

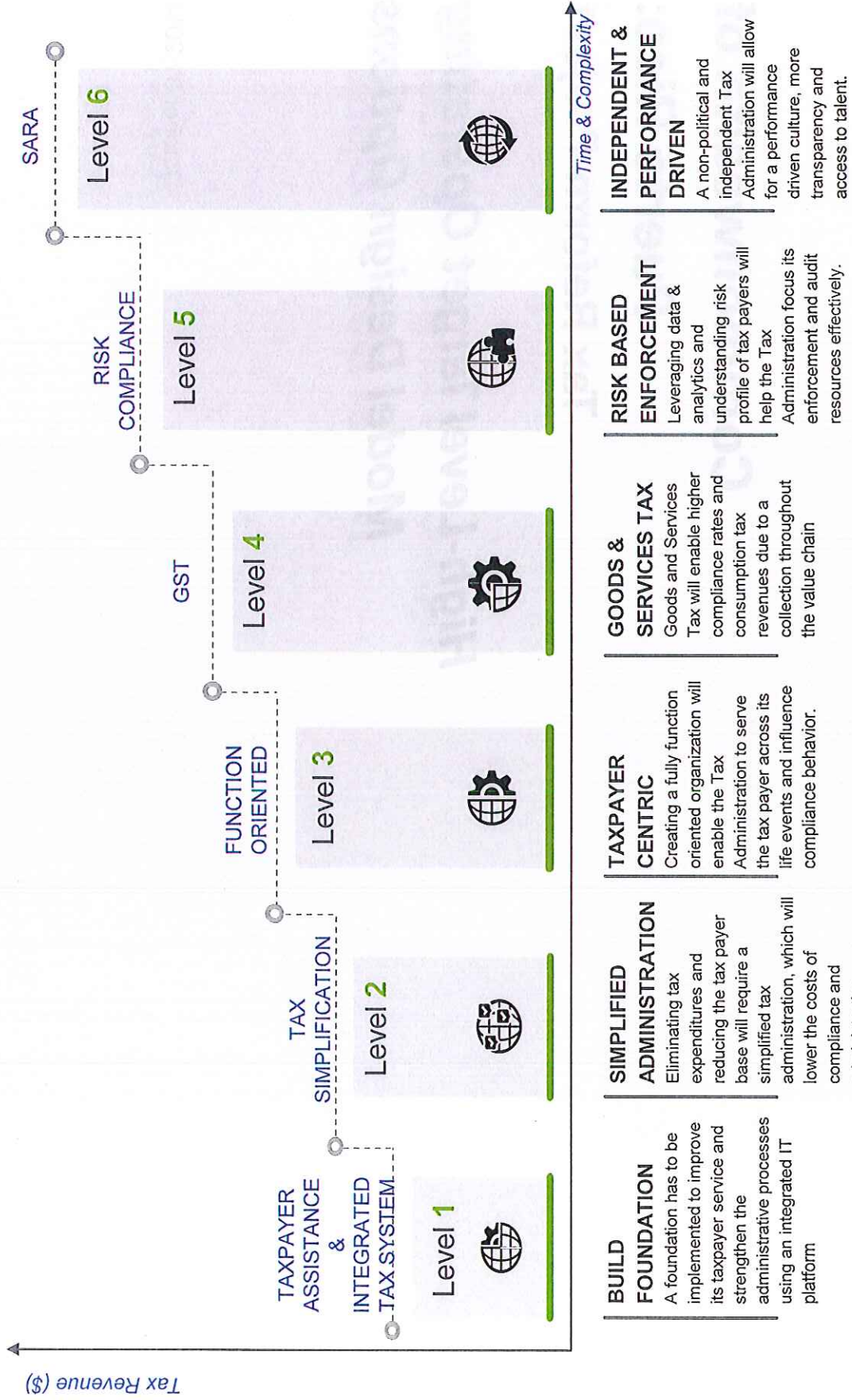
Commonwealth of Puerto Rico: Tax Reform Project

High-Level Target Operating Model Design Options

October 31, 2014

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Capabilities Evolution



Capabilities Evolution

Level 1: Improving the current Tax Payer Services and the corresponding service channels will increase efficiency and increase compliance

This opportunity develops a new taxpayer assistance service strategy focused on different service channels aimed at enhancing the relationships with the taxpayers and ease of doing business for taxpayers. Improving, implementing and offering new capabilities through service channels with special emphasis on the web and mobile channels to deliver a better service experience to taxpayers.

Taxpayer assistance services will support the new services that will be required before going live with any process improvement and/or integrated tax system implementation. This opportunity seeks to reduce costs of face-to-face services in order to facilitate taxpayer compliance and payment of tax liabilities. These services will provide tax education, advice and information to help taxpayers comply with tax obligations.

Level 1: Implementing an Integrated Tax Administration System will improve Puerto Rico's revenue authority operations

This opportunity defines the requirements, select, acquire and deploy a set of technical components (application systems, databases, user interfaces, security, web services, middleware and others) through tax integration to improve the tax administration capacity for managing current and historical information.

The implementation of this opportunity will support the following capabilities:

- Case and workflow management
- Real time registration and accounting of the taxpayers transactions
- Development, execution and monitoring of compliance programs
- Real time statistical and financial information for supporting risk-based compliance.

Capabilities Evolution

Level 2: Tax Simplification will reduce costs and improve operational efficiency

This opportunity will simplify the way tax declarations are done in order to increase taxpayer compliance, by adopting leading practices such as e-filing or pre-filled tax returns.

This opportunity considers the elimination of tax expenditures (deductions and exemptions), the reduction on the taxpayer base, reducing costs and increasing compliance; the reduction of manually filed tax return form that currently requires multiple processing steps and additional reviews during submission process.

Level 3: Implementing a Function Oriented Organizational Structure can reduce costs and increase efficiencies

This opportunity redesigns the organizational structure to enable the standardization of business processes across all taxes, simplify tax payment procedures, achieve process integration 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.

Establishing a function oriented organization will reduce costs by eliminating redundant positions and tax functions, optimizing processes, and organizing the Department based on responsibilities performed. Streamlining operations will lead to a reduction in overhead costs. Other jurisdiction have estimated a staff reduction of approximately 15% on average

Capabilities Evolution

Level 4: Adopting a broad-based Goods and Services Tax (GST) based on an invoice/credit mechanism will increase tax revenue and tax compliance

This opportunity proposes an integrated approach in the adoption of GST that should be supported by a statutory approval to guide the definition of operational requirements regarding staffing needs, implementation and/or adjustments of processes supported by an integrated IT system, implementation of an enforcement scheme, and the implementation of a communication strategy and training program to increase taxpayers and Department personnel about the tax processing and compliance requirements of the GST.

GST's has raised tax collections and compliance rates in a transparent, business-neutral manner in more than 150 jurisdictions into adopting this broad-based consumption tax, helping some of those governments to restore growth in times of economic crisis, making more capital available to their economies, improving labor productivity, and increasing national output in the long run. The preparation and technology implementation of a GST tax structure in New Zealand, a comparative tax structure to Puerto Rico with similar attributes, lasted between 18-24 months to fully execute.

Capabilities Evolution

Level 5: Adopting a risk based compliance management will improve enforcement and optimize tax collections

A risk based compliance management function adopts a new approach to assess potential fraud or tax avoidance risks of different taxpayer segments in order to focus enforcement efforts on the highest risk taxpayers, thereby reducing the administrative burden on compliant, low risk ones.

The audit and compliance function must be supported by a methodology that ensures detailed fiscal monitoring of taxpayers. This methodology, which must be led by a Compliance Risk Management Office, can be enhanced through technology solutions to improve the timing and effectiveness in the identification, analysis, prioritization and type of treatment for high risk cases. Comparable jurisdictions have a similar risk compliance strategy, which allows tax administrations to focus and prioritize their efforts on specific segments of the tax base, resulting in the collection of debts through active influencing of taxpayers, cost-benefit approaches, and documented management of their cases.

Decisions and subsequent implementation of IT solutions should consider the current maturity of the audit and compliance function in order to determine viable options that will generate higher tax collection efforts in the shortest time possible. It is recommended to gradually adopt a culture based on Compliance Risk Management.

Capabilities Evolution

Level 6: Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico's revenue authority operations

Creating a Semi-Autonomous Revenue Authority (SARA) helps to create an independent organization that's primary objectives are to increase collections, enforce non-compliance and help influence taxpayer, corporate and association's behaviors and perceptions in the way taxes are managed.

SARA will have the autonomy to manage its own internal systems, operations and resources. Tax administration autonomy will provide IRA the authority to design and implement its own operational policies and/or processes, such as:

- ▣ Discretion to allocate or reallocate budgeted administrative funds across administrative functions
- ▣ 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 governance for effective and efficient operation
- ▣ Provide transparency and integrity regarding tax administration
- ▣ Authority to administer its own support functions and systems, or to outsource such services to private contractors, if deemed appropriate

Level 1: Improving the current Tax Payer Services and the corresponding service channels will increase efficiency and increase compliance



Services, Functions & Process

- Reduction of requests for extensions to file Income Tax Returns
- Alternative channels for taxpayers
- Increase in voluntary tax filers
- Decrease volume of inquiries

Organization & Governance

- Accountability on tax payer assistance services
- Optimal span of control

Technology

- New technology supporting the new tax payers service strategy

Sourcing & Location

- Reduction of Collection Centers
- Reduction of Sourcing Costs

Performance Management

- Adopt mature key performance indicators on tax payer assistance services

People & Skills

- Reduction of FTEs
- Specialized training to manage cases will be required
- Reduction of the time spent interacting with taxpayers on traditional channels

Level 1: Implementing an Integrated Tax Administration System will improve Puerto Rico's revenue authority operations



Services, Functions & Process

- Update documentation processes according to the new integrated tax system
- New processes to be designed must reflect the legislative changes and simplified rules

Organization & Governance

- IT Organizational structural and governance changes will be required to ensure expected service levels are achieved

Technology

- Legacy databases must be cleansed to ensure smooth transition to the new system
- The current technology infrastructure will require gradual replacement due to the implementation of a new tax system

Sourcing & Location

- Existing support contracts must be kept until the legacy systems are replaced
- The mix of in-house/contracted staffing levels must be determined to ensure appropriate support of the new system

Performance Management

- The Adoption of Business Process Management (BPM) practices and technologies will support performance management objectives.

People & Skills

- IT staff must be knowledgeable in the new tax administration system

Level 2: Tax Simplification will reduce costs and improve operational efficiency



Services, Functions & Process

- Simpler tax return processing
- Less effort in validating returns
- Simpler tax returns will lower the volume of inquiries

Organization & Governance

- Reduction in number of staff involved in validating and checking processing returns

Technology

- Implement rules-based to minimize manual intervention
- Provide on-line documentation to taxpayer service reps.

Sourcing & Location

- Better Service Level Agreements (SLA) with third parties to support the organization

Performance Management

- Implement performance measurements (cost reduction, through put) around the effectiveness of e-filing

People & Skills

- Outplacement process of staff.
- Retooling and retraining of staff to focus more on enforcement, audits, tax payer services and data & analytics

Level 3: Implementing a Function Oriented Organizational Structure can reduce costs and increase efficiencies



Services, functions & process

- Duplicated efforts reduced and processes optimized.
- Procedures will have to be updated due to structure reorganization.

Organization & Governance

- More efficient use of resources within the IRA due to a streamlined organization.
- Focused on macro processes providing a integrated view of the tax payer

Technology

- Work simplification due to automated processes supported by leading technologies.

Sourcing & Location

- Less dependency on field operations due to centralized services that will be supported by integrated systems.
- Less dependency on human resources sourcing contracts.

Performance Management

- Highly efficient performance management process, due to the elimination of duplicated processes and an integrated management of taxes.

People & Skills

- New functions will have to be supported by highly trained personnel.
- Knowledge transfer process will have to be set in place in order to support the execution of the outplacement strategy.

Level 4: Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance



Services, functions & process

- GST filing frequency may impact on processing workloads.
- Requires the definition of an enforcement scheme based on Compliance Risk Management.
- Fraud prevention mechanism needs to be put in place.

Technology

- Cross-tax checking supported by an optimal registration process.
- Optimized audit process supported by data analytics capabilities.
- Access to external sources is required for effective enforcement

Performance Management

- The ability to measure throughout the value chain, using the invoice/credit mechanism, will provide data and information that is currently not available.

Organization & Governance

- Will require to optimize the capability to monitor taxpayer compliance.
- Will require extensive public awareness and media campaigns to ensure overall acceptance.

Sourcing & Location

- Need to optimize optimal organization of enforcement workforces along the country
- Taxpayer outreach and assistance program have to be set in place in several locations to provide coverage.

People & Skills

- Will require knowledge transfer regarding the Compliance Risk Management model.
- New skills to support taxpayer services must be adopted.

Level 5: Adopting a risk based compliance management will improve enforcement and optimize tax collections



Services, functions & process

- Better tracking on registered taxpayer's submission compliance
- Optimized capability to detect audit requirements and enforcement actions as a result of information cross-checking and risk analysis.
- Reduction of field audits/inspections.

Technology

- Implementation of Risk assessment tools such as Data Analytics and case management functionalities to optimally support monitoring on GST and income tax filers.

Performance Management

- Implementation of mature key performance indicators to measure the performance of the risk-based compliance strategy.
- Performance based compensation could be introduced

Organization & Governance

- Reduction in number of staff involved in executing tax audits and field inspections.
- Optimal monitoring due to centralized enforcement functions.

Sourcing & Location

- Empower the enforcement functions by changing legislations in order to gain access to taxpayer data from financial institutions and other sources, to apply optimal treatments to ensure the collection of any tax debt.

People & Skills

- Appropriate staffing and training will be needed to support the enforcement function.
- Professional profile should be higher, and as a result competitive salaries should be established.

Level 6: Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico's revenue authority operations



Services, functions & process

- Implementation of a function oriented structure that will avoid duplication of efforts and will provide an optimization of processes.
- Implementation of a Program and Innovation Office

Technology

- Creation of a dedicated IT department providing service exclusively for the tax administration systems and applications

Performance Management

- Development of a performance management system to support the compensation system.
- Higher service rates and operational efficiency,
- Higher levels of motivation among the staff

Organization & Governance

- Own decisions on strategic and operational matters
- Streamlined organization that will provide a more efficient use of resources.
- Strong legal support

Sourcing & Location

- More centralized services resulting on less dependency on field offices.
- Better SLA's on contract terms to support SARA's outsourcing needs

People & Skills

- Attract more developed and specialized talent by implementing a performance based compensation system.
- Perform a recruitment process in order to determine if they qualify for the new job descriptions