMA’s interviewers tried to explain clearly the tasks involved and the meaning of the different types of compliance work and let the respondents think about it.

🤔 During interviews, AMA’s interviewers and supervisors noticed that respondents sometimes answered the questions about time on Tax Compliance work very quickly. Rather than thinking about it and coming up with an accurate response, they might quickly say that they "waste huge amounts of time on it." A possible reason for such responses is that Armenia’s Tax System is complicated and they had many difficulties during their work. To solve this issue, AMA’s interviewers repeated questions again and were specific about the sort of responses they sought.

During the data analysis we had the following issues:

🤔 Outliers - as this problem could change the picture of the survey, AMA’s specialists, under the guidance of World Bank group specialists, removed them from the databases.

🤔 Non-response answers - to avoid any loss of information on the most important issues connected with tax compliance costs, AMA input the mean values of the appropriate turnover group whenever a business was unable to provide a useful response.