



Report and Recommendation of the President to the Board of Directors

Project Number: 53305-001
September 2021

Proposed Grant and Administration of Grants Solomon Islands: Domestic Resource Mobilization Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 20 August 2021)

Currency unit	–	Solomon Islands dollar/s (SI\$)
SI\$1.00	=	\$0.12
\$1.00	=	SI\$8.00

ABBREVIATIONS

ADB	–	Asian Development Bank
CED	–	Customs and Excise Division
COVID-19	–	coronavirus disease
GAP	–	gender action plan
GDP	–	gross domestic product
IMF	–	International Monetary Fund
IRD	–	Inland Revenue Division
MOFT	–	Ministry of Finance and Treasury
OECD	–	Organisation for Economic Co-operation and Development
PAM	–	project administration manual
PFTAC	–	Pacific Financial Technical Assistance Centre
TAIS	–	tax administration information system
VAT	–	value-added tax

NOTE

In this report, “\$” refers to United States dollars unless otherwise stated.

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 53305-001	
Project Name	Domestic Resource Mobilization Project	Department/Division	PARD/PLCO
Country	Solomon Islands	Executing Agency	Ministry of Finance and Treasury
Recipient	Solomon Islands		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=53305-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=53305-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		5.50
		Total	5.50
3. Operational Priorities		Climate Change Information	
✓ Accelerating progress in gender equality		GHG reductions (tons per annum)	0
✓ Strengthening governance and institutional capacity		Climate Change impact on the Project	Low
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.b		Effective gender mainstreaming (EGM)	✓
SDG 17.1		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization:	Low		
5. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		5.50	
Sovereign Project grant: Asian Development Fund		5.50	
Cofinancing		10.00	
Government of Australia - Project grant (Full ADB Administration)		3.50	
New Zealand - Project grant (Full ADB Administration)		6.50	
Counterpart		4.62	
Government		4.62	
Total		20.12	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed grant to Solomon Islands for the Domestic Resource Mobilization Project. The report also describes the proposed administration of a grant to be provided by the Government of Australia and a grant to be provided by the Government of New Zealand for the Domestic Resource Mobilization Project, and if the Board approves the proposed grant, I, acting under the authority delegated to me by the Board, approve the administration of the grants.

2. The proposed project will support the Government of Solomon Islands to improve tax administration. The development outcome will be improved domestic resource mobilization. This outcome will be achieved through (i) more efficient tax administration that provides better services to taxpayers; and (ii) increased capacity of the Inland Revenue Division (IRD) to manage the transition to a more efficient, fairer, and transparent tax framework. The project will assist in restructuring the IRD to (i) move to a functional structure and train staff in their new roles and processes, (ii) finance the acquisition of a new tax administration information system (TAIS) and train staff in its use, and (iii) deliver a public outreach program to increase taxpayer compliance.

II. THE PROJECT

A. Rationale

3. **Development context.** Solomon Islands is the third largest of the developing member countries of the Asian Development Bank (ADB) in the Pacific, with a population of about 721,000. ADB recognizes Solomon Islands as a small island developing state and a fragile and conflict-affected situation.¹ As a small open economy with a narrow economic base, the country is dependent on exports, which represented 42.0% of 2019 gross domestic product (GDP). Round logs accounted for 71.6% of exports and 22.0% of government revenues, and directly or indirectly supported nearly half of the workforce.² Despite these constraints, Solomon Islands had steady economic growth following the widespread civil conflict that lasted from 1998 to 2003. However, economic growth on a per capita basis has not been as robust because of the fast-increasing population (more than 2% per year since 2004); the GDP per capita of \$1,751, when adjusted for inflation, remains lower today than it was before the conflict. While poverty has declined, Solomon Islands has the second-lowest gross national income per capita among Pacific developing member countries (\$2,020 in 2018). The United Nations classifies it as a least-developed country.³ Under the National Development Strategy, 2016–2035, the government aims to improve social and economic livelihoods through inclusive economic growth.⁴ To achieve this goal, the government needs more sustainable revenues from domestic sources.

4. **COVID-19 exposed fragilities.** The coronavirus disease (COVID-19) pandemic has exposed fragilities in the Solomon Islands economy. ADB estimated an economic contraction of 4.5% of GDP for 2020.⁵ The government recognizes that new sources of growth need to be identified to broaden the productive base of the economy and support the economy as it recovers from the economic contraction caused by the pandemic. A prerequisite is a tax system that (i) is

¹ ADB. 2020. *Fragile and Conflict-Affected Situations (FCAS) and Small Island Developing States (SIDS) Groups*. Manila.

² International Monetary Fund (IMF). 2020. Solomon Islands: Staff Report for the 2019 Article IV Consultation. *IMF Country Report*. No. 20/49. Washington, DC.

³ World Bank. World Bank Open Data. [Solomon Islands](#) (accessed 5 March 2021).

⁴ Government of Solomon Islands. 2016. *National Development Strategy, 2016–2035*. Honiara.

⁵ ADB. 2021. *Asian Development Outlook 2021: Financing a Green and Inclusive Recovery*. Manila.

efficient, simple, inexpensive to administer; (ii) discourages unproductive tax avoidance and evasion activities; and (iii) actively supports growth. A broad-based tax system that encourages productive investments is particularly important in the post-COVID-19 era as the government seeks higher levels of investment to support economic growth. Solomon Islands performed well with a tax-to-GDP ratio of 30.4% in 2018, which is at the higher end of countries across Asia and the Pacific, however, tax revenues decreased by 7.8% in 2020 compared to 2019 because of the contraction caused by COVID-19.⁶ This highlights the need for tax policy and administration reform to enhance domestic resource mobilization in an economically efficient manner.

5. **Complex and unwieldy tax framework.** There are multiple discrete indirect taxes: a goods tax, excises, and customs duty levied on almost all imported goods, and services tax and stamp duty are applied selectively on internal transactions. Each has separate legislation; multiple tax rates; various generic and specific exemptions; different points of assessment; and different rules for the filing of returns, the timing of payments, offenses, and penalties. In addition to these indirect taxes, there are direct taxes on corporate, individual, and income withholding, each with different rules, frequencies of payment, and penalty regimes. Finally, the tax framework fosters unproductive behavior, including competition rounds for a fixed pool of discretionary exemptions.

6. **Government's tax reforms.** In late 2017, the government initiated a comprehensive review of its tax framework to simplify tax arrangements and broaden the tax base. The purpose of the review was to look at ways to raise revenue in an economically efficient manner, stimulate private sector growth, attract foreign investors, reduce the compliance costs on taxpayers, and lower tax administration costs. The government's tax reform program will result in new legislation that is expected to be enacted progressively at intervals from the end of 2021 until mid-2023, commencing with the Tax Administration Act that will standardize and simplify administrative procedures and penalties for the taxes administered by the IRD.⁷

7. A bill to introduce a value-added tax (VAT) is nearing completion, with final policy approvals and enactment expected in late 2021 for implementation in 2023. The current Goods Tax Act (1992), Sales Tax Act (1990), Stamp Duties Act (1940), and their associated regulations will be repealed with the introduction of a VAT. The customs duty on most imported goods will be removed, with the VAT levied on all imports, including any that remain subject to customs duty and excises. Modeling to determine the VAT rate and level of business turnover which requires registering for a VAT has been based on these reforms being revenue neutral. The introduction of the VAT will be a substantial change for the IRD and the business community, particularly large businesses, who will need to comply with the various obligations and reporting requirements.

8. A review of the Income Tax Act (1992) is scheduled for 2022, with a revised act to be finalized following work on the VAT. The Income Tax Act is expected to replace the current commissioner-imposed assessment system with self-assessment by taxpayers, enabling taxpayers to meet their tax payment obligations in a timely manner. The income tax review will also likely review the income tax rate and threshold analysis, taxation of noncash benefits, taxation of small businesses, and general modernization of the legislation.

9. **Overview of the tax administration system.** Government revenues are generated mainly from direct and indirect taxation (covering income taxes, consumption taxes, and border

⁶ Organisation for Economic Co-operation and Development (OECD). 2020. *Revenue Statistics in Asia and the Pacific 2021 – The Solomon Islands*. Paris; Government of Solomon Islands. 2020. *2019 Final Budget Outcome*. Honiara; and Government of Solomon Islands. 2021. *2020 Final Budget Outcome*. Honiara.

⁷ The Tax Administration Bill was presented to Parliament in August 2021.

taxes), with a smaller contribution from nontax revenue, such as revenue from fishing licenses.⁸ The IRD administers nine categories of taxes, other than customs duty and excises. The IRD is the central tax administration authority, with most staff and functions concentrated in the headquarters office in Honiara and two small tax branches in the provinces.⁹ The IRD has 118 staff, of which 69 are male and 49 female. Men make up most senior positions in the IRD, including all three executive team members, 18 of the 25 middle managers, and 22 of the 36 senior officers. The Customs and Excise Division (CED) collects revenue from customs duty levied on most imports and selected exports (primarily round logs), along with duty in lieu of excises on certain imported goods. In addition, the CED collects excises on selected products (tobacco and alcohol) from domestic producers and collects the goods tax on imported goods on behalf of the IRD.

10. **Inland Revenue Division's structure outdated.** Over the last 2 decades, tax administration reforms have focused on moving from a tax type structure to a functional structure, with a focus on compliance of high-risk taxpayers.¹⁰ The IRD is not structured as a modern functional organization. The organizational structure of the IRD is a hybrid between a tax type and functional structure, which provides for isolated administration of each tax without applying taxpayer data across the multiple taxes. This creates a significant burden for taxpayers, as information is not shared across the different teams within the IRD.¹¹ There is also an inability to flexibly use staff across the IRD as staff skills are largely confined to a particular tax.

11. Alongside the review of the tax framework, which began in late 2017, the government, with support from the Pacific Financial Technical Assistance Centre (PFTAC), started a review of the tax administration arrangements.¹² One of the changes being implemented is moving to a functional structure where staff are grouped by type of work rather than the type of tax, business, product, or customer. Grouping together activities that require similar skills will (i) support the achievement of gains through increased depth of knowledge in core areas of business expertise; and (ii) contribute to reduced compliance and administrative costs, simplification, and improved service levels.¹³ Some of the changes that have been implemented include creating a large taxpayer office and risk management unit, and appointing four assistant deputy commissioners.

12. **Current tax administration information system.** The IRD first introduced a specialized TAIS in 2005. The current TAIS is configured to support different business processes for each type of revenue (to support a tax type focus) and creates isolated data repositories and systems within the IRD. The current TAIS limits the IRD's ability to use the data it collects to perform analysis for strategic decisions and improve business processes and compliance activities. While the IRD has focused on automating the registration of taxpayers and allowing for e-tax filing and payments, the current TAIS does not support a shift to a modern functional structure and continues to constrain the IRD's performance, ultimately limiting domestic resource mobilization.

⁸ The export duty on round logs, income tax, and the goods tax (levied on imported and domestically manufactured goods) each accounted for about 20% of total domestic sourced revenue in 2020. Nontax revenue (mainly from the sale of fishing licenses) accounted for a further 10%, with the remaining 30% of domestically sourced revenue comprising import duty, excises, sales tax, stamp duty, and other fees and charges. Government of Solomon Islands. 2019. *Final Budget Outcome Report*. Honiara.

⁹ Provincial governments also have administration units for collecting local fees and charges such as business licenses, logging permits, and property charges, although the major proportion of local government revenues is constituted by budget transfers from the central government.

¹⁰ OECD. 2019. *Tax Administration 2019: Comparative Information on OECD and other Advanced and Emerging Economies*. Paris.

¹¹ Government of Solomon Islands, Ministry of Finance and Treasury (MOFT), IRD. 2015 *Constraints Analysis*. Honiara (funded by the New Zealand Ministry of Foreign Affairs and Trade).

¹² PFTAC. 2018. *Technical Assistance Report: Solomon Islands: Reviewing Tax Administration Reforms*. Suva, Fiji.

¹³ PFTAC. 2018. *Technical Assistance Report: Solomon Islands: Implementing a Function-Based Structure*. Suva, Fiji.

13. A modern TAIS (i) plays a substantial role in understanding the taxpayer base by enabling the government to identify unregistered and potential taxpayers and to manage the life cycle of taxpayer registration, tax assessment, collection, and reporting; (ii) facilitates efficient business processes, data sharing, risk management, reporting, and analysis to inform strategic direction and detailed compliance activities; and (iii) is essential to reap the benefits of moving to a functional organizational structure. Making better use of the available data encourages a more efficient way of working and better use of finite resources. The upgrading of TAIS capabilities facilitates a transition from the current authority-administered system to a self-assessment-focused audit. Compliance activities are undertaken according to a risk management approach. A more holistic approach also complements enhanced taxpayer-focused engagement and communication, which is necessary to encourage voluntary compliance. The government's TAIS vendor's latest product can meet these requirements.¹⁴

14. **Tax system disincentivizes women's participation in the formal economy.** While the labor force participation rate is 71.4%, only 62.4% of women are in the labor force, compared to 80.3% of men. As many as 75% of employed women—compared to 54% of men—are in vulnerable employment and unpaid family work.¹⁵ Based on anecdotal evidence, an underlying cause is that the tax system can be both a perceived and real disincentive for women to engage in the formal economy. Tax systems impact men and women differently, but gender analyses of tax systems and changes have rarely been considered. The current TAIS does not collect sex-disaggregated data. There is limited understanding of the implications and benefits of the tax system among formal and informal women entrepreneurs. Within government agencies, women are less likely to be involved in decision-making on tax policy and administration. While women comprise 42% of the IRD's workforce, only 28% are in senior positions.

15. **Strategic alignment.** The project's focus on improved public sector management aligns with ADB's Strategy 2030 operational priority 6 (strengthening governance and institutional capacity), and operational priority 2 (accelerating progress in gender equality, by mainstreaming gender equality into operations). Supporting tax reform is a key element of ADB's Pacific Approach, 2021–2025, by preparing and responding to shocks through strengthening domestic revenues and rolling out online systems and capacity building.¹⁶ The project is included in ADB's country operations business plan for 11 small Pacific island countries, 2021–2023.¹⁷ The project modality is appropriate to deliver the support needed by the government and is aligned with government and ADB strategies.

B. Project Description

16. The project is aligned with the following impacts: sustained and inclusive economic growth and funding for health, education, and social protection improved (footnote 4). The project will have the following outcome: domestic resource mobilization improved.¹⁸

17. **Output 1: Tax administration restructured along functional lines, and staff trained in new roles and business processes.** This output will continue the restructuring reforms of the IRD (paras. 10 and 11). It will require implementing a comprehensive plan, conducting workforce

¹⁴ The government's TAIS supplier is DataTorque, a New Zealand technology company.

¹⁵ United Nations Development Programme. 2019. *Human Development Report 2019—Beyond income, beyond averages, beyond today: Inequalities in human development in the 21st century*. New York.

¹⁶ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila; and ADB. 2021. *Pacific Approach, 2021–2025*. Manila. The Pacific Approach serves as the country partnership strategy for the 12 small Pacific island countries, including Solomon Islands.

¹⁷ ADB. 2020. *Country Operations Business Plan: Eleven Small Pacific Island Countries, 2021–2023*. Manila.

¹⁸ The design and monitoring framework is in Appendix 2.

analysis, designing and introducing new business processes, ensuring the new business processes are reflected in the upgraded TAIS, communicating regularly with staff on the rationale for change, managing staff who may find the change difficult, training staff, and being flexible to make changes to the approach. The reforms will consider female employees of the IRD and their career advancement opportunities. CED staff will also be provided with training given their role in collecting some taxes on behalf of the IRD, including the VAT. Once trained, IRD staff will be empowered to devote additional time and resources to collecting additional revenue from domestic taxpayers.

18. Output 2: A new fit-for-purpose tax administration information system acquired, and tax administration staff trained on how to obtain the greatest benefit from its use. The IRD will procure an upgraded version of its current TAIS through direct contracting. The upgraded TAIS will be tested and made fully functional under this output. This will expand its current functionality, i.e., improve management reporting, add a VAT module, collect sex-disaggregated data, and incorporate the latest security features to improve the integrity of the tax system and help prevent fraud. The TAIS provider will be required to provide comprehensive training to IRD staff to utilize the upgraded TAIS and ensure that there is compatibility with other government systems such as the CED's computerized information system and the financial management information system of the Ministry of Finance and Treasury (MOFT). The project will also fund the TAIS's license fees and maintenance costs during project implementation and the acquisition of new associated hardware and equipment. An upgraded TAIS will enable the IRD to better monitor taxpayers, provide higher quality management information to direct resources where they are needed, and contribute to better taxpayer compliance. This will contribute to higher government revenues.

19. Output 3: Inland Revenue Division capacity for gender-responsive and effective tax education and taxpayer services improved. With significant changes to the tax administrative arrangements and the introduction of a VAT, a comprehensive taxpayer education program will be rolled out to individuals, businesses, and others such as tax agents. The IRD and the project consultants will design and deliver the outreach program. Specific attention will be given to women taxpayers, including women micro and small entrepreneurs. A gender-responsive public information campaign on the tax system, including the VAT, will be part of the outreach program. Sex-disaggregated surveys at the beginning and end of the project will also assess if taxpayers have had improved experiences with the IRD. Greater understanding among taxpayers of their obligations will lead to higher levels of domestic resource mobilization.

C. Value Added by ADB

20. ADB support has included technical assistance on tax policy, tax modeling, and legislative drafting.¹⁹ ADB is providing technical assistance to support ongoing policy work to develop a VAT and review the income tax framework (paras. 7 and 8; and footnote 19). In addition, ADB has included tax reforms in its previous policy-based operation, and a future policy-based operation will build on these reforms.²⁰ Additionally, ADB is working with the government, the International Monetary Fund (IMF), and the PFTAC to prepare a medium-term revenue strategy. Finally, ADB will support the government to strengthen knowledge and capacity on tax policy and

¹⁹ ADB. 2017. *Establishment of the Domestic Resource Mobilization Trust Fund*. Manila; and ADB. 2019. *Technical Assistance for Improving Pacific Public Financial Management Facility*. Manila.

²⁰ ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Solomon Islands for the Improved Fiscal Sustainability Reform Program*. Manila.

administration through the Asia Pacific Tax Hub, which aims to strengthen domestic resource mobilization and international tax cooperation in ADB's developing member countries.²¹

21. **Lessons.** ADB's support to the government's tax reform program (para. 20) and similar previous ADB projects provide lessons, including (i) the necessity for adequate project preparation, management, and supervision; (ii) the deployment of sufficient consultancy expertise, including technology expertise for proper implementation; (iii) the importance of consulting with the community, especially businesses and their advisors when implementing a VAT; and (iv) due consideration to a realistic timeline.²² Accordingly, the project includes consultants to manage, supervise, and implement the project, with almost all consultancy inputs to be delivered full-time and in-country. Business community representatives are part of the project's steering committee and the project includes a comprehensive taxpayer education program. Consideration was also given to providing sufficient time for the implementation of project activities.

D. Summary Cost Estimates and Financing Plan

22. The project is estimated to cost \$20.12 million (Table 1).

Table 1: Summary Cost Estimates
(\$ million)

Item	Amount
A. Base Cost^a	
1. Output 1: Tax administration restructured along functional lines, and staff trained in new roles and business processes	11.92
2. Output 2: A new fit-for-purpose tax administration information system acquired, and tax administration staff trained on how to obtain the greatest benefit from its use	7.07
3. Output 3: Internal Revenue Division capacity for gender-responsive and effective tax education and taxpayer services improved	0.48
Subtotal (A)	19.47
B. Contingencies^b	0.65
Total (A+B)	20.12

^a Includes taxes and duty of \$4,215,000. The government will finance all taxes and duty by providing an exemption.

^b Physical and price contingencies, and a provision for exchange rate fluctuation are included.

Source: Asian Development Bank estimates.

23. Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM).²³ The major expenditure items are (i) the purchase of TAIS software, and (ii) consulting services.

24. The government has requested a grant not exceeding \$5.5 million from ADB's Special Funds resources (Asian Development Fund) to help finance the project. The summary financing plan is in Table 2. ADB will provide grant financing in the amount of \$5.5 million. The governments of Australia and New Zealand will provide grant cofinancing equivalent to \$3.5 million and \$6.5 million, respectively, to be administered by ADB.²⁴

²¹ ADB. Asia Pacific Tax Hub. <https://www.adb.org/what-we-do/asia-pacific-tax-hub/about>

²² ADB. 2020. *Completion Report: Fiscal Management Efficiency Project in Sri Lanka*. Manila.

²³ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

²⁴ The Government of Australia will provide A\$5 million and the Government of New Zealand NZ\$10 million. The actual amounts received may vary according to the exchange rate at the time ADB receives the funds.

Table 2: Summary Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Special Funds resources (Asian Development Fund grant)	5.50	27.3
Government of Australia ^a	3.50	17.4
Government of New Zealand ^a	6.50	32.3
Government of Solomon Islands	4.62	23.0
Total	20.12	100.0

^a The amount includes the Asian Development Bank's administration fee, audit cost, bank charges, and provision for foreign exchange fluctuations (if any), to the extent that these items are not covered by the interest and investment income earned on this grant, or any additional grant contributions by the government.

Source: Asian Development Bank estimates.

E. Implementation Arrangements

25. Implementation arrangements are summarized in Table 3 and described in detail in the PAM (footnote 23).

Table 3: Implementation Arrangements

Aspects	Arrangements		
Implementation period ^a	January 2022–December 2026		
Estimated completion date	31 December 2026		
Estimated grant closing date ^b	30 June 2027		
Management			
(i) Oversight body	Project steering committee Commissioner, Inland Revenue Division (chair) Representative, Information Communication Technology and Support Unit; representative, New Zealand Inland Revenue Department; representative, Solomon Islands Women in Business Association; and representative, Solomon Islands Chamber of Commerce (members) Representative, Australian High Commission, Honiara; representative, New Zealand High Commission, Honiara; and project officer, ADB (observers)		
(ii) Executing agency	Ministry of Finance and Treasury		
(iii) Key implementing agencies	Inland Revenue Division		
(iv) Implementation unit	Inland Revenue Division, 2 persons (including project director)		
Procurement	Direct contracting	1 contract	\$5,000,000
	Request for quotations	1 contract	\$200,000
Consulting services	QCBS	380 person-months	\$9,077,000
Advance contracting	The items of expenditure proposed for advance contracting are software, hardware, and consulting.		
Disbursement	Disbursement of the grant proceeds from the governments of Australia and New Zealand, and ADB will follow ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the Government of Solomon Islands and ADB.		

ADB = Asian Development Bank, QCBS = quality- and cost-based selection.

^a The implementation period starts from the expected month of commitment or signing.

^b Estimated closing date of the last grant.

Source: ADB.

26. The decision to use direct contracting for the TAIS upgrade was based on it being a natural extension of an ongoing service, the high switching costs of moving to another supplier, the current vendor's 15 years of good performance and its strong relationships with the IRD, and the current vendor's understanding of the government's institutional and administrative practices.

III. DUE DILIGENCE

A. Technical

27. With the analyses (footnotes 12 and 13) and ongoing support from the PFTAC, the IRD is well-placed to continue its restructuring.²⁵ This technical analysis provides the rationale, restructuring sequence, and a basis for the work to be undertaken during project implementation.

28. The technical specifications of the TAIS to be acquired under the project were developed by experts in tax administration and circulated to selected prospective vendors during project preparation. This roadshow confirmed that to minimize cost, the TAIS will be commercial off-the-shelf software, which requires only limited customization. The IRD currently utilizes commercial off-the-shelf software, and this has proven to be adequate for its needs.

B. Economic and Financial Viability

29. The project is considered economically viable, with the base-case results showing an economic internal rate of return of 13%.²⁶ The economic benefits include cost savings because of a more efficient tax administration, savings in avoided costs associated with the current TAIS system, and economic benefits from development spending associated with increased revenue collections from more efficient tax administration. Sensitivity analysis was also undertaken to further test the economic viability of the project. The results indicate that the project is still economically viable in the following scenarios: (i) 10% increase in costs, (ii) 10% increase in costs and 10% decrease in benefits, and (iii) no cost increase and 30% reduction in the economic benefit achieved from increased revenue collection. The financial analysis concludes that the project's incremental recurrent cost impact on the budget expenditures of the IRD will be relatively small and is fully manageable by the government.²⁷ The government has assured ADB that starting in 2027, it will allocate adequate resources to cover the maintenance costs of the TAIS.

C. Sustainability

30. The economic life of the project is estimated to be 15 years. Following the end of the 5-year project, the IRD will pay annual TAIS maintenance costs, which are estimated to be \$200,000 per year (0.04% of the 2021 budget), and the cost of an updated or replacement TAIS after 10 years, at a cost of \$5 million. The government has paid all fees and enhancement costs since the original TAIS was installed. Further, the government has stated that it will pay these expenses, given the importance of a working TAIS for revenue collection, and the small marginal cost increases to maintain the TAIS. The project is considered financially sustainable (footnote 27).

²⁵ For further technical analysis, please refer to the following: PFTAC. 2020. *Technical Report: Solomon Islands: Strengthening of the Audit Function*. Suva, Fiji; PFTAC. 2020. *Technical Report: Solomon Islands: Strengthening Tax Debt and Return Management*. Suva, Fiji; PFTAC. 2020. *Technical Report: Solomon Islands: Renewal of the Compliance Improvement Strategy*. Suva, Fiji; PFTAC. 2020. *Technical Report: Solomon Islands: Business Case for Modernizing the Inland Revenue Division*. Suva, Fiji; PFTAC. 2020. *Technical Report: Solomon Islands: Reviewing Implementing of the Large Taxpayer Office*. Suva, Fiji; and PFTAC. 2020. *Technical Report: Solomon Islands: Reviewing Implementation of a Function-Based Structure and Preparing a Business Case for Modernization*. Suva, Fiji.

²⁶ Economic Analysis (accessible from the list of linked documents in Appendix 2); ADB. 2017. *Guidelines for the Economic Analysis of Projects*. Manila; and ADB. 2002. *Handbook for Integrating Risk Analysis in the Economic Analysis of Projects*. Manila.

²⁷ Financial Analysis (accessible from the list of linked documents in Appendix 2).

D. Governance

31. The assessed pre-mitigation financial management risk is *substantial* (footnote 23). This is a result of a *substantial* rating for the inherent risk (country system and implementing agency) and a *substantial* control risk rating for the project financial management elements of the MOFT. When proposed mitigation measures are considered, the overall fiduciary risk will be *moderate*.

32. The assessed pre-mitigation project procurement risk is *high* (footnote 23). The main procurement is the TAIS package, which will use the direct contracting procurement method. Procurement capacity is generally weak in the country and exposed to risks related to weak integration with the budget cycle, integrity issues, and lack of a government e-procurement system. The project will mitigate the risk from high to medium by engaging a procurement specialist to assist the government in preparing and conducting procurement, and the government has agreed to delegate its consultant selection to ADB. The purchase of new hardware and equipment will use the request for quotations procurement method. The strategic procurement plan process was undertaken with active participation by the government.

33. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOFT. The specific policy requirements and supplementary measures are described in the PAM (footnote 23).

E. Poverty, Social, and Gender

34. **Poverty reduction and social benefits.** The project is categorized as a *general intervention*. The project will contribute to broadening the tax base by enhancing tax compliance. Creating a more sustainable public revenue base will allow the country to develop a more focused approach to allocating resources for its poverty reduction priorities and development strategies. The project team has developed a stakeholder engagement and communication strategy that will promote meaningful participation of diverse stakeholders from the government, the private sector, women entrepreneurs, civil society, and other nongovernment actors to ensure broad-based participation in initiatives to improve tax administration systems and services.²⁸

35. **Gender.** The project is categorized *effective gender mainstreaming*. A gender action plan (GAP) will address key gender issues identified and includes proactive gender activities across all three outputs.²⁹ The GAP includes measures to (i) improve the quality and management of sex-disaggregated taxpayer data, (ii) conduct training and improve practices within the IRD for mainstreaming gender equality and social inclusion into IRD human resource management and tax administration, and (iii) provide leadership training for female IRD staff. The project's third output will include conducting gender-responsive public information campaigns on changes to the taxation system and improving the quality and outreach of tax education to women consumers and micro and small entrepreneurs. Gender-sensitive indicators and sex-disaggregated targets have been included in the GAP and the project's design and monitoring framework (Appendix 1).

F. Safeguards

36. In compliance with ADB's Safeguard Policy Statement (2009), the project's safeguard categories are as follows.³⁰

²⁸ The stakeholder communication strategy is in the PAM (footnote 23).

²⁹ Gender Action Plan (accessible from the list of linked documents in Appendix 2).

³⁰ ADB. [Safeguard Categories](#).

- 37. **Environment (category C).** No permits are required to install the TAIS and replace obsolete equipment such as computers. Disposal of used equipment will follow Solomon Islands legislation on solid waste management, especially the Environment Act (1998). In case of environmental impacts, appropriate measures will be taken by the IRD in consultation with ADB.
- 38. **Involuntary resettlement (category C).** The project will not require any land acquisition or involve resettlement.
- 39. **Indigenous peoples (category C).** No adverse effects on indigenous peoples are expected.

G. Summary of Risk Assessment and Risk Management Plan

40. Significant risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.³¹

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Restructuring of the IRD is difficult because of the inability to attract and retain staff, leadership limitations, and resistance to change from staff	Significant analysis has outlined the best approach to restructure the IRD. A comprehensive plan, including support requirements, will be developed. Training will be delivered at regular intervals alongside regular communication with staff.
Weak financial management systems heighten fiduciary risks	Project administration is primarily delivered through a consulting firm. No imprest account is to be used.
Changes in political priorities and within the IRD hinder the project	ADB will coordinate with the government and development partners to maintain political commitment to the project.

ADB = Asian Development Bank, IRD = Inland Revenue Division.
Source: ADB.

IV. ASSURANCES

- 41. The government and the MOFT have assured ADB that implementation of the project shall conform to all applicable ADB requirements, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, financial management, and disbursement as described in detail in the PAM and grant documents.
- 42. The government and the MOFT have agreed with ADB on certain covenants for the project, which are set forth in the draft grant agreements.

V. RECOMMENDATION

43. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$5,500,000 to Solomon Islands from ADB’s Special Funds resources (Asian Development Fund) for the Domestic Resource Mobilization Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Masatsugu Asakawa
President

2 September 2021

³¹ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Impacts the Project is Aligned with Sustained and inclusive economic growth and funding for health, education, and social protection improved (National Development Strategy, 2016–2035) ^a			
Results Chain	Performance Indicators	Data Sources and Reporting Mechanisms	Risks and Critical Assumptions
Outcome Domestic resource mobilization improved	a. Tax revenues increase annually at the rate of nominal gross domestic product growth or higher by 2026 (2020 baseline: 0)	a. Annual tax reports prepared by the IRD (using International Monetary Fund gross domestic product estimates)	R: Changes in political priorities and within the IRD hinder the project
Output 1. Tax administration restructured along functional lines, and staff trained in new roles and business processes	1a. The IRD restructured along functional lines by 2026 (2020 baseline: IRD organized by tax type) 1b. At least 90% of IRD staff (49 women, 68 men) receive training and report increased skills in business processes by 2026 (2020 baseline: 0 trained) (OP 6.1.1) 1c. At least 20% of IRD women senior officers and team leaders access new training or coaching on management and/or leadership, and report increased skills, by 2026 (2020 baseline: 21 level 7 to level 10 officers and team leaders; 0 trained or coached) (OP 2.3.1) 1d. At least 90% of IRD staff (49 women, 68 men) trained in gender equality, social inclusion, and universal access for people with disabilities in the workplace, and reported increased skills, by 2026 (2020 baseline: 0 trained) (OP 6.1.1) 1e. At least 90% of senior IRD staff (8 women, 21 men) receive training on gender impact analysis in revenue-raising reforms and report increased skills by 2026 (2020 baseline: 0 trained) (OP 6.1.1)	1a–e. Quarterly project monitoring reports	R: Restructuring of the IRD is difficult because of the inability to attract and retain staff, leadership limitations, and resistance to change from staff

Results Chain	Performance Indicators	Data Sources and Reporting Mechanisms	Risks and Critical Assumptions
2. A new fit-for-purpose TAIS acquired, and tax administration staff trained on how to obtain the greatest benefit from its use	<p>2a. Upgraded TAIS that collects sex-disaggregated data for gender-sensitive tax analysis installed by 2025 (2020 baseline: Upgraded TAIS not installed) (OP 2.3.2)</p> <p>2b. Upgraded TAIS tested and fully operational by 2026 (2020 baseline: Previous version of TAIS that limits the IRD's functions)</p> <p>2c. At least 90% of IRD staff (49 women, 68 men) receive training and report increased skills on using the TAIS by 2026 (2020 baseline: 0%) (OP 6.1.1)</p>	2a–c. Quarterly project monitoring reports	R: Weak financial management systems heighten fiduciary risks
3. IRD capacity for gender-responsive and effective tax education and taxpayer services improved	<p>3a. Sex-disaggregated taxpayer end line survey taken during the second half of the project shows at least a 10% increase (compared to the baseline taxpayer survey taken during the first half of the project) among men and women taxpayers who rate their experience with the IRD as satisfactory or better (Baseline: To be determined)</p> <p>3b. At least 80% of the taxpayers assigned to the large taxpayer office participate in training on complying with new tax obligations, and report increased skills, by 2026 (2020 baseline: 0%)</p> <p>3c. At least 20% of the taxpayers who receive training on compliance with new tax obligations, and report increased skills, are women, by 2026 (2020 baseline: 0%)</p> <p>3d. At least 50% of the taxpayers required to remit value-added tax have at least one representative participate in one or more public information events by 2026 (2020 baseline: 0%)</p> <p>3e. At least 30% of the business owners' representatives attending public information events are women by 2026 (2020 baseline: 0%)</p> <p>3f. Gender-responsive public information campaign on tax</p>	3a–g. Quarterly project monitoring reports	

Results Chain	Performance Indicators	Data Sources and Reporting Mechanisms	Risks and Critical Assumptions
	system, including value-added tax, developed and implemented by 2026 ^b (2020 baseline: Not applicable) (OP 2.3.2) 3g. At least 200 women micro and small entrepreneurs trained on tax planning and compliance by 2026 (2020 baseline: 0)		
Key Activities with Milestones 1. Tax administration restructured along functional lines, and staff trained in new roles and business processes 1.1 Award contract for long-term advisors (by December 2021) 1.2 Establish project steering committee (June 2022) 1.3 Approve project plan including restructuring process and communications (by September 2022) 1.4 Make physical changes to the IRD offices (by December 2023) 1.5 Complete redesigned and operationalized business processes in the TAIS (by December 2026) 1.6 Long-term advisors provide training on change management and business processes (2022–2026) 2. A new fit-for-purpose TAIS acquired, and tax administration staff trained on how to obtain the greatest benefit from its use 2.1 Award contracts for upgraded TAIS (December 2021) and associated hardware (December 2022) 2.2 Install and operationalize new TAIS and associated hardware (2022–2026) 2.3 Conduct third-party quality assurance of TAIS installation (2022–2026) 2.4 TAIS vendor provides ongoing support and modifies the TAIS to be compatible with other government systems (2022–2026) 2.5 Staff trained on upgraded TAIS and its modules (2022–2026) 3. IRD capacity for gender-responsive and effective tax education and taxpayer services improved 3.1 Conduct sex-disaggregated baseline survey (by December 2022) and end line taxpayer survey (by June 2026) 3.2 Design gender-responsive tax education plan (by December 2022) 3.3 Provide training and public information events for taxpayers (2022–2026)			
Inputs Asian Development Bank: \$5.50 million (grant) Government of Australia: \$3.50 million (grant) Government of New Zealand: \$6.50 million (grant) Government of Solomon Islands: \$4.62 million			
Assumptions for Partner Financing Not applicable			

COVID-19 = coronavirus disease, IRD = Inland Revenue Division, OP = operational priority, R = risk, TAIS = tax administration information system.

^a Government of Solomon Islands. 2016. *National Development Strategy, 2016–2035*. Honiara.

^b E.g., dedicated campaigns aimed at women consumers and women entrepreneurs, pictorial materials, and diverse media using preferred channels of communication for women.

Contribution to Strategy 2030 Operational Priorities

Expected values and methodological details for all OP indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2). In addition to the OP indicators tagged in the design and monitoring framework, this operation will contribute results for:

OP 6.1: Entities with improved management functions and financial stability (number)

OP 6.2: Entities with improved service delivery (number)

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=53305-001-2>

1. Grant Agreement: Special Operations
2. Grant Agreement: Externally Financed – Government of Australia
3. Grant Agreement: Externally Financed – Government of New Zealand
4. Sector Assessment (Summary): Public Sector Management
(Tax Policy and Administration)
5. Project Administration Manual
6. Financial Analysis
7. Economic Analysis
8. Summary Poverty Reduction and Social Strategy
9. Risk Assessment and Risk Management Plan
10. Contribution to Strategy 2030 Operational Priorities
11. Gender Action Plan

Supplementary Document

12. Technical Assistance Facility Utilization Update