REIMBURSABLE ADVISORY SERVICES AGREEMENT

between

MINISTRY OF FINANCE OF THE REPUBLIC OF LATVIA

and the

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dated January 28, 2016
AGREEMENT FOR REIMBURSABLE ADVISORY SERVICES

AGREEMENT dated the 28th of January 2016, between MINISTRY OF FINANCE OF THE REPUBLIC OF LATVIA (the "Client") and the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the "Bank") (jointly referred to as the "Parties").

WHEREAS, the Client has requested the Bank to provide to the Client Reimbursable Advisory Services (the "Reimbursable Advisory Services" or "RAS") described in the Schedule to this Agreement to conduct a tax system review from a lens of equity, revenue mobilization, efficiency, and competitiveness to inform the formulation of a medium-term tax strategy by Government of Latvia, while supporting dialogue on tax reforms among interested stakeholders.

NOW, therefore, the Parties hereto agree as follows:

1. **Reimbursable Advisory Services.** The Bank shall provide to the Client the services ("Reimbursable Advisory Services" or "RAS") described in the Schedule to this Agreement, on the terms and conditions set out in this Agreement, including the Annex hereto, which constitutes an integral part hereof.

2. **Client Contacts.** In carrying out the Reimbursable Advisory Services, the Bank will work closely with designated officials of the Client. The Client will provide the Bank with the names and contact information for said designated officials.

3. **Timing.** While the Bank undertakes to mobilize all reasonable means to carry out the Reimbursable Advisory Services in a timely manner, the work program and timetable set out in the Schedule to this Agreement have been prepared in good faith based on information currently available to the Bank, and are given on an indicative basis assuming that: (i) the Client and its personnel will carry out their respective duties in a satisfactory and timely manner; and (ii) the Client will at all times act in a timely manner in providing information, making decisions and providing necessary support as provided herein and as requested from time to time by the Bank.

4. **Payment**

   (a) The Client shall pay the Bank a fixed fee of three hundred thousand Euro (EUR 300,000) in accordance with the following schedule of payment:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Event upon which Payment is Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st payment</td>
<td>upon completion of the note giving &quot;A rapid assessment of the tax system developments and main challenges, and detailed study plan&quot;</td>
</tr>
<tr>
<td>EUR 45,000</td>
<td></td>
</tr>
</tbody>
</table>
2nd payment
EUR 90,000 upon submission and approval of the “Draft report for stage 1 of the tax review”

3rd payment
EUR 75,000 upon submission and approval of the “Draft report for Stage 2 of the tax review”

4th payment
EUR 90,000 upon submission and approval of the final report on “Tax policy review and policy options for Latvia”

(b) All payments to the Bank hereunder shall be made in full when due, upon submission of an invoice by the Bank. Payment shall be made in Euros, in immediately available funds, without any deductions whatsoever for taxes, duties, charges or other withholdings, and notwithstanding any pending dispute between the Parties, to such account as the Bank may from time to time designate in writing.

5. Effectiveness. This Agreement shall become effective as of the day and year first above written, once it has been duly signed by both Parties.

6. Expiration. This Agreement shall expire on July 31st, 2017 unless it shall earlier be renewed with the mutual agreement of the Client and the Bank.

7. Termination. Either the Client or the Bank may terminate this Agreement prior to its expiration upon ninety (90) days’ written notice to the other. Upon receipt of such notice, the Parties shall take all appropriate steps to terminate in an orderly manner the activities then ongoing under the Reimbursable Advisory Services and to settle promptly all outstanding matters.

8. Cooperation.

(a) The Client shall at all times provide the Bank in a timely manner with any and all information (presented in the table 2 of the schedule) that may affect the performance of the Reimbursable Advisory Services, inform the Bank of any developments relating to the Reimbursable Advisory Services, and do all things necessary to enable Bank Personnel to carry out the Reimbursable Advisory Services hereunder. The Client shall, in particular, without limitation:

(i) provide to the Bank all information on the Client and the Reimbursable Advisory Services as may be necessary for the purpose;

(ii) permit Bank Personnel to visit the Client facilities and to have access to books and records relevant to the Reimbursable Advisory Services and to
Client staff working in relation to the Reimbursable Advisory Services to be provided by the Bank;

(iii) promptly notify the Bank of any proposed change in the nature or scope of the Reimbursable Advisory Services and of any event or condition which has or could reasonably be expected to have a material effect on the performance of the Services; and

(iv) promptly provide to the Bank such other information as the Bank from time to time reasonably requests about the Reimbursable Advisory Services to be performed by the Bank.

(b) It is expressly agreed and understood that the Bank shall bear no responsibility for delay in performance occasioned by the Client's failure to provide its contribution as set forth in Section D of the Schedule or otherwise cooperate as set forth in paragraph (a) above.


(a) All notices required or permitted to be given pursuant to this agreement shall be in writing and shall be deemed to have been duly given or made when delivered by hand or by mail, or facsimile to the signatories to this Agreement at their addresses as set out below or such other addresses as may be notified by either party from time to time. Notices forwarded by registered mail shall be deemed to be delivered upon delivery. Notices made by facsimile transmission shall also be confirmed by mail, with their effective date being the date of initial transmission.

(b) The following addresses are specified for the purposes of this Agreement:

For the Client:

Ministry of Finance
Smilšu iela 1,
Riga, LV-1919
Latvia

Phone: (371) 67095667
Fax: (371) 67095503
For the Bank:

World Bank Group
1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

Attention: Emile van der Does de Willebois
Phone: (202) 477-1234
Fax: (202) 477-6391

IN WITNESS WHEREOF, the Parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names as of the day and year indicated below.

MINISTRY OF FINANCE
OF THE REPUBLIC
OF LATVIA

By: Authorized Representative
Name: Edgars Rinkavids
Title: On behalf of the Minister of Finance, the Minister of Foreign Affairs
Date: 28/01/2016

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

By: Authorized Representative
Name: Grzegorz Wolszczak
Title: Operations Officer, ECCPL
Date: 28/01/2016
SCHEDULE

Description of the Reimbursable Advisory Services

A. Reimbursable Advisory Services. Except as the Client and the Bank may otherwise agree, the Reimbursable Advisory Services shall include the following activities and outputs.

The Bank will conduct a tax system review from a lens of equity, revenue mobilization, efficiency and competitiveness to inform the formulation of a medium-term tax strategy by the Government of Latvia, while supporting dialogue on tax reforms among interested stakeholders. The assessment would be delivered in two stages:

Stage 1

- **Component 1: Rapid assessment of tax system developments and main challenges.** The Bank will analyze the critical challenges faced by the Latvian tax system using existing data by (i) Reviewing tax system developments in Latvia; (ii) Reviewing existing reports/studies on the tax system; (iii) Benchmarking the tax system against other countries (including Estonia and Lithuania and other OECD and relevant non-OECD countries); (iv) Providing an overview on overall equity, efficiency and competitiveness impact of the tax system; (v) Summarizing growing spending pressures (based on existing reports/studies); and (vi) Summarizing the main policy challenges.

The Bank will use feedback on data and methodology received from social partners and the government’s counterparts during consultations on the findings of the rapid assessment. This feedback will help to finalize the analysis under Components 2-6 and the report for Stage 1.

- **Component 2: Revenue adequacy and scope for increasing tax revenues.** The Bank will conduct an assessment of the current tax system to examine the room that exists for increasing government revenues, taking into account impacts on equity and competitiveness. This will include: (i) benchmarking tax revenues and composition by tax instrument for Latvia against that in comparison countries in detail; (ii) assessing existing tax expenditures, including tax exemptions, allowances, credits, reduced rates and tax deferral; (iii) estimating tax capacity and tax effort using various methods, including looking at the predicted tax-to-GDP ratio taking into account the country's specific macroeconomic, demographic, and institutional features; and (iv) using stochastic frontier analysis to compare a country's tax ratio with the maximum achieved by others with similar characteristics, and comparing.
• Component 3: Options for increasing tax collection through improved tax compliance, reducing grey economy. The Bank will carry out an overview of tax compliance challenges built on: (i) Analysis of tax gap analysis for personal income tax (PIT), corporate income tax (CIT) and value-added tax (VAT); (ii) Analysis of existing work on tax evasion (the prevalence among different groups and occupations/sectors); and (iii) Identification of tax leakages due to broad tax administration issues.

• Component 4: How to balance taxation of wages and capital. The Bank will do an assessment of the current balance of income taxation, looking at wage and capital income (business profit, dividends and interest received by individuals, capital gains, rents, capital transfers and property and other assets). This will involve: (i) benchmarking against international trends in capital income and wage taxation; and (ii) a focus on selected issues of special interest including (a) the effective tax rate across different income sources, (b) impact of capital taxation on efficiency and tax base mobility, and (c) horizontal equity (e.g. wage versus capital gains taxation).

• Component 5: Corporate income tax and Microenterprise tax review (macro level analysis). The Bank will conduct an assessment of corporate taxation and Microenterprise tax in Latvia that will focus on: (i) assessing the parameters of the CIT system, including tax expenditures; (ii) Reviewing the microenterprise tax regime, including if the necessary data is available, a calculation of incidence (by sector, occupation, and income) and an assessment of the expansion of the regime since implementation (including the implications for social insurance contributions); (iii) comparing Latvia to selected benchmark countries; (iv) evaluating if Estonia model (of taxing only distributed profits) offers solution for Latvia and (v) assessing the macroeconomic impact of the CIT (including a focus on investment).

• Component 6: Distributional analysis of taxes. The Bank will do an assessment and policy options for making the tax system more equitable, including: (i) conducting a distributional analysis of the impact of taxes and transfers using household survey data (and then in stage 2 using tax/social insurance administration data if available) based on the Commitment to Equity (CEQ)¹ approach, making the analysis comparable to that done for selected countries, thus allowing for cross-country benchmarking. Apart from aggregate poverty and inequality measures, an assessment of who benefits and who bears the burden by household type, age structure, etc. will be provided. (ii) updating tax-benefit models for different family types (e.g. single-earner households versus households with children) to examine the current situation and assess alternative policy

scenarios. (iii) cross-country benchmarking of the labor tax wedge and marginal tax rates for low-income groups. The impact of the changes to PIT rates on revenues will be assessed for different income groups by analyzing the elasticity of taxable income (if the necessary administrative tax data is available).

- Summary of findings and outlining policy options.

Stage 2

- **Component 7: Social security contributions—Balance between employers and employees.** The Bank will examine the structure of social security contributions (SSC) incidence. In particular, the following issues will be addressed: (i) Ceilings on application of SSC; (ii) SSCs for different type of wage income (labor contracts vs. self-employment vs. microenterprises); and (iii) Incidence of SSCs and impact of changes to social security contributions on workers/employers (wages, employment) based on the review of theoretical and empirical literature.

- **Component 8: Examining who is not paying PIT.** The Bank will carry out an overall assessment of PIT compliance using individual tax administration data linked to household survey or population registry and social insurance data (if appropriate administrative data is available).

- **Component 9 (follow-up of component 5): Distributional analysis of taxes, including an update of the tax-benefit model and simulations of reform options.** Additional analysis to be done using State Revenue Service data (if appropriate administrative data is available).

- **Summary of findings and outlining policy options.**

A final report will be prepared summarizing the results of all the analysis in Stage 1 and Stage 2. This will include revisions to Components 1 to 8 based on comments received. The report will present the alternative tax policy reform scenarios that have been developed and assessed, including the impact on employment/investment, revenue adequacy and inequality/poverty. The work will include a matrix of tax policy design and administration reform options, with a summary of costs and benefits of each reform; and potential implementation issues.

Any change to the foregoing scope of work shall be set out in writing signed by the Client and the Bank, setting out the additional work to be undertaken and the fees in respect thereof.
B. Timetable. Except as the Client and the Bank may otherwise agree, the Bank shall endeavour to perform the Reimbursable Advisory Services in accordance with the following tentative indicative timetable:

Table 1 Expected Outcomes and Timetable

<table>
<thead>
<tr>
<th>Expected Outputs</th>
<th>Expected Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A note giving an assessment of the tax system developments and main challenges, and detailed study plan</td>
<td>March 2016</td>
</tr>
<tr>
<td>2. PowerPoint presentation of first results and policy options.</td>
<td>April 2016</td>
</tr>
<tr>
<td>3. Draft report for Stage 1 of the tax review</td>
<td>June 2016</td>
</tr>
<tr>
<td>5. PowerPoint presentation on study results and policy options.</td>
<td>October 2016</td>
</tr>
<tr>
<td>7. Final report</td>
<td>December 6, 2016</td>
</tr>
</tbody>
</table>

In order to meet the timeline for activities (1) to (7) set out in Table 1 above, it is expected that the Bank will receive the necessary background data from the Government of Latvia at least six weeks after signing this Agreement. The background data needs are outlined in Table 2 below. Where there is a delay in receiving the data or the data is not available, the Bank team will work with the Recipient to revise the timetable and content of the affected Components.

Table 2. Data Needs for Advisory Services Components

<table>
<thead>
<tr>
<th>Activity</th>
<th>Data needs and timing for data receipt</th>
</tr>
</thead>
</table>
| 1. A note giving an assessment of the tax system developments and main challenges, and detailed study plan | (i) Copies of legislation, tax declarations and relevant background reports of the Government of Latvia on the tax system  
(ii) Aggregate administrative data from the State Revenue Service and Ministry of Finance on taxes |
| 2. PowerPoint presentation of first results and policy options.           | No data requirements                                                                                   |
3. Draft report for Stage 1 of the tax review

| (iii) Government spending data by social welfare program (including social insurance and social assistance benefits) |
| (iv) EU Statistics on Income and Living Conditions (national versions, 2007-2014) |
| (v) Labor Force Survey (national versions, 2007-2014) |
| (vi) Household Budget Survey Data (2007-2014) |
| (vii) Tax gaps for PIT, and VAT (the State revenue Service Calculations) |
| (viii) Tax data needed to calculate effective income tax rates by income level. |

4. PowerPoint presentation of revised study plan for Stage 2.

| No data requirements |

5. PowerPoint presentation on study results and policy options.

| (ix) Administrative data from the State Revenue Service for Component 5, 6 (administrative data-based analysis) and Component 8 |

6. Draft report for Stage 2 of the tax review

| same as (ix) above |

7. Final report

| No data requirements |

C. **Bank Personnel.** The Bank will be responsible for determining the appropriate composition of teams needed to fulfill the Advisory Services. The following is an indicative list of categories of Bank Personnel likely to be involved in carrying out the Reimbursable Advisory Services: Economists, Public Sector Management Specialists and Tax reforms Specialists.

D. **Counterparts and Facilities.** The Client shall provide the following facilities in support of the Reimbursable Advisory Services:

(a) The Client shall provide the Bank Personnel with necessary administrative and organizational support for the Reimbursable Advisory Services

(b) The Bank will provide all written outputs in English. The Client will be responsible for any translation and will make publicly available the original report on the Ministry of Finance website.

(c) The Bank will assist the Client with the dissemination process, consisting of participation in seminars and conferences and other discussions as agreed with the Government. With regard to any seminars or conferences the Bank will be responsible for the travel costs and payment for Bank Personnel only. The Client
will provide a venue, any hospitality services needed, translation and printing. The Bank will not reimburse the expenses of participants other than its staff and short-term consultants.

The main counterpart will be the Ministry of Finance. The Ministry of Finance team is guided by the State Secretary and also the Parliamentary Secretary of the Ministry of Finance. The Ministry of Finance has put together a small technical groups that the Bank team will work with day to day to get inputs and data, and a project coordinator will be identified in the Ministry of Finance to be the point person for the team.

E. **Records.** The Bank shall keep appropriate records of the Reimbursable Advisory Services in accordance with its normal record-keeping practices and shall furnish to the Client such information regarding the Reimbursable Advisory Services as the Client shall reasonably request. As such, the Bank shall maintain appropriate records for a period of seven years after the end of the Bank's fiscal year to which the record pertains.
1. **Performance Standard; Non-Exclusivity.** The Bank hereby shall carry out the Reimbursable Advisory Services with the same care and diligence as it uses in its other analytical and advisory activities. The engagement of the Bank as adviser to the Client hereunder is non-exclusive and shall not restrict the Client from engaging other advisers on the same or related issues.

2. **Bank Personnel.** The Bank shall, in its sole discretion, determine the composition of the staff (including staff holding consultant appointments) ("Bank Personnel") assigned to perform the Reimbursable Advisory Services. The Schedule to this Agreement contains an indicative list of Bank Personnel likely to be involved in carrying out the Reimbursable Advisory Services; provided, however, that the Bank retains at all times the right to assign such other person or persons in addition to, or substitution for, any of the persons appearing on that list as the Bank may deem necessary or appropriate in the performance of its duties hereunder. The Client may, if it has reasonable cause for dissatisfaction with the performance of any of the Bank Personnel, request the Bank to replace such person(s). For avoidance of doubt, it is agreed and understood that this Agreement does not create any employment or other contractual relationship between the Client and Bank Personnel.

3. **Client Contributions.** The Client shall carry out the activities and provide the facilities and other arrangements set out in the Schedule to this Agreement.

4. **Bank Operational Policies.** The Bank shall provide its advice in a manner consistent with its relevant environmental and social safeguards policies.

5. **Confidentiality.** The Parties agree that this Agreement and the outputs set out in the Schedule to this Agreement shall only be made available to the public after the Client has given its written consent to such disclosure. For this purpose, the Client hereby authorizes the Bank to publicly disclose this Agreement and the outputs set out in the Schedule to this Agreement in their final form. With respect to underlying information provided by the Client in support of the Reimbursable Advisory Services, the Client reserves the right to designate said information as confidential. The Bank may publicly disclose such information only after the Client has given its prior consent. With respect to underlying information (other than the final outputs) provided by the Bank in support of the Reimbursable Advisory Services, the Bank reserves the right to designate said information as confidential. The Client may publicly disclose such information only after the Bank has given its prior consent.

6. **Intellectual Property.** The intellectual property rights of the Parties in any of its pre-existing data or documents used by the Bank in connection with the Reimbursable Advisory Services shall remain with that Party. The intellectual property rights in new materials prepared by the Bank in connection with the Reimbursable Advisory Services
shall belong to the Client; provided, however, that the Bank shall have the global, non-exclusive, perpetual (for the duration of the copyright), fully sub-licensable and royalty-free right to use, copy, display, distribute, publish and create derivative works of all or part of these materials and incorporate the information therein in its research, papers, publications, web sites, and other media without the consent of the Client, subject to the limitations on disclosure of confidential information and any third party rights, as indicated in paragraph 5, Confidentiality, of this Annex.

7. **Representation of the Bank's views and use of the Bank's name, marks and logo.**

   (a) The Client agrees that it shall not represent, or permit the representation of, the Bank's views without the prior written consent of the Bank.

   (b) The Client further agrees that it shall not use, or permit the use of the Bank’s name, marks or logos in any advertisements, promotional literature or information without the prior written consent of the Bank, and that if such consent is provided that it shall use the name, marks and logos strictly in accordance with the permission provided and with the insertion of the Bank’s usual disclaimers.

   (c) Both Parties shall include the appropriate attribution and disclaimers in new materials prepared in connection with the Reimbursable Advisory Services.

8. **Disclaimers and Liabilities.**

   (a) While the Bank will make diligent efforts in its performance of the Reimbursable Advisory Services, the Bank makes no express or implied representation or warranty as to the extent of success that may be achieved in the implementation of any recommendation contained in any work product prepared by or with the assistance of the Bank or Bank Personnel.

   (b) Without limitation to the immunities and privileges of the Bank under its Articles of Agreement and other applicable rules of law, the Bank shall not be liable to the Client or other third party for any loss, cost, damage or liability that the Client shall incur as a result of the Reimbursable Advisory Services, unless those resulting from the gross negligence or willful misconduct of the Bank or Bank Personnel. Notwithstanding anything herein, the Bank's liability, if any, to the Client hereunder shall not extend to any indirect, punitive or consequential damage, loss of profit or loss of opportunity, nor shall it exceed the amount of the professional fees received by the Bank for its account under this Agreement.

   (c) The Parties acknowledge and agree that it is not the purpose of this Agreement to create a partnership, joint venture or similar arrangement whereby the Parties could be held jointly liable vis-a-vis third parties or for any other purposes. Nothing herein shall constitute a commitment by the Bank to provide financing to the Client.
9. **Governing Law.** This Agreement is governed by, and shall be construed in accordance with, the laws of England.

10. **Settlement of Disputes.**

(a) The Parties hereto will endeavor in good faith to resolve any differences and disputes under, or in connection with, this Agreement by amicable settlement. Any dispute arising out of or in connection with this Agreement which is not settled by agreement of the Parties shall be finally settled by arbitration in accordance with the UNCITRAL Arbitration Rules in force on the date of this Agreement. In the event of a conflict between the UNCITRAL Arbitration Rules and the terms of this Agreement, the terms of this Agreement shall govern.

(b) Neither the Client nor the Bank shall be entitled in any proceeding under paragraph (a) of this Section to assert any claim that any provision of these Standard Conditions or of the RAS Agreement is invalid or unenforceable because of any provision of the Bank's Articles of Agreement

11. **Privileges and Immunities; Tax Immunity.** The Client recognizes and shall take all reasonable steps to give effect to the status, immunities and privileges of the Bank and its Personnel set forth in the Bank's Articles of Agreement and other applicable rules of law. The Parties acknowledge and agree that no provision of this Agreement, nor the submission to arbitration by the Bank, in any way constitutes or implies a waiver, renunciation, termination, or modification by the Bank of any privilege, immunity or exemption of the Bank granted in the Bank’s Articles of Agreement and other applicable rules of law. This includes, inter alia, the immunity of the Bank, its assets, income and its operations and transactions, from all taxation and customs duties.

12. **Amendments.** Any amendment or waiver of, or any consent given under, any provision of this Agreement shall be in writing and, in the case of an amendment, signed by the Parties.

13. **Saving of Rights.** No course of dealing and no failure or delay by any party hereto in exercising any power, remedy, discretion, authority or other right under this Agreement shall impair, or be construed to be a waiver of or an acquiescence in, that or any other power, remedy, discretion, authority or right under this Agreement, or in any manner preclude its additional or future exercise.

14. **Successors and Assignees; No Assignment without Consent.** This Agreement binds and benefits the respective successors and assignees of the Parties, provided that none of them may assign this Agreement in whole or in part without the prior consent of the other.

15. **Entire Agreement and Counterparts.**
(a) This Agreement, together with its Schedule and Annex, constitutes the entire agreement among the Parties hereto and supersedes any and all prior agreements, understandings and arrangements, oral or written, between the Parties with respect to the subject matter hereof.

(b) This Agreement may be executed in several counterparts, each of which is an original, but all of which constitute the same agreement.

16. **Termination.** Notwithstanding termination or expiration of this Agreement, the provisions of this Agreement relating to (i) obligation of confidentiality under Section 5 of this Annex, (ii) the obligations spelled out in Sections 6 on Intellectual Property and 11 on Privileges and Immunities of this Annex; and (iii) the obligation of the Client to pay to the Bank remuneration for the Reimbursable Advisory Services performed prior to the date of termination or expiration of the Agreement, as well as reimbursement of any reasonable costs related to the termination of the Agreement by the Client, shall continue in full force and effect.