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**Technical Assistance to Support Tax Administration Reforms
FY 2011**

FINAL REPORT

Contract No: EEM-I-05-07-00005-00

Deloitte Consulting LLP

May 2011

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TECHNICAL ASSISTANCE TO SUPPORT TAX ADMINISTRATION REFORMS

DELOITTE CONSULTING LLP

MAY 2011

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List of Acronyms

Acronym	Term
AAP	Annual Audit Plan
AMIS	Audit Management Information System
CBA	Central Bank of Armenia
COP	Chief of Party
EU	European Union
FS	Functional Specifications
GOAM	Government of Armenia
HQ	Headquarter
IMF	International Monetary Fund
IFC	International Finance Corporation
IT	Information Technologies
LTI	Large Taxpayers Inspectorate
MOE	Ministry of Economy
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
PME	Performance Monitoring and Evaluatio
RBASS	Risk-Based Audit Selection System
SOW	Scope of Work
SCC	State Customs Committee
SRC	State Revenue Committee
STS	State Tax Service
TASTAR	Technical Assistance to Support Tax Administration Reforms
TIN	Taxpayer Identification Number
TOT	Train of Trainers
USAID	US Agency for International Development
TPS	Taxpayer Service
VAT	Value-Added Tax
WB	World Bank

Executive Summary

The USAID Technical Assistance to Support Tax Administration Reforms (TASTAR) Program was developed to support reforms at the State Revenue Committee (SRC) to increase tax revenues and improve tax processes making them more business friendly. This was accomplished by providing targeted technical assistance to the SRC, ensuring that tax administration reforms improve the business environment. The three areas of assistance included:

- Improving Audit;
- Improving the System for VAT Refunds;
- Improving Taxpayer Services.

Component A – Improving Audit: The overall goal of this initiative was to develop an effective risk-based audit selection process targeting high-risk taxpayers to significantly reduce the number of audits, increase audit quality and decrease the resources deployed by the SRC for audit purposes.

Component B - Improving the System of VAT Refunds: The objective of this component was to develop an effective VAT refund system to reduce the uncertainty associated with both exports and VAT compliance; reduce stock of VAT refund arrears, thus freeing private financial capital for business development, stimulating growth in the export sector.

Component C – Improving Taxpayer Services: The goal of this initiative was to facilitate taxpayer access to information, thereby reducing filing errors and increasing the accuracy of self-assessment; improving flow of information in both directions thus strengthening the taxpayer-tax collector relationship and building confidence in the self-assessment system.

The table below summarizes the TASTAR deliverables against the project's tasks and objectives.

Task	Deliverables	Status
Component A - Improving Audit		
Assist development of a new tax audit strategy (or improvement of the existing one)	<ul style="list-style-type: none"> ▪ Concept for Audit Planning and Risk-Based Audit Selection System 	100% complete
Provide assistance in developing and implementing risk-based audit selection system (RBASS)	<ul style="list-style-type: none"> ▪ Methodology for RBASS ▪ Business Processes for RBASS ▪ Methodology to Analyze Selection Criteria vs. Audit Results ▪ Testing Plan ▪ Risk-Based Audit Selection System Testing Results ▪ RBAS System Implementation Roadmap 	100% complete
Assist in design of an application for RBASS	<ul style="list-style-type: none"> ▪ Document on RBAS System's Functional Specifications. 	100% complete
Assist SRC in the preparation of revised audit manuals	<ul style="list-style-type: none"> ▪ Audit Guidebooks for four specific sectors: (1) Transportation, (2) Real Estate Transactions, (3) Tourism, and (4) Use of Cash Registers ▪ The guidebooks were published and disseminated to 700 SRC inspectors 	100% complete

Provide training in improved audit techniques	<ul style="list-style-type: none"> TOT course for the SRC Headquarter auditors Training on Audit Techniques was provided to 179 SRC inspectors throughout Armenia TOT and General Training Materials 	100% complete
Assist the RBASS software developers and the end users*	<ul style="list-style-type: none"> Document on Use Cases, which served as a base for the RBAS System testing and acceptance procedures 	100% complete
Develop Audit Planning System*	<ul style="list-style-type: none"> Concept and Procedures for Annual Audit Plan Audit Plan Process Diagrams Workshop on Audit Planning for the SRC Audit Department personnel 	100% complete
Develop a project plan for the an audit management system*	<ul style="list-style-type: none"> Conceptual Design for Audit Management Information System Audit Management Process Diagrams 	100% complete
Conduct audit proficiency assessment*	<ul style="list-style-type: none"> Audit proficiency assessment Recommendations on promotion and encouraging mechanisms based on audit proficiency assessment 	100% complete
Design Audit Quality Review Program*	<ul style="list-style-type: none"> Audit Quality Review Program 	100% complete
Component B - Improving the System of VAT Refunds		
Develop risk-based methodology to assess validity of VAT refund request	<ul style="list-style-type: none"> Guidelines on introduction of VAT refund system Organizational and Procedural Methodology following application of criterion VAT Refund Criteria Rankings Automated VAT Refund System Business Processes 	100% complete
Support development and implementation of a mechanism for risk-based audit and an automated VAT system.	<ul style="list-style-type: none"> Automated VAT Refund System User Interfaces Automated VAT Refund System Functional Specification Automated VAT Refund System Roadmap 	Development <i>support</i> was 100% completed <i>Implementation</i> support was not completed, since the task was contingent on software development by the SRC
Develop and implement procedures required for VAT automated refund, using risk criteria developed jointly with SRC.	<ul style="list-style-type: none"> The VAT Automated Refund System Internal Procedures 	100% complete
Facilitate Legislative Revisions	<ul style="list-style-type: none"> Findings and Recommendations on appropriate legislative changes in the Armenian tax legislation Policy Memorandum Document 	100% complete
Counterpart Training	<ul style="list-style-type: none"> TOT course for the SRC Working Group selected members TOT materials Open Session for the SRC Regional Tax Inspectorates staff and Large Taxpayer Representatives on VAT refund proposed system - <i>System's Overview, Functionalities, Benefits & Consequences</i> 	100% complete

Component C – Taxpayer Services		
Advise on plan for deployment and equipping of (five) regional taxpayer service centers, for both walk in and possibly call center	<ul style="list-style-type: none"> ▪ Concept for Call Center; Action Plan for Call Center introduction ▪ Structure/operations/equipment proposed for Service Centers ▪ Criteria and quality standards for staff's responsibilities and services provided by the Service Centers ▪ TPS Field Operations Procedures 	100% complete
Develop and initiate training program for taxpayer service center designated staff.	<ul style="list-style-type: none"> ▪ ToT Course for the SRC TPS Centers' and HQ personnel ▪ Guideline for Classroom Instructor Training ▪ Workshop on Taxpayer Services for the SRC HQ staff - <i>Information, Education, and Assistance in Support of Voluntary Compliance</i> 	100% complete
Provide training to SRC staff on taxpayer services and treatment of customers.	<ul style="list-style-type: none"> ▪ Taxpayer Service Training Program – Basic Taxpayer Service Techniques ▪ Training on <i>Taxpayer Service Techniques and Treatment of Customers</i> for 209 SRC employees 	100% complete
Develop a simulation model for tax revenues analysis and forecasting and strengthen analytical capacities.	<ul style="list-style-type: none"> ▪ Profit Tax Micro-simulation Model ▪ User Guide for the Profit Tax Micro-simulation Model ▪ Capacity building training the SRC Tax Analysis team 	100% complete
Assess E-services capacity and develop appropriate recommendations	<ul style="list-style-type: none"> ▪ Recommendations for Enhancing Armenia Tax E-Services ▪ Review of Taxpayer Ledgers and VAT Invoicing System and Recommendations for Enhancing these systems ▪ Recommendations on Improving Tax Indicators on Doing Business Survey ▪ Recommendations on the enhancement of the SRC website 	100% complete

Memorandum of Understanding

The technical assistance to the SRC in Tax Administration Reform supported the US Mission Performance Plan under the Objective: 4. Economic Growth; Program Area: 4.1 Macroeconomic Foundation for Growth; and Program Element: 4.1.1 Fiscal Policy. The assistance was also one of the vital areas in the USG Country Assistance Strategy in Armenia for 2009-2013, under the Priority Goal 4: Increase Armenia's competitiveness and economic sustainability.

On May 4, 2010, USAID/Armenia Mission Director Jatinder Cheema and the Head of the SRC Gagik Khachatryan signed a Memorandum of Understanding (MOU), outlining a shared vision and the parties' collaboration to improve the efficiency of Armenia's tax administration, increase tax revenues, and improve relevant processes making them more business-friendly.



MOU signing ceremony on May 4, 2010

Component A – Improving Audit

Risk-Based Audit Selection System

Background. Armenian tax authorities engage in too many taxpayer audits, significantly increasing the cost of doing business in Armenia. The costs of complying with tax legislation in Armenia is one of the highest across the former Soviet Union – driven primarily by the cost of preparing for and participating in tax audits. The legacy of too-frequent and too costly audits could be addressed by a rule-based risk analysis and risk scoring system that selects a relatively low percentage of taxpayers for audit based on weighted risk factors that imply a high probability that tax liability has been underreported. In such a system, the risk score represents an indicator of whether a taxpayer is “profitable to audit” or “not profitable to audit”.

Risk-based audit selection employs specific activity indicators to effectively analyze and rank taxpayers as potentially non-compliant as part of an audit management information system (AMIS). The AMIS drives the development of the audit program; enforces case tracking and

support notification of file transfer; provide oversight of the audit workload and the development of improved audit reports; identifies and catalog common taxpayer errors; and monitors the productivity of auditors.

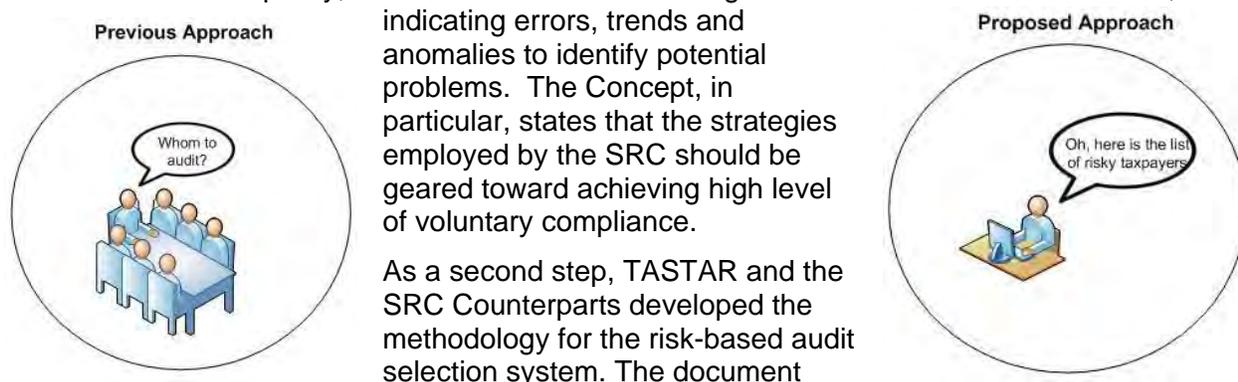
The Project activities that were designed to improve audit efficiency included:

- Development of a concept for an effective risk-based audit selection targeting high-risk taxpayers;
- Development of a methodology and business processes for identifying procedures for the audit selection process;
- Development of necessary documentation for the development of the risk-based audit selection application.

Concept and Methodology. As an integrated component of the AMIS, TASTAR proposed development of a single risk-based process to be used to allocate the majority of audit resources (roughly 70-80%) through an Annual Audit Plan (AAP).

The TASTAR Team's first step was the development of a Concept for a Risk-Based Audit Selection System. In this regard, the Project team worked with an SRC Working Group¹ to assess the Armenian legislation, and to involve them in developing the new processes to ensure their buy-in. The Concept describes a risk-based selection system for audit and includes audit planning and selection programs.

The concept development process enabled the SRC to understand the importance of moving from a 100% audit policy, and the effectiveness of using criteria to test Tax Return details,



indicating errors, trends and anomalies to identify potential problems. The Concept, in particular, states that the strategies employed by the SRC should be geared toward achieving high level of voluntary compliance.

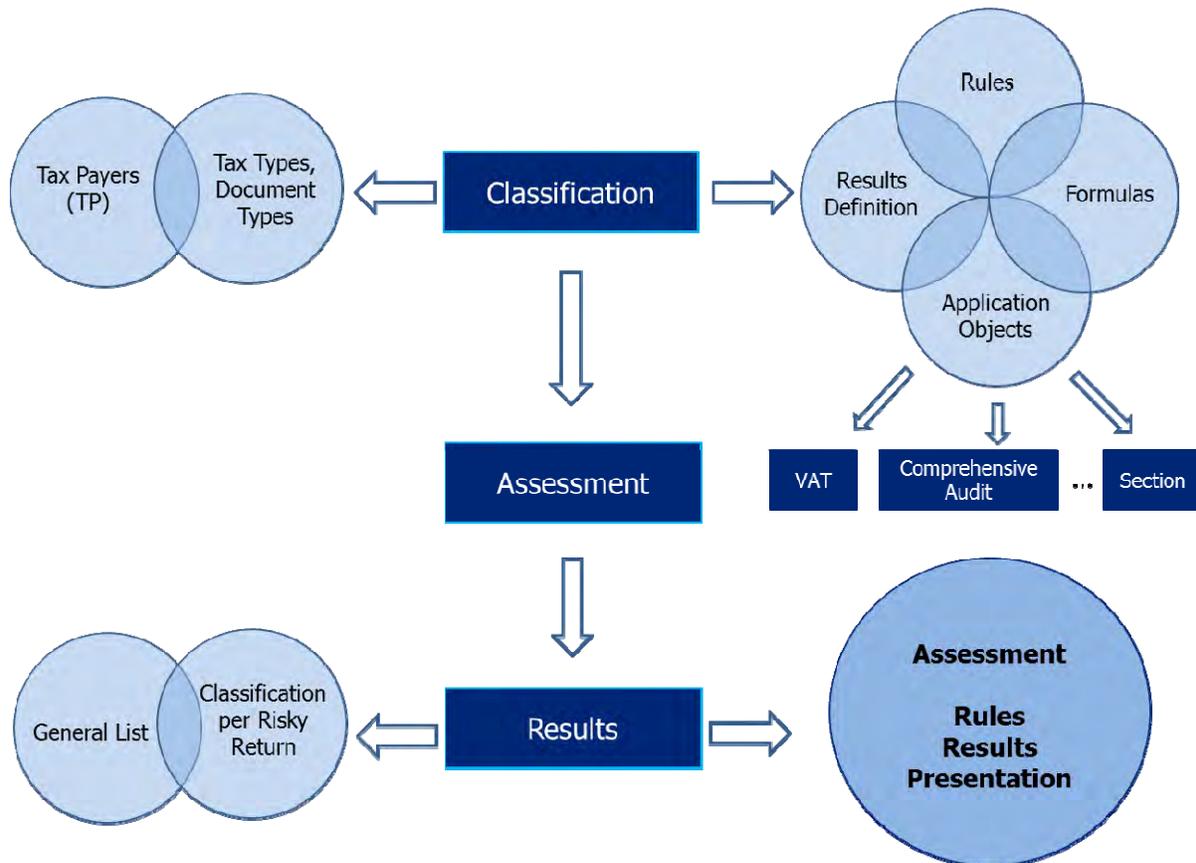
As a second step, TASTAR and the SRC Counterparts developed the methodology for the risk-based audit selection system. The document

describes the system with the procedures to be followed; the taxpayers grouping approach; and the algorithms of defining risk criteria per tax types. The System business processes diagrams were designed as well.

The TASTAR team developed the algorithms for five groups of taxpayers - Profit Tax, Simplified Profit Tax, VAT, Income Tax, and Social contributions returns. This work included designing the approach to be used, the criteria, the weights, and the exact specifications for each criterion.

¹ The SRC Work Group for the development of Risk Based Audit Selection System consisted of 8 officials from different SRC departments. The Head of Work Group was Mr. Muradyan, the Deputy Head of Strategy and Planning Department.

System Structure



The Methodology also includes the provision for a random selection of taxpayers, according to which the taxpayers with low risk should be selected randomly for audit purposes. This will provide an additional opportunity to the SRC to assess criteria and keep a control on compliance of less risky taxpayers.

Functional Specifications. Based on the Methodology, as well as the Project's assessment of the SRC's existing capacity -- including required management and audit reports and affiliated business processes -- TASTAR drafted software functional specifications for the RBAS System and developed an implementation plan for application development.

On May 2010, the package of RBAS documentation was approved by the SRC Council on Development of Electronic Management System. Among the members of the Council is the Head of the SRC, all Deputy Heads, the Head of IT Department, representatives of the Ministry of Finance (MOF), Ministry of Economy (MOE), Central Bank of Armenia (CBA) as well as the Advisor to the Prime Minister. The Council decided to: (1) ask Government to announce a tender on RBAS System's development (the tender is already in process), (2) present the complete package on the System to the Supreme Board for Implementation of New Revenue Administration Culture, headed by the Prime Minister.

System Testing and Implementation. IUNetworks LLC, an Armenian software firm, was selected by the Government Tender Committee to develop the RBAS System for the SRC. During the development stage, the Project assisted the SRC vendor as well as guided the development process by monitoring the progress of application development against established specifications.

In addition, TASTAR participated in the initial stage of the System Testing. At the end of the initial testing, the Project submitted to the SRC a document presenting the status of the testing and system readiness for deployment. The document also provided recommendations on the testing finalization, and system implementation approach, outlining the roadmap along with high-level schedule. The system has all functionalities necessary for:

- Setting up Risk Sets with all elements;
- Assign Risk Sets to Taxpayers groups;
- Setting up parameters for scoring execution;
- Executing scoring;
- Filtering and presenting results in different ways.

The TASTAR Team also recommended pilot implementation of the System to allow the SRC to obtain confidence in the results and apply them to audit planning. The pilot implementation will also ensure confidence in the RBAS system by monitoring and analyzing results and will confirm that the Risk Sets are representative and reliable for different classes.

Methods to Analyze Audit Results and Update Formulas. The SRC Audit staff that will continue to work on scoring formulas need to have skills to analyze audit results and determine which criterion needs to be revised. In this regard, the Project conducted a series of workshops with the Counterpart relevant personnel to present a myriad of issues that need to be addressed in the implementation of the new risk based selection system. The objective of the workshops was to raise awareness about the issues and task the members of Audit and IT teams with determining the exact procedures that will be used to carry out the programs.

In addition, the TASTAR prepared a document outlining the methodology and the precise steps to be used in the analysis of audit results and the assessment of the effectiveness of each criterion in the formula and delivered to the Counterpart.

Audit Management Information System. The TASTAR team also produced business process diagrams and system design concept for the Audit Management Information System (AMIS). Since the risk model covers all tax types, and the downstream processes (after audit selection) being the same for all field audits, the proposed concept is fully integrated, covering initially valued-added and corporate profit tax, and can be extended to include other tax types.

The purpose of the document is to explain and describe to the SRC management the conceptual design of an AMIS for implementation in the SRC. AMIS would automate audit processes, capture key data, and improve monitoring and control. Development and implementation of an AMIS will depend on the reform of audit processes, which are currently under consideration. The AMIS would particularly cover the following main processes:

- Risk Assessment
- Cameral Studies
- Appeals
- VAT Refunds
- Assigning Audits
- Third Party Information
- Audit Planning Field Audit
- Management Information System
- Discretionary Audits
- Auditor Timesheets.

Audit Planning

At the request of the First Deputy Chairman TASTAR assisted the SRC in developing the methodology and process diagrams for Audit Planning. The document describes the procedures for the annual audit plan and how the plan is used in conjunction with RBASS, and states that a key ingredient in the annual plan process is to determine the coverage level for each class of taxpayers. Our objective was to show how to allocate the Audit manpower in a strategic manner to achieve coverage for each of the separate classes of taxpayer. This typically means assigning staff to larger business classes with greater risk to achieve higher coverage; and to have lower coverage in the high population smaller business taxpayers.

The Project's other key deliverable was the design of process diagrams for audit planning. Since Audit Planning Module must be flexible and must distribute lists of required audits to local tax offices, the module requires information on available resources and the average time needed to conduct different types of audits. In that regard TASTAR recommended that the SRC implement timesheets for auditors in order to calculate the real time spent on audits and to perform monitoring.

Audit Quality Review

TASTAR worked with the Counterparts to develop an Audit Quality Review Program. The Project briefed the SRC Audit Department team explaining the audit quality review process. A series of working meetings with the relevant staff were held to develop audit quality standard attributes, a questionnaire for reviewers and a case selection method, etc. As a result of the work, the Project prepared two versions of guides for use in Audit Quality Review: (1) an Audit Quality Review Handbook, and (2) a No Work Paper Audit Quality Review Handbook.

Two handbooks were necessary because the SRC did not have working papers and hence reviewers would not be able to determine from the case file whether the quality standards and attributes were met for many of the standards. The standards were therefore adjusted to meet that reality. Two of the important standards, Internal Control and Customer/Taxpayer relations, were eliminated.

The TASTAR Team also prepared Forms and Exhibits for use with the two handbooks. Additionally, the Project assisted the Counterpart in the development of a case selection methodology for cases to be reviewed by the Audit Quality Review reviewers.

Audit Techniques Sectoral Guidebooks

The TASTAR Team and the SRC jointly developed guidebooks for conducting comprehensive audits in four key economic activities in Armenia: Tourism, Transportation, Real Estate and Use of Cash Registers. These guidebooks were designed to enhance audit practices, provide new audit techniques and standardize audit activity. They define audit procedures such as initial interviewing, reviewing records, examining recordkeeping, and probing for potentially unreported income.

After completion of these books, training was provided to SRC auditors throughout Armenia. Beginning on Nov 2010, these classes were conducted featuring four Armenian Senior Tax Inspectors, and by TASTAR's experienced Audit Advisor.



The Sectoral Audit Guidebooks were posted on the SRC's website: <http://www.taxservice.am/index.php?menuID=197&tid=2&pid=&lng=9> and published by the TASTAR project. The Audit Books were presented to the SRC by USAID Armenia Mission Director Jatinder Cheema during an official ceremony held on March 22, 2011. During the ceremony the SRC Chairman indicated that the SRC would establish mechanisms for encouraging the usage of the Guidebooks by their inspectors.

Training on Audit Techniques

Training on Audit Techniques was provided to 179 SRC auditors throughout Armenia. Beginning on Nov 8th, 2010, these classes were conducted featuring four Armenian Senior Tax Inspectors, and by TASTAR's experienced Audit Advisor - Certified Public Accountant.

Using traditional classroom techniques participants were engaged throughout the training and were able to ask questions and learn leading international practices in these audit areas. In addition, audit areas new to Armenia such as Electronic Commerce, were discussed. The training promoted proper application of the law as well as standardization in the steps to conduct an audit.



Component B – Improving the System of VAT Refunds

Refunding overpayment of liability is a critical component of a viable VAT system. The majority of taxpayers owed a VAT refund in Armenia, as in most countries, are exporters who pay VAT on inputs but then have zero-rated sales (exports). Failure to refund VAT overpayments effectively taxes exports, reducing Armenia's competitiveness in the world economy, disadvantaging both exporters and other firms in the value chain, and limiting opportunities for future growth and investment.

The challenge to implementing a viable and sustainable system to support prompt VAT refunds is establishing an environment where all parties are confident that fraudulent claims will be identified and prosecuted and rapid payment of legitimate claims is viewed as a critical performance metric. The following activities were designed to put in place applications that support a risk-based VAT refund system that brings about this confidence and improved taxpayer compliance: (1) develop a Methodology for Automated VAT Refund, (2) support development of Business Processes and Application Software, (3) train Counterparts, and (4) assist in the development of necessary Legislation and Regulations.

Automated VAT Refund System

Methodology for Automated VAT Refund. TASTAR designed and assisted the SRC in developing an Automated VAT refund process based on international leading practice, one that would expedite the payment of legitimate VAT refunds to the majority of VAT refund claimants. The refund work-flow differs from the proposed risk-based audit selection process in that it depends on high-level data integrity checks and the taxpayer's payment history. The refund system should be integrated into the current SRC's Taxpayer 3 system, providing inputs into the audit selection modules and case tracking systems.

The developed methodology incorporates the principle that refund requests should be processed in a timely manner upon receipt with the majority of all such submissions quickly identified for prompt payments. Only in those cases where there is limited (or poor) taxpayer performance history, or where the claim fails high-level integrity checks, should a refund be flagged for further investigation. Regardless of payment status, all refund claims should be evaluated after the fact as part of the normal audit process. In designing the methodology, TASTAR incorporated the following norms drawn from international experience:

- Pre-refund audits should be limited to high-risk refund claims only;
- Preferential treatment should be accorded to those taxpayers with a sound compliance history against their perceived level of risk;
- Refunds should be processed within the period set by statute, supported by suitable case monitoring and managerial systems, as well as authorization and oversight procedures;
- Information on the VAT refund requests should be substantiated against multiple data sources and import/export data provided by the customs service, most notably import and export data provided by the customs service.

During the System development, TASTAR cooperated with the SRC Deputy Chairman Mr. Kocharyan and the Working Group² on Development and Implementation of VAT Overpayments Refund and Tax Overpayments Offset System.

Cooperation with the Working Group was challenging initially; however, the Project managed to make significant progress, including development of: (1) criteria/indicators for automated risk-based VAT refund system; (2) all relevant formulas for automated risk-based VAT refunds system; and (3) methodology for an automated risk-based VAT refund system.

The list of Criteria was the most challenging to develop because of the SRC's concern with loss of control. However, as the SRC staff began to understand the suggested criteria, as well as the flexibility of the tool to be adjusted and changed at each stage of program development, testing and piloting, the list was produced and agreed upon.

Once the criteria were agreed the production of the criteria rankings and algorithms proved to be an easier task. Related to this issue, the Project developed document on "*Criteria ranking and algorithms guidelines for use*", which explained the stage of the tables creation that would provide the formula for input into the main system.

The Project organized three Workshops that were very productive in reaching agreement on the methodology of an automatic VAT refund system. The Workshops particularly:



² The Work Group consisted from nine representatives of the SRC following departments: Tax Offset and Refund, Internal Supervision and Monitoring, Taxpayer Service and Tax Procedures, TI Coordination, Information Technologies and Local Tax Inspectorates.

- increased the SRC staff's knowledge of the risk management approach through providing adequate information on the proposed Reform of VAT Refunds System, and
- brought together the representatives of the various SRC departments involved in VAT Refunds in order to work out particular issues, make mutually-acceptable decisions.

Business processes for the system were developed as well, and they served as a base for the development of User Interfaces and Functional Specification documents of VAT refunds System. The figure below shows high-level of VAT Refund chain of processes for the proposed automated VAT Refund System.



Functional Specifications and Roadmap. Effective tracking of VAT payments, of VAT refund audits and of audit results is crucial to establishing the validity of the refund request and a taxpayer's record of performance. TASTAR assisted the SRC in developing appropriate workflow and business procedures to ensure timely processing of VAT refunds. In developing a viable VAT refund system the Project ensured that the appropriate IT applications are in place to mitigate the risk of inadvertent payment of a fraudulent claim.

After researching the regulations and VAT Refund functionalities supplemented by User Interfaces the Project develop documents on Functional Specifications (FS) and on Application Objects. The documents define the functional requirements for the core functions of the System as well as the description of the relevant application modules. The FS document is the basis for the system design and development. Using the FS as a guide, software developers have started building database and operations processing applications to fulfill the requirements described in the FS. The FS also will be a basis for quality assurance and acceptance procedure of the final System implementation at SRC. The documents show that the System consists of three main modules.

- The first module will be used by the Risk Assessment Methodology group and particularly will provide functionalities for defining criteria and their characteristics, including criterion formula and values.
- The second module ensures functionalities and features for processing monthly batch of requests for refunds. Business rules for: (1) identifying the set of VAT returns to be processed, (2) calculating the risk score of a return, and (3) allocating funds to offsetting, carry forward, and/or refund are incorporated in the software.
- The third module's functionality supports the generation and distribution of notifications to Taxpayers and generating operational and management reports.

On December 28th, 2010, these documents were formally submitted to the SRC Chairman Mr. Gagik Kachatryan.

In addition, a roadmap was developed using both narrative and the Microsoft Project program, in order to assist the SRC in the development of software and implementation stages which would commence after the end of the Project. It demonstrates a logical progression of tasks and milestones that will indicate to the System owners how, what and when of the various stages of development and implementation.

Training

Auditors who rely on the refund-checking and case-monitoring systems need to possess the competencies necessary to use the systems correctly and require adequate training and performance review. To this end, the Project designed and implemented a training program covering TASTAR-supported software to develop the SRC's ability to use the system with confidence and accuracy. Through a ToT approach, TASTAR ensured the SRC capacity to train its auditors in detecting and prosecuting fraudulent VAT refund claims, while simultaneously allowing for prompt payment and low-risk refund claims. The Project also provided training curricula and materials. These materials prepared the participants to become not only trainers for the implementation phase but also user liaison contacts during the System software development.



On March 2011, three sessions -- one of which was an open session devoted to the SRC and Business representatives -- were conducted. During the Course delivery it was confirmed that the funds for the software development had been agreed and software development would start immediately. This suddenly made the training much more critical for the SRC as the attendees would be using their skills soon.

Legislation for Automated VAT Refund

To the extent that national legislation required revision, TASTAR facilitated that process. During the initial stage of the project legislation required that all VAT refund claims be audited. To revoke this requirement, the Project identified the relevant provisions in existing legislation and proposed alternative language. The relevant amendments to the Law on VAT were presented to the National Assembly by the SRC and adopted in December 2010. These amendments made the automatic VAT refund system feasible.

TASTAR also drafted a Policy Memorandum outlining areas of the Law and SRC procedures where improvements were needed if the Government is to achieve its objective of having a full input/output VAT regime. The majority of the recommendations have a direct bearing on the more effective running of the VAT Automated Refund System, all are in line with the IMF and World Bank past recommendations and will effect a more open and transparent system in keeping with best international practice. The Policy Memorandum was shared with the MoF and IMF as well.

Component C – Taxpayer Services

The challenge in improving taxpayer service in Armenia lies in transforming the current adversarial relationship between taxpayers and tax collectors into one of mutual understanding. Concurrently, the organization must develop a more proactive approach for taxpayer outreach. The focus of the SRC needed to shift from imposing compliance to supporting compliance. This paradigm shift on the part of the SRC must be mirrored by a shift on the part of the taxpayer from being forced to comply with tax legislation to making a good-faith effort to comply.

The following activities were designed to support the modernization of the service culture and the technological capabilities of the SRC:

- Development of Concept for Taxpayer Service Centers and Call Center;
- Design and implementation of training programs;
- Support for E-filing.

Concept for Taxpayer Service Centers and Call Center

TASTAR's approach to improving customer service in the SRC was based on supporting the development of a comprehensive customer service capability with geographic convenience and greater use of technology. The Project's vision for developing an improved culture of service began with emphasizing the need for the SRC to provide the taxpayer with the information and guidance to accurately self-assess tax liability as well as with retraining existing staff in customer service. Improved service can take the form of clearer forms and

instructions and more easy access to them; access to electronic information databases; responding to taxpayer questions in a helpful and timely manner; or simply service with a smile.



Newly established TPS center in Yerevan



Newly established TPS Center in Vanadzor

To the extent that the establishment of regional Service Centers required a significant redefinition of staff roles and responsibilities, TASTAR assisted the SRC functional implementation team in preparing required staff position descriptions for the Service Centers. The Project focused on defining staffing needs, competencies of employees, and software and hardware requirements for the centers. TASTAR also developed Procedures Manual for Taxpayer Service Field Operations.

These materials served as a basis for the SRC to establish of three Taxpayer Service Centers throughout

Armenia, two in Yerevan and one in Vanadzor. It is anticipated that three additional service centers, as well as a Call Center, will be established in 2011-2012.

With regard to the Call Center, TASTAR supported the SRC in the development of the Plan for deployment and equipping of a unified Call Center for Armenia in order to:

- Support voluntary compliance and reduce the burden on the taxpayer by providing easy access to information and assistance;
- Maximize resources by centralizing telephone assistance; and
- Reduce face to face contact with taxpayers.

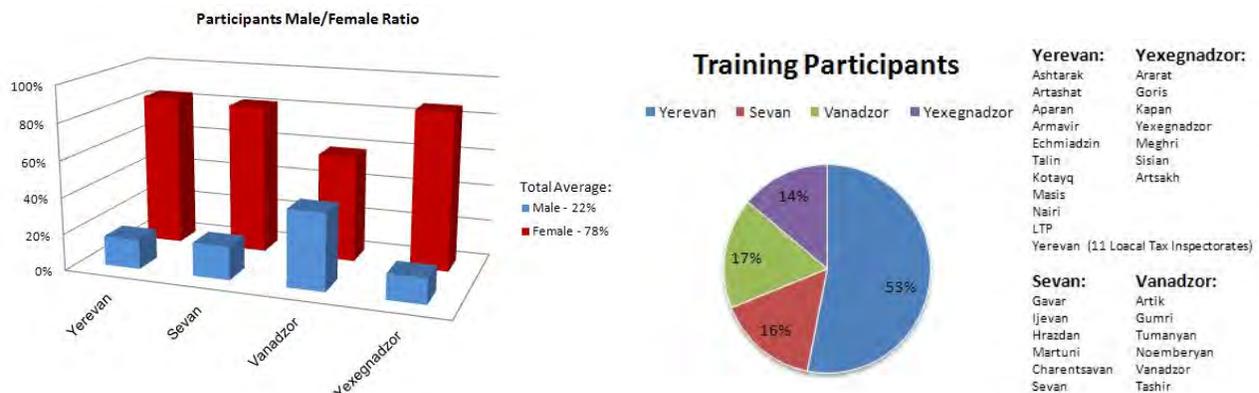
Training Programs

TASTAR developed and implemented the training programs required to transform the SRC into an effective service organization. The Project created curricula and training materials based on a training needs assessment in order to establish a prioritized training focus. Training was based on a ToT program, ensuring that the capacity to retrain current staff and train new hires remains with the SRC at the program end.

The institutional reform planned by the SRC envisions the formation of unified procedures in the Headquarters, with clear delegation of authority to field offices. Such redefinitions of professional roles require significant retraining of the workforce. To ensure a unified application of procedures for taxpayers across Service Centers and RTIs, all customer-facing and supervisory staff received consistent training on providing taxpayer guidance and customer service. The objective was to ensure that all taxpayers receive the same answers to their questions, the same direction when appealing a decision, and the same courteous and professional treatment, no matter which office they walk into. Through the customer service training program TASTAR promoted consistent application of SRC policy and procedures, and sought to ensure a consistent level of customer satisfaction.



Training on Taxpayer Service Techniques. Trainings on Taxpayer Services were held for 209 SRC employees working at the Taxpayer Service Centers and Taxpayer Service Divisions throughout the country, in four different regions of Armenia: Sevan, Vanadzor and Yeghegnadzor and Yerevan.



The purpose of the training was to increase SRC staff's knowledge of the taxpayer services by providing adequate information on the TPS procedures, as well as information on international best practices in this regard. The training covered the following topics:

- Taxpayer registration
- Acceptance of Tax Returns/Declarations
- Providing Appropriate Statements
- Taxpayer Strategy
- Providing Tax Information
- Internal and External Customer Service
- Stress Control
- Effective Communication Skills/Listening skills
- Complain recovery process.

E-filing

Improvements in customer service in the SRC have increasingly moved online in the form of electronic information repositories and e-filing. In 2010 the number of taxpayers filing their returns with the tax authority electronically grew from 0 to 4,700 by the year-end. Furthermore, presently 27 types of tax returns out of around 40 can be submitted electronically. In essence, in this area a considerable step has been already taken by the SRC towards the introduction of the e-governance system. During the life of the Project we worked very closely with the SRC IT Department on different aspects of tax administration, including implement an e-filing capability. The Project's Recommendations for Enhancing Armenia E-Services included:

- Description of E-filing service functionalities and features,
- Recommendations for improving the E-Filing;
- Recommendations for development and implementation of additional Tax E-Services; and
- Recommendations on the implementation approach.

Other important E-services discussions (and subsequent recommendations) were made related to online access to Taxpayer's Tax Accounts, online submission of Appeals, requests for VAT refunds, requests for Excise stamps, and obtaining Taxpayer's Tax Statement.

The recommendations emphasized Tax E-Payment service as a service which would significantly improve the efficiency and effectiveness of Tax Administration and decrease the burden on Taxpayers.

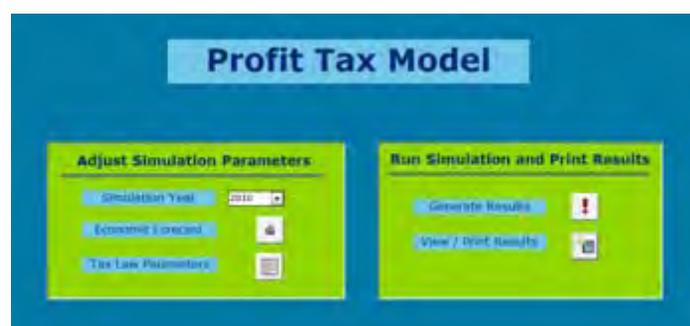
Revenue Forecasting

TASTAR's efforts were also focused on the development of a Profit Tax Micro-simulation Model. The Project's advisor built a model in Microsoft Word and Visual Basic programs. The picture on the right presents the main menu/screen of the model. The model was developed to be used by policy analysts and revenue forecasters to:

- Estimate the impact of tax legislation on profit tax liability;
- Project profit tax liability for future years under different economic conditions and/or tax law scenarios;
- Understand the structure and interactions among elements of the profit tax system.

The Project prepared and submitted to the Counterpart the User Guide for the Profit Tax Micro-simulation Model. With the User Guide the modeler will only need a basic knowledge of computers and a sound understanding of the economic drivers of the revenue base and the legislation defining tax liability, in order to analyze complex tax issues, execute simulations of alternative tax regimes, and conduct accurate revenue forecasting.

Each and every step of the modeling process was thoroughly discussed and explained to the Tax Analysis team to build tax simulation capacity at the SRC and ensure sustainability.



Coordination with International Organizations

TASTAR's coordination efforts with international community were beneficial for all parties involved in the tax administration supporting activities. The Project established an outstanding business relationship with the in-country donor community involved in the area of tax administration, i.e. IMF, the WB, IFC and EU.

Donors	Activities in Tax Administration	TASTAR's Coordination Area
IMF	IMF provides assistance on organizational reforms and change management, including work with the Large Taxpayers Office as well as sets up triggers for the Government to achieve planned reforms in tax area.	Regular meetings with IMF resident representatives and IMF missions had a purpose of briefings, information sharing, discussions of the statistics, the SRC performance and the discussions of the strategy, which were very efficient. The coordination areas in particular were Audit and VAT Refunds. The IMF triggers with regard to the Automated VAT Refund mechanisms were vitally important and supportive for the Project to achieve the tasks under Component 2 (<i>Improving the Systems of VAT Refunds</i>).
WB	The WB's current policy-based lending operation, the <u>Development Policy Operation (DPO)</u> , is constructed around two pillars to support the Government's institutional and economic reform efforts in the medium-term period of 2009-2011. These are policies to mitigate the financial crisis' implications in the short run and to address the country's growth challenges in the medium to long run. The latter task is seen in the spectrum of fundamental reforms to take place in the tax/customs administration as well. The DPO is supporting a satisfactory macro-fiscal framework, as well as significant reforms in both tax and customs. Additionally, the WB's planned <u>IDF grant on Fiscal Management and Tax Compliance Capacity</u> is going to provide hands on expertise in audit methodology and implementation.	Periodic meeting with WB missions and advisors had an aim of mutual briefings and ensuring avoidance of effort duplication. The coordination areas in particular were Audit Selection System, Audit sectoral guidebooks, and VAT Refund.
EU	The EU has assisted the SRC in the digitalization of tax forms and is planning to engage with the SRC in support of the proposed Free Trade Agreement with the EU.	TASTAR coordinated its activities with regard to promoting e-filing and enhancing IT infrastructure.
IFC	The IFC has conducted a tax compliance cost survey and is going to support with SME tax regime improvement/design.	The activities coordination area was particularly taxpayer services area.

Annex 1. Success Stories

SUCCESS STORY

“Risk Management in Tax Administration is a Fair and Justified Treatment Toward Taxpayers”

Risk management is not a magic formula that always will give the right answers.

It is a way of working and thinking that will give better answers to better questions. It is a tool for decision-making and will help the organization to reach its objectives.

Armenian tax authorities engaged in too many taxpayer audits, significantly increasing the cost of doing business in Armenia. The Armenian European Policy and Legal Advice Center reported that the costs of complying with tax legislation in Armenia is the highest across the former Soviet Union

– driven primarily by the cost of preparing for, and participating in, tax audits.

The legacy of too-frequent, too costly audits can be addressed by a rules-based risk analysis and risk scoring system that selects a relatively low percentage of taxpayers for audit based on weighted risk factors that imply a high probability that tax liability has been underreported.

USAID funded TASTAR Project has provided extensive technical assistance to the Armenian Tax authorities in one year and a half to develop and introduce a Risk-Based Audit Selection System.

The System has enabled the State Revenue Committee to move from a 100% audit policy. It uses a series of criteria to test Tax Return details and indicate errors, trends and anomalies to identify potential problems.

The SRC officials already recognize that an effective risk-based audit selection process targeting high-risk taxpayers will significantly reduce the number of audits, increasing audit quality and decreasing the resources deployed by the SRC for audit purposes.

The System will also provide an incentive for taxpayers to comply with tax laws. The end result will be fewer, but better audits; a significant improvement in tax collection efficiency; and a business enhanced enabling environment.



Testing of the System's application



SUCCESS STORY

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USAID funded TASTAR Project and RA State Revenue Committee introducing an Automated VAT Refunds System in Armenia

Following the Memorandum of Understanding, signed by USAID/Armenia and the State Revenue Committee (SRC) on May 4, 2010 to improve Armenia’s tax administration and relevant business processes, the USAID-funded initiative for technical assistance to support tax administration reforms (TASTAR) provided intensive assistance to the SRC to develop a Concept, Methodology and all IT relevant documentation introduce a System of Risk-Based Automated VAT refunds.

The developed approach incorporates the principle that refund requests should be processed in a timely manner



upon receipt with the majority of all such submissions quickly identified for prompt payments. Only in those cases where there is no (or a poor) taxpayer performance history, or where the claim fails high-level integrity checks, should a refund be flagged for further investigation.

On April 11, 2011 the TASTAR and the SRC conducted an Open Session to update SRC entire staff and the business community on progress with the introduction of the Automated VAT Refund System in Armenia.

A presentation made by the Project and SRC explained the functionality, the benefits and the consequences of the System and the timeline of full introduction.

“The cooperation with TASTAR Project has brought us closer to our main goal, which is functioning risk-based Automated VAT refund system in Armenia,” during the Open Session said SRC Deputy Chairman Rubik Kocharyan. “A viable system capable of identifying probable fraud will increase the SRC’s confidence that VAT refunds can be paid with nominal risk, and will contribute to taxpayers’ perception that the tax authorities work transparently to collect only those taxes that are legally owed to the Government,” he said.



MAIN OUTCOMES

- Improved business enabling environment due to reduced uncertainty with VAT compliance
- Enhanced taxpayer confidence, which simultaneously improves the accuracy of self-assessment
- Reduction in the stock of VAT refund



SUCCESS STORY

209 SRC Inspectors from Service Centers and RTIs Trained on Taxpayer Service Techniques

Following the MOU signed by the SRC and USAID/Armenia to improve the efficiency of Armenia's tax administration, the USAID-funded initiative for Technical Assistance to Support Tax Administration Reforms (TASTAR) and State Revenue Committee (SRC) began a series of



joint trainings in order to: (1) increase SRC staff knowledge of recent laws, procedures and methods, and (2) improve SRC staff capacity in taxpayer services.

The joint seminars began on August 17th and included six sessions that were held in Yerevan and in the regions of Yeghegnadzor, Sevan, and Vanadzor.

The primary objective of the training program was to support the SRC in its process to transform into an effective service organization. The courses focused on improving the culture of taxpayer service, and developing effective taxpayer communication skills. The objective has been to ensure that all taxpayers receive the same answers to their questions, and the same courteous and professional treatment in each of the 39 SRC offices around the country.

The seminars were very interactive. In addition to using standard classroom techniques the participants had the opportunity to re-enact real-life scenarios related to practical cases. Mr. Vahagn Aganikian, TASTAR's experienced Taxpayer Service specialist, discussed various real-life issues and demonstrated techniques and approaches dealing with typical taxpayer service situations.

The training promoted improvement in application of SRC policy and procedure, and consistency in the level of customer satisfaction for taxpayers across Service Centers. The training demonstrated that customer service is essential for the image and the reputation of tax authority. It created the necessary mind-set within the SRC to encourage the dedication to taxpayer support necessary for delivering outstanding customer service.

Overall, the training was a success. In their evaluation questionnaires, the trainees provided numerous insights on the benefits of the training and the opportunity it provided them to interact with the specialists from the SRC and TASTAR and discuss issues of concern.

SRC top management has been extremely pleased with outcome of the training series and is determined to organize similar trainings in the future.



SUCCESS STORY

Audit Guidebooks Developed for Certain Industries for use by SRC Auditors

USAID-funded TASTAR project and the State Revenue Committee (SRC) jointly developed guidebooks for conducting comprehensive audits in four key economic activities in Armenia: Tourism, Transportation, Real Estate and use of cash registers. These guidebooks are designed to enhance audit practices, provide new audit techniques and standardize audit activity. They define audit procedures such as initial interviewing, reviewing records, examining recordkeeping, and probing for potentially unreported income.

After completion of these books, training was provided to auditors throughout Armenia. Beginning on Nov 8th, these classes were conducted featuring four Armenian Senior Tax Inspectors, Mr. Avagyan, Mr. Vardanyan, Mr. Semijyan, and Mr. Barseghyan and by Mrs. Patricia Leatherwood, Certified Public Accountant, and TASTAR’s experienced Audit Advisor.

Using traditional classroom techniques participants were engaged throughout the training and were able to ask questions and learn leading international practices in these audit areas. In addition, audit areas new to Armenia such as Electronic Commerce, were discussed. The training promoted proper application of the law as well as standardization in the steps to conduct an audit.

In addition, the guidebooks were published by the TASTAR project and presented to the SRC by USAID Armenia Mission Director Jatinder Cheema during an official ceremony held on March 22, 2011.

“These guidebooks will particularly help to standardize tax audits in specific sectors and ensure that SRC auditors have published job reference aids that document policies, work methods, audit techniques and procedures,” remarked SRC Chairman Gagik Khachatryan. He also indicated that improving the quality of audits is a key goal of the SRC.



Group picture after TOT sessions



Training session in Yeghegnadzor



Non-formal discussion after Presentation event



The SRC will establish mechanisms to encourage the usage of the Guidebooks by their inspectors