The project provides the framework and financing to support a comprehensive modernization of Armenia’s revenue administration. The project will finance critical investments in the basic ICT infrastructure of the State Revenue Commission (SRC). These investments will enable the SRC to modernize its business processes, expand the use of e-governance, including electronic filing of tax returns, and to introduce a more targeted, risk based compliance strategy, based on voluntary compliance. The project is organized into four components. Component 1 is aimed at improving the organizational structure, strengthening strategic planning and human resource management, including technical and managerial training for SRC staff as well as enhancing SRC’s internal control environment. Component 2 will support strengthened operations and compliance management by supporting introduction of risk based audit methodologies and improved tax payer services, including implementation of a modern service centers and a centralized call centre which will allow for cost-efficient service delivery and more effective quality assurance in the responses provided to tax payers. Component 3 will enhance SRC’s IT environment to support modernized business processes, automation and business intelligence, including establishment of a centralized data processing centre, data warehouse, disaster recovery facilities and improved networking capacities. Component 4 will support the client in implementing the project in compliance with Bank procedures and to address change management challenges.

I. Project Context

Country Context

Armenia’s strong growth record in the 2000s was followed by a severe downturn during the global financial crisis and a slow recovery in 2010-11. The recent economic crisis reversed some of the achievements as Armenia experienced a sharp downturn with output contracting by 14 percent in 2009. After the crisis hit Armenia, the poverty profile deteriorated and more than one third of the population fell below the poverty line. The government’s strong counter-cyclical fiscal policy focused mainly on increased spending on infrastructure, social protection and emergency financing for enterprises. While the counter-cyclical spending helped to protect the poor and maintain jobs, the pace of recovery remain slow with only 2.1 percent growth in 2010 and at expected 4.1 percent in 2011.

After pursuing a significant fiscal expansion during the crisis, the Government is now focused on consolidating its fiscal accounts. The government’s crisis response policies led to a substantial expansion of the fiscal deficit to 7.8 percent of GDP in 2009. As a result, the public debt to GDP ratio more than doubled in just two years and is expected to peak at about 42 percent of GDP in 2011 (up from only 13.6 percent of GDP at end-2008). To restore a sustainable fiscal path, the Government has embarked on a significant fiscal consolidation effort. The general government deficit has been reduced to around 2.9 percent of GDP in 2011 and the authorities plan to further reduce the overall fiscal deficit to less than 2 percent of GDP by 2013.

While the Government has reined in countercyclical expenditures, increases in revenue collection are an important component of a sustainable deficit reduction. While the State Revenue Committee (SRC) has successfully maintained the level of revenue collection through the economic downturn, at about 16.2 percent Armenia’s tax (excluding social security contributions) to GDP ratio remains low for its level of income. Further gains in revenue collection are required to realize fiscal space for investments in key public services and infrastructure, needed to deliver on the Government’s poverty reduction and economic growth objectives.

II. Sectoral and Institutional Context

Despite past efforts, Armenia continues to face significant challenges in terms of raising its revenue performance. Despite modest increases over the past decade, Armenia’s tax-to-GDP ratio at about 20 percent (including the social security payment) continues to be lower than in most countries in the region and at comparable income levels. While Armenia’s tax rates for most major taxes, including CIT, PIT and VAT are at similar levels to other countries in the region, tax productivity has been persistently below regional averages and other lower middle income countries, even during periods of high growth. Weak capacity to detect and penalize tax frauds has undermined compliance and contributed to wide spread informal sector activities. At the same time, high compliance costs for taxpayers undercut the business climate and private sector
development in the formal sector. The IFC Paying Taxes 2011 report ranks Armenia only 153st out of 183 countries with regard to the ease of paying taxes. Business surveys have regularly identified weaknesses in tax administration, arbitrary and corrupt behavior by tax officials, as major impediments to the formation and success of small and medium enterprises.

The Government is committed to implement comprehensive tax administration reforms. In 2011 the Government adopted a key strategic document to guide tax administration reforms from 2011-14 with the following key elements:

- Removing barriers for taxpayers to fulfill their obligations through simplified procedures, including e-filing, and enhanced taxpayer services;
- Business process re-engineering and modernization of core information technology (IT) systems, including integration of data bases, centralized data processing, back-up and business continuity capabilities;
- Improved compliance management through modern risk based and (computerized) audit selection and targeted enforcement activities based on amount of revenue at stake and risk incurred;
- Performance oriented management of human resources to improve efficiency and effectiveness of the SRC, including skill development and introduction of internal control mechanisms.

Improved IT support is a critical enabler for the implementation of the envisaged tax administration reforms and for enhanced performance of the SRC. While the IT Department of the SRC continues to make progress in modernizing its technological infrastructure and information systems, current IT support is not well integrated and suffers from severe capacity constraints. As a result, the SRC continues to rely heavily on manual processes and face to face interactions with taxpayers, although some improvements have already been made in this area. Improvements in SRC’s basic information and communication technology (ICT) infrastructure are needed to enable business process improvements, expand the use of e-governance and to introduce a more targeted, risk based compliance strategy, based on voluntary compliance.

III. Project Development Objectives
The Project development objective (PDO) is to modernize Armenia’s tax administration in order to (i) increase voluntary tax compliance, (ii) reduce tax evasion, (iii) reduce compliance costs; and (iv) increase administrative efficiency. This objective will be achieved by:

- introducing modern, integrated information technology to support SRC operations;
- improving data exchange between the SRC and other agencies to enhance better risk management and targeting of compliance activities (“third part information”);
- reengineering and automation of business processes to improve efficiency and effectiveness; and
- expanding eGovernment, including e-filing and e-payments to lower the compliance burden for the private sector.

IV. Project Description
Component Name
Institutional Development
Strengthened Operations
Infrastructure and System Modernization
Project Management

V. Financing (in USD Million)
For Loans/Credits/Others Amount
BORROWER/RECIPIENT 3.10
International Development Association (IDA) 12.00
Financing Gap 0.00
Total 15.10

VI. Implementation
Implementation Arrangements: The State Revenue Committee (SRC) will be the responsible implementing agency for the project. Implementation arrangements are designed to ensure cross-departmental coordination internally within the State Revenue Committee (SRC) and externally with the MOF and other stakeholders. Implementation arrangements comprise multiple layers to cover policy and strategic management, project management and operational functions and to ensure collective decision-making, mutual accountability and commitment among key stakeholders. A Steering Committee(SC), comprising the MoF, SRC, and Prime Minister’s office will be responsible for strategic management and guidance. A Project Management Board (PMB) and a Project Director within SRC will oversee day to day implementation of project activities. The existing Foreign Financing Projects Management Center (FFPMC) at the Ministry of Finance will provide operational support services to the PMB, including procurement and financial management.

Results Monitoring and Evaluation: A results framework with project specific indicators and actionable monitoring arrangements has been developed jointly with key counterpart to support progress monitoring and result oriented project implementation (Annex 1). The SRC will develop a robust system for monitoring and evaluation (M&E) of the target outcomes and outputs. The M&E system will support the successful implementation of the Project by maintaining records on implementation and generating the following performance reports: (i) quarterly reports prepared by the SRC; and (ii) annual reports prepared within four months of the end of the financial year, focusing on results-based accountability and accomplishments against performance expectations.

VII. Safeguard Policies (including public consultation)

| Safeguard Policies Triggered by the Project | Yes | No |
| 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 |

VIII. Contact point

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