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Introducing Program Budgeting in Armenia

Pavel Safaryan
Zhora Asatryan

Urgency of Introducing Program Budgeting in Armenia

Through the years, Armenia practiced input-based budgeting which focuses on the resources used to provide services. As international practices show, it is very important to switch to output-based budgeting in order to improve public spending.

The objective is to provide efficient information on the outputs or services that are funded by the government budget. By re-shaping the programs and evaluating them financially per services, the Government of Armenia (GoA) and the public will have better information on the cost of services. This will facilitate understanding the potential consequences of spending decisions for certain services and, thus, will help to channel the resources to those areas and measures which will best ensure the government achieves its goals. In other words, this information is extremely crucial in strengthening the direct correlation between policies and budgets in Armenia. Alongside this, the political needs and demands have increased within the context of the PRSP process with regard to providing transparent relations between achieved results and accountability. Such needs make the above mentioned reforms a necessity defined by the National Assembly and the government.

Measures Taken towards the Introduction of Program Budgeting

The steps towards introducing a new program budgeting in Armenia can be divided into two stages: first, 2001 to 2003; and, second, from 2003 to today.

During the first stage, the GoA initiated preparatory activities and created the necessary preconditions for a gradual change. As a result, the 2002-2004 Government Budgets (Law on 2003 Budget and Budget Statements for 2002 and 2004 Budget Laws) included the expected output indicators for government-funded programs in social sectors (education, health and social safety).

In order to carry out those activities, the GoA closely cooperated with experts invited with assistance from the UK Department for International Development. At the same time, trainings were held at the Training Center of the Ministry of Finance and Economy to familiarize public servants with the new budgeting methods.

During the second stage, an Action Plan for Budgeting Reforms was developed. It acknowledges the facts that an efficient structure of expenditures serves as a basis for successful program budgeting and that there is an interrelationship between policies and annual budgets.

According to the Action Plan and as an introduction to program budgeting, all public bodies must redefine their programs in a manner that allows a useful combination of services, simultaneously ensuring the allocation of funds to all expenditures within a program. These include not only direct allocations to programs, but also indirect expenditures (allocations to policy-making, monitoring and support services as they exist currently and not included in respective recurrent expenditure items of national or local government bodies for salaries, utility payments and maintenance). To ensure that the service-based programs DO reflect all the costs of providing those services (previously grouped in the maintenance expenditures of central government bodies), they need to be allocated among all programs. In practice, this approach was tested on programs provided by the Ministry of Labor and Social Affairs during 2003-2004 (as it was envisioned in the Action Plan). Since 2004, three more ministries switched to program budgeting. The three include the Ministry of Health, the Ministry of Education and Science and the Ministry of Culture and Youth Affairs. As stated in the Action Plan, the Ministry of Labor and Social Affairs published its new list of programs in the 2005-2007 Medium Term Expenditure Framework (MTEF) and included the list in the 2005 Annual Budget Law. The new lists of programs of the other three ministries were included in 2006-2008 and 2007-2009 MTEF and the 2006 Annual Budget Law.

At the same time, these ministries started to report in the same format: the Ministry of Labor and Social Affairs since 2005; the other three ministries since 2006.

The draft 2007 Annual Budget Law continues the efforts in this area as an important step in program budgeting. Apart from the new formats adopted by the abovementioned ministries, the Budget Statement contains performance criteria at the organizational level for programs.

New Format for Program Budgeting

New formats applied to budget the programs of the four ministries in the draft 2007 Budget has two levels of classifications: programs and policy measures.

Programs are sets of policy measures grouped by certain logic under the allocations of a government body. These are activities

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carried out by government agencies and bodies to help achieve the goals set for the GoA as a whole. The programs are presented in a more general manner that is more expedient from planning, budgeting and reporting purposes. In other words, programs are not segregated interventions implemented through policy measures. Rather, they are combinations of complementing interventions that aim toward certain goals, outcomes or objectives that the Government strives to achieve.

Policy measures are interventions by the state that can be services, transfers, capital expenditures, loans, etc. provided or rendered by government bodies, the state or other organizations. This level aims to identify which interventions the GoA plans to use to achieve its goals. It is also important that the National Assembly approve these interventions and that budget allocations are made for these policy measures. Notably, they need not be excessively aggregate or too detailed. In the first case, the transparency of the Budget is compromised and too much authority is given to a government body in deciding how and where to spend public funds. In the second case, the flexibility of the implementing agency is restricted with regard to efficiently managing the allocated funds, especially in cases when a prompt and effective response to unforeseen changes is needed.

Main Principles of the New Format

When defining programs, it is necessary to take into account the following:

- They need to include policy measures with a certain common logic.
- They shall include only those policy measures that are either directly implemented by a given agency or body or on behalf of that agency or body.
- All policy measures are covered by a program and are never repeated in another program.

The structure of policy measures was defined (grouped) based on the following principles:

- A similar nature in expenditures, i.e. policy measures include either services, transfers or capital expenditures, and not as combinations thereof.
- A policy measure shall include services or capital assets of a similar nature.
- A policy measure can be defined by its relationship to GoA priorities or desired outcome.

- A policy measure can never include both current and capital expenditures at the same time.

The policy measures also identify the performance criteria for ministries implementing each program: they include quantitative (and qualitative, when possible) and monetary data on the services to be rendered, capital expenditures to be financed or loans to be extended. In each case, the program receives a title and a description of the services, capital asset acquisition or transfers. Additional characteristics of the latter are also provided.

For example, in the case of capital assets, their expected life and total cost are specified, together with funds spent on the same asset in previous budget years. If the asset is built or acquired during several fiscal years, the description of the maintenance data in the previous year is given, as well as how the planned expenditures will affect the asset's qualitative or quantitative parameters.

With regard to the next steps, it is worth noting that current discussions center around how to introduce a new practice or function whereby a separate document – an annual plan for each agency or body – can be developed. This practice will be applied first to the pilot ministries and then rolled out to subsequent ministries. This document also aims to present the strategic objectives and performance criteria of each agency or body to the general public (National Assembly, public and international community). Furthermore, the potential solutions to systemic and technical problems revealed so far are being discussed.

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Community Budget or Budget for Community? Commencing Reforms in Local Governments

Suren Poghosyan

During the last decade, Armenia has made noticeable structural reforms at the local government level, including decentralization in the administrative and the financial areas. However, the budgeting system itself has not been reformed significantly and, in general it seems to lag

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behind overall country reforms. Moreover, budgeting reforms at the central government level have extended to include more advanced configurations than the ones at the local government level.

The limited nature of local budgets is basically a result of the traditional methodology of budgeting multiplied by a lack of attention paid by the central government on introducing contemporary budgeting models at the local level.

In recent years, Armenia's central government gradually introduced contemporary tools in relationship to local communities. It granted more autonomy and delegation power to local officials, as well as provided local governments with more financial resources by increasing the level of "equalization subsidies" and allowing communities to take part in administering local tax collections. The central government also enabled more flexible budget decision-making on the expenditures side of the ledger. Furthermore, according to the National Statistics Service (NSS), both the revenues and the expenditures of local governments have grown, on average, at a rate double to that of the central government.¹

However, although communities are given considerable autonomy in terms of budgeting and decision-making, old-fashioned perceptions of budgeting and the heritage leftover from a central planning system still have a strong impact on the overall performance and effectiveness of local budgets in Armenia. The budgets of local governments, in general, represent only one out of four dimensions of a budget, i.e. the "Operations Guide" one (see Box 1). Such practice is largely based on previous budgeting systems that included highly centralized control and governance systems.²

As a result, local governments still use inputs (information on

resources rather than information on services delivered) as the core of their budget documents even though they cannot be analyzed and used by anyone other than local officials in executing the budget.

Avoidance from budget delivery accountability (i.e. precise execution of inputs, regardless of what they were used for) allows local government officials avoiding accountability both in front of the society and control/supervision authorities (e.g. Control Chamber of the National Assembly). At the same time, introducing a results-oriented budgeting system should be simpler at the local level due to its smaller size and complexity compared with the multi-level arrangements included within a central budget system. Many countries have made program budgeting reforms both central and local levels to enhance the functionality of budgets so they are more than just operational guides (see Box 1).

A policy study developed by the author has analyzed the current environment to initiate program budgeting reforms and the capacity of local governments to introduce and manage such reforms, as well as the extent of the central government's role in the overall organization of these reforms. A review of communities - both cities and villages from various regions and with different populations - reflects a widespread situation where the public does not receive budgets in a format it can analyze, assess and monitor results. Moreover, the professional civil organizations (NGOs, think-tanks, etc.) face similar difficulties because the budgets mostly present information useful to the financial officers and financial supervision bodies.³

A comparison with strategic plans illustrates that, in most cases, there is capacity to design budget programs using information that enables communicating the budget to people. Several aspects

Box 1: Four functions of budgets

<i>Function of budget</i>	<i>Description</i>
1. Policy analysis	<i>To scrutiny and assess the policy implications of the budgets</i>
2. Expenditure planning	<i>To provide time dimension to the budgets, i.e. presenting current year expenditures in dynamics with future expenditure plans</i>
3. Communications devices	<i>To communicate the government intentions with the beneficiaries and their representatives, e.g. community councils, media, NGOs, etc. This particular aspect also allows a more performance related monitoring and auditing process to function effectively</i>
4. Operations guide	<i>To act as an operational hand to some budget users, e.g. treasury, community employees, etc</i>

¹ Source: Annual Statistical Reports (1999-2005), National Statistics Service of the Republic of Armenia

² See Guess G., "Decentralization and municipal budgeting in four Balkan states", 60th Annual Conference of the American Society for Public Administration (ASPA), Orlando, 1999, p.2

³ For more detailed information on these issues see S. Poghosyan, "Budget Format Issues and Challenges for Budget Reforms in Armenia", Economic Policy and Poverty, 2nd Volume, Issue 3, Yerevan, March-April 2005, pp. 4-5

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of the strategic plans and budget design are analyzed in a quality comparison. It shows the plans and designs are not the main impediments to communication. Rather, the impediments stem more from challenges related to administrative and reform/change-management issues.

Another key aspect of the policy study was that it emphasized the significance reforms could make to planning at the front-end of the budget cycle, although comprehensive changes will be required to link it with the rest of the cycle. A gradual introduction of program budgeting elements is required rather than a radical shift from current to new budget systems. The reason behind such an approach is the necessity to have plans developed appropriately, and then suggesting delivery, monitoring and reporting cycles to meet the requirements of the plan. This is also supported by the experiences of the central government in implementing other budget reforms. Noticeable capacity and implementation constraints appeared when too many reforms were introduced into the budget cycle at the same time. Hence, learning from doing similar reforms indicates that stakeholders perceive planning-side as a preceding step for some period (one to two budget cycles) before introducing other reforms such as budget delivery, monitoring, reporting and auditing.

Although the survey findings indicate local government officials have the capacity to adopt new methodologies in planning, the role of the central government is recognized as vital to achieving positive results for any reforms. This is necessary both to motivate local governments to commence the reforms and to ensure equivalent progress among all communities. Unfortunately, Armenia is still at a stage where pressure from the central government usually is a more important factor than pressure from the community itself. Also, the country is still in a transition period when lots of general institutional and structural changes are being implemented in parallel. This makes it even more complicated for local governments to initiate specific budget reforms themselves and to invest required resources into a new path of reforms without centralized leadership and coordination.

Based on the analysis presented in this policy paper, the author argues that centrally driven reforms are required to commence community budgeting reforms across Armenia. To achieve this, the central government must use a mix of intervention instruments, such as legislation changes; centrally driven methodology development; and technical assistance on local capacity building. More specifically, the policy paper encourages implementation of the following actions:

- Design and high-level approval of a nationwide reform strategy,

- Increased public awareness to introduce the basic concepts and show what is gained through the reforms. This might include wider dissemination of budget execution reports; extensive involvement by think-tanks, NGOs and media in discussions; more political involvement through presentations by political parties and members of parliament, for example, of the results achieved.
- Donor and non-governmental involvement to help shape reforms. The government should call for assistance from donor and NGO communities.
- Legislative amendments to facilitate the proposed reforms and to support program classification in community budgeting (Budget System Law).
- Use of administrative instruments to reward local leaders who pioneer reforms in their communities. These could include additional financing, or administrative and technical support in implementing the reforms, simultaneously providing pressure on communities that implement the reforms slowly.
- Develop and provide guidelines, instructions, pro-formas, etc., as well as deploy consultants, if necessary.
- Introduce relevant monitoring and auditing systems.

Conclusions

Hence, the general findings of the policy study are that communities have sufficient capacity to initiate the reforms; however, there is a need for the central government to provide leadership and to ensure parallel increases in the capacity of local government employees (as the supply side of the reforms) and public awareness (as the demand side of the reforms). The obvious advantage to Armenian governance is that reforms of a similar nature have been implemented at the central government level and, based on these experiences, valuable and localized conclusions and recommendations can be made on the direction and speed of reforms implemented at local levels.

In order to assess the feasibility of program budgeting reforms at the community level in Armenia, the author's policy paper considers several options and presents recommendations that could prove useful.

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Tax Prepayments and Advances as an Obstacle to Businesses

Ashot Markosyan
Davit Harutyunyan

Tax prepayments are used in almost all counties in the world; however, they are used more rigorously in transition economies and in developing counties with low budget revenues and tax collection rates. In this regard, Armenia is not an exception and its tax prepayment system has been amended through the years. As a result, each business and economic agent feels the negative aspects of this system when they interact with tax authorities.

The prepayment system widely used in developing countries acts as a purely fiscal tool to collect tax revenues, though it often neglects the interests of businesses. The Armenian prepayment system currently used applies to all taxes and both resident and non-resident entities, as well as resident businesses with foreign equity, feel its consequences.

Profit Tax

According to Article 2 of the Law on Profit Tax, this is a direct tax paid by taxpayers in amounts and methods defined in the legislation. In general, coming from the logic behind direct taxes, one can assume that the profit tax is paid from the outcomes of taxpayers' business activities; in this case, from profits. However, this logic does not apply to prepayments. One can view the legislative definition¹ for the calculation and payment of the minimum profit tax (effective since January 26, 2004) as an acceptance of the fact the country is pursuing an unbalanced tax policy. The essence of this amendment is that if the prepayments of profit tax are below 1 percent of a certain amount² then a business should pay the minimum monthly profit tax.

The monthly profit tax is calculated on the income from sales of assets (including goods and products) and the provision of services, both in Armenia and abroad, accrued during the previous month. The monthly amount is further calculated as 1 percent of the amount determined above, minus any applicable tax deductions.

Such an approach adversely affects business development and expansion because businesses have to pay profit tax (monthly prepayments) even if they do not earn enough profits as defined by legislation. (Profit tax is calculated based on annual results, deducting all eligible tax deductions from gross income.)

The taxpayers' interests are neglected in cases where the taxpayer has to perform monthly calculations (allocating time, efforts and financial resources) and select the option more beneficial to the government (i.e., pay prepayments either as minimum profit tax or "actual" for their financial performance, whichever is higher.)

This affects more negatively new businesses that are in their low profitability phase: these businesses have to pay profit tax from the start without even earning or benefiting from their profits. The businesses pay profit tax for unearned profits in anticipation of getting an adjustment at the end of the year.

It is worth noting that prepayments also apply to non-residents.

Based on these facts and justifications, we recommend abolishing the 1 percent minimum profit tax prepayment requirement and apply a simpler system or approach (i.e. profit tax payments should be based on the actual profit of the previous year and not on the sales income of the previous month.) Our recommendation is not an alien system to Armenia, and it does not entail any testing since it was previously in force and proved to be efficient.

Value Added Tax

Next, review the Value Added Tax (VAT), which has high economic, social and fiscal importance. The prepayments system is more relevant to the VAT. The very first Article of the Law on VAT declares it an indirect tax paid to the government when importing goods into Armenia and at all stages of producing goods and rendering services in the territory of Armenia.

For example, transactions eligible for 0 percent VAT are either deducted from other tax liabilities of the same taxpayer or are returned to the taxpayer at the end of the reporting period in accordance with Government³ procedures based on a certain document (within 30 days). According to the same Government decree, transfers of such refundable VAT amounts are a priority

¹Law on Profit Tax, Article 47

²Minimum Profit tax is calculated on accrued sales of goods and services (except for fixed assets, securities and stock exchange transactions) in the previous month (which does not include the indirect taxes paid when those incomes were earned) minus the depreciation of fixed assets not exceeding 50% of the income during the same period.

³The said procedures are approved by the Government Decree N 392 dated July 31, 2001 on procedures for the calculation of refundable VAT and submission of the relevant documentation.

for budget expenditures within the defined period at the expense of actual VAT revenues.

The number of transactions eligible for 0 percent VAT is very significant⁴. In practice, it turns out that the taxpayer with debited VAT amounts on their books must request a refund through bureaucratic procedures. As a result, the taxpayer loses time, as well as money that could have been used more efficiently otherwise. The complex tax regulations and procedures (that are apparent in the Law on VAT) create extreme difficulties for taxpayers. For these reasons, we recommend abolishing VAT prepayments for such transaction, especially because they are eligible for refunds.

In our view, the next shortcoming of the VAT Law is found in requiring VAT payments at the customs office when importing goods. The VAT on imports adds 20 percent on top of the sum of the customs value and duties. As a rule, the customs value is declared by importers (i.e., they advise the customs department on the value of their imports.) The purchase price, transportation, insurance and other intermediary service expenses are the basis for the determination. In cases defined by Customs legislation, the customs department can determine the customs value. For example, goods are imported with a declared customs value of AMD 15 mln. A 20 percent customs duty applies to those goods. Thus, the VAT payable equals AMD 3.3 mln $((15 + (15 \times 10\%)) \times 20\%)$.

In our view, these practices are not well justified since the taxpayer pays the VAT without yet having sold the goods or realizing any profits and with the expectation of getting the VAT money returned afterwards. In other words, the importers have to pay the VAT before selling the goods. Furthermore, the importer cannot definitely know the sales price nor the time period required to sell it.

We recommend relieving importers from paying VAT at customs and transfer these payments to the regular VAT regime (i.e., importers pay the VAT after they sell the goods.) This allows importers to invest that money somewhere else and not sink it into bureaucratic procedures. This can also assist in fighting against an informal economy since the customs department will clearly report the imported quantities to tax authorities. In turn, the latter will calculate and verify the payable VAT amounts based on the information received from customs.

As one can see, the prepayments system is widely used in the Armenian tax legislation. Nonetheless, businesses do not benefit from it since the government mostly focuses on collecting revenues in the short term and ignoring the need to promote business development.

In general, it is necessary to simplify taxation procedures, reduce the tax prepayments system and be mindful of the interests of business that are, eventually, the interests of the state.

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Agreements on Preventing Double Taxation

Aram Muradyan

As a whole, agreements to prevent double taxation between countries are general enough to cover all aspects of cooperation between the parties. By regulating taxation issues in trade and commercial relations between two countries, these agreements significantly affect the international economic policies of the countries involved.

Such agreements mainly aim at:

- a) Preventing double taxation of revenues and property, thus reducing the adverse impact of taxes on foreign trade and investments. This promotes entrepreneurship by encouraging beneficial competition, as well as promotes investments by creating beneficial tax regimes for foreign investments.
- b) Creating a predictable and stable tax environment. Taking into account that legislation in transition countries are characterized by frequent changes, international agreements provide for a stable tax environment for foreign businesspeople in the medium term (since such agreements regulate taxation issues of applicable tax rates on major income sources: dividends, interests, royalties.)

Such agreements provide a mechanism to prevent double taxation, as well as to prevent taxation discrimination of individuals by the countries involved. In particular, these agreements usually stipulate cooperation between the tax authorities of the participating countries. The level of cooperation can include clauses relating to the solution of disputes regarding tax legislation and applica-

⁴Law on VAT, Article 16

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tion thereof, as well as exchange of information in order to prevent tax evasion.

Under such agreements, the Republic of Armenia (RoA) bears financial liabilities since it agrees not to tax income earned in Armenia by residents of other countries nor to tax them at low rates.

In particular:

1. Such agreements limit the taxing rights on incomes earned in Armenia by residents of another country. The RoA may tax these incomes only when the business activities are carried out by a permanent entity registered in Armenia and only for the amounts earned by the permanent resident unit.

In general, agreements on prevention of double taxation do not apply to business activities of permanent representatives or units. Therefore, the following activities are exempted from taxes in Armenia:

- a) use of facilities for storage, displaying or delivery purposes,
- b) maintenance of goods or production for storage, displaying and delivery purposes exclusively,
- c) maintenance of goods or production by another enterprise for further processing purposes only,
- d) maintenance of a permanent location for an enterprise exclusively for the purposes of purchases of goods or data collection,
- e) maintenance of a permanent location for an enterprise exclusively for the purposes of preparatory or support measures for another type of activity, and
- f) maintenance of a permanent location for an enterprise exclusively for the purposes of a combination of any of the above types of activities provided that the combined activities are of a preparatory or a support nature.

2. Profit from international transportation services by ships, airplanes or trucks of a resident entity of one of the countries is subject to taxation only in the host country.

3. Income earned by a resident of another country from professional services or other types of independent activity can be taxed in Armenia if:

- a) The foreign entity has a permanent location or base for activity in Armenia (in this case, only the income from that unit is taxed),

- b) The presence of a foreign entity in Armenia equals or exceeds 183 days within a year (in this case, only income from activities carried out during its presence in Armenia can be taxed).

4. Salaries (or similar remuneration) earned by a resident of another country in Armenia is exempted from taxing in Armenia if:

- a) The recipient was present in Armenia in a given year for a period(s) with a total duration less than 183 days,
- b) Remuneration is paid by or on behalf of an employer that is not a resident of Armenia,
- c) The remuneration or salary expenses are not borne by the resident representative in Armenia.

5. Income of an artist or sports person of another country in Armenia is exempt from taxes if the activities of the artist or sports person falls under a joint cultural or sports program set by the two agreeing countries.

6. A resident of the other country (which is party to the agreement) studying in a certified university, college or any other educational institution or who carries out research activities in Armenia is exempted from taxation of income or remuneration for such activities in Armenia provided that the remuneration comes from sources outside that country. However, such exemption does not apply if the activities are carried out not for public, but rather for private interests of an individual or individuals.

7. A student or intern who is (or who was before arriving in Armenia) a resident of the other country (which is party to the agreement) and lives in Armenia solely for studies or specialization is not taxable for the income received through transfers for living, studying or specialization if these amounts are generated outside Armenia.

8. Dividends paid by a company resident in Armenia to a resident of the other country (which is party to the agreement) can be taxed in Armenia. However, if the actual shareholder is a resident of the other country, the tax rate shall not exceed the rate defined in the agreement. It is worth noting that the tax rate applied in international agreements between Armenia and other countries does not exceed 15 percent.

Agreements preventing double taxation limit the cases and possibilities of Armenia levying taxes on interests and royalties of entities that are residents in the other countries. Meanwhile, if the actual recipient of interests or royalties is a resident of another country, the tax rate shall not exceed the rate defined in the agreement, but usually within 5 to 15 percent.

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It is also worth noting that agreements to prevent double taxation stipulate mutual privileges for the residents of two countries which come from the objectives of such agreements. Below is the list of agreements that prevent double taxation of income and property between Armenia and other countries.

LIST

Agreements to Prevent Double Taxation of Income and Property between the Republic of Armenia and Other Countries

- | | |
|---------------------------------|---|
| 1. Bulgaria | In force since December 1, 1995; applied since 01.01.1996. |
| 2. Ukraine | In force since November 25, 1995; applied since 01.01.1997. |
| 3. China | In force since November 30, 1996; applied since 01.01.1997. |
| 4. Iran | In force since July 10, 1997; applied since 01.01.1998. |
| 5. Romania | In force since August 25, 1997; applied since 01.01.1998. |
| 6. Russia | In force since March 17, 1998; applied since 01.01.1999. |
| 7. Turkmenistan | In force since May 18, 1999; applied since 01.01.2000. |
| 8. Lebanon | In force since December 13, 2000; applied since 01.01.2001. |
| 9. Georgia | In force since July 3, 2000; applied since 01.01.2001. |
| 10. France | In force since May 1, 2001; applied since 01.01.2002. |
| 11. Belarus | In force since October 19, 2001; applied since 01.01.2002. |
| 12. Latvia | In force since February 26, 2001; applied since 01.01.2002. |
| 13. Lithuania | In force since February 26, 2001; applied since 01.01.2002. |
| 14. Greece | In force since June, 1995; applied since 01.01.2003. |
| 15. Estonia | In force since January 23, 2003; applied since 01.01.2004. |
| 16. Belgium | In force since October 1, 2004; applied since 01.01.2005. |
| 17. Thailand | In force since November 12, 2002; applied since 01.01.2003. |
| 18. The Netherlands | In force since November 22, 2002; applied since 01.01.2003. |
| 19. Austria | In force since April 1, 2004; applied since 01.01.2005. |
| 20. India | In force since September 9, 2004; applied since 01.01.2005. |
| 21. Poland | In force since February 28, 2005; applied since 01.01.2006. |
| 22. United Arab Emirates | In force since December 19, 2004; applied since 01.01.2005. |
| 23. Moldova | In force since December 19, 2004; applied since 01.01.2005. |
| 24. Canada | In force since December 29, 2005; applied since 01.01.2006. |

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A Study of the Simplified Tax System in the Republic of Armenia

Narek Kosyan

Introduction

Armenia introduced a simplified tax system in 2000. In subsequent years (especially 2003 and 2005), the laws governing this system have changed considerably. The last change in this law was enacted in July 2005. Thus, we have a system whose real operation has yet to be examined. Therefore, my original research assesses how the introduction of a relatively new system of simplified taxation works in Armenia.

The original dataset developed for this study provided us with information needed to focus on simplified taxpayers. The simplified tax is targeted at small taxpayers. Such taxes are typically paid by enterprises that cannot keep good accounting records, often because they are one-person firms. Sometimes, these taxes are used to reduce contact with the tax service, possibly because of governance issues. Thus, the general purpose of my research is to collect original data by surveying small businesses in Yerevan; then using the survey results to analyze, examine and comprehensively assess the operation of the simplified tax system in Armenia.

Simplified Tax in Armenia

The system began in July 2000 after adoption of the Simplified Tax law. It is worth noting that the law “On Small and Medium Entrepreneurship State Support” was adopted a couple months later, in agreement with the simplified tax law. This innovation was connected to a general tax administration reform effort. Thus, taxpayers may not keep proper accounting records and receipts. Moreover, they may not present financial statements to taxing agencies.

According to the 2000 law, only juridical persons and sole proprietors were allowed to pay simplified taxes. However, in 2002, “juridical persons” were replaced with “commercial organizations” as simplified taxpayers.

Like in other CIS countries, the Armenian simplified tax system has specific requirements. The maximum amount of sales circulation is AMD 50 million per year. This amount is calculated by summing up the incomes received from all types of activities. According to January 2005 changes in the law, simplified taxpayers are shifted into the regular tax plan as soon as their sales circulation exceeds AMD 50 million during any period of a year¹. Another important aspect is connected to the use of cash registers. The law does not provide strict requirements for cash registers; even gross violations of cash register usage norms do not suppose a change in a person’s tax regime². (A. Alaverdyan and A. Mesropyan, 2005).

The rates for Armenian simplified tax regimes fall into two categories. For enterprises, trading through kiosks, a store’s simplified tax rate is 4 percent. For other types of activity, the simplified tax is calculated this way: 7 percent for the circulation of up to AMD 30 million, and 12 percent for incomes exceeding AMD 30 million³. (A. Alaverdyan and A. Mesropyan, 2005).

Methodology

The methodology used for my master essay study is the survey and the analysis of secondary data. We surveyed 120 small businesses currently operating in Yerevan. We used non-probabilistic sampling methods: mainly purposive or judgmental sampling, as well as partial quota sampling and a reliance on available subjects, whenever needed. We included various types of small businesses from almost all Yerevan suburbs. It is noteworthy that more than 500 small businesses were asked for interviews, from which only 120 agreed to participate⁴. Thus, the refusal rate was more than 75 percent. The method used was face-to-face interviews with the people who

¹Until this change in law, simplified taxpayers shifted into regular regime from the beginning of the next year.

²In the initial version of law, a simplified taxpayer would have to shift into regular tax regime at such cases.

³Until 2005 the rate system has been quite complex, which has created redundant complications. Subsequent changes in the law simplified the existing regime of rates.

⁴The number of simplified taxpayers in Armenia is approximately 20,000; thus, our sample size constitutes nearly 0.45 to 0.50 percent which is quite normal and admissible for such cases.

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actually make decisions in the participating enterprises (owners, directors, managers, etc.) We also used other existing data in the secondary analysis.

Findings

One hundred twenty small businesses participated in the survey with businesses operating in almost all districts of Yerevan included⁵. The main area of activity for the respondents was in retail service. There were also several hair salons, catering booths, stores, and a reconstruction company.

A very interesting point is the size of the average salary paid in the companies. A more comprehensive picture of average salaries in Yerevan's small businesses can be seen in Table 1.

Table 1: Salary Ranges for Enterprises

Salary Ranges	Total Number of Firms (120)	Total Number of firms [%]
Up to 20,000	26	21.7
20,000-30,000	69	57.5
30,000-40,000	17	14.2
40,000-50,000	4	3.3
More than 50,000	4	3.3

One of the most important issues of tax administration is the visit by the agency inspectors. As Table 2 indicates, the general purpose of the tax agency visit is to audit and to inspect records.

Table 2: The Purpose of Visits by Tax Inspectors

	Purpose of Visits (119 respondents)	Purpose of Visits (all respondents, %)	Purpose of Visits (only simplified taxpayers: 91)	Purpose of Visits (only simplified taxpayers, %)
Inspection/audits	79	66.4	57	62.6
Cash registers	15	12.6	15	16.5
Tax collection	19	16.0	15	16.5
Employees	3	2.5	2	2.2
No purpose/extra-legal requirements	3	2.5	2	2.2

The respondents were also asked whether they had been solicited by tax or social fund inspectors to pay a bribe. Only a few (eight out of 120) business people confessed they received such an offer from a tax inspector; 15 respondents refused to answer this question.

The respondents were also asked to evaluate the following aspects of the simplified tax regime: tax rate, tax accounting, tax forms/filing, payment methods, frequency of reporting, frequency of payments, inspections, audits, frequency of changes in rules and rates, extra legal requirements for advance payment of taxes, and other problems. Figure 1 presents the distribution of responses by percentage.

Our findings also revealed some key characteristics of Armenian small and micro businesses, or simplified taxpayers. Table 3 presents the key characteristics of simplified taxpayers and all respondents in percentages.

Most of the respondents named "frequent inspections" and "corruption" as the main problems with the simplified tax regime. Among other comments were remarks about bureaucratic complexities, unnecessary documentation and unclear mechanisms.

⁵ However, the majority of respondents were from the Center and the Arabkir districts that are the most populous and business-developed areas in the city. A small number of participants represented Kanaker-Zeytun, Nor Nork, Avan, Erebuni, Mashtots, Malatia-Sebastia, Ajapnyak and Nor-Aresh districts.

Figure 1: Opinion of Taxpayers about the Simplified Tax by percents

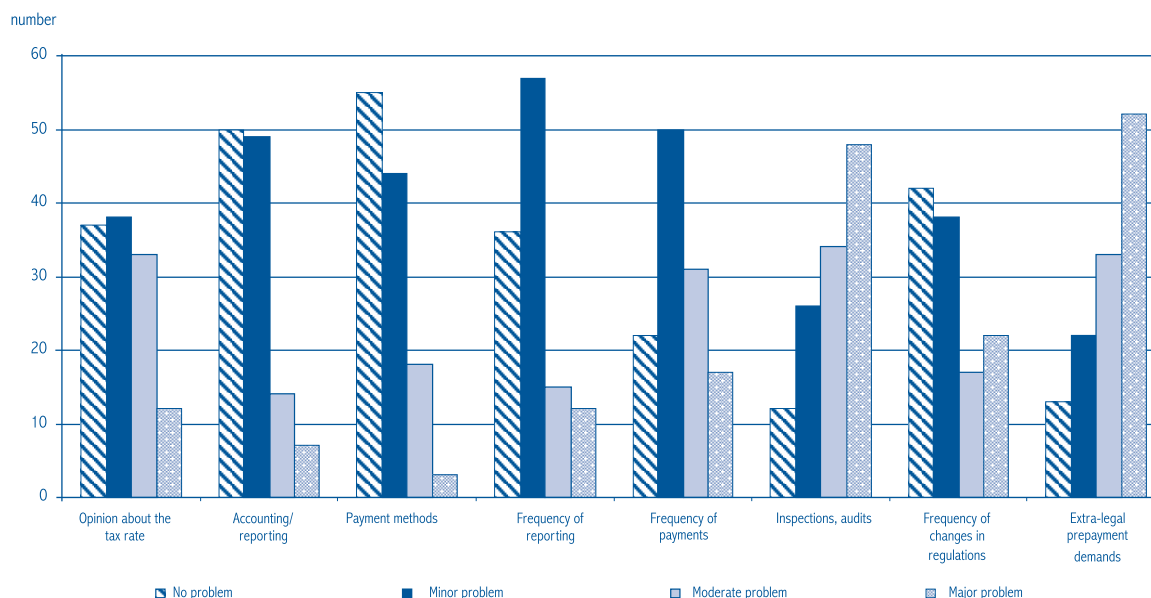


Table 3: Key Characteristics of Simplified Taxpayers and All Respondents in Percents

	Simplified Taxpayers (%)			All Respondents (%)		
	Yes	No	No Answer	Yes	No	No Answer
Pay AMD 6,000 as social payment for each employee	89	11	0	85	15	0
Have accountant	49	51	0	50	50	0
Get accurate receipts from suppliers	57	16	26	52	14	33
Use cash registers	76	24	0	66	34	0
Have multiple branches	14	86	0	18	81	2
Were established as simplified taxpayers	60	40	0	45	55	0
Would like the simplified tax to be abolished	5	63	32	10	50	39

Analysis and Conclusions

The simplified tax has been in effect since 2000. Since its introduction, the number of simplified taxpayers has risen 10 times by the end of 2004⁶. Nevertheless, the average contribution by a single taxpayer to the state budget has steadily decreased.

This survey helped us to answer our research questions, as well as to draw very relevant conclusions about the simplified tax system in Armenia. Our general conclusions are listed here.

- Actually, simplified taxpayers do not differ much from regular ones in the sense of their numbers of employees and

average wages. Considerable evidence suggests that there is serious under-reporting of these numbers for two possible reasons: to pay less social and tax payments, and/or to remain eligible for simplified taxes by reducing the size of the overall circulation. From this point of view, the simplified tax does not justify its initial purpose since micro and small businesses operating in different tax regimes do not differ tangibly.

- Tax service representatives visit and inspect all small enterprises several times a year. The state spends a considerable amount of finances and effort for the inspection of this sector, which provides a very small part of total state revenues.

⁶ In 2004, the number of simplified taxpayers was nearly 20,000, while VAT payers were nearly 27,000.

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Considerable evidence suggests corruptive purposes of such activities. Because of these regular, numerous inspections, the simplified tax regime and tax administration generally are deterred from their main purpose: to encourage self-reporting and voluntary contributions by taxpayers, and to ease the job of simplified taxpayers, who cannot afford enough time, means and effort for frequent and complex reporting procedures. Thus, the simplified tax regime is heavily biased against compliance checking rather than revenue collection.

- In their comments and private conversations, Armenian taxpayers admit to serious levels of corruption within the sphere; however, the vast majority of them categorically refuse to admit the fact that they have offered to pay such bribes.
- The procedures or rules of the simplified tax itself are not much of a problem for Armenian simplified taxpayers. Payment methods, frequency of reporting, accounting - no technical or documentation part of the simplified tax system is a serious problem for these enterprises. They are quite satisfied with the simplified tax regime, its rules, regulations and even tax rates. In contrast, the major problems for them are extra-legal pre-payment demands, inspections and audits, and the corruptive practices. Thus, simplified taxpayers are satisfied with the simplified tax system per se, yet are very discontented with the administration of that system by the State Tax Agency.
- It was assumed that the simplified tax would assist those enterprises unable to afford hiring an accountant and to conduct rather complicated accounting procedures of receipts from suppliers. Nonetheless, most of the simplified taxpayers employ an accountant and get accurate receipts from their suppliers. In this case, they do not differ much from regular taxpayers. From this point of view, the simplified system again does not meet its initial purposes.
- Simplified taxpayers actively use the opportunities of the law. The overwhelming majority of them pay fixed AMD 6,000 as social payment for each of their employees. Many of them do not have cash registers (without which it is extremely difficult to calculate their overall circulation). Some of them own multiple branches (a micro business would hardly be able to have branches). These above-mentioned issues clearly illustrate the flaws of the system, which allows small enterprises to circumvent the rules when it is to their benefit.

- The simplified tax system is very attractive to Armenia's small businesses. For instance, the majority of simplified taxpayers have been in the regime since their founding. Moreover, only a very tiny portion of simplified taxpayers agree the system should be abolished.

Summing it up, we can contend the following: The simplified tax system in Armenia is favorable to small businesses; they are satisfied with its regulations, but unhappy with its administration. The system is useful for the country; it somehow promotes small entrepreneurs in Armenia; nevertheless, it has serious flaws that may reduce its revenues and be a factor for increasingly corruptive practices. For the tax agency and its administration, the system is beneficial because it makes the procedures easier to follow and enforce, but it is also detrimental because it allows enterprises to seriously circumvent and avoid paying some revenues, as well as seemingly "encourages" tax inspectors in corrupt practices.

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Large Taxpayers in Armenia

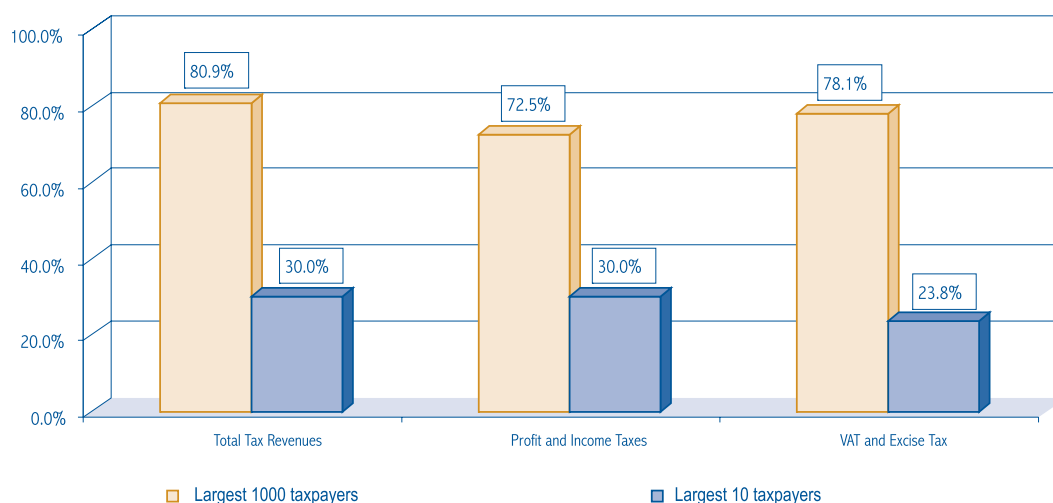
In accordance with the Tax Law of Armenia (Article 30), the State Tax Service regularly publishes information on the top 1,000 taxpayers in Armenia and their tax and stamp duty payments¹. It also publishes information on entities who pay AMD 3 million and above in social insurance payments and their contributions², as well as a list of commercial entities who have declared staff of 100 and more employees³.

The above listed data and information for January-September 2006 are summarized and analyzed in the present article.

During the first nine months of 2006, the largest 1,000 taxpayers paid AMD 215.4 billion in taxes and stamp duties. This constituted 81 percent of the total tax revenues⁴ in the state budget. It is worth mentioning that over 30 percent of the 215.4 billion was paid by the top 10 of the largest taxpayers.

The largest taxpayers are Zangezur Copper-Molybdenum mining company, ArmenTel, ArmRusGasProm, Flash and Car Petrol Service.

Figure 1: The Share of Large Taxpayers in Total Budget Tax Revenues, January-September 2006



The 10 largest taxpayers paid 37 percent of the total taxes and stamp duties paid by the largest 1,000 taxpayers; in particular, they paid 42 percent of profit and income taxes, 30 percent of VAT and excise taxes, and 55 percent of presumptive taxes paid at customs (See Figure 2).

A number of sole proprietors, as well as educational and healthcare institutes, are found in the list of the largest 1,000 taxpayers, along with commercial and industrial enterprises⁵. For example, Yerevan State University is listed among the first 100 largest taxpayers at number 98.

Organizations with 100 and more employees totaled 423. The staff numbers in about 57 percent of those entities does not exceed 200, though 19 enterprises have a staff of more than 1,000 (See Figure 3). The largest enterprise, in terms of staff numbers, is the Electric Networks of Armenia CJSC with 8,000 employees. The next largest employers include ArmRusGasProm, ArmenTel, Armenian Railways and Haypost (postal service)-with about 4,000 employees.

¹ Website of the State Tax Service of the RA: <http://www.taxservice.am/1000cank.htm>, uploaded on 25.10.2006.

² Same web-site: <http://www.taxservice.am/Soc.htm>, uploaded on 25.10.2006.

³ Same web-site: <http://www.taxservice.am/100evaveli.htm>, uploaded on 25.10.2006.

⁴ Total tax revenue indices are taken from the "Social-Economic Situation in Armenian during January-September, 2006" statistical report of the National Statistical Service of Armenia.

⁵ 15 higher education universities and 6 large hospitals and medical center

Box

Figure 2: The Share of Taxes and Duties Paid by the Top 10 of the Largest 1,000 Taxpayers per Taxes

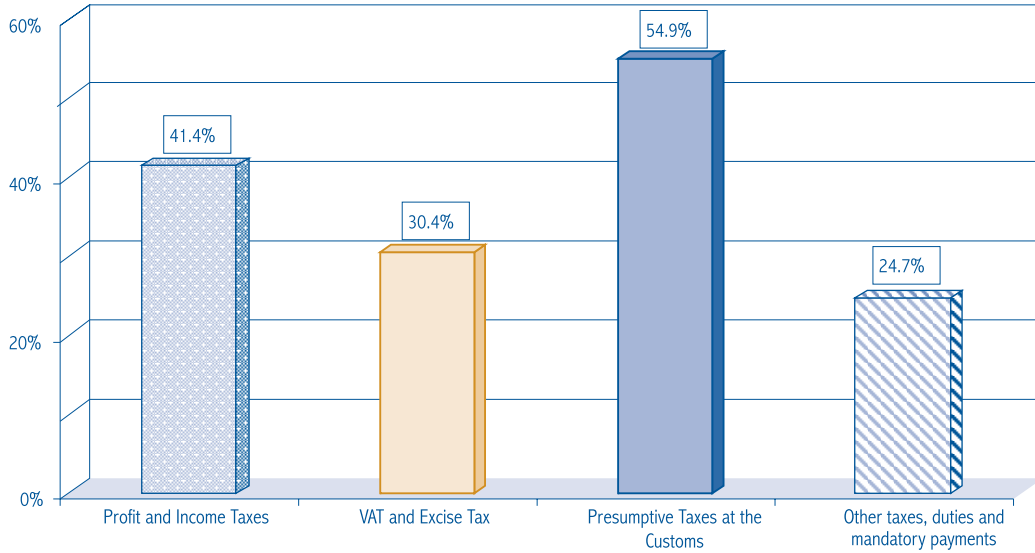
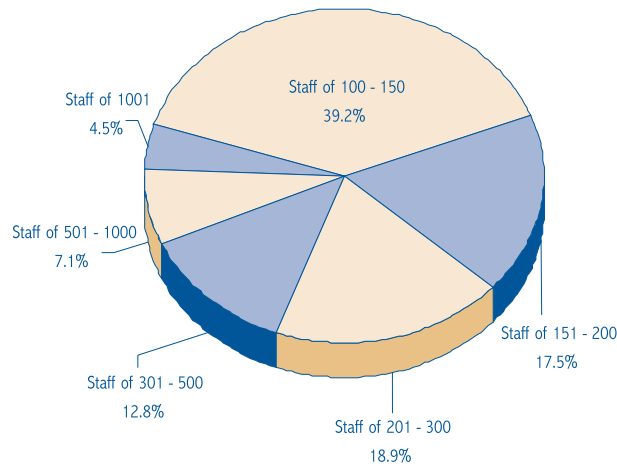
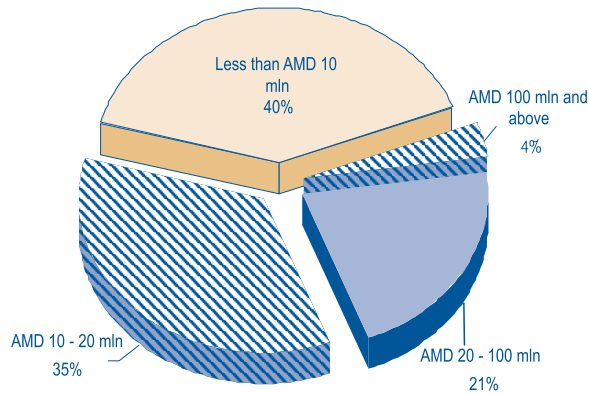


Figure 3: Breakdown of Entities with 100 and More Staff, January-September 2006, percent



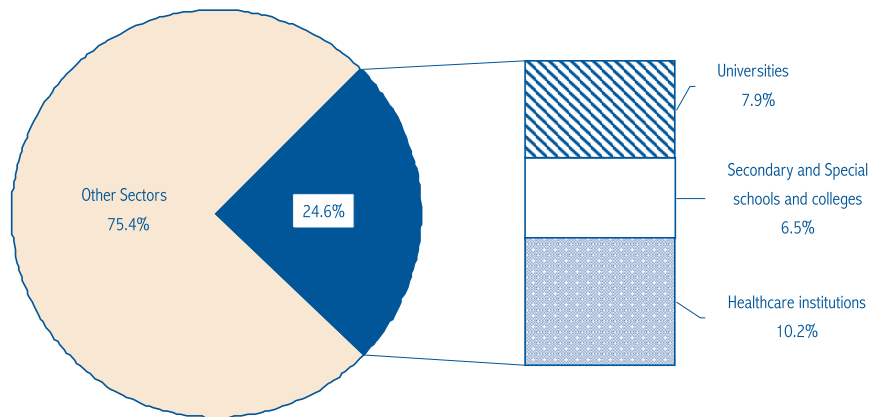
For the first nine months of 2006, the list of entities that pay AMD 3 million and above in social insurance contributions was published. According to that list and respective payment data, about 40 percent of all insurers' payments fall below AMD 10 million, whereas only 37 insurers paid more than AMD 100 million in social insurance payments. Among those 37, only Armenian Electric Networks paid more than AMD 1 billion.

Figure 4: Breakdown of Social Insurance Payments per Size of Payments, All Those That Pay AMD 3 Million and above, percent



In analyzing the social insurance contributions, the following was observed: about 25 percent (AMD 26.4 billion) was paid by 33 universities, 143 healthcare entities and 174 secondary and special education schools and colleges (See Figure 5).

Figure 5: Share of Social Insurance Contributions by Educational and Healthcare Institutions in Total Contributions of Above AMD 3 million, percent



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Economic Outlook

Economic Trends in Armenia: January-September 2006

Real Sector

Real growth of the Armenian economy during the first nine months of 2006 equaled 12.5 percent which exceeds the growth rate recorded during the same period in 2005 by 0.8 percentage points. Generated GDP was equivalent to USD 4,000 million, which exceeded the same indicators for January-September 2005 by USD 640 million. As a consequence, per capita GDP increased by USD 259 reaching USD 1,242.

A total of 7.3 percentage points of the economic growth took place due to 37 percent growth in the gross value added in construction. Among other sectors, services and trade contributed significantly to the economic growth by 2.7 and 1.0 percentage points, respectively. Budgetary revenues from net taxes grew by 13.5 percent, thus providing for 1.2 percentage points of total economic growth. High growth rates were recorded, along with construction, in services, transport (and communication) and trade sectors at rates of 15.8 percent, 14.8 percent and 13 percent, respectively. Gross value added in industry decreased by 1.6 percent, whereas, during the first three quarters of 2005, industry grew by 6.1 percent.

Sixty-one percent of the GDP growth was generated through manufacturing, 30.3 percent through services, and 8.7 percent from net taxes (subsidies deducted).

Fiscal Sector

According to the actual data for January-September 2006, budgetary expenditures growth rate exceeded that of revenues by two percentage points: as a consequence, a budget deficit of AMD 25.9 billion was recorded (equivalent to 1.5 percent of the GDP).

The recorded 17.9 percent growth in budgetary revenues was mostly provided by high growth rates in revenues from VAT, profit and income taxes, as well as revenues from capital transactions (15.9, 38.4, 34.3 and 40.2 percent, respectively.) Official transfers increased by 31 percent or AMD 1.4 billion as compared to the same period in 2005. Tax revenues increased by 19.5 percent which was mostly due to increased revenues from VAT, profit and income taxes (7.4, 6.2 and 3 percentage points, respectively.)

Major expenditures for the government were education and sci-

ence, transportation (road sector and communications) and healthcare, as well as the social insurance and the social security sectors. As compared to January-September 2005, budgetary expenditures in these areas increased by 29 percent, 67.6 percent, 31.9 percent and 20 percent, respectively. Expenditures for defense (which constituted 17.3 percent of total expenditures) increased by 11.8 percent as compared to the same period in 2005. At the same time, expenditures in all other areas decreased by 7.4 percent.

A total of 6.8 percentage points of the total increase in expenditures were due to increased capital expenditures (which rose by 37.3 percent) Another 4.7 percentage points were the result of increased procurement of goods and services, as well as current transfers (10.3 percent and 25.8 percent, respectively). As compared to January-September 2005, interest payments on public debt decreased by 6.7 percent, including interest on external debt, which decreased by 8 percent, and interest on domestic debt, which decreased by 5.7 percent.

Foreign Trade

As compared to the same period in 2005, exports of goods decreased by 0.9 percent during January-September 2006, while imports grew by 19.4 percent. For comparison, the export growth rate during the first nine month of 2005 was 9.1 percentage points faster than that of imports (exports grew by 40.6 percent). As a result, the trade deficit during January-September worsened by 45 percent, or USD 251 million, and reached 20.2 percent of GDP. The trade deficit (excluding humanitarian assistance of USD 36.8 million) equaled USD 772.5 million.

Foreign trade turnover increased by 12.2 percent during the same period. The largest trade partners during that period were Russia and Germany at USD 293.1 million and 210.9 million, respectively.

Monetary Sector

According to the preliminary data of the Central Bank of Armenia, Broad Money increased by AMD 8.5 billion (2.2 percent) during September (as compared to the end of August) and reached AMD 405.4 billion. Both cash outside the banking sector and dram deposits grew by AMD 10.6 billion and AMD 13.4 billion, respectively. Meanwhile, FOREX deposits decreased by 10.7 percent; however, they still remain at AMD 24 billion higher than dram deposits.

Economic Outlook

Armenia: Main Macroeconomic Indicators

	2003	2004	2005	2003	2004	2005	2006
Real Sector		Annual		January-September			
Nominal GDP (AMD mln)	1,624.6	1,907.9	2,244.0	1,052.9	1,253.9	1,453.7	1,720.1
GDP Per Capita (in US dollars)	874.4	1,113.4	1,524.6	562.1	716.1	983.9	1,242.4
GDP Real Growth (%)	14.0	10.5	14.0	15.5	10.7	11.7	12.5
GDP Deflator (%)	4.6	6.3	3.2	3.7	7.6	3.8	5.1
Inflation (period-average, %)	4.7	7.0	0.6	3.8	7.9	0.9	2.0
Inflation (end-of-period, %)	8.6	2.0	-0.2	1.1	-1.3	-3.6	2.4
Economic Sectors (Real Growth Rates, %)							
Industry	15.6	2.2	7.4	20.9	2.0	6.1	-1.6
Agriculture	4.2	14.2	11.2	0.4	16.9	9.0	0.0
Construction	45.5	15.3	35.1	56.9	14.6	32.8	37.0
Transport and Communication	8.3	19.5	13.2	10.2	19.1	11.2	14.8
Trade and Catering	14.1	10.6	9.6	13.6	9.5	7.3	12.0
Services	8.6	11.7	10.9	11.7	13.7	10.9	15.8
Fiscal Sector (State Budget Indicators by Financing)							
Revenues and Grants(AMD bln)	292.0	302.2	374.7	201.9	213.5	259.4	305.9
Expenditures (AMD bln)	312.7	334.0	417.5	218.2	230.5	276.8	331.8
Deficit (AMD bln)	20.7	31.7	42.8	16.4	17.0	17.4	25.9
Tax Revenues (% of GDP)	13.1	13.1	13.6	14.1	14.1	14.5	14.7
Expenditures (% of GDP)	19.2	17.5	18.6	20.7	18.4	19.0	19.3
Deficit (% of GDP)	1.3	1.7	1.9	1.6	1.4	1.2	1.5
External Sector							
Exports (FOB, USD mln)	685.6	722.9	950.4	504.3	501.9	705.5	699.4
Imports (CIF, USD mln)	1,279.5	1,350.7	1,767.9	936.1	961.6	1,264.0	1,508.7
Trade Balance, (% of GDP)	21.2	17.6	16.7	23.9	20.0	17.7	20.2
Exports Growth Rate (%)	35.7	5.4	31.5	42.5	-0.5	40.6	-0.9
Imports Growth Rate (%)	29.6	5.6	30.9	39.6	2.7	31.4	19.4
Exchange Rate (AMD / USD, period-average)	578.8	533.5	457.7	583.5	545.1	459.5	430.0
Exchange Rate (AMD / USD, end-of-period)	566.0	485.8	450.2	570.1	508.2	444.2	381.5
Monetary Sector							
Broad Money (End-of-period, AMD bln)	233.8	285.9	365.6	212.1	253.5	332.4	405.4
Net Foreign Assets of the CBA (AMD bln)	157.8	149.3	237.6	143.5	145.0	224.6	273.9
Broad Money Velocity*	6.9	6.7	6.1	5.0	4.9	4.4	4.2
Money Multiplier	2.05	2.18	1.85	2.02	2.19	1.91	1.83

* Calculated as nominal GDP and Broad Money ratio.
Source: NSS of RA, EDRC calculations.

Economic Outlook

Broad Money increased by 21.9 percent as compared to September 2005, largely due to a 41-percent increase in cash outside the banking system. Dram deposits have grown by 56 percent (their share in the Broad Money increased to 25.7 percent) since September 2005. FOREX deposits decreased by 9.9 percent, reducing their share in the Broad Money by 11.2 percentage points and reaching 31.7 percent.

Exchange Rates

The dram appreciated against all major currencies during September 2006, including by AMD 14 against the U.S. dollar (USD), or 3.6 percent; by AMD 24 against the Euro (EUR), or 4.8 percent; and AMD 0.6 against Russian Ruble (RUR), or 3.7 percent. The highest exchange rates on USD, EUR and RUR occurred during September when they reached AMD 395.9, AMD 508.8 and AMD 14.8, respectively. As a result, between January and September, the dram appreciated, on average, by AMD 30, AMD 47 and AMD 0.6 against USD, EUR and RUR, respectively.

By the end of September, the dram appreciated (as compared to December 2005) by AMD 69 against USD (15.3 percent), by AMD 47 against EUR (8.9 percent), and by AMD 1.4 against RUR (8.8 percent).

Consumer Markets

A 0.3 percent deflation was recorded in consumer prices during September 2006, including a 0.7 percent deflation in prices for food products and 0.2 percent in prices for non-food products,

though the prices for service products grew by 0.5 percent.

Prices for food products did not grow homogeneously during this period. Prices for eggs and fish grew by 7.2 percent and 4.3 percent, respectively. On the other hand, prices for vegetables and potatoes decreased by 9.1 percent, while prices for fruits fell by 2.9 percent, sugar prices dropped by 1.7 percent, and prices for vegetable and animal oil went down by 1.1 percent.

Among non-food products, prices for gardening tools grew by 5.7 percent, while prices for carpets increased by 5.4 percent, footwear and shoes went up by 2 percent, and apparel prices increased by 1.1 percent. Prices for textiles dropped by 3.2 percent, while prices for jewelry fell by 2.6 percent and prices for beauty products decreased by 2 percent. Prices for cars and petroleum dropped by 1.4 percent.

An increase in the prices for services was mostly conditioned by a 4.2-percent increase in prices for educational services, as well as a 1.3-percent increase in leisure services.

As a result, consumer prices grew by 2.4 percent during the January-September 2006 period, whereas the average price level increased by 2 percent as compared to the average for January-September 2005.

GDP deflator was recorded at 5.1 percent for the first three quarter of 2006.

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Recent Amendments in Tax Legislation

Recent Amendments in Tax Legislation of Armenia

During the first nine months of 2006, a number of amendments were made to the Armenian Tax legislation. Below are summarized the major amendments published during the first nine months of 2006 which we consider the most important.

Law on Value Added Tax

- Law on Amendments in the Law on Value Added Tax (HO-87-N) passed on May 23, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting December 28, 2007.

This amendment edited the 10th paragraph of Article 15, p.17, by replacing “standard gold (bank) bars” with “bank gold”.

- Law on Amendments in the Law on Value Added Tax (HO-129-N) passed on June 13, 2006 (*RA Official Bulletin 38 (493), 2006*). Effective starting July 22, 2006.

The present amendment added new codes to Article 6¹: 250510, 250900, 251820, 2836, 39162010, 76041090, 8419, 8426, 8429, 8430, 8435, 8443, 8478, 8479, 85023100, 870410 codes were added after “8475”. Payment of VAT for commodities under the above-mentioned categories imported through the Armenian customs is prolonged by one year.

Law on Income Tax

- The Law on Amending the Income Tax Law (HO-165-N) passed on July 07, 2006 (*RA Official Bulletin 43 (498), 2006*). Effective starting January 1, 2008

The present amendment of the Income Tax Law replaces all such words as “declaration,” “declaring” and their conjugations thereof with “calculation” and “calculating” and respective forms thereof. Apart from that, Article 31 was also amended: “in accordance with provisions defined by the Government of Armenia” was added after the word “present/submit.” Furthermore, “starting March 1” was replaced with “starting April 15” in p.5 of the same Article: the latter amendment extends the deadline for the submission of the annual tax calculations of natural persons.

Moreover, Article 24, Article 31 p.9, and Article 38 p.4 are deemed ineffective.

Law on Approving the list of goods, imported by organizations and individuals eligible for 0 custom’s duty rate and not subject to excise tax, for which VAT shall not be calculated and paid to Customs

- Law on Amendments in the Law on Approving the list of goods, imported by organizations and individuals eligible for 0 custom’s duty rate and not subject to excise tax, for which VAT shall not be calculated and paid to the Customs Taxes (HO-130-N) passed on June 13, 2006 (*RA Official Bulletin 38 (493), 2006*). Effective starting July 22, 2006.

The list of goods falling under 8471 coding were deleted; instead, a category was added as “8471 Computation machines and block thereof.”

Law on Presumptive Taxes

- Law on Amendments in the Law on Presumptive Taxes (HO-92-N) passed on May 25, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting July 8, 2006.

Article 60 p. (b) was amended by replacing “guarding cars in temporary parking and vehicles against reimbursement” with “Paid temporary parking for cars.”

Law on Presumptive Taxes for Tobacco Products

- Law on Amendments in the Law on Presumptive Taxes for Tobacco Products (HO-81-N) passed on May 25, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting July 8, 2006.

The rates for goods under Article 3, p. 1 of the Law (codes 24021000011 and 2402 90 000 11, Tobacco Cigar and Other Cigar) were reduced from “AMD 1,500,000 and AMD 1,100,000” to “AMD 550,000 and AMD 300,000”.

Law on State Duties

- Law on Amendments in the Law on State Duties (HO-116-N) passed on June 01, 2006 (*RA Official Bulletin 34 (489), 2006*). Effective starting June 29, 2006.

Clauses on Human Rights Defender were added to the clauses on privileges and exemptions for duties (Articles 22, 26 and 29.

- Law on Amendments in the Law on State Duties (HO-93-N)

Recent Amendments in Tax Legislation

passed on May 23, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting July 8, 2006.

Article 19, p. 11 was amended for the duty rates for the licenses for the nuclear energy sub-sector. The list of activities is reviewed and state duty rates modified.

- Law on Amendments in the Law on State Duties (HO-88-N) passed on May 23, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting December 28, 2006.

Two new sub-paragraphs were added to Article 19 (rates of duties for licenses); p. 18 – 18.10 and 18.11 were added for activities such as definitions of standards of precious metals and production of standard bank gold bars.

- Law on Amendments in the Law on State Duties (HO-109-N) passed on June 01, 2006 (*RA Official Bulletin 36 (491), 2006*). Effective starting July 16, 2006.

Article 16 was amended to delete p. 4.7 on the rates of state duties for lawyers with special licenses payable for the registration

with the Cassation Court.

- Law on Amendments in the Law on State Duties (HO-151-N) passed on June 13, 2006 (*RA Official Bulletin 38 (493), 2006*). Effective starting January 12, 2007.

A new paragraph 17¹ is added to Article 19 of the Law relating to activities in the social protection sector.

Law on Local Duties and Payments

- Law on Amendments in the Law on Local Duties and Payments (HO-90-N) passed on May 23, 2006 (*RA Official Bulletin 33 (488), 2006*). Effective starting December 28, 2006.

This Amendment affected Article 7 on the types of local Duties and Payments. According to the Amendment for the retail sale of jewelry (precious metals), in accordance with Article 8 of the Law on Precious Metals, a local duty is set in the amount of AMD 50,000 annually.

Statistical Data

Hereby we present you some statistical data on the Execution of State Budget Revenues and Expenditures by quarters. The source of this statistical data is "Socio-Economic Situation of the Republic of Armenia" monthly informational reports for 2003-2006 from the National Statistical Service of the RoA..

Table 1.1 State Budget Expenditures by Economic Classification (billion AMD)

Indicators	2003				2004				2005				2006		
	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV	Q I	Q II	Q III
Total Expenditures	51.8	125.6	218.2	312.7	61.0	135.1	230.5	334.0	66.9	164.3	276.8	417.5	83.9	202.4	331.8
Current Expenditures	40.2	95.6	156.0	222.3	50.5	111.6	184.8	262.8	57.4	132.3	216.3	329.1	72.1	158.8	249.0
Wages	1.6	4.4	7.9	13.7	4.5	10.0	16.0	24.2	5.9	13.6	21.6	32.9	7.4	16.8	26.7
Interest Payments	3.4	6.2	9.1	11.4	2.4	4.6	7.6	9.8	2.2	4.5	6.9	9.9	2.4	4.4	6.4
Domestic Debt	1.2	2.7	4.3	5.7	1.1	2.3	4.1	5.4	1.0	2.4	3.8	5.1	1.4	2.4	3.6
External Debt	2.2	3.6	4.8	5.7	1.4	2.4	3.5	4.4	1.2	2.1	3.1	4.9	1.1	2.0	2.9
Subsidies	3.2	6.3	10.8	14.5	6.1	9.3	14.1	18.1	3.6	7.4	11.7	14.7	3.1	7.2	13.9
Current Transfers	7.9	17.8	29.6	41.8	10.7	22.3	35.9	50.1	14.1	32.2	50.7	72.4	19.1	40.9	63.7
Goods and Services	24.2	60.7	98.6	140.9	26.8	65.2	111.2	160.5	31.6	74.6	125.4	199.2	40.0	89.4	138.3
Capital Expenditures	9.9	26.2	55.3	83.8	8.3	18.3	37.5	60.6	6.7	25.8	50.6	75.3	8.4	34.8	69.4
Net Lending	1.7	3.9	6.9	6.6	2.1	5.2	8.2	10.5	2.8	6.2	9.9	13.1	3.4	8.8	13.4

Table 1.2 State Budget Expenditures by Economic Classification (in % to GDP)

Indicators	2003				2004				2005				2006		
	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV	Q I	Q II	Q III
Total Expenditures	27.3	24.1	20.7	19.2	28.1	22.2	18.4	17.5	26.9	23.1	19.0	18.6	31.5	25.0	19.3
Current Expenditures	21.2	18.4	14.8	13.7	23.2	18.4	14.7	13.8	23.0	18.6	14.9	14.7	27.1	19.6	14.5
Wages	0.8	0.9	0.8	0.8	2.1	1.7	1.3	1.3	2.4	1.9	1.5	1.5	2.8	2.1	1.6
Interest Payments	1.8	1.2	0.9	0.7	1.1	0.8	0.6	0.5	0.9	0.6	0.5	0.4	0.9	0.5	0.4
Domestic Debt	0.6	0.5	0.4	0.3	0.5	0.4	0.3	0.3	0.4	0.3	0.3	0.2	0.5	0.3	0.2
External Debt	1.2	0.7	0.5	0.4	0.6	0.4	0.3	0.2	0.5	0.3	0.2	0.2	0.4	0.2	0.2
Subsidies	1.7	1.2	1.0	0.9	2.8	1.5	1.1	0.9	1.4	1.0	0.8	0.7	1.2	0.9	0.8
Current Transfers	4.2	3.4	2.8	2.6	4.9	3.7	2.9	2.6	5.7	4.5	3.5	3.2	7.2	5.1	3.7
Goods and Services	12.7	11.7	9.4	8.7	12.3	10.7	8.9	8.4	12.7	10.5	8.6	8.9	15.0	11.0	8.0
Capital Expenditures	5.2	5.0	5.3	5.2	3.8	3.0	3.0	3.2	2.7	3.6	3.5	3.4	3.2	4.3	4.0
Net Lending	0.9	0.7	0.7	0.4	1.0	0.9	0.7	0.6	1.1	0.9	0.7	0.6	1.3	1.1	0.8

Table 2.1 State Budget Expenditures by Functional Classification (billion AMD)

Indicators cumulative	2003				2004				2005				2006			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
Total Expenditures	51.8	125.6	218.2	312.7	61.0	135.1	230.5	334.0	66.9	164.3	276.8	417.5	83.9	202.4	331.8	34.7
Public Services of Common Nature	4.7	11.7	19.8	30.0	6.4	15.3	25.1	36.6	8.8	19.6	31.4	44.2	9.4	21.7	34.7	34.7
Defense	7.3	19.5	32.7	44.3	10.0	24.8	39.2	52.3	11.2	29.3	48.0	64.4	14.6	33.1	53.6	53.6
Maintenance of Public Order and Security	3.5	8.3	13.9	20.8	4.1	10.0	15.9	24.6	5.9	13.6	21.9	35.0	6.7	17.2	27.3	27.3
Education and Science	5.2	13.2	23.4	34.8	7.3	16.8	30.6	47.4	10.0	24.9	41.0	60.8	12.8	34.0	52.9	52.9
Public Health	4.6	7.6	13.1	19.6	4.6	9.3	15.4	24.7	4.3	12.0	19.6	31.1	6.8	16.3	25.9	25.9
Social Insurance and Social Security	6.3	12.8	20.1	29.3	7.7	16.4	25.2	35.0	9.4	20.0	31.3	44.1	11.3	24.3	37.5	37.5
Culture, Information, Sport and Religion	1.8	5.4	9.0	14.1	1.8	3.8	5.9	8.5	2.0	4.6	7.3	10.4	2.5	6.0	9.6	9.6
Housing and Communal Facilities	3.5	9.2	17.9	37.8	2.1	4.7	7.6	12.0	2.8	8.8	13.9	22.7	3.3	9.8	15.4	15.4
Fuel and Energy Complex	1.8	4.4	5.8	7.0	2.2	4.7	7.5	9.6	0.7	1.0	2.2	3.6	0.8	1.7	3.5	3.5
Agriculture, Forestry and Aquaculture, Fishing	2.4	6.7	12.6	19.9	4.2	7.6	12.6	16.4	2.9	5.9	10.2	13.2	2.8	5.6	12.8	12.8
Industry, Mineral Fossils (excluding fuel), Construction and Nature Protection	0.3	0.8	1.4	-6.3	0.3	1.0	1.7	3.1	0.8	2.0	3.4	4.8	0.9	3.0	4.9	4.9
Transport, Communication and Roading	4.0	6.9	20.5	30.4	3.1	5.9	12.2	18.5	2.0	6.4	13.6	21.1	4.3	11.6	22.8	22.8
Other Expenditures	6.4	18.9	28.0	31.1	7.1	14.7	31.6	45.3	6.2	16.1	32.9	62.1	7.6	18.2	30.8	30.8

Table 2.2 State Budget Expenditures by Functional Classification (in % to GDP)

Indicators cumulative	2003				2004				2005				2006			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
Total Expenditures	27.3	24.1	20.7	19.2	28.1	22.2	18.4	17.5	26.9	23.1	19.0	18.6	31.5	25.0	19.3	19.3
Public Services of Common Nature	2.5	2.2	1.9	1.8	3.0	2.5	2.0	1.9	3.5	2.8	2.2	2.0	3.5	2.7	2.0	2.0
Defense	3.8	3.8	3.1	2.7	4.6	4.1	3.1	2.7	4.5	4.1	3.3	2.9	5.5	4.1	3.1	3.1
Maintenance of Public Order and Security	1.8	1.6	1.3	1.3	1.9	1.7	1.3	1.3	2.4	1.9	1.5	1.6	2.5	2.1	1.6	1.6
Education and Science	2.7	2.5	2.2	2.1	3.4	2.8	2.4	2.5	4.0	3.5	2.8	2.7	4.8	4.2	3.1	3.1
Public Health	2.4	1.5	1.2	1.2	2.1	1.5	1.2	1.3	1.7	1.7	1.4	1.4	2.6	2.0	1.5	1.5
Social Insurance and Social Security	3.3	2.5	1.9	1.8	3.6	2.7	2.0	1.8	3.8	2.8	2.2	2.0	4.2	3.0	2.2	2.2
Culture, Information, Sport and Religion	1.0	1.0	0.9	0.9	0.8	0.6	0.5	0.4	0.8	0.6	0.5	0.5	0.9	0.7	0.6	0.6
Housing and Communal Facilities	1.8	1.8	1.7	2.3	1.0	0.8	0.6	0.6	1.1	1.2	1.0	1.0	1.3	1.2	0.9	0.9
Fuel and Energy Complex	1.0	0.8	0.6	0.4	1.0	0.8	0.6	0.5	0.3	0.1	0.2	0.2	0.3	0.2	0.2	0.2
Agriculture, Forestry and Aquaculture, Fishing	1.3	1.3	1.2	1.2	1.9	1.3	1.0	0.9	1.2	0.8	0.7	0.6	1.0	0.7	0.7	0.7
Industry, Mineral Fossils (excluding fuel), Construction and Nature Protection	0.2	0.2	0.1	-0.4	0.2	0.2	0.1	0.2	0.3	0.3	0.2	0.2	0.3	0.4	0.3	0.3
Transport, Communication and Roading	2.1	1.3	1.9	1.9	1.4	1.0	1.0	1.0	0.8	0.9	0.9	0.9	1.6	1.4	1.3	1.3
Other Expenditures	3.4	3.6	2.7	1.9	3.3	2.4	2.5	2.4	2.5	2.3	2.3	2.8	2.9	2.3	1.8	1.8

Table 3.1 State Budget Revenues (billion AMD)

Indicators cumulative	2003				2004				2005				2006			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
Total Revenues and Grants	53.9	119.6	201.9	292.0	57.5	128.2	213.5	302.2	77.9	161.2	259.4	374.7	82.5	194.0	305.9	305.9
Total Revenues	48.2	105.6	168.6	241.6	56.7	125.8	206.5	288.5	74.5	157.2	254.9	363.1	81.7	189.8	300.1	300.1
Current Revenues	46.6	103.9	166.0	238.3	56.4	124.8	198.8	279.4	74.0	153.2	247.9	350.8	79.1	184.4	290.3	290.3
Tax Revenues	42.7	93.0	148.0	212.2	50.2	109.5	176.3	250.1	61.0	132.6	211.0	304.3	70.9	158.5	252.0	252.0
VAT	23.0	48.8	76.3	107.8	24.8	51.5	82.8	117.9	31.3	61.2	98.2	146.8	31.8	69.5	113.8	113.8
Personal Income Tax	3.4	7.6	11.5	16.8	4.1	9.2	14.6	20.4	5.2	11.2	18.2	26.6	7.6	15.4	24.5	24.5
Enterprise Profit Tax	3.5	7.6	11.5	17.6	4.9	14.2	21.8	32.0	6.7	23.1	34.3	46.6	11.5	32.7	47.5	47.5
Excise Tax	7.5	16.6	27.9	39.1	9.1	18.9	29.8	40.7	8.0	16.6	28.1	38.6	9.0	17.5	28.6	28.6
Customs Duties	1.9	4.6	7.2	10.7	2.2	5.3	8.5	12.5	3.5	7.3	11.4	16.5	3.6	8.2	12.8	12.8
Other Taxes	3.4	7.8	13.5	20.2	5.1	10.4	18.8	26.7	6.4	13.2	20.7	29.2	7.3	15.3	24.9	24.9
State Duties	2.8	7.0	11.7	15.2	3.3	7.5	12.9	16.9	3.2	7.2	13.0	17.3	3.7	8.2	14.3	14.3
Non-Tax Revenues	1.1	3.9	6.3	10.9	2.8	7.9	9.6	12.4	9.9	13.3	24.0	29.2	4.6	17.8	24.0	24.0
Capital Revenues	1.6	1.6	2.6	3.2	0.3	1.0	7.8	9.1	0.5	4.0	7.0	12.4	2.6	5.4	9.9	9.9
Grants	5.8	14.1	33.3	50.5	0.8	2.4	7.0	13.7	3.4	4.0	4.4	11.6	0.8	4.2	5.8	5.8

Table 3.2 State Budget Revenues (in % to GDP)

Indicators cumulative	2003				2004				2005				2006			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
Total Revenues and Grants	28.4	23.0	19.2	18.0	26.4	21.1	17.0	15.8	31.3	22.7	17.8	16.7	31.0	24.0	17.8	17.8
Total Revenues	25.4	20.3	16.0	14.9	26.1	20.7	16.5	15.1	29.9	22.1	17.5	16.2	30.7	23.4	17.4	17.4
Current Revenues	24.5	20.0	15.8	14.7	25.9	20.5	15.9	14.6	29.7	21.6	17.1	15.6	29.7	22.8	16.9	16.9
Tax Revenues	22.5	17.9	14.1	13.1	23.1	18.0	14.1	13.1	24.5	18.7	14.5	13.6	26.6	19.6	14.7	14.7
VAT	12.1	9.4	7.2	6.6	11.4	8.5	6.6	6.2	12.6	8.6	6.8	6.5	12.0	8.6	6.6	6.6
Personal Income Tax	1.8	1.5	1.1	1.0	1.9	1.5	1.2	1.1	2.1	1.6	1.3	1.2	2.9	1.9	1.4	1.4
Enterprise Profit Tax	1.9	1.5	1.1	1.1	2.2	2.3	1.7	1.7	2.7	3.2	2.4	2.1	4.3	4.0	2.8	2.8
Excise Tax	3.9	3.2	2.7	2.4	4.2	3.1	2.4	2.1	3.2	2.3	1.9	1.7	3.4	2.2	1.7	1.7
Customs Duties	1.0	0.9	0.7	0.7	1.0	0.9	0.7	0.7	1.4	1.0	0.8	0.7	1.4	1.0	0.7	0.7
Other Taxes	1.8	1.5	1.3	1.2	2.3	1.7	1.5	1.4	2.6	1.9	1.4	1.3	2.7	1.9	1.4	1.4
State Duties	1.4	1.4	1.1	0.9	1.5	1.2	1.0	0.9	1.3	1.0	0.9	0.8	1.4	1.0	0.8	0.8
Non-Tax Revenues	0.6	0.7	0.6	0.7	1.3	1.3	0.8	0.6	4.0	1.9	1.6	1.3	1.7	2.2	1.4	1.4
Capital Revenues	0.8	0.3	0.2	0.2	0.1	0.2	0.6	0.5	0.2	0.6	0.5	0.6	1.0	0.7	0.6	0.6
Grants	3.0	2.7	3.2	3.1	0.4	0.4	0.6	0.7	1.3	0.6	0.3	0.5	0.3	0.5	0.3	0.3

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