Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean

Chapter 2. Conceptual Framework

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Authors
Arturo Jacobs
Subject Matter Expert
USAID/LPFM
e-mail: arturoaj@aol.com

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<td>Integrated tax information system</td>
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Chapter 2. Conceptual Framework

The purpose of this chapter is to establish the conceptual framework, or major aspects of tax administration – basic mission, core functions, main responsibilities, and operating environment – that will be used to guide the remaining chapters of this document. As defined in Chapter 1, "taxes are the compulsory, unrequited payments to the general government sector" – a definition adopted by the OECD, the IMF, and the World Bank. The tax administration is the division of government tasked with collecting taxes.

Each major aspect of tax administration is fully addressed in subsequent chapters. The purpose of this chapter is to highlight features that deserve special emphasis, including the concept and practice of self-assessment and voluntary compliance, lessening the cost and burden on taxpayers, taxpayer identification numbers (TIN), taxpayer current accounts, and computerized integrated tax information systems (ITIS). The operating environment in which the tax administration conducts its business processes is also described in this section. "Operating environment" includes a country’s economic and technological development, the business enabling environment, the complexity of the universe of taxpayers that a tax administration needs to control, and the tax administration’s relationships and coordination with other government institutions and private sector groups that are engaged in various activities related to tax administration.

A maturity model is presented in this chapter to describe the general level of development of any tax administration. The model is adapted and applied in subsequent chapters to describe four maturity levels with respect to each of the major aspects of tax administration. As described below, the 'maturity model' contains sets of characteristics that describe tax administrations at various levels of maturity, from emerging to leading ones. Interested tax administrators and practitioners can use these characteristics to assess a particular tax administration, describe its current level of maturity, and understand the steps needed to take the tax administration to a new level of maturity. Aspects of the maturity model can also serve as "rules of thumb" that interested officials can reference to conduct self-assessments of their organizations’ strengths and weaknesses.

2.1. Exclusions from the Term "Tax Administration"

This product does not discuss the administration of taxes on international trade or tax policy.

2.1.1. Customs

A few countries around the world have merged their domestic tax administration and Customs. For example, an OECD study\(^1\) determined that, as of 2010, only nine OECD member countries had merged tax administrations and Customs. In Latin America, a recent study by CIAT\(^2\) found that seven of 17 countries – Argentina, Brazil, Colombia, Guatemala, Honduras, Mexico, and Peru – have merged tax administration and customs.

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\(^1\) OECD (March 2011), p. 15.
\(^2\) Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 13.
administrations and Customs. With Caribbean countries included – which were not included in the CIAT study – non-merged administrations exceed merged ones by a ratio of three to one. The CIAT study concluded that the merging of tax administrations and Customs, after gaining some momentum in the late 1990s and early 2000s, suddenly came to a standstill. One of the possible reasons was the reversal by Canada in 2003 – a country seen as a model for tax administration in the region – which had merged Customs and the domestic tax administration many years earlier but decided to separate them again. Other reasons included the fact that actual mergers had proved to be mere formalities, rather than meaningful in terms of day-to-day operations.

Whether Customs and the domestic tax administration should be merged is further addressed in Chapter 4. Current leading international practices – the guiding principles for this product – strongly suggest separate administrations. The term "tax administration" in this product does not include Customs. This, however, does not diminish the very important need for both agencies to establish ongoing cooperation and coordination through memoranda of understanding and legal documents that authorize and formalize information sharing agreements to the extent provided by law, as discussed later in this chapter.

The authors' decision to exclude Customs from this product is not intended to discount the great importance of Customs in LAC countries in terms of tax revenue. However, the authors' believe that a separate product on Customs would likely be the better approach and a very worthwhile undertaking.

2.1.2. Tax Policy

An early decision was made to exclude tax policy from this product, as this would similarly be a large undertaking of its own. The tax administration, however, does play an important part in the development and amendment of tax policies, by requiring its Legal Department to closely monitor, analyze, and report on the positive or negative impact of tax policy and legislation on the operations of the tax administration, as well as to recommend changes.

2.2. Core and Support Functions of Tax Administration

The core or basic functions that a modern tax administration performs in its direct operations are:

- Taxpayer registration – the collection, recording, and maintenance of basic identifying taxpayer information in the tax administration's master database that permits the tax administration to understands its taxpayer base and to plan accordingly;
- Taxpayer services – the information, forms, publications, and tax education that the tax administration provides taxpayers to help them comply with their tax obligations, to demonstrate that they are considered valued customers of the tax administration, and to reduce the need for extensive enforcement, given limited resources;
- Processing of tax declaration filings and tax payments – the processes and forms designed by the tax administration for taxpayers to file their tax return(s) and pay their tax liabilities on
specified dates, and the processes used by the tax administration to receive, document, review, correct if necessary, and archive the tax returns;

- Taxpayer audits – the processes used by the tax administration to monitor compliance, by selecting filed tax returns to audit/verify income, expenses, and supporting information reported by the taxpayer and to make additional assessments which require collection action;
- Taxpayer objections (administrative appeals) – the processes offered to taxpayers to first dispute proposed additional tax assessments in forums within the tax administration’s field offices;
- Taxpayer appeals\(^3\) – the formal processes available to taxpayers under the law to protest proposed additional tax assessments or other actions by the tax administration at forums away from the direct jurisdiction of the tax administration’s compliance offices, including judicial reviews and hearings;
- Collection of tax arrears (as opposed to current tax payments) – the business processes used by the tax administration to collect taxes which are due, assessed, and not paid by the due date under the law, including use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers’ property; and
- Tax-fraud investigations – the processes used to investigate financial transactions declared by taxpayers on their tax returns in cases in which the tax administration has a reasonable cause to suspect that the taxpayer has committed tax fraud. Tax-fraud investigations also involve cases of tax evasion, when taxpayers subject to tax do not register, file, and pay their taxes.

Support functions provide the resources, support, and guidance to the staff that perform the core functions. These support functions are:

- Information technology – computerization of systems and business processes of the tax administration, and data networking;
- Legal services – services provided to technical and management personnel by a cadre of attorneys of the tax administration, including legal interpretation of tax laws and regulations, and representation of the tax administration in all judicial forums, including tax appeals;
- Human resources – personnel management, training, and development functions;
- Budget planning and resource management (physical space, facilities, and other property management);
- Strategic and operations planning – the formulation of long-term strategic plans of the tax administration and the drafting, implementation, and monitoring of annual work plans for all its departments consistent with the objectives of the strategic plan;
- Internal audits – the processes of conducting periodic reviews to ensure that selected regulations, operations, and administrative procedures and programs conform to specified

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\(^3\) Objections and appeals are discussed together in Chapter 11. However, there is an important distinction between the two. Objections are reviewed by the tax administration, whereas decision-making related to appeals is outside the span of control of the tax administration.
standards and are being implemented efficiently and effectively, including the analysis and verification of accounts, financial transactions, and reports; and

- Integrity investigations – investigations about the conduct, such as alleged or suspected corruption, of any member of the tax administration’s staff.

The core and support functions are staffed with three general categories of staffing – management, technical, and administrative. In large countries with large taxpayer populations and large numbers of tax administration staff, the tax administration is organized around a headquarters office, two or more regional offices, and multiple district/field offices. In smaller countries, with fewer taxpayers and tax administration staff, regional offices are not established, and their usual roles are performed by the headquarters office. The roles of the headquarters and regional and district or local offices are discussed in Chapter 4. Each of the core and support functions is fully described in its respective chapter, as are the roles of the categories of staffing and the division of roles and responsibilities among headquarters, regional, and field offices.

In many LAC countries, tax administrations organize and staff some non-tax-revenue support functions. Staff usually provide information, assistance, and collection services for various government licenses and fees. For example, while it has no legal authority for them, Tax Administration Jamaica provides information and assistance on the following processes:

- Drivers’ licenses and motor vehicle documentation;
- Payment of traffic tickets;
- Property taxes;
- Titles for motor vehicles;
- Trade licenses; and
- Stamp duty and transfer taxes.

Unfortunately, these activities detract from the core functions and performance of a modern tax administration and should be re-assigned to other agencies in Jamaica, as was observed and recommended by the IMF in its 2010 mission report and by other advisors. Therefore, despite their practice by tax administrations of LAC countries, this product excludes such support functions from discussion.

2.3. Main Mission and Responsibilities of the Tax Administration

All national governments must have the revenue necessary to fund the operations of their various departments, to provide infrastructure and services for the population, to invest in economic development, and to advance various other priorities. The main mission of the tax administration is to collect the tax revenue due and needed by their governments from taxpayers, under the country’s tax laws, without hindering private sector development. Its main responsibilities are:

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Facilitate and encourage voluntary compliance by taxpayers with the country’s tax laws;
Administer the tax laws fairly and impartially;
Minimize the cost and burden on taxpayers to comply with their tax obligations;
Monitor compliance;
Enforce the country’s tax laws in cases of non-compliance;
Use its resources efficiently and effectively; and
Ensure tax officials perform their functions with integrity and honesty.

In pursuing their mission, all tax administrations confront similar challenges, such as how to: broaden the tax base by continually bringing non-registrants and non-filers into compliance, strengthen organization and management, control tax evasion, improve tax collection, and facilitate voluntary compliance. The greatest challenge for any tax administration is achieving and maintaining a high degree of voluntary compliance, which can be facilitated by vigorous taxpayer service and education programs and creative measures to minimize the burden on taxpayers in complying with their tax obligations.

2.3.1. Self-assessment and Voluntary Compliance

There are three principal methods to determine and assess the amount of tax liability due from each taxpayer: (1) one-on-one assessment on taxpayers by staff of the tax administration, usually in a tax administration office, upon presentation of taxable information by the taxpayer at designated times, (2) self-assessment and declaration by the taxpayer, and (3) tax withholding by third parties at the source. The first method has been used in countries in early development of their tax administrations, where very few taxpayers are registered in the tax administration’s registration database. Given limited resources this method is inadequate, ineffective, and inefficient to handle tax computation and assessment for more than a very small percentage of any country’s taxpayer population. Furthermore, the one-on-one approach has proven to be a gateway for collusion and corruption between taxpayers and tax administration staff and should be avoided.

The second method, self-assessment and declaration by the taxpayer, coupled with effective risk-based audit programs and other verification mechanisms by the tax administration, is the preferred method to determine and collect the amount of tax liability due from each taxpayer. For a self-assessment system, the country’s tax laws must include provisions to the effect that taxpayers will: provide to the tax administration the facts on which their tax liability can be computed; compute the tax liability themselves; file a tax return on specified due dates showing and declaring the result of the computation and the tax due; and pay the amount of tax owed at the time of filing. In effect, taxpayers are expected to comply on their own with the country’s tax laws (i.e., to exercise voluntary compliance, under the self-assessment/declaration method). Of course, the usual complexity of tax laws in most countries, coupled with low literacy rates in many developing countries, cause taxpayers to rely on vigorous and extensive taxpayer service programs from the tax administration and/or assistance from professional tax practitioners in order to meet their tax obligations, as discussed later in this chapter.
The third method, withholding of tax at the source, is discussed in Chapter 3. Examples include the legal requirement for employers to determine, withhold, and pay to the government income tax from employees’ wages and for retailers to collect from consumers and pay to the government value added or general sales taxes.

The paramount objective of any tax administration is to encourage, facilitate, attain, and maintain a high degree of self-assessment and voluntary compliance by taxpayers with their tax obligations. A high degree of voluntary compliance in any country allows the tax administration to concentrate its resources on identifying and dealing effectively with those taxpayers who fail to fully comply with their tax obligations. In effect, extensive self-assessment and voluntary compliance by taxpayers, combined with targeted compliance and enforcement programs that are based on risk assessment strategies, allows the tax administration to administer the tax system effectively and efficiently by lowering administrative expenses and raising revenues. Without a doubt, the most successful tax administrations around the world continuously encourage, attain, and maintain a high degree of voluntary compliance.

2.3.2. Measures to Minimize Cost and Burden on Taxpayers

Of course, a high degree of voluntary compliance among all taxpayers does not just simply "happen." It is incumbent on the tax administration to design, implement, and practice complementary measures to encourage a self-assessment and voluntary compliance culture.

Among such measures are efforts to minimize the cost and burden of complying with the tax laws, such as providing simple overall procedures and facilities for taxpayers to file and pay their taxes. For example, small businesses, farmers, and self-employed individuals in developing as well as developed countries represent a large number of taxpayers, but they may lack proper books and accounting records to determine and self-assess their tax liabilities. For these reasons, it is very difficult and expensive for the tax administration to assess and collect taxes from these groups. Consequently, many
small businesses in the informal economy simply elude the tax "net" and are not taxed at all. For these groups, the tax administration can design, promote, and establish simple, optional presumptive tax schemes, such as: (1) standard assessments to assign lump-sum taxes to taxpayers on the basis of occupation or business activity; (2) assessments based on a taxpayer's estimated income from indicators or proxies of wealth specific to a given profession or economic activity, where key indicators can range from location of property to numbers of skilled employees or seating capacity; (3) alternative minimum taxes, such as a minimum tax irrespective of the taxpayer's level of income or economic activity, and (4) payment of a lump sum based on the small business’ turnover to be declared and filed on a single-page income tax declaration.

Box 2.1. Turnover taxes for small businesses

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<td>There are several advantages to a turnover tax. It can apply to all small businesses; it imposes little tax on businesses getting started; it is reduced when businesses experience difficult times and increases when business sales increase; it requires business persons to start rudimentary record keeping that can act at least as a crude proxy for a business’ profits; and, it can be designed to ease the transition and encourage small businesses to move into the formal economy. There are, however, disadvantages. Taxpayers with the same amount of net income will pay the same amounts of tax, if their turnover is the same. Consequently, the perception of fairness in the tax system may be lost.</td>
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For business taxpayers subject to the value added tax (VAT), tax administrations can and should establish variable tax-filing periods and requirements to lessen the cost and burden on small and medium taxpayers. Even for large taxpayers, who should and usually are required to file monthly, tax forms can be simplified through re-designs that eliminate the requirement to attach extraneous data. For example, a simplified filing system can just require a list of registered suppliers and customers, total purchases and sales, and total taxes paid and levied – and avoid requiring superfluous information, such as lists of all sales which some tax administrations require even though they are not necessary for audit verifications.

Also, for voluntary compliance to flourish, the tax administration must offer a wide variety of high-quality taxpayer services and taxpayer education programs with a dedicated staff to demonstrate that those taxpayers who comply voluntarily are respected and treated as valued customers by their government. A staff dedicated exclusively to the Taxpayer Services function is required to:

- Assist and advise taxpayers in understanding their rights and meeting their tax obligations;
- Attend the public counters and telephones and provide a high level and quality of assistance to taxpayers;
- Respond promptly to written inquiries regarding tax questions, procedural requirements, etc.;
- Ensure that adequate supplies of explanatory and information pamphlets, guides, return forms, applications for income, VAT, and excise tax registration, and other materials are available in public access offices;

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5 Daniel (2009), p. 43.
- Carry out taxpayer education activities (e.g., classroom orientations about tax laws for importers) and on-site visits to advise taxpayers about effective ways to establish and maintain books and records relevant to tax obligations;
- Resolve taxpayers’ problems with the tax administration promptly; and
- Explain taxpayers’ administrative objections and formal appeals procedures to dispute proposed tax assessments and other actions of the tax administration.

Concurrently, the tax administration must continually explore and execute vigorous compliance monitoring and enforcement programs aimed at taxpayers who are not in full compliance at any given time to lessen the burden on taxpayers who comply voluntarily. However, even compliance/enforcement staff engaged in their duties must encourage voluntary compliance. To do so, they must perform their duties in a manner that demonstrates all due respect and courtesy to taxpayers and third parties.

Another taxpayer incentive for voluntary compliance is a strong but fair penalty system for non-compliance. The country’s tax laws should provide substantial financial penalties for non-filing; non-payment and under-payment of tax liabilities; under-reporting of income; and failure to keep adequate books and records, as required by the tax law. In addition, the tax laws must provide for severe penalties for tax fraud and tax evasion convictions, including incarceration. Convictions of taxpayers for tax fraud and tax evasion should be highly publicized to the general public as strong examples of consequences for those who do not comply voluntarily with their tax obligations.

Establishing a reputation for efficiency and effectiveness in the tax administration helps promote voluntary compliance. The tax administration establishes such a reputation when it continually minimizes the potential risk of revenue loss by identifying and prioritizing its compliance monitoring and audit verification activities. The tax administration should focus first on the country’s largest taxpayers, who contribute between 60-75 percent of the tax revenue, then on medium taxpayers, and so on. Also, the tax administration establishes a reputation for efficiency and effectiveness when it designs, implements, and uses risk and case management systems to ensure that its staff continually works those audit and collection cases that have the highest risk of error and/or potential revenue loss to the government. Concurrently, under risk-based systems, taxpayers who generally comply fully with their tax obligations are not selected for needless, time-consuming, and expensive audits and other verifications – an indirect but powerful message that taxpayers, who comply voluntarily, are treated as valued customers.

A final incentive for taxpayers to comply voluntarily with the tax laws is to know that the tax administration has a reputation for administering fair and impartial administrative objections and
appeals programs for taxpayers to dispute proposed tax assessments and other actions of the tax administration.⁶

2.4. Operating Environment

The purpose of this sub-section is to describe the operating environment in which the tax administration conducts its business processes. Tax administrations all over the world are faced with powerful opportunities as well as challenges to use modern information technology in all of their operations. For developing countries, the opportunities offered by technology are more elusive and challenges are greater for several reasons, of which inadequate budgets are at the top. Beyond technology limitations and inadequate budgets, tax administrations in developing countries face additional daunting challenges, such as the complexities of the taxpayer population and the generally large informal or "underground" economy, the need to tailor different service and compliance strategies for small, medium, and large taxpayers for effective risk management, and the need to establish and maintain positive and productive relationships and coordination with various other institutions at all levels, such as Customs, the judiciary, academia, as well as various private sector groups, such as Chambers of Commerce, national and international associations of accountants and attorneys, and business and professional associations.

In developed countries, tax administrations have been fast embracing many technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents. Tax authorities have been moving quickly to redesign their basic business processes and to rapidly implement electronic receipt, processing, and delivery methods. They have been facilitating increased use of the internet for transmission of information and access to tax forms by taxpayers. They have also been implementing interactive telephone methods for taxpayers to file their tax returns and resolve queries and tax-account problems. Furthermore, they have developed and heavily utilize data-warehouse research methods to supplement traditional compliance tools. Direct interfaces with the sources of information, i.e., with external information systems, are becoming more and more common.⁷

Tax administrations in most developing countries are also confronted with many external obstacles on the path to modernizing their organizations. For example, they still face a weak legal/regulatory institutions, outdated tax policies, inadequate or non-existent civil service rules, regulations, and compensation-levels for attracting and retaining qualified staff, an absence of international accounting and professional standards, which are indispensable for tax purposes, and a lack of modern financial and banking standards and institutions. Computer equipment, data networks, and communications lines are still in short supply and expensive in many countries, and governments have very meager financial resources for their acquisition. Therefore, electronic and internet tax filing systems, electronic funds transfer and payment systems, and integrated tax administration data systems that enable electronic

⁶ Even though it is not within the purview of the tax administration, there is another incentive for taxpayers to comply voluntarily – effective, transparent, well aimed, and efficient public expenditures. The main incentive for taxpayers is to know that the tax revenues are well utilized.
forms processing – among the many tools in the "options basket" being adopted extensively by tax administrators of developed countries – are options available only to a limited degree for tax administrations in many developing countries that are engaged in the early stages of information technology modernization efforts.\(^8\)

The tax administration must learn not merely to cope, but to continually navigate successfully in its very difficult operating environment to attain its basic mission and successfully accomplish its main responsibilities.

### 2.4.1. Underground Economy

The problem of the "underground" economy is a serious problem to tax administrations all over the world. In developing countries, in particular, the number of "non-filers" is very high. "Non-filers" are taxpayers, who are required to, but have never registered for tax, and consequently have escaped paying their tax obligations altogether. They conduct their businesses or professions "under the radar" and go largely undetected. Tax administrations have a huge, continuous challenge to broaden the tax base by continually identifying large numbers of non-filers and bringing them into compliance, thereby lessening the burden on those taxpayers who do comply voluntarily.

There are a number of administrative tools that tax administrations can use to bring unregistered or non-filing taxpayers into the tax net.\(^9\) For example, an effective tool to identify non-filers and verify the accuracy of income and expense reporting by taxpayers is legislation that enables the tax administration to receive and match third-party financial data of taxpayers to its master file and mount compliance programs for omissions and discrepancies.\(^10\) Such legislation requires that financial institutions, contractors, and employers routinely submit third-party financial data, such as data on the payment of interest, dividends, wages, and other payments. Unfortunately, such legislation does not exist in many developing countries. This issue is addressed in Chapter 3.

### 2.4.2. Taxpayer Segmentation

As stated above, tax administrations must tailor different service and compliance strategies for small, medium, and large taxpayers for effective risk management. Therefore, over the years, more and more tax administrations have developed and implemented strategies for controlling their universe of taxpayers by type-of-taxpayer segments. The most common segmentation strategy has been to establish a Large Taxpayer Office (LTO) to control and provide services to those taxpayers who collectively account for between 60-75 percent of the government’s overall tax revenue each year. Inclusion in the LTO program is usually determined by a large annual turnover value and/or amount of tax liability of the taxpayer for the prior two or more years, plus other criteria. The nature of the business is also a factor. For instance, in many countries all taxpayers in certain industries—such as

\(^8\) Ibid., p. 3.
\(^9\) These are discussed in Chapter 7.
\(^10\) Chapter 9 covers a variety of issues and compliance programs to deal with the underground economy.
financial institutions and mining - are included in the LTO program, regardless of their turnover and actual size.

Additional segmentation of taxpayers has recently been extended in some countries to designing and implementing strategies and offices to control medium-size taxpayers, who usually contribute around 10-15 percent of the government’s annual tax revenue. Medium taxpayers have less formal structures and many deal mostly in cash, resulting in more opportunities to under-report income. Medium Taxpayer Offices (MTOs), by default, control those taxpayers neither covered by the LTO nor considered small taxpayers.

Small taxpayers, as stated above, are by far the largest taxpayer segment in most countries, and also the most difficult to control because of their sheer number and their lack of adequate record keeping. In lieu of applying scarce audit and compliance resources to this taxpayer population, presumptive tax strategies have been introduced in many countries, as described above, thus allowing these taxpayers to opt to pay, for example, a standard assessment based on occupation; an estimated assessment based on income activity; a minimum tax; or simple turnover tax, rather than be subject to more complex income tax requirements. Chapter 3 recommends that the country’s tax laws authorize the tax administration to design and implement effective presumptive schemes for small taxpayers, to be published in regulations. Presumptive taxation is considered an optimal method of curbing widespread non-compliance without employing excessive government resources, because it addresses the concerns of both the taxpayer and the tax authority. Presumptive taxation provides taxpayers with a simplified option for tax compliance without requiring full financial transparency. Although presumptive regimes may bring about significant simplification, they may also result in unequal tax burdens. Care should be taken to ensure that some level of equity is preserved – i.e., that all taxpayers with similar levels of income are allowed to opt into the presumptive regime (preferred), or that all taxpayers with similar levels of income pay similar amounts of tax, whether under the simplified regime or not.  

One disadvantage of too much taxpayer segmentation is duplication and fragmentation of functional units of the tax administration. For example, LTOs not only perform audits and collections with their own audit and collection staff, but they also provide taxpayer services to large taxpayers with their own taxpayer services staff. To ensure the uniform application of the law and a perception of fairness, when MTOs are also segmented to control medium taxpayers, functional staffs need to be established in MTOs for audit, collection, and taxpayer services as well. Similarly, and at the same time, functional units should be maintained for control of small taxpayers.

2.4.3. Coordination and Cooperation with Public and Private Sector Groups

There are many government agencies and institutions at various levels that play important support roles for tax administration. For example, the financial activities of importers and exporters and corresponding data in declarations that Customs documents and maintains are of vital importance for
the tax administration in its audit verification program and other compliance activities. Similarly, some information maintained by the tax administration applicable to importers and exporters is important to Customs for its own assessment purposes. Often, however, there are very strict legal restrictions to the sharing of information between the two agencies, even though both are usually under the Ministry of Finance and, in some cases, may even be under the same Director. Therefore, it is very important that the Heads of both agencies establish ongoing cooperation and coordination through memoranda of understanding, and legal documents that authorize and formalize information sharing agreements to the extent provided by law. In some cases, joint cooperation and coordination between the two agencies may be necessary to introduce and enact legislation to ensure that the most pertinent data to each may be shared.

Tax administration officials should also work in coordination with officials of the Ministry of Finance to identify and cultivate positive relationships with officials of parliament, or other legislative bodies, who can be "champions" to lead legislative initiatives of vital importance to the tax administration. Proposed legislation to authorize the tax administration and information technology to enable the administration to routinely receive and match third-party financial data is one example. Chapter 3 cites several other examples.

There are many other public institutions at local, regional, and national levels in most countries that record information about natural persons, partnerships, and corporations regarding registration, public tenders, purchases, rentals, licenses, etc. – information that is very important for all aspects of the tax administration’s compliance activities. Therefore, it is of great interest and importance for the tax administration to seek and establish positive relationships with these institutions to be able to access information on an ongoing basis.

The judicial institutions that routinely handle tax administration cases – appeals, prosecution of fraud cases, civil trials regarding enforcement issues, etc. – require ongoing, special attention by the tax administration to cultivate and establish positive relationships. Unfortunately, in many countries, it is not unusual for appeal cases of proposed tax assessments – often related to large taxpayers, with a great deal of money at stake – to linger for years without receiving attention from the judges. In many, if not most developing countries, the judges may be unfamiliar with the tax laws and reluctant to hear the cases. Even when the courts hear appeals, fraud, and other tax cases that have been well-developed and researched by the tax administration’s technical and legal experts, negative outcomes are not unusual. Therefore, it is incumbent on the tax administration to be proactive in establishing positive relationships and coordination with relevant judicial actors. For example, the tax administration’s tax attorneys and senior tax auditors can offer and provide classroom training in tax law for judges, and can also be available to judges upon request to discuss technical questions and issues.

The tax administration must also offer periodic forums for Chambers of Commerce, industry groups, business and professional associations, and other groups to share their views and concerns about the country’s tax laws, the tax administration’s practices, and any other issues that adversely impact on

12 Chapter 4 discusses the separation of Customs from the administration of domestic taxes.
their respective members. Of these groups, the associations of chartered accountants or similar groups whose tax practitioners prepare and file tax returns and legally represent taxpayers on audit, collection, objections, appeals, and tax-fraud cases deserve special attention from the tax administration. Because of the volume of taxpayers they represent collectively – particularly large and medium taxpayers – they could even be considered "informal partners" in the administration of the tax laws. They, too, must have opportunities to express their views to the tax administration about problems and issues, and the tax administration is obligated to review these issues and take corrective action promptly, wherever necessary. Leading international practices require that tax administrations establish a regular, periodic forum to meet with tax practitioners.

Since they almost always represent multiple taxpayers and/or prepare multiple personal and business tax declarations for taxpayers, individual professional tax practitioners (accountants, legal professionals, etc.) are very important stakeholders in promoting and maintaining voluntary compliance among the taxpayers they represent. While their first responsibility is to their clients, the great majority of professional tax practitioners abide by ethical standards and considerations, including a responsibility to their respective governments to abide by the law, regulations, and decisions that govern their field of tax practice.

Unfortunately, particularly in developing countries, professional tax practitioners often do not receive effective and efficient treatment and services from the tax administration.

Box 2.2. Taxpayer services in Curacao prior to 2008

The inadequate service provided by the tax administration to professional tax practitioners and taxpayers in Curacao in 2008 is representative of the level of service that professional tax practitioners routinely encounter in many developing countries. In Curacao, right before and on any "peak days" (due dates of monthly/quarterly tax declarations and tax payments), very long queues at the taxpayer service premises of the tax administration resulted in excessive waiting time, high costs, and dissatisfaction among taxpayers. To the chagrin of taxpayers and tax practitioners alike, professional tax practitioners were required to wait in line alongside individual taxpayers. Individual taxpayers experienced much longer waiting times than necessary, as the tax practitioners delivered multiple clients’ documents and payments for acceptance and validation.

Similar situations have been observed in several other LAC countries and in many other countries around the world in recent years. Some countries have simply established a separate delivery point for tax practitioners, away from the taxpayer service area.
Box 2.3. Taxpayer Representatives’ Center in Puerto Rico

In order to provide the necessary level of service to professional tax practitioners, Puerto Rico's Sub Secretary of Internal Revenue established the Taxpayer Representatives’ Center in San Juan in 2000 and staffed it with five taxpayer service technicians. The Center was separate from the regular taxpayer service premises. The center’s telephone and fax numbers were not generally publicized, but were made available to tax practitioners. Tax technicians at the center handled and resolved more difficult and complex cases, particularly the more complex tax account analysis cases of large employers, corporations, and multiple clients of tax practitioners. Once cases were resolved, resolutions were communicated to the representatives by fax, telephone, correspondence, and occasionally, with personal visits by practitioners to the center. The Center had grown to 22 technicians by 2004. Congestion, aggravation, and cost for all parties at the regular taxpayer service premises were reduced considerably and Sub Secretary of Internal Revenue and practitioners were equally pleased with the outcomes of the center’s special services.13

Finally, colleges and universities comprise another group of institutions that are worthy of special attention by the tax administration.

Box 2.4. Partnering with academia in El Salvador

Academia can be a very valuable partner for tax administration. A partnership between El Salvador’s Dirección General de Ingresos Internos (DGII) and academia is a good example. In 2003, the DGII was experiencing severe budget shortfalls that had made it difficult to fund the staff necessary to accomplish many of its program objectives. The taxpayer service program was hit particularly hard. On "peak days" – due-dates of tax declarations and tax payments – taxpayer queues in taxpayer service facilities throughout the country were extremely long. On-site, line managers had to continually divert audit and other taxpayer compliance staff from their regular work to provide service to taxpayers. Consequently, the audit and other taxpayer compliance programs, already persistently understaffed, suffered further adverse effects, year after year.

Starting in 2003, the DGII began to draw upon the universities to supplement its meager staffing. To graduate, university students in El Salvador were required by university authorities to complete one year of public service. The DGII, in collaboration with academia, recruited 300 students in 2003 and 500 in 2005. The students were assigned to support the various program functions, particularly the Taxpayer Service program. Students were also assigned as aides to the technical staff of the Audit and Taxpayer Non-Filer programs.

By turning mostly to seniors majoring in economics, accounting, law, and related fields, the DGII not only recruited those students more likely to be familiar with the DGII’s work, but also students who could become good prospects for permanent employment. The students were trained for three days on tax law related to the functional program tasks they would perform and on some task techniques, such as verification of records regarding taxpayers’ compliance. Whether three days of training were sufficient was a subject of periodic debate. Nevertheless, the DGII was fortunate to have the students at its disposal. The cost to the DGII (government) was only $8 per day for each student. The cost/benefit ratios in programs of taxpayer service, audit, and non-filers were reportedly analyzed frequently and consistently proved very favorable. Plans were made to recruit 700+ students in 2006 and beyond.

Budget shortfalls are a way of life, particularly in developing countries. Collaboration of tax administrators with academia to have students spend a year in public service as a prerequisite for graduation is a "win-win" strategy for the universities, the students, the tax administrations, and taxpayers. The students benefit from temporary employment and practical work experience; the tax

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administrations get much needed staffing support; the countries receive public service from thousands of students; and taxpayers enjoy improved (taxpayer) service.\textsuperscript{14}

2.5. Integrated Tax Information System (ITIS)

Chapter 12 addresses information technology in depth. This sub-section does not attempt to address technical aspects of information technology; rather, it covers the conceptual framework of what users need for the design and implementation of a computerized ITIS. The intent here is to describe, for tax administrations in developing countries, the functional components, data systems, and communications networks that need to be brought together to comprise an ITIS to support efforts to modernize operations – again, from the standpoint of the users.

The overall objective of information technology modernization efforts is to develop an ITIS that brings together most information that tax administrations need for successful operations in a way that facilitates ease of access and use by the ultimate users. The design of the overall system must address effective applications for various types of taxes generally levied in developing countries, including VAT or sales tax, individual income tax, corporate income/profits tax, excise taxes, property taxes, and property transfer taxes.

Notwithstanding the daunting challenges in the operating environment described earlier, tax administrations in developing countries still have to jump-start their modernization efforts through technological improvements to help meet their governments’ critical, ongoing, and ever-increasing needs for sufficient tax revenues to fund their operations. In the early stages of design and implementation of modern information technology solutions, they must replace systems that are still largely manual.\textsuperscript{15} At best, tax administrations often count only on a smattering of computer equipment at a few office locations, much of it old equipment supported by outdated technology. Yet, the design and implementation of modern, computerized, and integrated information systems and networks are indispensable to meet all major challenges.

Five constant challenges, which face all tax administrations and dominate their operations, were cited earlier. The successful design and implementation of a computerized ITIS is essential for overcoming these five challenges, as briefly illustrated in the following examples:

\emph{Broaden the Tax Base}

A computerized ITIS is necessary to implement a taxpayer numbering system that controls the issuance of a unique TIN for every taxpayer. The TIN is a necessary initial step to establish a "master file of all taxpayers" and define any meaningful tax base, under the existing tax laws of the country. Computerized systems also are indispensable in preparing for the conversion and implementation of a new or revised TIN system (e.g., in storing and tracking pre-registration lists of potential taxpayers.

\textsuperscript{14} Ibid., p. 1.
\textsuperscript{15} The tax administration may need to improve processes through analysis and re-engineering, rather than simply automate poor manual procedures.
derived from various sources). Tax administrations should assign a single TIN to each taxpayer for all taxes, rather than different numbers to the same taxpayer for different types of taxes.

Modern compliance surveys that aim to broaden the tax base also require the use of a computerized database to gather and track survey information, as well as to import data stored electronically in other systems, where possible, in order to facilitate cross-checking of information and identify potential new taxpayers.

**Strengthen the Organization and Its Management**

A computerized ITIS supports efforts to strengthen the tax administration’s organization and management. The design and implementation of administrative systems that provide management with critical data for planning and monitoring operations and progress on objectives, performance measurement, budgeting, accounting, personnel management, and asset management is very important for achieving this objective.

**Control Tax Evasion**

An ITIS that accurately collects and links information on all payments and liabilities within the tax system, with customs duties and payments, with land ownership and taxation, and with motor vehicle registration is an incredible force against tax evasion. Experiences in countries that have the ability to make queries and compare such data continually reveal many incidences of potential tax evasion. For example, the audit of taxpayers, who pay relatively little income tax, but are identified in related systems as owners of several profitable companies and one or more expensive automobiles, often reveal substantial under-reporting of income and lead to prosecution (and/or substantial penalties) for tax evasion.

Modern audit selection procedures based on risk analysis require effective, integrated computer systems to apply audit selection criteria for a specific tax or across taxes. However, cross-checking of information is only effective given accurate and complete storage of information on most or all taxes for each taxpayer, which is impossible to accomplish with manual systems. When taxpayers become aware that the tax authority has the ability to cross-check information on a routine basis using a computerized system, there is a positive impact on controlling tax evasion.

**Improve Collection of Tax Arrears**

The current situation in many countries requires the collection of tax arrears with very unreliable paper ledger cards and systems. Unless there is an accurate picture of open taxpayers’ liabilities, it is very difficult to confront taxpayers to collect taxes that may or may not be in arrears. An ITIS can easily identify amounts in arrears and compute and apply appropriate penalties and interest when requested by authorized officials. The automatic production and issuance of notices to taxpayers on a periodic basis with accurate collection information greatly improves collections of amounts due. For those notices that fail to elicit collection in full, the tax authority can easily identify arrears accounts and assign field enforcement personnel.
Facilitate Voluntary Compliance

An effective ITIS is one of the most powerful tools to facilitate voluntary compliance, because it enables the tax administration to establish and maintain:

- An up-to-date taxpayer registration system;
- An accurate taxpayer accounting system for taxpayers’ accounts;
- Effective audit/verification programs; and
- Timely monitoring of filing and payments for quick follow-up on omissions, etc.

In short, a strong ITIS allows the tax administration to establish a reputation for efficiency, effectiveness, accuracy, and reliability – qualities that encourage taxpayers to comply voluntarily.

2.5.1. Taxpayer Current Account and Taxpayer Identification Number

The taxpayer current account (sometimes referred to as the taxpayer ledger) is one of the pillars of modern and successful tax administrations, and it is a vital part of an ITIS. A taxpayer current account is really an accounting system for each taxpayer by which the tax administration tracks liabilities owed and payments made by each taxpayer for all types of taxes. All debit and credit transactions must be recorded in a timely manner—no matter where the activity takes place—to track all financial activity (liabilities and payments, respectively) on a taxpayer’s account. Automated current account systems are able to track and record tax declarations filed by the taxpayer, whether through the banking system, electronically (e.g., e-filing), or at a tax administration office anywhere in the country. Tax payments made at all locations must also be recorded to the taxpayer’s current account as quickly as possible. Prompt and complete posting of these data provide an audit trail with debit and credit transactions to track all financial activity (liabilities and payments, respectively) on each taxpayer’s account.

A given taxpayer’s current account is first established at the time the taxpayer registers with the tax administration and is given a unique TIN, another vital part of an ITIS. The TIN for each taxpayer is the electronic address where all transactions are recorded. At the time of registration, the particular taxpayer’s tax obligations are entered in his own current account in the tax administration’s master file database of taxpayers, using the unique TIN as the main identifier. The particular current account for that taxpayer lists the types of tax declarations for which the taxpayer is liable (VAT, income tax, excises, etc.) and the due dates of each tax return and payment. Thereafter, the automated system monitors the taxpayer’s current account for compliance or non-compliance with tax obligations. If the taxpayer does not file any of the required declarations by the due date, a non-filer case is issued soon thereafter by the automated system to the appropriate compliance unit for contact with the taxpayer (by mail, telephone, or field visit).

Similarly, if the taxpayer does file, but does not pay all or part of the tax due, then the automated system issues a tax arrears case to the appropriate division for contact with the taxpayer. The system also automatically calculates and records information to the taxpayer’s current account, including: penalties and interest assessed for each tax and period; tax deficiencies assessed, after audit; each
payment made for each tax and period; and, refunds made. The taxpayer’s physical address for tax purposes - or that of his legal representative - must continually be updated for issuance of official notices.

In short, all tax filing and financial activity must be entered and tracked in a timely manner so that the tax administration can identify instantly the status of any given taxpayer, and determine whether any compliance action or other response is required. Ideally, each taxpayer should be given electronic access to his/her current account. This can only be accomplished with a modern, computerized ITIS.

2.6. Maturity Model for Tax Administration

This section presents a four-level model to allow interested officials to self-assess the general level of maturity of the tax administration in a given country, using "rules of thumb" to assess strengths and weaknesses. An overview of the maturity model is provided in the figure below. In addition, this and subsequent chapters provide the detail of this same four-level maturity model for each of the major aspects of the tax administration to assist officials in making targeted self-assessments.

A maturity model is a tool that can be used by institutions, tax administrations in this case, to assess their current capabilities and to plan for improvement. The maturity model presented in this product is an integration of USAID’s human and institutional capacity development (HICD) approach with specific application to tax administration. The authors of the various chapters have used the maturity model to depict the general state of tax administration in LAC, although LAC countries vary widely in terms of tax administration challenges and successes. This product does not place individual countries at various maturity levels.

The purpose of using a maturity model is similar to that of a benchmarking exercise, but the maturity model is more powerful. In addition to describing and providing benchmarks for leading practices, a maturity model describes the usual practices in tax administration at lower levels of maturity. With this additional information, a maturity model has several advantages over benchmarking. Tax administrations that use a maturity model rather than benchmarking to leading practice or international norms:

- See a clearer progression from their current state to leading practice;
- See the potential progression of all components, and thus understand what is needed to sustain improvement and performance, rather than focusing on isolated, unsustainable interventions; and
- Are more appreciative of the capacity that they already have and are able to leverage existing systems, processes, and tools in planning for improvement.

Simplistically, a maturity model is usually presented in tabular format, where the columns of the table describe several levels of maturity (e.g., from basic to leading) and the rows of the table describe the specific parameters along which progress can be described and/or measured. The following is an example:
The example above uses four levels and shows two (high-level) parameters. While four levels are appropriate, a useful maturity model must be comprehensive. The maturity model should cover all areas of the tax administration’s delivery framework and must contain parameters for all core functions (e.g., registration, collections, audit, etc.), support functions (information technology, legal services, etc.), as well as governance and management.

A maturity model must be vertically integrated. This means that if a tax administration is at a specific level of maturity with respect to one area, it will likely be at the same level across other areas. Vertical integration ensures that the model is realistic. In tax administrations, for example, if third-party data are not available and not used in identifying non-filers, they are likely not available and not used in indirect audits, the registration database is likely not well maintained, and the collection function is likely not fully effective. The levels of the maturity model must draw on practical examples of tax administrations in leading or emerging economies to be useful.16

Conceptual Framework: Maturity Level 1

Key word: "Unaware"

- The tax administration lacks awareness of its taxpayer population due to ineffective, inefficient, and/or inaccurate taxpayer registration, taxpayer accounts, and compliance strategies and surveys.
- There are no provisions in the tax laws for self-assessment, so one-on-one assessments are the rule, with very limited compliance coverage, and the potential for corruption is extensive.

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16 In addition, maturity models may have additional dimensions (e.g., systems and tools vs. performance), may contain a scoring mechanism to assign scores to tax administration capacity, and may contain quantitative benchmarks for each characteristic. A complex maturity model with all such characteristics, however, deserves separate research. The maturity model presented here is accessible. Thus, to the extent that quantitative benchmarks for the tax administration are available, those are discussed in the section on key benchmarks in each chapter.
• Voluntary compliance is unknown or not a trusted concept, and the informal economy is rampant.
• Service to taxpayers is largely non-existent.
• Mutual hostility exists between the tax administration and taxpayers.
• The tax administration has neither conclusively identified large taxpayers nor brought them under control.
• Necessary written policies and procedures for staff of core and support functions do not exist, and staff act independently, inconsistently, and erratically.
• Strategic plans and annual operations plans are non-existent. Ad hoc, day-to-day operations are the norm for every department, each of which acts independently.
• Little modern technology or equipment is available, and most work and information systems are manual.
• Relationships with public and private-sector institutions are lukewarm, at best, and even border on hostility in many cases.
• There is a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.

Conceptual Framework: Maturity Level 2

Key word: "Awakening"

• Formal registration of taxpayers, usually with unreliable TINs, has begun, but taxpayer accounts are largely unreliable.
• Informal identification of large taxpayers has begun, but criteria for inclusion is not defined, and even those considered large taxpayers have not yet been brought under control.
• There are still no provisions in the tax law for self-assessment, but the tax administration is aware that one-on-one assessments severely limit their scope of operations and breed unlimited opportunities for corruption, and begins to seek legal changes to advance self-assessment and the concept of voluntary compliance.
• Taxpayer service programs have been established but are disorganized and severely understaffed, with erratic levels of competence among the existing staff.
• Compliance strategies and surveys, even if ill-conceived and without a focus on high-risk segments and individuals, are launched irregularly to identify non-filers. They generally identify an abundance of very small taxpayers with very small tax liabilities, who require an inordinate share of the tax administration’s scarce resources to control.
• Annual operations plans of the departments are loosely drafted independently by the various core functions, without coordination among them, but long-term strategic plans for the overall tax administration still do not exist, and there is no concept of "direction" for the tax administration.
• Little modern technology or equipment is available, and that which does exist is supported by outdated technology, so most of the work is still done manually.
Institutionalization of procedures varies across departments, as do skills of the staff, and procedural manuals are minimal, developed on an ad hoc basis, and sparsely used.

"Hot-and-cold" efforts by top-level officials to establish good relationships with some public and private sector groups – particularly with Customs and public accountants – are initiated but lack coherence and stability.

There is still a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.

**Conceptual Framework: Maturity Level 3**

Key word: "Poised"

- There are provisions in the tax law for self-assessment, with limited opportunities for corruption, and an estimated 70-75 percent of taxpayers comply voluntarily.
- Formal registration of taxpayers, with a "best-practice" system of TINs, has largely been completed, and taxpayer accounts are usually accurate.
- Formal definition, identification, and fairly good control of large taxpayers have been accomplished. However, the criteria for selecting and deselecting taxpayers that fall under LTO control are nebulous, and so the number of taxpayers under control is never certain.
- Compliance strategies and surveys that begin to focus on high risk taxpayer segments and individuals are launched in a timely manner and in accordance with annual work plans. However, the tax administration only has a partial grasp of the size of the informal economy and non-filer population.
- Long-term, strategic plans are drafted and used to develop and coordinate annual operations plans of the various core functions. However, while the tax administration may achieve many of the objectives in its strategic and annual work plans, there is greater focus on short- and medium-term objectives, with a lack of focus on long-term direction.
- Procedural and policy manuals have been developed for each of the tax administrations’ functions and are closely followed by skilled staff, but the manuals suffer from a lack of timely updates.
- Relationships with public and private sector groups are usually positive – memoranda of understanding with Customs for exchange of data are generally successful, as are forums for public accounting and Chamber of Commerce groups, etc. However, there are exceptions, such as less than cordial relationships with the judiciary or other groups.
- Modern technology and equipment are available, but there is often a shortage in specific departments, and funds for purchase are often somewhat limited.
- There is an obvious presence of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions. The tax administration has started to embrace many technological advances used in the private sector,
such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.

**Conceptual Framework: Maturity Level 4**

Key word: "Solid"

- Provisions in the tax law for self-assessment have existed for several years, and at least 85 percent of taxpayers comply voluntarily. Incidences of corruption within the tax administration are extremely rare.
- Registration of taxpayers has been tested over several years and proven to be very accurate, and taxpayer accounts are rarely inaccurate.
- Multiple criteria have been established for selecting and deselecting large taxpayers, who are continually identified for control by the LTO and have a high level of compliance, as confirmed by various tests and other verification measures. The LTO itself has experienced staff.
- Vigorous enforcement programs and targeted surveys, which consistently identify risk by segments, are launched periodically to effectively bring into compliance and under control small pockets of taxpayers who are not in compliance.
- Strategic plans, with a clear focus on "the big picture" and the long-term objectives of the organization, strongly guide the development and implementation of annual work plans, and objectives of the strategic and annual work plans are almost always met.
- Clear, concise procedural and policy manuals are available electronically for each of the tax administrations’ functions, are closely followed by skilled staff, and are promptly updated electronically.
- Relationships with public and private sector groups are very positive – memoranda of understanding with Customs for exchange of data are very successful, as are forums for public accounting and Chamber of Commerce groups, the judiciary, etc.
- The tax administration has reliable information systems supported by the latest technology and has already embraced and implemented many technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.
- There is a strong presence of legal/regulatory institutions, modern tax policy, civil service rules, regulations and competitive salaries for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions. The tax administration has embraced technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.
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