PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA62327

Project Name	Tax Administration Modernization Project (P127734)
Region	EUROPE AND CENTRAL ASIA
Country	Moldova
Sector(s)	General public administration sector (100%)
Theme(s)	Tax policy and administration (90%), Public expenditure, financial management and procurement (10%)
Lending Instrument	Investment Project Financing
Project ID	P127734
Borrower(s)	Republic of Moldova
Implementing Agency	Main State Tax Inspectorate
Environmental Category	C-Not Required
Date PID Prepared/Updated	16-Apr-2016
Date PID Approved/Disclosed	16-Apr-2016
Estimated Date of Appraisal Completion	22-Apr-2016
Estimated Date of Board Approval	25-May-2016
Appraisal Review Decision (from Decision Note)	_

I. Project Context

Country Context

Moldova is a low income country still coping with the challenges of political and market transitions. Since independence in 1991, Moldova has established a parliamentary regime and the formal institutions of a market economy. After a period of relative stability and significant progress in its reform efforts, Moldovan politics has re-entered a phase of instability, manifesting itself as frequent changes of governing coalitions. There have been seven substantive or acting prime ministers and three periods without a Government between September 2014 and January 2016, the most recent sworn in on January 20, 2016. Notwithstanding this political instability, Moldova’s formal integration with the European Union (EU) has continued. Moldova and the EU signed an Association Agreement (AA) and a Deep and Comprehensive Free Trade Area (DCFTA) agreement in June 2014. The DCFTA provides for mutual elimination of customs duties for industrial and most agricultural products, further liberalization of the services market, addressing other barriers to trade. The AA also provides a framework for critical cross-cutting area reforms in governance, public administration, independence of the judiciary and rule of law. Visa-free access for Moldovan citizens travelling to the Schengen area came into effect in April 2014.

Moldova’s economy is still recovering from the global recession. After 2009 tax policy and administration reforms, combined with expenditure rationalization, brought the fiscal deficit close to a sustainable level, promoting private sector growth, while enhancing priority social and capital spending. Real gross domestic product (GDP) grew by 7.1 percent in 2010 and 6.8 percent in 2011. However, in 2012, GDP contracted by 0.7 percent, as the economy was hit by both a slowdown in external demand due to the Eurozone crisis and a drought-induced contraction in agriculture. In 2013, growth rebounded, driven by a record harvest in agriculture, with GDP increasing by 9.4 percent. Growth declined to 4.6 percent in 2014. Recessions in the Russian Federation and Ukraine, together with restrictions on agro-food imports from Moldova and another severe drought, are expected to contribute to a 2 percent decline in GDP in 2015.

Sectoral and institutional Context

In recent years Moldova has made substantial progress with respect to the time to comply with tax requirements. According to the 2016 Doing Business report, in Moldova it takes 185 hours to prepare, file and pay taxes (about 21 payments per year) compared with, on average, 234.3 hours in the Europe and Central Asia region (20.5 payments per year) and 175.4 hours in OECD (11.8 payments per year). This declining trend in compliance transaction costs has been brought about by the introduction of the “e-declaration” system, online payment for some taxes, and the reduction in the number of declarations.

Tax revenue collections have shown a less positive trend. Revenue collections as a share of GDP have declined three years in a row, reaching a five-year low in 2014 at 30.2 percent of GDP. Poor performance is in large part a consequence of structural and capacity constraints in tax administration.

The State Tax Inspectorate (STI) has a fragmented structure with 35 local offices and a large taxpayer office (LTO) each having separate legal status. While the Head of the local office is appointed by the STI Chairman, all other staff recruitment and human resources issues are managed at the local level. This is an unusual structure for Moldova, where most other public organizations, including the Customs Service, have centralized human resource management functions. Decentralized human resource management severely limits selection of the available talent and the efficient allocation of staff in line with business needs. A gap analysis of management systems conducted by the Internal Control Directorate identified a lack of process descriptions, criteria for performance assessments to measure the efficiency of various tax functions, inadequate human and financial resources and risks in key business processes. The tax administration is insufficiently focused on areas of highest yield, paying far too much attention to small taxpayers, with a large number of ad hoc audits and a focus on minor compliance matters. The lack of mobility of staff, the lack of transparency in procedures and weak oversight of local operations leads to a weak governance environment.

Compliance management remains an issue despite existence of risk management elements in administering taxes. STI has a relatively well-functioning Large Taxpayers’ Office (LTO) that services and audits about 450 large taxpayers. This number is determined by capacity constraints rather than the formal criteria for determining large taxpayers (sales over MDL 50 million and taxes of over MDL 2 million). The LTO accounts for about 38% percent of tax revenues, which is low by international standards. The LTO recently introduced risk profiling for the selection of comprehensive audits and arrear collection. As a result the number of audits went down from 971 in

2012 to 543 in 2014, while collections from audits increased from 39 to 46 MDL million. However, information matching (other than VAT purchase to sales) continues to be manual due to fragmented information systems. The arm's length principle was introduced in Moldova in 1998 to address the transfer pricing issues but the transfer pricing regime is basic and lacks a number of critical elements. Transfer pricing methods, for instance, are not specified and place the tax administration lacks the information required for the effective administration of the transfer pricing regime. Auditors have limited skills in complex tax issues such as financial sector operations, hard-to-tax groups, transfer pricing and illicit financial flows.

Taxpayer services are complicated by lack of transparency and clarity on rules and procedures. Taxpayers see the tax administration as inefficient and corrupt. 46 percent of business and 40 percent of household respondents to a 2015 Transparency International survey reported that informal payments are frequently needed to solve problems with tax inspectorates and estimated the total amount of bribes paid to the tax inspectorate by businesses in 2012 at 32.4 million lei ($2.54m). Stakeholders from the business community, interviewed as a part of project identification, complained of lack of transparency on tax issues, lack of clear guidance on tax policy and procedures, lack of clarity on rules and procedures for audits and appeals, and limited access to information on the appeals process as key issues contributing to increased governance risks in the tax administration in Moldova.

Investment in staff training - a critical element in a modern tax administration - is limited. The HR Directorate is responsible for developing the annual training plan where inputs from local offices on training needs are considered. However, training is conducted on an ad hoc basis, restricted to one day events, with informal peer-to-peer learning for new recruits. STI does not have a learning needs assessment or strategic approach to curriculum development. Access of staff outside of headquarters to learning is limited by lack of distance learning opportunities. Development of facilities for distance learning and e-learning with refresher courses and mid-career programs on advances in various tax functions would help develop the capacity of staff outside the capital.

STI’s Information Technology (IT) applications suffer from significant deficiencies that affect their ability to offer modern tax services to taxpayers. IT applications that are aging, end-of-life products still form the backbone of some current applications. This prevents sharing of information between applications, makes it difficult to form an integrated view of taxpayer data and identify risks. Development of new systems and maintenance of the existing systems is the responsibility of the STI’s subsidiary, FiscServInform (FSI), which reports to the STI via a management board. To improve its access to and quality of information used, the STI has established a new Monitoring and IT Development Division that would coordinate with the FSI. However, the new division is not yet staffed. An assessment by the Bank team reinforces observations made by other development partners (such as the IMF), that the current system is approaching its breaking point and cannot be modified to support a modern tax system. The STI has proposed procurement of an off-the-shelf web-based integrated tax management system (ITMS) with embedded best practices providing services to all core tax functions within the STI. This includes risk and case management.

The Government of Moldova seeks to fundamentally restructure and modernize the tax administration. Draft legislation (Law on the State Tax Service) provides a legal framework for the organization and functioning of the new STS with its main purpose being “…creating conditions for the taxpayers favoring voluntary compliance with the provisions of the law and uniform application of regulatory policies in taxation”. Implementation of centralized and unified structure is critical to further strengthen tax administration. The Government plans to reorganize the tax administration into a single legal entity, with a central headquarter and 3-5 regional offices. The local offices will then be subordinated to the regional offices and the regional offices to the headquarters. Most of the core revenue functions (such as audit, collection, appeals) will be performed by the regional offices, while the local offices will provide taxpayer services such as registration and taxpayer identification. Implementation of these reforms will require significant changes in operating procedures, reallocation of staff and investments in information technology and capacity building.

II. Proposed Development Objectives

To improve revenue collection, tax compliance and taxpayer services

III. Project Description

Component Name

Tax policy reform

Comments (optional)

This component will finance technical assistance for capacity development on tax policy reform including tax systems and ensuring compliance of the Moldova tax system with the EU-Moldova Association Agreement; support the Ministry of Finance by providing recommendation on implementation of the tax legislation; and the development and implementation of the transfer pricing controls in line with international standards. The component will also support capacity building for revenue forecasting, tax expenditure analysis and tax rulings.

Component Name

Institutional development

Comments (optional)

This component will support changes to STIs organizational structure. It will finance: a comprehensive review and redesign of the organizational structure at headquarters, regional, and local offices based on the STI restructuring plan; implementation of the reorganization based on the restructuring plan; strengthening of capacity for strategic management and performance assessment within the STI; a comprehensive review of HR policies; and development of revised work flow analysis, workforce planning and strategy. In addition, the component will finance: development of a training strategy and curriculum for tax administration staff; purchase of technical and training equipment for the training center and distance learning system; and building capacity of STI through study tours, managerial

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Component Name

Operational development

Comments (optional)

Compliance management based on self-assessment and risk management is the cornerstone of an efficient tax administration. The component will finance: technical assistance on strengthening the capacity of the Large Taxpayers Office, in particular on profiling of entities to be serviced by LTO; improved compliance risk management and audit practices; and required organizational changes, and capacity building through audit training. The component will also enhance STI capacity for enforced collection and appeals handling. It will support analysis of case-workflow management for appeals, audits and collection.

Component Name

IT Infrastructure and system modernization

Comments (optional)

This component will acquire and implement an Integrated Tax Management System that will unify IT support for all business functions including: user role management and security, transaction audit trails and logging, taxpayer registration, returns processing, accounting, payment processing, collections and enforcement, objections and appeals, audit, risk assessment, management reporting, case work flow, data warehouse and business intelligence tools, a document management system and a portal interface. The new system will provide for electronic interaction with the taxpayers and enable further taxpayer self-service through the web portal. It will be supported by an integrated data management system, include all required hardware, network improvements, and software to support the ITMS and d

Component Name

Project management and change management

Comments (optional)

Funds under this component will be used to support the functioning of the Project Implementation Unit within the MSTI, which will carry out day-to-day project management and help the MSTI coordinate project activities and interact with all local and international entities involved in the project as well as facilitating engagement of a private sector advisory panel. The component will finance: national and international consultants to support procurement, financial management and technical implementation; international advisors for IT project management, training and change management; and operating costs associated with the implementation of the Project. In addition, the subcomponent will finance audit and operational expenses.

IV. Financing *(in USD Million)*

Total Project Cost:	20.00	Total Bank Financing:	20.00
Financing Gap:	0.00		

For Loans/Credits/Others	**Amount**
BORROWER/RECIPIENT	0.00
International Bank for Reconstruction and Development	12.58
International Development Association (IDA)	7.42
Total	20.00

V. Implementation

The Moldova State Tax Inspectorate will be the implementing agency for the project. Implementation arrangements are designed to ensure cross-departmental coordination internally within the MSTI and externally with the MoF and other stakeholders covering high level policy and strategic management among major stakeholders, external coordination and accountability, project management functions, and the management of specific project activities.

A Project Steering Committee was established to make key strategic decisions, ensure inter-agency coordination, and provide overall project monitoring. The Committee comprises high level representatives of the key government stakeholders, including MoF, MSTI (Project Director, Heads of STI departments, Head of I.I. “FiscServInform”), State Chancellery (e-Gov) and chaired by the Head of MSTI. The Committee will provide strategic guidance to the MSTI on issues related to project implementation and overall revenue administration modernization reforms and will ensure inter-agency coordination. The resolution establishing the Committee was approved in February

2016.

The STI Deputy Chief will serve as Project Coordinator. The Project Coordinator will oversee daily project implementation, monitor progress and ensure timely completion of the project activities. The Project Coordinator will act as focal point for communication with the World Bank team on project related issues. The Project Coordinator will be supported by a Project Manager. The Project Manager will assist the STI with project preparation, including preparation of procurement documents to ensure timely launch of the TAMP and assist the STI in development of necessary project management skills and technical support capabilities. The Project Manager will head a Project Management Unit (PMU). The PMU will help STI undertake procurement, financial management, contract management, monitoring and evaluation, and reporting functions under the project. The PMU will be staffed by a team of consultants in procurement and financial management. This would also allow mitigating capacity risks of the project. The project will be implemented based on a Project Operational Manual which will be adopted by the STI before project effectiveness and is an effectiveness condition.

As one element of the change management activities of Component 5, the PMU will facilitate citizen engagement by MSTI steering committee members through creation of a private sector advisory panel to seek feedback of taxpayers on tax administration issues.

The outputs generated during the project period – changes to the tax policy and administration framework, procedures, business processes and capacity building – are permanent system improvements. The change management strategies supported by the project, including communications, consultations and stakeholder workshops, are expected to deepen ownership of the reforms within and across institutions. Broad-based training in technical and soft skills will generate benefits for civil servants and reduce sustainability risks from staff turnover. Reforms are also expected to generate tangible benefits in terms of improvements in the efficiency of tax administration, lower compliance costs, and higher tax revenues, which should help build a broader constituency in support of reforms.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01		✗
Natural Habitats OP/BP 4.04		✗
Forests OP/BP 4.36		✗
Pest Management OP 4.09		✗
Physical Cultural Resources OP/BP 4.11		✗
Indigenous Peoples OP/BP 4.10		✗
Involuntary Resettlement OP/BP 4.12		✗
Safety of Dams OP/BP 4.37		✗
Projects on International Waterways OP/BP 7.50		✗
Projects in Disputed Areas OP/BP 7.60		✗

Comments (optional)

VII. Contact point

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