

2024 -
June

ARMENIA

Component: *Revenue*

Modules: *RM I – Tax Policy*
RM II – Revenue Administration

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PROJECT SUMMARY	
COUNTRY:	Armenia
LEAD DEPARTMENT:	FAD
REGION:	MCD
PROGRAM ID:	[To be filled out by Secretariat]
PLANNED DATES:	July/2024 – May/2025
FUNDING PROGRAM TITLE:	[to be added by Secretariat]
PROJECT MANAGERS:	
RM I – TAX POLICY	Rakhimova, Parvina - FADT1
RM II – REVENUE ADMINISTRATION	Graham Reginald Whyte – FADR1 (Lead)
ESTIMATED BUDGET	\$318,115
BUDGET FOR ENDORSEMENT:	\$318,115

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*ARMENIA***ACRONYMS**

CD	Capacity development
FAD	IMF's Fiscal Affairs Department
PIT	Personal income tax
SBA	IMF Stand-By-Arrangement
SRC	State Revenue Committee
SSC	Social security contribution
STX	Short-term expert

*ARMENIA***I. PROJECT PURPOSE**

Despite the robust growth that Armenia's economy experienced since 2022, the worsened regional security situation and multiple long-standing economic challenges have put increasing pressure on the government to raise revenues to secure its fiscal stability. In view of this and its on-going Stand-By-Arrangement (SBA) commitments,¹ the country's authorities requested the IMF's Fiscal Affairs Department (FAD) to continue its technical assistance and support further tax policy reforms and tax administration modernization. The objective of this project is to address the government's request and support its efforts in strengthening revenue and improving the tax system.

The new one-year capacity development (CD) project will help the government implement tax policy reforms and further modernize the tax revenue administration. In the tax policy area, the project will guide the government on introduction of the capital gain tax, and financial activities tax, and will conduct an analytical assessment of the structure, buoyance, and progressivity of the tax system in comparison with peer countries. In tax administration, the project will build capacity in the State Revenue Committee (SRC) to measure the Personal Income Tax (PIT) and Social Security Contribution (SSC) gaps and address emerging risks to Armenia tax system so as to maintain and also mobilize revenue.

The key activities and the timeline for their delivery under the project were agreed with the government.

The estimated budget for this one-year project is \$318,115 and endorsement is requested for the full amount through FY25.

¹ See <https://www.imf.org/en/Publications/CR/Issues/2023/12/14/Republic-of-Armenia-2023-Article-IV-Consultation-and-Second-Review-Under-the-Stand-By-542533>.

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II. BACKGROUND

Macro-fiscal situation

Armenia's economy grew rapidly since 2022, driven by robust private consumption and investments. Inflow of highly skilled workers from Russia also supported growth and resulted in increased employment and strong nominal wage rise.² Both strong domestic consumption and increased employment boosted tax collections from VAT, income tax, and social security contributions. Armenia's tax-to-GDP ratio was 21.9 percent³ in 2022.

However, it is expected that a combination of factors including border tensions with Azerbaijan, influx of 100,000 refugees from Nagorno-Karabakh, subsiding labor and capital inflow, and tight monetary policy will steer growth down in the medium-term. Armenia's authorities are broadly aware of viable downturn economic projections and agree that sustaining a strong fiscal position will help them in addressing potential risks. This goes in line with on-going SBA recommendations to intensify structural fiscal reforms. Country engagement and alignment to reform priorities

Armenia's on-going SBA supports the authorities' reform efforts in revenue mobilization. The Armenian authorities show commitment to their SBA commitments and plan to launch a broad reform program yielding at least 0.75 percent of GDP in additional revenue cumulatively by 2026.⁴ The authorities have exhibited high engagement with earlier CD and demonstrated that they have the capacity to put into action FAD recommendations.

FAD has provided significant CD to the authorities on tax policy and administration in recent years. The SRC is highly engaged on CD and has demonstrated a capacity to absorb our RA advice and to implement it, albeit with some guidance.

Tax policy reforms:

- An assessment of buoyancy and structure of the tax system. The authorities would like to undertake an analytical assessment of the buoyancy and stability of the tax system to reveal whether the current system is aligned with growing sectors of economic activity and to identify its weak and strong spots. An assessment of the progressivity of the system and comparison with country comparators is also expected.
- A review and update of the existing vehicle property tax, road tolls and fuel tax. The government would like to review existing legislation in relation to these taxes and update it according to the most recent international practices.

Revenue administration reforms:

FAD's recent tax administration CD delivery (funded as part of a regional project by the European Commission's Directorate General for Neighborhood and Enlargement Negotiations (DG NEAR)) has continued to focus on revenue mobilization (RM) through the maturing of Armenia's Compliance Risk

² See IMF Country Report No. 23/205.

³ See IMF Country Report No. 23/205.

⁴ IMF, 2023 Article IV Consultation and 2nd review under the Standard-By Arrangement and Request for Modifications of Performance Criteria and Monetary Policy Consultation Clause.

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Management Framework (CRM). The SRC is requesting additional CD on implementing more complex parts of CRM and additional CD resources are needed for this as the current DG NEAR funding is exhausted and CD support from the IMF's Caucuses, Central Asia, and Mongolia Regional Capacity Development Center (CCAMTAC) is limited. This includes CD on measuring the Personal Income Tax (PIT) and Social Security Contributions (SSC) gaps and International Tax Noncompliance (Transfer Pricing).

III. PROJECT MODULES - DESCRIPTION

This proposal will provide CD support to Armenia in the area of tax policy and revenue administration. FAD CD will support improvements within the strategic objectives presented in Table:

Table 1. Summary of Objectives covered by the Proposal

Component	Module	Objective
Revenue	RM I / Tax Policy	Improve Tax Policy Design
Revenue	RM I / Tax administration	Strengthen revenue administration management, governance, and reform arrangements, and improve core tax administration functions.

A. RM I – Tax Policy

Scope

The project will be aligned with the Government's priorities and the IMF SBA both in tax policy and tax administration. In tax policy, the IMF SBA aims to increase revenue, improve tax system's efficiency by addressing distortions and increasing progressivity. In tax administration, CD is focused on revenue mobilization in the medium term, in particular, complex compliance risks that impact on the revenue base.

The main objective of the tax policy component of the project is to support tax policy reforms planned by the government and to consider refining and expanding them where necessary. To achieve these objectives, the CD activities will focus on:

- An analytical intervention on the structure, buoyancy, and progressivity of the tax system, including comparisons with peer countries.
- A review and update of the existing vehicle property tax, road tolls and fuel tax.

Program Objectives

The CD project is designed to strengthen support for the implementation of the tax policy reforms planned by the government and to consider refining and expanding them where necessary. This will have to increase the revenues and improve the efficiency of the tax system. Specifically, the work will seek to:

- Conduct analytical assessment of the structure, buoyancy, and progressivity of the tax system, including comparisons with peer countries. The goal of this assessment is to reveal whether the current tax system is aligned with growing sectors of economic activity and to identify its weak and strong spots.

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An assessment of the progressivity of the system and comparison with country comparators is also expected.

- Review and update the existing vehicle property tax, road tolls and fuel tax. The goal of this assessment is to review existing legislation in relation to these taxes and update it according to the most recent international practices.

Expected Results (outcomes)

The project is expected to achieve the following operational results:

- Increased tax revenue.
- Improved distributional fairness across taxpayers due to amended tax rates or base.
- Increased economic efficiency by minimizing economic distortions or addressing externalities or market failures.

B. RM II / Revenue Administration

Scope

The main objectives of the revenue administration component of the project are to strengthen revenue administration management, governance, and reform arrangements, and improve core tax administration functions. To achieve these objectives, the CD activities will focus on:

- Support to estimate the PIT and SSC (collected at the same time as PIT) Gaps.
- Expanding international tax compliance activities that are in an early stage.

Program Objectives

The CD program is designed to strengthen revenue administration management, governance, and reform arrangements, and improve core tax administration functions with a view to mobilizing and sustaining revenue collections through enhanced compliance. To achieve these objectives, the CD activities will focus on:

- Support to estimate the PIT Tax and SSC Gaps.
- Expanding international tax compliance activities that are in an early stage.

Expected Results (outcomes)

The project is expected to achieve the following operational results:

- An estimation of the PIT and SSC Gaps.
- Improved capacity to deal with international noncompliance.

IV. ORGANIZATIONAL ARRANGEMENTS

A. Country Engagement

Armenia's ongoing SBA supports the authorities' reform efforts in revenue mobilization. The Armenian authorities show commitment to their SBA commitments and plan to launch a broad reform program

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yielding at least 0.75 percent of GDP in additional revenue cumulatively by 2026.⁵ The authorities have exhibited high engagement with earlier CD and demonstrated that they have the capacity to put into action FAD recommendations.

B. Delivery Modalities

CD will comprise of a mix of remote and in-person activities. Virtual deliveries will be used to provide efficiencies to in-person support, including pre-engagement meetings and post-follow-up meetings. The following CD activities will be delivered as a package:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, ensure STX work is aligned to plans, coordinate with other CD providers, and adjust reform implementation plans.
- **Short-term expert (STX)** visits to help implement the recommendations delivered by the HQ missions; a limited number of STXs will be assigned to provide specialized assistance in specific areas of revenue administration and public financial management. The project will seek to use Portuguese-speaking experts.

C. Coordination / Cooperation

Coordination			
Partner	Type of coordination	Area of coordination	Frequency
AD country team, Resident representative	FAD activities on tax policy support program benchmarks.	Tax policy and administration	Quarterly
Cooperation			
Partner	Type of coordination	Area of coordination	Frequency
World Bank (WB), UNDP	Exchange information/agree on areas to be covered by each donor	<u>Tax policy</u> : coordination of efforts in provision of advice in the area of tax policy. <u>Tax administration</u> : Coordination with WB and European Commission to ensure that advice is complementary	Quarterly, annual

⁵ IMF, 2023 Article IV Consultation and 2nd Review under the SBA and Request for Modifications of Performance Criteria and Monetary Policy Consultation Clause.

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V. RISK ASSESSMENT AND MITIGATION

General or Module	Description	Risk Assessment	Mitigation Measures
External climate/conditions			
General	The risk is that external events create a more challenging environment to implement reforms.	Medium	Program execution allows for sufficient flexibility ability to adjust activities in the case of adverse events.
Political Support			
General	Lack of political support for reforms.	Low	The SBA is a strong sign of political support.
Management and Technical Staff Support and Commitment			
RM I / Tax Policy	Low commitment of management and staff in finance and other ministries to adopt and implement fiscal risk management practices.	Low	All past CD projects have evidenced the availability and engagement of qualified staff.
RM II / Revenue Administration	Low commitment of management and staff in finance and other ministries to adopt and implement fiscal risk management practices.	Low	All past CD projects have evidenced the availability and engagement of qualified staff.
Resource Adequacy			
General	The project is constrained by MoF/SRC staff capability and capacity	Low	Advice will include a realistic implementation timetable. This would ensure the CD complements the authorities' ongoing work. Staffing options will be explored early in the project.
Other risks			
General	Emerging risks as the project evolves.	Medium	Continuous monitoring of emerging risks and mitigations developed.

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VI. CD DELIVERY PLAN

Table 2. Summary of Indicative CD Delivery

CD Modalities (Remote or Field-based CD)	FY25	FY26	FY27	FY28	FY29	Grand Total
RM I – Tax Policy						
HQ-led remote mission	1	-	-	-	-	1
HQ-led CD mission	1	-	-	-	-	1
RM II / Tax Administration						
STX CD (10 business days) - Remote	1	-	-	-	-	1
STX CD (10 business days) – Field Based	2	-	-	-	-	2
Total	5	-	-	-	-	5

Note:

- In-person delivery was chosen in some instances because of technical nature of the missions and need for in-person interactions with counterparts on the ground.
- Remote delivery was chosen in some instances because of short duration of the activity and the nature of the activity that can be completed remotely.
- Collectively the blend of CD delivery proposed over the duration of this project/program reflects the optimal balance of in-person, remote, and hybrid activities needed to achieve the project/program outcomes taking into account the needs of the country and the resources available.

Table 3. First year workplan

Timing	CD Modality	Proposed Topics of CD
RM I – Tax Policy		
Q2/FY25	Remote activity	Analytical assessment of the structure, buoyancy, and progressivity
Q2/FY25	Field-based work	Presentation of Analytical assessment and other selected topics
RM II / Tax Administration		
FY25 Q2	Tax administration Mission – STX x 1 (two missions)	PIT/SSC Gap Measurement (Scoping and measurement)
FY25 Q3	Tax administration Mission – STX x 2	Expanding international tax compliance

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VII. PROGRAM FINANCIALS

	FY25	FY26	TOTAL (USD)
RM I - Tax Policy	\$192,081	-	\$192,081
RM II – Revenue Administration	\$105,223	-	\$105,223
Subtotal	\$297,304	-	\$297,304
Trust fund management fee (7%)	\$20.811	-	\$20.811
TOTAL	\$318,115	-	\$318,115

The estimated budget for this one-year project is \$318,115 and endorsement is requested for the full amount through FY25.

VIII. TARGETED LOGICAL FRAMEWORK

A. RM I – Tax Policy

Objective	
Strengthen policy monitoring, evaluation, and institutions	
Outcome(s)	Indicator(s)
Improved structures (e.g., tax policy units) or capacity (e.g., models and tools) related to tax policy advice and analysis	Improved models to evaluation tax policy adopted

B. RM II – Revenue Administration

Objective	
Strengthened revenue administration management and governance arrangements	
Outcome(s)	Indicator(s)
Corporate priorities are better managed through effective risk management	Improved identification, assessment, ranking and quantification of compliance risks
	Better mitigation of risks through a compliance improvement program
	Improved monitoring and evaluation of compliance risk mitigation activities