



ASSESSING TAX SYSTEMS USING A BENCHMARKING METHODOLOGY

April 2004

This publication was produced for review by the United States Agency for International Development. It was prepared by Mark Gallagher of Development Alternatives, Inc. with the Georgia State University and the Boston Institute for Developing Economies through Task Order No. 03 under SEGIR: EP, Contract No. PCE-I-00-00-00015-00 for the “Fiscal Reform in Support of Trade Liberalization” project.

Assessing Tax Systems Using a Benchmarking Methodology

CONTENTS

| | |
|---|----|
| LIST OF FIGURES | 1 |
| TABLES | 1 |
| Introduction..... | 1 |
| Development of the Methodology | 3 |
| The Benchmarks | 6 |
| Tax Structure and performance..... | 6 |
| Organization..... | 13 |
| Legal framework..... | 17 |
| Enforcement..... | 19 |
| Receipts and collection | 23 |
| Systems and resources | 23 |
| Next steps..... | 25 |
| Annex: The Benchmarks as Developed in the Guatemala Study | 27 |

LIST OF FIGURES

| | |
|----------------|----|
| Figure 1 | 11 |
|----------------|----|

TABLES

| | |
|--|----|
| Table 1: Administrative Costs of Taxation at National Level (mid-1990s) | 9 |
| Table 2: VAT Gross Compliance Ratio (GCR)..... | 10 |
| Table 3: Enterprise Income Tax Productivity..... | 12 |
| Table 4: Personal Income Tax Productivity..... | 13 |
| Table 5: Functional organization of tax administration..... | 14 |
| Table 6: Countries that have established Semi-Autonomous Revenue Authorities | 15 |
| Table 7: Tax Administrations with Large Taxpayer Units | 17 |
| Table 8: Public employees in the national tax administration..... | 20 |
| Table 9: Active taxpayers per tax official..... | 21 |

Assessing Tax Systems using a Benchmarking Methodology

Mark Gallagher*,*

January 2004

Abstract

International institutions, such as the World Bank, the International Monetary Fund, and the U.S. Agency for International Development, have been assessing tax system performance and capabilities for decades without having a solid international comparator basis for undertaking these assessments. This paper provides a series of indicators and benchmarks that can help to put such assessments into an international perspective, set specific targets for performance, reform, and modernization, and monitor progress over time.

Introduction

Until recently, there has been only limited effort to develop comprehensive tools for assessing tax systems, despite the fact that national governments and international organizations or foreign assistance agencies, such as the World Bank, the International Monetary Fund of the U.S. Agency for International Development, have been assessing tax systems in developing and emerging market countries for decades.

A recent pamphlet produced by Michael Lane of an international consulting firm, Sandler Travis Trade Advisory Service in Washington, DC, provides a checklist for customs operations, but offers no international comparator information.¹ Barbone *et alia* (undated) provide a “Framework for Diagnosis of Tax System Weaknesses”, which is a matrix of policy formulation, accountability, and service delivery by performance, capacity and institutions.² This framework provides a good guide for what analysts should look for when comparing tax systems across countries, but provides no

* Director of the *Fiscal Reform in Support of Trade Liberalization* worldwide program funded by the U.S. Agency for International Development and an economist with Development Alternatives, Inc. The opinions expressed here are solely attributable to the author and should not be taken to represent those of the U.S. Agency for International Development nor Development Alternatives, Inc.

* The author thanks Richard Bird, David Dod, George Guess, Ted Kill, and Art Mann for their helpful comments. All errors and omissions, of course, are attributable only to the author.

¹ Lane, Michael (1997) *Workbook for Customs Modernization*, Global Customs Advisors.

² See especially page 6 of Barbone, Luca, Arindam Das-Gupta, Luc De Wulf and Anna Hansson (undated) *Reforming Tax Systems: The World Bank Record in the 1990s*, World Bank.

comparator data nor, in most instances, even verifiable indicators. Jit Gill (2000) presents a very useful framework for assessing revenue administration, with a focus on process and environment but with very few international comparators.³ More recently, the World Bank has developed a website devoted to evaluating tax policy and administration, but this site does not include any international comparators, and it provides little basis for establishing specific, quantitative goals and targets, although it does discuss many of the institutional and resource matters that are discussed in this paper.⁴ Moreover, despite the website's title, it offers very little substance for evaluating tax system performance.

Bird and Banta (1999) present a number of indicators of fiscal sustainability covering the basic economy statistics, tax policy, specifically, VAT, tax administration, public expenditure management, decentralization, and pensions.⁵ This set of indicators is very comprehensive, but is not meant specifically to assess tax systems, though clearly it can be used that way. In addition, the paper includes data for 26 countries of East and Central Europe and the Former Soviet Union. In a second paper, Bird (1999), in the same volume, presents a number of comments and criticisms that were raised during a conference regarding the indicators system.⁶ Some of these are repeated in the final section of this paper. Building on the shoulders of giants, several of the Bird and Banta observations are included in this paper.

Das Gupta (2002) strives "towards a framework for tax system performance" to assess tax and tax administration reform in India using indicators of performance, capacity, institutions, and exogenous constraints.⁷ He creates a number of specific indicators that he then applies to the pre-reform period and the post-reform period to assess the quality of the reform. The framework for Das Gupta's assessment then is to determine if improvement in India has taken place. This allows judgments of improvement and status for seven broad rating indicators, ranging from "external constraints" to "policy research capacity" and "administrative capacity." For these seven indicators Das Gupta judges that they have shown some improvement, no change, or some deterioration. Das Gupta

³ Jit B.S. Gill (2000) *A Diagnostic Framework for Revenue Administration*, World Bank. See: [http://wbln0018.worldbank.org/prem/ps/iaamarketplace.nsf/075c69a32615405f8525689c0051fb88/4cdd74a05fd3506b8525689c005333bc/\\$FILE/DIAGFRMWK-5-2000.doc](http://wbln0018.worldbank.org/prem/ps/iaamarketplace.nsf/075c69a32615405f8525689c0051fb88/4cdd74a05fd3506b8525689c005333bc/$FILE/DIAGFRMWK-5-2000.doc)

⁴ See the World Bank's "Tax Policy and Administration" website at: <http://www1.worldbank.org/publicsector/tax/themes.html>.

⁵ Bird, Richard and Susan Banta (1999) "Fiscal Sustainability and Fiscal Indicators in Transition Economies," in Shapleigh, Alexander, Fuat Andic and Susan Banta eds. *Transition Economies and Fiscal Reforms: Proceedings of the Conference on Central and Eastern Europe and the New Independent States*, June.

⁶ Bird, Richard (1999) "Some Reflections on the Conference," in Shapleigh, Andic, and Banta op. cit.

⁷ Das Gupta, Arindam (2002) "Central Tax and Administration Reform in the 1990s," in *Development, Poverty, and Fiscal Policy*, Rao, M. Govinda editor, Oxford University Press, New Delhi.

also judges that these indicators show the status of the Indian tax system to range from “poor” to “inadequate” to “adequate.”

The EU has been developing its "Draft Fiscal Blueprints" that provide guidelines for would-be member-nation tax administrations in many areas of administration and even provide a listing of performance indicators. The Blueprints are fairly comprehensive, but lack any discussion of comparative "quantitative goals and targets."

It is interesting to note that the Organization for Economic Cooperation and Development and the Asian Development Bank have both seen fit to produce checklists, questionnaires and surveys for assessing public expenditure management systems, yet have not produced similar tools for tax system assessment.⁸

This paper goes beyond these attempts and presents benchmarking as a tool for assessing both tax system performance and the inputs and systems of any tax administration. It is a means of comparing a set of specific indicators that capture the essence of most any tax system to either international best or perhaps most relevant practices. The system also helps to facilitate establishing goals and specific targets for tax system improvement and modernization. Specific benchmarks can be tracked over time and can show how reform or modernization efforts are being implemented and even how they contribute to performance.

Benchmarking can be used not only to compare a country's tax system with a regional or international set of norms or comparators, but it can also be used to compare the condition and performance of the tax system over a period of time, either discrete snapshots in time or evolution of the benchmark or indicators over a number of years. The methodology can be generalized to all national-level tax systems throughout the world.

The next sections provide a discussion of the development of the methodology and the benchmarks, discussion of many of the benchmarks, and finally, a discussion of how the benchmarking methodology can be improved.

Development of the Methodology

This benchmarking methodology has been developing over a few years through application in a number of countries. First, some of the international comparators were applied in El Salvador, by Julio Piza (1994).⁹ Later Gallagher (1995) extended the application to assess the Guatemalan tax system.¹⁰ Gallagher (1997) applied the

⁸ See Allen, Richard and Daniel Tommasi (2001) *Managing Public Expenditures: A Reference Book for Transition Countries*, OECD, and

⁹ Piza R., Julio Roberto (1994) *Administracion Tributaria de los Impuestos Internos de El Salvador*, USAID, December.

¹⁰ Gallagher, Mark (1995) *Options for Donor Assistance in Tax Policy and Administration Reform in Guatemala*, USAID/Guatemala, March.

methodology in Nicaragua¹¹ then later in parts in Tanzania.¹² In 2001, a comprehensive system was applied and further developed in Guatemala by Mann et al (2001), covering all tax operations, as well as customs, in 2001.¹³ The 2001 Guatemalan case represents the first time the entire methodology has been applied in a fully systematic way. Most recently, in December 2003, Gallagher applied the methodology to the Egyptian tax system and made a presentation of the preliminary results at the USAID Mission to that country.

Piza (1994) prepared an assessment of tax administration in El Salvador. Piza included a number of international comparators in his report, including: tax ratio (tax revenue as percent of GDP), number of tax administrators per 1,000 of national population, and, comparative tax administration costs.

One indicator that was subsequently developed is called the VAT-Gross Compliance Ratio, which compares actual VAT collections to potential VAT collections if there were no evasion, tardiness in payment, or exemptions and exonerations. Other indicators were developed with time. Some had been developed elsewhere, such as indicators of tax evasion and efficiency in collections. Tanzi (1996) clearly delineated a number of criteria of good tax systems, relating to the simplicity of the tax system, which Gallagher (1997) subsequently converted into specific, quantitative indicators; these were subsequently developed and applied in Nicaragua.¹⁴

Gallagher (1995) undertook an assessment of tax and customs performance. In this assessment Gallagher compared a number of other indicators, such as maximum and minimum income tax rates and collections in percentages of GDP to the other Central American countries. Gallagher also compared import duty collections and other results indicators in Guatemala to those in neighboring countries.

The set of indicators was expanded and applied partially in a paper on the Nicaraguan tax system. Many of the results of the Gallagher (1997) study were incorporated into the tax and trade reform legislation developed and enacted in the same year. However, the 1997 reforms were almost exclusively focused on policy, especially simplification, and little attention was paid to administration.

¹¹ Gallagher, Mark (1997) *Propuesta de Reforma Tributaria Integral*, Núcleo Especial Para Análisis e Implementación, Managua, January. http://www.fiscalreform.net/library/pdfs/nicaragua--propuesta_de_una_reforma_tributaria_integral.pdf.

¹² No specific report was prepared for Tanzania, rather the methodology helped in the development of the tax reform agenda of 1998 and 1999.

¹³ Mann, Arthur, Arturo Jacobs, Mark Gallagher, Harry Alison, James Westrick, Alex Segovia, and Ted Kill (2001) *APLICACIÓN DE MEJORES PRÁCTICAS INTERNACIONALES AL DESEMPEÑO DE LA ADMINISTRACIÓN TRIBUTARIA DE GUATEMALA: Un Estudio de Benchmarking*, USAID/DevTech Systems, and DAI

¹⁴ Tanzi, Vito (1991) *Public Finance in Developing Countries*, Edward Elgar Publishing, England.

In Tanzania the methodology was only partially applied. It showed the need for further modernization of the tax system in terms of improving the application of the stop or late filers systems, automated notices, and linking customs and internal revenues information systems. In addition, one specific indicator – the Gross Compliance Rate for VAT, discussed later in this paper – was used to project the likely revenues that would be generated in the first year of the operation of the VAT. This projection, based on the GCR, was used as the revenue projection in the national budget for 1997/98. As it turns out, this projection was very accurate, i.e., within one percent of actual collection.

The first full-blown application of the benchmarking methodology was conducted in Guatemala in 2001, at the request of the Minister of Finance, and funded by the U.S. Agency for International Development.¹⁵ This study showed the considerable progress that had been achieved in tax system performance and the institutional development of the tax administration, and laid out the major areas for continuing support and progress.

Most recently (in December 2003) Gallagher undertook a review of U.S. Government assistance to the Government of Egypt in tax policy and administration and applied an abbreviated version of the benchmarking system. The results of the abbreviated application of the benchmarking methodology were presented in a seminar held at the U.S. Agency for International Development Mission to Egypt. Several participants in the seminar expressed the opinion that the methodology would have been useful to establish a set of specific targets for the U.S. assistance program to monitor progress and performance.

As mentioned, no single source of comparator data exists for all of the useful indicators of tax system performance. For some indicators, see tables 1 through 4, data are available in international sources, such as the IMF's *Government Finance Statistics Yearbooks*. Other data must be extracted from other sources, such as Article IV Consultations of the IMF, country sources, and from the Spanish Tax Institute.

For the Guatemala project a team of highly skilled and widely experienced specialists was assembled to develop a useful set of comparator indicators. These are in the Annex to this paper.

The benchmarks are in a number of important areas, but before going into the structure of the benchmarks, it would be worthwhile to discuss the make up of the team that was sent to Guatemala to undertake the benchmarking study.

1. **Two public finance economists worked on the study.** Their focus was on tax system performance from the perspective of comparing compliance, collection efficiency, and changes in tax policy and how these would affect performance. Between them, these two economists have more than 50 years of experience working on fiscal reform in developing countries, with many of those years working on these issues in Latin America, and especially in Central America.

2. **One tax administration consultant.** This expert had a long and high profile career with U.S. Internal Revenue Service, has worked on tax administration reform in several Latin American countries and in other countries of the world, including Former Soviet Union, Balkans, and Africa.
3. **One computer systems consultant, with specialization in tax systems.** This expert has worked on the design and implementation of tax modernization programs throughout the world, including the U.S. Specifically, in recent years, he has worked on tax and customs modernization in Central America, specifically Guatemala, and the Balkans.
4. **One customs administration consultant.** This expert had a 30 year career with U.S. Customs and has spent an additional 15 years advising customs officials in developing countries of Latin America and Asia.

The Benchmarks

Tax system performance indicators come from a variety of sources. Some were created in the process of developing the benchmarking system itself, whereas others are the result of other people's work or standard methodologies. It is also important to keep in mind that appreciating or assessing tax system performance requires knowledge of the other factors found in this system.

The benchmarks are discussed in the following sections.

Tax Structure and performance

Number of taxes that comprise the top 75% of receipts: This benchmark provides some of the degree of dispersion or, on the contrary, concentration of the tax system. A tax system that relies on very few sources of revenue runs the risks of higher volatility in revenue receipts from year to year and also faces greater challenges in forecasting revenue performance. The risks of relying on too few tax sources has been most obviously demonstrated in countries that rely on a single commodity for most of their revenues. A case in point is Nigeria's, which relies on the petroleum sector for 80% of public revenues that fluctuate wildly from year to year. Relying on too many taxes represents an administrative burden and creates taxpayer compliance concerns. In short, if the number is too low, there is too much risk for the fiscal system. If it is too high, there is too much dispersion, management difficulty, and annoyance to taxpayers.¹⁶

¹⁶ Mann, Arthur and Robert Burke (2002) *El Gasto Tributario en Guatemala*, DevTech Systems, Inc. for USAID/Guatemala and DAI. See: http://www.fiscalreform.net/library/pdfs/el_gasto_tributario_en_guatemala--revision_marzo_2002.pdf. Also, the Guatemalan Tax Administration now publishes its calculations of tax expenditures on its website. See: <http://www.sat.gob.gt/estadisticas/pdf/EstudioExenciones2002-2004.pdf>.

Broad tax base with limited exemptions: Obviously, the international standard is that the tax base should be as broad as possible. This means that tax systems should incorporate all sectors of their economy and have as few exemptions as possible. We found that in Central America, in general, and Guatemala, specifically, that the tax base is narrow and that there are many exemptions. In a later work, “tax expenditures”, i.e., exemptions, exonerations, deductions, and other special privileges, in Guatemala were equal in value, in terms of foregone revenues, to the entire total of tax receipts.

Percentage of total taxpayers that provide 75% of tax receipts. In general, throughout the world, because of disparities in company size, exemptions and exonerations, and poor administration and inability to reach certain sectors, such as agriculture and informal city merchants, only a limited percentage of the taxpaying companies pay the majority of a country’s taxes, be they corporate income tax, sales or VAT, or excises and customs duties. The more limited this number of major contributors, the more vulnerable the tax system is to economic change. More important, however, is that the more limited this number is, the less deeply inserted into the fabric of society is the tax system.

Limited number of tax rates. Consistent with Tanzi’s recommendation that tax systems not be overcomplicated, it is important that the structure of tax rates for any given tax not be complicated. Too many tax rates make the system confusing, encourage tax avoidance schemes, may provide perverse incentives to economic activity, and make tax administration complicated. The international best practice is to have very limited number of company and personal income tax rates, as well as to have single or near single sales or VAT rates. The income tax need not necessarily be “flat” but a relatively simple table of income tax rates does not detract from the ability to impose a somewhat progressive income tax system. The import duty schedule would be best if it were uncomplicated. Indeed, all international trade texts demonstrate that if the import tariff is to be used for revenue generation, then it should focus on limiting the damage it does to a country’s international competitiveness and limit protectionism by having as minimal a divergence between input commodities, capital goods imports, and the duty rates on final goods.

In Central America and Guatemala, the tax systems are not overly complicated by complex rate structures. The reforms of the income tax and the sales taxes in Egypt over the recent decade have greatly simplified tax structures, but there remains much to be done.

VAT rate. The international benchmark is for a single rate VAT at about 16%. The benchmark for Central America is 13%, and the actual nominal rate in Guatemala is 12%.

No particular rate should be considered “correct”. More important, however, is whether there is a single rate. For instance, the best practice is for all goods and services to be taxed at the same rate, except for exports, which should be zero-rated.¹⁷ Certain items

¹⁷ Zero-rating means that when a product is exported, the exporter is refunded all of the VAT paid on prior stages of production are refunded back to the exporter. This differs from exempted products, where the

may be exempted from VAT, but these should be relatively few. All of the Central American countries have only one general VAT rate. In Egypt, the General Sales Tax – a “near VAT” – has a variety of rates, ranging from 5% to 20% of value.

Indirect as percentage of total taxes. There is no right or correct ratio of indirect to total tax revenues, however, richer countries tend to collect a greater proportion of their tax revenues from direct taxes, while poorer countries collect a greater share from indirect taxes. In the U.S., which has no VAT or sales tax at the federal level, direct taxes on companies and individuals generate the overwhelming proportion of tax revenues at the federal level, while the property tax (real estate and personal property) is the largest local revenue generators for many localities. On the other hand, in Europe, the VAT generates a relatively large share of central government revenues.

VAT collections as percent of total tax collections. Given the importance of the VAT in most tax systems around the world, this indicator is obvious. The international norm is for the VAT, where it exists, to generate about 35% of all tax revenues. In Central America, the average VAT share comes to 45%, and in Guatemala it was 44%, as of 2001.

Tax ratio. This indicator predates any efforts at establishing the benchmarking system. It is the ratio of actual tax collections to Gross Domestic Product (GDP). Generally, the higher is per capita income in a country, the higher is the expected tax ratio.

Indeed, the tax ratio for high income countries is about 40%, according to Government Finance Statistics of the International Monetary Fund. For middle income countries it is around 25% of GDP and about 18% in low income countries. In Latin America, the tax ratio tends to be low, given income levels, especially compared to Africa, where it tends to be high given the low incomes of these countries. In oil producing countries, the tax ratio is lower than in countries with similar income levels; this is due to the high reliance on royalties and other revenues related to oil exploitation. For instance, 80% of Federal Government revenues in Nigeria derive directly from the oil sector. In Egypt, about half of government revenues come from oil royalties and receipts from the Suez Canal.

Administrative cost of taxation. This is a rather gross indicator of efficiency and it covers up a number of differences in tax administration, economic structure, and overall societal modernity. Yet, it also goes directly to the heart of the matter. How much does it cost, in administrative terms, for a government to impose taxation on its people? Internationally, the administrative costs vary widely, with the richest countries generally having the lowest costs with respect to how much they collect, whereas the poorest countries have the highest costs. However, there is even considerable variance among countries of similar development levels. That said, the numbers are very interesting and lead to other questions that need to be answered in any tax system assessment.

final seller of the exempted product is not required to collect the VAT on the final sale, but is not refunded back the VAT that had been paid on all prior stages of production.

Table 1 presents a cross section of countries with their administrative costs per \$100 in collections.

Table 1: Administrative Costs of Taxation at National Level (mid-1990s)

| <i>Country</i> | <i>Administrative costs per \$100 in tax collections</i> |
|-------------------|--|
| Nicaragua | 3.86 |
| Guatemala (1995) | 3.16 |
| Guatemala (2001)* | 2.25 |
| Peru* | 3.00 |
| Tanzania* | 3.00 |
| El Salvador | 2.19 |
| United Kingdom | 1.47 |
| Canada | 1.18 |
| Spain | 0.90 |
| Colombia | 0.87 |
| USA | 0.83 |

Sources: Piza (1994) (original from The State Tax Administration Agency of Spain), Gallagher (1995).¹⁸ 2001 data for Guatemala are from the Superintendencia de la Administracion Tributaria, see Mann et al. (2001).
 * These tax administrations are Semi-Autonomous Revenue Authorities and their budgets are a fixed, 3%, of the revenues collected.

Gross Compliance Ratio. One measure for assessing the degree to which the VAT is applied is the Gross Compliance Ratio (GCR). The GCR is merely the actual VAT collection in ratio, or as percentage, to the total, potential VAT collection. Total conceivable VAT collection is that collection that would be achievable in the absence of evasion or exemptions. This indicator is fairly easy to calculate in countries where only one VAT rate applies. Our team calculated the international benchmark value of 69% GCR for advanced countries: indeed, the highest GCRs for Latin America were 64% for both Costa Rica and Chile.

VAT Productivity. A very commonly used indicator of how well a VAT is applied in a country is the VAT Productivity rate. This is merely the ratio of VAT collections to GDP divided by the nominal VAT rate. This is easier to calculate than the GCR, since there is no need to collect data on aggregate private consumption in an economy. On the other hand, however, private consumption information is usually readily available from official sources. In addition, the GCR is a superior measure because it does adjust for this very important difference in structure of national economies.

¹⁸ Gallagher, Mark (1995) *Opciones para la Política Fiscal y la Reforma Administrativa de Guatemala*, USAID/Guatemala.

Table 6 presents GCRs and VAT Productivity Rates calculated for a set of countries, mostly based on data from the mid-1990s.

Table 2: VAT Gross Compliance Ratio (GCR)

| <i>Country</i> | <i>Private Consumption % GDP</i> | <i>VAT collection % GDP</i> | <i>Potential collections % GDP</i> | <i>Nominal VAT rate</i> | <i>GCR</i> | <i>Productivity</i> |
|---|----------------------------------|-----------------------------|------------------------------------|-------------------------|------------|---------------------|
| Nicaragua | 90-80 | 5.4 | 13 | 15 | 42 | .36 |
| Brazil | 81 | 6.5 | 13.8 | 17 | 47 | .38 |
| Madagascar | 81 | 3.2 | 12.2 | 15 | 26 | .21 |
| Guatemala (93) | 85 | 2.7 | 6.0 | 7 | 45 | .39 |
| Guatemala (94) | 81 | 1.6 | 5.7 | 7 | 28 | .23 |
| Guatemala (2000) | -- | -- | -- | 12 | 49 | -- |
| Costa Rica | 58 | 3.7 | 5.8 | 10 | 64 | .37 |
| Ecuador | 63 | 1.3 | 3.8 | 6 | 34 | .22 |
| Honduras | 72 | 1.5 | 3.6 | 5 | 42 | .30 |
| Haiti | 98 | 1.1 | 9.8 | 10 | 11 | .11 |
| Dominican Republic | 74 | 0.9 | 4.4 | 6 | 20 | .15 |
| Panama | 56 | 1.9 | 2.8 | 5 | 68 | .38 |
| Bolivia | 73 | 0.3 | 3.7 | 5 | 8 | .06 |
| El Salvador (94) | 81 | 4.5 | 8.1 | 10 | 45 | .45 |
| El Salvador (95) | 81 | 5.0 | 8.1 | 10 | 63 | .50 |
| Chile | 70 | 9 | 12.6 | 18 | 68 | .50 |
| Source: Data are taken from various issues of <i>Government Finance Statistics Yearbook</i> , International Monetary Fund and from <i>International Financial Statistics</i> , International Monetary Fund. | | | | | | |

Guatemala's GCR of 49% in 2001 shows a marked improvement from 1994, when it had only reached about 28%.

In El Salvador, the GCR rose significantly from 45% in 1994 to 63% in 1995. This increase resulted from strenuous tax efforts, including the incarceration of tax evaders

and shutting down of businesses for non-compliance. On the other hand, the deterioration in Guatemala from 1993 to 1994 resulted from a demoralized tax administration, lax enforcement, climbing corruption, and weak leadership. See Gallagher (1995) for further discussion. The improvements to 2001 result from a thoroughly reformed tax administration, with a professionalized staff, and the proper personnel incentives and systems in place.

The GCR is only related to private consumption rather than total consumption. This neglects government consumption, which is usually nominally subject to the VAT. The rationale for this is that government consumption in most developing countries is for the most part expenditure on wages and salaries of government employees, which are not subject to the tax.

There is a clear relationship between the GCR and the VAT Productivity measure as can be easily seen from the following figure.

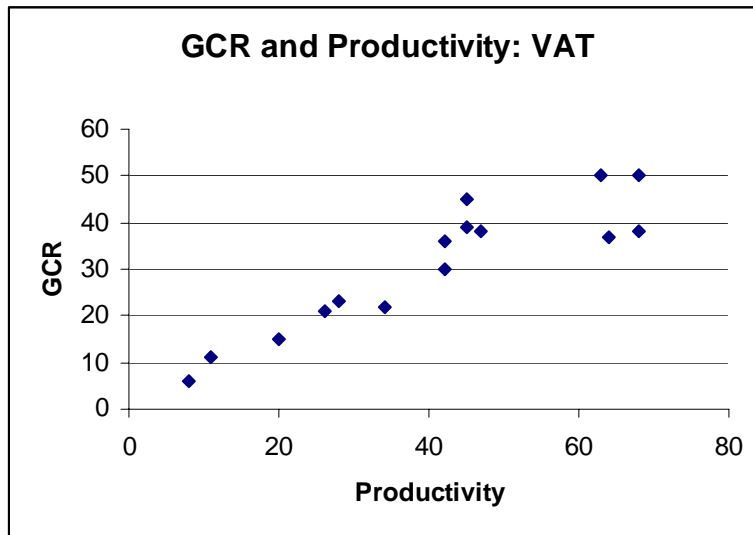


Figure 1

VAT Efficiency Rate. The GCR differs from the more commonly used VAT Efficiency Rate.¹⁹ The GCR relates the VAT rate to private sector consumption in the economy, whereas the Efficiency Rate relates the VAT rate to VAT collections in the entire economy. Since VAT is usually on consumption, it seems a better fit to relate VAT collections to consumption rather than the entire economy. For instance, VAT is generally zero-rated on exports and creditable against investments.

VAT Evasion Rate. Evasion is similar to the calculation of the GCR, but it makes an attempt to net out of the taxable base those goods and services that are legally exempt. Hence, the Evasion Rate calculation is superior, in concept, to the GCR since it is an attempt to measure only evasion, whereas the GCR bundles evasion with exemptions.

¹⁹ See Bird and Banta (1999) for a discussion of the VAT Efficiency Rate.

Enterprise Income Tax Productivity. The productivity of the enterprise income tax is calculated in a way that is quite similar to the calculation of VAT productivity, that is, the ratio of the revenue yield to GDP is divided by the top enterprise income tax rate. As Stotsky and WoldeMariam (2002), although most countries apply only a single enterprise income tax, when there are multiple rates, the upper rate should be used as this is the rate that is applied to most companies, at least when weighted by collections.²⁰

Table 3: Enterprise Income Tax Productivity

| | Maximum enterprise income tax rate | Revenues as % of GDP | Productivity | Productivity (about 2001) |
|--------------------|------------------------------------|----------------------|--------------|---------------------------|
| Argentina | 35 | 1.2 | 0.034 | 0.043 |
| Bolivia | 25 | 1.1 | 0.044 | 0.059 |
| Brazil | 15 | 1.5 | 0.100 | 0.060 |
| Colombia | 35 | 3.9 | 0.111 | 0.114 |
| Costa Rica | 30 | 0.5 | 0.017 | |
| Dominican Republic | 25 | 1.0 | 0.040 | 0.044 |
| El Salvador | 25 | 1.9 | 0.076 | 0.078 |
| Guatemala | 31 | 1.1 | 0.035 | 0.037 |
| Panama | 30 | 2.0 | 0.067 | 0.049 |
| Peru | 30 | 2.2 | 0.073 | 0.061 |
| Uruguay | 30 | 2.0 | 0.067 | 0.076 |

Sources: Data extracted from Stotsky and WoldeMariam (2002).
Most base data are from late 1990s, latest productivity data are from up to 2001.

Personal Income Tax Productivity Measure. The personal income tax is an important aspect of most tax systems throughout the world, but in most developing countries it is usually a very minor revenue source. This stems from a variety of factors, including: low compliance, high degree of exemptions and exonerations, and usually large, unreachable sectors of the economy, such as the urban informal sector and smallholder agriculture.

The nature of the personal income tax is different from place to place. The treatment of capital gains, corporate dividend income, and the levels and types of tax deductions and credits that are available differ from region to region and country to country.

Despite these difficulties, the personal income tax productivity measure is an attempt to compare the revenue productivity of the person income tax across a number of countries. The following table presents the most basic structural aspects of the personal income tax in a number of countries in Latin America. The factors include: the zero-income tax bracket, which is the level of income that is not subject to the income tax; the top income

²⁰ Janet Stotsky and Aseggedech WoldeMariam (2002) *Central American Tax Reforms: Trends and Possibilities*, Working Paper, International Monetary Fund.

tax bracket, which is the level of annual income where the top marginal tax rate takes effect; and, the maximum and minimum marginal income tax rates. These income brackets are expressed in multiples of per capita GDP.

The Personal Income Tax Productivity Measure is similar to the Enterprise Tax Productivity Measure. It is calculated by dividing the personal income tax revenue as percent of GDP by the top marginal tax rate, expressed in integers, and multiplied by the top income tax bracket value.

Table 4: Personal Income Tax Productivity

| | Zero-bracket | Top-bracket | Marginal tax rates | | Revenue as % of GDP | Productivity |
|--|--------------------|-------------|--------------------|----------|---------------------|--------------|
| | multiple of pc GDP | | lowest | highest | | |
| | <u>A</u> | <u>B</u> | <u>C</u> | <u>D</u> | | |
| Argentina | 1.4 | 16.5 | 35 | 35 | 0.6 | 0.28 |
| Bolivia | 0 | 0 | 13 | 13 | 1.9 | 0.15 |
| Brazil | 1.5 | 3.1 | 15 | 27.5 | 0.3 | 0.03 |
| Colombia | 4.1 | 16.6 | 35 | 35 | 0.2 | 0.09 |
| Costa Rica | 0.8 | 3.7 | 10 | 25 | 1.7 | 0.25 |
| Dominican Republic | 2.3 | 5.8 | 15 | 25 | 1.5 | 0.35 |
| El Salvador | 1.2 | 11 | 10 | 30 | 1.3 | 0.48 |
| Guatemala | 5 | 22.5 | 15 | 31 | 0.2 | 0.15 |
| Nicaragua | 7.7 | 61.2 | 10 | 25 | 0.3 | 0.73 |
| Panama | 0.9 | 57.8 | 2 | 30 | 0.3 | 0.58 |
| Peru | 2.9 | 22.3 | 15 | 20 | 1.2 | 1.34 |
| Sources: Central American Tax Reform: Trends and Possibilities, Janet Stotsky and A. WoldeMariam, FMI, 2002, as well as other IMF and Ministry publications. | | | | | | |

This table is telling in a number of ways. According to this measure, the Peruvian personal income tax system is the most productive of all the represented countries. The yield of 1.2% of GDP is the second highest among the sample countries. The Bolivian tax has the highest revenue yield at 1.9% of GDP and the lowest maximum rate, which is also its highest rate that is applied to all earned income.

A similar comparative table can be constructed for countries in other regions.

Organization

Functional organization. Modernized tax administrations have found that organization around functions rather than according to taxes or types of taxes leads to greater integration of operations, better management of staff, and improved compliance and enforcement. For instance, it is generally considered suboptimal to have the tax administration organized into the VAT, Income, and Excise Departments, and better to have them organized into Audit, Services, Archiving, and Enforcement Departments.

Table 5: Functional organization of tax administration

| <i>Country</i> | <i>Functional organization</i> |
|---------------------------|--------------------------------|
| Bosnia (Federation) | Yes |
| Bosnia (Republica Srpska) | Yes |
| El Salvador | Yes |
| Guatemala | Yes |
| Hungary* | Yes |
| Kazakhstan | Yes |
| Kyrgyzstan* | Yes |
| Latvia* | Yes |
| Lithuania* | Yes |
| Moldova* | Yes |
| Nicaragua | Yes |
| Belarus* | No |
| Bulgaria* | No |
| Croatia* | No |
| Czech Republic* | No |
| Egypt | No |
| Estonia* | No |
| Georgia* | No |
| Macedonia* | No |
| Romania* | No |
| Turkmenistan* | No |

* These observations are from Bird and Banta (1999).

Autonomy. A trend among tax administrations in developing countries is the establishment of the tax department into a semi-autonomous revenue authority (SARA). SARAs generally are able to provide better pay and other incentives to their staff while also imposing greater accountability for performance. They generally are outside of the normal institutional setup of government and may have their own budgetary authorities, perhaps linked to performance. The jury is still out, though many practitioners have been recommending SARAs as one step toward institutional reform.

The following countries have established SARAs.

Table 6: Countries that have established Semi-Autonomous Revenue Authorities

| <i>Country</i> | <i>Date of establishment</i> |
|--|---|
| Argentina | 1988 |
| Bolivia | 1987, defunct in 1988, reestablished in 2000/01 |
| Bulgaria | -- |
| Colombia | 1991 |
| Ecuador | 1997-99 |
| Ethiopia | -- |
| Ghana | 1996 |
| Guatemala | 1998/99 |
| Guyana | 2000 |
| Jamaica | 1981 |
| Kenya | 1995 |
| Lesotho | 2001-03 |
| Malawi | 1995-2000 |
| Malaysia | 1994 |
| Mexico | 1997 |
| Peru – national | 1988–91 |
| Peru – municipality of Lima | 1996/97 |
| Rwanda | 1998 |
| Sierra Leone | 2002 |
| Singapore | 1992 |
| South Africa | 1996/97 |
| Tanzania | 1995/96 |
| Uganda | 1991 |
| Venezuela | 1993 |
| Zambia | 1993/94 |
| Zimbabwe | 2000 |
| Data from ongoing research being conducted by Arthur Mann, DAI/Fiscal Reform Project. www.fiscalreform.net | |

Customs and tax integration. A number of countries, such as Guatemala and Ecuador, have integrated their tax and customs departments into a single agency. Peru is in the process of integrating domestic tax administration with customs.²¹ This has a number of advantages; primary among them are the better flow of information and the ease of conducting more integrated and integral audits.

²¹ Canada had integrated customs and domestic tax administration during the 1990s, but has just recently separated these functions into two separate agencies. This makes sense for Canada, since customs is more a border security issue than it is a revenue agency.

In developing countries the VAT, which is a tax on domestic consumption, is collected as much in customs as it is in the domestic tax administration system. Indeed, in many countries half of all gross VAT collections occur in customs. The integration of domestic tax agencies and the customs operations makes more and more sense as countries move toward ever greater reliance on VAT as a revenue source.

Fiscal projections unit. An important function in a Ministry of Finance and in the Tax Administration organization is the regularized revenue and receipts projections function. This is a core function of the fiscal management system. Receipts should be projected by tax and by region, department or organization, as may be appropriate.

Governments should project annual revenues in order to adequately manage their overall system of public finance, as well as to manage the macroeconomy. Receipts projections on monthly or quarterly basis are required for setting revenue targets and tracking progress in meeting these targets.

Tax fraud unit. Tax administrations should have an office specifically set up to prosecute cases of tax fraud. This requires special skills beyond those of the rest of the tax administration staff, including knowledge of the tax fraud legislation, knowledge of the courts and appeals systems, and law enforcement expertise and ability to liaise with other governmental offices, such as the Internal Ministry.

Large Taxpayer Unit. There is some difference of opinion about whether tax administrations should separate out the largest taxpayers from the rest of the taxpayer public. The argument being that this then allows the tax administrators to ignore or not dedicate enough resources and effort to the non-large taxpayers. Nonetheless, most advisors, the IMF, and our Team all feel that it is a good practice to provide special attention, especially with regard to audit and enforcement to the largest taxpayers.

Silvani and Baer find:

In most countries which have established Large Taxpayer Units the compliance of this taxpayer group has improved. In Uruguay, Bolivia and Sri Lanka, for example, where the large taxpayers represent a high percentage of total tax collection, the percentage of stopfilers among the approximately 1,000 largest taxpayers dropped from 1987 to 1991. At the same time, in many countries payments from this group increased significantly (about 20 percent in real terms) after they began to be monitored by a LTU.²²

The following table shows countries with and without large taxpayer units.

²² Silvani, C. and K. Baer (1997) "Designing a Tax Administration Reform Strategy: Experiences and Guidelines" WP/97/30, International Monetary Fund, March.

Table 7: Tax Administrations with Large Taxpayer Units

| <i>Country</i> | <i>Exists</i> |
|--|--------------------|
| Guatemala | Yes |
| El Salvador | Yes |
| Nicaragua | Yes |
| Egypt (as of 2003) | Yes (experimental) |
| Bosnia (Republica Srpska) | Yes |
| Bosnia (Federation) | Yes |
| Hungary* | Yes |
| Latvia* | Yes |
| Lithuania* | No |
| Slovenia* | Yes |
| Bulgaria* | Yes |
| Armenia* | Yes |
| Azerbaijan* | Yes |
| Georgia* | Yes |
| Kazakhstan* | Yes |
| Kyrgyzstan* | Yes |
| Moldova* | Yes |
| Russia* | No |
| Turkmenistan* | No |
| Ukraine* | No |
| * These observations are from Bird and Banta (1999). | |

The international benchmark is that there should be a large taxpayer unit. Guatemala, Nicaragua, El Salvador, Tanzania, and most recently, Egypt, have all established special units that cater to the needs and undertake audit of their largest taxpayers.

Legal framework

Tax administration code. The ideal tax code is a single, comprehensive piece of legislation that defines all the legal rights, requirements, and recourses for taxpayers and the tax administration, alike. The tax code defines all terms that are to be used in the tax system, and establishes overall procedures, such as filing and retention of information, organizational setup of the tax administration, establishment and roles of various organizations, such as the appeals tribunal. The tax code in many countries either exists as a large variety of laws, often contradicting each other, with roles, rights, and responsibilities of taxpayers and tax authorities often not clearly established.

There have been many efforts underway over the past decade and a half to define ideal or model tax codes. For instance, the IMF has developed a model tax code that it calls “taxastan.” In addition, the Inter-American Center for Tax Administrations (CIAT) in Panama has produced a model tax code.

Existence of tax fraud felony. Tax administrators in many countries are stymied in their enforcement activities by the lack of a tax fraud law. Such a law should impose appropriate sanctions for fraudulent declarations and preparation of purposely false documentation. While a tax fraud law is not a panacea, tax enforcement without such a law is very difficult and it will not lead to voluntary compliance, the cornerstone of modern taxation.

Application of the tax felony authorities. The idea of voluntary compliance is that taxpayers will comply with tax laws for a number of reasons, one of which is their desire to not have tax fraud punishments applied to them. This means that for voluntary compliance to be effective, tax authorities must from time to time impose the criminal sanctions that are in tax fraud felony legislation. Too many such applications of this law mean that something is wrong, probably that the tax fraud laws are being used for reasons other than to encourage compliance, such as for prosecution of political enemies.

On the other hand, too little application of the tax fraud law, especially in light of open fraud, means that the tax authorities have little power and the law is without teeth. It is very difficult to encourage voluntary compliance under these circumstances.

In developed countries, the tax fraud felony is only applied sporadically and often its application is given high profile in the news media. In many countries in the developing world, tax fraud has only recently been made a criminal offence, still application is very weak, limited, and in some cases, these sanctions have never been applied despite having the law on the books.

Two Central American cases are illustrative. In El Salvador, which enacted its tax fraud felony legislation about ten years ago, only a handful of cases have been brought to courts for enforcement. Usually, however, the threat of imposing the weight of the tax fraud law is enough to force corrections to forms and declarations and renewed compliance from fraud committing tax filers. On the other hand, since its enactment in the mid-1990s in Guatemala, the tax fraud law has not once been applied.

The Government of Egypt has recently submitted a revamped sanctions law for enactment by its Parliament. This sanctions law includes large and escalating financial penalties for tax fraud, but its structure indicates that the application of jail time for tax fraud, although contemplated, will never transpire.

Appeals tribunal. Most countries of the world have an appeals process where taxpayers are able to dispute the decisions of tax authorities. This is an important institutional arrangement that helps to ensure the protection of taxpayer rights, lends credibility to the overall tax system, and helps to keep tax authorities under external review.

Enforcement

This section discusses a number of indicators related to enforcement of the tax laws.

Current account. A current account is an accounting of all the taxes that a taxpayer is responsible to file and pay. The current account shows on an always current basis the taxes that a person owes and the monies that may be owed the taxpayer, say as a rebate on VAT payments. The current account is an easily conceived instrument, but its implementation and maintenance are not easy to set up. A current account requires an automated payments or receipts system, an up-to-date taxpayer registration system, and careful monitoring of taxpayer liabilities.

Automated audit selection. Audit selection, whether for income tax, VAT or customs duties should be based on unbiased risk assessment based on statistically determined parameters. Such a system will help to select for audit those firms and individuals that are more likely concealing information and therefore under-declaring their tax obligation.

An automated selection process also is useful for reducing the discretion of tax authorities and should be an integral part of any tax modernization program, and especially any program that seeks to reduce politicization of the governmental institutions and to reduce corruption.

Auditors as percent of administrative staff. Obviously, the entire professional staff of the tax administration cannot be dedicated to audits. Staff are needed for recording and information technology, legal analysis, and other administrative processes. However, an appropriate portion of the staff should be dedicated to audit. The international benchmark indicates that about 30% of professional, administrative staff of the tax administration should be dedicated to audit.

Use of external data. For tax enforcement to function efficiently, tax authorities need to have access to information on taxpayers about such things as their ownership of other companies, vehicle registrations, and land or real estate holdings. This type of information provides an important source for determining when a tax declaration seems inconsistent with other assets. The international benchmark is that this type of information is usually available to tax authorities on-line.

“Stop filers” as percent of active filers. In many developing countries, seemingly unexplainable drops in fiscal revenues have resulted due solely to the fact that taxpayers have found that they can simply stop filing their monthly VAT declarations with impunity. Tax administrations should have automated notification systems that immediately remind taxpayers of their responsibility to file and pay their tax obligations. Keeping a lid on stop filers cannot be overemphasized.

Crossing information among taxes. Many tax administrations in developing countries miss the opportunity to improve their understanding of their taxpayers by simply not having immediate and useful crossing of information among the different types of taxes that their taxpayers are paying and declaring. Such information might include: VAT paid

in customs and VAT paid on domestic transactions; real estate taxes and income taxes; import duties and VAT.

Number of tax administrators per 1,000 of the national population. This is merely an indicator of the size of the tax administration and its extension into the overall population. The international benchmark, or norm, is about one tax administrator per 1,000 population. In Central America the benchmark is only 0.27 tax administrators per 1,000 population. In Guatemala it is even lower, at only 0.17

Table 6 presents this indicator for a number of countries. These data, for the most part, date to the mid-1990s, although the data for Guatemala are from 2001.

Table 8: Public employees in the national tax administration institution

| <i>Country</i> | <i>Number of tax staff per 1,000 of national population</i> |
|----------------------------------|---|
| United Kingdom | 2.36 |
| Germany | 2.10 |
| Belgium | 1.98 |
| France | 1.79 |
| Canada | 1.49 |
| Egypt | 1.00 |
| United States | 0.92 |
| Bosnia (Federation) (2004) | 0.82 |
| Bosnia (Republica Srpska) (2004) | 0.67 |
| Spain | 0.66 |
| Uruguay | 0.55 |
| Armenia | 0.53 |
| Argentina | 0.50 |
| El Salvador | 0.32 |
| Costa Rica | 0.27 |
| Nicaragua | 0.22 |
| Colombia | 0.19 |
| Chile | 0.15 |
| Guatemala (2001) | 0.17 |
| Guatemala (1994) | 0.15 |
| Bolivia | 0.14 |
| Ecuador | 0.13 |
| Peru | 0.13 |
| Brazil | 0.11 |
| Dominican Republic | 0.11 |
| Tanzania | 0.10 |

Source: Some of these data are from Piza (1994). Data from Guatemala are from the Ministry of Finance (1994) and the Superintendencia de la Administracion Tributaria (2001). Data from Nicaragua are from the Ministry of Finance in 1995. Data for Tanzania were collected from the Tanzania Revenue Authority in 1998. Data for Bosnia are from records of the respective tax administrations in 2004.

Active taxpayers per tax administrator. For Central America, in general, the number is 81 per tax administrator, and in Guatemala, it is only 51. In El Salvador, there are about

200 taxpayers per tax and customs official, while in Tanzania the ratio is about 100 to 1. For Egypt, there are 71 taxpayers per tax official. In the U.S., the number is about 1,000 taxpayers per Internal Revenue Service employee.

The following table presents some observations on the number of taxpayers per tax official.

Table 9: Active taxpayers per tax official

| <i>Country</i> | <i>No. of taxpayers per official (approximate)</i> |
|---------------------------|--|
| US | 1,000 |
| Armenia* | 616 |
| Moldova* | 520 |
| Bosnia (Republica Srpska) | 462 |
| Ukraine* | 327 |
| Hungary* | 308 |
| Uzbekistan* | 208 |
| El Salvador | 200 |
| Tanzania | 100 |
| Lithuania* | 100 |
| Egypt | 71 |
| Guatemala | 51 |
| Bosnia (Federation) | 50 |
| Kazakhstan* | 36 |
| Georgia* | 34 |
| Bosnia (Republica Srpska) | 33 |
| Latvia* | 22 |
| Kyrgyzstan* | 20 |

* These observations are from Bird and Banta (1999).

The ratio of taxpayers to tax administration staff varies very widely. This has to do with mainly four factors. First, many countries do not actually register all those individuals who are incorporated in their income tax systems. For instance, if tax is withheld from wages and the wage earner does not have multiple sources of income, that taxpayer is not required to prepare a tax declaration and probably need not be included in the tax registry. In addition, tax systems that rely heavily on VAT and VAT registration is only required for relatively large firms, then registration will be very low. For example, in the mid-1990s, there were only 29 firms registered in the Mongolian VAT system.

Second, many tax administrations have made less effort to incorporate tax registrants in their tax rolls. A case in point, in Bosnia the Republica Srpska has registered all those individuals with incomes, including pensioners, regardless of their tax liabilities. This compares with the Federation in Bosnia, where tax authorities have decided not to register taxpayers who are only subjected to local taxes (these are collected by the tax departments in both Republica Srpska and the Federation.)

Third, many tax authorities have simply not made adequate effort to extend their presence into their societies. For instance, comparing Guatemala to El Salvador, which have

similar tax systems, legal systems, and socio-economic structures, it becomes pretty clear that Guatemalan officials have ample room to increase the number of tax registrants.

Performance Indicators System for Audit and Auditors. The international best practice, although not very widespread, is to evaluate the tax administration's audit and its auditors by developing performance monitoring systems. These can have many different forms and not one way is necessarily superior to another.

Such performance indicators might include comparisons of *ex ante* and *ex post* valuation of income tax revenues that would be generated by a specific audit case. Systems for such valuation are based on statistical analyses and good databases. Monitoring audit cases per auditor or team can be developed to assess overall performance.

The international benchmark is that tax administrations should have such performance indicator systems for their audit function. Such systems have been worked on in Costa Rica and El Salvador, but they are not fully developed and cannot be considered the norm. The Guatemalan tax administration, in 2001, had begun to develop the statistical systems that could be developed for audit selection and analysis, but this is very much lagging in its development. Tanzania had not developed such a system. Nor had El Salvador, as of 1995, although it was in the stages of designing such a system.

Clean taxpayer registry. One of the very first efforts in tax modernization is the cleaning up of the taxpayer registry. This registry should be a directory of all taxpayers in the country, along with their addresses, economic activities, and links to other asset ownership, such as vehicles and bank accounts, and legal residence. The taxpayer registry is the backbone of all tax administrations.

It should be automated, easy to enter data and to register taxpayers, and easy for the rest of the tax administration to link to.

Percent of taxpayers subject to annual audit. Too much auditing implies inefficiency and harassment. Too little calls into question the enforcement efforts of the tax administration. In developed countries about one percent of taxpayers are subject to audits in any given year. In Central America the audit rate has reached to about two percent of the taxpayer population. Audit data were not available to the benchmarking team for Guatemala. In some countries, such as Bosnia and Egypt today or Tanzania a few years ago, the attempt at 100% audit is actually not audit at all, but rather official tax assessment. Such assessment is completely inconsistent with the concepts of "voluntary compliance" and is not generally recommended.

Bird (1999) shows audit at 45% of taxpayers in Kyrgyzstan, and 50% in Moldova and Turkmenistan.

Unified audits. An old shibboleth is "do not audit the tax, audit the person." A unified audit, for our purposes, combines the audit of companies for their VAT or sales tax, income tax and taxes on imports. This is an important international trend, though not widely practiced yet. It is not done in Guatemala or Central America, or Egypt or Bosnia, or Tanzania, yet.

Receipts and collection

The payment of taxes should be as simple and low cost as possible. Keeping this compliance cost down is an important way to encourage voluntary compliance. It is also necessary that the tax authorities have a payment system that will provide accurate data on a very timely basis and that this information directly feeds into the other information management systems of the tax authorities, such as the revenue tracking system and the taxpayer current account.

Bank system payments. An important innovation over the last ten years in many developing countries has been the move to tax payment through the banking system. Compared to payment at government offices, banking system payment can be substantially more efficacious. It is usually more convenient for taxpayers, provides fewer errors since it is often introduced with effective automation systems, and is often at lower cost for the tax or treasury administrations.

Percent of large taxpayers paying via the internet. In both developed and developing countries payment of tax obligations via the internet is a very important step in reducing compliance costs and improving tax accounting.

Improved tax administration, especially with lower corruption and compliance costs, can come about by reducing the opportunities for direct, face-to-face contact between taxpayers and tax administrators. This is one reason why bank or internet payment systems are to be preferred to payment at government collection offices or cashiers. Of course, in developed countries, where the banking system functions well, check payment by mail has long been the preferred means for payment of taxes, although more and more taxpayers have been opting to file and pay their taxes via the internet in rich countries.

Late payments as percent of total domestic tax receipts. The management of delinquent taxpayers is a key function of any tax administration. Tax administrations need to make every effort to keep these delinquents under control. The Guatemala benchmarking team set a five percent standard, although this is based on the experience only of one of the team members and no readily available international data are available.

Systems and resources

Internal procedures and manuals. All public entities need to clearly specify in terms of internal regulations or rules the procedures that are to be followed in carrying out their functions. Manuals are the handbooks that explain how these procedures are to be carried out. These manuals should cover basic organizational functions, such as personnel policies and financial control, as well as document and explain the requirements for the implementation of all of the tax administration processes, such as audit, document receipt and handling, archiving, and the other main tax administration business processes.

While internal procedures and manuals are generally well documented in developed countries, many developing countries have not documented their internal procedures or their documentation of these procedures has lagged the changes in these procedures. By

the same token, many developing countries have only inadequate manuals or handbooks, if they have any at all.

Planning and monitoring systems. Developed country tax departments generally have a corporate planning department that sets performance targets, monitors the attainment of these targets, plans for capital programs, and leads the overall direction of the development of the tax department. In most developing countries the planning and monitoring systems are very rudimentary and usually not paid much attention.

Coordinate information with ministries and others in government. Of course, the rights of taxpayers must be respected. However, certain information should be shared that will not violate these rights. The tax department should have information sharing arrangements with the central bank, the Ministry of Finance, customs, and local governments. Information to be shared can include, total revenue receipts by type of tax, macroeconomic and sectoral economic data, public investment, imports, exports and international capital flows, data related to criminal behavior, and data related to international transfer pricing.

General use of automation. All modern tax administrations employ automated systems for most major processes, such as document receipt and management, issuance of notices, filing and imaging, taxpayer services-related information sharing, and so on.

Interconnectivity between headquarters and local revenue offices. In many developing countries information is shared with considerable lag. In some countries information is not included into modern technological systems and paper trails and physical transfers and photocopying are the order of the day. In other countries, data transfer may take place either with the physical delivery of data disks or tapes. Still, in other countries, taxpayer and tax payment information is transferred, usually on a one-way basis, between the local office and the headquarters, on a batch basis a few times per day. All of these methods lead to errors, untimely delivery of information, and may leave information loopholes that fraudulent taxpayers can exploit.

Data and systems backups. All modern public institutions should ensure that their data and computer systems are backed up on a daily basis. Such backups are particularly important for the tax administration as the taxpayer database they manage is the absolute core of the tax system. The value of this database and its daily backups cannot be overstated. Such backup systems are routine in industrialized countries, but in many emerging market countries, the effort and expense for backing up these systems is just not sufficiently appreciated, leaving these tax administrations at great risk.

The next indicators relate to the quantity and quality of human resources of the tax administration.

Percentage of employees with university degrees. University graduates tend to have a much higher representation among tax administration staff in developed compared to emerging market countries.

Ratio of “director” level salaries to that of tax auditors. Generally, in industrialized countries the top paid person in the tax administration may have about twice the salary as does the average tax auditor. This seems to vary considerably among emerging market countries.

Ratio of average tax administrator’s salary to average GDP per capita. In industrialized countries the average tax administrator’s salary may be equivalent to about twice the average per capita income in the country. This is not a particularly high salary, per se, but it is enough to attract sufficient professional staff to operate the tax administration. In emerging market countries tax administration staff salaries are several multiples of the average per capita income, yet these salaries are still too low to attract high caliber professionals.

Next steps

Bird (1999) lists a number of criticisms of the Bird and Banta (1999) indicators. Some of these criticisms have some validity and could apply to this set of international benchmarks as well. In particular, the most appropriate criticism was that these tax systems are complex and 1) they cannot be represented by simplifying indicator systems, and 2) they should not be represented in this way. Since Bird and Banta (1999) specifically were presenting a set of indicators for fiscal sustainability that were meant to be used in international comparisons, perhaps the critique has some relevance. For this benchmarking exercise, however, this must be rejected. The point of establishing benchmarks is to help counsel tax authorities on what needs to be done to improve their tax administrations and international comparison information is a useful, but not the only, point of departure.

That said, Bird (1999) puts paid the critique in the following comment.

... life is complex and there is not and cannot be any perfect way to attempt such a task. All that can be done is take as comprehensive and consistent approach as possible, to set out the evidence and methodology as fully and clearly as possible, and to be as open as possible to comments, corrections, criticisms, and suggestions for change.

Page 234 in Shapleigh, Andic, and Banta

Future work on this benchmarking system should include broader and a more comprehensive application to other countries, comparative case applications, and a systematic data collection effort.

This system has been developing over a number of years. In each year an indicator or two has been added, corrected, or removed from the overall system. Application of the methodology to other countries, as well as follow up applications in the countries that have already been studied, would help to validate the indicators used, demonstrate their

usefulness as performance or target indicators, and incorporate ever more useful indicators.

Performing a number of comprehensive benchmarking studies in specific regions and around the world would be useful to enrich the system and provide better guidance to individual countries with regard to their own performance enhancement and tax organization and administration efforts. Regional comparisons are useful since tax administrators, at least in my experience, seem to want to compare their own systems with those of neighboring or regional competitors.

A broader set of comparative studies can be helpful since there is much that can be learned about innovation and reform from outside of a particular region. An example of this is the so-called trend towards the creation of autonomous revenue agencies, when in fact, this is only a trend in Africa and Latin America. In the Asia Pacific region, for example, only New Zealand and Singapore have established autonomous revenue authorities, while the Philippines government has been studying the case of Peru in the design of its own autonomous revenue authority. Clearly, lessons can be got from outside of one's own backyard.

Finally, in an ideal situation, data for all the benchmarking indicators would be collected for a large number of countries, regional and taxonomic groupings and averages or norms could be calculated, and a book produced, perhaps on a periodic basis.

Annex: The Benchmarks as Developed in the Guatemala Study

| <i>Indicator</i> | <i>International Benchmark</i> | <i>Central America Benchmark</i> | <i>Guatemala in 2001</i> |
|---|--------------------------------|----------------------------------|--------------------------|
| Tax Structure | | | |
| Number of taxes making up 75% of collections | 6 | 4 | 4 |
| Broad tax base with limited exemptions | Yes | No | No |
| Percent of all taxpayers that pay the top 75% of revenues | 5% | 1% | 1% |
| Limited number of tax rates | Yes | Yes | Yes |
| Domestic VAT as percent of VAT on imports | n.a. | 100% | 70% |
| Indirect taxes as % of total tax revenues | 50% | 70% | 76% |
| VAT collection as percent of total tax take | 35% | 45% | 44% |
| VAT rate | 16% | 13% | 12% |
| Tax ratio: high income countries | 40% | n.a. | 10% |
| Tax ratio: middle income countries | 25% | n.a. | 10% |
| Tax ratio: low income countries | 18% | 14% | 10% |
| Enforcement | | | |
| VAT evasion | 10% | 25% | 33% |
| VAT productivity | 0.58 | 0.39 | 0.41 |
| VAT Gross Compliance Rate | 69% | 46% | 49% |
| Use of performance indicators for audits and auditors | Yes | No | No |
| Number of tax administrators per 1000 national population | 1.00 to 2.00 | 0.27 | 0.17 |
| Ratio of active taxpayers to tax administrators | 150 to 250:1 | 81:1 | 51:1 |
| Audited taxpayers as % of total taxpayers, per year | 1% | 2% | n.a.. |
| Unified domestic and import audits | Trend | No | No |
| Ex post customs audits | Trend | No | No |
| Separation of taxpayers by size or nature | Yes | Yes | Yes |
| Payments and Collections | | | |
| Banking system payments | Yes | Yes | Yes |
| Percent of large taxpayers declaring via Internet | 100% | n.a. | In process |
| “Stop-filers” as % of active taxpayers | 5% | n.a. | n.a. |
| Late payments as % of total tax receipts | 5% | n.a. | n.a. |
| Administrative cost as % of total receipts | 1% | 1.5% | 3% |
| Share of adjustments and fines collected | 80% | n.a. | n.a. |
| Business days for VAT refunds | 25 | 30 to 90 | 30 to 90 |
| Institution that establishes revenue targets | Ministry | Ministry | Ministry |
| Automated Systems | | | |
| Use of automated systems for daily use | Yes | Yes | Yes |

| <i>Indicator</i> | <i>International Benchmark</i> | <i>Central America Benchmark</i> | <i>Guatemala in 2001</i> |
|--|--------------------------------|----------------------------------|--------------------------|
| Interconnectivity between HQ and local tax offices | Yes | Yes | Yes |
| Backup systems for all uses | Yes | Limited | Almost all |
| Operating taxpayer current account (also under enforcement) | Yes | Yes | In preparation |
| Clean and operating taxpayer registry | Yes | Yes | In preparation |
| Automated audit case selection | Yes | Yes | In preparation |
| Tax declaration entry with automatic error correction | Yes | Yes | n.a. |
| Use of exogenous information (filers>vehicles>real estate) | Yes | Trend | No |
| Use of third party databases | Yes | Trend | In preparation |
| Data crossing among taxes | Yes | Trend | In preparation |
| Late or stop filers system | Yes | Trend | No |
| Planning and Coordination | | | |
| Appropriate use of planning, monitoring, and evaluation systems for tax organization | Yes | Limited | No |
| Coordination of data flows among tax administration, Ministry, and other agencies | Yes | Trend | No |
| Human Resources | | | |
| % of employees with university or college degrees | 70% | 40% | 40% |
| Ratio between director and auditor salaries | 2:1 | 4:1 | 5:1 |
| Ratio between average tax administrator's salary and average GDP per capita | 2:1 | 5:1 | 5.5:1 |
| Existence of administrative career plan | Yes | Trend | In preparation |
| Existence of formal retirement plan | Yes | Trend | No |
| Sanctions and Penalties | | | |
| Tax code | Trend | Some, new | Yes |
| Tax fraud felony | Trend | Some, new | Yes |
| Application of tax fraud felony sanctions | Little | Very little | No |
| Appeals tribunal | Yes | Yes | Yes |
| Organization, Institutional Credibility and Public Confidence | | | |
| Stability of top-level leadership | Fixed appointment | Variable | Variable |
| Professionalism of top-level staff | Excellent | Good | Good |
| Tax fraud unit in tax administration | Yes | n.a. | No |
| Unit for investigation of internal corruption | Yes | n.a. | No |
| Diversity and quality of taxpayer services | Yes | Limited | Limited but improving |
| Internal regulation | Yes | Trend | n.a. |