

Tax administration reforms and the IMF

The importance of a tax agency in a country's path to economic development can hardly be underestimated. It plays a key dual role. First, a tax agency enables the government to achieve its fiscal objectives, which commonly include promoting economic growth, achieving macroeconomic stability, and alleviating poverty. Second, a tax agency shapes the *business climate*, as the higher the cost of tax compliance, the harder it is for private firms across sectors to invest, grow, and provide more jobs.

Against this background, the International Monetary Fund (IMF) works with a number of countries in the area of tax administration. Countries like Armenia, which have long-standing weaknesses in revenue administration and economic programs supported by IMF arrangements, often seek the Fund's involvement in tax administration reforms more heavily, including through technical assistance. To support implementation of reforms, specific measures that are considered critical to meeting macroeconomic objectives, may be included as part of policy conditionality. Notwithstanding the nature of IMF involvement, ownership of the reform process by the country's authorities is the key for efforts to be effective and sustainable.

Modern tax administrations work in a predictable, reliable, and fair way and adapt their approach to the different needs of different taxpayer groups. A key role of the tax administration is to facilitate maximum voluntary compliance by all taxpayers, which is the key to sustainable increases in tax collection. International experience shows that enforced collections from noncompliant taxpayers can provide a potentially large source of tax revenue in the short-term, but for the long term, it is far more important to improve voluntary compliance rates by the taxpayers.

Armenia, while undertaking considerable reforms, has lagged behind comparator countries towards achieving these standards. Surveys have systematically shown that high tax compliance costs have been an important impediment to doing business in the country (as documented by Doing Business Report from World Bank, EBRD-World Bank Business Environment and Enterprise Performance Survey, Armenia, USAID Armenia Corruption Survey). In addition, some taxpayers—firms and individuals—do not voluntarily comply with their obligations, and contribute to a significant “tax gap” (i.e., the gap between the amount that is paid and the theoretical amount that would be paid if all taxpayers were to fully comply with their tax obligations), with some evidence suggesting that the share of tax collection from large taxpayers has been trending downwards, particularly during the crisis. This may reinforce perceptions by some that actual collections depend heavily on tax payments by smaller businesses..

Armenia has been characterized by shortcomings in the operating framework of its tax collecting agency, leading to an environment of mutual distrust between tax officials and taxpayers. These shortcomings were reflected both in the absence of some powers and capacities common to modern tax agencies, and also in the absence of some basic protections for taxpayers. From the tax officials' perspective, deficiencies included a weak penalty

regime, inadequate access to taxpayers' records, and lack of budgetary allocations to provide the necessary refunds. From the taxpayers' perspective, the tax laws did not offer sufficient protection from receiving large arbitrary tax assessments or requests for advance tax payments that are not provided for in the law. Weaknesses in the legal framework and the appeals process governing taxpayer rights have led to lengthy delays in processing refunds.

The government, supported by the IMF, has made efforts to tackle these weaknesses, including important recent reforms. It has recently set up an appeals Board to deal with legal and procedural disputes of taxpayers. The position of the Board—outside of the State Revenue Committee (SRC) —should boost the perception of impartiality in the appeals process. Also, the SRC significantly reduced the stock of unprocessed late VAT refund claims, with almost all VAT refunds being now processed within the statutory 90-day period. If valid claims are not refunded within 90 days, firms are entitled to receive interest on all late VAT refund claims. In parallel, reforms have also enabled the SRC to strengthen the penalty regime for delinquent taxpayers and to allocate necessary budgetary allocations towards making VAT refunds. Legislative and other reforms, including software improvements, will also enhance the SRC's capacity in the near future to undertake its audit function by improving its capacity to select high-risk cases for tax audit and the verification of VAT refunds. Also, by having adopted specific and clear manuals for various sectors the SRC will be able to follow improved and more effective processes for audits.

Efforts by the revenue administration authorities to ease the burden of compliance may be facilitated by a simple and transparency tax policy regime. Here, the Fund supports the government's efforts to overhaul the tax code that will streamline and simplify tax laws. The recent decision to significantly reduce reporting requirements, which will greatly benefit small and medium enterprises, is particularly welcomed. In order to reduce further any perception of arbitrariness, the government has also recently stipulated that clarifications and interpretations of laws, legislative provisions, and bylaws on taxes, duties, and mandatory fees should be agreed by SRC in advance with the Ministry of Finance. These clarifications and interpretations are now being published on the SRC's website and will in future be applied consistently across all taxpayers.

An additional weakness has been the lack of effectiveness of the tax collecting agency arising from shortcomings in the structure of its organization. A key focus of attention in this regard has been the arrangements to deal with large taxpayers. In order to ensure the necessary expertise to deal with these cases, the Fund has supported the consolidation of the large taxpayer inspectorate (LTI) and specialist inspectorates (excises, banking and mining) into a single inspectorate for large taxpayer administration. Assistance to define the criteria for the large taxpayers has been provided, and a push to increase the number of large taxpayers in the LTI will ensure that large taxpayers' contribution in terms of total domestic revenues will continuously increase starting next year. The Fund welcomed the alignment of SRC headquarters to a more typical, function-based organizational model, clearly delineating its role from that of operational field inspectorates. A reduction in the number of regional inspectorates will increase efficiency. A modern tax administration based on self-assessment also needs to have stronger taxpayer services, which have been recently improving in

Armenia, as efforts continued towards the creation of full-scale operation of taxpayer service centers, and the expansion of services delivered by these centers. Finally, the setting up of analytical teams both in the SRC and the Ministry of Finance to better understand and analyze revenue trends, forecasts, and tax credits, among others, is important for advancing the capacity of these institutions in Armenia.

Much has been achieved, but a lot remains to be done. The time has come for the reform process to be institutionalized and become continuous and systematic. The tax agency, together with IMF, is now working to develop a strategic planning framework which will culminate in a new strategic plan for 2012-15. The new strategic plan will hopefully drive improvement forward at a faster pace.