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“RA STS Administrative Capacities Assessment” Project

August-November 2007

## EXECUTIVE SAMMARY

**Assessment of Administrative Capacities of the State Tax Service under the  
Government of the Republic of Armenia**

(based on the indicators approved by the European Commission)

ON

THE REPORT

## **Executive Summary**

*Assessment of administrative capacities of the State Tax Service under the RA Government (RA STS) was carried out. The activities were performed in accordance with the guidelines (hereinafter EU benchmarks) serving as a tool for the EU membership, using 344 key indicators, 77 strategic objectives and multilateral assessment mechanism of 14 administrative systems. During four months all administrative legal materials, of the tax authority, application practice in their real life were examined, a number of interviews and discussions, round tables with different concerned groups were held.*

*As a result detailed analysis-report of about 450 pages was prepared. It elaborates on weaknesses and strengths of administrative work of the tax service in the context of the European tax standards, which is a legal base for further design of reforms.*

## **Project Objectives and Beneficiaries**

The main objective of the administrative capacities assessment project of the State Tax Service under the Government of the Republic of Armenia (RA STS) is to assess the administrative capacities of the RA State Tax Service through comparison with the European criteria. Another objective of the project following the assessment is to process suggestions, as well as to input a precise action plan and mechanisms for the development of the fiscal administration in the Republic of Armenia.

The main beneficiary in achieving this aim is the Republic of Armenia on behalf of the RA STS, which should constantly review policy implementation, improve the mechanisms, according to the significance and substance of the objectives laid before it. The assessment of the RA STS capacities is a part of the overall process assessing the Republic of Armenia state bodies' administrative capacities. It is implemented within the frames of the European Neighbourhood Policy Action Plan, regarding which the RA ministries and agencies were given exact instructions by the RA President and the RA Prime Minister, who believed such assessment works were important for the improvement of state performance effectiveness.

The expert assessment of the RA STS administrative capacities was carried out within the frames of the RA STS administrative capacities improvement project implemented jointly by the US Agency for International Development (USAID), Armenian Tax Improvement Program (ATIP), and the Armenian-European Policy and Legal Advice Centre (AEPLAC).

The assessment was implemented according to the Fiscal Blueprints developed in 2005 by the working group established by the European Commission, which are used as a basis in the EU accession process by "Aharon Paradigma" consultant-research company during August-November 2007.

During the assessment the RA State Tax Service underwent complete diagnosis; afterwards the obtained results were compared with the minimum "desired" level defined by the EU according to all FBs, which are:

1. Overall Framework of a Tax Authority
2. Structure and Organisation
3. Tax Legislation
4. Ethics

5. Human Resources Management
6. Revenue Collection and Enforcement
7. Tax Audit
8. Administrative Cooperation and Mutual Assistance
9. Tax Fraud and Tax Avoidance
10. Taxpayers' Rights and Obligations
11. Systems for Taxpayers' Management
12. Voluntary Compliance
13. Information Technology
14. Communications

### **Brief summary (extract from the Report)**

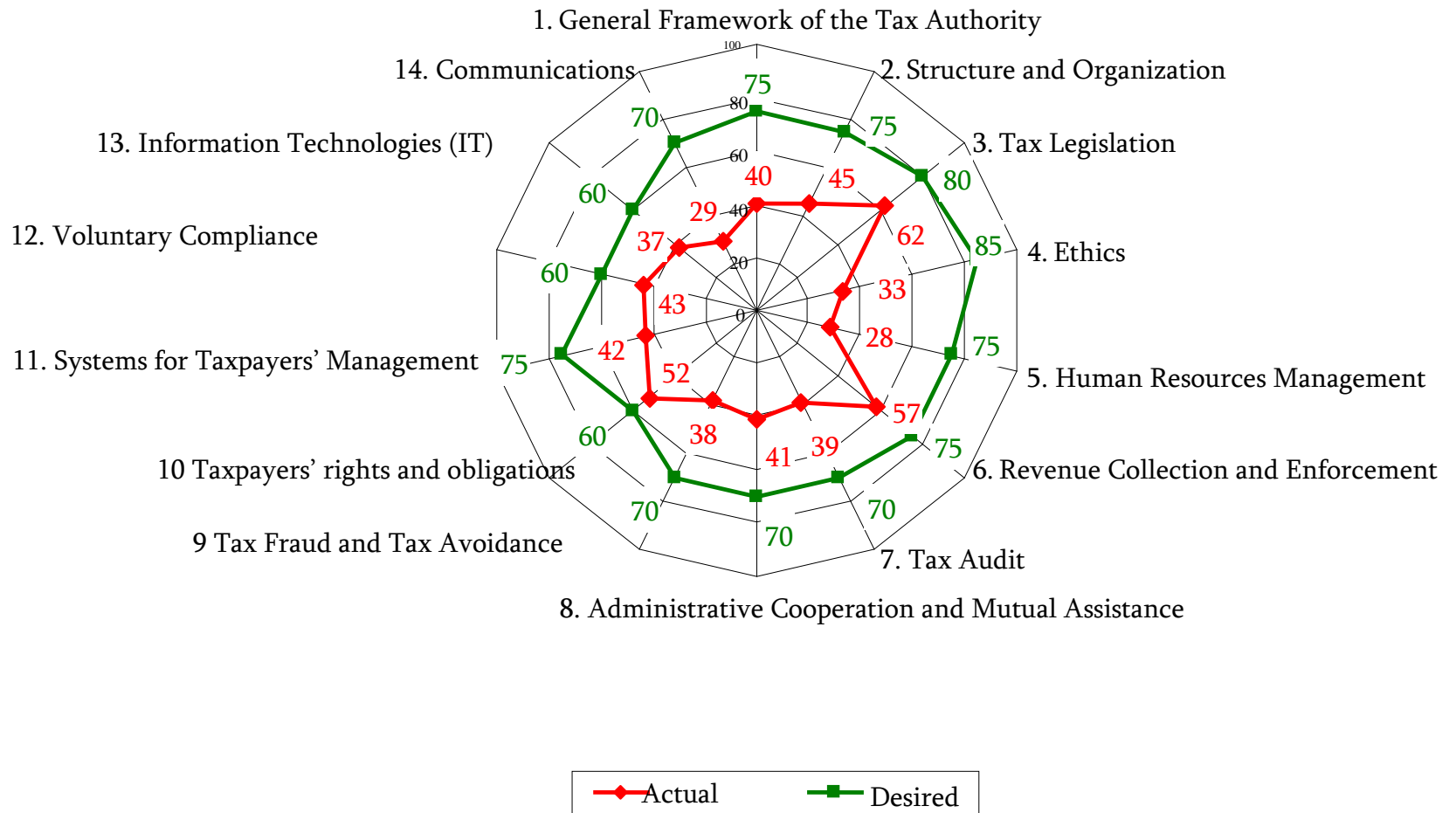
The analysis was carried out according to 77 strategic objectives and 14 administrative systems – relevant FBs – and their 5 groups. The main results of the peer review are presented below in the form of radar picture, separate table, as well as in the form of text.

1. Assessment of STS administrative capacities according to the total of 14 functional systems, as opposed to the EU benchmarks was 58.67%,
2. The closest to the EU benchmark indicator was 86 % (FB 10) - “Taxpayers’ Rights and Obligations”),
3. The next two systems, where Armenia Tax Administration is in “good” shape are as follows:
  - a) FB 3. “Tax Legislation” - 77.8 %, and
  - b) FB 6. “Revenue Collection and Enforcement” - 76.4 %.
4. The lagging or the gap as opposed to the European 1000 unit-based tentative basket is 413.3 units. In the structure of that gap the three weakest areas include:
  - a) FB 4. “Ethics” – gap of 12.5 %,
  - b) FB 5. “Human Resources Management” – gap of 11.3 %,
  - c) FB 14. “Communications” – gap of 9.9 %.
5. The EU FB-s requiring the highest score are FB 3 (Tax Legislation) and FB 4 (Ethics), correspondingly 80 and 85 scores. In Armenia the highest scores were collected by the same FB 3 and FB 6 (Revenue Collection and Enforcement). This means that the EU preferences include legal (law) and social (ethics) procedures, whereas the Armenian Tax Administration priorities go to the laws and tax collection. The Armenian administration so far has well-articulated “power” image.
6. This picture was contributed by the rather unfavorable situation with FB 14 (Communications). In terms of communication with taxpayers and tax employees the Armenian Tax Administration is 2.4 times behind the European benchmark.
7. Analysis of 5 groups applied in EU (e. g. *Framework, structures and basis or Support*) show that the STS administration level is almost equally or evenly distributed in parallel with the European level. In terms of main direction, the Armenian Tax Administration is virtually comparable with key European administration approaches.
8. Despite the comparability with key European approaches, the level of harmonizing scores within the groups of FB scores is higher in EU than in Armenia. This means that for the analysis of findings of the STS administrative capacities assessment, the best and targeted way is through FB-s, viz. the 14 functional systems.

9. Currently the Tax Administration is in better shape in terms of well-elaborated tax legislation (particularly definition of rights and responsibilities, availability of administrative and criminal legislation combating tax frauds, a clear cut system for tax computation (registration), as well as international tax treaties.
10. Currently the most vulnerable are not the technical, legislative or organizational factors, but the human factor. The lowest performance level (around 20% of the European threshold) is recorded in the following two strategic objectives:
  - o Human resources policy and practice which promotes, supports and protects the employees; and
  - o Effective internal communication system.
11. In addition to human resources and communications, the Tax Administration has to put significant efforts to bridge the following gaps:
  - a) Tax Administration divisions' (and staff) performance assessment and productivity management system (including through internal audit mechanisms);
  - b) Structure and management based risks and priorities;
  - c) Full and uniform application of tax legislation;
  - d) Effective refund procedures;
  - e) Effectiveness of tax audits (inspectors using modern tools, knowing accounting programs and regularly undergoing trainings);
  - f) Coordinated procedures of exchange of information with Tax Administrations of other countries;
  - g) Tax fraud nature, occurrence, estimates, risk-based control system, as well as tax fraud and avoidance prevention strategy;
  - h) Sanctions promoting tax compliance, a sufficiently fair and simple system;
  - i) Application of modern IT,
  - j) Provision of updated and comprehensible guidance (explanations, instructions) to taxpayers;
  - k) A special strategy on communication with taxpayers, particularly informing the community on achievements and objectives of the Tax Administration.
12. Detail analysis (though less eloquent compared with FB-s or SO) show that from 344 detailed questions only in case of 9.3% the Tax Administration function, procedure was assessed by the experts as the highest. 63% of SO-s falls below average.
13. The level of harmony is higher in the KI-SO part as opposed to the FB-functions group. This mean that after the general analysis when planning next steps and activities:
  - a) The role of the main axle must be played by strategic objectives,
  - b) Details of that "mechanism" must be considered on the SO level,
  - c) Reforms must include all 14 systems functioning on the FB level.

Besides, it should be noted that according to the assessment, today the Tax Administration does not have a comprehensive and consistent program approach, so in the future, in order to improve effectiveness of the works it is crucial that STS is able to coordinate all projects and efforts implemented. It will be reasonable that based on currently defined programs and analysis the STS complete and comprehensive strategy is developed (reviewed) and the STS mission is publicized.

### Comparative Picture of the RA STS Capacities Assessment



## RA STS Administrative Capacities Assessments

### Table of the Main Results

FBs in relevant groups	Score		Deviations		
	Actual	EU	Absolute deviation from the EU defined Col. 2- col.1	Level of achieving the EU level % [col. 1)/col. 2]*100%	Absolute deviation structure % col. 3 / col. 3 TOTAL
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<b>First group: scopes, structure and basis</b>	<b>146.7</b>	<b>230</b>	<b>83.29</b>	<b>63.79</b>	<b>20.1%</b>
<i>1. General Framework of the Tax Authority</i>	39.9	75	35.07	53.24	8.5%
<i>2. Structure and Organization</i>	44.5	75	30.45	59.4	7.4%
<i>3. Tax Legislation</i>	62.2	80	17.76	77.79	4.3%
<b>Second group: Human Resources and Behavior Issues</b>	<b>61.8</b>	<b>160</b>	<b>98.17</b>	<b>38.64</b>	<b>23.8%</b>
<i>4. Ethics</i>	33.4	85	51.56	39.35	12.5%
<i>5. Human Resources Management</i>	28.4	75	46.61	37.85	11.3%
<b>Third group: Systems and works</b>	<b>174.6</b>	<b>285</b>	<b>110.38</b>	<b>61.27</b>	<b>26.7%</b>
<i>6. Revenue Collection and Enforcement</i>	57.3	75	17.67	76.44	4.3%
<i>7. Tax Audit</i>	38.7	70	31.31	55.27	7.6%
<i>8. Administrative Cooperation and Mutual Assistance</i>	40.8	70	29.25	58.22	7.1%
<i>9. Tax Fraud and Tax Avoidance</i>	37.9	70	32.147	54.08	7.8%
<b>Forth group: Taxpayer Service</b>	<b>137.4</b>	<b>195</b>	<b>57.63</b>	<b>70.45</b>	<b>13.9%</b>
<i>10. Taxpayers' rights and obligations</i>	51.6	60	8.41	85.98	2.0%
<i>11. Systems for Taxpayers' Management</i>	42.3	75	32.69	56.42	7.9%
<i>12. Voluntary Compliance</i>	43.5	60	16.54	72.44	4.0%
<b>Fifth group: Support</b>	<b>66.1</b>	<b>130</b>	<b>63.87</b>	<b>50.87</b>	<b>15.5%</b>
<i>13. Information Technologies (IT)</i>	36.9	60	23.09	61.51	5.6%
<i>14. Communications</i>	29.2	70	40.78	41.74	9.9%
<b>TOTAL (by all 14 FBs and 5 groups)</b>	<b>586.7</b>	<b>1000</b>	<b>413.34</b>	<b>58.67</b>	<b>100.0%</b>

