Commonwealth of Puerto Rico:
Tax Reform Project

Agreed Elements to Include in Target Operating Model (TOM) Design

October 31, 2014

Table of Contents

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1. Background

KPMG assessed the Puerto Rican tax structure to develop alternative scenarios for the Department of Treasury (Department) to evaluate how an improved tax administration will provide improved compliance rates and tax revenues through a more streamlined and effective system combined with a more effective oversight.

KPMG met with the Department to discuss the parameters to be considered during the execution of this engagement. The Hacienda stated the goals are to:

- Increase revenue to reduce or eliminate the deficit
- Increase Puerto Rico's economic competitiveness
- Have an equitable distribution of the tax burden
- Create a more efficient tax administration

The methodology used to assist the Department in achieving these goals required an understanding of how the Department currently operates and performs. The understanding of the current state allows us to recommend actionable and implementable improvement scenarios taking into consideration the Department's existing capabilities.

2. About this Report

Purpose of this Deliverable

The "Agreed Elements to Include in Target Operating Model (TOM) Design" presents a series of operational improvement initiatives that have been agreed upon by Internal Revenue Area (IRA). These initiatives are stated as hypotheses and will be used as the definition input of the design options to be included in the TOM.

Considering the goals of this project, the hypotheses were formulated to obtain the benefits stated in the "3-03 Current Operating Model Assessment" report:

- Operational focus on performance and primary outputs and deliverables
- Improved organizational structure, governance and capabilities in support of an organizational change that enables the administration to achieve their Tax Reform strategy, as well as to sustain increased levels of performance
- Focus on performance, business constraints and business priorities
- Improved, standardized and consistent business processes
- Clear link between Tax Reform goals and operational measurements across the Department
- A motivated organization with ambitious, yet realistic goals

Report Scope

The scope of this report is to identify operational improvements in the Internal Revenue Area that will support the achievement of creating a more efficient tax administration. Work product related to the legislative or taxation changes required to achieve Tax Reform's stated goals is not intended to be part of this report and will be presented in another workstream. This report presents a total of eight hypotheses that will be used as the basis for developing the TOM design element options as part of the Tax Reform initiative.

3. Approach

The Target Operating Model (TOM) methodology is used to achieve a change in the IRA operating performance and structure by:

- Analyzing and assessing the current operating model using external comparators (Comparable Jurisdictions) to identify opportunities for improving IRA's organization, processes and technology; and
- Designing a new operating model (TOM), to achieve and sustain the Secretary of the Treasury's vision and goals.

According to the Target Operating Model (TOM) methodology, this report completes the "Assess" phase and creates the input for initiating the "Design" phase.

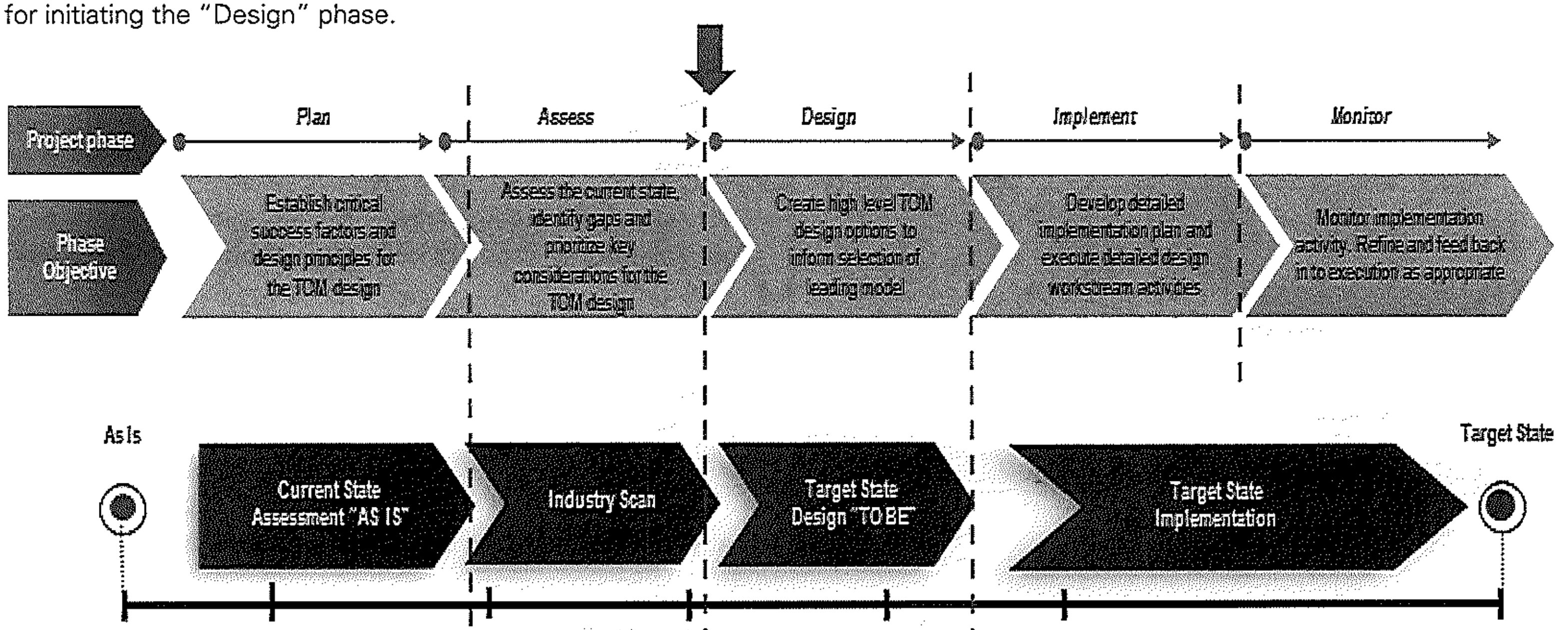


Figure 1: Target Operating Model Phases

Eight hypotheses have been designed and presented to the IRA, using supporting tools provided by the Fact Based Consulting Methodology, in order to gain consensus and agreement on opportunities that should be determined and developed to design the TOM end-state.

3. Approach (Continued)

The Fact Based Consulting methodology was used to define a set of hypotheses based on the issues, recommendations and benefits identified in the assessment of the IRA's current operating model components (Deliverable 3-03). The hypotheses were presented by a working group of senior managers and consultants, and validated and agreed by the IRA.

The Hypothesis Detail template, shown at the right, contains the following sub-sections:

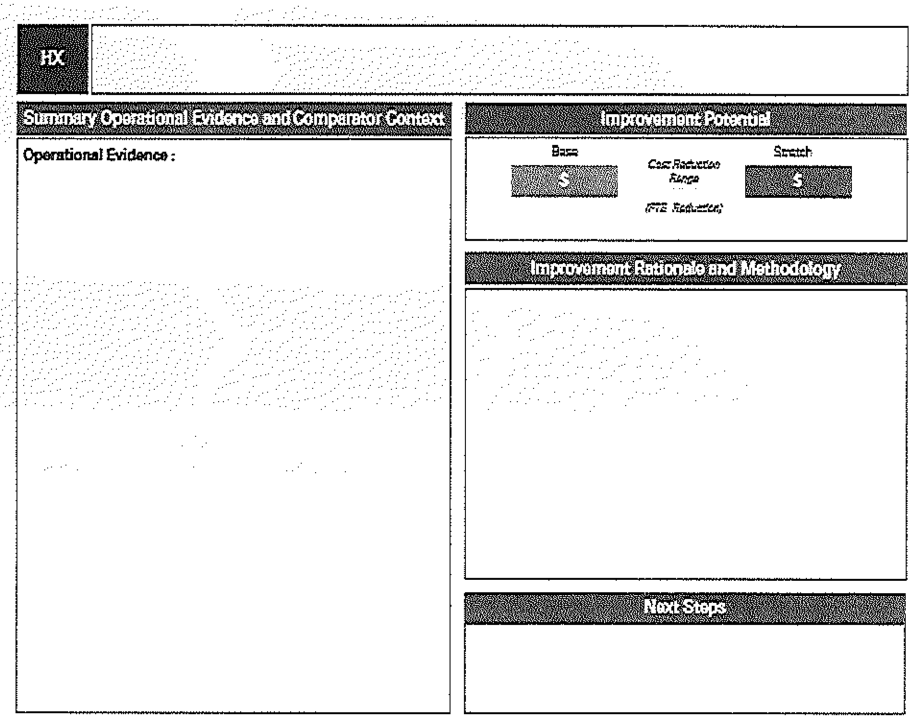
- **Hypothesis:** is a statement describing a change in the current operations that may create a benefit or improvement. It does not describe a solution but explains what can be done to make an improvement or correct an issue.

- **Summary Operational Evidence:** provides an overview of the key evidence and rationale supporting the hypothesis.

- **Improvement Potential:** describes the improvements quantitatively by establishing base and stretch targets (e.g. savings, additional revenues, lower administrative costs, better service, etc.) in order to quantify the gaps between the organization and other jurisdictions or commonly accepted practices.

- **Improvement Rationale and Methodology:** provides an explanation of decisions/actions required from the Department of the Treasury and the way the improvement will be achieved.

- **Next Steps:** suggests further activities in order to transform the hypothesis into an improvement opportunity.



Hypothesis Detail Template

4. Designed and Agreed Hypotheses

DRIVERS		HYPOTHESIS	IMPROVEMENTS & BENEFITS
• High volume of tax returns are filed on paper forms. • High volume of tax returns are processed manually	H1.1	A reduction of taxpayer roll may reduce operational workload and increase efficiency	• Lower processing costs • Mandatory electronic tax return submission above an income threshold • Increase automation in paper-based returns processing (OCR, Analytics)
• Mandatory electronic tax return submission • Incorporation of pre-filled tax returns	H1.2	Increase e-filing and use of pre-filled forms may reduce costs and improve operational efficiency	• Adoption of pre-filled personal tax returns (for employed individuals with employer W2 filings) • Improve automation of employer reporting and taxpayer account data quality through an integrated and modern tax administration solution
• Large network of IRA collection centers are expensive to operate	H2:	Implementing alternative payment channels may reduce operational costs within the Internal Revenue Area	• Alternative payment channel options for improved taxpayer convenience • Reduction in the number of Collection Centers
• High level of tax evasion • Low collections • High CIT evasion • High volume of corporate exemptions	H3:	Improving the compliance rate for regular corporations by optimizing enforcement may increase the total corporate tax revenue	• Automated tax enforcement processes (increased use of data analytics) and performance improvement mechanisms (Case Management, Rules-based processing) • Publication of tax corruption and fraud cases, as well as audit plans, to encourage taxpayer compliance behavior. • Improve fiscal audit of entities who are eligible for exemptions and amnesties
• High dependency on face-to face services	H4:	Improving taxpayer assistance service options may reduce cost of face-to-face services	• Implement self-help channels and automated processes • Improved Case Management capability
• The Internal Revenue Area has a hybrid tax organization (tax type based and function based)	H5:	Reorganizing the Internal Revenue Area structure may reduce operational costs	• Implementing a full function-oriented organizational and operational structure by grouping all bureaus by services • Reduction of personnel, optimization of processes and functions, in order to increase operational efficiency and customer experience
• High operational dependency on the Department of the Treasury and bureaucracy	H6:	Creating a (semi) autonomous Internal Revenue Agency, may improve operational efficiency, stabilize and professionalize the IRA staff, ensure better resource management and increase revenue to be collected	• Minimize evasion through better, more accountable enforcement • Increase efficiency by establishing performance targets and rewarding achievements • Ability to create own rulings to enforce the standardization of penalties and prosecutions
• Increase Consumption Tax compliance • High Consumption Tax evasion	H7:	Improving the consumption tax audit and enforcement on the largest merchants (by economic activity) may increase consumption tax revenue	• Automated tax enforcement processes (increased use of data analytics) and performance improvement mechanisms (Case Management, Rules-based processing) • Publication of tax corruption and fraud cases, as well as audit plans, to encourage taxpayer compliance behavior

4. Designed and Agreed Hypotheses

	HYPOTHESIS	REVENUE INCREASE BASE	REVENUE INCREASE STRETCH	COST REDUCTION BASE	COST REDUCTION STRETCH
H1.1	Reducing taxpayer roll may improve operational efficiency of the Treasury Department of Puerto Rico			$6.8 M	$9.6 M
H1.2	Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency			$3.5 M	$4.9 M
H2:	Implementing alternative payment options may reduce operational costs within the Internal Revenue Area			$5.8 M	$9.1 M
H3:	Improving the compliance rate for regular corporations, optimizing enforcement, may increase the total corporate tax revenue	$77 M	$126 M		
H4:	Improving taxpayer assistance service options may reduce cost of face-to-face services			$1 M	$342 K
H5:	Reorganizing the Internal Revenue Area organizational structure may reduce operational costs			$2.4 M	$8.4 M
H6:	Creating a (semi) autonomous Internal Revenue Area, separate from the Department, may improve operational efficiency, stabilize and professionalize the IRA staff, ensure better resource management and increase revenue to be collected	$342 M	$683 M		
H7:	Improving the consumption tax audit and enforcement on the largest merchants (by economic activity) may increase consumption tax revenue	$241.5 M	$302 M		

TOTAL REVENUE INCREASE BASE	TOTAL REVENUE INCREASE STRETCH
$660.5 M	$1,111 M

TOTAL COST REDUCTION BASE	TOTAL COST REDUCTION STRETCH
$19.5 M	$32 M

H1.1 Reducing taxpayer roll may improve operational efficiency of the Treasury Department of Puerto Rico.

- Lower processing costs
- Less paper handling

Summary Operational Evidence and Comparator Context

Operational Evidence :

- Tax return forms filed manually require a number of processing steps and reviews that are currently performed in the Submission area.
- Fiscal year 2012 statistics:
  - 44% (556,945 out of 1,265,784) individual tax returns were filed electronically
  - 100% of corporate income tax returns are processed manually (paper-based)
  - 0.3% of individual tax returns were filed by taxpayers with gross income net above $5,000. The Internal Revenue Code states: "Every individual resident of Puerto Rico who is an individual or married taxpayer if his gross income for the taxable year, reduced by exemptions provided in §1031.02, exceeds five thousand (5,000) dollars" shall file a tax return
- Fiscal year 2013 statistics (until July 2014)
  - 91% of tax revenue from individuals came from paper-based tax filings
  - 52% (635,555 out of 1,222,222) individual tax returns were filed electronically, representing 9.13% of revenue collected
  - 13.52% of individual paper-based tax returns included payments
  - Total net collections for individual tax was -$88 M ($267 M revenue v. $355 M refunds)
  - As of July 2, 90% of individual tax returns filed electronically had been refunded while 73% of individual tax returns filed manually had been refunded
  - 100% of corporate income tax returns are processed manually (paper-based)

Improvement Potential

Base	Cost Reduction Range (FTE Reduction)	Stretch
$6.8 M		$9.6 M

Improvement Rationale and Methodology

- Cost reduction is calculated from an estimated impact on the FTE base in the applicable IRA bureaus as follows:
  - Processing Bureau: 100% (330 FTE)
  - Taxpayer Services: 20% (48 FTE)
  - Collections: 15% (254 FTE)
  - NACCE: 10% (6 FTE)

Actual:
- 638 FTE (not including Corporate Returns Processing) – fully loaded salary cost of $13,862,000

Base (50% of reduction in tax returns filing)
- Reduction to 319 FTE = $6.8 M in savings

Stretch (70% of reduction in tax returns filing)
- Reduction to 191 FTE = $9.6 M in savings

Next Steps

- Determine the overall tax revenue impact based on the reduction of individual taxpayer base through the economic model
- Evaluate the cost per FTE to confirm the potential savings

H1.2

Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency.
- Mandatory electronic tax return submission
- Incorporation of pre-filled tax returns

Summary Operational Evidence and Comparator Context

Operational Evidence :

- Manually filed tax return forms require multiple processing steps and additional reviews during the Submission process, which precedes the Processing Bureau (approximately 350 FTE which represents an annual cost of $7.7 M)
- Fiscal year 2012 statistics:
  - 44% (out of 1,265,784) individual tax returns were filed electronically
  - 100% of corporate income tax returns were processed manually (paper-based)
  - Personal Income Tax Revenue from June 2012 to July 2013 was $2.2 B
- Fiscal year 2013 statistics (until July 2014)
  - 91% of tax revenue from individuals came from paper-based tax filings
  - 52% (635,555 out of 1,222,222) individual tax returns were filed electronically, representing 9.13% of revenue collected
  - 13.52% of individual paper-based tax returns included payments
  - As of July 2, 90% of individual tax returns filed electronically had been refunded, while 73% of individual tax returns filed manually had been refunded
  - 100% of corporate income tax returns are processed manually (paper-based)

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Improvement Potential

Base		Stretch
$3.5 M	*Savings*	$4.9 M

Improvement Rationale and Methodology

Cost savings are estimated as follows (assuming no decrease in taxpayer roll):

Area	FTEs	e-filing and pre-filling Impact	FTEs Affected	Cost
Submission (Preliminary Review, Numbering)	56	100%	56	$1,232,000
Data Entry	152	90%	137	$3,009,600
Processing (Data Perfertion, Amendment, Repairs)	122	50%	61	$1,342,000
Corporate	20	50%	10	$220,000
			TOTAL	$5,803,600

Cost per paper return:

Number of paper returns	739,434
Estimated cost per paper filed return	$7.85

Savings due to Increased e-filing and pre-filling

Increase %	Savings
60%	$3,482,160
85%	$4,933,060

H1.2

Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency.

- Mandatory electronic tax return submission
- Incorporation of pre-filled tax returns

Summary Operational Evidence and Comparator Context (continued)

Comparator Evidence :

- Finland utilizes the internet for electronic tax administration to help lower government costs, provide useful services to taxpayers, and encourage private sector growth. Finland created a web-based system for taxpayers to use to adjust their income tax withholding services, which has helped reduce tax administrator staffing by 11% over 6 years. By making government services more efficient, Finland can free up more of its labor force for private sector employment.[***]
- German officials reported that the Act on the Reduction in Tax-Related Bureaucracy 24, adopted by the Federal Cabinet in July 2008, continues the strategy of modernizing tax procedures. The Act includes provisions for the expansion of electronic communication between companies and tax authorities, for example, by paperless transmission of tax declaration data and supplementary documents concerning corporate taxes. [****]
- In Slovenia, persons liable for personal income tax receive what are known as "informative calculations." The recipient is responsible for checking these calculations for accuracy. If the taxpayer agrees, they are not obligated to confirm the amount and the calculation becomes an enforceable personal income tax decision after 15 days. [****]
- USA: Significant processing cost savings could be achieved as a result of a paid preparer mandate. A Federal mandate requiring paid preparers to e-file would provide significant processing cost savings to the IRS and would accelerate the time it will take for the IRS to meet its 80% e-filing goal. In addition, this would significantly reduce the volume of tax returns with keypunch errors that require correction. [**]
- Canada: Individuals and Corporations can file their tax returns on the Internet, which results in immediate confirmation, faster processing, and faster refunds. (Taxpayer Assistance in Canada) (*)
- Mexican officials reported that its online e-filing capability for the personal income taxes has significantly reduced the use of paper returns, reduced demand at walk-in sites, and reduced the time for providing refunds to taxpayers by 50% (from around 40 to 20 days). It is estimated that taxpayers who filed their 2007 return in 2008 had savings of 90 million pesos and those who qualified for refunds had derived additional savings/benefits equivalent to 800 million pesos (around $US 55 M) [****] Considerable progress was achieved in 2008/09, the rate of e-filing usage for personal self assessed tax returns reached 69%, a 50% increase on the prior year. [****]
- France reported that less than 25% of VAT registered taxpayers use e-filing. To reduce burden, it has introduced mandatory e-filing for businesses with annual sales over €760,000. [****]
- Singapore's use of pre-filling eliminated tax returns for 30% of taxpayers in 2009. (*)
- Australia enables pre-filling via its e-filing system, which was used by 70% of taxpayers in 2008/09. [****]
- New Zealand has replaced traditional tax returns for 50-60% of its citizens using a pre-filling-type capability. [****]
- Belgium has established a web-based, pre-filled personal tax return capability that has been estimated to produce annual reductions in administrative burden of almost €150 million. [****]

H1.2

Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency.

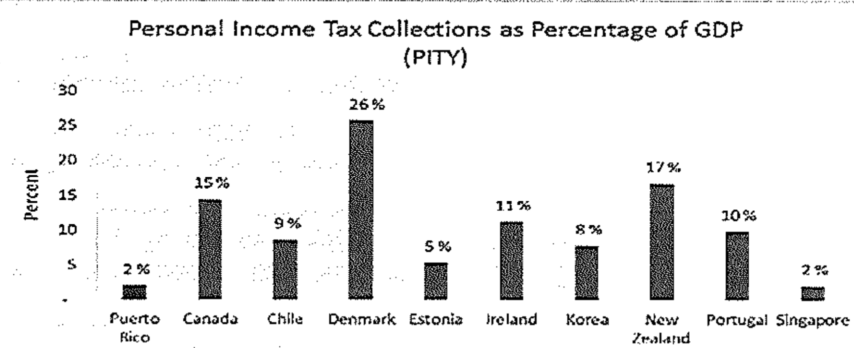
- Mandatory electronic tax return submission
- Incorporation of pre-filled tax returns

Summary Operational Evidence and Comparator Context (continued)

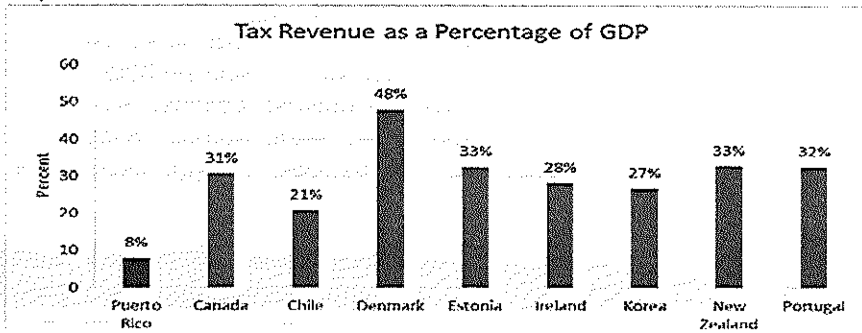
Comparator Evidence (continued)

- The Netherlands provides a pre-filling capability via the Internet, used by 24% of taxpayers in its first year of operation. [****]
- Chile has extended the use of pre-filling to certain business income-related information for returns of business and self-employed persons. [****]
- Estonia, France, Hong Kong, Iceland, Italy, Lithuania, and Portugal display substantial use of pre-filling to partially complete tax returns. [*]
- France, Slovenia and South Africa provide pre-filled tax returns for over 90% of taxpayers. Spain and Mexico also reported extensive use of pre-filling for personal tax returns. [****]
- Currently, 24 U.S. states are using scanning technology, including scanbands and barcodes, to improve the efficiency of tax return processing. The barcode technology captures all of the data on a State individual income tax return in most of the States. [**]
- California State tax return preparers use tax preparation software that creates a scannable section on the face of the return called a "Scanband." The Scanband includes all the tax return information that is needed to process the return, such as name, address, income, and refund amount. The remaining pages of the return contain the same data that were included in the Scanband. [**]

- The chart bellow shows the level of personal income tax collections as percent of GDP.



- The chart below shows tax revenue as a percentage of GDP for the year 2012.



H1.2 **Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency.**

- Mandatory electronic tax return submission
- Incorporation of pre-filled tax returns

Summary Operational Evidence and Comparator Context (continued)

Operational Evidence :

- The UK's HMRC has been very active in the e-filing area. It reported a concentrated effort of increasing online filing and expanding payment options with an eye towards reducing the burden of providing information to HMRC and increasing timeliness, accuracy and confidence levels. [****]
- The cost of processing a single paper-filed tax return is $2.87, compared to $0.35 for an e-filed return according to a report from the Inspector General for US Treasury Department titled: "Repeated Efforts to Modernize Paper Tax, as of September 2010." [**]

Figure #1 Maturity Model of pre-filling capabilities *

LEVEL OF PREFILLING		Capability Description	LEVEL OF PREFILLING
BASIC (LIMITED)	1	A paper form pre-filled with limited taxpayer identity &/or history information	MINOR
	2	An electronic form pre-filled with limited taxpayer identity &/or history information	
	3	A paper form pre-filled with taxpayer identity &/or history information & limited income/deduction & credits information	
	4	An electronic form pre-filled with taxpayer identity &/or history information & limited/ deduction/ credits information	
	5	A paper form pre-filled with taxpayer identity &/or history information & most/all income/deduction & credits information	
	6	An electronic form pre-filled with taxpayer identity &/or history information & most/all income/deduction/credits information	
ADVANCED (COMPLETE)	7	Full automation (enabling elimination of original process)	MAJOR

[*] Source: OECD: Tax Administration 2013 - Comparative Information on OECD and Other Advanced and Emerging Economies

[**] Source: *"Repeated Efforts to Modernize Paper Tax Return Processing Have Been Unsuccessful; However, Actions Can Be Taken to Increase Electronic Filing and Reduce Processing Costs.,"* September 10, 2009. Reference number: 2009-40-130

[***] *Best Practices In Tax Administration: A Look Across The Globe: Hearing Before The Committee On Finance United States Senate, April 12, 2011*

[****] *Forum On Tax Administration: Taxpayer Services Sub-group; Information Note Programs To Reduce The Administrative Burden Of Tax Regulations; March 2010*

H1.2

Increasing e-filing and using pre-filled returns may reduce costs and improve operational efficiency.
- Mandatory electronic tax return submission
- Incorporation of pre-filled tax returns

Next Steps

- May require creating incentives for e-filing and will require investment in improving e-filing capability to increase the percentage of e-filed returns
- Will require revamping the e-filing processing for full automation and inclusion of corporate return e-filing. Other opportunities may exist in improving the remaining paper-based returns processing
- Pre-filled individual tax returns using employer submitted W2 data will facilitate individual e-filing and reduce internal processing costs
- Additional savings could be identified by further reviewing internal Post Office (mailroom) processes where some preliminary handling of the paper returns is performed v. the process done in the Preliminary Review section
- Improvement (savings) range is calculated using other jurisdiction's experience. The potential savings can be realized mainly in reducing the number of temporary staff in the Processing Bureau.
- Determine which level of pre-filing the Department of the Treasury wants to achieve according to the "Maturity Model of pre-filling"
- Establishing key indicators to calculate the estimated time of tax return processing

H2

Optimizing the network of Collection Centers may reduce operational costs.

- Alternative payment channel options
- Lower collection costs
- Collection Centers merge/reduction

Summary Operational Evidence and Comparator Context

Operational Evidence

- IRA has a large network of Collection Centers (89) across the island. These Collection Centers collected approximately $2.9 B during 2013.
- During 2013, IRA collected $2.7 B of revenue through e-Payments.
- Collection Center rent payments represent an annual cost of approximately $9.5 M.
- Collection Centers are supported by 490 FTE´s, 192 of which are contracted personnel.
- Kelly contracted personnel within Collection Centers costs the Department approximately $2.1 M/year.
- CTS contracted personnel within Collection Centers costs the Department approximately $1.8 M/year.
- Currently, 36 of the 89 Collection Centers are being analyzed to determine if they can be closed or merged with other Collection Centers. These 36 Collection Centers collected approximately $231 M during 2013, with operational costs of approximately $2 M.
- Activities within these 36 Collection Centers are being supported by 171 employees, 52 of which are contracted personnel, representing approximately $924 K/year in salaries.
- Secure transport of valuables (cash, checks) currently costs about $30 K/year.

Improvement Potential

Base	*Cost Reduction Range*	Stretch
$5.8 M	⟷ *(Collections Centers Reduction)*	$9.1 M

Improvement Rationale and Methodology

- Savings rationale: Optimizing the network of Collection Centers will be achieved by reducing the number of Collection Centers and utilizing alternative payment channels. Typically on-site and in-person payments channel are considered to be more expensive than alternatives means of payment.
- Savings mechanisms: Target the contracted employees as the FTE savings target and closing the expensive Collections Centers in urban areas.
- Taking into consideration staff and operational cost, the total cost of the 89 Collection Centers is approximately $21 M.
- **Base**: By closing 40% of Collection Centers (36) and considering a potential increase of 20% in total cost of the remaining Collection Centers, the annual savings could reach $5.8 M.
- **Stretch**: By closing 60% of Collection Centers (53) and considering a potential increase of 40% in total cost of the remaining Collection Centers, the annual savings could reach $9.1 M.

H2 **Optimizing the network of Collection Centers may reduce operational costs**

- Alternative payment channel options
- Lower collection costs
- Collection Centers merge/reduction

Summary Operational Evidence and Comparator Context (continued)

Comparator Context

- European revenue bodies such as Greece and Portugal are taking steps to scale down the size of their office networks to reduce operational costs. [*]
- 12 revenue bodies reported that the majority of payments were made by fully electronic methods, including six where the aggregate proportion exceeded 75% (Chile, Estonia, France, Ireland, Netherlands and Sweden). [*]
- Some countries consider alternative payment methods, e.g. Chile and Mexico use credit cards. France: between 66% (individuals) and 84% (corporate) of all payments are "fully electronic." Japan uses ATMs for making payments. Hungary uses bank card and POS terminal. [*]
- The negotiated fee charged by banks to process tax payments typically ranges from 0.75% to 2.5% of the amount of the tax payment. [*]
- In Greece, processing of all tax payments in local offices is being discontinued and replaced by mandatory bank transfers and payments at banks. [*]

[*] Source: OECD: Tax Administration 2013 - Comparative Information on OECD and Other Advanced and Emerging Economies

[**] Collections Channels: a) Field Force; b) Office-Based (Mail); c) Call Center

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Next Steps

- This cost reduction needs to be accompanied by an increase of the other payment channels that are less expensive, like electronic payments or the use of banking institutions
- Determine the Government's willingness to use other banking institutions and to outsource collections function
- Before reducing staff, there must be a knowledge transfer process

H2

Optimizing the network of Collection Centers may reduce operational costs.
- Alternative payment channel options
- Lower collection costs
- Collection Centers merge/reduction

Summary Operational Evidence and Comparator Context (continued)

Comparator Context

Country	Payment methods available (✓ denotes availability, figures in brackets denote usage where known as a % of total payments)							
	Mailed cheque	In person payments		Phone banking	Internet banking	Direct debit payment	Payment kiosk	Other
		At agency	At revenue body					
1) OECD countries								
Australia	✓ (13)	✓ (30)	×	✓ (4)	✓ (50)	✓ (3)	×	
Austria/1	✓ (<1)	✓ (2)	✓	×	✓ (50)	×	×	✓/1 (47)
Belgium	×	✓	×	✓	✓	×	✓	
Canada/1	✓ (19)	✓ (39)	✓ (<1)	✓ (n.avail.)	✓ (42)	✓ (<1)	×	✓/1 (2)
Chile/1	×	✓	×	×	✓	✓	×	✓/1
Czech Rep.	×	✓	✓	✓	✓	✓	×	
Denmark	×	✓	✓	×	✓	✓	×	
Estonia	×	✓	✓	×	✓ (98)	×	×	
Finland	×	✓	×	✓	✓	✓	✓	
France	✓	×	✓	✓	✓	✓	✓	
Germany	✓	✓	×	✓	✓	✓	×	
Greece	✓	✓	✓	×	✓	×	×	
Hungary/1	×	✓	✓/1*	✓	✓	×	×	✓/1**
Iceland	✓	✓	✓	✓	✓	✓	×	
Ireland	✓	✓	✓	×	✓	✓	×	
Israel	✓ (88)	✓ (2)	✓ (5)	×	✓ (5)	✓ (<1)	×	
Italy	×	✓ (29)	×	×	✓ (42)	✓ (29)	×	
Japan/1	×	✓ (75)	✓ (5)	×	✓ (1)	✓ (17)	✓/1 (1)	✓/1 (2)

[*] Source: OECD: Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)

H2

Optimizing the network of Collection Centers may reduce operational costs.
- Alternative payment channel options
- Lower collection costs
- Collection Centers merge/reduction

Summary Operational Evidence and Comparator Context (continued)

Comparator Context

Country	Payment methods available (✓ denotes availability, figures in brackets denote usage where known as a % of total payments)							
	Mailed cheque	In person payments: At agency	In person payments: At revenue body	Phone banking	Internet banking	Direct debit payment	Payment kiosk	Other
1) OECD countries								
Korea	×	✓ (70)	✓ (2)	✓ (1)	✓ (24)	×	✓ (3)	
Luxembourg/1	✓	✓	×/1*	×	✓	×/1**	×	
Mexico	×	✓ (52)	×	×	×	✓ (48)	×	×
Netherlands/1	×	✓ (<1)	×	×	✓ (30)	✓ (19)		✓/1 (50)
N.Zealand/1	✓ (43)	✓ (6)	×	✓	✓/1 (51)	✓	×	×
Norway	✓	✓	✓	✓	✓	✓	×	
Poland	×	✓	✓	✓	✓	×	✓	
Portugal/1	×	✓ (38)	✓ (42)	×	✓ (<1)	×	×	✓/1 (20)
Slovak Rep./1	×	×	×	×	✓	✓/1 (85)	×	✓ (15)
Slovenia	✓	✓ (60)	×	✓	✓ (40)	✓	×	
Spain/1	×	✓	×	✓	✓	✓	×	✓/1
Sweden	×	✓	×	✓	✓	✓	×	
Switzerland	×	✓	✓	✓	✓	✓	×	
Turkey	✓	✓	✓	✓	✓	✓	×	
UK/1	✓ (30)	✓ (28)	✓	✓	✓	✓ (41)	×	✓/1 (1)
USA/1	✓ (40)	✓ (13)	✓ (<1)	✓ (3)	✓ (16)	✓ (8)	×	✓/1 (20)

[*] Source: OECD: Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)

H2 **Optimizing the network of Collection Centers may reduce operational costs.**
- Alternative payment channel options
- Lower collection costs
- Collection Centers merge/reduction

Summary Operational Evidence and Comparator Context (continued)

Comparator Context

Country	Payment methods available (✓ denotes availability, figures in brackets denote usage where known as a % of total payments)							
	Mailed cheque	In person payments: At agency	In person payments: At revenue body	Phone banking	Internet banking	Direct debit payment	Payment kiosk	Other
2) Selected non-OECD countries								
Argentina	×	✓ (85)	X	✓	✓ (5)	✓ (10)	×	✓ (<1)
Bulgaria/1	×	✓	×	×	✓	✓	×	✓/1
China	n.avail.	n.avail.	n.avail.	n.avail.	n.avail.	n.avail.	n.avail.	n.avail.
Cyprus/1	✓	✓/1	✓	×	×	×	×	
India	×	✓ (30)	×	×	✓ (70)	×	×	
Indonesia	×	✓	×	×	✓	×	×	
Latvia	×	✓	×	×	✓	×	×	
Lithuania	×	✓	✓	×	✓	×	×	
Malaysia	✓ (52)	✓ (45)	✓ (<1)	✓ (<1)	✓ (3)	✓ (<1)	-	✓/1 (<1)
Malta/1	✓/1 (68)	✓ (26)	✓ (5)	×	✓ 1	×	×	
Romania	×	✓	✓	×	✓	✓	×	
Russia	×	✓	×	×	×	✓	×	
S.Arabia	×	✓ (97)	✓ (3)	×	×	×	×	
Singapore	✓ (19)	✓ (12)	×	✓ (4)		✓ (46)	✓ (14)	
S.Africa	✓	✓	✓	×	✓	✓	×	

[*] Source: OECD: Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)

H3

Improving the compliance rate for regular corporations by optimizing enforcement may increase total corporate tax revenues.
- Implementing automated tax enforcement processes and performance improvement mechanisms
- Publicizing tax corruption and fraud cases as well as audit plans to encourage taxpayer compliance behavior
- Complying with the Tax Code alternatives to enforce compliance, such as penalties or punishments

Summary Operational Evidence and Comparator Context

Operational Evidence:

- The significant number of current vacancies in the Fiscal Audits and Consumption Tax bureaus impacts the enforcement capabilities of the IRA.
- The Internal Revenue Code, 2011, §6041.11, specifies penalties for failing to file informative forms, tax return forms and reconciliation reports on time. Those penalties are not being applied and collected because the system (PRITAS) has not been programmed to enforce compliance.
- Unclear responsibilities for audits and inspections for Consumption Tax compliance.
- Audit templates are not standardized across municipalities. As a result, key audit points may be overlooked in some municipalities.
- Penalty/Debt forgiveness is not administered consistently in field offices.
- Currently, tax auditor efforts are focused on audits of 2009, since the 2009 cases face statute of limitations expiration.
- The current practice of keeping the audit plans internal to IRA do not directly influence taxpayer's compliance behavior.
- Low compliance of corporate and individual taxpayers.

Improvement Potential

Base		Stretch
$77 M	*Increase Revenue*	$126 M

Improvement Rationale and Methodology

- In 2012/2013 total revenue from regular corporations: $909.5 M paid by 43,000 corporations resulting in an average of $21 K
- Total number of registered business head offices in Puerto Rico: 113,033
- Total number of exempt regular corporations: 1,200
- Currently the number of regular corporations that are submitting their tax returns is approximately 43,000, which is equivalent to a 38% compliance rate and an average tax revenue of $21 K.

Base:
Improving the compliance rate by 10% to an equivalent of 42% (an additional 7,000 corporations) using an average tax revenue per corporation of $11,000 equals $77 M in additional revenue.

Stretch:
Improving the compliance rate by 30% to an equivalent of 68% (an additional 21,000 corporations) using an average tax revenue per corporation of $6,000 equals $126 M in additional revenue.

H3

Improving the compliance rate for regular corporations by optimizing enforcement may increase total corporate tax revenues.
- Implementing automated tax enforcement processes and performance improvement mechanisms
- Publicizing tax corruption and fraud cases as well as audit plans to encourage taxpayer compliance behavior
- Complying with the Tax Code alternatives to enforce compliance, such as penalties or punishments

Summary Operational Evidence and Comparator Context (continued)

Comparator Evidence :

- Since 2003, the Australian Commissioner of Taxation has published his entire program of compliance activities. This program has been well received by both the community and the media and serves to raise community awareness of taxation compliance. [*]

- The Swedish Tax Agency arranges a press conference every year to outline planned compliance activities (together with results from the previous year). This act garners significant media attention. [*]

- According to the Handbook for Tax Simplification, publicizing corrupt practices of Tax Administration officials and businesses can significantly deter corrupt behavior. The potential shame and humiliation of unethical behavior can play a role in deterring officials. Also, many businesses seek to promote their image as responsible corporate citizens to win favor with the public. Publicizing corrupt practices can be a significant deterrent to businesses. [**]

- Strategies that may help to enhance the legitimacy of a tax authority's power to enforce compliance include encouraging media reports of successful prosecutions or publishing information that provides taxpayers with early warnings of behavior that may be regarded by the authority as non-compliant. This kind of "alert" may, for example, provide reports of court or tribunal decisions or interpretive rulings by the authority on matters of law or administrative practice. [*]

- According to Ayres and Braithwaite, the threat of severe punishment is most effective when it is used in conjunction with a hierarchy of lesser sanctions. That is, regulators will be able to speak softly when carrying big sticks (and crucially a hierarchy of lesser sanctions). Paradoxically, the bigger and more variety of sticks, the greater the success regulators will achieve by speaking softly. Sanctions are important, not so much as a deterrent, but as a mechanism to convince people that others are complying.[*]

- El Salvador implemented an automatic recorded call system for non-compliers notifying the delay of the submission of the Tax Filing Form. This new approach brought 2,685 stop-filers into compliance in the first half of 2009, compared to 917 who had responded to mailed reminder notices in the first half of 2008. The call center was able to deliver 34,721 robo-calls in 2009 as opposed to 3,495 letter notices in 2008 and the corresponding tax collections from stop-filers rose from $1.57 M to $3.12 M.

- The Australian Taxation Office performs data matching and analytics projects to examine a wide range of compliance risks and to validate the income reported by taxpayers.

[*] Source: OECD Compliance Risk Management: Managing and Improving Tax Compliance, 2002
[**] Source: World Bank Group: A Handbook for Tax Simplification, 2009
Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean, USAID, Aug. 2013)
[***] IRS compliance and enforcement trends; Journal of Accountancy

H3

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Summary Operational Evidence and Comparator Context (continued)

Comparator Evidence :

- The Australian Taxation Office (ATO) recently used a similar approach that employs taxpayer communication via letters and an online magazine ("Targeting tax crime – a whole of government approach – July 09"), talking to tax agents about compliance trends, and benchmarking industries to set guides. The taxpayer letters and conversations with tax agents were particularly successful. Taxpayer letters were sent to 40,000 taxpayers within the micro and individual segment. The letters indicated that the ATO was focusing on the taxpayers. As a result of this campaign, $235 M revenue was collected. [***]

- The IRS (US) hopes to raise voluntary compliance rate to 90% by 2017, which would reduce the current $450 B tax gap by about 40% to $266 B. *Every one percentage point increase in compliance generates at least $27 B*, and the most recent compliance rate is 83.1%, so the 2017 target, if met, would increase revenue by $186 B. [***]

- US: Increase tax document matching and mail audits. Computer matching of documents, such as Forms 1099 and W-2, results in a 99% compliance rate in reporting those amounts. However, for certain small businesses, the compliance rate is only 44% because their income generally is not subject to such matching. In 2011, 70% of compliance audits were conducted via mail, and 30% were field audits. In 1995, the ratio was 54% mail audits to 46% field audits. Based on ROI, the trend towards more automated compliance activity will very likely continue. [***]

- Increase compliance rate to 90% by 2017. The voluntary compliance rate is the amount taxpayers actually pay versus what they should report and pay. The most recent IRS study of compliance rates, completed in January 2012, reported 83.1% voluntary compliance on 2006 returns, which falls within the 83% to 84% range that has prevailed for the past 27 years. [***]

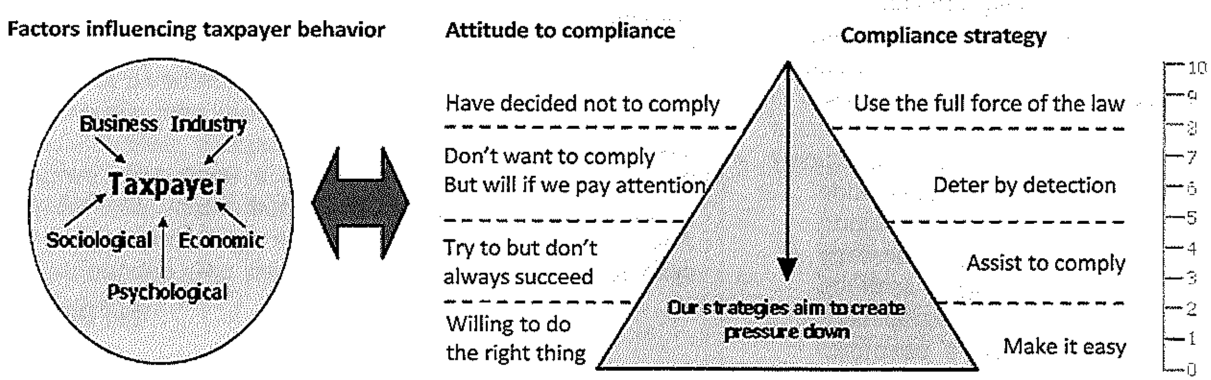
- Officials from one of IRS's enforcement programs (Automated Under Reporter) estimated that having all tax return information available electronically would increase tax revenue annually by $175 M. [***]

H3

Improving the compliance rate for regular corporations by optimizing enforcement may increase total corporate tax revenues.

- Implementing automated tax enforcement processes and performance improvement mechanisms
- Publicizing tax corruption and fraud cases as well as audit plans to encourage taxpayer compliance behavior
- Complying with the Tax Code alternatives to enforce compliance, such as penalties or punishments

OECD Spectrum of Compliance Behavior



Taxpayers move up and down the continuum of the compliance pyramid for a variety of reasons. These reasons (drivers) are what revenue authorities attempt to identify through the risk assessment process. Experience has taught us that overall, it is a more cost effective proposition to achieve compliance by increasing the numbers of taxpayers at the lower levels of the pyramid. Thus, the challenge for authorities is to employ strategies that progressively move taxpayers down the continuum to the lower levels.

Source: OECD Compliance Risk Management: Managing and Improving Tax Compliance, 2002

Next Steps

- Review tax enforcement process in order to determine possibilities for technology-based improvement
- Develop standard procedures, employee manuals
- Examine the legal ramifications of publishing criminal cases and Audit Plan

H4

Improving taxpayer assistance service options may reduce cost of face-to-face services.

- Improve Case Management

Summary Operational Evidence and Comparator Context

- There is an increased volume of consultations/requests for debt certifications and other services within Taxpayer Services Centers due to inaccurate information in operational systems.
- Some taxpayer assistance services are offered through the worldwide web, which does not provide sufficient information and still requires significant face-to-face support.
- Client requests and inquiries are not recorded, so there is no information on the nature of the request and its resolution.
- Currently, there are 7 taxpayer service centers, managing an average of 4,200 cases/month per service center, requiring an average of 30 minutes per service.

Comparator Context [*]:

- Turkey recently introduced two call centers to handle taxpayer calls from across the entire country. As a result, taxpayer consultation over the phone has decreased written and oral applications to tax offices. In turn, the tax offices have seen a decrease in workload and thus a reduction in administrative overhead. Implementing "auto call back service" reduced average wait times in the first year of operation from 168 to 127 seconds, or by around 25%.
- Some OECD jurisdictions do not allow taxpayers and/or their legal representatives access to the compliance areas of the audit, collection, and fraud investigation functions of the tax administration offices.

[Continues on next page]

Improvement Potential

Base	Cost Reduction	Stretch
$970 K		$342 K

Improvement Rationale and Methodology

- Average of 4,200 cases/month with an average service time = .5h (30 minutes)
- Average Service Center Employee wage = $11.66/hour, resulting in an annual cost of face-to-face service of approximately: $2 M
- Considering:
  - **Base:** Average of 3,360 cases/month (considering reduction due to improved e-services). Average service time = 0.33h (using case management solutions), resulting in annual cost of face-to-face services = $970 K
  - **Stretch:** 2,100 cases/month. Average service time = 0.16h (by implementing advanced case management solutions) resulting in approximate annual cost of face-to-face service = $342 K
- Additional web-based, self service options like taxpayer information access and FAQs will reduce face-to-face services and require investing in new functionality and technologies to preserve client privacy.
- Improve taxpayer's satisfaction due to the elimination of trips to Department of the Treasury locations.
- Client inquiry/problem resolution details can provide management information for process optimization and root-cause analysis of trending issues for proactive resolution and improved customer service (Knowledge Management).

H4 | **Improving taxpayer assistance service options may reduce cost of face-to-face services.**
- Improve Case Management

Summary Operational Evidence and Comparator Context (continued)

Comparator Context (continued):

- In Moldova, for instance, the State Tax Inspectorate, the country's tax administration, established "internet café"-style taxpayer service centers inside municipal government facilities, where taxpayers were able to register, obtain forms and instructions, update their status, or access their tax statement via an intranet portal.
- Micro and small companies' website (Chile): The objective of the initiative was to provide micro and small companies with an application that allows them to issue invoices and other tax documents electronically. The application also provides a simplified accounting system that pre-fills the data for the annual, as well as monthly, tax declarations, thus reducing the amount of accounting-related records that taxpayers have to keep in paper. Commencing with a free online invoicing application and subsequently enhanced with an accounting function, the system is now fully functional and in use. The initiative has: 1) reduced the use of paper, saving some $US 22.5 M each year; 2) reduced processing time from 30 days to instantly; and 3) allowed VAT auditing. The application is now widely used and further segment penetration strategies have been developed.
- Switzerland reported that one of the key Federal Tax Administration projects is the construction of a VAT Portal. Almost every company in Switzerland pays VAT, so they are in regular contact with the FTA. Today, the companies have to fill out paper forms for registration, refund or other business. For most of the information, those companies have to call the VAT Administration. This is a significant burden for the companies and also labor intensive for the FTA due to excess paperwork and phone call management. Therefore, the FTA launched the project — VAT Portal. The project's key goals include developing: 1) an electronic VAT registration process; 2) an interface to the company's ERP system; 3) on-line account statements; and 4) automatic workflow initiation.
- Mexican officials reported that their web-based applications for taxpayers to review their transactions with the revenue body (e.g. registration, payments, returns filed, customs, accounting opinions, etc.) has produced a range of benefits including: reduced walk-in center demand, reduced paper use, and taxpayer travel costs savings. Some 129,000 taxpayers used this online web channel in 2008. A similar web-based facility, with appropriate authentication controls, enabling taxpayers to access and update registration-related information had been used for over 1.6 million transactions in 2008, producing savings for taxpayers estimated at around 244 million pesos (approx. $US 20 M)

[*] Sources:
- Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean, USAID, Aug. 2013)
- OECD: Tax Administration 2013 - Comparative Information on OECD and Other Advanced and Emerging Economies

H4

Improving taxpayer assistance service options may reduce cost of face-to-face services.

- Improve Case Management

Next Steps

- Determine the current mix of taxpayer service channels (face-to-face, Call Center and Web) to determine current operational costs
- Review the implementation of an integrated case management solution that will allow for a full view of a taxpayer's status.
- Evaluate taxpayer customer experience and identify areas of improvement

H5

Reorganizing the Internal Revenue Area organizational structure may reduce operational costs.

- Implementing a full function-oriented organizational and operational structure by grouping all bureaus by services
- Reduction of personnel, optimization of processes and functions, in order to increase operational efficiency and customer experience

Summary Operational Evidence and Comparator Context

Operational Evidence:

- The current structure of the Internal Revenue Area combines two types of organizational structures. Most bureaus are organized by type of service and one bureau, Consumption Tax, is structured by type of tax. Using a combination of organizational structures may lead to duplication of efforts, mainly the functions of inspection, audit and taxpayer services regarding Sales Tax and Excise Tax (IVU & Arbitrios). There are currently 41 Auditors that perform Sales and Use tax only, in the Consumption Tax Bureau.
- Taxpayer Services Bureau is mainly dedicated to individual tax. The taxpayer directly contacts other Internal Revenue bureaus for assistance. Taxpayers cannot resolve all their tax issues in one service center, leading to a duplication of efforts.
- The Corporate and Estimated Tax Section, Adjustment and Requirements Section and the Account Administration Section of the Processing Bureau, provide assistance to Taxpayers.
- A recent study by the Organization for Economic Cooperation and Development's Forum on Tax Administration confirms that 43 out of 49 tax administrations operate functional structures.
- Most international experts with extensive tax reform experience, including those from the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank, strongly and consistently favor functional organizational structures for national tax administrations.

[Continues on next page]

Improvement Potential

Base	Annual Cost Reduction Range	Stretch
$ 2.4 M		$ 8.4 M

Improvement Rationale and Methodology

Actual: Annual Cost of IRA staff 2,168 FTE = $53.3 M

Base: Reduction of 15% of the IRA staff 325 FTE and contemplating a compensation raise of 12% to the remaining staff, would generate an annual saving of $2.44 M

Stretch: Reduction of 25% of the IRA staff 542 FTE and contemplating a compensation raise of 12% to the remaining staff would generate an annual saving of $8.42 M

	Total Staff	Total Compensation	Annual Compensation per FTE
Base 15%	2168	$53,304,799	$24,587
	325		
	1843	$50,861,280	$27,600
	Reduction %	5%	
	Reduction savings	**$2,443,519**	
Stretch 25%	2168	$53,304,799	$24,587
	542		
	1626	$44,877,600	$27,600
	Reduction %	16%	
	Reduction savings	**$8,427,199**	

H5

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- Implementing a full function-oriented organizational and operational structure by grouping all bureaus by services
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Improvement Rationale and Methodology

- Reorganization will permit standardization of similar processes across all taxes, simplify taxpaying procedures, permits greater uniformity across the organization and promote greater efficiency and higher productivity of the overall tax administration as it avoids the duplication of processes across tax categories.
- Costs can be reduced by eliminating redundant positions and tax functions, optimizing processes, and organizing the Treasury based on responsibilities performed. Streamlining Treasury operations will lead to a reduction in overhead costs. Other jurisdictions have estimated a staff reduction of approximately 15% on average.

Summary Operational Evidence and Comparator Context (continued)

Comparator Context:

- Latvia provided an update to their Community Innovation Survey 2010 (CIS) organizational reforms. The main objective of the reorganization was the introduction and optimization of a new tax administration structure. Latvia centralized its support units leading to efficiency in reviewing and modifying the way services were rendered throughout their Treasury. Additionally, they removed redundant and inefficient processes. The number of State Revenue Services (SRS) employees decreased from 5,338 in 2008 to 4,374 in 2011, which is an 18.4% decrease. The cost of collecting 1 Latvian Lat (LVL) decreased by 10.6% from 2008 to 2011 - which shows efficiency gains.
- Lithuania implemented reorganization of the State Tax Inspectorate (STI) in 2011 at the direction of the EU. As a result, STI's main functions were centralized by establishing dedicated Tax Accounting, Debt Administration, Excise Duty Administration, Tax Information, Financial Accounting, and Selection and Audit Support Departments in the central office. In addition, the control system was re-organized. Key objectives included the improvement of activity processes, application of the consistent practices, increased functional efficiency and cost/staff reductions (7.86% from 3,816 to 3,516).
- The United Kingdom's HMRC is currently completing a work program to improve its overall capabilities by ensuring that its operating model, structures, processes, performance measures and culture, align with its goals and at the same time reduce overall spending by 25% by 2014. In implementing the operating model, a new organizational structure has been designed. HMRC has carried out robust selection exercises aimed at having people with the right business skills in critical and key leadership posts. The current program will streamline processes, improve performance, improve effective decision making, clearly identify accountable parties and reduce duplication/waste.

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Summary Operational Evidence and Comparator Context (continued)

	Selected features of revenue bodies' internal organizational structure							
Country	Main criterion *	High net worth individual unit	Large taxpayer division/unit	Dedicated processing centres	Debt collection function	Tax fraud function	Dedicated disputes function	Full in-house IT function
OECD countries								
Australia	All	✓	✓	✓	✓	✓	✓	✓/1
Austria	All	x	✓	x	✓	✓	✓	✓/1
Belgium	All	x	✓	✓	✓	✓	x	x
Canada	F	x	✓/1	✓	✓	✓	✓	✓
Chile	All	x	✓	✓	x/1*	✓	✓	✓/1**
Czech Rep.	T, F	x	x	✓	✓	✓	✓	✓
Denmark	All	x	✓	✓	✓	✓	✓	x/1
Estonia	All	x	x	✓	✓	✓	✓	✓
Finland	F,TP	x	✓	✓	✓	✓	x	x/1
Germany/1	F,TP	✓	✓	✓	✓	✓	✓	✓
Ireland	TP	✓	✓	✓	✓	✓	x/1	✓
Mexico	F,TP	x	✓	✓	✓	✓	✓	✓/1
Netherlands	F/1	x/1*	✓/1**	✓	x	✓	x	✓
Slovenia	F,TP	x	✓	✓	✓	✓	✓	✓
Turkey	F	x	✓	✓	✓	✓	✓	✓
United Kingdom	All	✓	✓	✓	✓	✓	✓	x/1
United States	TP	✓/1	✓	✓	✓	✓	✓	✓
Non-OECD countries								
Argentina	All	✓	✓	✓	✓	✓	✓	✓
Brazil	F	✓	✓	x	✓	✓	✓	x
Colombia	F	x	✓	✓	✓	x	✓	✓
Latvia	F	x	✓	x	✓	✓	✓	✓/1
Singapore	F,T	x	✓/1	✓	✓	✓	x	✓

(*) Structural criterion: Function-F; Tax type-T; and Taxpayer type-TP.

/1. Australia- Mainframe, network & communications hardware & support are outsourced; Austria IT functions provided by the MOF or similar department; Canada- Dedicated large taxpayer compliance program; Chile- *SII perform only the initial effort to collect tax debts. ** Only relates to tax return and sworn statement processing; ** It has been many years that criminal prosecutions have not been carried out by Direct Tax Department; Denmark, Finland, UK- IT operations are largely outsourced; Germany- Most states have tax office for large taxpayer audits and tax fraud function, specialized debt collection units, appeals units, and full in-house IT functions; Ireland- While Revenue do not have a dedicated unit in charge of appeals disputes, it does have an appeals function. Customers may lodge complaints at their local office, submit their case for an internal or external review and/or make an appeal under statutory provisions (via the Appeals Commissioners, Ombudsman's Office or the Equality Tribunal; Latvia- IT operations are partly outsourced; Mexico- A dedicated organizational unit responsible for IT functions but with substantial outsourcing of its operations; Netherlands- * Large Business Taxpayers Units in Regional Tax Offices. ** No separate HNWI-units but coordinated approach in horizontal monitoring programme; Singapore- There are separate large taxpayer departments for Corporate Tax and Goods and Services Tax; USA- Establishment of HNWI unit in course of development.

H5

Reorganizing the Internal Revenue Area organizational structure may reduce operational costs.

- Implementing a full function-oriented organizational and operational structure by grouping all bureaus by services
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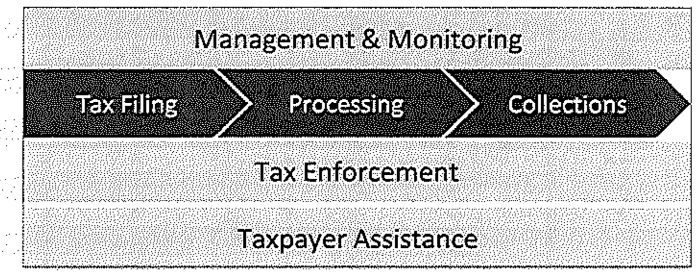
Summary Operational Evidence and Comparator Context (continued)

Comparator Context:

- Ireland's Government Employment Control Framework set a staffing target of 5,467 FTEs by end-2015 (compared with actual usage of 5,962 FTEs in 2011), almost a 10% decrease of the existing workforce. Working within the target set, it will continue a process of coordinated recruitment to fill crucial skills gaps and strengthen capabilities in key strategic areas. In addition, there has been a Government-wide Comprehensive Review of Expenditures by all departments to reduce costs and/or increase efficiencies and productivity. This ongoing process, aims to increase revenue via use of electronic systems and the transfer of some administrative functions, such as HR, to government-shared service arrangements.

- The chart below shows a value chain of a full function oriented organizational structure - one in which tax administration is structured on the basis of the type of work performed, grouping together activities that require similar skills or specialties.



[*] Source: OECD: Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)

Next Steps

- Perform an exhaustive analysis of all the functions, processes and activities performed by the staff in order to find all the possible duplication of efforts, especially in audit, enforcement and taxpayer services.
- Analyze all of the processes and functions performed by the Consumption Tax Bureau and contrast them against the rest of the bureaus in order to determine if there is an existing duplicity of functions, efforts and resources.
- The Department needs to identity which employees are close to retirement and create a succession plan to avoid the loss of institutional knowledge before reducing the amount of FTE.
- Perform an investigation in order to have a clear view of the operational costs that can be reduced using this approach, taking into consideration the centralization of the regional offices after the restructuring of personnel.

H6

Creating a (semi) autonomous Internal Revenue Agency (IRA) may increase revenue by improving operational efficiency and retaining and attracting highly qualified staff.

- Minimize evasion through better, more accountable enforcement
- Pay competitive salaries to attract and retain professional staff
- Specially train personnel to manage evasion cases and fraudulent payments
- Establish ability to create own rulings to enforce the standardization of penalties and prosecutions
- Increase efficiency by establishing performance targets and rewarding achievements

Summary Operational Evidence and Comparator Context

Operational Evidence:

- **High Dependency**: Currently, the Internal Revenue Area (IRA) is an operational unit of the Department of the Treasury and is therefore subject to the guidelines, laws, procedures, budget and resources provided by the Department.
- **High Inefficiency:** Currently, core and administrative processes are highly inefficient, such as: hiring (i.e. approximately 3 months), reward systems (outdated since 1994) and budget approval, among others.
- **Span of control above the optimal ratio**: 60% of the Directors and 33% of Division Chiefs are above of the optimal ratio regarding the span of control.
  - Currently 3 of the 6 bureaus do not have a formal Sub-Director in place.
  - There are Chief of Division positions that are vacant, causing the Supervisor to report directly to the Director.
- High attrition rates with limited knowledge transfer increases the loss of institutional knowledge and expertise.
- Common perception that the tax expertise and knowledge is higher outside of the Department.

Improvement Potential

Base		Stretch
$342 M	*Revenue Increase*	$683 M

Improvement Rationale and Methodology

- Based on the comparable jurisdictions implementing a semi-autonomous Revenue Agency, the median percentage revenue increase is approximately 4% and the average is about 8% (exempting Argentina and South Africa)

FY12 Total Tax Revenue	Base Increase	Stretch Increase
	4%	8%
$ 8,540,000,000	$341,600,000	$683,200,000

H6

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- Increase efficiency by establishing performance targets and rewarding achievements

Summary Operational Evidence and Comparator Context (continued)

Comparator Context:

Impact of the Creation of Semi-autonomous RA Vs. Tax Revenue (**)

Country	Year RA was established	First Year Increase
Peru	1988	9%
Mexico	1997	13%
Argentina	1988	8%
South Africa	1997	26%
Malaysia	1994	17%
Singapore	1992	12%
Philippines	2003	11%

- Tax administration autonomy will provide the Department freedom to design and implement its own operational policies and/or processes, such as:
  - Discretion to allocate/reallocate budgeted administrative funds across administrative function
  - Discretion to set its own administrative performance standards (e.g. for taxpayer service delivery)
  - Establish accountability for its operations and is subject to control and assessment
  - Operate own structure and powers for effective and efficient operation
  - Provide transparency and integrity regarding tax administration
  - Authority to administer its own in-house IT systems, or to outsource such services to private contractors (*)

- Governments of developed countries have sought ways to deliver better service by turning to a form of semi-autonomous agency operations to help meet the goals of improved collections, better customer service, and more flexible human resource management options. (*)
- In twenty eight (28) countries, tax administration is the responsibility of a unified semi-autonomous body (for China, a separate body) that reports to a government minister. In ten (10) of these countries, a formal management/advisory board comprised of external representatives has been established. (*)
- Thirty six (36) countries have separate bodies for tax and customs administration. Of the 36, nineteen (19) countries have allocated the excise administration to the customs body, not the revenue body. (*)
- Denmark - In March 2010, the Danish Tax Administration merged with the Danish Ministry of Taxation to form a single unified and autonomous tax administration with a corporate structure, headed by a single (internal) board chaired by the Permanent Secretary of the Ministry of Taxation. The integrated Danish revenue body is now officially referred to as the "Danish Ministry of Taxation" (Skatteministeriet). Governments in Australia and the United States have established special bodies independent of the revenue body to report on the tax system's operations, in particular, on aspects of tax administration. (*)
- In some OECD countries, the national revenue body is responsible for real property and/or motor vehicle taxes, while in others such taxes are administered by separate sub-national government agencies.(*)

(**) Tax Administration Reform: (Semi-) Autonomous Revenue Authority Anyone? - Rosario G. Manasan

H6

Creating a (semi) autonomous Internal Revenue Agency (IRA) may increase revenue by improving operational efficiency and retaining and attracting highly qualified staff.

- Minimize evasion through better, more accountable enforcement
- Pay competitive salaries to attract and retain professional staff
- Specially train personnel to manage evasion cases and fraudulent payments
- Establish ability to create own rulings to enforce the standardization of penalties and prosecutions
- Increase efficiency by establishing performance targets and rewarding achievements

Summary Operational Evidence and Comparator Context (continued)

The table below provides greater insight into the range and nature of powers that semi-autonomous OECD and non-OECD revenue bodies have been delegated:

Country	Delegated authority that can be exercised by the national revenue body/1								
	Make tax rulings	Remit penalties/interest	Design internal structure	Allocate budget	Fix levels/mix of staff	Set service standards	Influence staff recruitment criteria	Hire & dismiss staff	Negotiate staff pay levels
1) OECD countries									
Australia	✓	✓/2	✓	✓	✓	✓	✓	✓	✓
Canada	✓	✓	✓	✓	✓	✓	✓	✓	✓
Chile	✓	✓	✓	✓	✓	✓	✓	✓	✓
Denmark	✓	✓	✓	✓	✓	✓	✓	✓	✓
France	✓	✓	✓	✓	✓	✓	✓	✓	✓
Germany	✓	✓	✓	✗	✓	✓	✓	✓	✗
Italy	✓	✓	✓	✓	✗	✓	✓	✓	✗
Mexico	✓	✓	✓	✓	✗/2*	✓	✓/2**	✓	✓
Netherlands	✓	✓	✓	✓	✓	✓	✓	✓	✓
New Zealand	✓	✓	✓	✓	✓	✓	✓	✓	✓
Sweden	✓	✓	✓	✓	✓	✓	✓	✓	✓
Switzerland	✓	✓	✓	✓	✓	✓	✓	✓	✓
Turkey	✓	✓	✓	✗	✗	✓	✓	✗	✗
UK	✓	✓	✓	✓	✓	✓/2	✓	✓	✓
USA	✓	✓	✓	✓	✓	✓	✓	✓	✓
1) Selected non-OECD countries									
Argentina	✓	✗	✓	✓	✓	✓	✓	✓	✓
Russia	✗	✓	✓	✓	✓	✓	✓	✓	✓
Singapore	✓	✓	✓	✓	✓	✓	✓	✓	✓

[*] SOURCE : FORUM ON TAX ADMINISTRATION - Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)

/1. Separate references for countries with multiple revenue bodies.
/2. Australia- Not for penalties imposed by a court; France- Recruitment by competitive examination; Germany- Generally 16 States MOF can decide on the internal structure. Most important decisions on levels & mix staff are made by State and Federal Parliaments as part of the budget. Each of 17 MOF can hire within the limitations provided by its budget and can influence recruitment criteria, but dismissing staff is virtually impossible under German civil service law. Most of 16 States and Federal MOF maintain own IT operations; Mexico- * It is necessary to obtain authorization from a different government agency (Secretaría de la Función Pública) to modify the number and type of staff for the institution. ** Appointments for 6 of the 11 high level positions must be designated by the President and ratified by the Senate; UK- Public Service Agreement targets have to be agreed with Ministers.

H6

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Next Steps

- Evaluate the operational cost and required resources
- Evaluate the organizational and financial impact
- Evaluate regulatory framework for tax administration
- Define the governance model:
  - Unified semi-autonomous body
  - Unified autonomous body
  - Unified semi-autonomous body with Board
- Restructure the current organizational structure and value chain
- Identify the roles and functions of key processes

H7

Improving the consumption tax audit and enforcement on the largest merchants (by economic activity) may increase consumption tax revenue.

- Minimize evasion through better, more accountable enforcement
- Specially train personnel to manage largest merchants
- Leverage technological solutions and improve enforcement processes
- Increase efficiency by establishing performance targets and rewarding achievements

Summary Operational Evidence and Comparator Context

Operational Evidence:

- In 2012/2013 total consumption tax revenue was approximately: $1,080 M
- The compliance rate for consumption tax is approximately 56%, hence 10,464 pay an average of $82 K annually.

Comparator Context:

"For the entire sample, over the period 2000-2011, the average VAT Gap is 17%, and the median 13%. In 2011, it was estimated that the total VAT Gap for the EU-26 countries amounted to approximately 193 B Euros (Table 3.1.1), or about 1.5 percent of EU-26 total GDP, an increase from the 1.1% of EU-26 GDP recorded in 2006, and above the 2000-2011 average of 1.2%."*

[*] Source: *Study to Quantify and Analyze the VAT Gap in the EU-27 Member States TAXUD/2012/DE/316.*

[Continues on next page]

Improvement Potential

Base		Stretch
$241.5 M	*Revenue Increase*	$302 M

Improvement Rationale and Methodology

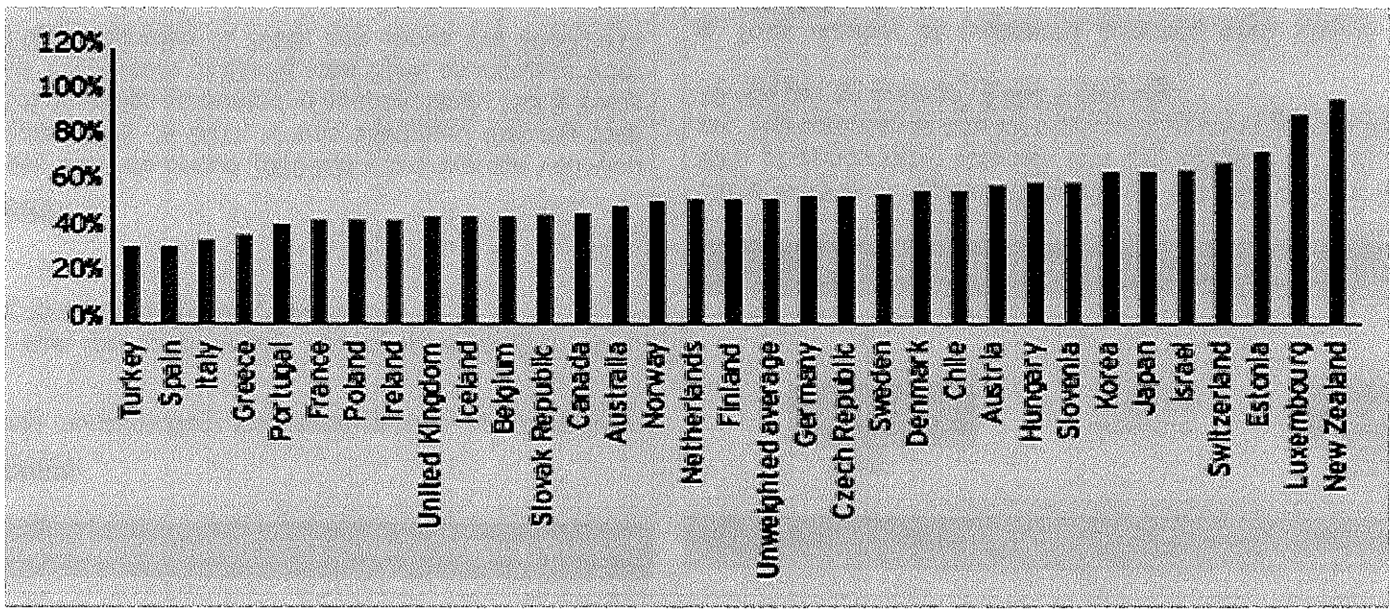
Close to 10% of registered merchants (23,780) account for approximately 90% of all economic activities that may result in payment of consumption tax. The compliance rate for consumption tax is approximately 56%, hence 10,464 pay an average of $82 K annually.

- Total number of registered business head offices in Puerto Rico: 113,033
- Total number of registered locations in Puerto Rico: 563,377
- Total number of registered active merchants at Treasury Department: 113,033
- Total number of non-exempt merchants required to file consumption tax: 68,331
- **Base:** Improving the consumption tax compliance rate for the largest merchants by 30% (an additional 4,024 merchants) using an average tax revenue per corporation of $60,000 equals $241.5 M in additional revenue.
- **Stretch:** Improving the consumption tax compliance rate for the largest merchants by 50% (an additional 6,707 merchants) using an average tax revenue per corporation of $45,000 equals $302 M in additional revenue.

H7	**Improving the consumption tax audit and enforcement on the largest merchants (by economic activity) may increase consumption tax revenue.** · Minimize evasion through better, more accountable enforcement · Specially train personnel to manage largest merchants · Leverage technological solutions and improve enforcement processes · Increase efficiency by establishing performance targets and rewarding achievements

Summary Operational Evidence and Comparator Context (continued)

The graphic below shows the estimated VAT revenue ratio among OECD countries (reflecting 2009 data), only about half of projected VAT revenues are collected. The effective rate across the OECD countries is about 50% to 60% of expected VAT revenues, which includes exemptions, zero and reduced rates, fraud and avoidance. The lowest, at 30%, are Mexico, Turkey and Spain and the highest, at close to 100%, for New Zealand and Luxembourg.



[*] SOURCE : VAT/GST and Excise Rates, Trends and Administration Issues. Consumption Tax Trend 2012. OECD

H7

Improving the consumption tax audit and enforcement on the largest merchants (by economic activity) may increase consumption tax revenue.

- Minimize evasion through better, more accountable enforcement
- Specially train personnel to manage largest merchants
- Leverage technological solutions and improve enforcement processes
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Next Steps

- Review tax enforcement process in order to determine possibilities for technology based improvement
- Examine the legal ramifications of publishing criminal cases and Audit Plan
- Consider Compliance Risk Management as a methodology to be implemented within enforcement functions