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Report No: PAD3414

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT PAPER

ON A

PROPOSED ADDITIONAL LOAN

IN THE AMOUNT OF EUR 4.8 MILLION
(US$ 5.306 MILLION EQUIVALENT)

TO

MONTENEGRO

FOR THE

REVENUE ADMINISTRATION REFORM PROJECT

SEPTEMBER 19, 2019

Governance Global Practice
Europe And Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective August 23, 2019)

Currency Unit = EUR

EUR = US$1.1055

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

CIT	Corporate Income Tax
COTS	Commercial-Off-The-Shelf
CPF	Country Partnership Framework
EFD	Electronic Fiscal Devices
EFI	Electronic Fiscal Invoicing
EIRR	Economic Internal Rate of Return
EU	European Union
FIRR	Financial Internal Rate of Return
GDP	Gross Domestic Product
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFR	Interim Unaudited Financial Report
IMF	International Monetary Fund
IPF	Investment Project Financing
IRMS	Integrated Revenue Management System
ISR	Implementation Status and Results Report
IT	Information Technology
MOF	Ministry of Finance
MPA	Ministry of Public Administration
MTA	Montenegro Tax Administration
NPV	Net Present Value
PBG	Policy-Based Guarantee
PDO	Project Development Objective
PMU	Project Management Unit
POM	Project Operational Manual
RARP	Revenue Administration Reform Project
RFB	Request for Bid
SORT	Systematic Operations Risk-Rating Tool
TSU	Technical Services Unit
VAT	Value Added Tax
WB	World Bank

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BASIC INFORMATION – PARENT (Revenue Administration Reform Project - P149743)

Country	Product Line	Team Leader(s)		
Montenegro	IBRD/IDA	Srdjan Svircev		
Project ID	Financing Instrument	Resp CC	Req CC	Practice Area (Lead)
P149743	Investment Project Financing	EECG2 (9751)	ECCWB (7001)	Governance

Implementing Agency: Montenegro Tax Administration

Is this a regionally tagged project?	

Bank/IFC Collaboration

No

Approval Date	Closing Date		Original Environmental Assessment Category	Current EA Category
31-Jul-2017	31-Mar-2023		Not Required (C)	Not Required (C)

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach [MPA]	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-Linked Indicators (DLIs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a Non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made disaster
[ ] Alternate Procurement Arrangements (APA)	

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.

Ratings (from Parent ISR)

	Implementation		Latest ISR
	09-Feb-2018	13-Oct-2018	01-May-2019
Progress towards achievement of PDO	MS	MS	MS
Overall Implementation Progress (IP)	MS	MS	MS
Overall Safeguards Rating			
Overall Risk	S	S	S

BASIC INFORMATION – ADDITIONAL FINANCING (Additional Financing for the Montenegro Revenue Administration Reform Project - P170454)

Project ID	Project Name	Additional Financing Type	Urgent Need or Capacity Constraints
P170454	Additional Financing for the Montenegro Revenue Administration Reform Project	Restructuring, Scale Up	No
Financing instrument	**Product line**	**Approval Date**	
Investment Project Financing	IBRD/IDA	10-Oct-2019	
Projected Date of Full Disbursement	**Bank/IFC Collaboration**		
30-Jun-2023	No		

Is this a regionally tagged project?	
No	

Financing & Implementation Modalities

[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-Linked Indicators (DLIs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a Non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made disaster
[ ] Alternate Procurement Arrangements (APA)	
[ ] Contingent Emergency Response Component (CERC)	

Disbursement Summary (from Parent ISR)

Source of Funds	Net Commitments	Total Disbursed	Remaining Balance	Disbursed
IBRD	15.70	0.78	14.98	4.9 %
IDA				%
Grants				%

PROJECT FINANCING DATA – ADDITIONAL FINANCING (Additional Financing for the Montenegro Revenue Administration Reform Project - P170454)

FINANCING DATA (US$, Millions)

SUMMARY (Total Financing)

	Current Financing	Proposed Additional Financing	Total Proposed Financing
Total Project Cost	15.70	5.31	21.01
Total Financing	15.70	5.31	21.01
of which IBRD/IDA	15.70	5.31	21.01

Financing Gap	0.00	0.00	0.00

DETAILS - Additional Financing

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	5.31

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any other Policy waiver(s)?

[ ] Yes [✓] No

INSTITUTIONAL DATA

Practice Area (Lead)

Governance

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

No

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

No

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

No

PROJECT TEAM

Bank Staff

Name	Role	Specialization	Unit
Srdjan Svircev	Team Leader (ADM Responsible)		EECG2
May Cabilas Olalia	Team Leader		EECG2
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Extended Team

Name	Title	Organization	Location
Milos Markovic	Consultant		
Peter Poulin	Consultant		
Wyatt Grant	Tax ICT specialist		

I. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING

1. **This Project Paper seeks the approval of Executive Directors to provide an additional loan in an amount of EUR 4.8 million (approximately US$ 5.306 million equivalent) for the Montenegro Revenue Administration Reform Project (RARP, P149743, parent Project).** The proposed additional financing is sought to restructure the parent Project and include a new component for the Electronic Fiscal Invoicing (EFI) with no change to the original Project Development Objective (PDO) and the current closing date.

2. **The additional financing was requested by the Government of Montenegro to enable implementation of a comprehensive approach to modernization and digitalization of tax administration.** The implementation of the EFI solution will allow the Montenegro Tax Administration (MTA) to generate more secure real time business transaction information, which is a critical input to a comprehensive compliance control framework. It would improve MTA's operational effectiveness and in parallel reduce the compliance costs of taxpayers, especially corporate taxpayers. It is consistent with the PDO of the parent Project. Successful implementation of the EFI will allow for an early win under the parent Project given that the EFI will be implemented and deployed ahead of the full Integrated Revenue Management System (IRMS) that is central to the RARP and the modernization and digitalization of the MTA. More importantly, the EFI and the IRMS together would transform the MTA into an "[e]lectronic tax administration [that] leverages the capabilities of modern integrated [information and communications technology] tax management solutions, which encourages voluntary tax compliance by providing the data necessary to support enforcement and compliance programs and by providing electronic services that simplify taxpayer service and compliance".[1] Moreover, the additional financing was requested, instead of a new stand-alone operation, to reduce the Government's costs for a separate project preparation and implementation while leveraging on the World Bank expertise.

3. **The proposed restructuring will revise the results framework, components and costs, exclude financing of value added tax (VAT), technical and economic analysis, and the risk analysis of the parent Project to reflect primarily the impact of the additional financing and recent developments in available technical assistance to the MTA.** Likewise, the procurement arrangements will be updated to indicate that the Procurement Regulations for Investment Project Financing (IPF) Borrowers of July 2016, revised in November 2017 and August 2018, will apply to procurement that will be financed under the additional financing loan. The Consultant and Procurement Guidelines[2] will continue to apply to procurement under the parent Project.

4. **The RARP was approved by the Board in July 2017. The IBRD loan (No. 8772) agreement was signed in January 2018, six months following the Board approval, per the Minutes of Negotiations because the parent Project was to be included in Montenegro's budget starting only in 2018.** An initial

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[1] Rajul Awasthi, Hyung Chul Lee, Peter Poulin, et al. The Benefits of Electronic Tax Administration in Developing Economies: A Korean Case Study and Discussion of Key Challenges. (A Collaborative Research Paper of the World Bank and the KDI School of Public Policy and Management). May 2019.

[2] Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers dated January 2011 (revised July 2014) and Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers dated January 2011 (revised July 2014).

allocation of EUR 30,000 was secured in the 2018 budget to start implementation allowing the MTA, the implementing agency, to establish the Project Management Unit (PMU) which was a condition for effectiveness. The IBRD loan became effective in March 2018.

5. **Upon effectiveness, the Ministry of Finance (MOF) communicated its intention to introduce the EFI system before implementing other activities envisaged by the RARP and requested the Bank for this to be included as a new component.** To support the new priorities of the Government of Montenegro, the Bank agreed to fund an EFI feasibility study from RARP loan proceeds. The feasibility study concluded that: (i) it is viable to introduce an EFI system that allows for real-time receipt delivery to MTA; (ii) the optimistic deadlines for the introduction of EFI would require immediate adoption and passing of the relevant law and secondary legislations, as well as the timely launch of procurement processes[3]; (iii) the introduction of an EFI system will require a whole suite of new hardware and software complements; (iv) a phased-approach to implementation should be considered; (v) tax revenues can increase with EFI introduction provided capacities of tax inspectors and better reporting are in place (both of which are covered by the RARP); and (vi) there maybe resistance to the introduction of the new system by existing distributors of fiscal cash registers and small taxpayers whose current registers cannot be adapted to the new system.[4] The Bank generally agreed with the findings of the study. The Bank also concluded that support for the introduction of the EFI would require additional financing as the current financing for the parent Project is fully required to successfully implement the parent Project. To this end, the MOF formally requested in January 2019 the EFI's inclusion under the RARP through additional financing.

6. **The Project is currently rated moderately satisfactory for both implementation progress and prospects for achieving the PDO.** Due to the start-up delay, disbursement remains low at 4.9 percent of the loan and with no significant advances in results indicators. The MTA had to wait for decision on the future of the EFI before initiating a full implementation of the RARP. In this regard, following the delivery of the EFI feasibility study in the summer of 2018, the drafting of the law on the introduction of EFI, and MOF confirmation to include EFI under RARP with additional financing, the MTA initiated Project implementation in the fall of 2018. MTA hired two long-term advisors on Tax Administration and Information Technology (IT) and, subsequently, focused on developing the Inception Report for the RARP.

7. **Implementation has improved following the approval of the Inception Report and its endorsement by the Project Steering Committee in March 2019.** The procurement plan was also updated and approved by the Bank on April 4, 2019.[5] The Inception Report provided for new project milestones, including a provision for a one-year implementation of the IRMS before the current Project closing date of March 31, 2023. The MTA, PMU and Technical Services Unit (TSU), the unit in charge of fiduciary aspects within MOF, are working proactively and intensively to meet these new project milestones.[6]

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[3] Based on experience in Croatia, Slovenia and Czech Republic, it would take 6-9 months from the date of adoption of the law or completion of the procurement for the solution (whichever is later) to start with the implementation.
[4] Montenegro Electronic Fiscal Invoices: Implementation Feasibility Study (July 2018).
[5] Commitments by end-September 2019 are expected to amount to about EUR 1.2 million. Current commitments total EUR 505,283.97 (for PMU staff, perception surveys, VAT gap analysis, EFI feasibility study, IT advisor, change management, and data cleansing). In addition, the contract for the functional requirements development is under negotiations while the bid for quality assurance consultancy is advertised and closing in September 2019.
[6] According to the Inception Report and recently approved Procurement Plan, the most critical commitments of about EUR 10.95 million will be made in FY20 for the IRMS software solution and initial hardware requirement for

II. DESCRIPTION OF ADDITIONAL FINANCING

Context

8. **The Montenegrin economic outlook is positive but fiscal vulnerabilities persist.** Fiscal vulnerabilities primarily come from large publicly financed infrastructure investments that contribute to economic growth while increasing government debt.[7] The combined effects of the heavy debt burden partly due to large-scale public infrastructure investments, untargeted social programs, steady rises in public wages and pensions, and a narrow tax base threaten medium-term fiscal sustainability.

9. **The gradual fiscal consolidation program led to a reduction in the fiscal deficit but higher than initially planned public expenditures are delaying reaching the objective of a balanced budget.** After reaching 5.6 percent in 2017, the overall fiscal deficit declined to 3.8 percent of Gross Domestic Product (GDP) in 2018. This reduction in the deficit was facilitated by fiscal consolidation. Revenue growth was supported by increases in VAT, corporate income tax, and non-tax revenues, while excises revenues dropped. On the expenditure side, spending on social benefits declined but spending on public sector wages and goods and services increased compared to 2017. Despite the declining fiscal deficit, public debt reached 71 percent of GDP in 2018 and public and publicly guaranteed debt at 75.7 percent. [8]

10. **Enhancing policy predictability and accelerating structural reforms is required to reduce downside risks and assure the continued improvement of growth and labor market prospects.** In this regard, the Government has announced reforms in public financing, public administration, the labor market, the business environment, and health sector as well as the continuation of tax and procurement reforms. Successful implementation of these reforms is of utmost importance to achieving sustainable and inclusive growth.[9] With respect to tax reforms, in early 2018, the Government decided to advance additional tax revenue measures including the introduction of EFI, which will inform MTA's compliance control strategies that are being supported under the parent Project.

11. **The EFI will help establish in MTA a comprehensive compliance framework and an effective cross-checking information system.** Specifically, the EFI aims to record electronically all business cash and non-cash transactions to reduce undeclared turnover and income. A flagship initiative of the Prime Minister and the MOF, its high-level objectives are increasing revenue and reducing both the informal economy in the country as well as tax evasion. Together with the parent Project, the EFI would contribute to the goal of macroeconomic and fiscal sustainability articulated in the Montenegro Development

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the IRMS. The rest of the hardware needs for the IRMS are expected to be contracted in FY22 for about EUR 0.8 million. With respect to disbursements, these are projected to amount to EUR 1.8 million (12.85% of the loan) in FY20 and EUR 4.3 million (30.7% of the loan) in FY21. The bulk of the disbursements are expected in FY22 and FY23 consistent with the projected timeline for the IRMS development.

[7] IMF Article IV Consultation. Country Report No. 18/121. (May 2018).

[8] World Bank. Report Number 137090-ME. Montenegro Performance and Learning Review of the FY16-20 Country Partnership Framework. (August 2019).

[9] Ibid.

Directions 2018-2021 (MDD). The EFI and the parent Project are also identified as critical interventions in the MTA's Corporate Strategy for 2019-2022 with its vision of a robust, modern and efficient tax administration. The introduction of EFI was contemplated in the First Policy-Based Guarantee (PBG) Operation on Fiscal and Financial Sector Resilience (P166205, closed April 2019) to be part of the second PBG. It would target increased revenue collection especially from tourism and catering services, as well as reduce VAT compliance costs. In this regard, the enactment of the "Law on Fiscalization for Transaction in Goods and Services" ("EFI Law" approved by Parliament on July 31, 2019) is a prior action under the second PBG operation (P167665) that is under preparation.

12. **During the preparation of the parent Project, several organizational, human resource, and IT challenges that undermine effective performance of the tax administration were identified.** Accordingly, the RARP was designed to support investments required to acquire a modern revenue management IT system and equip the staff with new tools for improving tax registration, collection, audit, enforcement and taxpayer services. Specifically, the RARP was to improve the operational effectiveness of the MTA and reduce the compliance burden of corporate taxpayers. This approach was consistent with Montenegro's Fiscal Strategy for 2017-2020, its Program of Accession to the European Union (EU) 2014-2018 and the MTA's business strategy for 2014-2019. The support provided under the RARP is also aligned with the Bank Group's Country Partnership Framework (CPF) for the period FY2016-2020 (Report No. 105039-ME) and contributes to the CPF's first focus area of enhancing macroeconomic and financial resilience.[10]

13. **Montenegro has an existing model of fiscal invoicing that was introduced in 2001 using electronic fiscal printers/electronic tax registers (otherwise known as fiscal cash registers) to monitor VAT payments on cash transactions.** These registers have a tamper-proof fiscal memory and are certified but are not electronically connected to the MTA.[11] The current model is considered complex, outdated, limited to cash transactions, and does not fully support quality monitoring, reporting and risk analysis. In addition, the large size of the gray economy remains a concern. According to the latest available Survey on the Conditions for Doing Business for Companies and Entrepreneurs in Montenegro that was conducted in late 2014, 38.4% of Montenegrin economic operators were engaged in gray economy activities.[12] Moreover, MTA identified that avoiding tax obligations (through use of cash and not reporting of sales revenues and fraudulent invoicing), observed in both retail sales (B2C) and wholesale transactions (B2B), is due to unavailability of detailed transaction and turnover information necessary to control and prevent such practices. This undermines operational effectiveness of tax administration and efforts to cut compliance costs of taxpayers as well as reduces public trust in the revenue collection system.

14. **As envisaged under Article 2 of the EFI Law, "Fiscalization [or EFI] shall mean a procedure carried out by persons liable of fiscalization for cash and cashless payments by submitting data on transactions in goods and services and fiscal invoices in real time, using permanent internet connection and a fiscal service to the administration authority competent for public revenues collection affair . . ."** It requires the taxpayer to issue an invoice/receipt to a customer after MTA has recorded and verified the correctness of the receipt electronically and in real time. This will allow MTA to track both cash and non-cash

[10] World Bank. Report Number 105039-ME. Country Partnership Framework for Montenegro for the period FY2016-2020 (May 16, 2016).
[11] Data on transactions is transmitted at the end of the working day and there is no 24/7 connection with the MTA.
[12] Montenegro Electronic Fiscal Invoices Implementation Feasibility Study (2018).

transactions in real time and thus enable it to take corrective action as necessary. It includes the following features:[13]

a. service for exchanging messages in electronic fiscal invoicing of cash and non-cash payments;
b. public mobile and web application for verification of whether a receipt has been filed with the MOF, MTA, which may be done by the customer or another receipt recipient;
c. public web application for verification of whether a receipt has been filed with the MOF, MTA, which may be done by the customer or another receipt recipient tax;
d. web application for tax officials allowing them to verify fiscal invoicing in real-time;
e. register of fiscalization obligors;
f. register of taxpayers' business premises;
g. web application for registered certified invoice books for MTA officials;
h. reporting system; and
i. portal for e-oversight, risk analysis, audit and management.

Scope of Additional Financing

15. **With the enactment of the EFI Law on July 31, 2019 ("Official Gazette of the Republic of Montenegro" 33/19-2/15, August 7, 2019), and to facilitate the launch of an EFI system in early 2020, the MOF requested World Bank assistance to implement an EFI system as a new component under the RARP through a restructuring and additional financing of EUR 4.8 million (US$ 5.306 million equivalent, including front-end fee).** The EFI component is proposed to support the requirements of the MTA in developing and implementing an EFI system which will include software, hardware, consultancy services, and training/workshops. This new component will support the MTA to develop and implement an EFI system through, *inter alia*:

a. customization of a solution for an EFI system and its implementation;
b. procurement of the hardware and complementary software and licenses necessary for the implementation of the EFI system;
c. integration of the EFI system with other MTA systems including the IRMS;
d. consultancy services to support the MTA in monitoring and quality compliance; and
e. training of the MTA staff to implement the EFI system.

16. **The additional financing will not fund the preparation of secondary legislation, registers of fiscalization obligors and taxpayers' business premises and the public outreach campaign.** The readiness of secondary legislation and the registries as well as the communication outreach to taxpayers and the public are being pursued and financed by the Government as part of preparation for the additional financing. With respect to the secondary legislations, required adjustments to the legal framework related to the "Law on Electronic Identification and Electronic Signatures" have been finalized by the Ministry of Public Administration (MPA), as the responsible authority for digital certificates. The proposed amendments to the Law on Electronic Signature have been submitted to the legislative secretariat and are expected to be approved by the Government in September, and thereafter by the Parliament. In

[13] Montenegro Ministry of Finance. Request for Bid: Procurement of *System for on line electronic fiscalization of cash and non-cash transactions in real time in Montenegro* (August 2019).

addition, the MPA will launch the procurement process for a web-based certificate management system which will allow for issuance of required digital certificates for EFI. In parallel, the MTA is progressing in conducting an inventory of fiscalization obligors and taxpayers' business premises. The MOF also led initial public discussion and outreach campaign through consultations with businesses, as part of the process of consulting on the EFI Law and will continue to do so in developing the secondary legislations. A broader public outreach campaign will also be launched in September to facilitate EFI implementation in early 2020.[14]

17. **With the new EFI component, the Project remains aligned with and relevant to the Government's Fiscal Strategy, Program of Accession to the EU, updated corporate strategy of the MTA (2019-2022) and the CPF (Report No. 105039-ME) as discussed above.** Moreover, the Project now directly complements the two Fiscal and Financial Resilience PBG's by helping to ensure the implementation of a prior action.

18. **The PDO will not be revised with this proposed new component and will be implemented using existing institutional arrangements.** The additional financing will be implemented under the existing institutional arrangements with the PMU at the MTA for overall project implementation and TSU at the MOF providing fiduciary services. Consistent with the existing implementation arrangements, wherein working groups have been established in MTA for each specific activity, a new working group has been established for the EFI component.[15] This working group, led by MTA, is composed of staff from MTA and MOF and builds on the existing working group established by MOF to facilitate EFI implementation. Other critical stakeholders will be consulted on an as needed basis. In addition, to support the EFI project manager who will be supervising the EFI contract, the Project will finance an advisor who will support monitoring and quality compliance of the EFI implementation. The Project Operational Manual (POM) has been updated accordingly.

19. **Revisions will be introduced to the results framework, components and costs, technical and economic analysis.** Likewise, the procurement arrangements will be updated as well as the discussion on risks. In addition, the loan agreement (IBRD No. 8722) for the parent Project will be amended to align it with the additional financing to exclude financing of VAT under the loans.

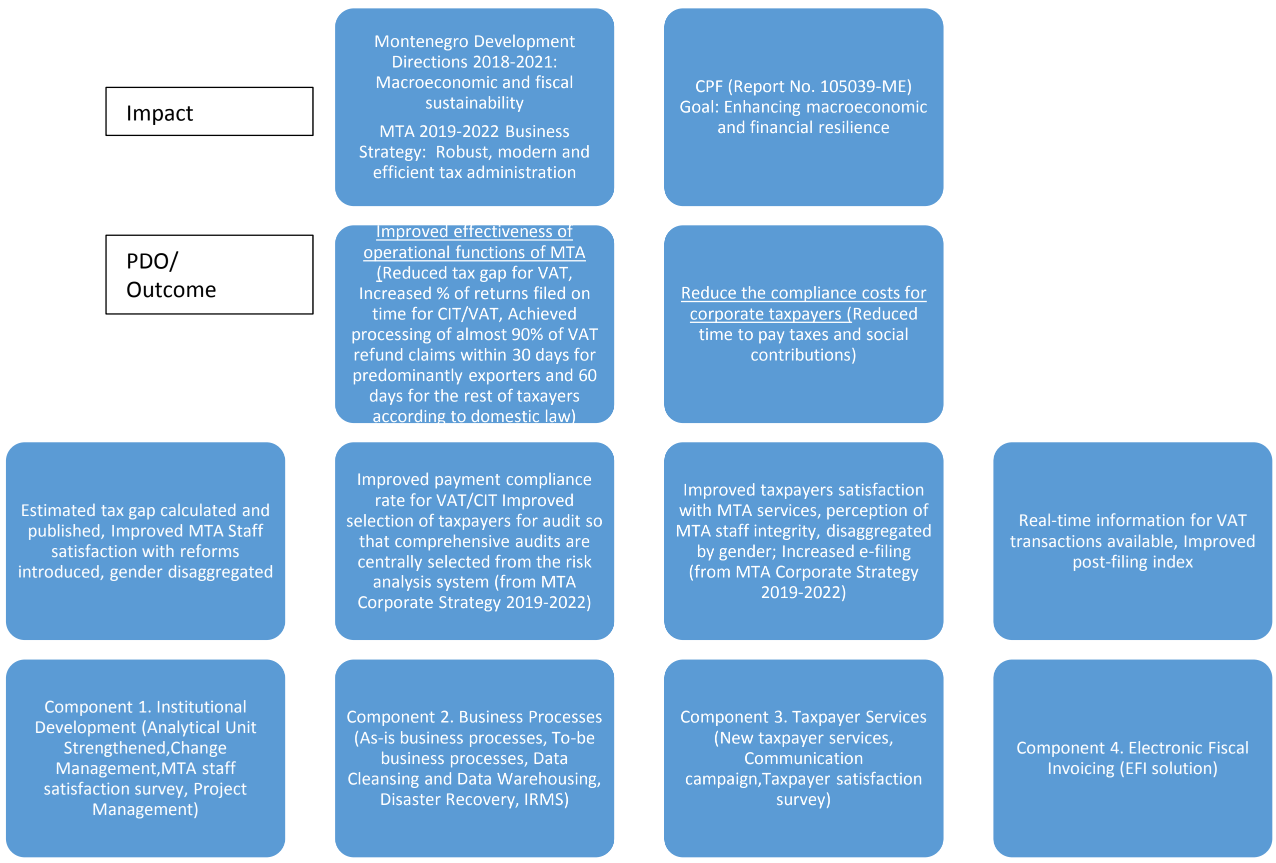
Results Framework/Benefits of the Additional Financing

20. **The EFI component will enhance the development impact of the RARP.** The implementation of an EFI system is expected to contribute to the existing PDO of improving effectiveness of operational functions of Montenegro's tax administration and reducing the compliance costs for corporate taxpayers. Specifically, the EFI system will help improve the effectiveness of MTA's operations by facilitating the collection of real-time and high-quality data enabling better oversight of taxpayers and improved statistical reporting and analysis. In addition, EFI will limit options for VAT evasion and manipulations of fiscal invoices since every fiscal invoice will be registered and approved by the MTA prior to the completion of fiscal transaction. In addition, meddling with cash registers to revoke fiscal invoices will not be possible. Over time and once the corporate taxpayers have absorbed the initial necessary adjustments related to

[14] Preliminary terms of reference for the public campaign has been shared with the Bank for comments.
[15] MTA Decision No. 03/1-20102/1-19 dated September 2, 2019.

the introduction of the EFI (i.e., reengineering sales processes, software adjustments and/or purchase and registration of cash registers/equipment), the compliance costs for corporate taxpayers are also expected to decrease through simplification of accessory tax obligations and reduction of costs for preparing tax filing. This was observed in other countries that have adopted EFI (e.g., Brazil, Korea).

Figure 1: RARP: Theory of Change



21. **The proposed additional financing will require revisions to the Theory of Change and results framework to include the contributions of the EFI component.** In addition, it will add new results indicators to better capture the linkages between Project activities and expected results, as well as recalibrate target values for current indicators.[16] The revised results framework is presented in Section VIII. The revised Theory of Change for the Project is presented in Figure 1.

Change to Components and Project Costs

22. **Apart from the introduction of a new component for EFI, there are no changes in the existing component descriptions.** However, informed by the March 2019 Inception Report on the RARP, the required inputs have changed for components 1 and 2 due to MTA's preference to use grant funded-

[16]Given start-up delay.

technical assistance, that was not available during the preparation of the parent Project, as well as increased reliance on internal resources and expertise.

23. **Under component 1 (Institutional Development), the RARP will no longer finance the use of external consultancies for strategic focus and planning capacity and staff management and training since MTA is benefiting directly from grant-funded technical assistance from the International Monetary Fund (IMF) and the EU under its Instrument for Pre-Accession Assistance Project in these areas.** The RARP will now complement and support this technical assistance with study tours on said topics to enhance in-house knowledge on international best practices and workshops/consultations within MTA to build consensus and increase ownership for the RARP.

24. **Under component 2 (Business Process), instead of relying heavily on external consultants to conduct the analysis to inform modernization of the revenue administration, MTA has decided to take greater ownership of the Project.** This has been ensured through greater reliance on its own staff to conduct an analysis of the "as-is" state of current processes, with technical advisors facilitating the process and providing necessary guidance on how to set "to-be" business processes consistent with international standards and good practices. Likewise, specialized external consultants will be hired for very specific and highly technical areas (e.g., risk analysis, inspections based on applications for VAT refund, transfer pricing and e-inspection), to serve as process moderators (e.g., in the case of data cleansing and rationalization), and to provide quality assurance in the development and implementation of the IRMS. The RARP proceeds will also be utilized to finance study tours to countries with similar tax administration regimes to help inform MTA's decision on the "to-be" or future business processes. This will help to inform the functional and non-functional requirements and preparations of technical specifications for the development of the IRMS which will be supported by an international consultancy firm[17]. With respect to the development of the IRMS, MTA's approach is to engage a consultancy firm to provide external validation and quality assurance support in the process, particularly to ensure compliance with the legislation, security policies and standard procedures for data protection, as well as with the best practices. Engaging a quality assurance consultant is a good practice adopted by the Project not seen in similar projects, that should serve the MTA well given the complexity of planned investments.[18]

25. **In terms of costs, in addition to the new component that will support the development and implementation of the EFI, the proposed additional financing will also revise the costs of other Project components.** These revisions are done in line with the changes in Project inputs per the Inception Report as discussed above, including the availability of grant-financing from the IMF and EU. The budget estimates for the IRMS software development were also increased considering recent procurement results of similar solutions in other countries.

26. **Consequently, the funding requirements for the institutional development component (Component 1) was significantly reduced.** On the other hand, the funding requirements for business processes component (Component 2) increased significantly with the set-aside for contingency allocation now fully absorbed under this component. Table 1 presents the new Project cost per component.

[17] Contract to be signed in September 2019.
[18] Bid has been launched and closing in September 2019.

Table 1: Project Costs Per Component

Components	Original Costs (EUR M)	Revised Costs (EUR M)
Institutional Development	2.12	1.226
Business Processes	10.29	12.528
Taxpayer Services	0.29	0.21
EFI	0	4.78
Contingencies	1.27	0
Total Project Costs	13.97	18.75
Front-end Fee	.03	.048
Total Financing Required	14	18.8
Of which disbursed as end-FY19	0.645 (or USD 0.78 million, 4.9% of the IBRD loan)	

Other Changes

27. The restructuring will also require an amendment to the loan agreement (IBRD No. 8722) for the parent Project to exclude financing of VAT under the loan, to align arrangements with the additional financing and ensure adequate financing for the IRMS. It is noted that the Project Appraisal Document of the parent Project (Report No. PAD 1119) contemplated a potential request for additional financing from Montenegrin authorities in the event the costs of the acquisition of IRMS software and hardware exceed initial estimates.

III. KEY RISKS

28. **The overall risk, rated Substantial, and individual risk categories of the Project, is maintained with the additional financing, except for the risk on institutional capacity, which is now rated high.**

a. **Macroeconomic risk remains Substantial due to external and internal factors.** Montenegro is vulnerable to a slowdown in capital inflows, weak export demand, lower remittances, and thus growth, that may increase debt service requirements over the medium term in a volatile financing environment. Among emerging domestic risks are delays in implementation of structural reforms, further motorway cost overruns, the vulnerability of some smaller banks, and possible pressures on public spending in the run-up to the 2020 elections. The on-going fiscal consolidation and strong Government commitment to implement critical structural reforms including the digitization and modernization of tax administration with IRMS and EFI could help mitigate the risk with the expected positive impact on contribution to increasing revenue collection.
b. **Technical design risk remains Substantial.** Technical risks are related to the design and implementation of the IRMS and EFI Systems. The overall Project provides for the implementation of a commercial off-the-shelf (COTS) solution for both IRMS and EFI. Both are complex undertakings and pose risks related to the capacity of the MTA to manage and implement them. To mitigate technical design risk, the Project provides for the contracting of international

specialists (including advisors for IT and external quality assurance focused on IRMS) and an advisor focused solely on EFI.

c. **The high risk related to institutional capacity is due to capacities in MTA being overstretched and the tight implementation schedule.** In this regard, while the implementation of the EFI component along with the larger IRMS will strain MTA capacity, the establishment of a working group on EFI, hiring of an additional advisor in the MTA solely focused on the EFI, and training of EFI staff on EFI are proposed to mitigate the risk. It is noted that establishment of working groups within MTA for the activities under the parent Project has built ownership for the RARP within the organization. Another implementation risk relates to the tight schedule with the MOF aiming to roll-out the EFI by early 2020. To support this, the Bank agreed to advance procurement processes and issued the no objection on August 11, 2019 for the request for bid (RFB), that was promptly published by the TSU on August 12, 2019.[19] However, the Bank's "no objection" to proceed with the signing of the contract for the EFI solution is contingent on the approval by the Bank's Board of Executive Directors and signing of the Loan Agreement for the additional financing. Moreover, continued intensive collaboration among the MOF, MTA, PMU, TSU and the Bank is necessary to ensure successful procurement within an ambitious and tight timeframe for the EFI while ensuring sustained progress under the RARP in developing and deploying the IRMS within the current Project timeframe. Further, the Bank will provide training to the bid evaluation committee for the EFI procurement. Moreover, the MOF issued a resolution establishing a working group led by MOF and composed of MPA and MTA officials to closely oversee and ensure coordination, across all concerned agencies, the timely and satisfactory implementation of the EFI.[20]

d. **The risks related to resistance to change by internal and external stakeholders remain the same at moderate**. Likewise, mitigation measures remain the same and include change management, a targeted communications campaign and building constituencies for reform. For example, the Nota Carioca (i.e., the City of Rio de Janeiro EFI System) case should be considered. In the city of Rio de Janeiro, "Private sector allies in the business community were instrumental in encouraging participation of business owners".[21] In particular, the Accountants Union and the Commercial Association of Rio the Janeiro conducted meetings with business owners on the new system and this approach was most effective for addressing concerns of small cash-based businesses. In this regard, the MOF has lined up consultation sessions with businesses in developing the rulebooks/secondary legislations for EFI to facilitate readiness for implementation of the businesses and affected taxpayers. Support for small businesses/operators are also being considered to manage resistance with respect to the initial cost of the required EFI-compliant equipment. MOF and MTA will also launch intensive communication campaigns aimed at taxpayers to comply with the EFI law and the general public to encourage requesting for and reporting of invoices received; thereby, supporting successful implementation of the EFI.

[19] https://www.devbusiness.com/ProjectViewer.aspx?ProjectID=208285&ProjectType=1
[20] MOF Resolution No. 01-13240/1 dated August 28, 2019.
[21] Neil Fowler. "How Rio de Janeiro Used an Electronic Invoicing Program and the Participation of Stakeholders to Streamline and Increase Service-Tax Collection". Global Delivery Initiative Case Study (October 2015).

IV. APPRAISAL SUMMARY

A. Economic and Financial Analysis

29. **Regarding economic benefits, several studies confirm that the introduction of EFI does help increase revenues and reduce compliance costs.** In the case of Nota Carioca, it appeared to have contributed to increasing revenues in some sectors and increasing the tax base with the addition of smaller businesses.[22] In the case of Korea, the introduction of compulsory EFI (or Electronic Tax Invoicing) that the government adopted in 2011 enabled taxpayers and the tax authority to achieve substantial costs savings and contributed to improving tax compliance, transparency of business transactions and taxpayer service.[23] The IMF Working Paper WP/15/73 on electronic fiscal devices (EFDs) indicate that increases in revenue from the introduction of EFDs cannot be solely attributed to EFDs but is a combined effect of EFDs and complementary compliance strategies.[24] This reinforces the importance of incorporating the EFI component into the parent Project.

30. **With respect to reducing the grey economy, the December 2014 report published by the Montenegrin Employers Federation (MEF) indicate that the "Key causes of grey economy in Montenegro, according to MEF's findings are: weak rule of law, inadequate regulatory framework, implementation of policies and laws which is not efficient and effective enough, and relatively high business costs."**[25] Vis-à-vis these causes, the overall Project with the combination of IRMS, EFI and modernization of the MTA, which are intended to improve operational effectiveness of tax administration and reduce compliance costs could help reduce the grey economy by addressing some of the key causes.

31. **The original cost benefit analysis performed for the parent Project in 2017 has shown both financial (i.e. Financial Net Present Value, NPV, of EUR 343 million and Financial Internal Rate of Return, FIRR of 96 percent) and economic (i.e. Economic NPV of EUR 113.6 million and Economic Internal Rate of Return, EIRR of 95 percent) viability of the Project.** Based on the cost benefit analysis for the additional financing for EFI, the economic NPV of the EFI component is EUR 7.2 million while the EIRR is 64 percent, which confirms that the additional financing is viable. Likewise, the financial analysis shows that EFI implementation is viable from the financial perspective, as the financial NPV is positive at EUR 42.5 million while FIRR is 567.4 percent. For a detailed economic and financial analysis of the EFI component, please refer to Annex 1.

B. Technical

32. **Regarding technical aspects, incorporating the EFI into the parent Project, which was the agreed approach with the MOF to ensure complementarity between IRMS and EFI, is consistent with the main**

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[22] Ibid.

[23] Hyung Chul Lee. "Can Electronic Tax Invoicing Improve Tax Compliance? A Case Study of the Republic of Korea's Electronic Tax Invoicing for Value-Added Tax" World Bank Policy Research Working Paper 7592 (March 2016).

[24] Peter Casey and Patricio Castro. IMF Working Paper on Electronic Fiscal Devices: An Empirical Study of their Impact on Taxpayer Compliance and Administrative Efficiency. (WP/15/73)

[25] MEF and Dr Vasilije Kostic. Report: Informal Economy in Montenegro – The Enabling Environment for Sustainable Enterprises in Montenegro. MEF. (December 2014).

conclusion of the IMF Working Paper WP/15/73 on electronic fiscal devices (EFDs). The paper states: "the implementation of EFDs can only be effective if it is a part of a comprehensive compliance improvement strategy that clearly identifies risks for the different segments of taxpayers and envisages implementing a set of measures to mitigate the risks"[26]. The IMF Working Paper also confirms the introduction of EFDs do provide opportunities for improving tax compliance approaches and strategies. It also emphasizes the importance of effective follow-up and enforcement, which are areas being addressed under the institutional development component of RARP.

33. **Moreover, the Bank agreed with the Government that the most practical approach would be to procure a COTS solution that can be customized for Montenegro given the Government's ambitious timeline of launching the EFI in January 2020.** A phased-implementation, as envisaged in the Government's technical specifications for EFI and proposed in the EFI feasibility study, is the most practical approach and would be beneficial to enable adjustments to the software and allow adequate time for smaller businesses to prepare. This is consistent with successful implementation of EFI in other countries. It is noted that in the case of the Nota Carioca, the city initiated the EFI implementation with voluntary compliance and thereafter mandatory requirement was phased in.[27] The Croatia model, that covered cash transactions only and served as the inspiration for Montenegro's EFI, was implemented in three stages. (See Box 1.)

Box 1:Implementation of Cash Transaction Fiscalization Procedure in Businesses: Case of Croatia

Implementation of Cash Transaction Fiscalization Procedure in Businesses: Case of Croatia
(Alenka Tot and Kristina Detelj. Paper Presented at the Central European Conference on Information and Intelligent Systems, September 14-17, 2014)

"Fiscalization was implemented through three stages in which different subjects had to start issuing invoices under the fiscalization process [11]. The first phase began on January 1st, 2013 for all the medium-sized and large businesses, and for small business dealing with accommodation and food service activities. The second phase began on April 1st 2013 for the obligors from wholesale and retail trade, repair of motor vehicles and motorcycles as well as for the independent professions (freelancers, veterinarians, lawyers, writers, athletes, journalists, notaries, auditors, architects, lawyers, tourism professionals, translators, tax advisors, etc.). The third and final phase beginning July 1st 2013 obliged all the other businesses that collect their revenue in cash and have not been previously included in the fiscalization [11]".

[11] PU, "Fiscalization obligation" [in Croatian]. Tax administration, 2013.

34. **With respect to technical capacity to implement, a working group has been established to focus on the EFI implementation.** It would build on a previous working group convened by MOF for defining the EFI's technical specifications. An additional advisor within the PMU will be hired to support the EFI

[26] Op cit.
[27] Neil Fowler. "How Rio de Janeiro Used an Electronic Invoicing Program and the Participation of Stakeholders to Streamline and Increase Service-Tax Collection". Global Delivery Initiative Case Study (October 2015).

project manager who has been appointed by MTA for EFI contract management[28]. The advisor will support monitoring and quality compliance. In addition, training of MTA staff to use the EFI system will be conducted.

C. Financial Management

35. **The financial management arrangements for the parent Project will be adopted for the additional financing.** The MTA is the implementing agency with a PMU which is led by a Project Manager. The MTA prepares project budgets, bidding documents in coordination with Working Groups, evaluation reports, and ensures compliance with the World Bank Financial Management and reporting requirements. The TSU within the MOF 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. Internal controls and procedures designed for the original loan and also detailed in the POM will be applied. Planning and budgeting for the project will be a process led by the MTA, with support from the PMU and TSU. Financial management performance of the parent project is satisfactory and fiduciary risks are rated moderate.

36. **In line with the parent Project, additional financing funds will be disbursed either as an advance, via a Designated Account, or by direct payment, on the basis of withdrawal applications.** Reimbursement will also be allowed disbursement method. Funds will be withdrawn to the Designated Account, up to the ceiling amount that will be described in the disbursement and financial information letter, through withdrawal applications signed by the authorized signatories. Funds from the original loan and additional financing will be pooled in the same designated account opened for the original loan. The project annual financial statements will be audited by independent auditors acceptable to the World Bank and based on terms of reference 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. IFRs and annual project financial statements will represent consolidated reports for both sources of financing, i.e., the original loan and the additional financing.

D. Procurement

37. **As per Bank policy, the Procurement Regulations for Investment Project Financing (IPF) Borrowers of July 2016, revised in November 2017 and August 2018, will apply to procurement that will be financed under the additional financing loan.** The Consultant and Procurement Guidelines[29] will continue to apply to procurement under the parent Project.

38. **In line with the parent Project, MTA/PMU will continue to provide the technical inputs in the preparation (e.g., technical specifications) and evaluation of bids, contract management, and overall project implementation for activities financed under the additional financing.** Also, the TSU will continue to be responsible for fiduciary aspects. The TSU has sufficient capacity and adequate procurement

[28] MTA Decision No. 03/1-19865/1-19 dated September 2, 2019.

[29] Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers dated January 2011 (revised July 2014) and Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers dated January 2011 (revised July 2014).

knowledge and experience in fiduciary aspect of the project. Current procurement performance is rated satisfactory. While the Bank has already provided training to the TSU on the new procurement regulations, additional training is recommended and will be provided by the Bank team. Likewise, given the complexity of the procurement, training for members of the bid evaluation committee for the EFI procurement package will be conducted before the deadline for bid submission in September 2019.

39. **The Project Procurement Strategy Document (PPSD) for the additional financing has been prepared by the TSU and PMU and approved by the Bank.** Based on the market analysis, an international tender is recommended for the procurement of the software and hardware inputs required to implement the new EFI component. Moreover, given the Government's implementation timeline, Advanced Procurement has been used with prior approval of the Bank. On August 11, 2019, the Bank issued its no objection to the RFB for a single stage, one-envelope bidding process. The contract for the EFI implementation can only be signed after the signing of the Loan Agreement for the additional financing.

E. Social (including Safeguards)

40. **No social safeguard issues have been identified with the additional financing for the project.**

41. **Existing arrangements for enhancing citizen engagement in the Project will be strengthened with:**

a. satisfaction surveys to be conducted annually to capture taxpayers and MTA staff satisfaction with the modernization and digitalization of the MTA (the first satisfaction surveys of taxpayers and MTA staff were launched in June 2019 and the baseline values are expected to be available in the fall of 2019);
b. annual multi-stakeholder consultations through the Project's Revenue Modernization Advisory Board, which include several taxpayers' representatives and therefore enabling participatory approach in decision-making, will serve as platform to: (i) present and discuss satisfaction survey results and consider taxpayers' concerns, (ii) explain how feedback was addressed and which actions have been taken, and (iii) better inform the Project's implementation approach; and
c. MTA working groups enabling participatory approach in decision-making and implementation by taking into consideration results from the taxpayers and MTA staff satisfaction surveys and recommendations from the Revenue Modernization Advisory Board.

With these mechanisms, the Project complies with the Citizen Engagement/Beneficiary Feedback Indicator Commitments under the CPF (Report No. 105039-ME).

42. **The Project is not gender tagged.** Nevertheless, reporting on satisfaction of taxpayers and MTA staff will continue to be disaggregated by gender to discern if there is a need to adjust and differentiate Project implementation approaches.

F. Environment (including Safeguards)

43. **No safeguard issues have been identified with the additional financing for the project and there are no changes to the environmental assessment category.** With the additional financing, the Project's

Environmental Assessment category rating will remain C.

44. **Project design provides adaptation opportunities in e-governance through data infrastructure that incorporates data recovery and back-up in the event of natural disasters or climate-related extreme events.** In terms of mitigation opportunities, the Project will contribute to a reduction of energy consumption through utilization of modern and energy-efficient IT equipment. Also, given that all transactions will already be recorded by the MTA, the VAT appeals procedure will be improved and tax payers would not have to travel to MTA field offices which would result in reduced fossil fuel consumption.

45. **The climate and disaster risk screening conducted as part of the additional financing preparation concluded that there is low risk to the implementation of the EFI.** As discussed in the CPF (Report No. 105039-ME), like other Balkan countries, Montenegro is particularly sensitive to climate and precipitation change, with weather related events becoming more frequent and intense, including increased risks of urban and river flooding as well as extreme heat events that may affect IT infrastructure. The project seeks to address this vulnerability through some of its proposed interventions. Specifically, the IT investments' vulnerability will be addressed through proper installation in climate controlled and flood-safe locations. As such, the residual climate and disaster risks on the Project's expected outcome are anticipated to be low and negligible.

Other Safeguard Policies (if applicable)

46. **Not applicable.**

V. WORLD BANK GRIEVANCE REDRESS

47. **Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB'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 WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB 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 Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit *www.inspectionpanel.org*

VI SUMMARY TABLE OF CHANGES

	Changed	Not Changed
Results Framework	✔	
Components and Cost	✔	
Procurement	✔	
Implementing Agency		✔
Project's Development Objectives		✔
Loan Closing Date(s)		✔
Cancellations Proposed		✔
Reallocation between Disbursement Categories		✔
Disbursements Arrangements		✔
Safeguard Policies Triggered		✔
EA category		✔
Legal Covenants		✔
Institutional Arrangements		✔
Financial Management		✔
APA Reliance		✔

VII DETAILED CHANGE(S)

COMPONENTS

Current Component Name	Current Cost (US$, millions)	Action	Proposed Component Name	Proposed Cost (US$, millions)
	0.00	New	Electronic Fiscal Invoicing	5.30
Institutional Development	2.61	Revised	Institutional Development	1.35
Business Processes	12.69	Revised	Business Processes	13.85
Taxpayer Services	0.36	Revised	Taxpayer Services	0.23

TOTAL	15.66			20.73

Expected Disbursements (in US$)

Fiscal Year	Annual	Cumulative
0000	0.00	0.00
2017	0.00	0.00
2018	610,475.00	610,475.00
2019	124,879.29	735,354.29
2020	4,750,000.00	5,485,354.29
2021	7,290,000.00	12,775,354.29
2022	5,510,000.00	18,285,354.29
2023	2,500,000.00	20,785,354.29

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Latest ISR Rating	Current Rating
Political and Governance	Moderate	Moderate
Macroeconomic	Substantial	Substantial
Sector Strategies and Policies	Moderate	Moderate
Technical Design of Project or Program	Substantial	Substantial
Institutional Capacity for Implementation and Sustainability	Substantial	High
Fiduciary	Moderate	Moderate
Environment and Social	Low	Low
Stakeholders	Moderate	Moderate
Other		
Overall	Substantial	Substantial

LEGAL COVENANTS – Additional Financing for the Montenegro Revenue Administration Reform Project (P170454)

Sections and Description
No information available

Conditions

VIII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY: Montenegro
Additional Financing for the Montenegro Revenue Administration Reform Project

Project 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.

Project Development Objective Indicators by Objectives/ Outcomes

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Improve effectiveness of operational functions of MTA *(Action: This Objective has been Revised)*							
Tax Gap for VAT (Text)		No methodology for Tax Gap for VAT estimation	No methodology	VAT Gap methodology adopted	Tax Gap for VAT reported using Methodology adopted in 2019 - baseline established	3% reduction in Tax Gap for VAT compared to value established in 2020 as baseline	6% reduction in Tax Gap for VAT compared to 2020 value

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Action: This indicator has been Revised	***Rationale:*** ***Delete proxy and provide current information based on consultancy on VAT Gap analysis.***						
Percentage of tax returns filed on time (Text)		VAT: 82; CIT: 89	VAT: 82; CIT: 89	VAT: 82; CIT: 89	VAT: 86; CIT: 89	VAT: 90; CIT: 94	VAT: 92; CIT: 96
Action: This indicator has been Revised	***Rationale:*** ***Slipped target values for CIT to align with IRMS implementation.***						
Achieved processing of almost 90% of VAT refund claims within 30 days for predominantly exporters and 60 days for the rest of the taxpayers according to domestic law (Text)		Exporters: 70%; Rest: 65%	Exporters: 70%; Rest: 65%	Exporters: 75%; Rest: 70%	Exporters: 80%; Rest: 75%	Exporters: 85%; Rest: 80%	Exporters: 88%; Rest: 85%
Action: This indicator is New	***Rationale:*** ***To reflect the value added of the additional financing (i.e. EFI component) to the project outcome***						
Reduce compliance costs for corporate taxpayers *(Action: This Objective is New)*							
Time it takes to pay taxes and social contributions (Hours)		314.00	314.00	310.00	280.00	250.00	200.00
Action: This indicator has been Revised	***Rationale:*** ***The target values are not revised. The revision is simply to complete information requirements of the results framework template.***						

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Institutional Development							
MTA staff satisfaction with the new skills and ability to apply them, disaggregated by gender (Text)		No baseline	No survey conducted	First survey conducted in 2019 and baseline established	Increase by 5% compared to baseline established in 2019	Increase by 7% compared to baseline established in 2019	Increase by 10% compared to baseline established in 2019
Action: This indicator has been Revised	***Rationale:*** ***Revised to delete proxy and reflect current situation.***						
Estimated tax gap is calculated annually and suitable for publication by year 5 (Text)		No	No	No	Yes	Yes	Yes (with publication)
Action: This indicator has been Revised	***Rationale:*** ***Target values updated in line with actual implementation. Likewise, specified in the indicator formulation that publication of tax gap estimate will be made in year 5.***						
Business Processes							
Payment compliance rate for VAT (Percentage)		62.00	62.00	62.00	80.00	84.00	87.00
Action: This indicator has been Revised	***Rationale:*** ***The revision introduced is to clarify in the definition that this refers to VAT and not all revenues. Likewise, the revision completed information requirements of the results framework template.***						
Payment compliance rate for CIT (Percentage)		81.00	81.00	81.00	86.00	91.00	93.00
Action: This indicator has been Revised	***Rationale:*** ***The revision is to advance the end-target value and align with Montenegro CPF indicators. Likewise, the definition of the indicator was clarified to only refer***						

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
	to CIT and not all revenues.						
Improved selection of taxpayers for audit so that comprehensive audits are centrally selected from the risk analysis system (Text)		no comprehensive audit centrally selected from risk analysis system	no change from baseline	no change from baseline	15% of comprehensive audits centrally selected from risk analysis system	60% of comprehensive audits centrally selected from risk analysis system	75% of comprehensive audits selected centrally from risk analysis system
Action: This indicator is New	***Rationale:*** ***To reflect value-added of IRMS from the supply side***						
Taxpayer Services							
Taxpayers satisfaction with MTA's quality of taxpayers services and integrity of MTA staff, disaggregated by gender (Text)		No baseline	No survey conducted	Survey conducted and baseline established	Increase by 5% compared to baseline established in 2019	Increase by 7% compared to baseline established in 2019	Increase by 10% compared to baseline established in 2019
Action: This indicator has been Revised	***Rationale:*** ***Deleted proxy and reflected current status of implementation.***						
Increased e-filing for VAT (Percentage)		75.00	75.00	75.00	80.00	90.00	95.00
Action: This indicator is New	***Rationale:*** ***To reflect value-added of activities to improve taxpayer services that is not just perception based.***						
Electronic Fiscal Invoicing (EFI) ***(Action: This Component is New)***							
Improved post filing index (Text)		70.49	70.49	70.49	increased by 4% from baseline	increased by 6% from baseline	increased by 8% from baseline

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Action: This indicator is New	***Rationale:*** ***To reflect the value added of the EFI component***						
Real-time information for VAT transactions available to MTA (Text)		no real time EFI system in place	Draft EFI law submitted to Parliament	EFI law enacted, contract signed and under implementation	EFI system available 99.5% of the time for all cash transactions	EFI System available 99.5% of the time for all cash transactions	EFI system available 99.5% of the time for all transactions
Action: This indicator is New	***Rationale:*** ***To monitor availability of the EFI solution and ensure it functions as envisaged***						

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Tax Gap for VAT	Measures difference between total amounts of VAT owed to the Government vs amount actually received	Annual	Monstat data and MTA estimates based on tax gap methodol ogy developed in 2019	Methodology to be developed in 2019	MTA unit for planning and reporting
Percentage of tax returns filed on time	Number of returns filed on time as percentage to the total number of returns for VAT and CIT	Annual	MTA data/perform ance indicators	MTA standard methodology	MTA collection and IT department

Achieved processing of almost 90% of VAT refund claims within 30 days for predominantly exporters and 60 days for the rest of the taxpayers according to domestic law	Percentage of VAT refund claims processed according to domestic law.	Annual	MTA data/report on realized activities from reform plan	MTA methodology	MTA unit for planning and reporting
Time it takes to pay taxes and social contributions	Number of hours it takes to comply with tax and social security legislation	Annual	Doing Business data	Doing Business standard methodology	MTA, PMU

Monitoring & Evaluation Plan: Intermediate Results Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
MTA staff satisfaction with the new skills and ability to apply them, disaggregated by gender	Baseline established in 2019	Annual	Surveys conducted annually from 2019	Perception surveys	MTA/PMU
Estimated tax gap is calculated annually and suitable for publication by year 5	Measures ability of MTA to calculate the tax gap	Annual	Monstat data and MTA's estimates based on tax gap methodology developed in 2019	Internal procedures/methodolog y to be developed in 2019 by MTA	MTA unit for planning and reporting
Payment compliance rate for VAT	Percentage of VAT paid on time to total VAT declared during the year	Annual	MTA's performance indicators/Dat	MTA methodology	MTA Collection and IT Department

			e from EFI		
Payment compliance rate for CIT	CIT paid on time to total CIT declared during the year	Annual	MTA's Performance Indicators	MTA methodology	MTA Collection and IT Department
Improved selection of taxpayers for audit so that comprehensive audits are centrally selected from the risk analysis system	Measures improvement in selection of taxpayers and consistent with the MTA Corporate Strategy 2019-2022. Risk analysis system refer to the combined impact of EFI, data warehouse, BI and IRMS.	Annual	MTA's Performance indicators, Report on realized activities from reform plan	MTA Methodology	MTA unit for planning and reporting and IT Department
Taxpayers satisfaction with MTA's quality of taxpayers services and integrity of MTA staff, disaggregated by gender	Baseline to be established in 2019	Annual	Surveys condu cted annually from 2019	Perception surveys	MTA/PMU
Increased e-filing for VAT	Measures increase in e-filing for VAT consistent with MTA Corporate Strategy 2019-2022.	Annual	MTA's performance indicators, report on realized activities from reform plan	MTA Methodology	MTA IT Department (Tax Returns and Processing Unit)
Improved post filing index	Measures reduction in tax compliance cost which is based on four components: time to comply with VAT refund, time to obtain VAT refund, time to comply	Annual	Doing Business data	Doing Business methodology	MTA, PMU

	with corporate income tax correction and time to complete corporate income tax correction.				
Real-time information for VAT transactions available to MTA	Measures the availability of the EFI system that allows the MTA to have real time information on VAT transactions.	Annual	MTA IT Department, EFI system provider	Standard IT methodology for calculation system availability	MTA IT Deparment

ANNEX 1: ECONOMIC AND FINANCIAL ANALYSIS

1. **This economic analysis considers the effect of activities proposed under the request for additional financing to the parent Project.** The parent Project's total value is EUR 14 million of which EUR 700 thousand has been disbursed to date. The Project is scheduled to be implemented over a period of five years starting from 2018. It includes financial and technical support for: revenue collection methodologies and procedures; an IRMS and other IT infrastructure; and training, tax audit, operational systems refinements, and technical assistance. The original economic analysis performed in 2017 had shown both financial (i.e. financial NPV of EUR 343 million and FIRR of 96 percent) and economic (i.e. economic NPV of EUR 113.6 million and EIRR of 95 percent) viability of the Project.

2. **The request for additional financing of EUR 4.8 million includes introduction of an EFI system that will allow for real-time receipt delivery and their verification by MTA which is expected to increase revenue collection by limiting options for VAT evasion and manipulation with fiscal invoices.** Benefits to be realized through introduction of EFI are compatible and build on the ones envisaged by implementation of RARP, primarily in the domains of MTA staff capacity building and reporting.

3. **Introduction of EFI is expected to yield economic benefits from reduced compliance costs of corporate taxpayers and improved operational effectiveness of MTA.** Introduction of EFI is expected to bring operating cost reduction to MTA through streamlined and optimized oversight procedures and improved statistical reporting and analysis. These benefits are calculated as a reduction in the ratio of MTA operating costs and total revenue collected of 0.01% starting from the year of 2021. These benefits range from EUR 218,000 in 2022 to EUR 258,000 in 2028. The reduced compliance costs will be achieved through simplification of VAT filing procedures and hence the less time spent by corporate taxpayers to perform all compliance related tasks. According to the latest (i.e. 2019) Doing Business report, the average time spent for VAT compliance in Montenegro was 168 hours per year. EFI is expected to bring this number down by 5 percent in 2021 and additional 10 percent in the last year of EFI implementation (i.e. 2022). Economic benefits which will accrue as a result of the reduced hours required for VAT compliance are estimated to be on average EUR 2.7 million per year over the period of 10 years.

4. **Several benefits have not been quantified in this analysis although they were to an extent implicitly included in calculation of some of the benefits presented above.** For example, the benefits which would materialize through the improved business environment, clarity and certainty around VAT filing and payment.

5. **Economic costs brought by EFI system are estimated to encompass project investment costs, MTA staff time required for EFI implementation, operation and maintenance costs of the supporting IT system and equipment, as well as taxpayer compliance costs.** Investment costs of the EFI implementation are distributed in such a way that EUR 2.5 million is assumed to be disbursed during 2020, while the remaining EUR 2.3 million will be disbursed in 2021. EFI implementation will require

commitment of 40 part-time (i.e. 24 hours per week) and 5 full-time (i.e. 40 hours per week) MTA staff during the EFI implementation and 10 part-time and 2-full time during the operational phase. These costs are estimated to be on average EUR 119,000 over the investment horizon. Operation and maintenance cost of EFI system including licenses and software licenses are estimated to be at the level of 10 percent of the original cost. Finally, Project implementation will include one-off costs for the corporate taxpayers to adopt their registers to the new system. Also, these costs will include reengineering sales processes, software adjustments and purchase of new equipment. Given the number of active taxpayers and their size distribution, these taxpayers adjustments costs were estimated to be EUR 4.44 million and would occur in 2021.

Table 2 : Economic Costs and Benefits

in EUR	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Project Investment	0	2,500,000	2,300,000	0	0	0	0	0	0	0
Staff time expense for project implementation	0	192,749	195,447	198,184	200,958	56,213	57,000	57,798	58,607	59,428
Taxpayer's adjustment cost	0	0	4,444,225	0	0	0	0	0	0	0
O&M cost	0	0	0	0	0	480,000	480,000	480,000	480,000	480,000
Front end fee	12,000	0	0	0	0	0	0	0	0	0
Commitment fee	12,000	5,750	0	0	0	0	0	0	0	0
Total economic costs	**24,000**	**2,698,499**	**6,939,672**	**198,184**	**200,958**	**536,213**	**537,000**	**537,798**	**538,607**	**539,428**
Savings from improved operational effectiveness	0	0	0	218,118	229,699	241,200	245,300	249,470	253,711	258,024
Savings from reduced compliance costs	0	0	938,807	2,788,262	2,855,571	2,924,504	2,995,102	3,067,404	3,141,451	3,217,285
Loan disbursements	0	2,500,000	2,300,000	0	0	0	0	0	0	0
Total economic benefits	**0**	**2,500,000**	**3,238,807**	**3,006,381**	**3,085,270**	**3,165,704**	**3,240,402**	**3,316,874**	**3,395,162**	**3,475,310**
Net benefits	**-24,000**	**-198,499**	**-3,700,866**	**2,808,197**	**2,884,311**	**2,629,491**	**2,703,402**	**2,779,076**	**2,856,555**	**2,935,882**
EIRR	**63.8%**									
NPV	**7,171,231**									

6. **Given the estimates of economic costs and benefits, the economic NPV of EFI introduction is positive at EUR 7.17 million, while EIRR is 63.8 percent, significantly above the discount rate of 10 percent.** Table 2 shows the economic cost and benefits items for each year of the project horizon together with net cash flow estimates used for calculation of performance indicators.

Other underlying assumptions:

- The investment horizon for the EFI implementation is 10 years, which is the horizon used in similar projects across the world, including the original RARP economic analysis.
- The discount rate used for purposes of economic performance indicators is 10 percent.

- The MTA staff wage used for estimating the costs of EFI implementation is EUR 560 monthly.

7. **Financial analysis of the Project considers costs and benefits using a cash flow approach.** Financial benefits include primarily increases in VAT collection which will materialize through increasing the tax base and reducing the informal economy by limiting options for VAT evasion and manipulation with fiscal invoices. Revenue collection is currently (i.e. at the end of 2018) at the level of 22.6 percent of GDP. Introduction of EFI is expected to result in a temporary increase in revenue collection by 0.1 percent of GDP in 2021 (i.e. second and final year of EFI implementation) and a permanent increase of 0.2 percent of GDP from 2022 (i.e. the year when EFI is assumed to be fully operational) onwards. Revenue increase is estimated to be EUR 9.1 million on average over the 10 years of investment horizon. Financial costs are the same as economic costs.

Table 3 : Financial Costs and Benefits

in EUR	**2019**	2020	2021	2022	2023	2024	2025	2026	2027	2028
Project Investment	0	2,500,000	2,300,000	0	0	0	0	0	0	0
Staff time expense for project implementation	**0**	**192,749**	**195,447**	**198,184**	**200,958**	**56,213**	**57,000**	**57,798**	**58,607**	**59,428**
Taxpayer's adjustment cost	0	0	4,444,225	0	0	0	0	0	0	0
O&M cost	0	0	0	0	0	480,000	480,000	480,000	480,000	480,000
Front end fee	12,000	0	0	0	0	0	0	0	0	0
Commitment fee	12,000	5,750	0	0	0	0	0	0	0	0
Total financial costs	**24,000**	2,698,499	6,939,672	198,184	200,958	536,213	537,000	537,798	538,607	539,428
Increased tax collection	0	0	5,207,000	10,962,000	11,544,000	12,122,000	12,328,074	12,537,651	12,750,791	12,967,555
Loan disbursements	0	2,500,000	2,300,000	0	0	0	0	0	0	0
Total financial benefits	**0**	2,500,000	7,507,000	10,962,000	11,544,000	12,122,000	12,328,074	12,537,651	12,750,791	12,967,555
Net benefits	**-24,000**	-198,499	567,328	10,763,816	11,343,042	11,585,787	11,791,074	11,999,853	12,212,184	12,428,127
FIRR	**567.4%**									
NPV	**42,454,074**									

8. **Financial analysis suggests that EFI implementation is viable from the financial perspective, as the financial NPV is positive at EUR 42.45 million while FIRR is 567.4 percent which is higher than the discount rate of 10 percent.** Table 3 shows the estimated financial costs and benefits used for calculation of the financial performance indicators.

9. EFI system implementation is expected to enhance the development impact of RARP as it will be integrated with the introduction of IRMS and associated optimization of business processes as well as capacity development initiatives under RARP. The changes in RARP design due to the introduction of EFI component bear no effect on the originally estimated stream of economic and financial costs and benefits. The aggregate economic and financial net benefits from both original RARP and EFI implementation are shown in Figures 2 and 3.

Figure 2: Aggregate economic net benefits, original RARP and EFI

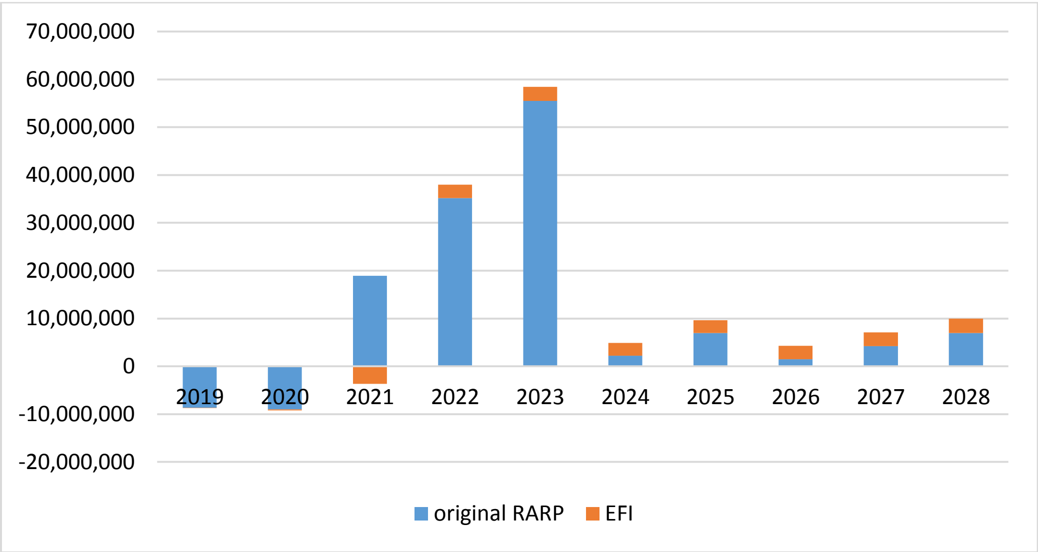

Figure 3: Aggregate financial net benefits, original RARP and EFI