

Document of  
The World Bank

**FOR OFFICIAL USE ONLY**

Report No: PAD1658

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 5.3 MILLION (US\$7.42 MILLION EQUIVALENT)

AND

PROPOSED LOAN

IN THE AMOUNT OF US\$12.58 MILLION

TO THE

REPUBLIC OF MOLDOVA

FOR A

TAX ADMINISTRATION MODERNIZATION PROJECT

May 12, 2016

*Governance Global Practice*  
*EUROPE AND CENTRAL ASIA*

This document is being made publicly available prior to Board consideration. This does not imply a presumed outcome. This document may be updated following Board consideration and the updated document will be made publicly available in accordance with the Bank's policy on Access to Information.

## CURRENCY EQUIVALENTS

(Exchange Rate Effective May 2, 2016)

Currency Unit = MDL  
MDL 19.79 = US\$1  
US\$ 1.423360 = SDR 1

## FISCAL YEAR

January 1 – December 31

## ABBREVIATIONS AND ACRONYMS

AA	Association Agreement	ITMS	Integrated Tax Management System
CPS	Country Partnership Strategy	LCS	Least Cost Selection
CQS	Consultant Qualification Selection	LTO	Large Taxpayer Office
DA	Designated account	MDL	Moldovan Lei
DC	Direct contracting	MoF	Ministry of Finance
DCFTA	Deep and Comprehensive Free Trade Area	NHIF	National Health Insurance Fund
ECA	Europe and Central Asia	NPV	Net Present Value
EU	European Union	PDO	Project Development Objective
FBS	Fixed Budget Selection	PEFA	Public Expenditure and Financial Accountability
GDP	Gross Domestic Product	PMU	Project Management Unit
GoM	Government of Moldova	QBS	Quality Based Selection
GPN	General Procurement Notice	QCBS	Quality and Cost Based Selection
GRS	Grievance Redress Service	SH	Shopping
HR	Human Resources	SOE	State-owned enterprise
IBRD	International Bank for Reconstruction and Development	SPN	Specific Procurement Notice
IDA	International Development Association	SSS	Single (or Sole) Source Selection
IC	Individual Consultant selection procedure	STS	State Tax Service
ICB	International Competitive Bidding	TA	Technical assistance
ICR	Implementation Completion and Results Report	TAMP	Tax Administration Modernization Project
IEG	Independent Evaluation Group	TF	Trust Fund
IPF	Investment Project Financing	VAT	Value Added Tax
IT	Information Technology	USD	United States Dollar

Regional Vice President:	Cyril Muller
Country Director:	Qimiao Fan
Senior Global Practice Director:	Deborah Wetzel
Practice Manager:	Adrian Fozzard
Task Team Leader:	Oleksii Balabushko
Co-Task Team Leader:	Jan Loeprick

**MOLDOVA**  
**Tax Administration Modernization Project**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b>I. STRATEGIC CONTEXT .....</b>	<b>7</b>
A. Country Context.....	7
B. Sectoral and Institutional Context.....	7
C. Higher Level Objectives to which the Project Contributes .....	11
<b>II. PROJECT DEVELOPMENT OBJECTIVES .....</b>	<b>11</b>
A. PDO.....	11
B. Project Beneficiaries .....	11
C. PDO Level Results Indicators.....	11
<b>III. PROJECT DESCRIPTION .....</b>	<b>12</b>
A. Project Components .....	12
B. Project Financing .....	13
C. Project Cost.....	14
D. Lessons Learned and Reflected in the Project Design.....	14
<b>IV. IMPLEMENTATION .....</b>	<b>15</b>
A. Institutional and Implementation Arrangements .....	15
B. Results Monitoring and Evaluation .....	16
C. Sustainability.....	16
<b>V. KEY RISKS.....</b>	<b>17</b>
A. Overall Risk Rating and Explanation of Key Risks.....	17
<b>VI. APPRAISAL SUMMARY .....</b>	<b>18</b>
A. Economic and Financial Analysis.....	18
B. Technical.....	19
C. Financial Management.....	20
D. Procurement .....	21
E. Social (including Safeguards).....	21
F. Environment (including Safeguards) .....	22
G. Other Safeguards Policies Triggered .....	22

H. World Bank Grievance Redress.....	22
<b>Annex 1: Results Framework and Monitoring .....</b>	<b>24</b>
<b>Annex 2: Detailed Project Description.....</b>	<b>30</b>
<b>Annex 3: Implementation Arrangements .....</b>	<b>36</b>
<b>Annex 4: Implementation Support Plan.....</b>	<b>43</b>
<b>Annex 5: Economic and Financial Analysis .....</b>	<b>45</b>

**PAD DATA SHEET***Moldova**Tax Administration Modernization Project (P127734)***PROJECT APPRAISAL DOCUMENT***EUROPE AND CENTRAL ASIA  
GOVERNANCE GLOBAL PRACTICE*

Report No.: PAD1658

<b>Basic Information</b>			
Project ID P127734	EA Category C - Not Required	Team Leader(s) Oleksii Balabushko, Jan Loeprick	
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]		
	Financial Intermediaries [ ]		
	Series of Projects [ ]		
Project Implementation Start Date 01-Oct-2016	Project Implementation End Date 31-Oct-2021		
Expected Effectiveness Date 30-Sep-2016	Expected Closing Date 31-Dec-2021		
Joint IFC No			
Practice Manager/Manager Adrian Fozzard	Senior Global Practice Director Deborah L. Wetzel	Country Director Qimiao Fan	Regional Vice President Cyril E Muller
Borrower: Republic of Moldova			
Responsible Agency: Main State Tax Inspectorate			
Contact: Telephone No.:	Serghei Pușcuța 0037322823353	Title: Email:	Chairman mail@fisc.md
<b>Project Financing Data(in USD Million)</b>			
[ X ] Loan	[ ] IDA Grant	[ ] Guarantee	
[ X ] Credit	[ ] Grant	[ ] Other	
Total Project Cost:	20.00	Total Bank Financing:	20.00
Financing Gap:	0.00		

<b>Financing Source</b>	<b>Amount</b>
BORROWER/RECIPIENT	0.00
International Bank for Reconstruction and Development	12.58
International Development Association (IDA)	7.42
Total	20.00

### **Expected Disbursements (in USD Million)**

Fiscal Year	2017	2018	2019	2020	2021	2022	0000	0000	0000	0000
Annual	1.00	1.00	2.50	5.50	8.00	2.00	0.00	0.00	0.00	0.00
Cumulative	1.00	2.00	4.50	10.00	18.00	20.00	0.00	0.00	0.00	0.00

### **Institutional Data**

#### **Practice Area (Lead)**

Governance

#### **Contributing Practice Areas**

#### **Cross Cutting Topics**

- Climate Change
- Fragile, Conflict & Violence
- Gender
- Jobs
- Public Private Partnership

#### **Sectors / Climate Change**

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Public Administration, Law, and Justice	General public administration sector	100		
Total		100		

I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

#### **Themes**

Theme (Maximum 5 and total % must equal 100)

Major theme	Theme	%
Public sector governance	Tax policy and administration	90

Public sector governance	Public expenditure, financial management and procurement	10
Total		100
<b>Proposed Development Objective(s)</b>		
To improve revenue collection, tax compliance and taxpayer services		
<b>Components</b>		
<b>Component Name</b>	<b>Cost (USD Millions)</b>	
Tax policy reform	1.50	
Institutional development	1.2	
Operational development	1.30	
IT Infrastructure and system modernization	15.00	
Project management and change management	1.00	
<b>Systematic Operations Risk- Rating Tool (SORT)</b>		
<b>Risk Category</b>	<b>Rating</b>	
1. Political and Governance	High	
2. Macroeconomic	High	
3. Sector Strategies and Policies	Substantial	
4. Technical Design of Project or Program	Substantial	
5. Institutional Capacity for Implementation and Sustainability	Substantial	
6. Fiduciary	Substantial	
7. Environment and Social	Low	
8. Stakeholders	Moderate	
9. Other		
<b>OVERALL</b>	Substantial	
<b>Compliance</b>		
<b>Policy</b>		
Does the project depart from the CAS in content or in other significant respects?	Yes [ ]	No [ X ]
Does the project require any waivers of Bank policies?	Yes [ ]	No [ X ]
Have these been approved by Bank management?	Yes [ ]	No [ X ]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [ X ]
Does the project meet the Regional criteria for readiness for implementation?	Yes [ X ]	No [ ]
<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>



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

### Legal Covenants

Name	Recurrent	Due Date	Frequency
Project implementation responsibility	X		CONTINUOUS

### Description of Covenant

The Recipient shall vest the overall responsibility for the implementation of the Project in STS, and to this end, through STS, shall: (a) operate and maintain, throughout Project implementation, the Project Implementation Unit (PIU) with qualified staff in sufficient numbers, as well as adequate funds, premises, services and other resources for Project implementation (including procurement, financial management and monitoring and evaluation), all acceptable to the Association and described in the Project Operational Manual; (b) ensure that any staff of the PIU financed out of the proceeds of the Credit is selected and hired in accordance with Section III of this Schedule; and (c) no later than ninety (90) days after the Effective Date, have selected and hired the financial management and procurement specialists referred to in Part 5 (b)(ii) of the Project in a manner acceptable to the Association.

Name	Recurrent	Due Date	Frequency
Private sector Advisory Panel		31-Oct-2016	

### Description of Covenant

No later than ninety (90) days after the Effective Date, the Recipient/Borrower shall, through the STS, establish and operate, throughout Project implementation, a private sector advisory panel vested with the responsibility to facilitate citizen engagement in the implementation of Project activities, with terms of reference and membership acceptable to the Association/Bank, as described in the POM.

### Conditions

Source Of Fund	Name	Type
IDA	The Project Operational Manual has been adopted by the STS	Effectiveness

### Description of Condition

The STS will prepare and approve the Projects Operational Manual laying out detailed implementation arrangements for the Project as acceptable to the Bank.

Source Of Fund	Name	Type
----------------	------	------

IDA	Legal instrument governing the organization of the STS adopted	Effectiveness		
<b>Description of Condition</b>				
The Recipient has adopted a legal instrument governing the organization of the STS, in form and substance acceptable to the Association, and said legal instrument has been published in the Official Gazette.				
<b>Source Of Fund</b>	<b>Name</b>	<b>Type</b>		
IDA	Loan Agreement executed and delivered	Effectiveness		
<b>Description of Condition</b>				
The Loan Agreement has been executed and delivered and all conditions precedent to its effectiveness (other than the effectiveness of Financing Agreement) have been fulfilled.				
<b>Source Of Fund</b>	<b>Name</b>	<b>Type</b>		
IBRD	Financing Agreement executed and delivered	Effectiveness		
<b>Description of Condition</b>				
The Financing Agreement has been executed and delivered and all conditions precedent to its effectiveness (other than the effectiveness of the Loan Agreement) have been fulfilled.				
<b>Team Composition</b>				
<b>Bank Staff</b>				
<b>Name</b>	<b>Role</b>	<b>Title</b>	<b>Specialization</b>	<b>Unit</b>
Oleksii Balabushko	Team Leader (ADM Responsible)	Senior Public Finance Specialist	Tax Administration	GGO15
Jan Loeprick	Team Leader	Public Sector Specialist	Tax Policy and International Taxation	GGOPS
Elena Corman	Procurement Specialist (ADM Responsible)	Procurement Specialist	Procurement	GGO03
Oxana Druta	Financial Management Specialist	Financial Management Specialist	Financial Management	GGO21
Constantin Rusu	Team Member	Consultant	Project Support	GGODR
Elena Segura Labadia	Counsel	Senior Counsel	Legal	LEGLE
Iryna Shcherbyna	Team Member	Public Sector Specialist	Public Sector Management	GGO15
Luis M. Schwarz	Team Member	Senior Finance Officer	Finance Officer	WFALA
Rajul Awasthi	Team Member	Senior Public Sector Specialist	Tax Administration and Tax Policy	GGO15

Robert H. Montgomery	Environmental Specialist	Lead Environment Specialist		GEN04	
<b>Locations</b>					
<b>Country</b>	<b>First Administrative Division</b>	<b>Location</b>	<b>Planned</b>	<b>Actual</b>	<b>Comments</b>
Moldova	Chisinau	Chisinau	<b>X</b>		
<b>Consultants (Will be disclosed in the Monthly Operational Summary)</b>					
Consultants Required ?    Consultants will be required					

## **I. STRATEGIC CONTEXT**

### **A. Country Context**

1. 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 prime ministers 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.

2. 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, contributed to a 0.5 percent decline in GDP in 2015.

3. In recent years Moldova has made progress 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. The 2016 Doing Business report ranks Moldova 52 among 189 countries assessed, However, a service users' survey undertaken by the Government in June 2013 revealed significant gaps between the expectations of recipients of administrative services and actual delivery, including: delays, lack of information, the need for repeat visits to public institutions and demands for informal payments. The World Economic Forum's Global Competitiveness Report (2014-15) and the World Bank-EBRD Business Environment and Enterprise Performance Survey (2013) both identify corruption as the major constraint to business and development, a view shared by citizens according to the latest Eurobarometer Survey (2014). The recent banking sector crisis has brought corruption, accountability and trust in government to the fore of the policy agenda.

### **B. Sectoral and Institutional Context**

4. Increased tax revenue collection is a priority for the Government. Overall collections of tax revenue have grown at 12 percent annually since 2010 in nominal terms. However, revenue collections as a share of GDP 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.

Table 1. Tax revenue in Moldova in nominal values and as share of GDP, 2010-14

Tax item	2010		2011		2012		2013		2014	
	MDL, bn	% of GDP	MDL, bn	% of GDP	MDL, bn	% of GDP	MDL, bn	% of GDP	MDL, bn	% of GDP
<b>Tax revenue</b>	<b>22.1</b>	<b>30.7</b>	<b>25.1</b>	<b>30.5</b>	<b>28.1</b>	<b>31.8</b>	<b>31.4</b>	<b>31.2</b>	<b>33.7</b>	<b>30.2</b>
<b>Direct taxes</b>	<b>9.8</b>	<b>13.6</b>	<b>10.8</b>	<b>13.1</b>	<b>13.2</b>	<b>15.0</b>	<b>14.3</b>	<b>14.2</b>	<b>16.0</b>	<b>14.3</b>
<i>Profit tax</i>	0.5	0.7	0.6	0.7	2.0	2.2	2.1	2.0	2.4	2.2
<i>Personal income tax</i>	1.5	2.1	1.8	2.1	2.0	2.3	2.2	2.2	2.4	2.2
<i>Social Fund contr.</i>	6.0	8.3	6.6	8.0	7.2	8.1	7.8	7.7	8.4	7.5
<i>Health Fund contr.</i>	1.5	2.1	1.6	2.0	1.8	2.0	2.0	2.0	2.4	2.2
<i>Other, incl. property tax</i>	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
<b>Indirect taxes</b>	<b>12.3</b>	<b>17.1</b>	<b>14.3</b>	<b>17.4</b>	<b>14.9</b>	<b>16.8</b>	<b>17.1</b>	<b>17.0</b>	<b>17.7</b>	<b>15.9</b>
<i>Excises</i>	2.1	2.9	2.7	3.2	2.9	3.3	3.5	3.5	3.4	3.1
<i>-collections</i>	2.2	3.0	2.7	3.3	3.0	3.4	3.8	3.8	3.7	3.3
<i>-refunds</i>	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.3	-0.3	-0.2
<i>VAT</i>	9.1	12.7	10.5	12.7	10.7	12.1	12.2	12.1	12.9	11.5
<i>-collections</i>	3.3	4.5	3.2	3.8	3.5	4.0	4.0	4.0	4.4	3.9
<i>-refunds</i>	-1.1	-1.5	-1.2	-1.5	-1.7	-2.0	-1.9	-1.9	-2.4	-2.2
<i>-collections by customs</i>	7.0	9.7	8.5	10.4	8.9	10.1	10.1	10.1	10.9	9.7
<b>Other</b>	<b>1.1</b>	<b>1.5</b>	<b>1.2</b>	<b>1.4</b>	<b>1.3</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>	<b>1.5</b>	<b>1.3</b>

Source: Ministry of Finance of Moldova.

5. The State Tax Service's (STS) organizational structure and administrative support systems are inefficient and hinder improvements in revenue collection. STS currently has a fragmented structure with 35 local offices and the Main State Tax Inspectorate each having separate legal status. While the Head of the local office is appointed by the STS 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 lack of mobility of staff, intransparent procedures and weak oversight of local operations leads to a weak governance environment and undermines STS's effectiveness in managing taxpayer compliance.

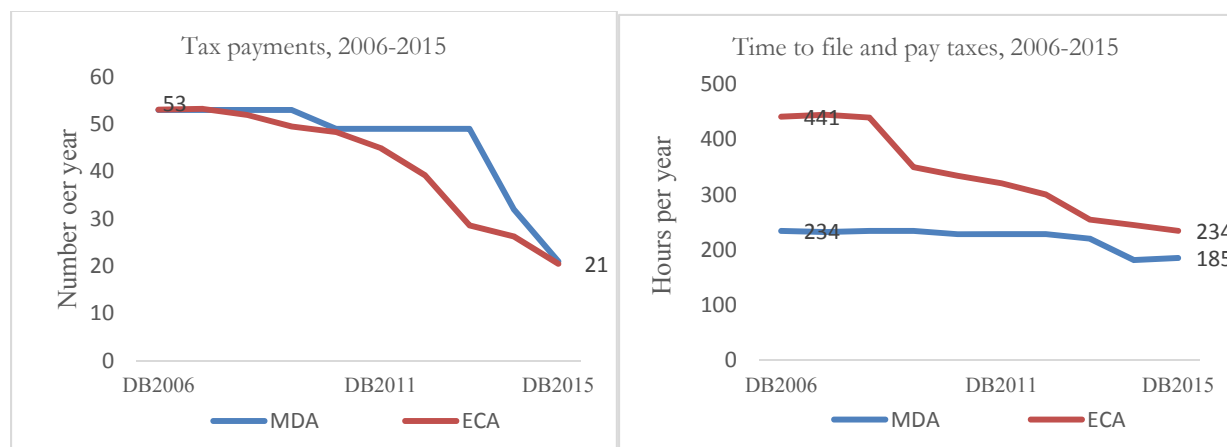
6. Revenue collection is also hampered by inadequate focus on large-taxpayers, the resources assigned to assessments of small taxpayers and a focus on minor compliance matters. STS has a relatively well-functioning LTO that services and audits about 450 large taxpayers. This number is determined by capacity 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 in 2015, which is low by international standards. The STS recently improved risk profiling for the selection for comprehensive audits for large taxpayers. 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. Strengthening and expanding risk based compliance management in STS’s operations thus holds the potential of enhancing the administration’s efficiency and revenue collection.

7. The STS does not have all the relevant tools at its disposal to protect its corporate tax revenue base. The Government is concerned about its vulnerabilities to international profit shifting and base erosion. While the arm's length principle was introduced in Moldova in 1998 current legal instruments to counter base erosion lack a number of critical elements. In the absence of disclosure and documentation requirements, STS lacks the information required for the effective administration. Auditors lack experience in complex tax issues such as financial sector operations, hard-to-tax groups, international tax evasion and illicit financial flows.

8. While some aspects of the taxpayer interface have been improved, there is considerable scope to enhance taxpayer services and increase voluntary compliance. 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.

Figure 1. Administrative Burden of Tax Compliance in Moldova and ECA, 2006-15



Source: World Bank staff based on Doing Business.

9. 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, inconsistencies in primary and secondary legislation, lack of clear guidance on tax policy and procedures, and lack of clarity on rules and procedures for audits and appeals as key issues contributing to increased governance risks in the tax administration in Moldova. There are relatively few formal appeals to tax assessments but the number is growing. In 2014, about 560 appeals (against 5,000 audit or inspection decisions) were filed to STS, 60 more than in 2013. 70 percent of appeals were filed

in the headquarters and 30 percent in local offices. The first instance of dispute resolution is either in the local office where the tax audit was performed or in the headquarters. Rejected appeals represent 70 percent of all appeals and 90 percent of those rejected are subsequently taken to court. 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 STS in appeals before the court.

10. Increases in revenue collection require an improvement of the effectiveness of STS's operations. 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 based on inputs from local offices and annual staff evaluation. However, training is conducted on an ad hoc basis, restricted to one to five day events, with informal peer-to-peer learning for new recruits. STS does not have a learning needs assessment or strategic approach to curriculum development. In the absence of adequate in-house trainers, training facilities, courses are organized by calling for tenders where providers and training rooms are selected for specific issues. 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.

11. Several STS's Information Technology (IT) applications suffer from significant deficiencies that affect their ability to offer taxpayers modern tax services and apply risk based compliance management. Aging, end-of-life products still form the backbone of the current IT system. This prevents sharing of information between applications, and 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 STS's subsidiary, FiscServInform (FSI), which reports to the STS via a management board. To improve its access to and quality of information used, the STS has established a new Monitoring, Information and Monitoring Division that would coordinate with the FSI. However, the new division is not yet fully 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 STS 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 STS. This includes risk and case management.

12. The Government of Moldova's Tax Administration Reform Strategy 2011-2015 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. Most of the core revenue functions (such as audit, collection, appeals, enforced collection and anti-fraud activities) will be centralized, while the local offices will provide taxpayer services such as registration, filing, 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.

### **C. Higher Level Objectives to which the Project Contributes**

13. The proposed tax administration modernization project is closely aligned with the Country Partnership Strategy (CPS) for the Republic of Moldova for FY 2014-17. The World Bank Group's CPS for FY2014-17 has 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 support the competitiveness objective by helping improve the business climate and strengthening governance.

14. The proposed Tax Administration Modernization Project (TAMP) is closely aligned with the World Bank Group's twin goals of shared prosperity and poverty reduction. Implementation of the reforms will reduce the tax compliance burden for businesses and small-businesses in particular. Improvements in transparency and accountability of the tax administration will contribute to improvements in the overall governance environment. TAMP will contribute to the goal of reduced poverty, including for the bottom 40 percent, by supporting the automation and integration of tax administration and thereby ensuring sufficient revenues to meet social obligations of the state to the most vulnerable groups.

## **II. PROJECT DEVELOPMENT OBJECTIVES**

### **A. PDO**

15. The development objective of the project is to improve revenue collection, tax compliance and taxpayer services in the Republic of Moldova.

16. The long-term vision supported by the project 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. The modernized tax administration will improve the business environment and improve the country's competitiveness.

### **B. Project Beneficiaries**

17. The immediate beneficiaries are the employees of the State Tax Service who will benefit from an improved working environment based on streamlined operations and working methodologies as well as extensive training and access to international best practice provided by the project. The Government of Moldova and its public finance institutions will benefit from improvements in the administrative efficiency of tax administration. The ultimate beneficiaries are Moldovan taxpayers and citizens. Moldovan taxpayers—business community and individuals—would benefit directly from lower compliance costs and indirectly through more revenues collected to finance important social and infrastructure expenditures.

### **C. PDO Level Results Indicators**

18. The following indicators have been agreed with the STS, to evaluate the development impact of the project:

(a) improve revenue collection:

(i) Overall efficiency of VAT collection;

(ii) Efficiency of VAT collection by the STS;



- (b) improve tax compliance:
  - (i) Additional tax assessments per audit;
  - (ii) Share of active taxpayers filing income declarations in total registered taxpayers;
- (c) improve taxpayer services:
  - (i) Time required to comply with taxes as reported by Doing Business.

### **III. PROJECT DESCRIPTION**

#### **A. Project Components**

19. The project seeks to improve STS's institutional arrangements and management systems to implement a highly automated, low-discretion, risk-based system. The project provides support for: revenue collection methodologies and procedures; information technology and other technological infrastructure and training, tax audit and operational systems refinements and technical assistance to underpin STS's management decisions on organization structure. The project consists of five components.

20. **Component 1: Tax Policy Reform.** This component builds on results of existing Tax Legislation Revision TA financed under DFID TF which supports efforts to align Tax Code with EU requirements. The component will finance a comprehensive review of the legal framework, including: (i) revisions to align Moldovan legislation on VAT and Excise Duties in line with the EU-Moldova Association Agreement; (ii) options to strengthen legislation and administrative practices to counter international profit shifting and base erosion risks for the Moldovan tax base and relevant capacity building in STS and MoF; (iii) strengthening national tax legislation by ensuring consistency of primary and secondary tax legislation, access to tax rulings and improvements in administration of local taxes and fees.

21. **Component 2. Institutional Development.** This component will support changes to STS's organizational structure and strengthen back office functions. It will finance: a comprehensive review and redesign of the organizational structure at headquarters and local offices based on the STS restructuring plan; implementation of the reorganization based on the restructuring plan; strengthening of capacity for strategic management, internal audit, and performance assessment within the STS; a comprehensive review of HR policies; and development of revised work flow analysis, workforce planning and strategy. Regular staff surveys will serve to monitor progress in reform implementation and perceptions of changes by STS employees. 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 STS through study tours, managerial, human resource management and language training. The component will support the development and implementation of a taxpayer service and communication strategy, taxpayer journey mapping and recommendations on improvement of the taxpayer experience. The component will also finance regular taxpayer satisfaction survey which will close the feedback loop by providing STS with data on taxpayer satisfaction. STS will publish the results of surveys together with the actions STS proposes to undertake to address key issues identified by stakeholders.

22. **Component 3: Operational Development.** The component will finance functions that deal directly with taxpayers. Compliance management based on self-assessment and risk management is the cornerstone of an efficient tax administration. The component will support: 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 STS capacity for enforced collection and handling of appeals. The component will provide technical assistance and related training to establish the tax fraud and “agent constator” function.

23. **Component 4: IT Infrastructure and System Modernization.** 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 data warehouse, and establish a business continuity recovery system. It will also provide a bi-directional link to other systems that share data with the STS including Customs Service, CNAS, NHIF, and Registru. The new system will be installed in the GoM’s e-Government data center and/or the Ministry of Finance data center, it will reuse appropriate existing GoM e-services provided by e-GOV and will have data replication to a business continuity center. ITMS implementation will include user training in the use of all ITMS functions and the use of the management reporting, business intelligence and document management tools.

24. **Component 5: Project Management and Change Management.** Funds under this component will be used to support the functioning of the Project Implementation Unit within the STS, which will carry out day-to-day project management and help the STS 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.

## **B. Project Financing**

25. The lending instrument proposed for the project is a IPF. Selection of the lending instrument followed considerations of the technical needs of the STS in managing a comprehensive institutional reform. STS expects substantial advice and independent assessments of implementation progress from supervision missions. STS will benefit from World Bank advice on the most economical way to procure international best practice in terms of highly specialized consultancy assignments, business processes, and information systems. The project will be financed through IDA credit and IBRD loan. As the bulk of the project will finance IT system for STS, the disbursements under the project will be concentrated the in final two years of implementation.

### C. Project Cost

26. The total cost of the project has been estimated at USD 20.0 million. The largest cost item, 75 percent of estimated project cost, will be procurement of hardware and software required to stabilize the current system and put in place an Integrated Tax Management System. Support to tax legislation reform is estimated at 7.5 percent of total project cost, 12.5 percent is allocated to technical assistance and capacity building and the remaining 5 percent supports oversight activities related to the IT investment. The Government of Moldova's contribution to the project will be in-kind and will include staff time, equipment and facilities.

Project Components	Project cost, million US\$	IBRD or IDA Financing	% Financing
1. Tax policy reform	1.500	1.500	100%
2. Institutional development	1.200	1.200	100%
3. Operational development	1.300	1.300	100%
4. IT Infrastructure and system modernization	15.000	15.000	100%
5. Project management and change management	1.000	1.000	100%
<b>Total Costs</b>	<b>20.000</b>	<b>20.000</b>	
Total Project Costs			
Front-End Fees	0.032	0.000	
<b>Total Financing Required</b>	<b>20.032</b>	<b>20.000</b>	

### D. Lessons Learned and Reflected in the Project Design

27. The project takes into account the lessons learned from IEG Evaluation of World Bank Support, Public Sector Reform: What Works and Why and recent Implementation Completion Reports, notably Ukraine State Tax Reform Administration Project and Bulgaria Revenue Administration Reform Project. These point to the following factors as being particularly important in the design and implementation of successful tax administration reform projects:

- Clear evidence of sustained political ownership and support for the reform plans by anchoring the project objectives, scope and activities firmly in Government's reform plans. The project is aligned with the priorities and implementation plan of the Government's tax administration reform strategy.
- Engagement with the key stakeholders, including private sector and taxpayers, in project monitoring to ensure the project meets its development objectives. A Steering Committee formed during preparation will continue functioning throughout the lifetime of the project. In addition, a survey of taxpayers will provide valuable feedback on key deficiencies in tax administration.
- Alignment of Bank investment and resources of other development partners. The project is aligned with the support provided by other development partners including EU, SIDA, USAID and US Treasury. The Steering Committee for the project will include representatives of all development partners as observers to ensure that there is a single platform for discussion of tax administration reform and donor support.
- Institutional reforms should be supported by change management and communications to engage with and address resistance from within the organization and identify appropriate corrective action where reforms are going off track. The project provides for support on

change management under Component 2. This includes the development of a training strategy and curriculum for tax administration staff; building capacity of STS through study tours, managerial/HR training and language training; and support to the development and implementation of a taxpayer service and communication strategy.

- Packaging of IT investments to minimize the need for systems integration by the client. The Project envisages a commercial off-the-shelf solution, which would minimize the need for integration on the client side. Component 5 will also support contract management capacity of the STS.
- Tax administration reform frequently requires changes in the legal framework. These changes must be initiated as early as possible in order to ensure a clear and sufficient legal basis for the reform. The project provides for support to legislation reform under Component 1, which includes revision of tax legislation in part related to tax administration.

#### **IV. IMPLEMENTATION**

##### **A. Institutional and Implementation Arrangements**

28. The Moldova State Tax Service will be the implementing agency for the project. Implementation arrangements are designed to ensure cross-departmental coordination internally within the STS 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.

29. A Project Steering Committee was established during the preparation of the project 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, STS (Project Director, Heads of STS departments, Head of I.I. “FiscServInform”), State Chancellery (e-Gov) and chaired by the Head of STS. Representatives of donor and international organizations are invited as observers. The Committee will provide strategic guidance to the STS 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 December 2015.

30. The STS Chairman or Deputy Chairman 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.

31. The Project Coordinator will be supported by a Project Manager. The Project Manager position was established under the Multi-Donor Programmatic Trust Fund for Europe and Central Asia Region Capacity Development (TF017145). The TAMP Project Manager will be selected under the project and will head a Project Management Unit (PMU). The PMU will help STS 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 STS before project effectiveness and is an effectiveness condition. The POM will lay out the project’s overall operating, fiduciary, and decision making procedures

and its results monitoring arrangements. The PMU is expected to be staffed with key FM and procurement personnel following the effectiveness of the project.

32. As one element of the change management activities of Component 5, the PMU will facilitate citizen engagement by STS steering committee members through creation of a private sector advisory panel comprising both individual taxpayers and companies. This advisory board will comprise taxpayers and business associations and meet regularly either on quarterly or on semi-annual basis and focus on both tax administration reform agenda as well as issues in tax administration more generally. During the meetings the STS will inform the board members on the actions taken based on outcomes of the previous advisory board meeting to ensure that taxpayers' views are taken into account.

## **B. Results Monitoring and Evaluation**

33. The project results framework is presented in Annex 1. STS is responsible for monitoring and evaluation of the project outcomes and intermediate indicators. The monitoring system will maintain records on implementation and generate mid-year project progress reports and annual reports prepared within four months of the end of the financial year, focusing on results-based accountability and accomplishments against performance expectations. Progress reports will be prepared by the PMU, approved by the Project Coordinator, presented to the STS Director, and forwarded to Bank and Steering Committee before implementation support missions to guide the discussion of key issues impacting project implementation.

34. The project will finance the implementation of surveys to assess STS's taxpayer services. The surveys will provide gender-disaggregated data (where feasible as in the case of individual taxpayers) and also monitor any gender differences in the feedback provided. The first survey will be completed in the first year of implementation of the project and will be used to establish a baseline for improved satisfaction of taxpayers.

35. World Bank implementation support missions will be undertaken at least twice yearly. The progress assessed during these missions will be reported by the World Bank team to its management through implementation status and results reports (ISRs) which will include a review of key implementation issues and performance indicators. A mid-term review is scheduled for the third year of implementation. Given the comprehensive nature of these reforms, there are many areas that the project will likely tackle but which cannot be predicted in advance. The results framework could be revisited and updated during the mid-term review.

## **C. Sustainability**

36. 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. The engagement of other development partners such as EU, IMF, Sweden, US Treasury, and USAID will help strengthen push for reforms and promote sustainability of project results. The EU, Sweden and USAID have ongoing technical

assistance and capacity development engagements, the IMF undertakes regular technical assistance missions on tax administration, and the US Treasury is expected to provide a technical advisor on change management.

## **V. KEY RISKS**

### **A. Overall Risk Rating and Explanation of Key Risks**

37. The overall risk rating for this project is substantial. Political and macroeconomic risks are considered high and policy, technical, institutional capacity and fiduciary risks are substantial and require close attention during preparation and implementation stages.

38. The political context is unstable owing to the short tenure of Government coalitions in Moldova. Changes in Government could lead to changes in the legal and policy framework and priorities or reversal of important institutional reform measures in advanced stage of implementation, such as the reorganization of STS. The modernization of the STS enjoys strong support within the MoF, STS, and key stakeholders including the Customs Service and CNAS. Moldova's EU orientation and continuing engagement in policy dialogue are expected to help sustain reform momentum. Continuous engagement with other development partners and technical level counterparts is critical to partially mitigate this risks. Achievement of PDOs and the benefits outlined in the economic analysis may also be challenging should the macroeconomic environment decline.

39. The technical risks are related to the design and implementation of the Integrated Tax Management System. This is a complex undertaking. The project design provides for the acquisition of a customized off the shelf ITMS solution with minimal customization. Definition of business process requirements for ITMS development and alignment of operational procedures with the new system requires significant technical capacity. In the past, the STS IT service provider (State Enterprise FiscServInform) has taken the lead role in developing all business requirements and planning system implementation. FiscServInform will need to be extensively engaged in finalizing TAMP business requirements and, implementation planning. STS may need to secure additional funding from the MoF for transfer to FiscServInform as they undertake work on a cost recovery basis. Inclusion of the e-GOV shared IT service provider as the host data center and platform means that the STS will be dependent on an additional external stakeholder agency. This will have to be managed under technical risks.

40. The risks related to institutional capacity are twofold: the first is related to STS's technical and managerial staff capacity to support the implementation of reforms; the second is related to resistance to organizational change. Technical and managerial capacity can be addressed through the provision of technical assistance. Component 5 allocates resources for project and change management capacity building and will finance national and international consultants to support project management, implementation planning, training, and change management activities. Organizational resistance poses a much more significant challenge.

41. There are a number of stakeholders that will be negatively impacted by the project: tax officials and tax payers engaged in corrupt practices that will be more difficult in a more automated and more transparent operating environment; tax officials who will lose their discretion or be required to move as a result of the organizational restructuring; and service providers that will lose influence and income, notably the State Enterprise which may have a less prominent role in system maintenance in the future. The STS will gather feedback on the change

process through regular staff surveys. Component 5 also provides support to the change management function to address these risks. This will include support for targeted communications with internal and external stakeholders (including citizen engagement) that will explain the rationale for reforms, build constituencies and address reform resistance.

42. Fiduciary risks related to IT procurement could have significant adverse impact on the project. The Bank will work closely with the STS to ensure a transparent competitive process for procurement of the ITMS. The Project Management Unit will support STS in conducting procurement. STS will contract an experienced management consultant to take on Project Management responsibilities. Component 5 allocates resources for capacity building and will finance national and international consultants to support procurement, financial management, project audit, and technical implementation; international advisors for IT project management, training and change management activities. STS will hire a consultant with experience in the design implementation of ITMS to support the procurement process and contract management during implementation.

<b>Risk Categories</b>	<b>Rating (H, S, M or L)</b>
1. Political and governance	H
2. Macroeconomic	H
3. Sector strategies and policies	S
4. Technical design of project or program	S
5. Institutional capacity for implementation and sustainability	S
6. Fiduciary	S
7. Environmental and social	L
8. Stakeholders	M
9. Other	n/a
<b>Overall</b>	<b>S</b>

## **VI. APPRAISAL SUMMARY**

### **A. Economic and Financial Analysis**

43. Economic and financial analysis of the project considers direct benefits and costs associated with the changes in economic welfare arising from the project. The reforms proposed under TAMP will generate economic benefits for taxpayers (reduced time to comply with taxes) and for the tax administration (efficiency gains in tax administration processes including reduced time for onsite audits and streamlined workflow). The economic analysis presented in Annex 5 estimates a ERR of 23 percent and NPV of USD 3.6 million. The estimate of the economic rate of return is conservative assuming a limited number of direct benefits. The economic analysis only assessed direct benefits. There are other potential benefits as a result of the project, such as potential outsourcing of accounting services and reduction in the number of inspections.

44. From the financial point of view, the project is expected to generate additional budgetary revenues through greater collections of tax arrears (primarily VAT) and higher compliance (both volunteer and enforced) with major taxes. It is also anticipated that compliance will be enhanced through reduced opportunities for corruption as a result of greater transparency and limited face-

to-face interaction between tax inspectors and tax payers. The financial analysis of the project is based on the project outflows and greater budgetary revenues (inflows) estimated using the elasticity approach whereby the increase in revenue for each major tax is interrelated with the growth in the tax base (GDP used as a proxy). Elasticity estimates are obtained for PIT (0.89), social security contributions (0.98), VAT (1.2) and CIT<sup>1</sup> (0.91) over the 2004-2014 period. At the IRR of 48 percent and NPV of USD 3 million the project is beneficial from an investment point of view. Details of economic and financial analysis are provided in Annex 5.

## **B. Technical**

45. Key tax administration issues that hamper revenue collection are a high compliance burden for taxpayers and low efficiency of enforced compliance efforts such as audits and inadequate focus on facilitation of voluntary compliance and taxpayer service. Tax administration effectiveness and efficiency are hampered by cumbersome business processes, a highly fragmented IT system with significant manual processing required for data entry and consolidation, an inaccurate taxpayer registry, and inadequate ability to deploy personnel where needed due to the decentralized organizational structure.

46. The project will support the implementation of an automated risk-based approach to maximize revenue collection; promote modern open interaction with taxpayers; and a fair, taxpayer-friendly approach to addressing taxpayer grievances. While the burden of compliance for compliant taxpayers is expected to drop significantly, the compliance costs of tax evaders is likely to increase significantly. The project will provide STS with tools and training to better focus on non-compliant taxpayers, including businesses that avoid paying taxes.

47. The project will also support the procurement of an off the shelf revenue management IT system. A high level design of the new IT system is already available in the functional and technical requirements developed under EU TA Project in 2011. The ongoing TAMP preparation grant has financed a consultancy that will update these requirements and elaborate on scope and timeline, number and location of users, transition arrangements from legacy systems, storage and disaster recovery, capacity building requirements, change management considerations, ongoing maintenance and upgrading needs.

48. The requirements of the GoM IT e-Services and infrastructure consolidation (MCloud) initiative and policy will need to be integrated into the technical specifications. ITMS technical specification must reuse and align to the MCloud technology architecture and the MCloud architecture will need to be agile enough to adapt to the most preferred application and database development environment (for example, being open to common application development environments such as .NET or JAVA, related application development tools, and common database management solutions such as Oracle, Windows, DB2, Postgrey, MsSQL, MySQL or some of the more popular open source products available) that are commonly used by potential bidders for the ITMS tender. If the MCloud platform owners (e-GOV) have any strict limitations on what can be used or deployed to the MCloud platform, these will need to be captured within the technical specifications and, if determined to be too restrictive resulting in a significant reduction of potential bidders (either discovered now during project preparation work or, through the first phase of the ITMS tender), then some mutually acceptable framework will need to be worked out to ensure broad enough competition for the tender. As a project risk mitigation

---

<sup>1</sup> For consistency purposes elasticity estimates for CIT do not cover the period of 2008-2011 when zero tax on business profit reinvested in a business was effective.



measure due to the length of time from now to when STS will be ready for contract award, FSI remains the contingency alternative infrastructure and data center services provider in the unlikely scenario where the e-GOV MCloud fails to meet ITMS needs, suffers a catastrophic disaster, or no longer remains a supported GoM policy.

49. The project proposes a comprehensive set of activities which cover the critical aspects of MTA operation. Maintaining such a complex set of interventions will be a substantial challenge for MTA management. For the expected project outcomes to materialize, it will be essential to pay close attention to the sequencing and interdependence of project activities. The project entails a significant project management component to manage this responsibility, including technical and change management capacity building.

50. The impact and sustainability of tax administration reforms, supported under the project, will be enhanced if improvements in tax policy are implemented. STS alone may not be able to implement all the changes needed in the tax administration. Improvements in the responsiveness to taxpayer needs for efficient ruling and resolution of disputes, for example, may require changes in tax policy framework. Similarly, some of the simplification of operational procedures to improve service delivery, improve effectiveness of tax audits, and deal with non-compliant taxpayers in both filing and payment may require refinements of tax laws. The recent EU Moldova Association agreement imposes certain requirements on Moldova in terms of tax legislation and is expected to contribute to an improved legal framework for taxation. These improvements will be supported under the ongoing DFID TF-financed technical assistance project on revision of tax legislation as well as under Component 1 of the project.

### **C. Financial Management**

51. The financial management assessment concluded that the STS would comply with World Bank requirements provided certain conditions are fulfilled. The STS does not have prior experience in the implementation of the World Bank financed projects, therefore fiduciary support by qualified consultants is critical for mitigating capacity risks and successful project implementation. The STS, with support of a Financial Management Consultant to be hired by the project, will handle project planning, budgeting, accounting, financial reporting, funds flow, internal controls and auditing. The project financial management arrangements, including internal control framework, will be described in detail in the Project Operational Manual. Project funds will be managed through the treasury system which is currently the common arrangement for all the World Bank funded projects implemented in Moldova. The annual audited financial statements together with the auditor's opinion and the management letter will be provided to the Bank within six months of the end of each fiscal year and at the closing of the project. The STS will be responsible for selection and appointment project auditor in accordance with the Terms of Reference agreed in advance with the World Bank, and financial audit will be financed from the project funds.

52. Although analytical assessment conducted (Public Expenditure and Financial Accountability (PEFA)) demonstrate weak downstream elements of the PFM system, efforts are being made at a portfolio level to use some elements of the country PFM system. In particular, the Treasury system is used to maintain the designated accounts of Bank-financed projects, including under TAMP, at the National Bank of Moldova. For all the other financial management elements (except for budgeting, where the country system is used) STS's financial

management systems including accounting and reporting are going to be used for this particular project.

#### **D. Procurement**

53. Procurement under the proposed project will be carried out in accordance with the Bank “Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers” published in January 2011, revised in July 2014 (Procurement Guidelines) and “Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers” published in January 2011, revised in July 2014 (Consultant Guidelines) and with the latest Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits dated October 15, 2006 and revised in January 2011.

54. The assessment of the capacity of STS to implement procurement activities was carried out in April 2016. The team assessed the risks that may negatively affect the ability of STS to carry out the overall procurement processes as High, given the complexity of the project, the existing capacity within STS and experience under the preparation grant. The findings of this assessment, the risks, and the proposed mitigation measures are described in Annex 3.

#### **E. Social (including Safeguards)**

55. The Project does not include activities which might cause social risks or negatively affect the general population and no differential impact for female beneficiaries were identified. The Project would benefit Moldovan citizens by promoting taxpayer compliance and improving taxpayer services by creating a more efficient tax administration. The project does not support any activities that may result in the reduction in staffing levels. However, there may be staff redeployment as a result of organizational restructuring and changes in budget processes.

56. Stakeholders interviewed by the project team in 2014 also identified 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 problems in the tax administration in Moldova. The component of the project focusing on improving the appeals process (Component 2) and streamlining tax ruling procedures (Component 1) will help resolve ambiguity in interpretation of tax rules and procedures. While tax administration is perceived as an obstacle to doing business only by 4.5 percent of taxpayers according to 2013 BEEPs, there is a need for regular feedback from taxpayers to ensure their needs are addressed and tax compliance is facilitated. Taxpayer satisfaction surveys are undertaken from time to time by the STS and will be supported by the project alongside with the development of a taxpayer service strategy. The satisfaction surveys will provide gender disaggregated data to allow for gender-focused analysis to assess the impact of tax policy and administration on men and women. Survey results will inform the development and implementation of initiatives to improve taxpayer satisfaction. The STS will publish the results of the survey as well as suggested actions to address key identified weaknesses on the STS website.

57. The restructuring of the STS is not expected to result in downsizing of staff due to already small staffing number of the STS, which is below 2,000. The STS has employees spread across headquarters, a large taxpayer office, a call center and a network of 35 regional tax offices. The regional offices employ over three quarters of the overall staff number. The restructuring would

focus on strengthening headquarters by implementing a headquarters organized according to functions with key supporting departments; and developing a consolidated regional delivery network.

58. In addition, the project will support establishment of private sector advisory board to strengthen the feedback loop from taxpayers to the tax authorities.

#### **F. Environment (including Safeguards)**

59. The Project does not trigger any World Bank environmental safeguard policies. Therefore, the Project has been assigned a Category C in accordance with the World Bank safeguard policy OP/BP/GP 4/01.

#### **G. Other Safeguards Policies Triggered**

60. The project is limited to the provision of technical assistance and procurement of the IT system to support the Government's tax administration reform agenda and will not have any negative environmental impact.

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>
<u>Environmental Assessment</u> (OP/BP/GP 4.01)	[ ]	[X]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OP 4.20, being revised as OP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

#### **H. World Bank Grievance Redress**

61. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit

---

\* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.

<http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

**Annex 1: Results Framework and Monitoring**  
**Country: Moldova**  
**Project Name: Tax Administration Modernization Project (P127734)**  
**Results Framework**

**Project Development Objectives**

PDO Statement

To improve revenue collection, tax compliance and taxpayer services in the Republic of Moldova

**These results are at** | Project Level

**Project Development Objective Indicators**

Indicator Name	Baseline	Cumulative Target Values									
		YR1	YR2	YR3	YR4	YR5	YR6	YR7	YR8	YR9	End Target
Time required to comply with taxes (Hours)	186.00	186.00	186.00	186.00	175.00	165.00					165.00
Increase in additional tax assessed per audit (Percent)	25822 MDL per audit in 2015	10.00	15.00	21.00	27.00	34.00					34.00
Share of active taxpayers filing income declarations in total registered	19.35	20.00	21.00	22.00	23.00	24.00					24.00

taxpayer (Percentage)											
Overall efficiency of VAT collection (Percentage)	52.3	52.4	52.7	53.3	54.2	54.7					54.7
Efficiency of VAT collection by the STS (Percentage)	11.06	11.16	11.34	11.70	12.20	12.54					12.54

### Intermediate Results Indicators

Indicator Name	Baseline	Cumulative Target Values									End Target
		YR1	YR2	YR3	YR4	YR5	YR6	YR7	YR8	YR9	
Share of income tax returns filed electronically (Percentage)	39.60	40.00	45.00	50.00	55.00	60.00					60.00
Share of large taxpayer audits which includes related parties in cases when related parties exist (Percentage)	0.00	0.00	10.00	20.00	30.00	35.00					35.00

Number of hits to the STS web-site (Number)	3,570,004	3,900,000	4,300,000	4,600,000	5,200,000	5,700,000					5,700,000
Decrease in tax arrears (Percentage)	8.50	8.50	8.50	8.00	7.50	7.00					7.00
The Training Center capacity in permanent training program (Text)	The list of training programs is not identified	The list of training programs is identified	The identified training programs are developed	The technical capacity, including IT solutions of the Training Center is developed	The permanent training program is fully functioning	100% of appropriate STS staff have been trained in use of business functions and new tools, data disaggregated by gender					100% of appropriate STS staff have been trained in use of business functions and new tools, data disaggregated by gender
Taxpayer satisfaction (Text)	Satisfaction not measured	Satisfaction in crease - 0% Baseline survey conducted with data disaggregated by gender, results and suggests actions of the STS to address weaknesses are published on the STS website	-	Satisfaction in crease - 10% (compared to baseline) Mid-project survey conducted with data disaggregated by gender, results and suggests actions of the STS to address weaknesses are published on		Satisfaction in crease - 20% (compared to baseline) Final survey conducted with data disaggregated by gender, results and suggests actions of the STS to address weaknesses are published on					Satisfaction in crease - 20%

				the STS website		the STS website					
--	--	--	--	--------------------	--	--------------------	--	--	--	--	--



### Indicator Description

#### Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Time required to comply with taxes	The indicator measures improved taxpayer services part of the PDO, as taxpayer services would lead to less time required to prepare, file and pay (or withhold) CIT, VAT, labor taxes, including payroll taxes and social contributions (in hours per year).	Annual	Doing Business	World Bank
Increase in additional tax assessed per audit	The indicator measures improved enforced compliance part of the PDO. Increased additional assessment (i.e., monetary amount assessed during audit) as a result of audit will measure improved efficiency of audit planning process and quality of audit. Better audits will lead to reduced non-compliance	Annual	STS management reports	STS
Share of active taxpayers filing income taxes out of registered taxpayers	The indicator measures improved voluntary compliance part of the PDO. Ratio of active taxpayers-economic agents filing income taxes (legal entities and individual entrepreneurs) to all registered taxpayers.	Annual	STS Management Reports	STS
Overall efficiency of VAT collection	The indicator measures improved revenue collection based on the c-efficiency of VAT (Ratio of VAT revenue to the product of the standard rate and consumption). Increases in the C-efficiency will be used as an indicator of reducing revenue losses as a result of issues with administering VAT.	Annual	Statistical data and STS's estimates	STS

Efficiency of VAT collection by STS	The indicator measures efficiency of VAT collection by the STS domestically, netting out performance of Customs. It is calculated as actual VAT collection over consumption net of imports	Annual	Statistical data and STS's estimates	STS
-------------------------------------	--	--------	--------------------------------------	-----

### Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Share of large taxpayer audits which includes related parties, when related parties exist	Indicator measures share of audits that include related parties in overall number of comprehensive audits of large taxpayers.	Annual	STS Reports	STS
Decrease in tax arrears	Share of tax arrears at the end of the year in tax revenues collected during the year	Annual	STS Reports and budget execution reports	STS
Taxpayer satisfaction	Survey to be carried out at least three times during implementation of the project to provide data on taxpayer satisfaction including disaggregated by gender	No description provided.	Survey	STS
The Training Center capacity in permanent training program	No description provided.	Annual	STS management reports	STS
Share of income tax returns filed electronically	Share of corporate income tax returns and personal income tax from entrepreneurial activity filed electronically by economic agents in overall number of returns	Annual	STS reports	STS
Number of hits to the STS web-site	Indicator measures number of times taxpayers accessed the STS web-site.	Annual	STS reports	STS

## Annex 2: Detailed Project Description

### MOLDOVA: Tax Administration Modernization Project

#### Component 1: Tax legislation reform

1. This component strengthens the legal framework to facilitate effective and efficient tax administration and to comply with requirements of the EU-Moldova Association Agreement. This component consists of three subcomponents:

2. **Sub-component 1.1: Review of Tax legislation compliant with EU-Moldova Association Agreement.** This subcomponent will finance a comprehensive revision of tax legislation including based on comparison with appropriate examples of EU member states to ensure that revised legislation reflects best practices including those of the EU and is in line with EU-Moldova Association Agreement requirements. This will include harmonization of VAT and Excise Duties legislation to European Union (EU) legislation according to clauses and terms settled in the Republic of Moldova - EU Association Agreement. The consultancy under this activity will deliver a draft Tax Code.

3. **Sub-component 1.2 Strengthening national legislation and administrative practice to counter risks of profit shifting and base erosion for the Moldovan tax base** This component will include a risk and needs assessment to determine sources (transactions, sectors, etc) of base erosion and profit shifting in Moldova. The review will include a comprehensive assessment of national legislation, available data-sources and provide detailed recommendations based on international practice. The consultancy will provide support to drafting legislative changes where requested. The sub-component also supports capacity development, including training for STS representatives on specific changes in legislation and development of a training program to be incorporated in the Training Center's schedule and delivery of initial training for trainers.

4. **Sub-component 1.3: Strengthening national tax legislation in order to increase its effectiveness and the efficiency of tax administration.** This subcomponent will provide analysis for increasing voluntary tax compliance by improving the consistency of primary and secondary tax legislation, timeliness of access to tax rulings and taxpayers' access to information on tax rules. The project will also support improvements in administration of local taxes and fees:

- (a) Review of national legislation to address inconsistencies in primary and secondary legislation; this will include a comprehensive review of all regulations, normative acts, by-laws (inventory) to identify bottlenecks and the provision of recommendations and drafting options to address these.
- (b) Analysis of current tax ruling practice from the client satisfaction point of view. Recommendations on improvement of tax ruling system in terms of institutional structures and processes, and the development of practical guidance for the the implementation of tax rulings.
- (c) Administration of local taxes and fees. Comprehensive analysis of local budgets' own revenues, including efficiency analysis of each local tax and its administration, analysis of legal and institutional framework of administration of the local taxes and fees. Recommendations, including cost-benefit analysis, on local tax administration system in a centralized way by State Tax Service vs by local government based on applicable international experience.

## **Component 2: Institutional development**

5. This component focuses on strengthening STS as an institution for tax service delivery through sub-components on organization restructuring, management capacity, HR development, and communications capacity as it relates to taxpayer service.

6. **Sub-component 2.1: Organization Restructuring.** The activities within this main sub-component will focus on supporting changes in organizational structure, i.e. unification of current model with 35 independent legal authorities as Territorial Offices into single legal entity. The sub-component will finance analysis and recommendations on implementation plans for the new structure of headquarters and local offices. The sub-component will include transition communication and implementation plans to address the impact of the restructuring on the staffing needs of the STS.

7. **Sub-component 2.2: Strengthening Management Capacity.** This sub-component will strengthen the capacity for strategic management and performance assessment within the STS. It will provide:

- (a) development and implementation of performance management system including performance indicators for STS by function/process;
- (b) workload and workforce analysis and recommendations for implementation;
- (c) training on strategic management, strategic planning, and leadership.

8. **Sub-component 2.3: Strengthening HR Development Capacity.** The sub-component will finance:

- (a) training needs assessment, development of a training strategy and curriculum for tax administration management and staff (in addition to the tax operational training covered in component 3);
- (b) building capacity of the STS training center including through purchase of technical and training equipment for the training center and distance learning;
- (c) building capacity of STS through study tours, managerial/HR training, and language training;
- (d) staff survey and assessment of HR policy, and development of HR policy;
- (e) development of career management framework

9. **Sub-component 2.4: Strengthening Taxpayer Service and Communications Capacity.** The sub-component will finance comprehensive needs assessment of taxpayer service function, including:

- (a) analysis of taxpayer services including taxpayer journey mapping and recommendations on their improvement with an objective of reducing time required to comply with taxes;
- (b) update of taxpayer service and communication strategy and support to its implementation;
- (c) recommendations on development of e-services for taxpayers, website improvements, and taxpayer aid publication.

10. **Sub-component 2.5: Strengthening Internal Audit Capacity** The sub-component will finance a diagnostic of current capacity for internal audit and best practices and internal audit

including recommendations for strengthening institutional capacity and will offer training in these areas.

### **Component 3: Operational Development**

11. This component strengthens STS's operational efficiency by modernizing all key tax collection operational functions including, filing declarations, tax payment, risk management and tax audit, collection of tax debts, dealing with tax appeals, and enforcement. Component activities will streamline business processes, define business requirements and strengthen the capacity in STS staff to implement the new information systems to support the integrated business functions. The component will include the following sub-components:

12. **Sub-component 3.1: Modernization of tax collection operational functions.** The sub-component will work alongside business process reengineering embedded in the proposed COTS revenue management system to drive best practices and business process reengineering within STS, especially in reference to the key tax collection functions. It will provide technical assistance on:

- (a) Review and recommendations for procedure manuals and processes for collection function;
- (b) Promotion of electronic filing of tax returns, payments and other communications with taxpayers (e.g. taxpayer portal, STS web site);
- (c) Improvements in procedures for payment processing, matching, and attribution to taxpayer sub-accounts to eliminate manual processing;
- (d) Analysis of the training needs of the returns and payment processing units, development of a permanent training program for the staff and deliver initial training in processing, including training of the unit's trainers and study tour of modern tax administrations operations.

13. **Sub-component 3.2: Strengthening of risk based compliance management across the STS, including the LTO.** This sub-component will provide technical assistance and capacity development in:

- (a) Development of an integrated database of taxpayers (legal entities and individuals) with data and information inputs from other third party sources; strengthening systems for information collection from third parties and internal dissemination and use of the data collected; creation of a central data warehouse that can support all STS operational activities in assessing risks; and development of a protocol for information exchange with other agencies and procedures for use of third party information by the STS; update of tax gap estimation methodology.
- (b) Revision of operating procedures for enforcement and compliance activities to incorporate international best practices; development of methodologies to evaluate risk of non-compliance by taxpayers and potential taxpayers for the risk-based tax administration across taxpayer registration, services, filing, payment and audit. This would include preparation of algorithms for the ranking of risk of non-compliance and enforcement priority (e.g. potential value of revenue at risk, probability of failure to comply or follow-up on commitments to pay outstanding amounts); development of manuals for industry-specific audits in coordination with the relevant authorities with

interest in the economic sector and in relevant topics such as international taxation and e-commerce. The component will cover development of compliance management methodologies for the LTO, e.g., horizontal monitoring.

- (c) Development of a permanent training program for auditors and deliver extensive training including: (i) develop curriculum and training materials to take full advantage of the audit software and (ii) training in audit techniques covering general audit, forensic audit, specialized economic sectors and specialized audit techniques

14. **Sub-component 3.3: Tax debts, arrears collection and non-filer.** This subcomponent will focus on improving capability of the STS to collect and manage tax debt through:

- (a) Review of current regulations, rules, and procedures for the management of arrears and enforced collection and preparing recommendations to improve the effectiveness of enforcement and compliance operations.
- (b) Development of manuals for tax debt management, arrears collection, and gap filer/non-filer enforcement.
- (c) Development of a permanent training program for the staff and deliver initial training in recovery of arrears and arrears management along with enforced return filing, including training of the unit's trainers.

15. **Sub-component 3.4: Strengthening the Capacity of the Legal and Appeals Function.** This component will improve the transparency and streamline the appeals process, ensuring greater consistency in rulings and reducing transaction costs for tax payers and the tax administration through:

- (a) Development and delivery of a training program for current Legal Department staff covering training on MoF and STS's business processes and computer systems for the Legal Department, including on issue of tax resolutions and rulings, and tax appeals
- (b) Development of methodology and capacity to implement multi-lateral and bi-lateral tax treaties.

16. **Sub-component 3.5 Tax Fraud.** This subcomponent will help the STS build auditor capacity to identify, investigate, and document (in preparation for criminal prosecution) cases of tax fraud or other economic by financing:

- (a) Identification of tax fraud training needs and course delivery;
- (b) Technical assistance on rules of evidence and chain of evidence procedures and relevant training.

#### **Component 4: IT Infrastructure and System Modernization**

17. This component will acquire and implement an Integrated Tax Management Solution (ITMS) that will unify IT support for all business functions for all taxes administered by the STS. The procurement strategy for the ITMS solution is to tender for a Commercial Off the Shelf tax solution (COTS) to be configured, customized, tested and implemented by the selected solution provider based on technical specifications finalized by the STS under preparation grant. Within the project and procurement strategy, the ITMS tender will include an option for the data center hardware and software provisioning (procurement, installation, and testing) as part of the vendor bids to ensure all integration and supply issues are managed by the vendor in case there

are any issues with capability of e-GOV Center to provide for all platform needs as currently envisioned. Installation and testing would be done in collaboration with the STS IT service provider (state owned enterprise FiscServInform and the e-Government Center under the State Chancellery) and if the option of hardware and software product selection by the vendor be executed, it would be done in alignment with the e-Gov architecture and technical specifications within the tender documents. The specified architecture is a browser based implementation with centralized transaction processing and data storage under a virtual server environment (M-Cloud – Government Shared Computing Infrastructure) with data managed by a relational database management system. The tender would include the option of provisioning hardware devices to replace existing devices in STS that do not meet the minimum technical requirements to support the ITMS applications. The component will finance procurement of network equipment or services in support of the restructuring or new COTS solution.

18. The chosen ITSM solution will include a security access layer that supports configurable role based system access by staff, transaction audit trails and logging, and support for security monitoring and investigations. The solution will include business continuity recovery tools and capability as well as automated fail over for key public facing components. Vendor implementation will include a data cleansing and conversion to load the operational databases as well as the data warehouse. This work will require close collaboration with the STS IT service provider FiscServInform as will implementation planning and workload transition from old systems to the new ITMS. The ITMS will also provide if needed a bi-directional links to other systems that share data with the STS including Customs Service, Registru, CNAS, and NHIF.

19. The COTS tax application provisioning will deploy modern tax operations functionality consistent with international good practices for: taxpayer registration, tax declaration processing, accounting, payment processing, collections and enforcement, objections and appeals, audit, risk assessment profiling, management reporting, case work flow management and execution solutions for collections and enforcement, audit, tax rulings, and appeals, and a document management solution. It also will deploy a taxpayer portal to improve self-service channels for taxpayers for both electronic filing and tax information enquiries. Implementation will support risk profiling through the creation of a data warehouse and provisioning, configuring, and training in use of business intelligence tools and potentially creation of dependent data marts (a subset of the data warehouse but including other 3rd party data). During the gap fit assessment done by the ITMS solution provider, the STS may opt to adopt some good practices included in the vendor solution rather than customize to their existing business processes. The solution provider will provide training modules, material and training delivery for all tax functions and the business intelligence, management reporting, and document management tools. The tender will include ongoing options for application maintenance.

20. ITMS will use the GoM's shared computing infrastructure M-Cloud data center virtual server environment. It will reuse appropriate existing GoM's platform e-services provided by the e-Government Center and will replicate data to the e-GOV business continuity center.

21. STS will require consulting assistance in project management, management training on the role of the functional business owner in developing business requirements and user acceptance testing, system development lifecycle for major IT projects, project management, and management of change. They would also benefit from periodic reviews of project implementation and management of change plans, progress against plans, risks, and issues.

## **Component 5: Project Management and Change Management**

### **Sub-component 5.1: Project Management**

22. Funds under this component will be used to support the functioning of the project management unit within the STS, which will carry out day-to-day project management including: procurement, financial management, and organization of audit activities; help the STS coordinate project activities and interact with all local and international entities involved in the project. In addition the subcomponent will finance audit and operational expenses.

### **Sub-component 5.2: Change Management**

23. Change management and communications will be financed under this Component as well as by communications activities in component 2. Emphasis will be on TAMP management of change strategy, communications plan, and content to address STS management and staff concerns as well as those of both public and private sector stakeholders. The sub-component will support establishing a private sector advisory panel for consultation to allow a significant level of citizen engagement in the design and monitoring of reforms.



### **Annex 3: Implementation Arrangements**

#### **MOLDOVA: Tax Administration Modernization Project**

##### **Project Institutional and Implementation Arrangements**

1. The State Tax Service under the auspices of the Ministry of Finance will be responsible implementing agency for the project. STS will ensure appropriate coordination internally within the STS as well as with the Ministry of Finance to achieve project objectives.
2. A Steering Committee was formed during the preparation stage to oversee the project implementation. The committee will comprise the Project Director, Heads of STS departments, Head of I.I. “FiscServInform”, representative of the Minister of Finance and other officials assigned by the Government, if needed. The Steering Committee will be responsible for making key strategic decisions, monitor overall project implementation progress, and resolve high level implementation and coordination issues as they arise.
3. The STS Chairman or Deputy Chairman will serve as a project Coordinator. The Project Coordinator will oversee daily project implementation, monitor progress and ensure timely completion of the project activities. The Project Coordinator will serve as a focal point for the communication with the World Bank team on project related issues. The Project Coordinator will work closely with a resident high-level adviser from US Treasury who will provide technical support to the STI in support of its tax reforms over a period of two to three years.
4. The Project Coordinator will be supported by a Project Manager. The Project Manager will assist the STS with project implementation. The Project Manager will head a Project Management Unit (PMU), staffed by a procurement and financial management specialists hired as consultants. The PMU will handle procurement, financial management, contract management, monitoring and evaluation, and reporting functions under the project.
5. The project will be implemented based on a Project Operational Manual which will be adopted by the STS. The POM will lay out: the project’s overall operating, fiduciary, and decision making procedures; and results monitoring arrangements.

##### **Financial Management, Disbursements and Procurement**

###### *Financial Management*

6. The findings of the financial management assessment conclude that the proposed project Financial Management systems and framework are adequate to support the implementation of the project. The project will rely on institutional and procedural set-up established by the STS. The Inherent Risk of the project is rated as Substantial, while the Control Risk is Moderate and the Overall FM Risk is Moderate taking into account the mitigation measures that will be completed by project effectiveness.
7. The STS will be responsible for carrying out the financial management function of the project, including planning and budgeting, accounting, flow of funds, financial reporting, internal control and auditing. The project’s FM assessment undertaken in October 2015 established that the STS has acceptable FM arrangements in place provided the action plan agreed during the project preparation is fulfilled.
8. The STS prepares its annual budget in accordance with the architecture of Moldova’s budget classification system. The project budget will follow the established procedure for

approval, budget execution reporting and monitoring at the Government level. Budget execution will be monitored through the regular budget reports submitted to the Ministry of Finance. Once reviewed and endorsed by the MOF, the Project budget will be included in the state budget. The approved annual budget will be entered into the accounting system and used for periodic comparison with actual results as part of the interim reporting.

9. The Economic-Financial Department is responsible for statutory accounting, planning and financial analysis within STS, and it will undertake the FM function of the project. The STS has an adequate internal control system in place for implementation of the Project, including adequate segregation of duties among its accounting staff. All fixed assets (FAs) of the STS are properly registered. The STS maintains lists of FAs assigned to each employee and FAs' registration cards. Stocktaking is performed annually (usually by the end of each calendar year).

10. Project management-oriented Interim Un-audited Financial Reports (IFRs) will be prepared under the project. STS will produce a full set of IFRs every quarter throughout the life of the project. The format of IFRs has been agreed during the assessment (incorporated into the FMM) and includes: (i) Project Sources and Uses of Funds, (ii) Uses of Funds by Project Activity; (iii) Project Balance Sheet, (iv) Designated Account Statement; and (v) SOE Withdrawal Schedule. These financial reports will be submitted to Bank within 45 days of the end of each calendar quarter for the quarter. The first quarterly IFRs will be submitted after the end of the first full quarter following the initial disbursement.

11. The STS will be responsible for regular audit of the project financial statements. The annual audits of the project financial statements will be provided to the Bank within six months of the end of each fiscal year, and also at the project closing. The Borrower has agreed to disclose the audit reports for the project within one month of their receipt from the auditors, by posting the reports on the STS Website. Following the Bank's formal receipt of these reports from the Borrower, the Bank will make them publicly available according to World Bank Policy on Access to Information. If the period from the date of effectiveness of the loan to the end of the Borrower's fiscal year is no more than six months, the first audit report for the project may cover financial statements for the period from effectiveness to the end of the second fiscal year. The contract for the audit awarded during the first year of project implementation may be extended from year to year with the same auditor, subject to satisfactory performance. The cost of the audit will be financed from the proceeds of the project.

#### *Disbursements*

12. STS will establish and manage a Designated Account opened specifically for this Project in the Single Treasury Account of the Ministry of Finance at the National Bank of Moldova. The National Bank holds all DAs for ongoing World Bank projects in Moldova. The Project's Designated Account will be managed by STS. Project funds will flow from the Bank, either: to the DA to be maintained in the Treasury, which will be replenished on the basis of SOEs or full documentation; or direct to payees on the basis of direct payment withdrawal applications and/or special commitments received from the STS. Withdrawal applications that document funds used from the DA will be sent to the Bank on a monthly basis. The following disbursement methods may be used under the Project: (a) reimbursement; (b) advance; (c) direct payment; and (d) special commitment. The DA ceiling will be reflected in the Disbursement Letter (DL).

#### *Procurement*

13. Procurement under the proposed project will be carried out in accordance with the Bank “Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers” published in January 2011, revised in July 2014 (Procurement Guidelines) and “Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers” published in January 2011, revised in July 2014 (Consultant Guidelines) and with the latest Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits.

14. An assessment of the capacity of the STS to implement procurement activities was carried out in April 2016. The team assessed the adequacy of procurement and related systems in place and the capability of the implementing agency to administer procurement in general and Bank-funded procurement in particular. The team also assessed the risks that may negatively affect the ability of STS to carry out procurement processes.

15. STS will be the implementing agency of the project supported by a PMU which will carry out the fiduciary functions. The PMU will include a Project Manager, FM Consultant, Procurement Consultant and technical experts. Currently STS implements a project preparation grant which is closing on April 30, 2016. Having no previous experience with Bank-funded projects and knowledge of Bank procurement policies and procedures, STS received training on selection methods applicable under the grant. However, given that the proposed project will use most of the procurement/selection methods applicable for large and small value contracts, STS will need to enhance their capacities by hiring an experienced Procurement Consultant with strong knowledge of Bank procurement policies and procedures who will advise and guide STS during the entire procurement cycle.

16. As part of the capacity assessment the team identified several risks for which mitigation measures were proposed, as follows:

(i) Risk: Limited knowledge of Bank procurement policies and procedures, including procurement of IT, which could influence the quality of procurement documents.

(ii) Mitigation Measure: Bank Procurement Specialist will deliver training on procurement procedures shortly after the effectiveness of the project. STS will be invited to attend all procurement-related events organized by the Bank in the region. The Bank will also consider the possibility of delivering a separate training on IT procurement by the Bank IT Procurement Specialist. It is recommended that an experienced Procurement Consultant is hired (preferably with experience in IT procurement) as early as possible.

(iii) Risk: The complexity of the proposed project and the limited experience of STS with Bank-funded projects may lead to delays in the procurement processes.

(iv) Mitigation Measure: There are several ways to mitigate this risk, such as: PMU consultants will guide and support STS through the procurement process and contract implementation, and the Bank team will provide guidance and recommendations to STS during the entire project implementation period. To avoid delays in the implementation of the ITMS, it is recommended that an IT Project Manager is hired to assist STS in the development of the Bidding Document, evaluation of bids and monitoring of the contract. The Bank will closely monitor the procurement processes both by prior reviewing large value procurement and by post reviewing smaller value contracts to make sure that the procurement was conducted without

delays and in line with the applicable guidelines. The Bank also expressed readiness to support and guide STS on any procurement, irrespective of its review status (prior or post).

(v) Risk: Insufficient technical capacity of the STI to manage the procurement of ITMS and monitor the contract.

(vi) Mitigation Measure: The Bank recommends that both the e-GC's Technical Experts and the IT Project Manager are involved in the entire procurement process starting with the preparation of the Bidding Document.

17. Given the complexity of the project and the risks identified during the assessment, as well as the existing capacity within STS and experience under the preparation grant, the overall project risk for procurement is "High".

#### *Procurement Arrangements*

18. **Procurement of goods and non-consulting services.** Goods and non-consulting services procured under the project would include, among others, procurement of the ITMS (including hardware), equipment for the training center, minor equipment for STS and PMU, and logistical services for training activities. Under International Competitive Bidding (ICB) procedures, procurement will be done using the Bank Standard Bidding Document (SBD) for Procurement of Goods. Goods and non-consulting services contracts below US\$100,000 may be procured through Shopping procedure in accordance with the provisions of paragraph 3.5 of the Procurement Guidelines.

19. **Procurement of ITMS:** International Competitive Bidding procedures will apply for this procurement. Bank's SBD for Supply and Installation of Information Systems will be used. Due to the complex nature of this contract and in order to avoid deviations from the STS specifications, the Bank recommended the use of a two-stage bidding procedure. First, unpriced technical proposals will be invited, subject to technical as well as commercial clarifications and adjustments, to be followed by amended bidding documents and the submission of final technical and priced bids in the second stage. The Bank also recommends that an IT Project Manager is hired in the PMU to assist STS during the procurement process and contract implementation.

20. **Procurement of consulting services.** Consulting services under the project are of various size and complexity. These would include, among others: review and drafting of the tax code, including tax ruling review, tax administration issues, and local taxes and fees administration reform; implementation plans for restructuring of STS including workload and workforce analysis and strengthening HR development capacity; fiduciary and technical consultants. Selection will be done using the Bank Standard Request for Proposals (SRFP). The employment of fiduciary and technical experts will be conducted through the selection of individual consultant in accordance with the provisions of the Section V of the Consultant Guidelines. In case the service is required from a consultancy firm, Quality- and Cost-Based Selection (QCBS) method will be applied in accordance with the Section II of the Bank's Consultants Guidelines. For the contracts below US\$300,000 equivalent Selection Based on Consultants' Qualification method may be used in accordance with paragraph 3.7 of the Consultants' Guidelines. The short list can comprise entirely national consultants, if the contracts with the firms are below US\$300,000 equivalent.

21. **Procurement of logistical and organizational services** for various events organized under the project would be done using Shopping procedures. Training activities in the form of study tours, or participating in national or international workshops shall be procured in accordance with the procedures agreed with the Bank. STS will develop a Training Plan which will be prior reviewed by the Bank. Each request to attend an event listed in the Training Plan or other events not listed in the plan will be submitted to the Bank together with the proposed list of participants, agenda of the event and the estimated budget with the breakdown of costs.

22. **Filing and records keeping.** Filing of procurement related documents, and records keeping under the project, will be done by STS. Procurement progress reports will be submitted to the Bank as per Financing/Loan agreements provisions.

23. **General Procurement Notice (GPN).** The GPN will be prepared and submitted to the Bank after negotiations. The Bank will arrange for its publication in UN Development Business online (UNDB online) and on the Bank’s external website. The GPN will contain information concerning the STS, amount and purpose of the loan, scope of procurement reflecting the Procurement Plan, and the name, telephone (or fax) number, and address(es) of the STS as the agency responsible for procurement, and the address of a widely used electronic portal with free national and international access or website where the subsequent Specific Procurement Notices will be posted.

24. **Procurement Plan (PP):** A PP for the entire scope of the project has been prepared. It specifies as well the procurement method and prior review thresholds which have been decided based on the risk rating for procurement. The document will be updated throughout the duration of the project at least annually. All PPs and their updates or modifications will be subject to the Bank’s prior review and no objection before implementation. After loan negotiations, the Bank will arrange the publication on its external website of the agreed initial PP and all subsequent updates once it has provided a no objection.

25. **Procurement Supervision.** Routine procurement reviews and supervision will be conducted by the Procurement Specialist. In addition, one supervision visit is expected to take place per year during which ex-post reviews will be conducted. The project team recommends to post-review at least 20 percent of contracts subject to post review. Procurement documents will be kept readily available for Bank’s ex-post review during supervision missions or at any other point in time. A post review report will be prepared, shared with STS and filed in the procurement post review system.

Major procurement packages:

No.	Description	Estimated Cost (\$ mln)	Review Status	Procurement/Selection Method	Date of IFB/REoI
1	TA on reviewing and drafting of the tax code, including tax ruling review, tax administration issues, local taxes and fees administration reform	1.4	Prior	QCBS	November, 2016
2	TA on implementation plans for restructuring of MSTI including workload and workforce analysis	0.6	Prior	QCBS	September, 2017

	and strengthening HR development capacity				
3	TA on procedures for payment, processing and accounting of tax obligations	1.1	Prior	QCBS	October, 2018
4	TA on compliance management, arrears management and anti-fraud	1.3	Prior	QCBS	January, 2019
5	Integrated Tax Management Solution	15	Prior	ICB	November, 2016

### *Environmental and Social (including safeguards)*

26. The project has been rated as Category “C” for environmental purposes and does not include activities which could cause any social risks or negatively affect Moldova’s population. None of the envisaged activities will require any special permission on environmental issues. Hence, the project will not be subject to the Environmental Impact Assessment procedures or any permission relating to environmental protection aspect. The Project will generate social benefits by reducing the compliance burden for tax payers and improving revenue collection, increasing the fiscal space for social and economic investments. There are no discernible gender differentiated impacts and/or risks, associated with the Project.

### *Monitoring & Evaluation*

27. The Government 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: quarterly reports prepared by the Project; and annual reports prepared within four months of the end of the financial year, focusing on results-based accountability and accomplishments against performance expectations. Progress reports will be submitted to the Project Steering Committee, which reviews the progress towards the achievement of key objectives and endorses reports submitted to the World Bank. A results framework with project specific indicators and actionable monitoring arrangements has been developed jointly with the government counterparts to support progress and monitoring of results of project implementation (Annex 1). The progress assessed during implementation support missions will be reported to the World Bank’s management through implementation status reports (ISRs), a mid-term review, and at the completion of the Project, an implementation completion report (ICR). Technical assistance and capacity-building for monitoring, evaluation and effective communications to various stakeholders throughout the reform process will be provided through the project.

### *Role of Partners*

28. The project is aligned with the support provided by other development partners including EU, SIDA, USAID and US Treasury. The Steering Committee for the project will include representatives of all development partners as observers to ensure that there is a single platform for discussion of tax administration reform and donor support. Currently, SIDA is providing technical assistance on risk-based audit, EC is providing support through the technical assistance program and EU-Moldova Association agenda to assist the MTA in meeting EU Association

requirements in the field of taxation. IMF is carrying out technical assistance missions on tax administration reform. US Treasury is planning to deploy a senior resident advisor on project implementation and change management who will work directly with the STS management on project implementation and associated change management process. In addition, the project will coordinate with the regional STAREP program, which supports the Ministry of Finance of Moldova in transposing the provisions of the EU *acquis communautaire* in the field of corporate financial reporting in the national law, in particular in part of Accounting and Auditing. The coordination will focus on linkages between corporate financial reporting and tax reporting.

## **Annex 4: Implementation Support Plan**

### **MOLDOVA: Tax Administration Modernization Project**

#### **Strategy and Approach for Implementation Support**

1. The strategy for Project Implementation Support has been designed to mitigate specific Project implementation risks, taking into account the political economy context, as well as the risks and challenges identified in lessons learned and the SORT assessment. The key features of the implementation strategy are addressed below.
2. **Policy Dialogue:** The project addresses the central issues in Moldova's tax administration reform agenda. Some of these issues will be addressed in dialogue in the context of the project. The CMU will be closely involved in the policy dialogue and follow up on key issues. The project implementation support team will work closely with the team preparing any future DPO to ensure consistency in approach.
3. **Technical and Change Management Support:** The Bank team has provided the Government with technical advice on specific design elements and the overall approach to change management. The Bank team will provide regular support on change management, including advice on communications, stakeholder consultations and the sequencing of the reforms. The Bank team will liaise closely with the project's PMU to ensure change management issues are in the forefront.
4. **Result Monitoring:** Regular implementation support missions will assist the Government in tracking progress towards the achievement of the intended project results and will advise on adjustments in project design and the reform strategy required to support the achievement of the project objectives. This will ensure that outputs translate into real impact in terms of a more efficient and effective tax administration.
5. **Procurement:** During project implementation, the Bank's procurement specialist will provide regular supervision, in line with procurement guidelines. Procurement implementation support by the Bank will include: providing training to the STS and the PMU staff; providing detailed guidance on the Bank's Procurement Guidelines; reviewing procurement documents and providing timely feedback; and monitoring procurement progress against the Procurement Plan. In addition, post reviews will be carried on selected contracts subject to post review. Contract deliverables will be physically inspected – as appropriate and feasible.
6. **Financial Management:** The Bank will conduct financial management implementation support mission within a year of the project effectiveness and then at appropriate intervals. In addition, the regular IFRs and annual project audit reports will be reviewed by the Bank. As required, a Bank-accredited Financial Management Specialist will assist in the implementation support and supervision process.
7. The team will maintain continuity and a regular dialogue with Government counterparts on all relevant operational, technical and policy issues. There will be at least two formal implementation support missions per year.



### Implementation Support Plan

<i>Time</i>	<i>Focus</i>	<i>Skills Needed</i>	<i>USD/yr</i>	<i>Partner Role</i>
<b>First twelve months</b>	Selection of key consultancies on (i) institutional development (ii) modernizing operations; and (iii) taxpayer services; reorganization of the STS structure	TTL. Procurement specialist, FM specialist; IT expert; Public sector specialist; local consultant	100,000	Participation in implementation support missions
<b>12-55 months</b>	Implementation of technical assistance packages for (i) institutional development (ii) change management, (iii) IT Procurement.	TTL. Procurement specialist, FM specialist; Public sector specialist; IT expert; local consultant	90,000	Participation in implementation support missions
<b>56-60 month</b>	Completion of project activities. Data collection and preparation for the ICR.	TTL Procurement specialist, FM specialist; Tax specialist; IT expert; local consultant	90,000	Participation in implementation support missions

#### *Skills Mix Required*

<i>Skills Needed</i>	<i>Staff Weeks / yr</i>	<i>Number of Trips</i>	<i>Comments</i>
TTL Project Management and Support	10 weeks	2 missions per year	
Procurement Specialist	10 week	None	
FM Specialist	8 weeks	None	
Public sector specialist	4 weeks	2 missions per year	
IT expert	5 weeks	2 missions per year	
Local consultant	10 weeks	-	

#### *Partners*

<i>Name</i>	<i>Institution/Country</i>	<i>Role</i>
SIDA	Sweden	Technical assistance and capacity development and risk based audit, transfer pricing capacity building
European Commission	EC Delegation to Moldova	Support through the technical assistance program and EU-Moldova Association agenda to assist the MTA in meeting EU Association requirements in the field of taxation.
IMF	Fiscal Affairs Department	Advisory services on technical dimensions of tax administration reforms.
US Treasury	USA	Resident advisor on project implementation and change management

## **Annex 5: Economic and Financial Analysis**

### **MOLDOVA: Tax Administration Modernization Project**

1. In an economy constrained by low domestic productivity, a high degree of political instability, binding governance constraints and the low quality of public services and infrastructure, direct investments of the scale, scope and quality to foster sectorial innovation and generate “endogenous” rates of sustainable, inclusive growth will only be realized if investors—both domestic and foreign—can rely on a clearly defined and uniformly defined tax regime. Relative to more engrained constraints and more medium- to long-term challenges linked to labor force education/skills, public infrastructure, or the overarching political culture, the modernization of the tax regime, the tax authorities’ capacity and instruments, and their conduct vis-à-vis the private sector represent a necessary initial step in the broader agenda of improving the country’s business and investment climate. As such, the project will have tangible—albeit difficult-to-quantify—impacts on Moldova’s ability to support private-sector activities and create additional and better paid employment opportunities. The resulting acceleration of economic growth will translate into correspondingly higher direct and indirect tax revenue base for the authorities, with permanent effects on its ability to raise domestic resources. The economic and financial assessments presented below will, however, abstract from these expected positive effects and focus on the impacts derived from: savings on tax compliance costs for the private sector (economic analysis); and temporary increases in relevant tax elasticities (financial analysis), implying that the combined effects can be expected to exceed and be more permanent than results derived in the economic and financial analyses.

#### **A. Economic Analysis**

2. This economic analysis attempts to quantify the impact of the likely project costs and benefits both for tax payers and the STS. The analysis follows an incremental approach, which, by design, compares the scenario without the project (counterfactual scenario) and the scenario with the project. It draws on the following sources of information:

- Project costs as defined in the appraisal document;
- STS administrative records for the number of active taxpayers and their characteristics (size, sector, type of tax administrated), year-end arrears by type of tax, and the average duration of an inspection by size of taxpayer;
- STS annual reports for information on revenues;
- The 2015 Doing Business Report for the average time to comply with taxes. The indicator is reported for a hypothetical medium-sized company, which needs, on average, about 185 hours/year (or approximately 23 days) to comply with major types of taxes and contributions in Moldova. The indicator can be subdivided further into the time needed to comply with the corporate income tax (42 hours or 5 days per year), labor taxes (88 hours or 11 days per year), and consumption taxes (55 hours or 7 days per year);
- The National Bureau of Statistics in Moldova, complemented by information from job advertising websites, with some additional adjustments after consultations with local audit companies, to ascertain the remuneration of accountants. In 2014, average remuneration of an accountant in 2014 is estimated at 17’000 MDL/month (\$850 per month) for the large companies, 7’000 MDL/month (\$350 per month) for the medium-

sized firm, about 5’500 MLD/month (\$275 per month) for the small and 4’500 MDL/month (\$225 per month) for micro firms. The analysis takes into account the fact that a typical large Moldovan company besides the chief account employees two assistant accounts (\$300 per month), while a medium-sized/small enterprise usually has one assisting accountant (\$275/\$250 per month)..

3. This investment project is expected to generate both tangible and intangible benefits and costs for the taxpayers and the STS. While the project costs are typically easy to define and quantify, measuring some benefits, as well as defining causal linkages between some outcomes, including behavioral responses, is not straight-forward.

4. For tax payers, the major economic benefits include reduction in the time to comply with taxes and the time spent on dealing with tax inspections. The latter will be achieved mainly through strengthened compliance risk management mechanism and the fact that tax inspectors would now need to spend less time on gathering and processing information, as well as surveillance (knowledge generation) during field audits. International experience has shown that the duration of inspections can be shortened when tax authorities have more reliable operational information on taxpayers, in addition to more targeted compliance risk assessment and specialization of tax inspectors.

5. For the STS, the major economic benefits are associated with optimized business processes within the service. The project is expected to automate and thereby eliminate much of the document processing undertaken by the STS staff and wasteful operational expenses such as printing of forms. Most of the benefits generated at the level of the STS will be in enhanced operational efficiency and effectiveness of services provided, “more” and “better” will be done with the same resources.

**Table 1. Estimation of Benefits.**

Type of taxpayer	Micro	Small	Med.	Large	Days 2014	*Days 2022
PIT payers	34,253	8,788	775	900	11	9
CIT payers	41,033	8,223	762	883	5	5
VAT payers	11,605	6,300	584	716	8	7
Individual tax payers	488	3	-	-	11	9
<b>Total active tax payers</b>	<b>87,379</b>	<b>23,314</b>	<b>2,121</b>	<b>2,499</b>		
Accountant(s) remuneration (per day)	11	24	28	57		
Total compliance cost, w/o project (1)	7.8	4.5	0.5	1.1	13.9	
Total compliance cost, w/ project (2)	6.3	3.6	0.4	0.9	11.1	
Av. duration of inspection, w/o project (days)	6	10	12	25		
*Av. duration of inspection, w/ project (days)	4.8	8	9	17.5		
Savings from reduced duration of inspection (3)	0.6	0.6	0.1	0.5	1.8	
Annual net economic impact (1) - (2) + (3)	2.1	1.5	0.2	0.7	4.5	

Note: \*The estimates correspond to the reduced number of days spent on tax compliance and dealing with tax inspections reached by 2022. For the large companies, the time to comply with PIT and VAT has been adjusted upward by 1.3.

6. The CBA is presented relative to the current state of the tax administration system in 2014 and takes into account two benefit streams: first, reductions in the time taken by tax payers to comply with major taxes (Compliance Time in Table 2); and the time to deal with tax inspections (Inspections in Table 2). The ERR is estimated at 23 percent and NPV of USD 3.6

million. On this basis the project is economically feasible and desirable. This analysis quantifies only the most likely realizable benefits and costs has been followed. However, there might be more benefits brought by the project (e.g. potential outsourcing of accounting services, decline in total number of inspections, etc.), although one-off measures, yet with long-lasting economic effects. As such, the estimate of the economic rate of return may represent somewhat a lower bound for actual net benefits of the project to the economy.

**Table 2. Economic Benefits and Costs, 2016-2025**

Project Schedule\Year	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
% of realization	10%	15%	20%	35%	20%						
WB financing	(2.0)	(3.0)	(4.0)	(7.0)	(4.0)	-					20.0
Benefit (compliance time)	0.0	0.0	0.9	1.3	2.8	3.4	3.5	3.7	3.9	4.1	23.4
Benefit (inspections)	0.0	0.8	1.2	1.4	1.6	2.0	2.3	2.4	2.5	2.6	16.9
Net Benefit	-2.0	-2.2	-1.9	-4.3	0.4	5.4	5.8	6.1	6.4	6.7	20.3
NPV											\$3.6
ERR, %											23.0

7. The CBA analysis is based on the following key assumptions:

- The time to comply with major taxes will start gradually declining from the third year of the project reaching the targeted values by the sixth year of the project (2021): the time to comply with PIT and VAT is expected to be reduced by 25 percent and 20 percent, respectively; the time to comply with CIT is expected to change moderately, by 10 percent starting from the same year.
- The time to deal with tax inspections (in days) will start declining from the second year of the project. The duration of an inspection will decline by 20 percent for micro/small firms, 25 percent for the medium-sized enterprises and 30 percent for the large companies by the end of 2022. Total savings are estimates as a product of time saved on inspections (in days) times accountant remuneration (USD/per day) and the number of active tax payers adjusted by the probability to be inspected (on average 50 percent).<sup>b</sup>
- The number of the STS staff will not change significantly over the project horizon and likely be fixed at the 2014 level, there will be an annual ten percent turnover in staff.
- The number of active tax payers will remain unchanged over the first two years of the project and will start increasing from the third year (2018) at the rate of 5 percent annually as the economy will enter a phase of more robust growth.
- The Social Discount Rate equals 14 percent. The European Commission guide to CBA (2014) recommends 5 percent SDR for Cohesion Countries and 3 percent for other Member States. The high SDR rate in the case of Moldova is the reflection of the high risk country premium.

## **B. Financial Analysis**

8. From the financial point of view, the project is expected to generate additional budgetary revenues through greater collections of tax arrears (primarily VAT) and higher compliance (both volunteered and enforced) with major taxes. The latter will be achieved through strengthened compliance risk management that would allow to prevent incidences of non-compliance by notifying the taxpayers in advance, as well as by better compliance targeting of tax payers that are not behaving honestly. It is also anticipated that compliance will be enhanced through lower

incidences of bribe as the outcome of improved tax payers' perception of the country's tax system coupled with less opportunities for tax inspectors to collect bribes. This is to be achieved by a random selection of inspectors for different stages of audit coupled with a procedural changes that would limit face to face interactions between tax inspectors and tax payers.

9. The financial analysis of the project is based on the project outflows and increases in budgetary revenues (inflows) estimated using the elasticity approach. Following this approach the growth in revenue for each major tax is interrelated with the growth in tax base (GDP used as a proxy). The analysis indicates that the project would generate an IRR of 48 percent and NPV of USD 3 million. The project is beneficial from an investment point of view.

**Table 3. Estimation of Additional Fiscal Revenues**

	CIT	VAT	PIT	SSC	Total
Tax revenue w/o project					
Historical elasticities, 2004-14	0.91	1.20	0.89	0.98	
Short-term elasticities, 2009-14	0.87	-0.12	0.89	0.68	
Revenue collected, LCU mln	2.95	1.86	3.02	9.84	17.68
Tax revenue w/ project					
Elasticities, project	1.05	1.25	1.10	1.10	
Revenue collected, LCU mln	15.94	6.48	37.16	45.50	105.08
FX, USD/MDL	21	21	21	21	
Additional fiscal benefits (2017), USD	0.62	0.22	1.63	1.70	4.16

**Table 4. Fiscal Benefits, 2016-2025**

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
% of realization	10%	15%	20%	35%	20%						
WB financing	(2.00)	(3.00)	(4.00)	(7.00)	(4.00)	-					20.00
Benefits	-	4.16	4.67	5.27	5.95	6.35	0.46	0.54	0.63	0.73	28.76
Net Benefit	-2.00	1.16	0.67	-1.73	1.95	6.35	0.46	0.54	0.63	0.73	8.76
NPV											\$3.01
IRR, %											48%
GDP, LCU bln	11.78	11.88	11.97	12.07	12.18	12.27	12.37	12.46	12.56	12.65	

10. The following key assumptions are used:

- Elasticity estimates are obtained for PIT (0.89), social security contributions (0.98), VAT (1.2) and CIT (0.91) over the 2004-2014 period. For consistency purposes elasticity estimates for CIT do not cover the period of 2008-2011 when zero tax on business profit reinvested in a business was effective. Improvements in tax administration and compliance will raise the corresponding elasticities above their historical values from the second year (2017) of the project cycle: from the trend values of 0.89 (PIT) and 0.98 (social security contributions) to 1.1, from the trend rate of 0.91 to 1.05 for CIT and from 1.2 to 1.25 in the case of VAT.
- The counterfactual scenario reflects the anticipated development in the corresponding tax revenues derived from the short-term elasticities for 2009-2014: PIT (0.89), social security contributions (0.68), VAT (-0.12), and CIT (0.87).

- The positive shock brought by the project will last only over five years (2017-2021), after that the elasticities are expected to converge to their historical values.
- Nominal GDP growth is projected at 9% for 2016-2020 and 10% onwards, based on the IMF WEO estimates up to 2020.
- The nominal exchange rate is expected to average 21 USD/MDL for 2016-2020, and 22 USD/MDL onwards.
- The Financial Discount Rate is 15%.