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R2017-0179/1

July 12, 2017

Closing Date: Monday, July 31, 2017 at 6 p.m.

FROM: Vice President and Corporate Secretary

Montenegro - Revenue Administration Reform Project

Project Appraisal Document

Attached is the Project Appraisal Document regarding a proposed loan to Montenegro for a Revenue Administration Reform Project (R2017-0179), which is being processed on an absence-of-objection basis.

Distribution:
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC and MIGA

Document of
The World Bank

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Report No: PAD1119

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF EUR14 MILLION
(US$15.7 MILLION EQUIVALENT)

TO

MONTENEGRO

FOR A

REVENUE ADMINISTRATION REFORM PROJECT (P149743)

JULY 7, 2017

Governance Global Practice
Europe and Central Asia Region
Western Balkans Country Management Unit

CURRENCY EQUIVALENTS

(Exchange Rate Effective May 31, 2017)

Currency Unit = Euro
Euro = US$1.121
FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

CPF	Country Partnership Framework
CIT	Corporate Income Tax
CQ	Consultants Qualification
DBA	Database Administration
DPO	Development Policy Operation
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
FM	Financial Management
FSL	Fixed-spread Loan
GDP	Gross Domestic Product
GoM	Government of Montenegro
GNI	Gross National Income
GRS	Grievance Redress Service
IAMTAX	Integrated Assessment Model for Tax Administration
IBRD	International Bank for Reconstruction and Development
IC	Individual Consultant
ICB	International Competitive Bidding
ICR	Implementation Completion and Results Report
IDA	International Development Association
IFR	Interim Unaudited Financial Report
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
IPF	Investment Project Financing
IRMS	Integrated Revenue Management System
IRR	Internal Rate of Return
ISR	Implementation Status and Results Report
IT	Information Technology
LTO	Large Taxpayer Office
MTA	Montenegro Tax Administration
MoF	Ministry of Finance
M&E	Monitoring and Evaluation
NPV	Net Present Value
OECD	Organization for Economic Co-operation and Development
PDO	Project Development Objectives

PEFA	Public Expenditure and Financial Accountability
PIC	Project Implementation Committee
PIT	Personal Income Tax
PMU	Project Management Unit
POM	Project Operating Manual
PSC	Project Steering Committee
QCBS	Quality and Cost Based Selection
RARP	Revenue Administration Reform Project
SAN	Storage Area Network
SIL	Specific Investment Loan
SORT	Systematic Operations Risk-Rating Tool
SQL	Structured Query Language
TIN	Taxpayer Identification Number
TOR	IDA
TSU	Technical Services Unit
VAT	Value Added Tax
VIES	VAT Information Exchange System
WB	World Bank

Regional Vice President:	Cyril E Muller
Country Director:	Ellen A. Goldstein
Senior Global Practice Director:	Deborah L. Wetzel
Practice Manager:	Adrian Fozzard
Task Team Leader(s):	Shilpa B. Pradhan

MONTENEGRO
Revenue Administration Reform Project (P149743)

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PAD DATA SHEET

Montenegro

Revenue Administration Reform (P149743)

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

0000009302

Report No.: PAD1119

Basic Information			
Project ID P149743	EA Category C - Not Required	Team Leader(s) Shilpa B. Pradhan	
Financing Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]		
	Financial Intermediaries [ ]		
	Series of Projects [ ]		
Project Implementation Start Date 01-Feb-2018	Project Implementation End Date 31-Jan-2023		
Expected Effectiveness Date 28-Feb-2018	Expected Closing Date 31-Mar-2023		
Joint IFC No			
Practice Manager/Manager	Senior Global Practice Director	Country Director	Regional Vice President
Adrian Fozzard	James A. Brumby	Ellen A. Goldstein	Cyril E Muller

Borrower: Montenegro			
Responsible Agency: Montenegro Tax Administration			
Contact:	Miomir Mugosa	Title:	Director
Telephone No.:	382067272353	Email:	Miomir.mugosa@tax.gov.me

Project Financing Data(in USD Million)					
[X]	Loan	[ ]	IDA Grant	[ ]	Guarantee
[ ]	Credit	[ ]	Grant	[ ]	Other

Total Project Cost:	15.7	Total Bank Financing:	15.7
Financing Gap:	0.00		

Financing Source	Amount
International Bank for Reconstruction and Development	15.7
Total	15.7

Expected Disbursements (in USD Million)

Fiscal Year	2018	2019	2020	2021	2022	2023	0000	0000	0000	0000
Annual	0.50	1.75	2.75	3.25	3.45	4.00	0.00	0.00	0.00	0.00
Cumulative	0.50	2.25	5.00	8.25	11.70	15.7	0.00	0.00	0.00	0.00

Institutional Data

Practice Area (Lead)

Governance

Contributing Practice Areas

Proposed Development Objective(s)

The development objective of the project is to improve the effectiveness of operational functions of Montenegro's Tax Administration and to reduce the compliance costs for corporate taxpayers.

The project supports Montenegro's long-term vision of a revenue administration that operates with streamlined risk-based business processes that contribute to the efficient collection of taxes and social contributions from all sources of economic activity. Increased compliance will generate a more robust revenue stream to provide essential services to citizens. Improvements in revenue administration capacity will also support the country's goal for EU accession and economic integration with EU member states.

Components

Component Name	Cost (USD Millions)
Institutional Development	2.61
Business Processes	12.69
Taxpayer Services	0.36

Systematic Operations Risk- Rating Tool (SORT)

Risk Category	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate

7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	
OVERALL	Substantial

Compliance

Policy

Does the project depart from the CPF in content or in other significant respects?	Yes [ ] No [X]
Does the project require any waivers of Bank policies?	Yes [ ] No [X]
Have these been approved by Bank management?	Yes [ ] No [ ]
Is approval for any policy waiver sought from the Board?	Yes [ ] No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X] No [ ]

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		X
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12		X
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50		X
Projects in Disputed Areas OP/BP 7.60		X

Legal Covenants

Name	Recurrent	Due Date	Frequency

Description of Covenant

Conditions

Source of Fund	Name	Type
	Establishment of the Project Management Unit	Effectiveness

Description of Condition

The PMU has been established within the MTA with staff, resources, functions and responsibilities satisfactory to the Bank.

Source of Fund	Name	Type
	Establishment of the Project Steering Committee	Effectiveness

Description of Condition

The Project Steering Committee has been established by the Borrower with terms of reference defining the functions and responsibilities satisfactory to the Bank.

Source of Fund	Name	Type
	Establishment of the Revenue Modernization Advisory Board	Effectiveness

Description of Condition

The Revenue Modernization Advisory Board has been established by the Borrower with terms of reference defining the functions and responsibilities satisfactory to the Bank.

Team Composition

Bank Staff

Name	Role	Title	Specialization	Unit
Shilpa B. Pradhan	Team Leader (ADM Responsible)	Senior Economist		DFIRM
Arben Maho	Procurement Specialist (ADM Responsible)	Procurement Specialist		GGO03
Ayse Seda Aroymak	Financial Management Specialist	Sr. Financial Management Specialist		GGO21
Agnes I. Kiss	Safeguards Specialist	Regional Environmental and Safeguards Advisor		OPSPF
Jasna Mestnik	Team Member	Finance Officer		WFALN
Luz Meza-Bartrina	Counsel	Senior Counsel		LEGLE
Matteo Mazzoni	Team Member	Legal Analyst		LEGKL
Nataliya Biletska	Team Member	Senior Public Sector Specialist		GGO15
Stella Ilieva	Team Member	Senior Economist		GMF03

Extended Team

Name	Title	Office Phone	Location
Wyatt Grant	Consultant		Ottawa

Locations

Country	First	Location	Planned	Actual	Comments

	Administrative Division				

Consultants (Will be disclosed in the Monthly Operational Summary)

Consultants Required ? Yes. See page 40 of Project Appraisal Document.

I. STRATEGIC CONTEXT

A. Country Context

1. Montenegro is a small, open economy relying primarily on tourism and foreign direct investments (FDIs) with GNI per capita of US$7,220 (Atlas methodology) in 2015, and has the highest per capita income among the Western Balkan countries. Montenegro started accession negotiations with the EU in June 2012 with a view of potential EU accession by 2020.

2. After experiencing a double-dip recession due to the 2008 global financial and the 2012 Eurozone debt crisis, Montenegro's economy expanded by 3.5 percent in 2013 but slowed down to 1.8 percent in 2014 and recovered to 2.5 percent in 2016. Montenegro remains highly susceptible to external shocks owing to its high external current account deficit and external debt ratio (19 percent and 138 percent of GDP in 2016, respectively).

3. The government's fiscal position has deteriorated recently. General government deficit was 7.3 percent of GDP in 2015 and declined to 3.6 percent of GDP in 2016 as a result of improvements in revenue collection and under-execution of capital spending. Nevertheless, rising public sector wages, social benefits, and pensions kept overall public spending high. Montenegro's public and publicly-guaranteed debt more than doubled between 2008 and 2016 to 74.8 percent of GDP. In December 2016, to contain fiscal deficits and public debt, the Government adopted a five-year plan for the rehabilitation of public finances. The new Fiscal Strategy 2017-20, adopted in June 2017, aims to bring public finances to balance by 2019 through frontloaded tax revenue measures. This would also stem further public debt growth that would be reduced from 2020 towards the fiscal rule target of 60 percent of GDP. In addition, the Government has substantial payment arrears, estimated at over 5 percent of GDP. The stock of tax arrears reached 15 percent of GDP by end-2016 driven by liquidity problems in the economy. A large part of the tax arrears are owed by insolvent or non-operating entities and are non-collectible, but difficult to write off under current legislation. One-fifth of the tax arrears are owed by local government units that have signed a tax debt reprogramming agreement with the Ministry of Finance (MoF).

4. Improved revenue collection is a government priority. Stable revenue flow is critical for ensuring macroeconomic stability and for financing important public investments in human capital and infrastructure. The efficiency of revenue administration also affects the business environment in the country which is a precondition for improved competitiveness of Montenegrin firms and higher foreign direct investment. The government has already undertaken reforms to improve the overall business environment and strengthen revenue collection. One manifestation of this initiative has been the establishment of the *Committee to Fight the Grey Economy*, chaired by the Minister of Finance and including multi-agency representation as well as representatives of Parliament. Some of the measures taken by the Committee have focused on legislative and administrative actions to increase the effectiveness of revenue collection. Growth in revenues has exceeded targets. However, longer-term sustainable improvements in the ability to collect taxes and social contributions require enhancement to tax administration systems, processes, and human resource skills that match the experience of similar organizations in the region.

B. Sectoral and Institutional Context

5. Revenue collection has improved consistently since 2010 supported by tax policy changes and improvements in tax administration (see Table 1). Between 2010 and 2016, tax and social

contribution revenues increased by 2.7 percent of GDP to 39.1 percent of GDP on account of stronger revenue collection mainly of value added tax (VAT), corporate income tax (CIT), and personal income tax (PIT), while social security contributions remained largely unchanged during this period. The recent buoyant revenue performance was a result of increases in the VAT and PIT rates, legislative amendments to facilitate the fight against the grey economy and a number of improvements in revenue administration. Improvements related to tax administration include increased effectiveness of tax audit, expanded use of e-services, and increased voluntary compliance as evident by constantly growing number of registered taxpayers.

Table 1. General Government Revenues as percent of GDP

	2009	2010	2011	2012	2013	2014	2015	2016
Total Revenues and Grants	**43.9**	**42.2**	**39.5**	**40.9**	**42.3**	**44.6**	**41.9**	**44.5**
Total Revenues	**43.5**	**41.9**	**39.2**	**40.7**	**42.0**	**44.3**	**41.5**	**44.1**
Current Revenues	**43.5**	**41.9**	**39.2**	**40.7**	**42.0**	**44.3**	**41.5**	**44.1**
Tax Revenues	**37.0**	**36.4**	**35.2**	**36.1**	**37.5**	**40.3**	**37.6**	**39.1**
- Personal Income Tax	4.1	3.7	3.5	3.4	3.7	4.0	3.7	4.2
- Corporate Income Tax	1.8	0.6	1.1	2.0	1.2	1.3	1.2	1.2
- Turnover Tax on Property	0.7	0.5	0.5	0.5	0.5	0.4	0.4	0.4
- VAT	12.4	11.7	12.0	11.1	12.8	14.4	12.6	13.3
- Excises	4.3	4.3	4.4	4.8	4.8	4.5	4.7	4.8
- Customs	1.6	1.6	1.4	0.9	0.7	0.6	0.6	0.6
- Other Taxes	1.7	1.8	1.5	2.0	2.0	2.2	2.3	2.3
- Social Security Contributions	10.3	12.2	10.8	11.4	11.9	12.8	12.1	12.3
Nontax Revenues	**6.5**	**5.5**	**4.0**	**4.6**	**4.5**	**4.0**	**3.9**	**4.9**
Capital Revenues w/o privatization	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Grants	**0.4**	**0.3**	**0.3**	**0.2**	**0.3**	**0.3**	**0.4**	**0.5**

Source: Ministry of Finance, MONSTAT

6. While tax rates are relatively low (9 percent for CIT and PIT and 19 percent for VAT), the burden of compliance for taxpayers is relatively high. According to *Doing Business 2016*, Montenegro is placed at 64th position out of 189 countries in terms of ease of paying taxes, mostly because of the significant time required to pay taxes and social contributions; 314 hours per year compared to close to 260 hours for other countries in the Western Balkan region. The high compliance burden is a result of narrow scope and effectiveness of taxpayer services, as well as weaknesses in legislative framework and Information Technology (IT) systems being used for revenue management.

7. Montenegro has taken important steps in recent years to reform and modernize its tax administration. The legal framework on tax administration has been recently amended to clarify the role of tax and customs administration in revenue collection, simplify tax procedures, strengthen internal control of tax administration and the integrity of tax officials, and improve enforced tax collection. An important legal amendment was the repeal of a provision that was introduced in 2013 and envisaged transfer of the tax audit function to a new government-wide Inspection Directorate. Enhancements were also initiated in the organizational structure of the tax administration, its strategic management and management of IT resources.

8. Nevertheless, tax administration faces a number of organizational, human resource, and IT challenges that hinder further improvements performance. Significant investments are required to

acquire a modern revenue management IT system and equip the staff with modern tools for improving tax registration, collection, audit, enforcement and taxpayer services.

9. The Montenegro Tax Administration (MTA) is responsible for collection of substantial part of the tax revenues in the country and contributions to the Health and Pension Funds. The MTA is also responsible for administering the accounts of taxpayers and providing pertinent data to a variety of other public institutions including Customs Administration, Health and Pension Funds, Treasury, and Central Bank. In addition to its tax responsibilities, MTA has assumed responsibility for managing the system used to register all businesses and to collect financial statements from all registrants. In January 2015, responsibility for the collection of excise duty was transferred to the Customs Administration.

10. The organizational structure of MTA is still evolving. On July 1, 2013, the MTA was subsumed under the authority of the MoF and the MTA lost its status as an autonomous entity. As a result, the MTA's departments and staff responsible for financial management, legal services, and human resource management were merged into a single department within the MoF. While many of the tax administrations in Organization for Economic Co-operation and Development (OECD) countries operate as semi-autonomous bodies, the degree of autonomy of the MTA is limited.[1] This poses a challenge for institutional development particularly because decisions on managing human resources and training are taken outside the agency. At the same time, new departments were established in headquarters such as the Department for Plan and Analysis responsible for leading analytical work and preparing strategic and business operations plans. The MTA has an extensive regional structure with eight regional offices and 13 branch offices located throughout the country while more than 50 percent of the revenues are collected by the Podgorica tax office where nearly 30 percent of MTA staff are employed. The Government is currently reviewing the feasibility of the organizational integration of the MTA and the Customs Administration.

11. A Large Taxpayers Office (LTO) was established in 2012. The LTO is responsible only for tax audits and does not provide any taxpayer services[2]. There are currently 245 large taxpayers, which contributed EUR317 million (excluding excise collection) of tax revenue or close to 34 percent of total net revenue in 2016. This is relatively low share; LTOs in modern tax administrations typically collect close to 50 percent of the revenues.

12. Human resource capacity has been constrained by organizational changes and lack of clear strategy. The transfer of the human resource management function to the MoF has restricted the ability of the MTA to independently manage its staff. Furthermore, the MTA does not have a clearly outlined human resources strategy to ensure that it is adequately staffed with relevant skills. There are vacancies for auditors, IT, technical/legal and analytical skills which are critical for the effectiveness of the agency. Some of the regional offices and the tax audit function of the LTO are understaffed. A significant number of staff currently classified as providing taxpayer services, often perform other functions or are tasked with manual operations such as data entry resulting from shortcomings of the current IT system. Several key functions of a modern tax administration

[1] Montenegro Tax Administration Assessment: Key Findings and Recommendations, December 11, 2013, the World Bank.

[2] This is not consistent with the trend in most modern tax administrations which assign LTOs full responsibilities, including tax arrears management, taxpayer assistance, legal affairs, and tax audits.

such as business analytics, sophisticated risk models and a risk-based approach to enforcement, and public internal control, are either not developed or in nascent stages of development.

13. Human resource capacity has also been constrained by the lack of a clear training strategy. Training is provided on a regular basis but much of it is on-the-job training where a senior staff member imparts their knowledge to new staff. A limited number of formal training programs are offered to new and ongoing staff. This is especially critical for newly appointed tax auditors and staff in taxpayer services. The development of a long-term training strategy, beyond the current annual training plan, would help align staff skills with current and future business needs.

14. Fragmented and outdated IT systems result in many tasks being undertaken manually by staff and taxpayers. There are four IT systems currently in operation. Data is distributed across separate databases with limited interconnectivity. Consequently, data retrieval and production of consolidated reports and statistics is cumbersome and inaccurate due to inconsistencies in data across the various IT systems. Core procedures such as revenue management, tax audit, legal affairs, taxpayer assistance, and enforcement collection are not integrated. Fragmented IT systems also limit the ability of the MTA to systematically perform cross-checks with third-party data. Although the authorities use third party data sources, such as the Customs Administration, the Anti-Money Laundering Administration, the Real Estate Cadaster, and the Securities Commission, this information is collected manually on a case-by-case basis. Taxpayer registration is mostly a manual process. Although corporate taxpayers can register online, they are required to physically submit the required documentation at the MTA premises for revision. Individual taxpayers are required to manually complete and submit a registration form with the required documentation. Individual taxpayer data is entered into the system only after it has been verified and accepted, after which each taxpayer is assigned a unique taxpayer identification number (TIN). This process may take up to two days.

15. The MTA has developed an IT modernization plan and corporate governance framework to adequately prioritize and align IT needs over the medium- term (2014-2019). Several actions in the strategy have already been implemented. For example, electronic-filing for corporate income tax, excise, and VAT was introduced on March 27, 2014. This reduced compliance costs for taxpayers as well as time and costs for the MTA due to electronic data inputs. Increasing the frequency and coverage of returns filed electronically will likely help increase voluntary compliance and lead to efficiency gains. E-filing of CIT returns became almost universal by 2016, reaching 96 percent of total CIT returns and 98 percent for large taxpayers. However, the VAT e-filing rate is still low--24 percent of the total VAT returns and 70 percent for large taxpayers.

16. The MTA has recently convened a Working Group to assess and finalize the approach for the MTAs' IT systems. The Working Group comprised representatives from the IT department of the MTA, Ministry of Finance (MoF), Ministry of Information and Technology Society, and academics; and was chaired by an academic. The Working Group assessed the links between the current IT systems, the legislative framework, high-level business processes and future needs of the MTA. Based on this assessment, the Working Group highlighted the need for an Integrated Revenue Management System (IRMS). The MoF and MTA agreed to acquire a commercial IRMS.

17. The capacity of the IT department to maintain the current systems is stretched. The department has 22 staff and two contractors split equally between software developers and hardware engineers. The IT team has limited experience in managing projects. Given limited

exposure to managing complex contracts for large IT development, project management and contract management skills are not well developed. Furthermore, the deficiencies in the systems have resulted in the IT staff and their contractors being fully engaged in keeping the systems operating leaving little time to resolve underlying structural and programming problems or to significantly address the need for enhancements.

18. The tax audit process suffers from several procedural weaknesses. Tax audits tend to be prescriptive: the tax issue and period to be audited is specified and procedures are fairly rigid. In light of evidence of non-compliance or tax evasion, auditors do not have the authority to widen the audit to other taxes without first obtaining a revised audit order. If a tax period has been previously audited, legal provisions prohibit reassessment of this period for any reason. While this policy is designed to protect taxpayers, it prevents auditors who uncover evidence of significant tax evasion during a single-issue audit from expanding the scope of the audit to a comprehensive audit. Consequently, current procedures lead to an over reliance on comprehensive audits in cases where these may not be warranted resulting in an inefficient use of audit staff.

19. Total tax arrears outstanding as of December 31, 2016 were EUR567 million, which amounted to 38 percent of the total tax revenue collected in 2016. The tax arrears reprogramming enacted in 2016 aims to provide a one-off opportunity to settle tax arrears. By April 2017, a total of EUR150 million of tax arrears was requested for reprogramming. However, approximately 90 percent of tax arrears are older than one year, and many were incurred more than ten years ago. Although a significant portion of these arrears will never be collected, there is currently no legal provision to write them off. In addition, part of the stock can be attributed to the high number of delinquent taxpayers, averaging one-fifth of the total number of registered taxpayers during the last three years.

C. Higher Level Objectives to which the Project Contributes

20. The project is aligned with the World Bank Group Country Partnership Framework (CPF) for Montenegro for the period FY2016-2020. The main areas of focus of the CPF are: to enhance macroeconomic and financial resilience; and expand access to economic opportunities and jobs. This project will contribute to the first area of focus, by improving effectiveness and efficiency of the MTA, supporting a better environment for doing business in Montenegro, and reducing the burden of compliance with tax legislation.

21. This project is also aligned with the overall objectives of MTA as outlined in their strategic plan for the period 2014 – 2019, which, in turn, is aligned with Montenegro's Program of Accession to the European Union 2014-2018. MTA's mission as outlined in the Tax Administration business strategy for the period 2014-2019, is that "the Tax Administration efficiently performs the collection and control of invoicing and payment of public revenues, ensuring consistent application of the legislation, with a professional approach and partnership with taxpayers." The main objectives of the strategy are to strengthen the administrative capacity of the Tax Administration; develop and modernize IT in support of business processes; modernize MTA capacity, introduce a system for measuring performance, and improve orientation to taxpayers; increase collection of budget revenues; combat the gray economy and reduce the tax gap.

II. PROJECT DEVELOPMENT OBJECTIVES

A. Project Development Objectives (PDO)

22. The development objective of the project is to improve the effectiveness of operational functions of Montenegro's Tax Administration and to reduce the compliance costs for corporate taxpayers.

23. Montenegro's long-term vision is of a revenue administration that operates with streamlined risk-based business processes that contribute to the efficient collection of taxes and social contributions from all sources of economic activity. Increased compliance will generate a more robust revenue stream to provide essential services to citizens. Improvements in revenue administration capacity will also support the country's goal for EU accession and economic integration with EU member states.

B. Project Beneficiaries

24. The project's direct beneficiaries are the Government of Montenegro and its public finance institutions, while the ultimate beneficiaries are the Montenegrin taxpayers and citizens. Public sector beneficiaries include the Ministry of Finance, MTA, Treasury, Customs Administration, Pension Fund, and Health Fund. The MTA, in particular, will benefit from an improved working environment based on streamlined, updated and highly automated operations as well as extensive training and access to international best practice provided by the project. Montenegrin taxpayers—business community and individuals—would benefit directly from lower compliance costs and indirectly through more revenues collected to finance important social and infrastructure expenditures.

C. PDO Level Results Indicators

25. The following indicators have been agreed with the MTA, to evaluate the development impact of the project:

Improve effectiveness of operational functions

1. Voluntary (filing) Compliance
2. Tax Gap for VAT

Reduce compliance costs

3. Time taken to pay taxes and social contributions

III. PROJECT DESCRIPTION

A. Project Components

26. The project seeks to improve MTA's institutional arrangements and management systems to take full advantage of a highly automated, low-discretion, risk-based system. The project entails an investment of EUR14 million (US$15.7 million equivalent) over a period of five years. The project includes financial and technical support for: revenue collection methodologies and procedures; an IRMS and other information technology infrastructure; and training, tax audit, operational systems refinements, and technical assistance. The project has three components.

27. **Component 1: Institutional Development**. This component will help enhance the strategic focus of management, increase attention to integrity, strengthen staff management and

training, develop the analytical capacity required to support strategic management within MTA, improve the legal framework and the appeals function, and institute a modern revenue administration. Subcomponent one will focus on institutional and organizational development, enhancing strategic focus and planning capacity; strengthening executive, managerial, technical and operational capacity; and includes the introduction of an enhanced monitoring system to assist in the management of the MTA's performance. Subcomponent two will focus on strengthening the capacity for managing the change process. This sub-component will support the change process to build commitment of all staff and will facilitate the institutional development of the MTA. Subcomponent three will strengthen the MTA's capacity to coordinate project implementation and contract management. Particularly, this subcomponent will finance the recruitment of project management, contract management and administrative support to ensure the necessary expertise for the management of the project during implementation. This subcomponent will also finance office equipment and operational expenditures training for project management and fiduciary activities that will be undertaken for the project.

28. **Component 2: Business Processes**. This component supports modernization of MTA's business processes and improvements in operational effectiveness. This component has three sub-components. Subcomponent one will: introduce international best practices into the operational functions of the MTA; strengthen registration and return processing; formalize risk analysis in audit selection and enforcement activities, improve business analytics to identify where limited MTA resources should be deployed to return the best results or meet specific MTA objectives; and strengthen anti-fraud and criminal investigation capacity of the MTA. Subcomponent two will cleanse and rationalize data from the existing system in the first years of the project and enhance the IT infrastructure, including the enterprise architecture, data center, security, and disaster recovery plans. Subcomponent three will develop the specifications for the new IRMS system; procure, localize and implement a commercial IRMS system to replace the current system; and procure the necessary equipment required to implement the IRMS system.

29. **Component 3: Taxpayer Services**. This component will finance activities to modernize taxpayer services and increase understanding of revenue laws, procedures, rights and obligations of taxpayers, and thereby reduce the compliance burden to taxpayers, and strengthen external and internal communications. This component will review current taxpayer services and staffing needs and identify recommendations for improvements. Training curricular and materials will be developed for taxpayer services staff. Assistance will be provided for improving taxpayer relations including establishing charter of taxpayer rights, communication campaigns, and establishing performance standards for taxpayer services. The project will also finance activities for strengthening internal communications in the MTA.

B. Project Financing

30. The lending instrument proposed for the project is Investment Project Financing (IPF). Selection of the lending instrument followed careful considerations of the technical needs of the MTA in managing a comprehensive institutional reform. MTA expects substantial advice and independent assessments of implementation progress from supervision missions. MTA also expects to receive routine advice from the Bank on the most economical way to procure international best practice in terms of highly specialized consultancy assignments, business processes, and information systems. The loan type will be a EUR denominated fixed-spread loan (FSL).

C. Project Cost and Financing

31. The total cost of the project has been estimated at EUR14 million (US$15.7 million equivalent) to be fully financed by a loan from the International Bank for Reconstruction and Development (IBRD). The majority of the project cost is expected to be on capacity building and procuring hardware and software required to stabilize the current IT system. Capacity building will be financed through a combination of knowledge transfer from international advisers (included in the cost for consulting services), study tours, and class room style training (included in the cost for training). Project financing will also cover associated operating costs for the project. The Government of Montenegro will provide in-kind contributions to the project comprising staff time, equipment, and facilities. The authorities may request additional financing if the costs of acquisition of the IRMS software and hardware exceed initial estimates.

Table 1: Project Cost and Financing (EUR Millions)

Components / Project Cost	Estimated Total Cost (EUR Million)	Of which IBRD Financing (EUR Million)	Of which Government Contribution (EUR Million)	% IBRD Financing
1. Institutional Development	2.12	2.12	0.00	100%
2. Business Processes	10.29	10.29	0.00	100%
3. Taxpayer Services	0.29	0.29	0.00	100%
Total Component Costs	12.7	12.7	0.00	100%
Contingencies	1.27	1.27	0.00	100%
Total Project Costs	**13.97**	**13.97**	**0.00**	100%
Front-End Fee	0.03	0.03		
Total Financing Required	**14.00**	**14.00**	**0.00**	100%

D. Lessons Learned and Reflected in the Project Design

32. The project takes into account the lessons learned from the Implementation Completion Reports for tax administration reform projects in Ukraine, Bulgaria, and Croatia. These point to the following factors as being particularly important in design and implementation of successful tax administration reform projects with significant IT components:

- Clear evidence of sustained political ownership and support for the reform plans by anchoring the project objectives, scope, and activities firmly in Government's reform plans. The project is aligned with the priorities and implementation plan of the MTA's strategic plan for the period 2014 – 2019, which, in turn, is aligned with Montenegro's Program of Accession to the European Union 2014-2018. A Project Steering Committee will ensure sustained political ownership, oversight, and support to MTA in implementing the project activities.

- Projects should be designed on the basis of sound diagnostics of the organizational structure, operations and functions of the tax administration and using these diagnostics to inform project design. The project draws on an Integrated Assessment Model for Tax Administration (IAMTAX) assessment conducted by the World Bank in 2014.

- Engagement with the key stakeholders, including private sector and taxpayers, in project monitoring to ensure the project meets its development objectives. The project provides opportunities for engagement through a Revenue Modernization Advisory Board which includes representatives of associations of taxpayers, business associations, tax accountants and auditors.
- Projects introducing new information systems should ensure that legacy systems are maintained and, where appropriate, updated to accommodate emerging business needs up to the point where the new systems are fully operational. This significantly reduces the risks associated with delays in system development and facilitates the transition between operating systems. The project provides transitional support to the legacy system including provision for both hardware and software upgrades as needed.
- Institutional reforms should be supported by change management and communications to engage with and address resistance from within the organization and identify appropriate corrective action where reforms are going off track. The project provides for support change management under Component 1, including change management specialists and provision for communications.
- Projects should have a sequenced implementation plan that provides adequate time and technical capacity to support the appraisal of alternative system designs, development of technical specifications, market consultation, contract implementation and business process reengineering. The project provides for training and technical assistance to support the MTA through the complex process of selecting and implementing an integrated revenue management system.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

33. The MTA will be the implementing agency for the project. Implementation arrangements are designed to ensure cross-departmental coordination internally within the MTA and externally with the MoF and other stakeholders. Implementation arrangements comprise multiple layers to address: high level policy and strategic management among major stakeholders, external coordination and accountability, project management functions, and operations or functions associated with specific project activities.

34. A Project Steering Committee will be established to make key strategic decisions, ensure inter-agency coordination and provide overall project monitoring. The Committee will comprise high level representatives of the key government stakeholders, including MoF, MTA, Customs Administration, Pension and Health Funds, and will be chaired by the Minister of Finance. The Committee will provide strategic guidance to the MTA on issues related to project implementation and overall revenue administration modernization reforms, as well as ensure inter-agency coordination.

35. A Revenue Modernization Advisory Board will be established as a key part of the overall change management strategy for the project. The Advisory Board will be established for technical discussions with stakeholders heavily affected by the project to reflect their views on the institutional changes to be made by the project. Their views are especially important as they relate to the impact of activities supported under component three (taxpayer services), and as well as

those under the legal and appeals part of component one. The Advisory Board will include representatives of associations of taxpayers, business associations, tax accountants, and auditors. The Advisory Board will be established and will be convened as the need for consultation arises, but no less than twice per year. The Advisory Board will provide feedback on the views expressed by its representatives to the Project Steering Committee as the need arises, but no less than twice per year.

36. A Project Implementation Committee (PIC) has been established comprising the head of each project component and subcomponents led by a Project Coordinator. The PIC will ensure that activities are coordinated across functions and are not implemented in a fragmented manner.

37. Working groups will carry out day-to-day implementation of project activities of each component and subcomponent with the support of the Project Management Unit (PMU) described below. The working groups will develop the Terms of Reference (TOR), technical specifications, participate in evaluating the bids, and supervise the execution of consulting services in their respective areas. Four Working Groups have been established: institutional development; operational functions; IT systems; and taxpayer services. Working groups comprise officials of the respective MTA department and regional managers concerned with the specific activities.

38. A PMU will ensure the overall project management and the communication with the World Bank on project related issues. The PMU will be headed by project manager and consist of project management advisor, two change management experts, and administrative support staff. The PMU will be responsible for project management, project reporting and administrative aspects of the project to ensure timely completion of relevant milestones included in the implementation plans. The PMU will coordinate procurement, financial management, and disbursement with the Technical Services Unit (TSU) within the Ministry of Finance. The TSU is responsible for the fiduciary aspects of seven more projects and has highly qualified and experienced staff. Project funds will be used to finance the TSU staff on a pro rata basis with the ongoing World Bank projects. The change management experts will assist in the project implementation, ensuring coordination of changes across the project's components and subcomponents. The PMU will also coordinate the changes brought by all the projects, including those financed by other development partners and the government, so as to harmonize the effects of changes on tax administration reform.

B. Results Monitoring and Evaluation

39. A results framework with project specific indicators and actionable monitoring arrangements has been agreed with key counterparts. This will support progress monitoring and result-oriented project implementation (Annex 1). The MTA will establish a Monitoring and Evaluation (M&E) system to support the successful implementation of the project by maintaining records on implementation and generating mid-year project progress reports, and annual reports prepared within four months of the end of the financial year, focusing on results-based accountability and accomplishments against performance expectations. Surveys supported by the project will provide feedback from MTA's taxpayers on the quality of services and various performance dimensions. The surveys will generate gender-disaggregated data (where feasible as in the case of individual taxpayers) and also monitor any gender differences in the feedback provided. Bi-annual progress reports will be prepared by the PMU, approved by the Project Coordinator and the PIC, presented to the MTA Director, and forwarded to Bank and MoF one month after the end of the reporting period.

40. The project will be subject to regular implementation support missions conducted by the World Bank. Progress assessed during these missions will be reported by the World Bank team to its management through implementation status and results report (ISRs) which will include a review of key implementation issues and performance indicators. In the third year of project implementation, a more detailed mid-term review will be conducted.

C. Sustainability

41. The Government of Montenegro and the MoF have committed to modernize tax administration, strengthen capacity of the MTA, and improve revenue collection. MoF has underlined the importance of a modern tax administration as a means to improve revenue collection and reduce compliance costs for both the government and taxpayers. Parliament also demonstrated its commitment to a strengthened tax administration recently by approving an amendment to the Law on Tax Administration ensuring that the audit function remained in the MTA.

42. The MTA has demonstrated a high level of commitment to tax administration reforms by undertaking reforms financed from their own budget. The recent changes to the Law on Tax Administration provide an improved framework for enforcement and compliance activities that the MTA can undertake. The introduction of e-filing facilities along with increased outreach by taxpayer services are important steps on the path to modernization. In addition, recent staffing actions have increased the number of new staff in the audit and IT areas. The IT team is proceeding with stabilizing the existing IT systems to increase the reliability of data, and recent audit plans recognize the need to incorporate modern techniques into their operations.

43. The MTA has also demonstrated commitment to this project by actively participating in the preparation of the project. Project preparation missions benefited significantly from meaningful discussions with the management of the MTA. Top management of the MTA also demonstrated active support by commitment towards establishing the PIC and was engaged in all aspects of project preparation. Other MTA managers were also actively engaged in the discussion of project design and demonstrated deep understanding of the need for the planned reforms. The MTA has made sure the project design is responsive to advice received from key donors including the EC. The MTA has recently appointed a project coordinator who has been actively engaged in project design. All of these are strong indications of the MTA's commitment to achieving sustainable project impact.

44. Change management strategies and implementation arrangements supported by the project are expected to deepen ownership of the reforms within and across institutions. Change management approaches including communications, consultations and stakeholder workshops seek to build commitment of all staff involved in the change process. The change management team, which includes MTA staff, will manage and integrate the changes brought on by the project. Implementation arrangements envisaged by the project include participation from all stakeholders from the project preparation stage, further deepening ownership of reforms being undertaken by the project.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

45. The overall risk rating for this project is rated substantial. Macroeconomic, technical, and institutional capacity risks are considered substantial and will require close attention during implementation.

46. Macroeconomic risks are substantial given the prolonged period of high deficits, on average at close to 5 percent of GDP since the global crisis outbreak, and doubling of the direct public debt to 67.5 percent of GDP. In a country with limited scope for monetary policy interventions given its euroization, fiscal policy remains the key policy tool to ensure macro sustainability. Although the construction of the Bar-Boljare highway (a project contracted at the amount of 23 percent of GDP) will continue to drag on the deficit and debt over the medium term, the new Fiscal Strategy for 2017-2020 aims to support an ambitious fiscal consolidation program that would lead to balancing the budget and stemming the debt growth from 2019. The World Bank is currently preparing a development policy operation with the Montenegrin authorities to support fiscal and financial sector reforms, in close coordination with the International Monetary Fund (IMF).

47. Technical risks are related to the design and implementation of the Integrated Revenue Management System. The project provides for the implementation of a commercial off-the-shelf IRMS. This is a complex undertaking and poses risks related the capacity of the MTA to manage and participate in the implementation of the IRMS. To mitigate capacity related risks, the project provides for the contracting of international specialist in IRMS who will advise the MTA on contract management.

48. Institutional capacity risks are twofold: the first related to MTA's technical and managerial staff capacity to support the implementation of reforms, and the second related to resistance to organizational change. Technical and managerial capacity can be addressed through the provision of technical assistance and training. Organizational resistance to change poses a much more significant challenge. A number of stakeholders will be negatively impacted by the project, notably those engaged in tax evasion which will be more difficult in a more automated and more transparent operating environment. Component 1 provides support to the change management function to address these risks. This will include support for targeted communications with internal and external stakeholders that will explain the rationale for reforms, build constituencies and address reform resistance.

Risk Categories	**Rating (H, S, M or L)**
1. Political and governance	Moderate
2. Macroeconomic	Substantial
3. Sector strategies and policies	Moderate
4. Technical design of project or program	Substantial
5. Institutional capacity for implementation and sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and social	Low
8. Stakeholders	Moderate

Risk Categories	Rating (H, S, M or L)
9. Other	N/A
Overall	**Substantial**

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

49. The economic analysis of the project provides a quantitative assessment of the direct benefits and costs associated with changes in economic welfare arising from the project, using data from the Montenegro Tax Administration, Statistical Office, *Paying Taxes 2015*, as well as the IMF World Economic Outlook. The economic analysis indicates that the project generates a significant positive economic return: the net present value (NPV) in real terms is EUR113.9 million at 10 percent discount rate and Internal Rate of Return (IRR) is 95 percent. A detailed analysis is included in Annex 5.

50. For the purposes of the analysis, the economic costs are the resources that will be invested in the project. These include the investment cost and MTA staff time associated with the implementation of the project. Two economic benefits are estimated: reduced compliance costs for corporations; and improvements in MTA's operational efficiency. The decrease in corporate tax compliance costs will result from simplified filing and payment of taxes and social contributions; reduction in number of tax inspections; reduced time required for interactions with tax officials; enhanced taxpayer services, including updated and accurate information for taxpayers provided on the MTA's website and automated call centres. Lower compliance costs will provide greater scope for taxpayers to engage in productive and income generating activities. Gains in operational efficiency result from the modernization of MTA's operational functions, streamlining of business procedures and rationalization of existing IT systems. These measures will improve MTA's operational effectiveness and efficiency and impact the overall quality of taxpayer services.

51. There are additional economic benefits which cannot be quantified. These include reduced avenues for corruption, greater transparency and accountability of the MTA, and increased trust in the tax administration and government. The latter is a particularly important factor for improving a taxpaying culture which is likely to generate large fiscal benefits in the long run.

52. The financial analysis of the project considers costs and benefits using a cash flow approach. Financial benefits comprise increased collection of tax revenues and social contributions, including through the reduction of tax arrears, as well as available loan financing. Collection of revenue will grow as a result of improved tax administration and tax compliance due to many reform measures envisaged under this project. These measures include improving accuracy and integration of taxpayer registries; simplifying current procedures for taxpayer registration, filing and payment of taxes and social contributions; better assessing and mitigating risk through tax-gap analysis and risk-based audits; and enhancing quality of taxpayer services to support voluntary compliance. Financial costs are the same as economic costs.

B. Technical

53. MTA's effectiveness and efficiency is hampered by cumbersome business processes, highly fragmented IT systems with significant manual processing required for data entry and consolidation, an inaccurate taxpayer registry and a shortage of personnel with the requisite technical skills for modern tax administration. The project will support the implementation of an automated risk-based approach to maximizing revenue collection; promote modern open interaction with taxpayers; and a fair, taxpayer-friendly approach to addressing taxpayer grievances. While the burden of compliance for compliant taxpayers is expected to drop significantly, the compliance costs of tax evaders is likely to increase significantly. The project will provide MTA with tools and training to better focus on non-compliant taxpayers, including businesses that avoid paying taxes.

54. The project proposes a comprehensive set of activities which cover the critical aspects of MTA operation. Maintaining such a complex set of interventions will be a challenge for MTA management. For the expected project outcomes to materialize, project management will have to pay close attention to the sequencing and interdependence of project activities. The project will build project management capacity by employing technical, project management and change management specialists as part of the project team.

55. The impact and sustainability of the tax administration reforms supported under the project will be enhanced by changes in tax policy. Efficient ruling and resolution of disputes, for example, requires changes in the tax policy framework. Similarly, simplification of operational procedures to improve service delivery, improve effectiveness of tax audits, and deal with non-compliant taxpayers in both filing and payment may also require refinement of tax law. The project will provide advisory support on the legislative reforms alongside assistance provided by the IMF Fiscal Affairs Department and on-going negotiations on the alignment of Montenegro's tax law with the EU *acquis communautaire.*

56. Following the agreement of the MoF, MTA and the IT working group, the project includes the procurement and implementation of a commercial IRMS. The project will provide financing for the procurement for a commercial IRMS and for the procurement of hardware required to support the IRMS. The project will support the IT department by employing the services of an international IT project adviser. The project includes activities aimed at stabilizing the current IT system and resolving data inconsistencies which is a prerequisite for implementing an integrated system that provides the complete functionality necessary for a modern tax administration.

C. Financial Management

57. Financial management arrangements for the project are acceptable to the Bank. The MTA is the implementing agency. MTA will establish a PMU which will be led by a Project Manager. The MTA prepare project budgets, prepare bidding documents in coordination with Working Groups, evaluation reports, draft contracts and ensure compliance with World Bank Financial Management (FM) and reporting requirements. The Ministry of Finance's TSU will be responsible for fiduciary aspects of project implementation. TSU is a well-established unit with qualified staff experienced in World Bank financial management and procurement procedures. TSU currently manages the fiduciary function, including procurement for seven World Bank financed projects.

58. The Designated Account for the Project will be opened in a commercial bank acceptable to the Bank. The Designated Account will be in Euros. Funds will be disbursed either as an

advance, via a Designated Account, or by direct payment, on the basis of direct payment withdrawal applications. Funds will be withdrawn to the Designated Account, up to the ceiling amount that will be described in the disbursement letter, through withdrawal applications signed by the authorized signatories. The project financial statements will be audited by independent auditors acceptable to the World Bank, and based on TORs acceptable to the Bank. Interim Unaudited Financial reports (IFRs) will be submitted to the Bank in the agreed format, 45 days after the end of each calendar quarter throughout the life of the Project.

D. Procurement

59. An initial review of project procurement capacity and risk of the TSU conducted in March 2015, updated in October 2016, and confirmed in 2017, found that the TSU has sufficient experience on World Bank procurement procedures and has shown satisfactory performance on procurement for Bank financed projects. The potential issues and risks related to project procurement include: limited/lack of knowledge and of prior experience of the implementing agency (MTA) in terms of administering the contracts on Bank's financed operations; and potential risks of delays in project procurement due to lack of TORs. The above key risks will be mitigated through: establishment of a PMU within the MTA in charge of contract management and overall project implementation and preparation of a detailed input to procurement plan for the first eighteen months of project implementation; preparation and adoption of a Project Operational Manual including a chapter on procurement and clear responsibilities on procurement vs contract administration; and preparation of the bidding/proposal documents, including technical specifications, for the first year within one month after effectiveness.

E. Social

60. The Project does not include activities which cause social risks or negatively affect the general population, and no differential impact for female beneficiaries were identified. The Project will benefit Montenegrin citizens by promoting taxpayer compliance and improving taxpayer services by creating a more efficient tax administration. The project does not support activities that will result in the reduction in MTA staffing levels.

61. The Revenue Modernization Advisory Board established will provide a framework for stakeholder engagement. The Advisory Board will bring together external stakeholders directly affected by the project and provide an opportunity for them to discuss reform priorities, progress and impacts with decision makers in Government and the MTA. The Advisory Board will include representatives of associations of taxpayers, including small and medium enterprises, business associations, tax accountants and auditors. Taxpayer surveys will be used to gather feedback from taxpayers. This feedback will be used to monitor satisfaction with taxpayer services and identify areas where service improvements are needed.

62. The project will also support improvements in the tax appeals process. This deals with an important dimension of grievance redress in the field of tax administration. The project will review procedures and develop information systems to ensure both MTA and taxpayers are well informed of the appeals process. Appeals will be monitored to ensure timely resolution and equitable treatment of tax payers.

F. Environment (including Safeguards)

63. The Project has been rated as Category C for environmental purposes. None of the envisaged activities will require any special permission on environmental issues. Hence, the

proposed Project will not be subject to the Environmental Impact Assessment procedures or any permission relating to environmental protection aspect.

G. Other Safeguards Policies Triggered

64. The project is limited to the provision of technical assistance to support the Government's tax administration reform agenda and does not trigger any World Bank safeguard policies.

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[ ]	[X]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OP 4.20, being revised as OP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

H. World Bank Grievance Redress

65. Communities and individuals who believe that they are adversely affected by a World Bank supported project may submit complaints to existing project-level grievance redress mechanisms or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.

Annex 1: Results Framework

Project Development Objective (PDO): to improve the effectiveness of operational functions of Montenegro's Tax Administration and to reduce the compliance costs for corporate taxpayers

	Core	Unit of Measure	Baseline	Cumulative Target Values**					Frequency	Data Source/ Methodology	Responsibility for Data Collection	Description (indicator definition etc.)
				2018	2019	2020	2021	2022				
PDO LEVEL INDICATORS												
Improved Effectiveness of operational functions												
Tax Gap for VAT VAT to consumption ratio is being used as proxy	☐	Percent Ratio	12.3 (2010-14 average)	12.3	12.3	12.5	12.8	13.4	Annual	Monstat data and MTA's estimates based on taxpayer survey and methodology developed in the first year of project implementation	MTA Planning and Analysis Department	Methodology and baseline for tax gap to be developed during the first year of the project. VAT/consumption ratio is used as a proxy indicator.
% of returns filed on time		Percentage	VAT: 82 (2016) CIT: 89 (2016)	82 89	82 89	86 94	90 96	92 98	Annual	MTA data	MTA Collection and IT Department	Number of returns filed on time as percentage of to the total number of returns for VAT and CIT
Reduced compliance costs												
Time it takes to pay taxes and social contributions		Hours	314 (2015)	314	310	280	250	200	Annual	Doing Business data	MTA PMU	Number of hours it takes to comply with tax and social

Project Development Objective (PDO): to improve the effectiveness of operational functions of Montenegro's Tax Administration and to reduce the compliance costs for corporate taxpayers

	Core	Unit of Measure	Baseline	Cumulative Target Values** 2018	2019	2020	2021	2022	Frequency	Data Source/ Methodology	Responsibility for Data Collection	Description (indicator definition etc.)
												security legislation
INTERMEDIATE INDICATORS												
Estimated tax gap is calculated annually and suitable for publication by year 5.		Yes/No	No (2016)	No	Yes	yes	yes	Yes (with publication)	Annual	Monstat data and MTA's estimates based on taxpayer survey and methodology developed in the first year of project implementation	MTA Policy and Analysis Departments	The internal procedure will be developed by the MTA Policy and Analysis Departments
MTA staff satisfaction with the new skills and ability to apply them, disaggregated by gender		Percentage	(2018)	Increase by 0%.	Increase by 0%.	Increase by 5%.	Increase by 7%.	Increase by 10%.	Annual	Survey to be developed during first year of project implementation	MTA Planning and Analysis Department and Taxpayer Services Department	Percent of staff satisfied with the quality of new skills acquired
Data from the Staff Satisfaction Survey conducted by the MTA is being used as a Proxy			65 (2016)	65	65	70	72	75		Independent Agency (DAMAR) survey question on Employee satisfaction on new skills		
Payment compliance rate for VAT	☐	Percentage	VAT: 62 (2016)	62	62	75	80	85	Annual	MTA's Performance Indicators	MTA Collection and IT Department	Revenues paid on time to total revenues declared during the year
Payment compliance rate for CIT	☐	Percentage	CIT: 81 (2016)	81	81	86	88	91	Annual	MTA's Performance Indicators	MTA	Revenues paid on time to total

Project Development Objective (PDO): to improve the effectiveness of operational functions of Montenegro's Tax Administration and to reduce the compliance costs for corporate taxpayers												
	Core	**Unit of Measure**	**Baseline**	**Cumulative Target Values****					**Frequency**	**Data Source/ Methodology**	**Responsibility for Data Collection**	**Description (indicator definition etc.)**
				2018	**2019**	**2020**	**2021**	**2022**				
											Collection and IT Department	revenues declared during the year
Taxpayers' satisfaction with MTA's quality of taxpayers services and integrity of MTA staff, disaggregated by gender		Points	(2018)	Increase by 0%.	Increase by 0%.	Increase by 5%.	Increase by 7%.	Increase by 10%.	Annual	Survey to be developed during first year of project implementation	MTA Taxpayers Services Department	Baseline to be established in 2018.
Data from the Taxpayer Satisfaction Survey conducted by the MTA is being used as a Proxy		Percent	(2016) 68	68	68	70	73	75		Independent Agency (DAMAR) survey question on are taxpayers satisfied with the services of the officials in MTA	MTA	This is a proxy until the baseline from taxpayer survey is developed in 2018.

Annex 2: Detailed Project Description

1. The project description details the objectives for each of three project components and the set of activities necessary to achieve these objectives. These activities will be carried out either by MTA staff or by consultants retained under project financing. Adjustments to the distribution of work between MTA and consultant and contractor staff will be refined during the program as the terms of reference are prepared for bidding, giving full consideration to MTA's ability to provide human resources and to manage the consultants. This project consists of three components.

PROJECT COMPONENT 1: INSTITUTIONAL DEVELOPMENT

2. This component will help enhance the strategic focus of management, increase attention to integrity, strengthen staff management and training, improve the analytical capacity required to support strategic management within MTA, improve the legal framework and the appeals function, and institute a modern revenue administration on par with best practice in the EU. This component consists of three subcomponents: institutional development; change management; and, project management.

3. **Subcomponent 1.1: Institutional Development**. This subcomponent will support institutional and organizational development, enhance strategic focus and planning capacity; strengthen executive, managerial, technical, and operational capacity; and includes the introduction of an enhanced monitoring system to assist in the management of the MTA's performance. This subcomponent will finance the following:

A. Strategic Focus and Planning Capacity

a. Strengthening of the management process for MTA covering all levels of the agency, including accountability, monitoring, internal control, corruption management, and security/security management.

b. Enhancement of the monitoring system used to assess the performance of the MTA.

c. Expansion of the management information to be extracted from the current IT system to assist MTA management in the operation of the MTA. This information will be available (in appropriate detail and format) to each level of the MTA and will be used for operational monitoring, control and will provide baseline information for planning.

d. Assessment of management processes and preparation of an executive training program to strengthen MTA's management capacity. The management training program will cover, at a minimum, the following subjects: principles of general strategic management; strategic planning techniques; accountability system; quality assurance and quality control; and internal control systems.

e. A feasibility study for the proposed integration of the Tax and Customs Administrations.

B: Staff Management and Training

a. Enhancement of workforce planning and strategy for the new organizational set up, taking into account the need for new competencies and ageing of the current workforce, analysis of the workforce composition by gender and skills distribution and position in institution.

b. Review and improvement of MTA's training strategy including assessment of capacity development in terms of staffing, equipment, location and requirements for developing a training program to meet new competencies and address current and future needs of the MTA.

c. Development of annual training plans to support the implementation of the project as well as MTA's ongoing needs, including language training as required by the EU.

d. Assessment of the training effectiveness for management in MTA and preparation of a permanent training program for top and middle managers based on the materials developed under the project, tailored to findings in point (a) above.

e. Preparation of curricula and coordination of training to meet the needs of all components over the life of the project, including training materials, study visits, seminars, and case studies for the project (see individual components).

f. Development of the training curriculum for new MTA staff to ensure they have a broad understanding of the functions that MTA performs and deliver the first session that will train the trainers.

C: Analytical Processes

a. Review organizational placement of the analytical unit, its roles and responsibilities; define information needs and flows to ensure automated collection of data needed to carry out policy analysis and compliance and distribution studies; prepare departmental plan; define strategic targets for the duration of the project;

b. Development of modeling capacity to assess and analyze revenues and the VAT tax gap. Undertake a training program covering at a minimum modeling and statistical analysis.

D: Internal Control and Integrity Function

a. Analysis of the existing requirements of the internal control function and its capacity to manage integrity according to international and EU best practices. Preparation of recommendations to improve the capacity of the internal control function to proactively detect corruption in MTA and develop a program to further strengthen MTA's integrity and acquire necessary equipment. Develop a plan for reform.

b. Development of internal control manuals necessary to implement the proposed reform. Enhance internal control procedures for the Agency's activities and acquisition of the required equipment.

c. Development of the risk analysis criteria to be included in the IRMS to support internal investigations and internal control activities.

d. Implementation and monitoring of audit trails and other control and corruption detection mechanisms.

e. Development of a continuous training program for internal control and staff integrity, including: elaboration of training materials, and training on internal control and investigation techniques, according to the Agency needs.

E: Legal Framework

a. Review of the tax administration legislation, proposal of improvements to guarantee consistency with MTA operational needs and international best practice and improvement of the process of drafting regulations. Responsibility for the tax administration legislation rests with the MoF. The review will create a transparent feedback mechanism for continuous improvement of the Law on Tax Administration in response to government and taxpayer requirements.

b. Review of regulations to ensure internal consistency as well as consistency with primary legislation and identify gaps and ambiguities. Proposal of changes to facilitate online inter-agency data exchange, information matching and computerized issue notices.

c. Review of the process of providing legal rulings to taxpayers and recommendations to improve the quality, consistency and timeliness of such rulings. Development of service standards taking into account the requirements established by law.

d. Design and implementation of a training program on legal changes and interpretation of legislation for MoF and MTA staff. Delivery of legal training courses using a train-the-trainers approach.

F: Appeals (Objections) Process

a. Review of current regulations, rules, and appropriate procedures for the management of appeals and objections and prepare recommendations to ensure unified application of appeals/objections operations. Preparation of recommendations about the roles of the MTA and MoF in the appeals and objections process. Development of a manual for appeals/objections activities.

b. Revision of operating procedures to incorporate best practices and develop requirements for computer-based assistance to the management of the entire appeals process. Revision of procedures to ensure that both MTA and taxpayers are well informed of the appeals process through electronic access.

c. Analysis of the training needs of the appeals and objections units, development of a permanent training program for the staff and delivery of initial training in the use of the tools available through the current IT system, including training of the unit's trainers.

d. Development of business requirements for the appeals (objections) process to be included in the IRMS.

4. **Subcomponent 1.2: Change Management**. The Change Management subcomponent is intended to ensure that MTA reforms are based on common understanding of the purpose of the change. The reforms will be carried out using established change management approaches that seek to build commitment of all staff involved in the change process. This will facilitate the institutional development of the MTA. The change management team will consist of key staff involved in implementation and be assisted by a change expert who will help establish the team and a change management specialist experienced in the field. The team will prepare a change readiness assessment and develop the change management strategy in the first year of the project and will further manage and integrate the changes brought by the Project within MTA based on this strategy, approved by the MTA Director. The change management team is subordinated to the Project Manager (see Component 1.3). This subcomponent will finance the following:

a. Change expert, who will establish the change function in project implementation, assist in developing a change readiness assessment, assist in developing a change management strategy, including communications, and procedures to monitor change.

b. Change Management specialist who is a senior level change management practitioner.

c. Change management training to provide the necessary tools and methods to ensure successful management of Project implementation as designed.

5. **Subcomponent 1.3: Project Management.** MTA will put in place a Project Management Unit (PMU) with the objective of coordinating the implementation of the project and carrying out the administration of project investments. The PMU will be led by a Project Manager with a core staff sufficient to manage the responsibilities of the unit. The PMU office will be provisioned with any necessary equipment and training provided to staff in the critical skills of project management, financial management, and procurement. Procurement and financial management will be undertaken by the TSU at MoF which will ensure that financial and procurement management meet the quality and integrity requirements set forth in the World Bank's guidelines and international standards of accountability and transparency. This subcomponent will finance the following:

a. Project management and administrative support as required during the life of the project to manage the project; including an international advisor to project manager.

b. Translation services.

c. Auditing of Project accounts by an independent and qualified auditing firm.

d. Office equipment for PMU staff and consultants such as workstations, copiers, fax, projectors and printers.

e. Operational expenditures required by the PMU to execute its responsibilities such as internet service, phone service, postage, courier, and similar services as required.

f. Project management training to provide the necessary tools and methods to ensure successful management of Project implementation as designed.

g. Procurement training for MTA and TSU staff and participation in seminars on World Bank guidelines, policies and procedures.

h. Procurement, FM and disbursements provided by the TSU will be billed to the project.

PROJECT COMPONENT 2: BUSINESS PROCESSES

6. The activities within this component support new streamlined business processes and increased operational effectiveness of MTA. The data cleansing and rationalization of the existing IT systems will increase compliance and responsiveness to MTA's and taxpayers information needs. This component consists of three subcomponents: modernization of MTA's operational functions, data cleansing and IT infrastructure, and acquisition of an integrated revenue management system.

7. **Sub-component 2.1: Modernize of MTA's Operational Functions.** This subcomponent will: introduce international best practices into the operational functions of the MTA; strengthen registration and return processing; formalize risk analysis in audit selection and enforcement activities; improve business analytics to identify where limited MTA resources should be deployed to return the best results or meet specific MTA objectives; and improve anti-fraud and criminal investigations. This subcomponent will finance the following activities:

A: Registration Processing

a. Revision of current procedures for taxpayers' registration (legal and physical persons) to simplify the process where appropriate, including within the regional offices; definition of ownership in the registry and streamlining citizen ID and tax identification numbers. Alignment of procedures reflect best practices including those of the EU.

b. Provision of recommendations on how to merge existing registries where possible and eliminating duplicate information between registries where separate registries must be maintained and rationalizing the MTA's data holdings (i.e.: cleaning of data).

c. Recommendation of improvements to the management reporting requirements for registration, non-active taxpayer and collection statistics.

d. Development of business requirements for registration processes to be included in the IRMS.

B: Tax Return and Payment Processing

a. Promotion of electronic filing of tax returns, payments and other communications with taxpayers (e.g. taxpayer portal, MTA web site, etc.).

b. Improvement of procedures for payment processing, matching, and attribution to taxpayer sub-accounts.

c. Review of legal authorities for processing and requiring electronic returns and verification that appropriate legal authority exists to issue notices (notifications) from the current IT system.

d. Proposal of an expanded interface to provide taxpayers with multi-channel electronic notification, for example by e-mail and SMS.

e. Review of arrangements for data interchange with other government bodies and contribution to national coordination efforts.

f. Development of business requirements for the return and payment processing processes to be included in the IRMS.

g. Analysis of the training needs of the returns and payment processing units, development a permanent training program for the staff and delivery of initial training in processing, including training of the unit's trainers and study tour of modern tax administrations operations.

C: Enforcement and Compliance

a. Review of operating procedures for enforcement and compliance activities to incorporate international best practices including the review of current regulations, rules, and procedures for the management of arrears and enforced collection. Preparation of recommendations to improve the effectiveness of enforcement and compliance operations. Development of manuals for enforcement and compliance activities.

b. Preparation of algorithms for the ranking of risk of non-compliance and enforcement priority (e.g. potential size of revenue at risk, probability of failure to comply or follow-up on commitments to pay outstanding amounts, etc.).

c. Analysis of the training needs of the enforcement and collections units, develop a permanent training program for the staff and deliver initial training in recovery of arrears and arrears management along with enforced return filing, including training of the unit's trainers.

d. Development of business requirements for the enforcement and compliance processes to be included in the IRMS.

D: Tax Audit

a. Preparation of recommendations to promote a high level of uniformity in the application of the legal framework by MTA inspectors based on operational needs and international good practice.

b. Provision of expert support for the implementation of the risk-based selection of taxpayers for all taxpayer types and economic sectors.

c. Preparation of algorithms for the detection of non-compliance trends (segmented: large-, medium- and small-size legal taxpayers, wealthy individuals, and other taxpayers) to be used within the current IT risk engine used for audit case selection.

d. Development of a statistical methodology for quality assurance of the risk-based audit selection. The objective of this methodology would be to ensure that the risk management parameters within the risk engine are actually selecting proper taxpayers for audit and tune the risk selection algorithms to delivery better selection of cases.

e. Support to implementation of a risk-based VAT refund audit approach through the use of a quality assurance feedback process based on assessing the quality of the decisions made by the refund audit selection algorithms.

f. Enhancement to annual audit planning. Review of field audit procedures and strategy to fully coordinate with the annual audit plan.

g. Review of the relevant legislation on "issue" audits and the use of multi-tax audits to allow MTA to reduce the requirement for comprehensive audits.

h. Development and/or updating of manuals for industry-specific audits in coordination with the relevant authorities with interest in the economic sector and in relevant topics such as transfer pricing and e-commerce.

i. Development of a permanent training program for inspectors and deliver extensive training including: (i) develop curriculum and training materials to take full advantage of the audit software and (ii) training in audit techniques covering general audit, forensic audit, specialized economic sectors and specialized audit techniques (e.g.: cash registers, etc.) including on-going training in the law and regulations that affect audits.

j. Development of business requirements for the tax audit processes to be included in the IRMS.

E: Anti-Fraud, Criminal Investigations

a. Review of the organizational framework for the implementation of the compliance strategy including optimizing the distribution of responsibilities between the units responsible for anti-fraud and criminal investigations (i.e. non-compliant economic activity resulting in undeclared activities of registered or un-registered taxpayers), and the allocation of the assignment of responsibilities for documentary control and automated audit.

b. Review and proposal of improvements to the functioning of anti-fraud and criminal investigations, including the legal framework for the processes and operational procedures that govern their execution.

c. Analysis of training needs of the anti-fraud and criminal investigations team(s), development of a permanent training program for their inspectors and delivery initial anti-fraud, forensic audit and criminal investigations training, including training of trainers. Development of training in the use of the IT system, particularly the results from the risk analysis of taxpayers and information from third party matching, for anti-fraud and criminal investigation teams. Development of training for prosecutors and the judiciary in tax law.

8. **Sub-component 2.2: Data Cleansing and IT Infrastructure.** This subcomponent has two main sub-programs: cleaning and rationalization of data in the current IT systems in the first years of the project, and enhancement of the IT infrastructure, including the enterprise architecture, data center, security and disaster recovery plans, required to support the new IRMS. This subcomponent will finance the following activities:

A: Data Cleansing and Rationalization

a. Provision of consulting support to assist in the analysis, programming and implementation activities associated with data cleansing and system rationalization that, in the short term, will stabilize the current IT system and provide more timely and accurate information to the MTA staff, taxpayers and other recipients of MTA information (e.g. pension and health funds).

B: IT Infrastructure to Support IRMS

a. Procurement of equipment required for the new primary center server room including communication and server equipment (cabling raceways, racks, dual inter- and intra-net access points), dual electrical grids within the room and appropriate power conditioning, uninterrupted power supply along with backup and supplemental diesel generator capacity.

b. Procurement of hardware and software required for the Government of Montenegro's (GoM) business continuity / disaster recovery data center sufficient to seamlessly support MTA's internal and taxpayers' requirements, providing business continuity in the event of a systemic failure at the primary data center through real time replication of the primary data center's data.

c. Provision of consulting support for the continued centralization of data obtained from third parties.

d. Recommendation of changes to existing data security policies and procedures, security and access software requirements.

e. Revision of Business Continuity, Disaster Recovery and Contingency Plans to reflect new technologies and threats.

f. Provision of consulting and engineering support to develop the specifications for the new primary center server room.

g. Provision of consulting support to develop the IT enterprise architecture based on government recommendations for IT infrastructure and software environmental

9. **<u>Sub-component 2.3: Integrated Revenue Management System.</u>** This subcomponent has two main sub-programs: development of the specifications for the IRMS based on business requirements identified in the various sub-components; and procurement and implementation of the IRMS. This subcomponent will finance the following activities:

A: IRMS Specifications

a. Consolidation and rationalization of the business requirements from the business needs identified in components 1, 2.1 and 3 for the IRMS.

b. Analysis and review of the consolidated business requirements and development of the conceptual design and technical specifications for the IRMS.

c. Assessment of the implications of the proposed integration of Tax and Customs Administration on the design of the IRMS.

B: IRMS Implementation

a. Using the requirements developed in Subcomponent 2.3.A, procure and implement a commercial IRMS system. The system will provide, at a minimum: online self-service via an internet portal with appropriate security; registration; return processing; payment processing; taxpayer accounting; collection; revenue accounting; case management; risk analysis; and the other required functionality based upon the business needs. It will also include integrated security, along with integration with the MTA's risk management engine and associated data warehouse and integration with the MTA's document management facility. Data migration from existing databases will also be included as part of the acquisition as will be the deployment of standardized processes for data interchange to and from MTA (e.g. customs information, payments from the banking system, data transfers to and from other ministries and agencies).

b. Development of training materials to assist taxpayers in using the taxpayer portal effectively.

c. Development of a "train-the-trainer" approach and training of users in the use of the new system

d. Supply, configure and deploy the necessary IT infrastructure (e.g.: servers, storage, network, workstation/laptop, etc.) to execute the IRMS application within the MTA's primary and backup data centers.

e. Support for both on-site and off-site training ensuring continued smooth operation and maintenance of the IRMS system. This includes training IT staff in a number of software products (e.g.: training in IRMS maintenance and use of the business rules engine to adjust operations of the new system, Structured Query Language (SQL), Database Administration (DBA), network monitoring, Storage Area Network (SAN) maintenance, etc.).

f. Provision of consulting service to strengthen IT management to contribute to the development of the new system, assume full ownership during the project, and enable consistent and meaningful improvement to the system after the finalization of the project.

PROJECT COMPONENT 3: TAXPAYER SERVICES

10. This component will finance the modernization of taxpayer services to increase understanding of revenue laws, procedures, and rights and obligations of taxpayers and thus reduce the compliance burden to taxpayers; and strengthening of external and internal communications. This component will finance the following activities:

a. Review of the current taxpayer services offered by MTA, including all forms and publications and the use of existing delivery channels (e.g. counter service, call center, website, written inquiries, etc.). Proposal of new taxpayer services and delivery channels based on international good practices.

b. Review of the relationship between MTA headquarters and regional tax offices to strengthen the delivery of taxpayer services. Recommendation of necessary changes in organization and in the information (including delivery channels) to provide streamlined timely and responsive service to taxpayers and the public.

c. Identification of staffing needs and profiles to meet the demand for taxpayer services, both at headquarters and at local offices.

d. Development of a segmented approach to taxpayer services programs to meet the different needs of taxpayers.

e. Proposal of measures to allow management to oversee and improve service delivery.

f. Development of curricula and training materials for Taxpayer Services staff covering the tax legal framework, procedures, and inter-personal communication skills. Delivery training to taxpayer services staff.

g. Formalization of the stakeholder consultative process by establishment of a Revenue Modernization Advisory Board that would include significant taxpayer representation to provide an external accountability and strengthen consultative arrangements with key professional associations, e.g. business associations, accountants, tax professionals.

h. Study tours to taxpayer services in other tax administrations to acquaint MTA staff with international best practices.

i. Identification of staffing needs and profiles to meet the demand for taxpayer services, both at headquarters, regional and at local offices.

j. Implementation, monitoring and publication of performance standards for select taxpayer services.

k. Design and carrying out of public communication campaigns to maintain awareness and promote taxpayer services.

l. Periodic surveys to obtain taxpayer feedback on MTA performance, compliance, and other areas such as: procedures, information provided, access to MTA, treatment by MTA personnel, professionalism of MTA staff, use of information about revenues collected, and transparency, corruption, and equity issues.

m. Review of the communication strategy on issues of interest for MTA staff and management.

n. Preparation of a paper- and web-based information for dissemination, for internal communications.

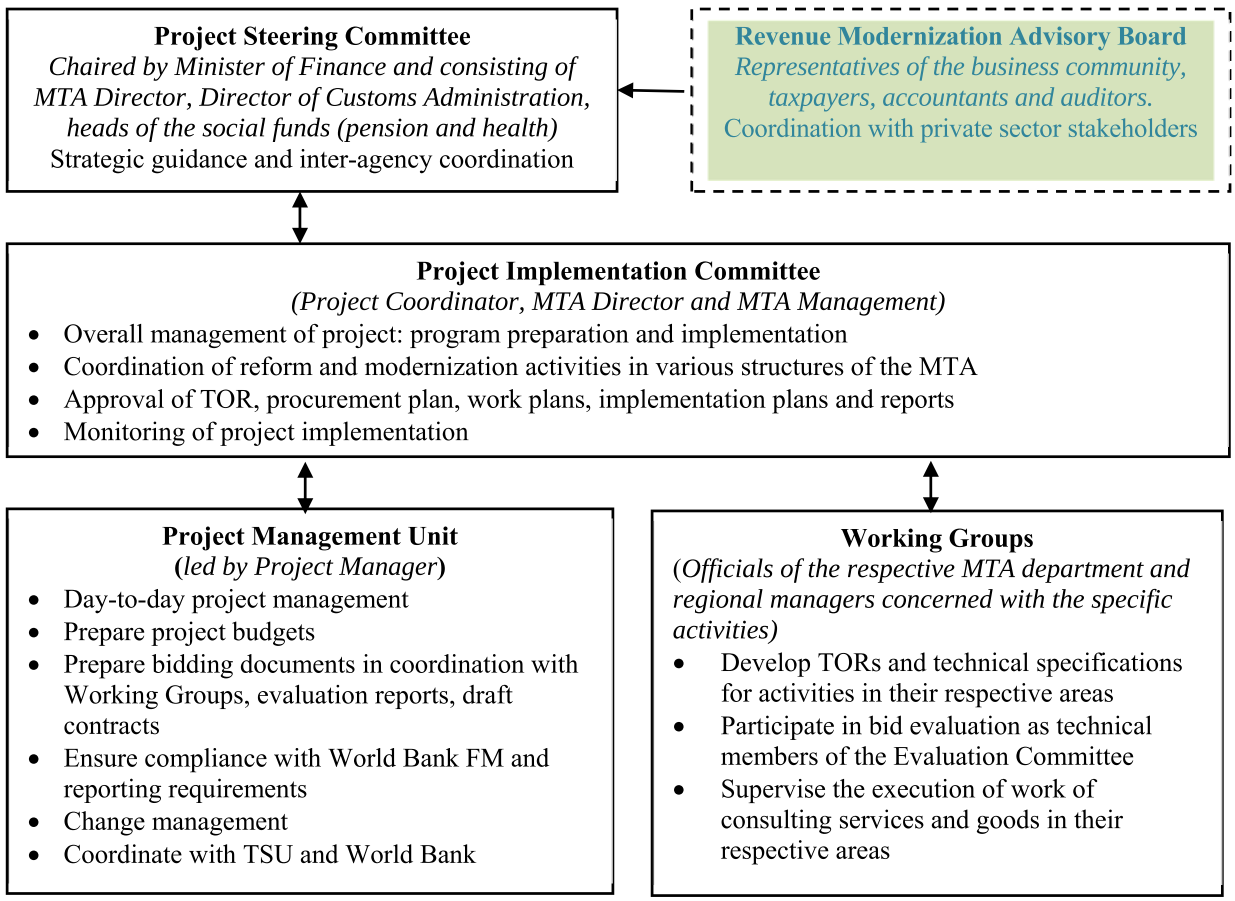
o. MTA Staff Feedback Surveys to track perception of managers and staff regarding the level of professional skills in selected functional areas and provide recommendations for improvement.

Annex 3: Implementation Arrangements

Project Institutional and Implementation Arrangements

1. Project implementation arrangements have been designed to: guarantee the highest possible degree of political ownership; ensure unified structure of management of governance reform and project implementation; and ensure agency level ownership and direction of project activities and results.

Figure 1: Project Implementation Arrangements



2. The MTA will be the implementing agency for the project. Implementation arrangements are designed to ensure cross-departmental coordination internally within the MTA and externally with the MoF and other stakeholders. Implementation arrangements comprise multiple layers to address: high level policy and strategic management among major stakeholders, external coordination and accountability, project management functions, and operations or functions associated with specific project activities.

3. The Project Steering Committee (PSC) will make key strategic decisions, ensure inter-agency coordination, and provide overall project monitoring. The Committee will comprise high level representatives of the key government stakeholders, including MoF, MTA, Customs Administration, Pension and Health Funds and will be chaired by the Minister of Finance. The Committee will provide strategic guidance to the MTA on issues related to project implementation

and overall revenue administration modernization reforms and will ensure inter-agency coordination. The Committee will be established prior to project effectiveness.

4. A Revenue Modernization Advisory Board will be established as a key part of the overall change management strategy for the project. The Advisory Board will be established for technical discussions with stakeholders heavily affected by the project to reflect their views on the institutional changes to be made by the project. Their views are especially important as they relate to the impact of activities supported under component three (taxpayer services), and as well as those under the legal and appeals part of component one. The Advisory Board will include representatives of associations of taxpayers, business associations, tax accountants and auditors. The Advisory Board will be convened as the need for consultation arises, but no less than twice per year. The Advisory Board will be established prior to project effectiveness.

5. A Project Implementation Committee (PIC) has been established comprising the head of each project component and subcomponents led by a Project Coordinator. The PIC will ensure that activities are coordinated across functions and are not implemented in a fragmented manner. The PIC has been established by an internal order.

6. Working groups will carry out day-to-day implementation of project activities of each component and subcomponent with the support of the PMU. The working groups will develop the TOR, technical specifications, participate in evaluating the bids, and supervise the execution of consulting services in their respective areas. Four Working Groups have been established by an internal order: institutional development; operational functions; IT systems; and taxpayer services. Working groups will comprise officials of the respective MTA department and regional managers concerned with the specific activities.

7. A Project Management Unit (PMU) will ensure the overall project management and the communication with the World Bank on project related issues. The PMU will be established through an internal order and will be staffed before project effectiveness based on terms of reference acceptable to the World Bank. The PMU will be headed by project manager and consist of project management advisor, two change management experts, and administrative support staff. The PMU will be responsible for project management, project reporting and administrative aspects of the project to ensure timely completion of relevant milestones included in the implementation plans. The PMU will coordinate procurement, financial management, and disbursement with the Technical Services Unit (TSU) within the Ministry of Finance. The TSU is responsible for the fiduciary aspects of seven more projects and has staff that are highly qualified and experienced. Project funds will be used to finance the TSU staff on a pro rata basis with the ongoing World Bank projects. The change management experts will assist in the project implementation, ensuring coordination of changes across the project's components and subcomponents. The PMU will also coordinate the changes brought by all the projects, including those financed by other development partners and the government, so as to harmonize the effects of changes on tax administration reform.

Financial Management

Country Issues

8. The 2009 Public Expenditure and Financial Accountability (PEFA) assessment identified considerable improvements in the public financial management systems in Montenegro. Fiscal and budget management systems were found to be sound in the areas such as aggregate outturn

compared to original budget classification and comprehensiveness of the budget, public access and transparency of fiscal information. While there is budget predictability, control over budget spending demonstrated a number of weaknesses. Accounting, recording and reporting proved to be timely, reliable and information readily available. The Treasury system is reliable and largely is being used by the Bank for flow of funds during implementation of the Bank supported projects. External scrutiny and audit were assessed to need further improvements and internal audit function was also assessed to lack capacity.

Financial Management Risk Assessment and Mitigation Measures

9. The overall financial management risk for the Project is rated as moderate. The project will be implemented by MTA and the TSU will assume the responsibility for financial management for the project. The current financial management arrangements of the TSU for the ongoing World Bank funded projects are satisfactory to the Bank and the same FM arrangements will be relied upon for the RARP.

10. There are no specific weaknesses for the project financial management and the TSU's involvement in the financial management is viewed as a strength for the project. The TSU is a well-established and experienced entity within Ministry of Finance. The financial management ratings for the projects that TSU currently supports have consistently been satisfactory.

Implementing Entity

11. The implementing agency is the MTA with the TSU providing fiduciary services for the Project. The TSU would work closely with the MoF to manage the loan disbursements. The MTA is an operating unit within the MoF and is led by the Director. The TSU established under the Treasury currently provides fiduciary services for seven World Bank funded projects and will assume the financial management responsibilities for the RARP. The TSU is very experienced and is adequately staffed with two dedicated financial management staff; a Senior Finance Officer and a Finance Officer.

Budgeting and Planning

12. As noted above, the operation will rely heavily on country public financial management systems. Budget for the Project will be included in the 2018 annual budget (estimated beginning of project implementation) and MTA will ensure that sufficient allocation will be included in annual budgets over the life of the Project. Procurement plans are utilized for monitoring project implementation with the dates serving as a determinant for annual budget estimations. The procurement plan for the project has been prepared by the MTA with close coordination with the TSU. This process utilized by the TSU for the current portfolio of projects is assessed as adequate. Coordination between MTA and TSU has been established and will be maintained over the life of the project. Variance between actuals versus projected as per the procurement plan will be monitored on a regular basis by the TSU and MTA and revisions will be processed on a timely basis for optimal utilization of project funds.

Staffing

13. The two financial management staff, Senior Finance Officer and Finance Officer, working at the TSU are highly qualified and experienced in World Bank financial management procedures. Capacity constraints will be closely monitored during project implementation and TSU will be supported with additional staff if required. The terms of reference for the financial management staff will be attached to the Project Operating Manual (POM). The contracts of the TSU staff are

the responsibility of the Treasury Debt Management Department of the Ministry of Finance. The Ministry is responsible for coordination and monitoring of World Bank loans.

Information Systems

14. TSU will be responsible for project accounting and reporting. TSU currently utilizes an off the shelf accounting software, SYSFM, for this purpose and the code of accounts that will be developed for RARP will be integrated into this system. The software is assessed as reliable and performing adequately for the ongoing projects. The TSU supports the SYSFM with excel worksheets for project reporting purposes. TSU will share the reports with MTA on a quarterly basis to facilitate project monitoring by the PMU. Additionally, they will take back-ups of both the SYSFM and excel worksheets on a regular basis.

Accounting Policies and Procedures

15. TSU will keep the accounts for the project on a cash basis in Euros. For the current projects there are acceptable accounting policies and procedures are in place at the TSU and the same will be adopted for the Project. These policies and procedures are described in the POM.

Internal Controls and Internal Audit

16. The contracts for goods, works and consultancy services under the project will be signed between the contractor/consultant and MTA. The Project Coordinator at the MTA will be responsible for approving the invoices. The TSU will develop a coding system that will facilitate associating each invoice with the procurement plan. The TSU will keep a copy of all contracts and upon receiving the invoices will prepare the payment request and send them to the MTA for recording it into their accounting system and preparing the payment order. This payment order will serve as the basis for the authorization of the Ministry of Finance for the payment. Upon receipt of payment orders properly authorized by the MTA staff, the TSU will control the payment orders and prepare the list of payments with the amount of fund to be withdrawn from the Designated Account in order to execute them through the Treasury System. Replenishments to the designated account will be prepared by the TSU and will be signed by the Ministry of Finance.

17. The TSU will be responsible for carrying regular reconciliation between the disbursement summaries, bank statements and the accounting records. They will also be responsible for maintaining a document management system that keeps supporting documentation for all transaction and will also show the approval trail. The internal control procedures for the Project including the roles and responsibilities of MTA and TSU will be described in detail in the project operations manual.

18. The Internal Audit department of the Ministry of Finance`s scope of work also covers MTA. They have two internal auditors assigned to MTA and they have conducted an audit in 2014 focusing on four priority areas: accounting and information systems, tax collection, inspection of tax payers and registration of businesses, and the call center. The Internal Audit Department states that tax officers comply with the procedures and MTA staff are qualified and experienced. The audit reports describe general compliance with the relevant laws and regulations and that the institution has satisfactory internal control procedures in place. There is close coordination between the Internal Audit Department and the State Audit Institution which carries out financial audit of MTA on an annual basis.

Reporting and Monitoring

19. TSU will maintain Project accounting records and will prepare the annual financial statements and the IFRs on a quarterly basis. The IFRs will be prepared in Euros and will include information on uses of funds by project components, disbursement categories, movements of the designated account, and explanatory note on the major project related events during the quarter. The format of the IFRs has been agreed and is attached to the minutes of negotiation. The IFRs will be submitted to the Bank within 45 days after every quarter.

External Audit

20. The annual project financial statements will be audited in accordance with Terms of Reference (ToR) and by auditors acceptable to the Bank. Audit reports will be submitted to the Bank within six months following the end of the audit period. TSU undertakes an umbrella contract with an external audit firm and separate contracts are made with the audit firm for each project. The current external auditors of the projects for which TSU provides fiduciary services is BDO. The auditors provide an audit opinion on each project financial statements and also provide a management letter. The audit reports for the projects in TSU`s portfolio were received on time and did not include any serious internal control issues. The audited financial statements and the audit report will be publicly disclosed in a manner acceptable to the Bank. The following chart identifies the audit reports and their due dates:

Audit Report	***Due Date***
Project financial statements including SOEs and designated account. PFS include sources and uses of funds by category and by components; SOE statements, Statement of Designated Account, notes to the financial statements and reconciliation statement.	Within six months after the end of each calendar year and also at the closing of the project.

Funds Flow and Disbursement Arrangements

21. The project will use standard disbursement method in which the Project funds will flow from the World Bank, either as an advance, via a Designated Account, or by direct payment, on the basis of direct payment withdrawal applications. The Designated Account will be opened in a commercial bank acceptable to the World Bank, and will be managed by the TSU and therefore will prepare the withdrawal applications for replenishments. The withdrawal applications will be signed by designated signatories (which will be described in the controls and procedures used for Project implementation and would include a Government official of at least Assistant Minister level). Payments from the Designated Account will be executed by the means of payment orders. After all the procedures with respect to flow of documents, verifications and authorizations which are summarized in the internal controls section and which will be further detailed in the POM are applied, the fund will be withdrawn from the designated signatory and payments will be executed through the Treasury System. In the case of direct payment, the application form for such payment method will be submitted to the Bank with the same authorized signatories as described above.

22. The ceiling for the Project Designated Account will be determined in the Disbursement Letter for the Project. Applications for replenishment of the Designated Account will be submitted on a quarterly basis or more frequently if needed. Documentation requirements for replenishment will follow standard World Bank procedures, as described in the Disbursement Handbook.

Monthly, bank statements of the Designated Account, which have been reconciled, will accompany all replenishment requests.

23. The authorities confirmed that retroactive financing up to an aggregate amount not to exceed EUR200,000 will be required under the Project.

Procurement arrangements, capacity and risk assessment

24. Procurement will be conducted by the TSU in coordination with the PMU to be set up within the MTA. The TSU currently is implementing seven projects financed by the WB and its staff is experienced in conducting procurement in accordance with the Bank guidelines. The TSU has two full time local consultants responsible for procurement: one Senior Procurement Officer (acting also as a Head of TSU) and Procurement Officer. The TSU staff have attended procurement training, procurement and IT training organized by the Bank in Podgorica in March 2014. The TSU staff has displayed increased knowledge and skills in international procurement, including in IT procurement, due to their previous and on-going involvement in the Bank projects and other donor financed projects.

25. Based on the risk assessment of the MTA as the main contract management and overall project implementation agency as well as the complexity of the Project, the procurement risk for this project is rated as Substantial.

26. The potential procurement issues and risks for implementation of the project have been identified and include: limited/lack of knowledge and of prior experience of the implementing agency (MTA) in contract management and overall project management for Bank financed operations, despite the TSU experience on Bank's procurement, including on contract conditions and dispute resolution mechanisms; and potential risks of delays in project implementation due to lack of ToRs for the first year of project implementation due to delays in establishing the PMU in MTA via formalized internal process.

Risk mitigating measures

27. The following procurement-related risks mitigation measures were agreed between the Bank and the client during project preparation.

Actions		Deadline/Status
1	Prepare a detailed procurement plan for the first 18 months of the implementation of the project.	Completed prior to Negotiations
2	Prepare and adopt a Project Operational Manual including a detailed chapter on procurement.	Completed prior to Negotiations
3	Establish the PMU within the MTA, through an internal order.	Completed prior to Effectiveness
4	Start the preparation of all first year bidding documents to avoid delays in project implementation	Within one month of Effectiveness
5	Regular procurement support, including attending training by both TSU and MTA, during project implementation by Bank procurement staff.	Ongoing

Applicable procurement procedures

28. Procurement for the project will be carried out in accordance with the World Bank's: "Guidelines for Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits and Grants" dated January 2011, revised July 2014; and "Guidelines for Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Recipients" dated January 2011, revised July 2014, as per provisions stipulated in the Financing Agreement. The different procurement or consultant selection methods, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank project team and reflected in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect actual project implementation needs and improvements in institutional capacity. The Bank standard bidding documents, including for supply and installation of Information systems, and evaluation report for procurement of goods and IT will be used, as well as the Bank's standard request for proposal for selection of consultants, and combined technical and financial evaluation report will be applied. Specific rules and regulations set forth in the Project Operational Manual will be followed during implementation of the project.

Procurement of Training

29. Procurement of training, seminars and similar activities planned under Component 3 will be carried out on the basis of the analysis of the most suitable program for training offered by organizations, availability of services, period of training, and reasonableness of cost. Training will be financed according to a program acceptable to the Bank.

Procurement Plan

30. A draft Procurement Plan for the first eighteen months of implementation, available as a separate project document, has been prepared by the MTA in coordination with the TSU. The Procurement Plan will be updated annually or as needed by MTA in coordination with the TSU to: reflect project implementation; accommodate changes that should be made; and add new packages necessary for the Project. Each update of Procurement Plan will be subject to the Bank's prior review. The Procurement Plan will be published in the World Bank's website. Procurement under the project will be carried out in accordance with the agreed Procurement Plan and updated as needed. Procurement Plan will include procurement and prior review thresholds that could also be updated from time to time.

31. Procurement planning under the project will be governed by the provisions of the POM. The procurement chapter of the POM should cover all procurement aspects such as: procurement implementation arrangements; procurement planning and reporting; procurement methods and thresholds; responsibilities of procurement staff and evaluation committees, including declaration of impartiality form for evaluation committee members; and procurement process and other process such as contract monitoring, contract administration, contract management, contract control procedures and dispute resolution procedures.

32. Procurement under the project will include the following categories: consulting services and goods. Goods will include development of Integrated Revenue Management Information System (IRMS) and procurement of other IT hardware and software, office equipment, etc. Consultant services will include technical assistance for preparation of IRMS bidding documents and other institutional and operational development of MTA, survey on taxation, as well as other expertise required for supporting the PMU in its day to day functions. The thresholds for

procurement methods and Bank prior review applied for procurement are mentioned in the Procurement Plan. The prior review thresholds may be adjusted during the project implementation to reflect the increased capacity of the implementing agency.

Post-review

33. Contracts not subject to prior review will be subject to post-review as per procedures set forth in Paragraph 5 of Appendix 1 of the Procurement Guidelines and Consultant Guidelines. The Bank will carry out procurement post-reviews on an annual basis with a sampling rate of initially 20 percent. This rate will be adjusted periodically during project implementation based on the performance of the project implementing agency.

Records keeping and filing

34. The PMU and TSU will keep procurement documentation safe and filed at their respective premises for each contract funded under the project. Current practices of record keeping seem inadequate as whole room is full of various folders and papers. More space should be arranged for TSU records keeping. Improvements in record keeping will be monitored during implementation.

Anti-Corruption Measures

35. The Borrower will ensure that the project, including procurement, is carried out in compliance with the current version of the Bank's Anti-Corruption Guidelines. All bidding documents, including contracts, used under the Project will include the latest version of the provisions on fraud and corruption. All members of the evaluation committees will sign a disclaimer on absence of conflict of interest and confidentiality for each evaluation process.

Goods and Non-Consulting Services

Prior Review Threshold: Procurement decisions will be subject to prior review by the Bank as stated in appendix 1 to the Procurement Guidelines and outlined in the Procurement Plan.

36. Procurement packages with methods and time schedules have been planned during appraisal. The details (description of packages, schedule, and methods) will be provided by TSU in coordination with MTA and will be further confirmed during negotiations.

Selection of Consultants

37. Prior review threshold: Selection decisions subject to prior review by the Bank as stated in Appendix 1 of the Consultant Guidelines and outlined in the Procurement Plan.

38. Short lists of national consultants: Short lists of consultants for services estimated to cost less than EUR240,000 equivalent per contract that may comprise entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines have been prepared and reflected in the procurement plan.

Environmental and Social (including safeguards)

39. The project has been rated as Category "C" for environmental purposes and does not include activities which could cause any social risks or negatively affect Montenegro's population. None of the envisaged activities will require any special permission on environmental issues. Hence, the project will not be subject to the Environmental Impact Assessment procedures or any permission relating to environmental protection aspect. The Project will generate social benefits

by reducing the compliance burden for tax payers and improving revenue collection, increasing the fiscal space for social and economic investments. There are no discernible gender differentiated impacts and/or risks, associated with the Project.

Monitoring & Evaluation

40. The Government will develop a robust system for monitoring and evaluation (M&E) of the target outcomes and outputs. The M&E system will support the successful implementation of the Project by maintaining records on implementation and generating bi-annual performance reports prepared within one month of the end of the reporting period focusing on results-based accountability and accomplishments against performance expectations. Progress reports will be submitted to the PIC which reviews the progress towards the achievement of key objectives and endorses reports submitted to the World Bank. A results framework with project specific indicators and actionable monitoring arrangements has been developed jointly with the government counterparts to support progress and monitoring of results of project implementation (Annex 1). The progress assessed during implementation support missions will be reported to the World Bank's management through implementation status reports (ISRs), a mid-term review, and at the completion of the Project, an implementation completion report (ICR). Technical assistance and capacity-building for monitoring, evaluation and effective communications to various stakeholders throughout the reform process will be provided through the project.

Role of Partners

41. Efforts will be made to coordinate support from other development partners. Regular World Bank implementation support missions would coordinate their activities with other development partners of MTA, particularly the IMF and EU. IMF is finalizing its proposal to provide technical advice to the MTA on tax administration issues. The EC's engagement with the MTA, through the Instrument for Pre-Accession Assistance (IPA) 2014 program, provides support to MTA in meeting EU pre-accession requirements in the field of taxation, including analysis of the interconnectivity between the MTA VAT system and the EU VAT Information Exchange System (VIES). The activities planned under IPA 2014 will be likely initiated in 2017 through twinning with the MTA and a Tax Administration from the European Union.

Table 1: Procurement packages with methods and time schedules

Reference Number	**Procurement Type**	**Description**	**Domestic Preference (Yes/No)**	**Estimated Start of Proc'mt Process**	**Review by Bank (Prior/Post)**
RARP/1	Shopping	PMU Office equipment including computer equipment and peripherals, furniture, FM software license	No	2018-Feb	Post
RARP/2	ICB	Equipment for primary and business continuity data centers (servers, racks, uninterrupted power supply, generators, network, tape, storage)	No	2019-Jan	Post
RARP/3	ICB	IRMS software and hardware	No	2019-June	Prior

Table 2: Consultancy assignments with selection methods and time schedule

Reference Number	Selection Method	Description	Estimated Start of Procurement Process	Review by Bank (Prior/ Post)
RARP-CS/1	IC	PMU local project manager	2017-Oct	Prior
RARP-CS/2	IC	PMU local project administrative support	2017-Oct	Post
RARP-CS/3	IC	PMU translation services	2017-Oct	Post
RARP-CS/4	IC	PMU International advisor to project manager	2018-Mar	Post
RARP-CS/5	QCBS	IT consulting firm to assist in stabilization of current system	2018-July	Post
RARP-CS/6	CQ	Design and conduct taxpayer and staff survey's including analysis of results	2018-July	Post
RARP-CS/7	CQ	Design and execution of communication strategy	2018-July	Post
RARP-CS/8	IC	Analytics including Tax Gap	2018-July	Post
RARP-CS/9	QCBS	Change management experts + training	2018-July	Post
RARP-CS/10	CQ	PMU External Auditors for project	2018-Mar	Post
RARP-CS/11	QCBS	Operational Development for MTA (registration, returns, compliance, enforcement, audit, anti-fraud and criminal investigations, taxpayer services)	2018-June	Prior
RARP-CS/12	QCBS	IT consulting firm for (i) 3rd party data, security policies and disaster recovery plans (ii) to develop specifications for data center room (iii) develop IT enterprise architecture (iv) for business requirement consolidation/rationalization and develop conceptual design and IRMS technical requirements	2018-August	Post
RARP-CS/13	IC	International advisor for strengthening IT management	2018-August	Prior
RARP-CS/14	QCBS	Institutional Development of MTA (strategic mgmt.) (A), internal control (D), legal (E) and objections (F), and staff management and training (B))	2018-Nov	Prior

Annex 4: Implementation Support Plan

1. The World Bank's support to the tax administration reforms is not limited to just financial resources but also includes technical support for project preparation and implementation. The Bank will continue to provide close supervision of project implementation and support the client's effort to achieve the intended project results. To enhance the value of the implementation support, the strategy for Project Implementation Support has been designed to mitigate specific Project implementation risks, taking into account the political economy context, as well as the risks and challenges identified in lessons learned and the SORT assessment. The key features of the implementation strategy are addressed below.

2. **Policy Dialogue**: The project addresses the central issues in Montenegro's tax administration reform agenda. Some of these issues will be addressed in dialogue in the context of the project and others will be addressed in the context of a future Development Policy Operations (DPO). The project implementation support team will work closely with the team preparing any future DPO to ensure consistency in approach.

3. **Technical and Change Management Support**: The Bank team has provided the Government with technical advice on specific design elements and the overall approach to change management. The Bank team will provide regular support on change management and the sequencing of the reforms, as well as review and quality assurance the technical design and specifications of major procurement packages. The Bank team will liaise closely with the projects change management experts to ensure that change management issues are in the forefront.

4. **Results Monitoring**: Regular implementation support missions will assist the Government in tracking progress towards the achievement of the intended project results and will advise on adjustments in project design and the reform strategy required to support the achievement of the project objectives. This will ensure that outputs translate into real impact in terms of a more efficient and effective tax administration.

5. **Procurement**: During project implementation, the Bank's procurement specialist will provide regular supervision, in line with procurement guidelines. Procurement implementation support by the Bank will include: (a) providing training to the TSU and the PMU, (b) providing detailed guidance on the Bank's Procurement Guidelines, (c) reviewing procurement documents and providing timely feedback, and (d) monitoring procurement progress against the Procurement Plan. In addition, post reviews will be carried on selected contracts subject to post review. Contract deliverables will be physically inspected – as appropriate and feasible.

6. **Financial Management**: The Bank will conduct financial management implementation support mission within a year of project effectiveness and then at appropriate intervals. In addition, the regular IFRs and annual project audit reports will be reviewed by the Bank. As required, a Bank-accredited Financial Management Specialist will assist in the implementation support and supervision process.

7. The team will maintain continuity and a regular dialogue with Government counterparts on all relevant operational, technical and policy issues. There will be two formal implementation support missions per year.

Implementation Support Plan

Time	Focus	Skills Needed	Partner Role
First twelve months	Establishing Steering Committee and Technical Working Groups; Selection of key consultancies on (i) institutional development (ii) modernize operations; and (iii) taxpayer services.	TTL Procurement specialist, FM specialist; Tax specialist; IT expert	Participation in implementation support missions
12-55 months	Implementation of technical assistance packages for (i) institutional development (ii) change management, (iii) modernize operations including IT enhancements and (iv) communications.	TTL; Procurement specialist, FM specialist; Tax specialist; IT expert	Participation in implementation support missions
56-60 month	Completion of project activities. Data collection and preparation for the ICR.	TTL Procurement specialist, FM specialist; Tax specialist; IT expert.	Participation in implementation support missions

Skills Mix Required

Skills Needed	*Staff Weeks / yr*	*Missions*	*Comments*
TTL Project Management and Support	20	2	
Procurement Specialist	10	None	
FM Specialist	8	None	
Tax Specialist	4	2	
IT expert	4	2	

Partners

Name	*Institution/Country*	*Role*
IMF	Fiscal Affairs	Advisory services on technical dimensions of tax administration reforms.
European Commission	EC Delegation to Montenegro	Support through the IPA 2014 program, to assist the MTA in meeting EU pre-accession requirements in the field of taxation,

		including analysis of the interconnectivity between the MTA VAT system and the EU VIES system.

Annex 5: Economic and Financial Analysis

Economic Analysis

1. Economic analysis of the project considers the direct benefits and costs associated with changes in economic welfare arising from the project. The project will generate numerous economic benefits. However, quantifying many of these benefits depends on the availability and reliability of data. This economic analysis provides estimates of benefits and costs using data obtained from the Montenegro Tax Administration, Monstat, *World Bank Doing Business*, as well as the IMF World Economic Outlook.

2. The estimated economic benefits include reduced compliance costs for corporations and improved MTA's operational efficiency. The decrease of tax compliance costs stems from simplified filing and payment of taxes and social contributions; reduced number of tax inspections and less time dealing with tax officials; and enhanced taxpayer services, including among others updated and accurate information for taxpayers provided on the MTA's website and automated call centre. Currently, according to the *Doing Business 2016* report, medium sized companies spent 314 hours a year on tax compliance, including 179 hours on VAT, 43 hours on CIT, and 92 hours on labour taxes. Lower compliance costs will provide greater scope for taxpayers to engage in productive and income generating activities. Gains in operational efficiency result from the modernization of MTA's operational functions, streamlining of business procedures, data cleansing and rationalization of existing IT systems. These measures will improve MTA's operational effectiveness and efficiency and impact the overall quality of taxpayer services.

3. There are additional economic benefits which are difficult to quantify. These include reduced avenues for corruption, greater transparency and accountability of the MTA and increased trust in the tax administration and government. The latter is a particularly important factor for improving the taxpaying culture which is likely to generate large fiscal benefits in the long run.

4. Economic costs involve resources that will be invested in the project and other expenses incurred during project implementation. Such costs will encompass value of an investment and MTA staff time associated with the implementation of the project and operation and maintenance costs of the IT system, including licenses and system operation and maintenance. In addition, the Government will have to periodically upgrade the IT system and move to an integrated revenue management system that is close to the technological frontier.

5. The economic analysis suggests that the project is feasible. The net present value (NPV) in real terms is EUR113.9 million at 10 percent discount rate, and IRR is 95 percent.

Key Assumptions

- Annual average inflation of 1.4 percent in Montenegro.
- The number of active taxpayers will increase during project implementation: for VAT by 5 percent, for CIT by 2.5 percent.
- The time required for dealing with taxes (time spent by corporations and their accountants) is expected to be reduced by 21 percent, or 120 hours by 2020 with the highest decline registered in the time required to deal with VAT—31 percent or 93 hours respectively.

- An average net remuneration for an accountant of EUR862 in 2015, adjusted for inflation during 2016-2020 period.
- Staff time spent on the project implementation is based on includes one FTE (project manager) and 24 hours per week for 580 staff. Staff time required for operation and maintenance of the system is 6 FTE from year 6.
- An average net wage in public administration is EUR500 (2014), adjusted for inflation, is used to estimate the cost of MTA staff involvement in the project
- Operation and maintenance cost is 10 percent of the investment, adjusted for inflation.
- The discount rate is 10 percent.

Table 1. Economic Costs and Benefits

(in thousand Euro, unless otherwise indicated)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Project investment	455	2,060	2,066	3,387	2,005	-	-	-	-	-
Staff time expense for project implementation	324	405	405	410	416	7	7	7	8	8
O&M cost	8,314	8,761	9,193	9,797	10,110	2,000	2,030	2,060	2,091	2,123
Front end fee	46	-	-	-	-	-	-	-	-	-
Commitment fee	39	31	21	10	-	-	-	-	-	-
Total economic costs, nominal	**9,177**	**11,257**	**11,684**	**13,605**	**12,531**	**11,980**	**2,037**	**2,068**	**2,099**	**2,130**
Savings from improved operational effectiveness	0	0	24,594	39,315	54,771	2,608	- 3,139	- 9,078	- 6,909	- 4,659
Savings from reduced compliance costs	0	0	3,767	5,757	11,092	11,596	12,116	12,653	13,206	13,777
Loan disbursements	500	2,266	2,272	3,726	2,206	-	-	-	-	-
Total economic benefits, nominal	500	2,266	30,633	48,798	68,068	14,204	8,977	3,575	6,297	9,118
Net benefits, nominal	**- 8,677**	**- 8,991**	**18,949**	**35,193**	**55,537**	**2,224**	**6,940**	**1,507**	**4,198**	**6,988**
Total economic costs, real	**9,177**	**11,091**	**11,342**	**13,011**	**11,807**	**11,121**	**1,863**	**1,863**	**1,863**	**1,863**
Total economic benefits, real	**- 8,677**	**- 8,858**	**18,393**	**33,656**	**52,326**	**2,064**	**6,347**	**1,358**	**3,727**	**6,111**
Net benefits, real	**- 8,677**	**- 8,858**	**18,393**	**33,656**	**52,326**	**2,064**	**6,347**	**1,358**	**3,727**	**6,111**
IRR	95%									
NPV, million Euro	113.6									

Financial analysis

6. Financial analysis of the project considers costs and benefits using a cash flow approach. Financial benefits comprise increased collection of tax revenues and social contributions, including through the reduction of tax arrears, as well as available loan financing. Collection of revenue will grow as a result of improved tax administration and tax compliance due to many reform measures envisaged under this project. These measures include improving accuracy and integration of taxpayer registries; simplifying current procedures for taxpayer registration, filing and payment of taxes and social contributions; better assessing and mitigating risk through tax-gap analysis and risk-based audits; enhancing quality of taxpayer services to support voluntary compliance; and expanding e-filing. Financial costs are the same as economic costs.

7. The financial analysis suggests that project is financially viable, with a high financial rate of return. The net present value (NPV) in real terms is EUR343 million, and IRR is 96 percent. The financial analysis shows that the project will generate sizeable fiscal gains for the budget. A 10 percent discount rate is assumed.

Table 2. Financial Costs and Benefits

(in thousand Euro, unless otherwise indicated)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Financial outflows										
Project capital and operating costs										
Project investment	455	2,060	2,066	3,387	2,005	-	-	-	-	-
Staff time expense for project implementation and system maintenance	324	405	405	410	416	7	7	7	8	8
O&M cost (excluding staff time)	8,314	8,761	9,193	9,797	10,110	2,000	2,030	2,060	2,091	2,123
Total costs	**9,092**	**11,226**	**11,664**	**13,595**	**12,531**	**2,007**	**2,037**	**2,068**	**2,099**	**2,130**
	-	-	-	-	-	-	-	-	-	-
Loan repayments and fees	-	-	-	-	-	-	-	-	-	-
Front end fee	46	-	-	-	-	-	-	-	-	-
Commitment fee	39	31	21	10	-	-	-	-	-	-
Repayments	-	-	-	-	-	1,369	1,369	1,369	1,369	1,369
Total cash outflows, nominal	**9,177**	**11,257**	**11,684**	**13,605**	**12,531**	**3,376**	**3,407**	**3,437**	**3,468**	**3,500**
Financial inflows										
Increased tax collection	-	-	16,335	25,728	43,609	53,220	63,146	73,394	74,641	75,910
Loan disbursements	3,000	3,000	4,146	4,146	4,146	-	-	-	-	-
Total cash inflows, nominal	**3,000**	**3,000**	**20,481**	**29,874**	**47,755**	**53,220**	**63,146**	**73,394**	**74,641**	**75,910**
	-	-	-	-	-	-	-	-	-	-
Net cash flows, nominal	**- 6,177**	**- 8,257**	**8,797**	**16,269**	**35,224**	**49,844**	**59,739**	**69,957**	**71,173**	**72,411**
		-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-
Total cash outflows, real	**9,177**	**11,091**	**11,342**	**13,011**	**11,807**	**3,134**	**3,115**	**3,097**	**3,079**	**3,061**
Total cash inflows, real	**3,000**	**2,956**	**19,880**	**28,569**	**44,994**	**49,402**	**57,750**	**66,130**	**66,260**	**66,391**
Net cash flow, real	**- 6,177**	**- 8,135**	**8,539**	**15,558**	**33,187**	**46,268**	**54,634**	**63,033**	**63,181**	**63,330**
IRR	**96%**									
NPV at	**343**	-	-	-	-	-	-	-	-	-