PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC6807

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	29-May-2014
Date PID Approved/ Disclosed	29-May-2014
Estimated Date of Appraisal Completion	02-Mar-2015
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Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Moldova is a lower middle income country still coping with the challenges of political and market transitions. Since independence, Moldova has established a parliamentary regime, established formal institutions of a market economy, and has made significant improvements towards macroeconomic stability. Since early 2010 the Government has been implementing a program to address macroeconomic vulnerabilities including reforms to restore fiscal sustainability; flexible monetary and exchange rate policies to keep inflation under control and to rebuild foreign reserves; and policies to ensure financial stability, though there remain challenges in this area. The next Parliamentary elections are scheduled for end-November 2014.

Moldova's economy has recovered from the recession in 2009. A strong reform program following the global recession in 2009 has largely restored macroeconomic stability and considerably improved macroeconomic performance in Moldova. Tax policy and administration reforms, combined with expenditure rationalization, have 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. Growth resumed in 2013 driven by agriculture as well as private consumption boosted by wage growth and remittances, with GDP increasing by 8.9 percent in 2013.

While Moldova has made progress in building institutions, the capacity of public institutions remains weak. In recent years progress has been made in strategic planning, policy co-ordination and mechanisms to establish a professional and merit-based civil service. This has created a good foundation for more effective and efficient government. However, public sector performance is still weak. In 2013, Moldova's lowest Country Policy and Institutional Assessment (CPIA) score (3) is for the quality of public administration. Moldova ranks 78th in the world in the "Doing Business" 2014 with weakest scores on dealing with construction permits (174th), trading across borders (150th), and paying taxes (95th). It ranked 89th out of 148 economies on the 2013-14 Global Competitiveness Index, lagging behind most of its neighbors and countries in the Commonwealth of Independent States (CIS).

Sectoral and Institutional Context

The Government of Moldova has undertaken important reforms to strengthen the tax administration. Moldova has a reasonably coherent tax system. The basics of direct and indirect taxation are compatible with European Union (EU) norms. The overall levels of taxation in Moldova (at 21 percent of GDP in 2012, excluding social contributions) compare well with countries in the region with similar level of Gross National Income (GNI) (such as Armenia which is at 20 percent and the Kyrgyz Republic at 24 percent). The Government has reduced contact between taxpayers and tax officials and improved voluntary compliance. A unique taxpayer identification number (TIN) has been adopted. Risk analysis methods for audit selection and e-filing have been initiated. Since January 2013, e-filing has become mandatory for all Value Added Tax (VAT) returns throughout the country. Low risk exporters are allowed to go through fast track VAT refund procedures, which accounts for about 60 percent of VAT refunds by value. Efforts are being made to improve automation of VAT refunds.

The State Tax Inspectorate (STI) is also undertaking several tax administration reform initiatives with the assistance of development partners. Ongoing assistance is provided by the International Monetary Fund (IMF), the European Commission (EC), the U.S. Agency for International Development (USAID), Netherlands, and Swedish Development Cooperation Agency (Sida). The EC has financed a feasibility study on restructuring the STI which outlines various options for a unified tax administration. The study is being discussed internally in the Ministry of Finance (MoF). The EC has recently signed an agreement to provide assistance to the Customs Service for Single Window and Integrated Border Management. The MoF has also requested the IMF to provide support on revising the tax code. The Business Regulatory, Investment, and Trade Environment (BRITE) Project supported by USAID, focuses on development of software for the taxpayers' current accounts, developing and implementing a communication strategy to improve the image of the tax administration, and streamlining procedures such as tax payments, collections, monitoring and employee development. A newly launched twinning project between the Swedish Tax Authority and the STI, supported by Sida, aims at improving the tax audit system and taxpayer services and the on-going Dutch assistance focuses on training for tax and customs authorities.

The establishment of the Strategic Management Directorate (SMD) within the STI headquarters is an important step towards coordinating and monitoring all reforms envisaged in the strategic plan for 2011-15. Based on the strategic plan, the SMD develops an annual plan for the STI in order to implement the reform strategy. The SMD also has a Communications Unit that provides information and outreach to internal and external stakeholders. The SMD lacks a system that would monitor and coordinate local and institutional level performance in an automated manner. Each local office provides 40 different reports which they send manually. While improvements in strategic management are needed, the establishment of the SMD has helped focus priorities for reform.

Notable weaknesses still remain in the organizational structure, human resources, operational effectiveness and information systems. The STI has a fragmented structure with 35 local offices and a large taxpayer office (LTO) each having separate legal status. As a result, all staff recruitment (except for the Head of the local office, who is appointed by the STI Chairman), and other Human Resources (HR) issues are managed at the local level. In contrast, most other public organizations in Moldova, including the Customs Service, have centralized recruitment. Decentralized recruitment at the STI severely limits selection of the best available talent and the efficient allocation of resources according to business needs and risk management principles. The Government is planning to move towards a unified tax administration as 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. This exercise will require a functional review and work flow analysis for reclassification of tasks and efficient reallocation of staff.

Human resources (HR) are the most important asset of the STI, yet investment in staff training is limited. Training of staff, a critical element in a modern tax administration, is rudimentary and training facilities are inadequate. Training is conducted on an ad hoc basis with informal peer-to-peer learning for new recruits. The HR Directorate is responsible for developing the annual training plan where inputs from local offices on training needs are considered. However, in the absence of adequate in-house training facilities, courses are organized by calling for tenders where providers and training rooms are selected for specific issues. As a result, most training programs are restricted to one day events. The STI would benefit from a well-equipped in-house training facility with an adequate complement of trainers and training materials. This will be useful for new recruits and existing staff. Facilities of distance learning and e-learning will also be useful for local staff along with refresher courses and mid-career programs on advances in various tax functions.

The STI has a relatively well-functioning Large Taxpayers' Office (LTO) that services and audits about 450 large taxpayers. While the main criteria for determining large taxpayers are sales over MDL 50 million and taxes of over MDL 2 million, the LTO limits the number of taxpayers serviced to 450 due to capacity constraints. The revenues collected by the LTO account for about 40 percent of tax revenues, which is low by international standards. The LTO uses risk profiles for selecting companies for audit and arrears collection. While e-invoices have been introduced for VAT, information matching (other than VAT purchase to sales) continues to be manual due to fragmented information systems. There are currently no laws or regulations on transfer pricing; the STI is in the process of developing these laws and regulations. There is a need to improve skills of the auditors, especially in fields like financial sector, hard-to-tax groups, transfer pricing, and illicit financial flows.

The STI’s Fiscal Control Directorate has recently developed a concept note for tax audits for 2013-15. The concept note includes development of a case management system, an audit manual, and methodologies for forensic audit. Most large and medium taxpayers are heavily concentrated in Chisinau. Of the 18,000 VAT payers, 13,000 are located in Chisinau. Taxpayers with sales below the VAT threshold of MDL 600,000 but above MDL 100,000, have the option to register for VAT or be assessed under the simplified taxation regime where the tax rate is 3 percent of sales.

The appeals function in the STI is inadequately staffed and not independent. The first instance of dispute resolution is either in the local office where the tax audit was performed or in the headquarters. In 2013, of about 500 appeals filed, 70 percent were filed in the headquarters and 30 percent in local offices. There is no separate appeals officer to deal with appeals in the headquarters or in the local offices. The Legal Directorate in the headquarters not only deals with appeals but also with preparing methodological instructions, clarifications, interpretations on ambiguous tax matters, and represents the STI in appeals before the court.

The STI has recently strengthened its internal audit functions and has identified further areas for improvement. Recent improvements include development of international audit standards, a national audit strategy, and an internal audit manual. The Internal Control Directorate has conducted a gap analysis of the financial management system in the STI. The gap analysis demonstrated the lack of process descriptions, criteria for performance assessments to measure the efficiency of various tax functions, and human and financ ial resources; and definition of risks for all business processes.

Business associations were generally complimentary about the efforts made by the STI to improve taxpayer service and reduce compliance costs. However, there were complaints about lack of communication among local offices and lack of consistency in interpretation of tax laws. Business associations also cited a delay in updating the taxpayers account to reflect the current payment situation as a weakness. Recent improvements to taxpayer services include e-filing, e-invoice and e-signature. A call center and a client website were established in 2010 with frequently asked questions for personal income tax (PIT). The taxpayer service is understaffed with 13 employees who not only answer calls but also update the knowledge database. Furthermore, the taxpayer function is under-developed and does not currently include modern service delivery channels that promote understanding of tax laws, procedures, rights and obligation of tax payers, and help reduce the compliance burden for tax payers.

The existing Information Technology (IT) applications in use within the STI suffer from a significant number of deficiencies that are affecting their ability to offer modern tax services to taxpayers. The current IT applications are aging. End-of-life products still form the backbone of some of the current applications, such as a distributed FoxPro system. This prevents sharing of information between applications thus inhibiting an integrated view of taxpayer data and identification of 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 staffed yet. An assessment by the Bank team reinforces observations made by other development partners (such as the IMF), that the current system is

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approaching its breaking point and cannot be modified to become a modern tax system. The STI has proposed procurement of an off-the-shelf web-based integrated tax management system (ITMS) with imbedded best practices providing services to all core tax functions within the STI. This includes risk management, case management and decreases reliance on paper.

Although the revenue functions of the National Social Insurance House (CNAS in its Romanian acronym) and the National Health Insurance Fund (NHIF) are not fully integrated within the STI, the STI performs audits and enforced collection functions for them. CNAS has automated all business processes with assistance from a World Bank funded project (2000-07) which integrated all contribution and payment processes. Payments are made by the employers directly to the Treasury. The CNAS provides information periodically to the STI. Currently data flow to the STI is slow because of old legacy applications still in use within the STI. Also STI sends information on arrears tracking to CNAS on paper rather than electronically, which further slows down the process. CNAS will benefit from the upgrade and integration of the STI's IT system.

Relationship to CAS

The proposed tax administration modernization project is closely aligned with the Country Partnership Strategy (CPS) for the Republic of Moldova for FY 2014-17 as well as Moldova's Tax Administration Reform Strategy. The World Bank Group's CPS for FY14-17 has been designed around three pillars: (i) Increasing competitiveness including continued institutional reforms related to the business enabling environment and governance; (ii) Enhancing human capital and minimizing social risks; and (iii) Promoting a green, clean and resilient Moldova. The CPS proposes a tax administration reform project that will help improve the business climate and enhance revenue collection.

The proposed Tax Administration Modernization Project (TAMP) is also closely aligned with the World Bank Group's twin goals of shared prosperity and reduced poverty by supporting government reforms that enable Moldovan tax administration to become a more effective and efficient institution and by improving governance. The Global Competitiveness Index ranks corruption as the top problem in doing business for the last two years in Moldova, with tax regulations ranking 5th in 2013 (increasing from 6th the previous year). In a Transparency International survey, 46 percent of business people and 40 percent of households reported that informal payments are frequently necessary to solve problems with tax inspectorates and estimated the total amount of bribes paid to the tax inspectorate by businesses in 2012 at MDL 32.4 million (US$ 2.54m). Stakeholders from the business community, interviewed as a part of project identification, have listed lack of transparency on tax issues, lack of clear guidance on tax policy and procedures, limited clarity on rules and procedures for audits and appeals, limited access to information on the appeals process as key issues contributing to increased governance risks in the tax administration in Moldova. The proposed institutional reforms will improve competitiveness by improving the business enabling environment. The proposed reforms will also strengthen the overall governance environment by improving transparency and accountability in the tax administration. TAMP also contributes to the goal of reduced poverty, including for the bottom 40 percent, by contributing to strengthening social insurance systems through improved and automated integration of various social insurance systems.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The development objective of the Tax Administration Modernization Project (TAMP) is to increase the effectiveness and efficiency of the tax system through strengthened voluntary compliance, reduced compliance costs, enhanced professionalism and integrity of STI staff and the use of modern technology.

The long-term vision is a tax administration with streamlined business processes supported by risk-based compliance management, effective use of electronic communication with taxpayers, skilled and professional staff, contributing to an efficient, client-oriented tax administration characterized by fairness, honesty and transparency. The modernized tax administration will improve the business environment and thereby increase country's competitiveness.

This project supports the Government of Moldova’s Tax Administration Reform Strategy for 2011-15. The strategy focuses on increasing voluntary compliance and improved service delivery to taxpayers through modernization of institutional procedures and use of modern information technology. The MoF leadership and STI top management requested the World Bank support for tax administration reform. There continues to be a high level of demand for and commitment to tax administration reform from the MoF, top management of the STI as well as buy-in from staff at the STI.

Key Results (From PCN)

TAMP will establish a results framework whereby progress on key project objectives will be measured and disseminated in a transparent manner. The following key Project Development Objectives (PDO) performance indicators are proposed:

Increased Effectiveness
- Tax gap for VAT
- Tax gap for Corporate Income Tax (CIT)
- Tax gap for Personal Income Tax (PIT)
- Productivity of VAT (VAT revenue as percent of GDP to VAT rate)
- Productivity of CIT (CIT revenue as percent of GDP to CIT rate)
- Productivity of PIT (PIT revenue as percent of GDP to PIT rate)
- Net adjustment per tax auditor

Improved Efficiency
- Average tax revenue collected per tax official
- Cost of revenue collection (STI current expenditures as percent of revenue collected)

Reduced compliance costs
- Percentage of taxpayers filing electronically
- Number of tax payments

Improved professionalism and integrity of STI staff
- Taxpayers’ satisfaction with quality of service and integrity of STI staff, measured through survey
- STI staff satisfaction with the new skills and ability to apply them, measured through staff survey

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III. Preliminary Description

Concept Description

The proposed project seeks to modernize the working of the tax system in Moldova to benefit from an integrated, highly automated, low-discretion, risk-based structure. The project will be implemented over five years to help the GoM achieve its objectives stated in the Strategic Plan for 2011-2015. This will include organizational restructuring, business process improvement, human resource management and training, and IT infrastructure changes necessary for optimal deployment of an Integrated Tax Management systems (ITMS). The project would include financial and technical support for improving revenue collection methodologies and procedures; information technology and other technological infrastructure; training, and technical assistance to underpin STI's organization structure and management, and operational systems refinements. In addition, technical assistance would be provided to the MoF to draft a new Tax Code to replace the significantly outdated Tax Code 1998. Project components would include:

- Component 1. Tax policy and analysis. This component will finance activities to provide technical assistance for: (i) revising the Tax Code; (ii) building in-house capacity in STI for tax modeling, revenue forecasting, and tax analysis; (iii) analyzing the levels of compliance of taxpayers; (iii) evaluating the efficiency and effectiveness of the STI; (iv) recommending additional revenue measures; and (v) building in-house capacity in STI for monitoring key performance indicators.
- Component 2. Institutional Development. This component will finance: (i) a comprehensive review and redesign of the organizational structure at headquarters, regional, and local offices based on the Government's regionalization plan; (ii) implementation of the reorganization based on the regionalization plan; (iii) strengthening of capacity for strategic management and performance assessment within the STI; (iv) comprehensive review of HR policies, and development of revised work flow analysis, workforce planning and strategy; (v) development of a training strategy and curriculum for tax administration staff; (vi) purchase of technical and training equipment for the training center and distance learning system; and (vii) building capacity of STI through study tours, managerial/HR training, and language training.
- Component 3. Operational Development. Strengthened compliance management is considered to be the cornerstone of an efficient tax administration. This component will be based on the re-engineered business processes that will be undertaken during project preparation. This will make the self-assessment and risk management system work more effectively and will provide further elaboration of business processes. The component will: (i) further elaborate on business process re-engineering; (ii) strengthen skills of STI auditors, especially in the LTO, in the detection of tax frauds; (iii) enhance staff capacity for enforced collection; (iv) improve internal control and internal audit; (v) revamp taxpayer services to develop modern service delivery channels; (vi) support the development of an independent tax appeals system with database for tracking of appeal cases; and (viii) strengthen internal and external communications functions.
- Component 4. IT Infrastructure and System Modernization. This component will: (i) acquire and implement an ITMS, based on an off-the-shelf web-based solution; (ii) develop an integrated data management system; (iii) acquire required hardware to support the ITMS and data warehouse; (iv) provide training in the use of the ITMS; (v) establish a business continuity recovery system. The ITMS will unify IT support for all business functions including: user management, registration, returns processing, accounting, payment processing, enforcement, objections and appeals, audit, risk assessment, reporting, 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. It will also provide a bi-directional link to other systems

that share data with the STI including Customs Service, CNAS, and NHIF. The new system will be installed in the GoM’s e-Government Center and will have data replication to a business continuity center.

• Component 5. Project Management and Change Management: This component will strengthen the STI capacity to provide timely and quality project implementation in accordance with the World Bank guidelines. The component will finance: (i) national and international consultants to support procurement, financial management, project audit, and technical implementation; (ii) international advisors for IT project management, training and change management; and (iii) operating costs associated with the implementation of the Project.

IV. Safeguard Policies that might apply

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

V. Financing (in USD Million)

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

Financing Source	Amount
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	20.00
Total	20.00

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