

The Nuts and Bolts

of

Revenue Administration Reform

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1. The object of this paper is to provide a brief overview of Revenue Administration¹ reform. The paper discusses the rationale behind revenue administration reform and offers some key indicators that could be used to assess if reform is needed. It presents a methodology to diagnose the institutional and organizational deficiencies of revenue administration. Thereafter, the paper surveys revenue administration reforms carried out in recent years in LAC and ECA countries, to provide a sense of the scope and nature of likely interventions. Finally, it summarizes some of the major lessons from experience.

I. WHY BOTHER ABOUT REVENUE ADMINISTRATION REFORM?

2. There are various reasons why revenue administration reform may be needed in a country. First, while tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government Treasury, to a large extent, depends on the efficiency and effectiveness of the revenue administration. Weaknesses in revenue administration lead to inadequate tax collections. Financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt or inflation, respectively. In the alternative, revenue shortfalls shrink the budgetary resource envelope, thus, affecting the government's ability to implement its policies and programs and provide public services. Unexpected dips in revenue collections also cause budget cuts that result in major inefficiencies in the public expenditure management.

3. Second, the quality of revenue administration influences the investment climate and private sector development. Firms contemplating investment are not only concerned about the formal tax system, but also about how the system works. A revenue administration that is perceived to be arbitrary or predatory discourages investment. Similarly, the efficiency of the customs administration in clearing cargo figures prominently in investment decisions, especially of multi-national companies that are a major source of foreign direct investment. Further, weaknesses in the enforcement capacity of the revenue administration put law-abiding firms at a competitive disadvantage, as their competitors in the informal sector are allowed to get away with tax evasion. This reduces incentives for businesses to join the formal private sector.

4. Third, tax and customs administrations routinely figure near the top of public-sector organizations with a high incidence of corruption. The cost of this corruption is high, both for

¹ 'Revenue administration' in this paper includes both Tax Administration and Customs Administration.

the government and taxpayers. The government suffers major revenue leakages as dishonest revenue officials allow unjustified tax breaks to obliging tax evaders. Honest taxpayers suffer as corruption in revenue administration leads to harassment, inflated assessments, high litigation costs and leniency towards non-compliant competitors. Any serious effort to reduce corruption in a country and improve governance, in all likelihood, has to involve reform of the revenue administration.

5. Finally, reform of the revenue administration may be needed to enable it to keep up with the increasing sophistication of business activity and tax evasion schemes. With globalization, goods and services are produced by taxable entities in multiple countries. This presents vast opportunities for manipulating transactions to reduce the tax burden. The existence of tax havens, electronic financial transactions and the increasing use of the internet in commerce pose major challenges in enforcing the tax laws. Even, run-of-the-mill domestic taxpayers are increasingly using information technology for running their businesses and for accounting. Without a matching increase in the professional and technological capacity of the revenue administration, its chances of monitoring taxable activity and countering tax evasion are seriously reduced.

II. SOME INDICATORS TO ASSESS IF REVENUE ADMINISTRATION NEEDS TO BE REFORMED

6. Various indicators could point to the existence of weaknesses in the revenue administration. A comprehensive list of indicators is available in *Diagnostic Framework for Revenue Administration*². Some of the important indicators are discussed below.

7. **Total tax revenue³/ GDP:** This is a readily available indicator that gives a sense of the fiscal pressure. Comparing the tax to GDP ratio of countries with similar economic and tax structures gives a sense of the relative effectiveness of the revenue administration. However, this indicator needs to be used with caution, because the tax raised in a country is a function of spending choices, expenditure needs and the availability of resources from other sources. Also, given the extent of the informal economy in developing countries, GDP estimates may not be very accurate. Nevertheless, times series data on tax to GDP ratio, for a given revenue administration, adjusted for changes in tax rates and the tax base, is useful in determining changes in its effectiveness over time.

8. **Actual tax revenue/ tax revenue estimated in the budget:** This indicator shows whether the revenue administration is able to meet the revenue targets set in the budget. However, optimistic revenue estimates, often resulting from political pressures, are a common problem in many countries and suitable allowances need to be made for this tendency.

² Gill, Jit B. S., *Diagnostic Framework for Revenue Administration*, Technical Paper # 472, The World Bank, June 2000

³ "Tax Revenue" includes taxes and customs duties.

9. **Tax revenue gap:** Where reliable data is available, it may be possible to estimate the potential tax revenue that can be collected under the current tax policy and compare it with the tax revenue actually collected. The difference indicates the tax revenue lost due to noncompliance and tax evasion, which is an indication of the overall effectiveness and efficiency of the revenue administration.

10. **Amount of tax revenue paid voluntarily/ total tax revenue collected:** Since maximizing voluntary compliance is a major objective of a revenue administration, the proportion of taxes and duties paid voluntarily indicates whether the tax administration is succeeding in this objective, both by facilitating voluntary compliance as well as by creating an effective deterrent against non-compliance through its enforcement activities.

11. **Additional tax revenue collected/ the number of declarations audited:** This ratio indicates the degree of success of the revenue administration in detecting concealment of tax liabilities, and therefore, its ability to enforce the tax laws.

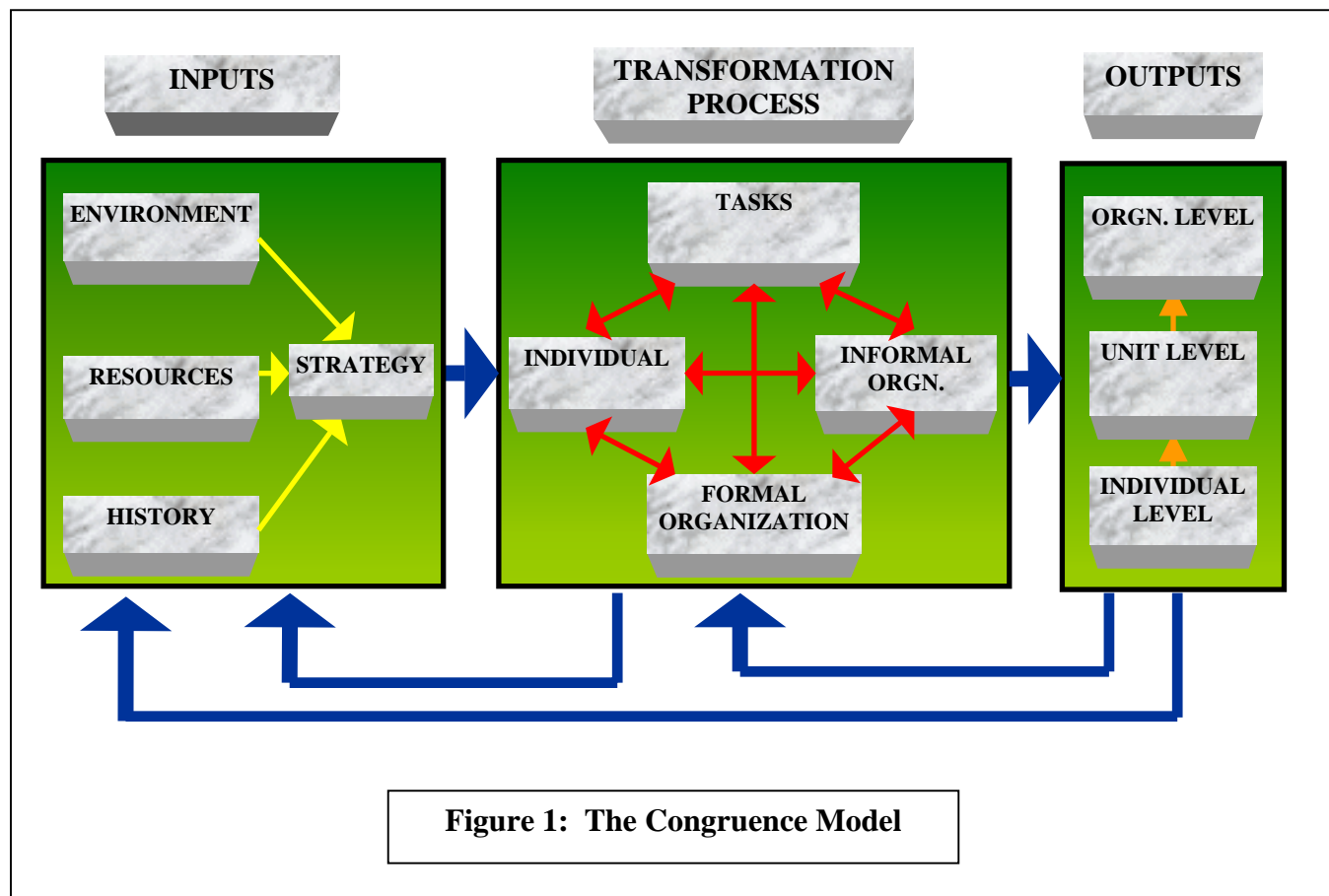
12. **Amount of tax revenue arrears collected/ Total tax revenue arrears:** This indicator shows the effectiveness of the revenue administration in recovering overdue revenues.

13. **Cost of collection:** The ratio of the total annual recurrent budget of the revenue administration to the total revenue collected provides an indication of the efficiency with which the tax administration is deploying its resources to collect taxes.

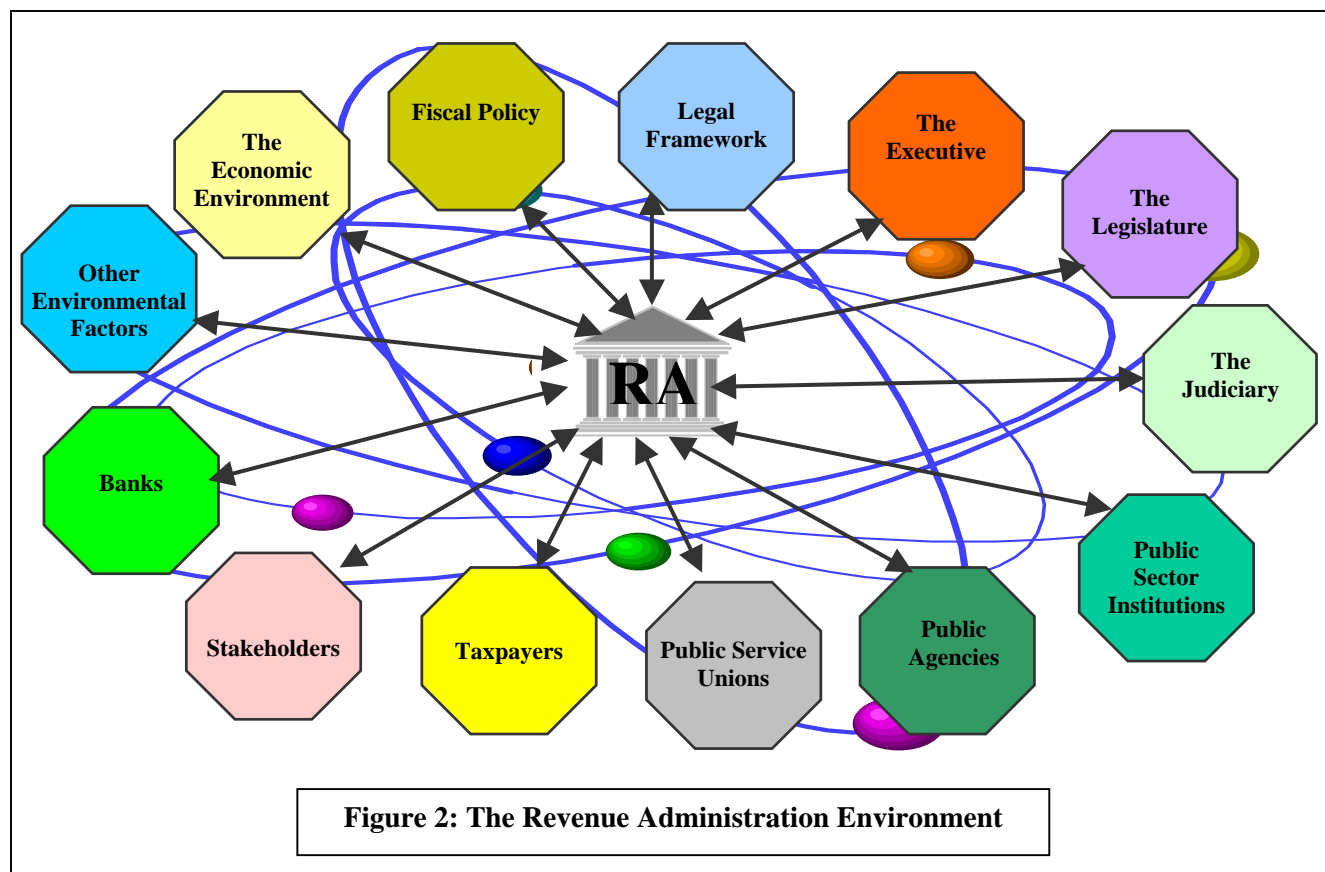
14. **Client perceptions:** Perceptions of taxpayers, traders, brokers, lawyers and accountants, as reflected in periodic surveys, about the integrity, trustworthiness, fairness, helpfulness and efficiency of revenue administration can provide important pointers to the need for reforms.

III. DIAGNOSING THE CAUSES OF REVENUE ADMINISTRATION WEAKNESSES

15. The *Diagnostic Framework for Revenue Administration*, referred to above, describes in detail a comprehensive methodology that can be used to get to the roots of revenue administration deficiencies. The methodology, based on the Congruence Model shown in Figure 1, treats the revenue administration as an open system consisting of an inter-related set of components, that interacts with its environment. It takes *inputs*, puts them through a *transformation process* and produces *outputs*.



16. Three direct inputs determine revenue administration performance. First, the environment in which it operates. An array of external actors, forces and circumstances constantly impinge on the revenue administration. Very often, its weaknesses can be traced to the constraints imposed by these external influences. At other times, they stem from the inability of the revenue administration to effectively deal with environmental challenges or exploit environmental opportunities. Therefore, in order to understand the reasons for poor performance of the revenue administration, we must first look *'outside the box'*, beyond the organizational boundaries of the revenue administration, and analyze the impact of important environmental factors on its performance. The major factors that need to be considered are shown in Figure 2.



17. Resources constitute the second main input for the revenue administration. Tangible resources consist of managers and staff; annual budgetary allocations; IT systems; and infrastructure - buildings, vehicles, office equipment, communication systems, weigh-bridges, X-ray machines, chemical laboratories, records storage facilities and so on. Intangible resources include the legal authority granted to the revenue administration for administration of the tax laws; the perception of taxpayers and the public about the fairness, transparency, integrity and enforcement capacity of the revenue administration; and the honesty, morale and commitment of revenue administration employees. Three general issues need to be considered with reference to the resources of the revenue administration. First, the aggregate level of resources. Lack of adequate resources may impose serious constraints on the revenue administration in managing voluntary compliance and countering tax evasion. It may also limit its ability to upgrade its operations to improve performance. Second, the quality of available resources. Skill deficiencies, outdated IT systems or run down infrastructure may be the cause of low performance in many critical areas. Third, the degree of flexibility available to revenue administration management in the use of resources. Inability to change the resource mix in response to emerging priorities and difficulties in re-tooling, retraining and reconfiguring resources may be the source of many chronic deficiencies.

18. The history of the revenue administration is the third direct input. History has a major impact on current performance. It also often restricts the degrees of freedom available for

future action. As such, a good understanding of at least the recent history of the revenue administration is essential. The main issues to be analyzed include: (i) effect of past events and decisions on current and future operations; (ii) nature of past crises and organizational response to them; (iii) evolution of core norms and values; and (iv) experience with past reform efforts.

19. From the direct inputs mentioned above a fourth input is derived. This is the strategy of the revenue administration consisting of its mission; vision; key result areas; performance objectives; and operational strategies to achieve performance objectives.

20. The inputs feed into the *Transformation Process* that is an interaction of four components: (i) *tasks*, (ii) *formal organizational arrangements*, (iii) *informal organization or culture* and (iv) *individuals*. *Tasks* are the specific work activities and functions that are carried out to achieve the objectives of the revenue administration. These cover both managerial tasks as well as operational tasks related to implementation of the tax laws. Table 1 indicates the main tasks of a revenue administration that need to be analyzed.

21. *Formal organizational arrangements* in the transformation process include (a) governance arrangements; (b) the institutional framework consisting of formal laws, rules and regulations applicable to the functioning of the organization; (c) the organizational structure, the design of specific jobs within the structure, and the formal systems for monitoring, reporting, coordination and control; (d) business processes; (e) information systems; (f) allocation of resources and workload for different tasks; and (g) the physical work environment. The *informal organization or culture* represents the informal arrangements that develop in every organization over time. These consist of informal norms, conventions, values, processes, patterns of relationships within and between groups, communication channels, influence mechanisms and role models. The informal arrangements are generally implicit and unwritten, but they greatly influence behavior within the organization. Sometimes, they support and complement the formal organization. At other times, they subvert or circumvent it. Therefore, they may either aid or obstruct organizational performance. Finally, *individuals* are the persons who perform different tasks of the revenue administration: managers, lawyers, auditors, inspectors, IT professionals, taxpayer service staff and clerks. The success of the revenue administration critically depends on their numbers, skill level, experience, commitment and morale. For each task in Table 1, the appropriateness and adequacy of (a) the formal organizational arrangements, (b) the informal organization and (c) the concerned individuals needs to be assessed to determine whether the revenue administration is equipped to perform the task properly.

Table 1: Main Tasks of Revenue Administration Requiring Analysis

ORGANIZATION AND MANAGEMENT TASKS	OPERATIONAL TASKS	
	Tasks Common to Tax Administration and Customs Administration	Special Tasks of Customs Administration
Strategy and policy formulation	Registration of Taxpayers	
Planning, budgeting, resource allocation	Taxpayer Services <ul style="list-style-type: none"> • Taxpayer education: • Taxpayer assistance: • Facilitation of voluntary compliance: 	Trade Facilitation
Monitoring and evaluation	Processing of Declarations and Payments	
Coordination	Monitoring of tax withholders and collection agents	
Financial management	Collection of information about taxable transactions: <ul style="list-style-type: none"> • Collection of information from third parties. • Intelligence operations. • Search and seizure and survey operations to obtain incriminating evidence. 	
Personnel management	Risk analysis and selection of cases for audit and investigation.	Risk analysis and selection of cases for physical inspection.
Information Technology Management	Audit and Investigation	<ul style="list-style-type: none"> • Physical inspection of cargo, passenger baggage, ships, aircraft and vehicles • Anti-smuggling operations
Asset management	Recovery of Tax Arrears	Monitoring and control of bonded warehouses
Internal control	Legal and Judicial Matters: <ul style="list-style-type: none"> • Legislation • Appeals • Prosecution 	
Anti-corruption	Fiscal studies	
External relations		

22. The results of the transformation process appear as outputs at the individual, unit and organizational levels. Outputs resulting from the performance of statutory functions include taxes and duties collected, tax declarations processed, shipments inspected, cases audited, orders imposing additional tax liability or penalties passed, appeals decided, revenue arrears recovered and confiscated goods sold. Outputs relating to taxpayer service comprise of guides and brochures distributed, television programs produced, advice given to taxpayers on specific

legal and procedural issues and so on. Finally, outputs pertaining to the internal management include action plans, progress reports, performance evaluations, posting and transfer orders, administrative instructions, financial accounts, and annual reports.

23. There is a continuous feedback from outputs to the transformation process, from the transformation process to inputs and from outputs to inputs. The feedback occurs through various channels such as formal supervision, reporting, and evaluation systems; surveys of taxpayers, employees and other stakeholders; complaints filed by taxpayers; or informal exchanges within the revenue administration and between it and its clients and other government entities.

24. The central idea of the diagnostic methodology is that the effectiveness of the revenue administration in achieving its objectives depends on the congruence or fit between different parts of the organization model. Effectiveness is greatest when (a) the strategy fits the environment, resources and history, on the one hand, and the transformation process outputs and feedback mechanisms, on the other; (b) the transformation process fits the strategy, desired outputs and feedback mechanisms; and (c) the four components of the transformation process i.e. tasks, formal organizational arrangements, informal organization and individuals fit each other. Whenever there is a lack of congruence between any of these elements, the result is inadequate performance. Therefore, in order to improve the effectiveness of the revenue administration what needs to be done is to, first, identify areas of lack of fit and, then, design remedial measures to improve the fit.

25. The Diagnostic Framework *for Revenue Administration*, discusses each element of the congruence model in detail; provides related diagnostic questions; illustrates the kind of institutional and organizational deficiencies that are likely to be encountered in different areas; suggests possible reform options and provides some guidance for converting the diagnosis into a reform strategy. The diagnostic approach has been used, with certain modifications, for developing the *Latvia State Revenue Service Modernization Project*, the *Colombia Public Financial Management Project – II*, the *Russia Tax Administration Reform Project- II* and the *Russia Customs Development Project*.

IV. RECENT TRENDS IN REVENUE ADMINISTRATION REFORM:

26. While different tax and customs administration reform projects in recent years have had country specific variations, most have sought to (i) improve the organization and management of revenue administration; (ii) strengthen the legal and regulatory framework; (iii) broaden the tax base by registering potential taxpayers; (iv) facilitate voluntary compliance; (v) improve capacity to process the massive information flows resulting from declarations filed by taxpayers, payment transactions and administrative actions; (vi) enhance availability of information about taxable transactions from third parties; (vii) develop risk-analysis capacity to zero in on cases involving potential violations of tax laws; (viii) strengthen investigation, audit and enforcement capacity; (ix) improve appellate procedures; (x) enhance analytical ability to

carry out fiscal studies to assess tax burdens, collection trends, compliance gaps and impact of tax policy changes; and (xi) reduce corruption. Additionally, in customs administration, there have been serious efforts to facilitate trade and strengthen anti-smuggling operations. These reforms have involved considerable experimentation with different organizational structures; strengthening of management systems; major changes in tax and customs codes; re-engineering of business processes; heavy investments in information and communication technologies; improvement of incentive systems; and active efforts to reach out to taxpayers and other stakeholders. An overview of some of the recent reforms undertaken by selected countries, by no means exhaustive, is provided below.

A. *Organization and Management Reforms:*

(a) *Organizational Restructuring:*

(i) *Positioning of Revenue Administration within the Overall Government Structure:*

27. The placement of the revenue administration within the government structure has a significant implications for its ability to muster political support to push needed legislative changes, implement reforms and take strong enforcement actions against vested interests. It also influences its autonomy in using financial resources, hiring and firing staff and taking day to day operational decisions. Different countries have adopted varying approaches with regard to the status of the revenue administration within the government. At one end, Russia, Armenia and Kazakhstan have established a full-fledged *Ministry* responsible for tax administration. The Minister has a cabinet level status and the same level of autonomy as other ministers. At the other end, Hungary, Bulgaria, Jamaica and Latvia have the revenue administration as an agency or department reporting to the Ministry of Finance. As a result the autonomy of the revenue administration is considerably lower. In between, are countries that have created *Independent Revenue Agencies*, such as Peru, Guatemala and Guyana (Peru has since brought the revenue administration under the Ministry of Finance). The independent revenue agencies have considerable autonomy, but a status less than a ministry. These agencies are typically constituted outside the civil service. The top management is recruited on fixed term contracts. Management has significant independence in financial, personnel and operational matters, but is accountable for delivering agreed results. Renewal of contracts of top managers depends on revenue administration performance. In Colombia, the revenue administration enjoys the status of a Special Administrative Unit and considerable autonomy, but it is not a separate agency and reports to the Ministry of Finance.

(ii) *Combining tax and customs administrations:*

28. Due to the considerable similarity in functions of tax and customs administrations, some countries have experimented with combining tax and customs administrations. Canada, Denmark have merged tax and customs administrations. In the early nineties, Colombia also fully merged its tax and customs administrations. However, in 1997, it created two separate

operational Directorates for taxes and customs within a single organization, with a unified management structure and shared corporate resources. An approach similar to this has been adopted by Latvia. In Jamaica, while the customs and tax administrations remain separate departments, these have been put under the same Director General. The potential benefits of combining tax and customs include economies of scale in infrastructure and ICT systems; improved information exchange between tax and customs activities; and improved taxpayer monitoring. However, cultural differences between tax and customs administrations can pose significant integration problems. Also, even though the revenue collection processes are broadly similar in tax and customs administration, customs functions relating to regulation of trade flows, prevention of prohibited goods and anti-smuggling are significantly different and require maintenance of specialized skills within the merged organization.

(iii) Assigning the responsibility for collecting social security contributions to tax administration:

29. This has been quite popular in ECA countries, such as Hungary and Russia. Again, the similarity between the tax administration's activities of declaration processing, assessment, audit and collection and the activities required to collect social security dues creates potential economies of scale. Also, tax administrations are usually better equipped to handle audit and recovery operations as compared to social security administrations. An additional advantage is that, since self-employed individuals and employers liable to pay social security contributions are also taxpayers, their compliance costs are reduced as they have to deal with only one government agency. The merger of social security collections with tax administration does create considerable strain on the latter in the initial years and needs to be supported by adequate IT infrastructure and increased staffing to handle the high volume of additional transactions.

(iv) Introducing a Functional Organizational Structure within the Revenue Administration:

30. Most revenue administrations are moving over to a functional organization structure, as against a structure based on tax types. This involves creating specialized units for taxpayer assistance, processing of tax returns and payments, tax audits, investigation and intelligence, appeals, recovery of tax arrears, financial management, human resource management, fiscal studies etc.. A functional organization structure has been or is being implemented in Latvia, Jamaica and Russia. In some countries, the reorganization has also been accompanied by reduction in the number of local offices and moving some of the local office functions requiring specialized skills, such as tax audits, to the regional level. Both Latvia and Russia have followed this approach, with Russia closing more than a 1000 local offices. Very often, moving to a functional organizational structure at the local level requires adjustments in the organizational structure at the regional and national levels, in order to ensure clear lines of reporting and coordination between different functions.

(v) *Creating Data Processing Centers:*

31. Another measure to exploit economies of scale is the consolidation of routine data processing functions, e.g. registration of taxpayers, processing of returns and payments, maintenance of taxpayer accounts, detection of non-filing, stop-filing and non-payment of taxes based on declarations and routine correspondence with taxpayers, into centralized Data Processing Centers (DPCs) serving multiple local offices. This also reduces contact between taxpayers and tax officials, thus, reducing opportunities for corruption. Inspired by DPCs in the US, Russia has built two in Volgograd and Moscow and is planning five more, besides a federal level DPC to consolidate information at the national level.

(vi) *Large Tax Payer Units:*

32. Large Taxpayer Units (LTUs) have been established in most transition countries and many countries in LAC. LTUs allow closer monitoring of compliance by important taxpayers, who have a major impact on aggregate revenue collections. Since these taxpayers also have more extensive or complicated transactions, the concentration of their cases in LTUs enables the revenue administration to deploy their best auditors and investigators to scrutinize these cases. LTUs are also an important mechanism for maintaining revenue collections at a reasonable level, while the rest of the tax administration is being modernized. The LTUs are an apparent exception to the functional organization principle, as they perform all tax administration functions with respect to specified taxpayers. However, internally, most LTUs are usually organized along functional lines. Russia has recently created federal level LTUs dealing with cases of large taxpayers in the oil, gas and alcohol industries. In addition, it has inter-regional LTUs, Regional LTUs and Local LTUs, focusing on the top taxpayers at each level.

(vii) *Tax Administration Organization in Federal Countries:*

33. In some federal countries, tax administrations tends to collect federal, regional and local taxes. Regional heads of tax administration are usually appointed by the federal authorities after consultation with the regional governors. In Russia, this has lead to a dual loyalty. Since regional heads are physically and, usually, politically closer to regional governors, there have been complaints of collection of local and regional revenues being given precedence over federal tax collections. Russia is attempting to break this nexus by creating inter-regional tax authorities at the level of the seven federal districts, or Okrugs. Although the inter-regional offices do not perform tax administration functions directly, they have a monitoring and reporting role vis-a-vis the regions under their jurisdiction. The formation of inter-regional large taxpayer units at the Okrug level, is aimed to further weaken the regional connection. Some opposition from regional governors has been reported. Another problem related to collection of regional and local taxes by the federal tax administration is that the sharing of the cost of collection of these taxes between the federal, regional and local governments is often not clear or equitable. In some cases, the lower levels of government pay less than their fair share

or receive free services. In other cases, the flow of funds from these governments to the revenue administration is erratic, leading to operational inefficiencies.

(b) *Management Strengthening:*

34. Reform in management of revenue administration has been under-emphasized in most countries. However, it is critical to achieving sustainable performance improvements. Some of the recent projects in Latvia, Russia and Colombia have focused on this area. The objective is to strengthen the capacity of managers for setting strategic goals; formulating operational policy; managing financial, human, information and physical resources effectively; supervising, monitoring and evaluating performance; improving coordination; anticipating and resolving operational problems; enforcing internal control systems; preventing corruption; improving mechanisms to redress taxpayer grievances; and interacting with external stake-holders. Training in general management and change management has been included in some projects.

35. Improving the management of the revenue administration is perhaps one of the most challenging areas. First, management improvements inherently require fundamental changes in the behavior of managers and staff - their sense of the mission and purpose of revenue administration; their desire to make optimal use of scarce resources to meet organizational objectives; their willingness to pursue powerful tax evaders and withstand the resulting political pressure; their commitment to integrity and taxpayer service and so on. In many developing countries, perverse management practices have been the norm for long and it is often very difficult to change the underlying culture. Second, in management of financial and human resources, revenue administrations are often constrained by laws and regulations that apply to the public sector as a whole. Thus, in many countries rules of public expenditure management seriously reduce the flexibility of the revenue administration to move financial resources from one activity to another, more important, activity. Similarly, revenue administration staff are often part of the general civil service. As a result, there is little leeway to improve their salaries and incentives. This poses a particularly difficult problem with regard to recruitment and retention of good managers, lawyers, auditors and IT professionals needed to run a modern revenue administration. Also, because of outdated disciplinary rules applicable to civil servants, revenue administrations frequently find it difficult to take prompt action in cases of corruption and misconduct.

36. Notwithstanding these difficulties, many countries have undertaken initiatives to improve revenue administration management. Organizational restructuring to improve the autonomy of the revenue administration in financial, personnel and operational matters has already been mentioned above. Many countries have used revenue administration restructuring as an opportunity to get rid of corrupt officials and dead wood. In Guatemala, Peru and Jamaica, existing employees of the revenue administration were screened through a rigorous process involving pschyo-metric tests, tests of job-specific skills, interviews and review of personnel records. This led to many employees not be taken into the reorganized entity. Also a number of young staff, often straight out of college and, therefore, presumably honest,

were inducted to improve the quality of human resources and the integrity of the revenue administration.

37. In order to improve salaries, countries opting for the independent agency model de-linked the salaries of revenue administration staff from the general civil service, thus, giving management the freedom to pay market salaries. In Guatemala, the salaries of top managers were increased very significantly. Other countries, like Jamaica, created a separate salary scale for tax administration staff. Some countries, including Russia and Albania, allow managers to distribute performance-based bonuses.

38. Improvements in management information systems to support decision-making have been implemented in many reforming countries. In addition, automated financial management and human resource management systems have been put in place.

39. To deal with corruption, Colombia carried out a systematic study of important business processes, resulting in preparation of *Corruption Risk Maps* to guide procedural changes to reduce opportunities of corruption. Strengthening of internal control systems, including vigilance against corruption has been undertaken in Latvia and Jamaica. Further, changes in tax and customs codes have been made to reduce discretion of revenue officials and simplify procedures. Work flows have been modified in Russia and Latvia to reduce interaction between tax officials and taxpayers. The access of taxpayers is restricted to the taxpayer service areas and they are prohibited from entering other offices. Also, as already mentioned, moving processing of returns and payments into DPCs that have no public contact has also distanced revenue officials from taxpayers. Other anti-corruption measures enabled by automation include restricting access of employees to scanned copies of original records to prevent tampering and creating audit trails of administrative decisions and changes made to taxpayer current accounts.

(B) Operational Reforms:

(i) Strengthening the Legal and Regulatory Framework:

40. Most revenue administration reform projects have involved extensive amendments to the tax and customs codes and related secondary legislation. The changes have been directed at removing ambiguities or loopholes in legislation that create unintended tax avoidance opportunities; strengthening taxpayer registration requirements to make it difficult for potential taxpayers to stay out of the tax net; strengthening enforcement powers of revenue authorities; enabling information exchange between different government agencies to facilitate more effective implementation of tax laws; increasing penalties for non-compliance; expanding withholding provisions or raising the threshold below which taxpayers do not need to pay tax, to reduce the administrative burden on the revenue administration; eliminating low revenue yield, or nuisance taxes; simplifying legal provisions, procedures and forms to make them easier to understand and comply with; reducing discretion of revenue authorities;

strengthening appellate systems to improve equity of the tax system and provide recourse to taxpayers against administrative excesses and so on.

41. Changes in laws and rules, especially, those aimed at strengthening enforcement capacity of the revenue administration often face concerted opposition from the business community, lawyers and accountants associations and citizen groups. While some of the opposition stems from the desire to prevent the revenue administration from being able to check tax evasion, in other cases it comes from genuine fears of likely misuse of authority and breach of privacy. The ensuing debate has often delayed enactment of required changes or has led to their dilution. This points to the need to sell the reforms effectively and build appropriate safeguards into them.

(ii) Registering Potential Taxpayers:

42. Most reforming countries have adopted a unique Taxpayer Identification Number (TIN) which is allotted to existing and potential taxpayers. In some countries, like Jamaica, appropriate legal provisions have been made to make the use of the TIN mandatory in transactions with tax authorities, for obtaining various licenses and permits and for significant economic transactions that have tax implications. This forces potential taxpayers to come to revenue administration and register. Field surveys to detect unregistered taxpayers, as well as extensive publicity campaigns have often accompanied the drive to allocate TINs. By 2001, Russia had allotted TINs to more than 93 million individuals and to most legal entities. The TIN forms the basic building block for revenue administration IT systems, as it allows connecting taxpayers to their returns, payments and major taxable transactions with third parties. There are discussions in some countries for adopting a single identification number for individuals to serve multiple purposes: national ID, social security and tax registration.

(iii) Fostering Voluntary Compliance:

43. Voluntary tax compliance does not have a long history in many developing countries. Therefore, encouraging it is a major challenge. This has involved efforts in three directions. First, various activities, often quite creative, have been undertaken to make potential taxpayers aware of the general concept of taxation and why they should pay their taxes. For this purpose, revenue administrations have organized awareness raising campaigns involving TV skits; radio programs; competitions to create advertisements displayed on buses; school plays on tax issues and fairy tales spun around tax compliance. Some administrations have also sought to incorporate tax themes in school curricula, in collaboration with Ministries of Education. Second, efforts are being made in most countries to make compliance easier for taxpayers who want to comply voluntarily. This consists of publishing pamphlets and creating web pages giving out information on tax laws, rules and procedures and changes thereto; organizing seminars and workshops for taxpayers, providing assistance to taxpayers in filling up tax returns, looking up their accounts to see how much they owe and clarifying doubts on legal and procedural matters; setting up telephone hot lines to answer questions; appointing floor walkers to assist taxpayers waiting in queues; improving waiting areas; and keeping tax offices

open for longer hours on days when there are declaration filing deadlines. Jamaica has also constructed one-stop Revenue Centers that provide services relating to all taxes, customs and issue of driver's licenses at one place. Efforts have also been made to reduce compliance costs through simplification of forms, reducing the number of steps required to obtain tax clearance certificates, re-engineering of business processes and introduction of electronic filing of tax returns and electronic payment of taxes.

44. The lack of an adequate number of private sector firms specializing in tax advisory work is a major drawback in most countries, especially in transition economies. Although large taxpayers usually have access to local branches of international accounting firms and some local firms, the small and medium taxpayers as well as individuals, generally, do not have this facility. This puts pressure on the revenue administration to double up as a tax adviser. For instance, the Volgograd tax administration in Russia has created an advisory service run by current and retired employees, who help taxpayers prepare returns and face audit queries, for a small fee. Ostensibly a Chinese wall exists between the advisory and administrative branches of the tax administration, but the potential for conflict of interest in this arrangements is obvious. Efforts are also being made in Russia to create and strengthen Taxpayer Associations and to catalyze the establishment of a tax advisory services profession.

(iv) Improving routine processing of declarations and payments:

45. The revenue administration receives a huge number of tax declarations and customs declarations. It also processes multiple payments by taxpayers during the year. Efficiently managing the massive documentary and information flows is critical to the revenue collection effort. For this purpose, most countries have turned to automation of the related processes. In addition, many tax administrations have delegated the task of receiving and processing tax declarations and payments to banks. For instance in Colombia, banks do the initial data entry related to tax returns and payments and pass on the information to the revenue administration along with the paper records. In some countries, taxes are collected by banks and reported to the national Treasury, which passes on the information in an electronic form to the tax administration. Requiring taxpayers, especially, large taxpayers, to file their tax declarations electronically is also becoming popular. This reduces the data processing burden of the tax administration and increases data accuracy, as the electronic system forces taxpayers to correct filing errors, before accepting the declaration. Electronic payment of tax dues is also being promoted to ensure timely transfer of tax payments to the Treasury and payment information to the revenue administration. Electronic filing of customs declarations by authorized brokers has been introduced in a number of countries.

(v) Strengthening enforcement:

46. Encouragement and assistance of taxpayers in complying with tax laws would not lead to higher tax collections, unless taxpayers perceive the risk of being caught and the penalty for non-compliance to be high. The aim of strengthening enforcement is to heighten the risk

perception and demonstrate the revenue administration's capacity to detect and punish evasion. This is perhaps still the weakest area in revenue administrations in most developing countries.

47. One tool used for improving compliance is a computer system that detects stop filers, non-filers and taxpayers who have not paid the full taxes shown as due in their returns. The system identifies defaulters soon after the statutory dates for filing and payment of taxes and automatically issues form letters to them asking for compliance. This heightens the perception that the revenue administration knows of the defaults and would pursue it. Consequently, a significant percentage of defaulters to comply.

48. In order to improve the ability of the revenue administration to verify the truthfulness of declarations, databases containing information provided by taxpayers to third parties, or relating to their transactions with third parties are being developed in most countries undertaking reforms. Comparison of the information contained in the third party databases with the information provided by the taxpayer is an effective way to identify potential concealment.

49. Development of sophisticated systems for risk analysis and selection of cases for audit and investigation is another tool to improve the enforcement capacity of the revenue administration. These systems, implemented in Chile, Colombia and Hungary, use information from different sources to zero in on cases where the risk of fraud is high. These cases are then picked for detailed investigation and audit and physical inspection (in customs). Adopting a risk analysis based approach to curbing tax evasion and smuggling has many advantages. First, since the selected cases, *prima facie*, have some suspicious characteristics, it is more likely to find actual tax evasion in these cases, than if cases were picked up at random. Thus, the productivity of enforcement activities in terms of gathering additional revenue and penalizing evasion increases. In turn, it also enhances the deterrent effect of such actions in the minds of the normal taxpayers. Second, risk analysis allows the revenue administration to be more selective in scrutinizing cases. The percentages of cases selected for examination is usually between 1 to 10% of the total number of cases. This leads to more intense scrutiny and better use of investigation, inspection and audit skills, that are invariably in short supply in most revenue administrations. Third, the reduction in the number of cases facing revenue administration interventions, implies that most of the other cases are accepted after only a cursory review, often conducted automatically by computer systems. There is, therefore, no need for any interaction between tax officials and taxpayers. On the one hand, this reduces opportunities for corruption. On the other, it reduces overall compliance costs of taxpayers. In the customs area, acceptance of most of the customs declarations means that goods can be cleared without physical examination, saving traders considerable time and cost.

50. Strengthening audit capacity itself is a major objective of most reform projects. Improvements in audit planning, collection of relevant information, methodology of conducting the audit and training of auditors are the key areas of focus. Some countries, e.g, Hungary, have imported a Danish Tax Audit system (ESKORT) that guides auditors through the steps of

an audit. Enhancing audit capacity is extremely crucial, as with the increasing sophistication of business transactions, including cross-border transactions, it is essential that the revenue administration be able to match wits with potential tax evaders.

51. Many countries, especially in the former Soviet Union, have instituted a Tax Police to investigate cases involving potential criminal liability. In most cases this is a sub-optimal arrangement as it artificially splits enforcement of tax laws between two organizations. While in most countries, the tax police and tax administration work closely, inefficiencies due to coordination problems, differing priorities, inter-institutional rivalries and dividing up of skills, that are scarce to begin with, are evident. In some countries (Latvia), both the tax administration and the tax police report to the Ministry of Finance. In Russia, the separation is greater: the Tax Police reports to the Ministry of Interior. A few years ago, Colombia also introduced a tax police that reports to the revenue administration.

52. Collection of arrears of tax has been a major problem in most countries, especially Russia. The problem is particularly acute in countries with continuing large number of inefficient public enterprises, that frequently default on their tax payments. Special organizational units at headquarters have been created to monitor arrears collection. Besides training in arrears collection, tax administrations have also developed systems to guide officials through the fairly protracted and legalistic processes involved in the recovery of overdue taxes.

(vi) Improving Administrative Appeals Mechanisms:

53. Most tax codes provide for appeals to the courts against decisions of tax authorities. However, the process can be quite long and expensive, both for the taxpayer and the tax administration. Efforts are now being made to set up transparent and neutral administrative appeals bodies that would act as appellate authorities of the first instance and provide a mechanism for expeditious disposal of a majority of the cases. A good appeals process is also essential for improving voluntary compliance, as it increases the taxpayers' trust in the fairness of the revenue administration.

(vii) Automating Revenue Administration Operations:

54. All modernizing revenue administrations recognize the critical importance of good information systems to improving performance. As a result, recent projects have invariably included heavy investments in information and communication technologies (some times as much as 80% of total project costs). The standard suite of modules of tax and customs administrations usually includes the following:

- **Taxpayer registration and assignment of TIN:** The system collects basic information about the taxpayer: name, address, phone numbers, legal status, economic activity, bank accounts etc.. In case of legal entities, the information also includes details of place of business, names and particulars of top managers, shareholders etc.. The information contained in the

registration system helps the tax administration to communicate with the taxpayer, send non-compliance notices and collect tax arrears. The registration process culminates in the allotment of a unique Taxpayer Identification Number (TIN), that must be quoted in all declarations, payments, correspondence with the tax administration and in major potentially taxable transactions. All information relating to a taxpayer in the revenue administration's information systems is keyed to the TIN. Since taxpayer information is dynamic, the system also includes mechanisms for periodic updating. In most countries, customs administrations have their separate registrations systems to register traders. In some countries, efforts are being made to use a single TIN for both tax and customs.

- **Processing of declarations:** In the case of tax administration, the system captures the information included in the tax declarations and verifies its completeness, checks the arithmetical accuracy of computation of the taxable base and the tax payable and posts the resulting tax liability in the current account of the taxpayer. A similar system pertaining to customs administration, verifies information about the nature, classification and valuation of goods declared; applies the appropriate tariffs, based on the nature of goods, country of origin and the customs regime under which they are being imported and exported; and calculates the taxes and duties payable.
- **Processing of payments and revenue accounting:** The core of the system is a the Taxpayer Current Account that contains complete chronological information about the liabilities and payments of a particular taxpayer, When payments are made, the system relates specific payments made by the taxpayers to the relevant tax type, assessment year, nature of payment i.e. whether advance tax payment, withholding, payment along with the declaration or payment in response to assessment or recovery notices. It posts these payments in the taxpayer current account. In addition, it calculates interest and mandatory penalties chargeable in case of delay in payment or non-payment of taxes. When taxpayers are allowed to pay their dues in installments, the system records the amount and dates when installments are due and received. The payment system is the basis for revenue accounting and generates reports relating to aggregate collections made on account of different taxes and by different tax offices.
- **Recovery of tax arrears:** Once tax payments become overdue, the information from the taxpayer current account is passed over to the tax recovery system. The system helps in analysis of arrears and prioritization of recovery actions. It guides the processes of persuasive recovery and, if these do not work, those of coercive recovery. Since recovery proceedings involve intricate legal issues, the assistance provided by the system in managing these processes is extremely useful. As and when arrears are recovered, the payments are posted into the taxpayer current account.
- **Risk analysis and selection of cases for audit and investigation:** The system uses information from national statistical organizations, third parties, the revenue administration's own databases containing information about compliance behavior of

taxpayers and information received through complaints and intelligence operations. In the case of customs administration, the risk analysis system also takes into account information about country of origin, brokers, shippers, transporters, nature of goods etc.. Through the use of multiple macro-economic, industry-specific and taxpayer-specific criteria the risk analysis system selects cases that need detailed examination. In customs administration, the risk analysis system works in conjunction with the declaration processing system and gives guidance to customs officers in real time about whether a particular shipment should be subject to physical inspection. The system is also used to identify cases for post-release audit.

- **Third party information system:** This system compiles information about tax transactions from official and non-official third parties. The system includes information from multiple public sources (registrars of companies, registrars of land transactions, customs, social security administration, foreign tax and customs administrations, Interpol etc.) and from private sources (sellers of luxury cars, banks and financial institutions, brokers of financial securities, large taxpayers selling and buying from other taxpayers etc.). The information supports the risk analysis process, enables comparison of actual taxpayer transactions with those declared and assists in investigation and audit.
- **System for administrative actions:** The revenue administration takes a number of administrative decisions that impact taxpayer liabilities. These include auditing of declarations, assessment of additional tax payable, including interest and penalties, issuing refunds for overpaid taxes, granting of installments for payment of dues, waiver of tax arrears, forgiveness of obligations in certain circumstances, review and modification of orders by superior administrative and appellate authorities etc.. Many tax administrations have developed systems to support such administrative actions. The relevant authorities directly issue the relevant orders through these systems. This creates a transparent record of who took a decision and on what basis. At the same time, the impact of these decisions on taxpayer liabilities is automatically reflected in the taxpayer current account.
- **Case management:** The case management system allows the management of processing of cases through different revenue administration processes, such as audit, assessment, issue of refunds, appeals etc..
- **Electronic filing of declarations and electronic payment of taxes and duties.** This system allows taxpayers to prepare and file their tax returns and pay taxes on-line. Electronic filing reduces errors, provides taxpayers with immediate proof of filing and reduces the tax administration's processing workload. In Colombia the management of this system has been sub-contracted to a private provider. In customs, electronic filing of customs declarations is usually done through authorized brokers. The brokers prepare the declaration, transmit it to customs and pay the required duties online.

- **System to detect non-filing, stop-filing and non-payment of taxes:** As mentioned above, this system identifies cases where taxpayers stop filing declarations, or do not file them on time or do not pay taxes payable as per the returns. The system automatically mails reminders to the defaulters and processes their responses.
- **System to manage warehousing of cargo:** The system controls warehousing of cargo pending its clearance by customs and issues release orders to warehouses once all customs formalities have been completed.
- **System to manage disposal of confiscated goods.** In the course of their operations, customs authorities confiscate prohibited cargo, smuggled goods, goods for which duties and taxes are not paid, or goods that have been abandoned. The system allows customs to prepare an inventory of the confiscated goods; manage their disposal through auctions or their destruction; and account for the goods and sale proceeds.
- **Other systems:** Some tax administrations have developed special systems to monitor banks that collect taxes, in order to ensure that the banks do not retain the revenue receipts beyond the permissible period. In addition, systems to control issue of VAT invoices and tax refunds have also been developed. Russia and Hungary have implemented systems to scan declarations to achieve a paperless environment. Most revenue administrations have developed websites to provide information to taxpayers. Web-based training courses for employees are also being created to enable continuous, self-paced, distance learning. Legal databases have also been compiled to provide convenient access to tax laws, regulations, administrative instructions and courts decisions to tax officials. Similarly, valuation databases to assist customs officials in determining the value of cargo are being developed.

55. The implementation of new computer systems has often been accompanied by extensive analysis of current administrative procedures and significant business process re-engineering. In addition to developing and implementing new software systems, reforming revenue administrations have invested heavily in building up the informatics infrastructure. This has included developing local-area and wide area networks, improving communications between local, regional and national offices, allowing local and regional offices access to national level databases to enable monitoring and investigation of cases spanning activities in multiple jurisdictions, increasing the density of computer availability within the revenue administration, so that more and more employees have access to the automated systems. E-mail based communications within the revenue administration are becoming increasingly important.

V. MAJOR LESSONS

56. Some of the major lessons from recent revenue administration reform projects include the following:

- Revenue administration reform is a serious undertaking, involving considerable costs and a multi-year effort. Without support of the top political executive, Parliament, in case legal amendments are needed, and managers and staff success is doubtful.
- The quality and continuity of leadership of the reform effort is a major determinant of success. Senior managers should be selected carefully. They should also put in place early in the reform process. Efforts should be made to minimize top management changes as these have a disruptive effect on the reform process.
- While computerization is necessary to improve efficiency and effectiveness in the Revenue Administration it is not sufficient. It is necessary to address a broad range of institutional weaknesses in order to achieve lasting performance improvements. Therefore, a well-rounded institutional development approach has to be adopted.
- Many facets of revenue administration reform are linked to overall public administration reform. Therefore, parallel progress in public sector reform should be pursued to make revenue administration reform successful.
- Legal changes aimed at strengthening the tax administration's enforcement powers, are likely to meet with opposition from vested interests. These should, therefore, be accompanied by proactive efforts to explain their rationale and purpose to taxpayers, representative associations and legislators. In this effort, safeguards built into the proposed legislation to protect taxpayers rights should be highlighted. To the extent possible, legal changes should be implemented as early as possible in the project.
- Changes in the organizational structure and functions of different departments and offices should, preferably, precede IT system development. Uncertainties regarding departmental structure and the roles and responsibilities of different organizational units make it difficult to precisely define system requirements. Also, organizational changes during system development lead to considerable rework, higher costs and implementation delays.
- Business process re-engineering should also precede development of IT systems, so as to avoid automating inefficient processes.
- Off-the-shelf software packages that can be customized have the advantage of lower costs and shorter implementation period. However, such packages should be selected only after a careful analysis of business requirements and a detailed evaluation of available packages, preferably carried out in real life settings.

- It is useful to implement individual modules of large information systems as soon these are ready, rather than waiting for development of the full system. This ensures more timely user feedback to inform the development process; makes it easier for users to learn how to use the system; and facilitates organizational change by providing tangible benefits at intermediate stages.
- Information systems introduced in revenue administrations, like all ICT systems have a built-in obsolescence – the hardware and software will need to be upgraded and replaced continuously. Suitable provisions in the recurrent budget of the revenue administration should be made for post-project enhancement of the systems.
- The introduction of sophisticated IT systems, requires persons with requisite skills to maintain these systems and exploit their full potential. A computer-based revenue administration, thus, has different skill needs than one based on manual processes. Significant training is needed to equip existing employees with the know how to operate the new systems. Employees who are not interested in learning new skills or are unable to do so, may have to be dismissed. In addition, a significant increase in IT professionals is needed. Since the market value of these professionals is high, mechanisms to pay them competitive salaries need to be developed.
- Management of software development contracts requires a high level of technical skills. Therefore, the Project Management should include experts in revenue administration and IT, who can monitor and guide the contractor and have the authority and know how to take the required technical decisions.