

## MODERNIZATION OF THE TAX ADMINISTRATION

(TC-94-10-28-4)

### EXECUTIVE SUMMARY

**BENEFICIARY:** Government of the Republic of Honduras

**EXECUTING AGENCY:** Department of Finance and Public Credit (SHCP)

**AMOUNT AND SOURCE:**

IDB (FSO):	US\$1,750,000
Local contribution:	US\$ 250,000
Total:	US\$2,000,000

**TERM:** Execution period: 30 months

**OBJECTIVE:** The general objective of the technical-cooperation program is to assist the Government of Honduras in modernizing its tax administration. The Revenue Branch, which has been established to replace the Directorate General of Taxation and the Directorate General of Customs, will enhance efficiency by managing all taxes and developing and introducing a comprehensive tax information system.

**DESCRIPTION:** The program will involve activities in the following areas: (i) regulation, to make the current regulations reflect the reforms passed by Congress and introduce the necessary adjustments into the tax information system; (ii) organization, to help design and start up the Revenue Branch, which will be responsible for all tax administration; (iii) collections, to strengthen information subsystems, renegotiate tax collection agreements with banks, and develop a procedure for enforced collections and the recovery of taxes in arrears; (iv) auditing, to consolidate experience in the use of auditing techniques, gain further expertise, and carry out specific and general auditing plans; (v) taxpayer service, to facilitate compliance with tax obligations at lower cost; and (vi) training, to instruct employees in how to use the new techniques and apply the new management procedures.

**ENVIRONMENTAL CLASSIFICATION:** The Environment Committee classified this as a Category II operation.

- BENEFITS:** The expected benefits are: (i) the establishment of an integrated and more effective tax administration that operates at lower cost; (ii) assurance, now and in the future, that the information entered into the tax information system is accurate and used effectively; and (iii) increased receipts, principally through the elimination of pockets of tax fraud.
- RISKS:** The traditional risks of employee turnover and lack of incentives will be allayed by establishing the Revenue Branch as a decentralized entity responsible for the entire tax administration.
- THE BANK'S COUNTRY STRATEGY:** The Bank's strategy establishes the following three priority areas: (i) human capital development; (ii) higher productivity of public and private investment; and (iii) the removal of financial constraints on the government stemming from the large fiscal deficit and the high cost of debt service.
- SPECIAL CONTRACTUAL CONDITIONS:** The first disbursement of the financing will be contingent on compliance with the following conditions precedent (see paragraph 3.14): (i) submission to the Bank of evidence that the targets set out in Annex I, section I, have been complied with by the end of the preceding technical-cooperation program; (ii) presentation of a copy of the contract with the specialized agency; and (iii) selection and appointment of the national counterpart technical staff.
- OTHER CONTRACTUAL CONDITIONS:** Other contractual conditions will include: (i) contracting the long-term consultants within 60 days after the agreement with the specialized agency has been signed (paragraph 3.6); and (ii) presentation of the initial, semi-annual, and final reports to the executive committee for review prior to their approval by the Bank (paragraph 3.10).
- EXCEPTION:** The executing agency has requested that CIAT continue to act as the specialized agency. The project team supports this request on the basis of the evaluations by the executing agency of CIAT's performance in previous operations in Honduras and the advantages of continuity.

## I. BACKGROUND

### A. The tax administration

- 1.1 The Department of Finance and Public Credit (SHCP) is the arm of the Honduran government whose responsibilities include managing public revenues. Until now, collections have been the responsibility of two Directorates General that report to the Under-Secretary of Revenue - the Directorate General of Taxation and the Directorate General of Customs. The former is responsible by law for the administration of domestic taxes; the latter is responsible for collecting customs duties.
- 1.2 Honduras has a traditional tax system based on a small number of taxes that contribute over 90% of receipts (income tax, sales tax, consumption and production tax, and external trade tax) and a series of levies which for reasons of history or expediency are applied to different economic and juridical acts and which produce low returns.
- 1.3 The following table shows the main taxes collected by the Directorate General of Taxation, which account for two thirds of total fiscal revenues; the other third is collected by the Directorate General of Customs.

Receipts in millions of current lempiras						
	1992	%	1993	%	1994	%
Income (1)	884.29	43.1	991.1	40.05	1,139.7	38.24
Sales	548.94	26.9	696.7	28.16	885.4	29.66
Other (2)	616.59	30.2	786.6	31.79	961.2	32.2
Total	2,049.7	100	2,474.4	100	2,986.3	100
(1) Includes income, inheritance, and property taxes.						
(2) Includes the other taxes: selective, production, and consumption.						

- 1.4 Studies conducted at the end of the last decade noted that the chief problems affecting the tax administration, including customs, were inadequate administrative organization, a staff with insufficient technical training, and the use of inefficient procedures (collections, information, and management control). But the most serious of all is undoubtedly political influence in employee appointments, particularly in customs, where turnover

caused by changes in government can affect up to 85 percent of staff. This serious problem affects the overall functioning of the tax administration and the consequences include personnel with no technical qualifications, low salary levels, lack of incentives, minimum impact of training, and tolerance for irregular activities.

B. Technical cooperation

- 1.5 The Bank financed two technical-cooperations programs to assist the Honduran government in addressing the problems in the tax administration. The first (ATN/SF-3204-HO) began in 1990 and ended in July 1992. Its general objective was to strengthen the Department of Finance and Public Credit through: (i) analysis and decision-making in the area of tax policy; and (ii) reorganization of the tax administration in order to reduce tax evasion and increase receipts. These objectives were attained and revenues peaked in 1991 and 1992. However, the final evaluation of the program pointed to certain problems stemming from the inadequate structure of the information system managed by the National Data Processing Center (CENI) <sup>1/</sup> and its inability to produce and process timely information of the quality required by the tax administration. It also noted organizational shortcomings and the need to step up taxpayer audits.
- 1.6 In April 1993, the Bank and the Government of Honduras signed technical-cooperation agreement ATN/JF-4172-HO financed with nonreimbursable resources from the Special Japanese Fund. The program was designed to consolidate, in 18 months, the results achieved in the preceding stage of the technical-cooperation program, carry out additional work in the field of auditing, and help to correct shortcomings in other areas such as data processing.
- 1.7 However, by the time that program began - 15 months after the previous one had ended - the problems and shortcomings mentioned above, coupled with political factors, had caused the tax administration to collapse. The result was a drop in receipts, and what is worse, most of the data that had been banked became unusable owing to its unreliability. Under these circumstances, the executing agency and the technical experts decided, with Bank approval, that it would be less costly and more efficient to design, develop, and introduce a totally new tax information system. Since not enough funds were immediately available for such an ambitious goal, it was decided to proceed with the design, but for the time being to develop and introduce only the modules necessary to track large taxpayers, who contribute more than 70 percent of domestic tax revenues.

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<sup>1/</sup> Congress has passed legislation to shut down CENI within six months.

- 1.8 In the course of the program, a completely new integrated information system was designed, including 25 subsystems, the prototype was built, and the modules needed to track 646 large taxpayers were brought on line (Annex III contains more information on the system). Security and internal control mechanisms have been built into the system to prevent erroneous data from being inputted and information from being used irresponsibly.

C. The Revenue Branch

- 1.9 Congressional Decree 159-94 established the Revenue Branch as a decentralized organ of the Department of Finance and Public Credit, with administrative, technical, and financial independence to carry out its mandate of managing all government taxes. It was established effective February 1, 1995, to replace the Directorates General of Taxation and Customs. The decree states that: "The only way of improving the performance of the employees of those Directorates, weeding out corruption, and boosting fiscal revenues is by establishing a revenue office that is technically organized and professionally staffed". The decree also states that: "The current structure of the Directorates General of Customs and Taxation is not geared to modern revenue-collection techniques".
- 1.10 The provisions of the decree go straight to the roots of the main problems in the tax administration. First, it orders that all the staff of the Directorates General of Customs and Taxation are to be examined, and only those who pass will be allowed to join the Revenue Branch (article 11). An international consulting firm will be hired to perform the employee evaluations and define the new job descriptions. Second, it establishes that the Revenue Branch will have its own system for administrative contracting, salaries, personnel, discipline, and a professional tax and customs career path "to ensure that its functions are carried out" (article 5). This indicates that there will be new selection procedures, job stability, clear grounds for dismissal, training incentives, internal promotion, and pay based on performance and productivity.

D. Justification of the operation

- 1.11 The establishment of the Revenue Branch entails a reorganization of the tax administration as a whole (including customs), redistribution of functions, evaluation of existing staff, selection, and training. These requirements, coupled with the need to continue developing and implementing the tax information system, justify a new operation to assist in designing and starting up the new branch that will be responsible for managing government revenues, and in consolidating earlier progress. The country's macroeconomic situation (per capita income, and the size of public sector debt and the cost of servicing it) justifies the use of nonreimbursable resources from the Fund for Special Operations.

E. Bank strategy

- 1.12 The Bank's Country Paper covering the period 1995 through 1997 suggests three main areas of action: (i) human capital development; (ii) more productive public and private investment; (iii) the removal of financial constraints on the government stemming from the large fiscal deficit and the high cost of debt service. The technical-cooperation program proposed here is fully in accordance with the third of these strategies and will make a marked contribution to reducing the fiscal deficit thanks to higher tax revenues. The Country Paper also notes that one of the areas most in need of technical cooperation is the tax administration. The Bank's actions in this area are rounded out by the loan to strengthen the customs system (899/SF-HO), which began in 1994 and is still in execution.
- 1.13 The Honduran government's program for sustained and equitable development includes modernization of the State as one of its macroeconomic objectives. In conjunction with the World Bank, the IDB is studying a loan operation to modernize the public sector. However, the urgent need for the government and the Bank to address the fiscal deficit requires that the technical-cooperation project proposed here be given priority. Nonetheless, it will be coordinated with the public sector modernization program which will build upon and maintain its achievements.
- 1.14 The Bank is supporting programs to strengthen the tax administrations in 17 countries in the region. The overall results indicate that efficiency levels with regard to collections and reductions in tax evasion have improved as a consequence of the introduction of computerized information systems, more effective controls, and modern auditing techniques.

II. OBJECTIVES AND INDICATORS

A. General objective

- 2.1 To assist the Government of Honduras in continuing the process of modernizing its tax administration, particularly in designing and setting up the new Revenue Branch and in developing and introducing a comprehensive information system.

B. Specific objectives

- 2.2 The specific objectives of the program are to:
- a. Increase voluntary compliance by taxpayers with their obligations.

- b. Reduce tax evasion by increasing the number of auditors and auditing programs.
- c. Increase the receipts from domestic taxes, specifically the income and sales taxes.
- d. Enhance the efficiency of the tax administration.
- e. Implement new tax management procedures, supported by a comprehensive tax information system.

C. Benchmarks

2.3 The program's progress towards the specific objectives will be measured using the following benchmarks that can be broken down into time periods. The indicators mentioned in subsections b and c will be compared to the data used in the initial report.

- a. Net increase of 10 percent in the number of taxpayers registered after the census has been processed.
- b. Reduction of 50 percent in the number of taxpayers who fail to file returns.
- c. Increase of 50 percent in the number of auditors and comprehensive audits of more than 4,500 taxpayers.
- d. Increase in receipts of 0.5 percent of GDP in 1995, 1.2 percent in 1996, and 1.4 percent in 1997.
- e. Increase in employee productivity as measured by receipts over the same period in the previous year. Productivity cannot be gauged, at least in year one of the program, on the basis of the current cost of collections (0.56 percent) since salaries are low and will be raised in the near future.
- f. Collection of at least 30 million lempiras from taxes in arrears.
- g. Implementation and use of at least 20 of the 25 subsystems in the tax information system.

### III. PROGRAM DESCRIPTION

#### A. Activities

3.1 The activities described in Annex I will be carried out for each of the following areas during the program:

- a. Regulation, to update the regulations to reflect the measures passed by Congress, prepare regulations to the Tax Code, and introduce the necessary adjustments into the tax information system.
- b. Organization and management, to help define and implement the new organizational structure which is essentially functional in nature and intended to integrate the Directorates General of Taxation and Customs. A start will also be made on decentralizing oversight of large taxpayers to regional and local offices.
- c. Collections, to strengthen the information system and its subsystems, review and renegotiate tax collection agreements with banks, and develop procedures for enforced collections and the recovery of taxes in arrears.
- d. Auditing, to consolidate auditing techniques used to verify compliance with tax obligations and gain more experience in them, and to carry out specific and general auditing plans.
- e. Taxpayer service, to facilitate compliance with tax obligations at lower cost.
- f. Training, to instruct employees on how to use the new techniques and apply the new management procedures.

#### B. Plan of execution

3.2 The Department of Finance and Public Credit, as the executing agency, will be ultimately responsible for the program, through the Revenue Branch. The Department proposed to the Bank that the Inter-American Center of Tax Administrators (CIAT) be contracted as the specialized agency. Given the evaluations of programs ATN/SF-3204-HO and ATN/JF-4172-HO, CIAT's efficient performance in these programs and in those of other countries, and the advantages of continuity, the project team supports the proposal to contract CIAT to direct the new program. Annex I provides more information on the agency and includes the terms of reference.

3.3 The contract between the Department of Finance and Public Credit and CIAT will be sent in advance to the Bank for approval. CIAT will be responsible for technical execution and for identifying,



contracting, supervising, and paying the consultants. CIAT will also procure the equipment for the program, in accordance with the Bank's rules and procedures, should the executing agency so request.

- 3.4 CIAT's participation, training for employees in the new techniques, and the benefits associated with the proposed modernization program will ensure that the improvements brought about as a result of this technical-cooperation project will be sustainable.
- 3.5 The program will have an executive committee, operating committees, and a national coordinator. Annex I describes the makeup and functions of the committees. The Department of Finance and Public Credit will take the steps needed to ensure that the committees function in accordance with the terms established in the technical-cooperation agreement.

C. Requirements

1. Consulting services

- 3.6 Consulting services will have to be hired for the areas in which program activities are to be carried out. The specialized agency will inform the Bank of the names of the consultants who have been identified prior to beginning the hiring process. Annex II in the technical documentation sets out the terms of reference for the following consultants in detail:

- a. **International consultants:** Expert in tax administration, expert in tax information systems, expert in tax arrears collection, expert in auditing and auditing techniques, expert in tax legislation and rules, and a senior adviser to plan the organization of the Revenue Branch. An expert in tax administration and information systems will also be contracted for monitoring and quality control of each of the management subsystems. The contract will be for discontinuous periods for a total of up to eight fortnights.
- b. **National consultants:** A computer expert in databanks, networks, and communications. The contracts of the experts hired under the previous program will be extended and the government undertakes to employ them in the tax administration by the beginning of year two of the program, with their salaries to be paid by the Revenue Branch.

2. National counterpart

- 3.7 The Department of Finance and Public Credit will appoint a national coordinator and a technical team composed of 14 computer experts, two tax lawyers, two tax experts, two auditors, two experts in tax collection, and one expert in organization and methods. The

Revenue Branch will also be responsible for ensuring that all of the units and bodies connected with each of the areas of action will participate in the program, chiefly through representation on the operating committees described in Annex I.

### 3. Equipment

- 3.8 If so requested by the Department of Finance and Public Credit, the specialized agency will use program funds to procure the equipment listed in Annex I, in keeping with Bank rules and procedures.

### 4. General support

- 3.9 The Revenue Branch will provide administrative and logistical support for the program, including office space, physical space for the equipment, office supplies, secretarial services, local transport, communications, and publications.

### D. Reports and monitoring

- 3.10 The Bank's Country Office in Honduras will be responsible for first-hand monitoring of the project in cooperation with the project team, and with its support. Monitoring will take the form of participation in the meetings of the executive committee and the initial, progress, and final reports to be presented by the specialized agency as described in Annex I.
- 3.11 The Department of Finance and Public Credit will present annual financial reports to the Bank within 90 days after the close of each year in which project funds have been spent, and a final report within three months following the final disbursement of the financing. All the reports will be audited by an independent firm approved by the Bank.

### E. Cost and financing

- 3.12 The program will cost an estimated US\$2 million equivalent, of which the Bank will provide the equivalent of US\$1,750,000 in nonreimbursable funds drawn on the Fund for Special Operations. The remainder, in the equivalent of US\$250,000, will be the local counterpart contribution. The budget is summarized below and set out in detail in Annex I.

CONSOLIDATED BUDGET (US\$)

ITEM	BANK CONTRIBUTION	LOCAL CONTRIBUTION	TOTAL
1.1 Salaries	<u>1,038,000</u>	<u>198,000</u>	1,236,000
a) Fees	823,000	198,000	
b) Overhead	215,000		
1.2 Equipment	380,000		380,000
3. Training	150,000		150,000
6. General support		40,000	40,000
7. Publications	12,000		12,000
8.1 Consultant for evaluations	20,000		20,000
98. Contingencies	<u>150,000</u>	<u>12,000</u>	<u>162,000</u>
<u>TOTAL</u>	1,750,000	250,000	2,000,000

F. Disbursements

- 3.13 Disbursements of the Bank's contribution of up to US\$1,750,000 equivalent will be administered by the Department of Finance and Public Credit. In order to facilitate financial execution, the Bank may - at the request of the Department - make direct disbursements to the specialized agency in accordance with Bank procedures. Also, at the Department's request, a revolving fund may be established of up to the equivalent of 10 percent of the Bank's contribution.
- 3.14 Prior to the first disbursement, the Department will present to the Bank: (i) evidence that the targets set out in Annex I, section I, have been met by the end of the previous technical-cooperation program; (ii) a copy of the contract with the specialized agency; and (iii) the names of the technical staff who will form the national counterpart.
- 3.15 Activities are expected to last for 24 months, and disbursements will be made over a period of 30 months counting from the effective date of the contract between the Government of Honduras and the Bank.

IV. BENEFITS AND RISKS

A. Benefits

- 4.1 The main benefits expected from the new operation are: (i) the establishment of an integrated and more effective tax administration that operates at a lower cost; (ii) assurance, now and in the future, that the information entered into the comprehensive tax information system is accurate and used effectively; and (iii) increased receipts, principally through the elimination of pockets of tax fraud.

B. Risks

- 4.2 High employee turnover is a frequent risk in operations of this kind. Establishment of the Revenue Branch, by law, will provide stability for the employees of the tax administration and enhance their professionalism. The law authorizes higher salaries and performance incentives for careers in the tax administration. In addition, the Department of Finance and Public Credit will use part of its contribution to pay a supplement of up to US\$250 equivalent as an incentive to the computer experts to remain in their jobs.
- 4.3 To replace employees who leave the institution despite the improvements, the program will stress ongoing training programs that will supply the tax administration with adequate numbers of staff with sufficient technical expertise to perform their jobs with the same efficiency as their forerunners.

V. EVALUATION

- 5.1 Program evaluation will examine the extent to which the planned activities were carried out and the objectives achieved and will report on any difficulties encountered and the solutions found. The Bank will conduct the evaluations described below.
- 5.2 Mid-term evaluation. The Bank will conduct an evaluation when one half of the funds have been committed. The purpose is to check the results against the indicators and targets. The executive committee and the Bank will study the results of the evaluation, making any necessary adjustments which could even mean suspending the program. Partial evaluations will also be carried out as required under the loan for the modernization of the State.
- 5.3 Final evaluation. In the 30 days before the end of the program, the specialized agency will present a draft final report, summarizing activities since the outset of the program and discussing the results and how they relate to the objectives. This information and the program indicators will be used for the evaluation, which will serve as a basis for the project completion report.

## PROGRAM EXECUTION GUIDELINES

### I. CONDITIONS PRECEDENT TO THE FIRST DISBURSEMENT

- 1.1 Paragraph 3.14 of the plan of operations lists the conditions that the executing agency must comply with prior to the first disbursement. Condition number one refers to compliance with the following targets:
  - a. Have available screened and reliable data on large taxpayers and other taxpayers subject to the net tax on assets covering the fiscal years 1991 through 1995.
  - b. Have introduced all the modules necessary to initiate management of those taxpayers through the tax information system.
  - c. Have set up and placed in operation the Large Taxpayers Service.
  - d. Have selected the computer equipment for the tax administration offices in Tegucigalpa, San Pedro Sula, and La Ceiba.
- 1.2 These measures will make it possible for the tax administration to use the initial modules of the tax information system to manage most of the country's taxpayers. The initial modules make it easier to detect noncompliance, so that effective enforcement procedures can be taken. The remaining modules and subsystems will be developed and introduced gradually during this program.

### II. PROGRAM EXECUTION AND MONITORING BODIES

- 2.1 Paragraph 3.5 of the plan of operations describes the execution plan and establishes that the Department of Finance and Public Credit will issue a resolution to ensure the functioning of the following committees.
  - a. Executive committee. This committee will be chaired by the Minister of Finance and, in his absence, by the Executive Director of the Revenue Branch, and its members will be the Assistant Director, the expert in tax administration, the national coordinator, and an official from the Bank. The first meeting of the committee will be held within 60 days after the technical coordinator has been hired. The committee's functions include coordinating program implementation, approving the initial report and the detailed schedule of work, reviewing and approving the progress reports prepared by the specialized agency, and periodically evaluating headway in the program. It will meet once every two months as a minimum. The minutes of

the executive committee meetings will be forwarded to the project team within 30 days following each meeting and will state whether the semiannual reports have been approved or rejected.

- b. Operating committees. Their members will be the chiefs of the areas in which an activity is to be studied and/or programmed, the national technical team referred to in paragraph 3.6 of the plan of operations, and the consultants specializing in the activity. These committees will be directly responsible for executing the different program activities and preparing the technical proposals to be studied by the executive committee.
- c. National coordinator. A qualified official of the executing agency who, under the supervision of the Executive Director of the Revenue Branch or the Assistant Director, will be responsible for monitoring daily progress in the work plans approved by the executive committee. He will act as the secretary of the executive committee and as liaison with the specialized agency. He will also be responsible for supervising the counterpart technical and support teams. The Revenue Branch and the specialized agency will oversee the establishment and functioning of these committees.

2.2 Specialized agency. The Department of Finance and Public Credit proposed to the Bank that the Inter-American Center of Tax Administrators (CIAT) be contracted as the specialized agency. Appendix III in the technical documentation justifies support for the government's proposal. CIAT will perform the following functions as technical director of the program:

- a. Selection and contracting of the consulting services needed for the project, with the approval of the Executive Director of the Revenue Branch and the Bank.
- b. Preparation of the general plan and schedule of activities, which will both be used as the basis for the mid-term and final program evaluations.
- c. Supervision of the consultants' work to ensure that it conforms to the terms of reference, plans, and schedules and lives up to the expected technical levels.
- d. Technical supervision of the project through short-term missions by specialists from CIAT headquarters.
- e. Submission of the statements of expenditure required by the Department of Finance and Public Credit and/or the Bank in support of disbursement requests and for any other purposes under the technical-cooperation agreement.

- f. Participation in program evaluations in conjunction with officials from the Department of Finance and Public Credit and the Bank.
  - g. Advisory services for the Revenue Branch and specific units of the tax administration throughout the program.
  - h. Preparation and presentation to the executive committee of the initial, semiannual, and final reports within the established deadlines. The committee will review and approve the reports and submit them to the Department of Finance and Public Credit and the Bank together with its comments.
- 2.3 Reports. The specialized agency will prepare the following reports which, after approval by the executive committee, will be forwarded to the Department of Finance and Public Credit (Minister) and the Bank:
- a. Initial report. To be presented to the committee within 60 days after the program's technical coordinator has been hired. The report will include the general plan and a detailed program of work with a timetable for the first six months of the project. It will contain the data to be used as benchmarks for measuring progress towards the quantitative indicators (voluntary compliance, status of audits, collections, productivity, and the development of the tax information subsystems).
  - b. Semiannual progress reports. To be presented at the end of each six-month period, summarizing the activities conducted in that period. They will include measurements of the indicators, where possible, and an evaluation of the work by the consultants hired during the period. They will also contain the work program and indicators for the following period.
  - c. Final report. To be presented in the month following completion of the program, including a summary of the activities carried out and the results obtained as gauged against the planned objectives.

### III. PROGRAM ACTIVITIES

- A. Regulatory area
- 3.1 To update the regulations governing the taxes administered by the Directorate General of Taxation to reflect the reforms passed by Congress and make the necessary adjustments in the tax information system.
- 3.2 To regulate the Tax Code and other rules and legislation stemming from the bills recently submitted to Congress.

- 3.3 To review and update the entire tax procedure and prepare the corresponding manual, in accordance with the Tax Code passed by Congress.
- 3.4 To prepare a manual on enforced collections based on the procedure provided for in the Tax Code.
- 3.5 To prepare rules for auditing procedures that take account of the powers conferred under the Tax Code and the new capabilities made possible by the information available in the tax information system.
- 3.6 To prepare rules for the functioning of the Revenue Branch.

B. Organization

- 3.7 To assist in developing a model for integrating the Directorates General of Taxation and Customs into the Revenue Branch.
- 3.8 To advise on a new organizational structure, ensuring that it is essentially functional and autonomous in nature.
- 3.9 To assist in evaluating the personnel of the Directorates General of Taxation and Customs and in selecting staff for the Revenue Branch.
- 3.10 To help implement the Large Taxpayer Service in Tegucigalpa and lay the groundwork for subsequently extending it to San Pedro Sula.
- 3.11 To decide on the timing for developing and introducing the customs management subsystem (included in the design) in order to integrate the management of domestic and foreign trade taxes.
- 3.12 To support the operative decentralization of administrative and computer functions relating to the master tax file, data capture, collections, and taxpayer monitoring.
- 3.13 To make the information in the central databank available to the operational units.
- 3.14 To establish and carry out a work plan for inputting taxpayer data for the fiscal years 1993 and 1994 into the tax information system.
- 3.15 To include the new rules and procedures in the databanks of the operational units.
- 3.16 To establish and regulate internal reporting channels for the purpose of coordinating the execution of central level directives by the regional and local offices.



3.17 To prepare the respective operational manuals by area and work post.

3.18 To establish procedures for internal and management control.

C. Collections

3.19 To renegotiate the tax payment agreements with banks, based on the draft prepared during the previous program, for the purpose of improving control over receipts and service by:

- a. checking deadlines for the submission of returns, their contents, and collections;
- b. stipulating the compensation to be paid to banks for their services;
- c. establishing penalties for failure to comply with the agreements.

3.20 To set up a system to control document receipt and reconciliation by banks: reconciliation of returns and receipts, including summaries, data review, control and correction of refunds made in error, and determination of sanctions for noncompliance.

3.21 To develop a system that will integrate accounting for all taxes, including customs duties.

3.22 To introduce the following tax collection support modules for all contributors:

- a. notification of taxpayers who have failed to file and/or to pay their taxes by the deadline; automatic transfer to the audit subsystem of the names of taxpayers who have failed to comply or have filed incorrectly;
- b. checking the calculations made by taxpayers in their returns in order to detect discrepancies at the time of submission or at a later date;
- c. control and reconciliation of current accounts.

3.23 To develop and introduce the module for tracking taxpayer assets recorded in databanks and for querying external databanks (financial agencies, property registers, business associations, etc.) when the tax information system indicates that assets are insufficient to cover the tax liability.

3.24 To develop and introduce a module for preparing and tracking tax installments and deferred payments.

- 3.25 To develop and introduce a module for monitoring taxpayers in arrears.
- 3.26 To define the collection enforcement procedure in accordance with the Tax Code.
- 3.27 To develop and introduce the module for enforcement, with the following functions applicable to all taxpayers:
  - a. selection and classification of overdue accounts by amount and the prospects for collection;
  - b. issuance of the final notice with automatic forwarding of the file to an investigator;
  - c. tracking of the enforcement procedure until the debt is collected or declared uncollectible and written off.
- 3.28 To define and establish procedures and systems for tracking tax litigation.

D. Auditing

- 3.29 To prepare auditing regulations to govern the exercise by civil servants of the powers established in the Tax Code and the obligations of taxpayers.
- 3.30 To develop and introduce the auditing subsystem for comprehensive monitoring of taxpayer compliance. This subsystem will include the following modules:
  - a. information outside the tax administration which can be used as support for auditing;
  - b. delinquent taxpayers notified by the collection units who have failed to respond;
  - c. checks of the calculations made by taxpayers in their returns, notification of adjustments, and demand for payment of any difference;
  - d. shadow returns based on information supplied by third parties, for comparison with the returns prepared by taxpayers, and notification of adjustments, reimbursement, or balance owing.
  - e. selection of taxpayers to be audited, preparation of the annual auditing plan, assignment of tasks to auditors, and monitoring;
  - f. studies to enable the planning and execution of efficient audits and to devise procedures that can be used as auditing guidelines.

- 3.31 To establish channels for the exchange of information relating to foreign trade to be included in the annual auditing plan.

E. Taxpayer service

- 3.32 To design, staff, and equip taxpayer service offices and support their establishment.
- 3.33 To design and implement taxpayer assistance programs to provide better information on tax obligations and improve voluntary compliance.
- 3.34 To develop a user-friendly module to assist small taxpayers in preparing their tax returns, particularly their income tax returns.
- 3.35 To establish programs to provide up to date information to the public on the organization and functions of each of the tax administration offices on the central and decentralized levels.
- 3.36 To inform the public of changes in tax rules.
- 3.37 To make information available on the services provided by the tax administration offices.

F. Training

- 3.38 To provide the training needed to continue to operate the systems and procedures developed in the first stage of the project.
- 3.39 To provide the training needed in the new systems and procedures developed and introduced.
- 3.40 To design and develop the training plan in the first year of the program and put it into effect in the second year.
- 3.41 To design and develop competitions for the selection of employees to be awarded study grants.

G. Publicity and dissemination

- 3.42 To design and introduce a stable policy for public communications.
- 3.43 To support campaigns to improve the image of the tax administration.
- 3.44 To publicize the activities and results of the tax administration.

**IV. COMPUTER EQUIPMENT**

- 4.1 The disappearance of the National Information Technology Center (CENI) which has provided support for the Directorates General of Taxation and Customs in recent years makes it necessary for the tax administration to obtain new equipment in addition to the equipment to be handed over by CENI.
- 4.2 The tax information system will be configured as follows: (a) a central computer in Tegucigalpa and terminals in the regional offices; (b) local PC networks at the offices in San Pedro Sula and La Ceiba, equipped with computers from CENI (WANG 3600-320 and WANG 486); and (c) local networks in the main customs offices. The equipment that will have to be procured is listed below:

COMPUTER EQUIPMENT FOR THE TAX ADMINISTRATION			
1. HARDWARE		2. SOFTWARE	
- UNIX central server with three processors, 768 RAM, 20 GB hard disk	148,000	- ADABAS	20,000
- 4 server terminals, 16 ports each	20,000	- Natural	55,000
- 40 Wyse 60 terminals	57,000	- Natural security	9,000
- One 1400 lpm printer	10,000	- Network	9,000
		- Operating system	52,000
<u>Total "hardware"</u>	<u>235,000</u>	<u>Total software</u>	<u>145,000</u>

V. DETAILED BUDGET

BUDGET CATEGORY	BANK CONTRIBUTION	GOVERNMENT CONTRIBUTION	TOTAL
1.1 Fees for the specialized agency			
a. International consultants			615,000
Expert in tax administration (24 months x US\$8,000)	192,000		
Expert in computer systems (24 months x US\$8,000)	192,000		
Expert in auditing (9 months x US\$10,000)	90,000		
Expert in collections (8 months x US\$10,000)	80,000		
Expert in tax legislation (3 months x US\$7,000)	21,000		
Adviser on Revenue Branch organization (1 x US\$8,000)	8,000		
Expert in tax information systems (8 15-day periods x US\$4,000)	32,000		
b. National consultants:			222,000
Expert in communications and databanks (4 months x US\$1,500)	6,000		
Computer experts (15 x 12 months x US\$600)	108,000		
(15 x 12 months x US\$600)		108,000	
c. Other:			184,000
Per diems for consultants (10 months x 30 x US\$100)	30,000		
Fares for consultants (16 x US\$1,500)	24,000		
Installation for consultants (2 x US\$20,000)	40,000		
Productivity incentive for staff computer experts (15 x 24 x US\$250)		90,000	
d. Overhead (14% of 1.1, 1.2, and 3)	215,000		215,000
1.2 Equipment (see section IV)	380,000		380,000
3.0 Training			150,000
3.1 In-service training			
a. Abroad:			
(5 x 15 days x US\$200)	15,000		
(5 fares x US\$1,500)	7,500		
b. On-the-job training (100 x 30 days x US\$25)	87,500		
(20 workshops x US\$2,000)	40,000		
6. General support			40,000
6.1 Premises and office space		15,000	
6.8 Communications and transport		25,000	
7. Publications			12,000
7.3 Printing	6,000		
7.4 Distribution	6,000		
8.1 Consultant on evaluation	20,000		20,000
98. Contingencies	150,000	12,000	162,000
<u>TOTAL</u>	<u>1,750,000</u>	<u>250,000</u>	<u>2,000,000</u>

## APPENDIX A

### PROPOSAL TO ENGAGE CIAT AS SPECIALIZED AGENCY

#### I. BACKGROUND

- 1.1 The Inter-American Center of Tax Administrators (CIAT) is a non-profit, public international agency that was founded in 1967. Its basic objective is to promote cooperation for improving tax administration in the countries of the Western Hemisphere. It currently has 27 regional and six nonregional members. Representatives are appointed by the Ministers of Finance of their respective countries and comprise the General Assembly, which is the Center's executive decision-making body.

#### II. JUSTIFICATION OF THE CONTRACT WITH CIAT

- 2.1 The Department of Finance and Public Credit hired CIAT as the technical director of programs ATN/SF-3204-HO and ATN/JF-4172-HO. The new authorities have informed the Bank of their wish to contract the agency. The project team supports the request on the basis of the very positive evaluation by the beneficiary and the Bank's Country Office in Honduras of CIAT's performance in the previous programs, and the advantages of maintaining the same technical criteria.

##### A. Technical advantages

- 2.2 CIAT is the only specialized institution in Latin America working in the field of tax administration and its technical expertise is acknowledged by its 27 regional member countries. It provides them with continuing support in the form of technical cooperation financed from bilateral and multilateral sources (IDB, World Bank, IMF). It receives technical support in its work from the United States (Internal Revenue Service), Germany (Agency for Technical Cooperation), France (Ministry of Finance), and Spain (Ministry of Economic Affairs).
- 2.3 Since CIAT seeks to improve tax administration in its regional member countries, its technical staff often has experience and qualifications that cannot be found on the same level in other entities or consulting firms. Based on its experience in national programs, and its involvement in modernization projects and new technologies being applied in industrialized countries (England, Australia, Spain, etc.), CIAT has designed models and methods and has prepared training manuals to operate the taxpayer master file

and current account system (RUC/CC). Its expertise is consistent with the technical levels required for the proposed operation.

- 2.4 Given its broad experience in implementing tax administration technologies in the region and in solving related problems, CIAT has developed a multidisciplinary approach and good ability to select the best specialized consultants in the different areas. It places this information at the disposal of the countries. It is adept at coordinating the work of consultants effectively and preparing consolidated specialized reports in cooperation with local experts.
- 2.5 Since 1983, CIAT has participated in Bank-financed projects to strengthen tax administrations in Central America, Panama, the Dominican Republic (ATN/SF-2231-RE), The Bahamas (ATN/SF-4124-BH), Barbados (OC/766-BA), Ecuador (ATN/SF-3361-EC), El Salvador (ATN/SF-3455-ES), Peru (ATN/SF-3777-PE), Suriname (ATN/SF-3548-SU), and Venezuela (VE-0070). The average score given to CIAT by the Bank's Country Offices has been "very good" as measured by the Bank's own evaluation system.

**B. Institutional advantages**

- 2.6 CIAT has extensive experience in coordinating technical-cooperation activities with government agencies in the region. In the case of Honduras, it has demonstrated its capacity to facilitate project execution (effective and efficient contracting mechanism, compliance with the clauses in technical-cooperation agreements, efficient administrative support system, disbursements of funds, progress reports). Past experience also shows that CIAT has followed the Bank's administrative procedures in previous operations (audits, exchange rate, procurement, etc.).
- 2.7 Another advantage offered by CIAT as compared to individual consultants and private agencies is that the latter lose contact with the beneficiary after their work has been completed, while CIAT maintains ongoing contact with tax administrations in the countries of the Hemisphere. This allows it to track formally and informally the activities in which it has participated.

PROPOSED RESOLUTION

HONDURAS. NONREIMBURSABLE TECHNICAL COOPERATION FOR  
THE MODERNIZATION OF TAX ADMINISTRATION

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such agreements as may be necessary and to adopt such measures as may be pertinent for the execution of the plan of operations referred to in Document AT-\_\_\_\_\_ with respect to nonreimbursable technical cooperation with the República de Honduras for the Modernization of Tax Administration.
2. That up to the sum of US\$1,750,000, or its equivalent, is authorized for the purposes of this resolution, chargeable to the net income of the Fund for Special Operations.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.