IMF Publication

Moldova - Technical Assistance Report on Taking Compliance Management Further

INTERNATIONAL MONETARY FUND

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Fiscal Affairs Department

MOLDOVA

TAKING COMPLIANCE MANAGEMENT FURTHER

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April 2012

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ACRONYMS

CCECC	Center for Combating Economic Crimes and Corruption
CIT	Corporate Income Tax
COTS	Commercial Off-The-Shelf Computerization Solution
FAD	Fiscal Affairs Department
HWI	High-Wealth Individuals
IAM	Indirect Audit Methods
IT	Information Technology
LTO	Large Taxpayer Office
MDL	Moldovan Lei
MoF	Ministry of Finance
MOL	Ministry of Labor
OECD	Organization for Economic Co-operation and Development
PIT	Personal Income Tax
PO	Prosecutor's Office
STI	State Tax Inspectorate
TA	Technical Assistance
VAT	Value Added Tax

PREFACE

This report concerns the delivery of a tax administration mission to Moldova during February 8 – 21, 2012 by the Fiscal Affairs Department (FAD) of the IMF as a component of implementing FAD's technical assistance strategy for Southeast Europe.

The mission was led by Mr. Allan Jensen (Chief) and comprised Mr. Norman Gillanders (FAD Regional Tax Administration Advisor); Mr. Enriko Aav (FAD); Mr. Frank Bosch and Mr. John Buchanan (both external experts). Invaluable input to the mission and the report was provided by Mr. Erik Hutton (FAD) on revenue performance analysis and Mr. Paul Martens (external expert) on large taxpayer management. Both happened to be on FAD assignments in Chisinau at the time of the mission.

The mission met with Mr. Veaceslav Negruta, Minister of Finance; Mr. Victor Barbaneagra, Deputy Minister of Finance; Mr. Nicolae Platon, Chief of the Main State Tax Inspectorate (STI); Mr. Gheorghe Cojocari, Mr. Adrian Timotin, Mr. Iuri Lichii, all Deputy Chiefs of the STI; Mr. Procopie Duca, Chief of the STI's Strategic Management and Innovation Directorate; Mr. Igor Ţurcanu, Chief of the STI's Large Taxpayer Office; Ms. Maia Tverdohleb, Chief of the STI's Innovation and Administration Methods Section, as well as many other managers and staff of the STI.

The mission also met with Mr. Vladimir Grosu, Deputy Minister, Ministry of Justice; Mr. Peter Menhard, Advisor to the Head of the State Tax Inspectorate in Moldova, from the EU's High-Level Policy Advisory Team to the Government in Moldova; and Mr. Vitalie Coceban, Director General, FiscServInform, a state enterprise that provides IT services to the STI.

To facilitate technical assistance coordination and encourage additional donor input to tax administration reform, the mission also met with Mr. Abdoulaye Seck, Country Manager, and Ms. Lillian Razzlog, Public Sector and Institutional Reform Specialist, both from the World Bank; Mr. Wolfgang Behrendt, Head of Political and Economic Section, and Mr. Oleg Hirbu, Project Manager, both from the Delegation of the European Union to Moldova.

The mission expresses its gratitude for the first-rate cooperation it received from all with whom it met at the Ministry of Finance and the STI. The mission is also very thankful for the support provided by Mr. Tokhir Mirzoev, IMF Resident Representative, and his staff before and during the mission. Finally, the mission appreciated the invaluable help provided by Ms. Lidia Dogaru, Mr. Serge Bufteac, Ms. Iulia Timotin, and Ms. Christina Umanet, the mission interpreters.

Executive Summary

Main conclusions

Supported by the Finance Minister, the STI continues to strengthen tax administration in line with IMF advice. Most importantly, to reduce tax evasion—and building on the Strategic Plan for 2011–15—the agency has come far with implementing a Compliance Risk Model (CRM), which is aligned with good international practices. A pilot testing of the model in 2011 showed encouraging results in terms of extra revenue. This has motivated the STI to roll out the model in full from January 1, 2012. However, effective implementation and long lasting compliance impact require considerable further improvements with regard to taxpayer services, audit, tax fraud investigations, information technology systems (IT), and the value-added tax (VAT) refund system. Of major concern is the current lack of prosecutions to deter tax fraud. In the medium term, this could seriously undermine the CRM efforts and the potentially large revenue gains from implementing the model. Continued technical assistance (TA) from the IMF and other TA providers during the next three–four years is essential to improve the areas mentioned.

Current situation and issues

The STI have come far in implementing a modern CRM. The pilot testing in 2011 of the CRM (which is based on the Organization for Economic Cooperation and Development(OECD)/EU compliance concept) was successful in increasing taxpayer compliance within the segments targeted by the pilot (e.g., about 20 percent revenue increase). The compliance plan for 2012 involves a full roll out of its use. The model uses a mixture of compliance approaches applied cohesively to an identified tax risk affecting a set of taxpayers. For example, in 2011, the STI contacted the riskier taxpayers in selected economic sectors with the aim to persuade them to improve their tax compliance voluntarily. Meetings were held with taxpayers and only later did the STI start to audit noncomplying businesses. As predicted, the vast bulk of tax recovered did not come from audit but from prompted voluntary compliance. The success of the 2011 pilot test suggests that the model has the potential to change taxpayer behavior, if implemented well. The compliance plan for 2012 further includes the compliance measures communicated in the Government's letter of intent concerning the Fund program, including to increase compliance within the segment of high-wealth individuals (HWIs); pursue the use of indirect audit methods; and improve the collection of payroll taxes.

Successful implementation and long-lasting impact of the CRM require that a number of tax administration components be further strengthened. Addressing the remaining shortcomings in a range of key tax administration areas puts a significant focus on training and also requires considerable TA in excess of what can be provided by the Fund; in particular this is the case with the much needed IT reform. The main areas for attention are:

- ***Taxpayer services must be strengthened and used to promote compliance.*** The STI has put in place the standard approaches necessary to handle taxpayers' queries. It has also begun to use publicity and marketing techniques to make taxpayers more conscious of their compliance obligations and of the dangers of being detected if they evade tax. However, much more can be done and a dedicated taxpayer services unit must be established at the STI headquarters to take on this agenda.

- ***A simple but effective first step is for the STI to work more closely with tax professionals and business groups to promote compliance.*** This would foster a better understanding of mutual problems and attempt to find ways of simplifying tax administration. The report proposes establishing a compliance cooperation council to allow constructive collaboration on critical compliance and administrative issues.

- ***Improved compliance will also require enhanced audit skills.*** Auditors must learn how to identify unreported income (including hidden wages), how to recognize evidence of serious tax evasion and aggressive tax avoidance, and how to combat these abuses. Filling these knowledge gaps will require a higher level of technical training over a sustained period.

- ***The authorities must learn how to bring a small but well-selected group of tax evaders before the courts each year.*** This will require a radical re-evaluation of the anti-fraud arrangements involving the STI and other agencies. A significant amount of time is spent on processing dossiers across a number of organizational boundaries; but without any single court conviction within the last three years. Clearer procedures and role definitions must be brought to this area, as the system now used is broken.

- ***Organizational structures can be improved.*** The mission supports the STI management's intention to start planning a rationalized regional structure. This would improve the handling of the STI's risk portfolio by placing staff where they are most needed. Initiatives around HWIs and indirect audit methods will take effect in 2013 and require dedicated staff working in new units.

- ***The Large Taxpayer Office (LTO) must continue its evolution***. It should begin by grouping its taxpayers into administrative units based on economic sector and increase the focus on the "top 40" businesses. The LTO must quickly acquire skills in core aspects of big business taxation. Unless this happens, the LTO will struggle to reach the benchmark level of accounting for 50 percent of the STI's total collections.

- ***The reform agenda relies on better IT.*** Core tax processes are in need for better IT. The CRM model must be driven by good intelligence drawn from IT systems based on high quality, well-integrated data. The mission endorses the STI's plans to install new software quickly and cheaply, using off-the-shelf software with minimal customization.

- ***Handling of VAT needs improvement.*** VAT control will benefit from improved audit training and better risk analysis. The large-scale VAT refund audit program shows little wrongdoing by taxpayers. Other countries (including some of Moldova's neighbors) achieve similar levels of VAT security using risk-based methods at far lower costs in terms of staff time. Finally, moves in this direction should accompany a move towards a full-refund VAT system. The existing system has accumulated huge liabilities for the Government to the detriment of businesses.