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# USAID'S LEADERSHIP IN PUBLIC FINANCIAL MANAGEMENT

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

### **Chapter 1. Introduction**

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

## Chapter 1. Introduction

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## List of Acronyms and Abbreviations

Acronym	Definition
CIAT	Inter-American Center of Tax Administrations
GST	General sales tax
IFC	International Finance Corporation
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
OECD	Organisation for Economic Co-operation and Development
VAT	Value added tax

# Chapter 1. Introduction

Taxation is a controversial topic in countries throughout the world. Opinions vary among tax practitioners, economists, and citizens in general as to how much tax a government should collect and which segments of the taxpaying population should shoulder the burden. In fact, there are disagreements about what even constitutes a tax. However, there is widespread agreement that a government needs to collect some level of revenue in order to provide goods and services to its citizens.

To collect revenues, governments use a variety of instruments. They derive income from property, charge fees, and impose taxes. For the purposes of this product, taxes are the compulsory, unrequited payments to the general government sector – a definition adopted by the OECD<sup>1</sup>, the IMF, and the World Bank. The fact that taxes are imposed on taxpayers and not visibly proportional to the benefits or services that taxpayers receive from government has far reaching implications that are beyond the scope of this product. However, adopting the OECD's definition of taxes helps to frame the contents. Though they vary across and within countries, modern taxes are similar enough to fit into a few categories – i.e., taxes on income and capital gains, payroll, property, goods and services, and international trade<sup>2</sup> – and to allow practitioners to discuss 'modern' tax systems that rely on 'core' taxes, such as income taxes, value added tax (VAT) or general sales tax (GST), excise taxes, property taxes, property transfer taxes, and customs duties. These, save for customs duties, are the types of taxes discussed throughout this product.

The tax administration is the division of the government tasked with collecting taxes. To the extent that taxes are defined by law(s), the tax administration is tasked with implementing the provisions of the law(s). Through its interaction with the taxpaying public, the behavior and performance of the tax administration contribute significantly to the public's perception of the government overall. An effective, modern tax administration ensures adequate and timely revenues, allowing the government to deliver goods and services, and minimizes hindrances to private businesses and economic growth. In practice, countries may have more than one tax administration. For example, many countries have a separate tax administration (Customs) to collect taxes on international trade (customs duties) and VAT on imports, as distinct from the tax administration responsible for 'domestic' taxes. The tax administration responsible for the core 'domestic' taxes is the focus of this product.<sup>3</sup>

## 1.1. Purpose

Of course, not all tax administrations are on equal footing (e.g., in terms of their resources, scope of responsibilities, performance, etc.). A 'modern' tax administration is one that is effective and efficient. In other words, a modern tax administration collects the right amount of tax, at the right time, and does so at minimal cost to the government and the least burden to taxpayers. The purpose of this product is

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<sup>1</sup> OECD (2012), p. 322.

<sup>2</sup> IMF (2001), p. 49.

<sup>3</sup> Whether or not Customs and the 'domestic' tax administration should be discussed separately is highlighted in Chapter 4.

to detail the workings of a modern tax administration. Specifically, this product is designed to enable tax administration officials and staff to assess their own performance against leading practices across the core components and functions of an effective tax administration. This product will also provide a tool for USAID officers, and other donors and practitioners, to engage with tax administrations on potential areas of technical assistance and to prioritize interventions. Finally, the product will be of interest to academia, as it presents an array of knowledge around effective tax administration practices.

While much of the content of this product is applicable across regions (e.g., leading practices in various aspects of tax administration, key benchmarks, etc.), each chapter also includes a specific focus on Latin America and the Caribbean (LAC). USAID has a long history of providing support to tax administrations in the LAC region, including substantial assistance in the 1990s after the end of civil wars in Central America. Current USAID assistance on tax administration in the region is largely limited to El Salvador and Jamaica. However, in recent years, the international community has shown increased, high-level political attention to the need for countries to mobilize domestic revenues to invest in their own development. While tax administration in the region has progressed in recent years, there is wide variation among countries, with many continuing to lag behind comparator countries and international standards on a variety of indicators related to revenue mobilization and tax administration.

Much has been written about efficient and effective tax administration. For example, the OECD Forum on Tax Administration has put forward significant information organized by topic (compliance, services, etc.) and by taxpayer segment (individuals, large businesses, other). The World Bank's online collection of publications on tax policy and administration is extensive and organized similarly to the thematic structure outlined for this product below. Of course, the International Monetary Fund (IMF) is well-known for its expertise in this area and offers a great number of research papers and related products. The World Bank, IMF, USAID, and others have also developed benchmarking methodologies and tools focused on tax administration. The International Finance Corporation (IFC) has written extensively on taxation, particularly as relates to tax simplification and reducing the taxpayer compliance burden. With respect to LAC, the Inter-American Center of Tax Administrations (CIAT) has published manuals on organization, management, audit, internal audit, and other topics, and is expending significant efforts in collecting comparative information and publishing guidelines on leading practices. This product builds on and contributes to the existing body of work by providing a comprehensive, user-friendly guide with a unique structure (detailed below) and a regional focus on LAC.

## **1.2. Reading the Product**

This product is a relatively large undertaking. Although it aims to derive the key benchmarks that tax officials, practitioners, and donors can use to evaluate tax administration performance, it also strives to provide sufficient detail to those who may be interested in delving deeper into the tax administration's functions and operations. Readers who would like to see high-level highlights should turn to the Overview (a separate document), which can also be used as a reference, guiding the reader to specific topics. Readers who are interested in specific areas should turn to individual chapters, which can be read sequentially as a full product, or as stand-alone 'leading practice' notes on the subject topics.

This product contains seventeen chapters as follows.

- Chapter 1 is this **Introduction**.
- Chapter 2 presents a **Conceptual Framework** for the document and discusses the key tasks and main functions of the tax administration, as well as the environment in which the tax administration operates.
- Chapter 3 presents the **Legal Framework** that enables the tax administration to perform its duties.
- Chapter 4 focuses on the tax administration's **Organizational Structure and Management**.
- Chapter 5 discusses taxpayer **Registration** and the need of the tax administration to know and manage its taxpayers.
- Chapter 6 addresses **Taxpayer Services** – the information, education, and support that tax administrations provide to taxpayers.
- Chapter 7 details the process of **Filing and Payment**, which are the two primary obligations of the taxpayer, and areas of related non-compliance.
- Chapter 8 discusses the monitoring of taxpayer compliance through **Audit**.
- Chapter 9 focuses on **Fraud Investigations** of taxpayers, who are suspected of knowingly falsifying declarations in order to minimize tax payments, and on taxpayers suspected of tax evasion and who pay no tax whatsoever.
- Chapter 10 discusses enforcing taxpayer compliance through the **Collections** of outstanding taxpayer debt.
- Chapter 11 addresses taxpayer recourse through **Objections and Appeals**.
- Chapter 12 details the number of ways in which **Information Technology** can support the tax administration.
- Chapter 13 focuses on the tax administration's **Human Resources**.
- Chapter 14 focuses on **Budget Planning and Resource Management** for tax administrations.
- Chapter 15 addresses **Strategic Planning** for tax administrations.
- Chapter 16 discusses the importance of **Internal Audit** to the continual improvement of tax administration's operations.
- Chapter 17 details considerations of **Integrity**.

Save for Chapters 1 and 2, all chapters follow the same structure. Namely, each chapter:

- Begins with a short introduction of its subject topic.
- Lists leading practices in its respective area.
- Discusses common trends in its respective area. 'Common trends' refer to practices that tax administrations around the world may be implementing or considering, but that are not yet proven leading practices.
- Presents a four-level maturity model. Each level of the maturity model shows the practices of tax administrations at various stages of development – from basic to leading. Such a model is useful as, besides allowing officials to identify their own administration's level of maturity, the

model presents a path forward for the administration (i.e., striving to achieve the characteristics found at the next level). The authors and editors of this document have attempted to make the maturity models practical and 'vertically' integrated across sections. That is, to the extent that tax administrations evolve along the maturity scale from one level to the next in one subject area, it is likely that they would be in a similar maturity level in other areas. Of course, there may be exceptions.

- Describes the state of tax administrations in the LAC region with respect to the specific subject topic and, to the extent possible, with respect to the maturity model of the section, but without presuming in any way to score or rank individual countries.
- Presents key guidelines in the form of rules of thumb, benchmarks, or questions that can provide an initial, high-level indication of tax administration performance in a given area.

In other words, although each chapter is designed as an independent 'leading practice' note, the chapters follow a common structure and combine to form a coherent overall product. While understanding that points of contention exist on many of these topics and that practices must be adapted to fit different country contexts, the chapter authors have strived to present detailed and unambiguous guidance wherever possible. The authors intend for this ambitious product to provide a comprehensive view of tax administration functions and operations, including actionable guidance to help tax administrators and donors understand leading practice, pinpoint areas with potential for improvement, and identify steps for moving forward.



## REFERENCES:

IMF (2001), *Government Finance Statistics Manual 2001*.

OECD (2012), "Revenue Statistics 1965-2011. The OECD Classification of Taxes and Interpretative Guide".