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USAID'S LEADERSHIP IN PUBLIC FINANCIAL MANAGEMENT

Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean
Chapter 3. Legal Framework

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List of Acronyms and Abbreviations

Acronym	Definition
CIAT	Inter-American Center of Tax Administrations
CRA	Canada Revenue Agency
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
LTO	Large taxpayer office
MOF	Ministry of Finance
SARA	Semi-autonomous revenue authority
SAT	Superintendencia de Administración Tributaria (Superintendent of Tax Administration in Guatemala)
VAT	Value added tax

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Chapter 3. Legal Framework

This section outlines the legal framework that enables the tax administration to operate effectively and efficiently, while safeguarding the rights of taxpayers at the same time. The types of taxes, tax rates, schedules, and similar features of tax law are not within the scope of this document. Instead, the focus is on the type of legal framework and selected administrative provisions of the tax laws.

3.1. Leading Practice

Although not a good practice, it is fairly common among many developing countries around the world to have their legal framework for taxation dispersed across a series of tax laws, each with its own set of provisions for tax administration (e.g., an income tax law, a value added tax (VAT) law, an excise tax law, etc.). These tax laws are always supplemented and supported by an assortment of regulations, executive instructions, and ad hoc decisions issued from a variety of sources. Both the tax administration and taxpayers find it difficult to follow such an assortment of multiple laws, regulations, instructions, and decisions, particularly since administrative provisions are usually inconsistent and always dispersed among the various laws and related documents.

Rather than a series of tax laws for each tax type, the international best practice is for government to enact a tax code, which incorporates all legal aspects of taxation into one comprehensive, coherent piece of legislation, and determines the legal principles of taxation. The tax code should include all national taxes, i.e., tax on the income of physical persons, tax on the income of legal persons, VAT, excise taxes, social insurance contributions, land and property taxes, taxes on the processors of minerals, and others.

Box 3.1. Unified tax code in the United States

The 11 subtitles of the U.S. Internal Revenue Code include provisions for all major taxes imposed by the U.S. Federal Government: income taxes, estate and gift taxes, employment taxes, and excise taxes. The Code also includes a single subtitle (section) for the administration of all taxes, with provisions for registration, filing and payment requirements, assessment and collections, penalties and interest, and other. The Internal Revenue Code, however, does not include all tax related provisions. The U.S. bankruptcy law – Title 11 of the U.S. Code – describes the filing of tax returns by the debtor.

Several influential international institutions have drafted model tax codes to encourage and guide officials of countries that want to improve their tax legislation. For example, several years ago the IMF's Legal Department developed a sample tax code for a hypothetical country (the Transition Republic of Taxastan) for use as reference material to provide assistance to countries in the preparation of legislative tax acts and the application of laws.[1] Also, a project sponsored by Harvard University's

[1] IMF Legal Department (2000), *Tax Code of the Republic of Taxastan. A Hypothetical Tax Law*, http://www.imf.org/external/np/leg/tlaw/2000/eng/stan.htm.

International Tax Program developed a tax code[2] several years ago to help developing countries with a legislative framework as they formulate modern tax policies and tax laws. Even though both models are several years old, they still offer excellent guidance for the development of a comprehensive tax code.

This sub-section draws on both hypothetical models cited above and from international best practices to describe a few very important features for the tax administration and for taxpayers that a modern tax code should include. Among those features are the principles of the tax code; basic provisions, including creation and organization of the tax administration; responsibilities and powers of the tax administration; rights of taxpayers; international taxation features; and some of the compliance and enforcement provisions most needed by the tax administration to administer the tax laws fairly, efficiently, and effectively.

3.1.1. Principles

Among the most important principles to be included in a tax code is the principle of self-assessment, as stated and described in Chapter 2. The code should also emphasize cooperation between taxpayers and the tax administration and should promote voluntary compliance rather than the enforcement of compliance by the tax administration.[3] Other important principles which need to be addressed in a tax code are:

- All amendments should be made to the tax code, rather than by enacting supplemental or separate pieces of legislation;
- In an ongoing effort to make the tax law simple and clear, regulations and rulings, which interpret the tax laws, should be published regularly by the tax administration and should be made easily available to individual taxpayers;
- Transparency and predictability of the tax laws and operations of the tax administration should be the norm;
- Some provisions should be included in the code in general terms, or certain changes should be permitted by executive order, to allow flexibility and avoid rigid, possibly unworkable requirements which could not be changed without costly and time-consuming amendments to the law, such as presumptive tax regimes for small taxpayers, as described in Chapter 2;
- Clear statements to the effect that, when there is conflict with provisions of laws at other levels of government, the tax code should prevail;
- On the other hand, tax treaty provisions of the country supersede tax code provisions, should there be a conflict; and
- There is deference to some provisions of common law, e.g., exempting tools of a trade or profession from seizure and sale for unpaid taxes.

[2] Hussey, Ward and Donald Lubick (1996), *Basic World Tax Code and Commentary*, Harvard University's International Tax Program.
[3] The need for focus on facilitating voluntary compliance is discussed in Chapter 2.

3.1.2. Basic Provisions

Of course, in addition to principles, tax codes must clearly cite and describe basic provisions of taxation. These provide the basic legal authority to the tax administration to collect taxes. Among the basic principles are:

- The requirement for taxpayers to acquire a tax identification number from the tax administration and register with the tax administration;
- The general content and requirements of tax returns, and filing and payment due dates;
- The place for filing tax returns to be determined in regulations and publicized by the tax administration in order to allow flexibility for changes in organization and technological changes, such as e-filing;
- The requirement for taxpayers to maintain adequate books and records;
- The responsibility of the tax administration to conduct audits and other verification measures;
- The requirement for third parties to collect tax at the source, such as the withholding of income tax by employers from employees' salaries and wages;
- Provisions for computation, assessment, and collection of tax, interest, penalties, and other charges for other than full compliance with the tax laws; and
- Definitions of violations punishable by fines or imprisonment, such as tax evasion and tax fraud, and the right of the tax administration to publicize convictions of such offenses.

To emphasize the importance of voluntary compliance and mutual cooperation between the tax administration and taxpayers, the tax code must outline the basic rights of taxpayers, including:

- The right to examine records of audits performed by the tax administration;
- The right to present explanations to tax authorities regarding his computation and payment of taxes with respect to the records of audits performed;
- The right to be represented by a qualified legal representative of their choice in matters before the tax administration;
- The right to reconsideration of decisions of the tax administration (objections);
- The right to formally appeal decisions of the tax administration in a manner stipulated in the tax code;
- The right to apply for and receive advance rulings about the position of the tax administration with regard to a proposed business transaction;
- The right to receive credits, refunds, and interest for overpayment of taxes; and
- For those taxpayers who have filed tax returns, protection with statutes of limitations for assessment and collection of taxes.

3.1.3. Provisions to Create and Organize the Tax Administration

The tax code must also provide the necessary organization and machinery to enforce and collect all taxes, including provisions to:

- Authorize creation of the tax administration, headed by a tax administrator/director general/commissioner (the "Head");
- Organize the tax administration into headquarters, regional (if necessary), and local offices along functional lines of core taxes in an efficient way that avoids duplication, overlap, and underutilization of staff (see also the discussion of semi-autonomous revenue authorities in the next sub-section);[4]
- Allow flexibility for future changes of the organization structure deemed necessary to the Head of the tax administration, with concurrence by the Minister of Finance;
- Establish procedures to select employees based solely on merit and their ability to do the work and to make promotions based on competitive procedures;
- Authorize the Head of the tax administration to determine whether, when, and how much tax is due, as provided for in the tax code and regulations, and the authority to enforce collections, perform audits, and otherwise perform the necessary administrative functions;
- With certain safeguards, authorize the Head of the tax administration to delegate his/her legal authorities to designated subordinates; and
- Protect tax officials acting within the scope of their official duties from personal liability to taxpayers.

The main responsibilities of the tax administration outlined in Chapter 2 – to facilitate and encourage voluntary compliance by taxpayers with the country's tax laws; administer the tax laws fairly and impartially; minimize the cost and burden on taxpayers to comply with their tax obligations; monitor compliance; enforce the country's tax laws in cases of non-compliance; and use its resources efficiently and effectively – should also be clearly stated in the tax code. Other, specific responsibilities of the tax administration which should be included in the code are:

- Organize and carry out taxpayer service and education programs to provide information to taxpayers which they need to comply with the tax laws;
- Design and implement effective presumptive schemes for small taxpayers and variable tax-filing periods for medium taxpayers, to be published in regulations (to avoid stipulating in the code systems which may prove unworkable and would require legislative action to change); and
- Safeguard and keep confidential all information provided by the taxpayer to the tax administration.

3.1.4. Critical Compliance and Enforcement Provisions

The tax code must include certain very important provisions that encourage voluntary compliance and grant a variety of compliance and enforcement tools to the tax administration. One of the most important is the provision which requires banks and other financial institutions, contractors, and

[4] Hussey et al. (1996), p. 185, for example, contains a relatively general provision, stating that "The Tax Service shall be mainly organized along functional lines. Functions shall be divided among the departments in such a way that every function is allocated, but also in such a way that the duplication of tasks is avoided." This provision defines only the broad principle and allows flexibility in the organization and avoids costly legislative amendments.

employers to routinely and regularly submit to the tax administration for its matching and compliance programs third-party financial information documents, such as the payment of interest, dividends, wages, and other payments. In fact, under the requirements of the tax laws of many countries, an extremely wide variety of transactions must be reported to the revenue body, generally in electronic format, including agricultural payments, brokers' transactions, capital gains distributions, non-employee compensation and fees, commercial fish purchases for cash, interest, dividends, real estate transactions, rents, sales of securities, wages, large cash purchases, etc. Such legal provisions enable the tax administration to receive and match third-party financial data of taxpayers to its master file and mount compliance programs for omissions and discrepancies detected from the matches. This use of third-party financial data is one of the most effective tools that a tax administration has for identifying non-filers and verifying the accuracy of the income and expenses reported by taxpayers.

The tax code should also legally require banks and financial institutions, as well as other government institutions such as Customs, to furnish specific taxpayers' financial information in their custody, when such information is requested by tax administration officials engaged in official activities, such as audits and enforcement. This provision not only is important for enforcement and compliance programs, but also strengthens the legitimacy of international exchange of information agreements. For example, in the context of negotiating a Tax Treaty or Tax Information Exchange Agreement, other countries are often interested in financial information on large, multinational corporations and very complex transactions, such as transfer pricing, between or among subsidiaries based in various countries.

The tax code needs to grant several other powers to the tax administration, if it is to perform its duties and responsibilities effectively. Examples of such powers are (not all-inclusive):

- Administratively compel testimony or the production of documents, i.e., enable the subpoena of documents or persons in order to conduct comprehensive audits and discover assets subject to enforcement for non-payment, etc.;
- File a tax lien for unpaid taxes, a legal claim which attaches after assessment, notice, and demand to all personal and real property of the taxpayer;
- Garnish funds due the taxpayer from third parties (accounts receivable) and funds of the taxpayer on deposit in banks or other financial institutions;
- Seize and sell many types of personal and real property, after notice and demand;
- Subject individuals or corporations to investigations for tax fraud/evasion, if warranted, and recommend criminal prosecution and severe penalties, including incarceration;
- Administratively determine and report certain tax arrears accounts as uncollectible, i.e., suspend collection activities in those cases where the likelihood of collection is nil or very low or the taxpayer cannot be located; and
- In exceptional circumstances, where collection of the tax obligation is deemed to be in jeopardy, as determined by the tax administrator, make a jeopardy assessment and enforce collection without regard to the rights of taxpayers to object and appeal proposed assessments, subject to a claim for refund and, if denied, subject to the right to file judicial proceedings for recovery.

3.2. Common Trends

While a tax code is generally viewed as superior to separate tax laws for a country's various tax types of taxes, some countries have chosen to pursue other alternatives for improvement, such as a tax procedures code, because of political or other circumstances. Also, in lieu of a tax code with specific provisions, some countries have experimented with "framework laws" for their tax legislation, which establish "intent" and defer procedural details for the subsequent regulations phase, thereby giving much more discretion to the drafters of secondary legislation (regulations). On the limiting side of trends, more and more countries are amending their tax laws to remove discretionary powers of the Minister of Finance or other government officials to grant certain tax "favors". The following is a discussion of these and similar trends.

3.2.1. Tax Procedures Code and Other Trends

While the Ministry of Finance and/or the tax administration may acknowledge the benefits of and wish to enact a unified tax code to replace separate pieces of legislation for each type of tax, it may not be feasible to do so, politically or otherwise. In such cases, the international best practice is for the Government to extract the administrative provisions from each of the tax laws and consolidate them in a single, uniform tax procedures code, separate from the substantive pieces of tax legislation. A uniform tax procedures code enhances transparency, clarity, and consistency in the application of the country's tax laws. Recently, countries such as Indonesia, New Zealand, Bosnia and Herzegovina (specifically Republika Srpska), Montenegro, and Serbia have implemented Tax Procedures Codes (Acts) successfully; and other countries are currently developing them, including South Africa, Namibia, Ghana, Malawi, Tanzania, Botswana, and Turkey.[5]

Another trend is for countries to draft legal, administrative provisions of tax legislation in general terms that grant "flexibility." For example, some countries, such as the United Kingdom[6], have relied on "framework laws". Framework laws are statutes which are drafted in general terms and merely lay down a framework, mostly in the form of overall principles, objectives and guidelines. With framework tax laws, the details are left to regulations to be designed, published, and made available to taxpayers by the tax administration. Examples of such flexibility are the general provisions described in Chapter 2 for presumptive assessment regimes for small taxpayers or, as may be required for e-filing and other technological advances, for the provisions for where tax returns should be filed.

One change in tax legislation gaining international momentum is to remove the discretionary power of the Minister of Finance or any other government official to grant exemptions or to negotiate "tax agreements." The practice has been generally viewed by taxpayers as one that opens opportunities for

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[5] Hook (2011), p. 1.

[6] The United Kingdom, with a decision of the House of the Lords in the case of Respondents vs. HM Commissioners of Inland Revenue ex parte Wilkinson [2006] STC 270, is likely moving away from framework type laws. The decision focused on the validity of concessions, but in general also discussed the power of HM Revenue and Customs to choose how to apply the law. Since the United Kingdom has been and is a trend-setting model in tax administration around the world, this type of "flexibility" trend in other parts of the world will likely vanish.

corruption and cronyism and one that treats taxpayers grossly unequally. Also, in some cases, countries are removing the power of the Head of the tax administration, Permanent Secretary, Minister, or any other government official to remit taxes and interest. The majority of countries now have a constitutional or statutory provision that allows exemptions only by a law of general application.[7]

3.2.2. Legal Provisions to Meet Technological Changes

To succeed in the modern world, tax administrations must have well-designed Integrated Tax Information Systems (see Chapter 12). Legal provisions, therefore, must be included in the tax legislation to enable the tax administration to operate effectively alongside economic, business, and social environments fully engaged and immersed in modern technology.

Tax authorities all around the world have been quickly moving to redesign their basic business processes and to rapidly implement electronic receipt, processing, and delivery methods. They have been facilitating increased use of the internet for transmission of information and access to tax forms by taxpayers. More and more, all large taxpayers are being required to file their tax returns and accompanying documents electronically. Electronic filing/electronic signatures improve the ease of compliance for taxpayers.[8] At the same time, the tax administration enjoys decreased costs from higher accuracy and greater compliance through electronic processing of tax returns.

Another very significant trend among tax administrators around the world is to legally authorize commercial banks to receive and process tax returns and tax payments. Tax administrators have recognized that cashier functions in their own operations represent a very outmoded method of doing business which lends itself to corruption and risk of revenue loss. Given provisions in the tax code or other tax legislation that enable alternative methods of cashiering, cashier functions in many countries have been outsourced under contracts negotiated by the Ministry of Finance or by the tax administration with commercial banks. Under these contracts, commercial banks receive and process tax payments, send key taxpayer-entity and payment information to the tax administration for reconciliation, and transfer funds electronically to the Ministry or the Central Bank. Many negotiated contracts also require the banks to receive and process tax returns together with payments; provide taxpayers with receipts; forward taxpayer-entity and payment information electronically daily to the tax administration; and bundle and forward tax returns and related paper documents once or twice per week. Free of charge, commercial banks have been provided software developed by the tax administration to perform all these tasks.

[7] Ibid., p. 3.

[8] This, of course, depends on infrastructure levels and the actual requirements of the law. A recent tax compliance cost survey of Nepal by the International Finance Corporation indicated a common perception that the e-filing process is "tedious" (International Finance Corporation (n.d.), p. 42).

3.2.3. International Taxation

As is readily obvious from some of the basic international provisions of tax codes, the variance in tax rates across different countries gives rise to a number of complex international tax issues that confront tax administrations all over the world, such as:

- Deciding which parts of capital should be treated as "domestic" or "foreign" in residence based taxation;
- Deciding what is "foreign" and what is "domestic" income (source rules);
- Matching of expenses and income to whichever expenses relate;
- Deciding which foreign taxes are paid against which income (cross-crediting); and
- Defining related-party transactions and arms-length transactions, including "transfer pricing".

Some basic legislative provisions to ease the tax administration in handling complex international tax issues include:[9]

- A clear definition of the object of taxation, including what constitutes residency, what constitutes a permanent establishment and what income is attributed to it and is subject to tax;
- Providing for credit for taxes paid to other jurisdictions wherever income from outside of the own jurisdiction is taxed, but setting limits on such credits to avoid transferring revenue to these other jurisdictions;
- Allowing for the withholding of tax on payments to nonresidents;
- Providing for rules that prevent the recognition of income or loss from the reorganization of entities;
- Providing for rules that do not allow deferral of taxation (e.g., taxing residents on income from abroad only when this income is remitted to the own jurisdiction); and
- Providing for anti-avoidance related to tax havens, including treating income from a tax haven as taxable, imposing restrictions on deductibility of expenses, imposing taxes on unrealized capital gains when a taxable person leaves the own jurisdiction, and as discussed below, adopting transfer pricing rules.

One of the most difficult international tax issues relates to transfer pricing. Transfer pricing is a way to allocate the profits of the taxpayer by manipulating the prices charged on intra-group (within related legal entities) cross-border transactions. This is done in such a way as to maximize taxable profits in low tax jurisdictions and minimize such profits in high tax countries. The law should include provisions in line with international practices to curb this type of tax avoidance, prescribing methodologies, documentation requirements, and penalties.[10]

[9] In addition, many countries may impose additional levies on nonresidents or on specific transactions under the argument that these are non-transparent.
[10] Comprehensive transfer pricing guidelines are published, for example, by the OECD. See *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2001*, OECD Publishing, 2001.

Of course, without access to financial information in other countries of cross-border corporations which are residents, tax administrations are impotent. The increasingly important objectives of bringing large, multinational taxpayers under control and their complex, cross-border financial transactions with related entities under closer scrutiny have given rise to the urgent need for provisions in tax legislation for tax treaties and international exchange of information. The tax administration has the responsibility to participate with Ministry and/or foreign affairs officials in negotiations of tax treaties and agreements for exchange of information.[11]

Box 3.2. Addressing international tax evasion in Canada

In 2005, CRA reported that over 16,000 Canadian corporate taxpayers were reporting some type of foreign transactions amounting to over $1.5 trillion in taxes to the government.[12] As a growing number of Canadian individuals, trusts, and corporations undertook transactions with entities in foreign jurisdictions, it was imperative for CRA to ensure that the correct amounts of taxes were withheld and that non-residents filed returns and paid the taxes they owed. In the same year, CRA budgeted for an additional $30 million to respond to the growing risk of international tax avoidance and implemented a new Aggressive International Tax Planning initiative. The initiative placed emphasis on increasing audit coverage and research studies on emerging international tax schemes, developing new risk assessment models, and recommending necessary legislative or treaty changes. In addition, in 2004 Canada enacted changes to its Income tax act to allow the government to deny a tax benefit under a tax treaty for abusive tax avoidance and, in 2006 CRA restructured its Compliance Programs Branch. According to a 2012 testimony before Parliament, these reforms had a total fiscal impact of over $2.5 billion in just four years.[13]

Canada's Economic Action Plan 2013 further enhances the capacity of CRA to combat international tax evasion and aggressive avoidance.[14] The Plan:

- Includes a new Stop International Tax Evasion Program that allows the CRA to pay individuals who supply knowledge of major international tax non-compliance;
- Requires financial institutions and others who currently report information on international electronic funds transfers greater than $10,000 to the Financial Transactions and Reports Analysis Centre of Canada to also report those transactions to the CRA;
- Streamlines the judicial process that provides the CRA authorization to obtain information from third parties such as banks; and
- Introduces additional requirements for Canadian taxpayers with foreign income or properties to report more detailed information, and extends the amount of time the CRA has to reassess those who have not properly reported this income.

3.2.4. Semi-Autonomous Revenue Authority (SARA)

As noted, tax administrations in developing countries face many formidable obstacles to modernize their institutions. Among their biggest challenges are meager budgets for space, equipment, and other resources necessary for operations. In fact, it is common for tax administrations to face budget shortfalls, even against meager preliminary budgets. Furthermore, under the Civil Service regulations of

[11] Exchange of information agreements, along with provisions to avoid double taxation and for conflict resolution, are usually part of bilateral tax treaties between countries. See *Model Tax Convention on Income and on Capital 2010*, OECD Publishing, 2012.
[12] Auditor General of Canada (2007), Chapter 7, p. 1.
[13] Downe (2012), para. 2.
[14] Canada Revenue Agency (2013), para. 5.

most developing countries, staff remuneration is generally very low and far from competitive with the private sector. Consequently, one often observes significant levels of corruption.

In response to these circumstances, one trend in developing countries (especially in Latin America and Africa), is for tax administrations, usually through legislation, to become semi-autonomous revenue authorities (SARAs) in hopes that this arrangement will lead to more adequate funding, higher salaries and other benefits. With legal authority given to Tax Administration Jamaica in April of 2013 to establish a SARA, SARAs currently exist in twelve LAC countries. The SARA model has received a great deal of attention among tax and customs administration experts, Ministries of Finance and international donor organizations. SARAs are tax administrations that have greater than usual autonomy along several organizational design dimensions, including: legal character, financing, governance, personnel policy, procurement policy, and accountability relationships.[15] Many advocates see SARAs as solutions not only to inadequate budgets and salaries, but also to low rates of tax compliance, ineffective tax administration staff, and corruption.

As a SARA, in effect, the tax administration is taken out of the MOF and established as a semi-autonomous entity. While there are many variations around a similar basic theme, the principal characteristics include: personnel systems outside of the civil service purview; self-financing mechanisms (usually with a given percentage of gross collections); and boards of directors that usually include the Minister of Finance, other key Ministries, and private sector representatives. A recent IMF conference listed several common arguments in favor of establishing SARAs, including easier reform, addressing civil service rewards, reduced corruption, autonomy from political motivations, etc. However, the IMF added that, except for "autonomy from political motivation", most of the expected benefits have not been realized.

There are nearly 40 SARAs around the world clustered largely in Africa and Latin America[16], according to an IMF study in 2006. In another study conducted in 2004, Arthur Mann[17] examined arguments in favor of and against establishing SARAs, identified elements associated with the "success" or "failure" of the SARA experiment, and offered estimates of overall performance through analyses of indicators such as tax ratios and tax collection productivity measures. Among his major conclusions, he found that a clear picture of success or failure of SARAs could not be detected.

Nevertheless, the objective of this sub-section is not to advocate for or against the SARA model, but to recognize the trend and confirm that a legal framework is absolutely necessary to establish a SARA. From among the many "lessons learned" cited in Mann’s study, he strongly recommended that SARAs "be established under Parliamentary Acts to give the SARA sustainable legal and political legitimacy."[18] The legal framework to establish a SARA comprises too many required provisions to cover here, but the articles cited by Mann and the World Bank offer practical guides for interested tax administration officials.

[15] World Bank (2005), p. 1.
[16] Kidd et al. (2006), p. 11.
[17] Mann (2004), p. 98.
[18] Ibid., p. 56.

3.3. Tax Administration Maturity

Four levels of maturity of the legal framework of tax administrations are presented below to help interested officials make determinations about the level of legal maturity and as rules of thumb to make self-assessments about strengths and weaknesses of their respective tax administration.

Legal Framework: Maturity Level 1

Key word: "Dispersed and Chaotic"

- The legal framework for taxation is dispersed across a series of tax-type laws, each with separate provisions for tax administration, and each administered by a separate tax department, with no coordination among them.
- There is no consistency among the administrative provisions of the separate income, corporate income, and VAT laws, each with different rates of penalties and interest for the same offenses, such as for late-filing, underpayments, etc.
- None of the tax laws establishes self-assessment or other principles of taxation. Consequently, collection by the tax administration, rather than by self-assessment, is the rule.
- No regulations, which interpret the tax laws, are ever prepared, and taxpayers are always in a state of confusion and subject to whatever interpretations are made by the tax administration.
- None of the laws officially creates its respective tax administration, and their organization structures are left to the discretion and mandates of their top tax administrators, who make frequent changes.
- None of the tax laws cites specific responsibilities of the tax administration nor rights of taxpayers.
- Segmentation and control of large taxpayers are not mandated.
- What few compliance and enforcement provisions exist in the separate laws are vague and conflict with laws at other levels of government. Enforcement is non-existent, and non-compliance is widespread.
- None of the laws provides for possible incarceration for tax fraud/evasion.
- There are no legal provisions in the separate laws for the use of banks for receipt of tax returns and payments. All payments are made at separate tax administration cashiers' offices, with very long queues the norm on payment due dates.
- Provisions for e-filing and electronic signatures do not exist in any of the tax laws.
- The Minister of Finance and/or other officials are given discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 2

Key word: "Still Dispersed but Seeking Codification"

- In the second level of maturity, there are still separate laws for each type of tax, but the tax administrations may have been placed under one Director General/Commissioner (the Head), who, with Ministry backing, is exploring initiatives to prepare proposed legislation to enact a tax code or a tax procedures code.

- There is still no consistency among the administrative provisions of the separate income and corporate tax and VAT laws, which each have different rates of penalties and interest for the same offenses, such as for late-filing or underpayments, etc.
- There is now recognition at Ministry and Head levels that relying on collection by the tax administration, rather than by self-assessment, is failing to raise the levels of tax revenue required by government.
- Taxpayers and their legal representatives have pushed the tax administration to prepare a few regulations, which interpret the tax laws, but their timeliness and clarity are usually poor.
- None of the laws officially creates its respective tax administration, but the Head and Ministry officials are exploring re-organizing from type of tax to functional structures[19].
- The various tax laws have been amended to include a few rights of taxpayers, such as the right to appeal proposed assessments, but there is little clarity about mechanisms and court levels involved, and coordination with the judiciary is poor.
- There is no segmentation and control of large taxpayers mandated. However, there is general recognition by the Head and management of the need to do both.
- There are no international tax treaties or exchange of information agreements with other countries.
- What few compliance and enforcement provisions exist in the separate laws are still vague, and they conflict with laws at other levels of government. Enforcement is rare, and non-compliance is still widespread.
- None of the laws yet provide for possible incarceration for tax fraud/evasion.
- There are still no legal provisions in the separate laws for the use of banks for receipt of tax returns and payments. All payments are made at the separate tax administration cashiers' offices, with very long queues the norm on payment due dates.
- Provisions for e-filing and electronic signatures still do not exist in any of the tax laws, but there are some locally initiated projects for e-filing.
- The Minister of Finance and/or other officials continue to have discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 3

Key word: "Codification"

- Either a tax code or a tax procedures code for administrative provisions applicable to all tax laws has recently been enacted.

[19] Functional organizational structures group staff according to their special skills, training, and primary function. In a functionally organized tax administration, for example, auditors will form an audit division and collectors will form a collections division, irrespective of the type(s) of taxes or taxpayers they handle. Functional and other types of organizational structures for tax administrations are discussed in Chapter 4.

- There is now a high degree of consistency in the administrative provisions of the law for violations, but what varies is interpretation and application by tax administration staff.
- The principle of self-assessment is established in the law, but some of the compliance staff still act as if collection by the tax administration is the best method for dealing with taxpayers.
- The tax administration regularly prepares and issues regulations, which interpret the tax laws; however, in too many cases each year, the timeliness and quality of the regulations are poor.
- The tax code/tax provisions code officially creates one tax administration, and generally requires a functional structure, with headquarters, regional (if necessary), and local offices. The Head, with concurrence by the Ministry of Finance, has discretion over the exact organizational structure and future changes.
- The tax code or tax procedures code cites specific responsibilities of the tax administration and rights of taxpayers. However, there are too many proven cases where taxpayers' rights have been violated by tax administration officials.
- Segmentation and control of large taxpayers are authorized by law.
- A few tax treaties and exchange of information agreements authorized by the tax code/tax procedures code have been negotiated, but a few necessary ones are still pending.
- There are some compliance and enforcement provisions in the law, with a certain degree of clarity about their position with regard to laws at other levels of government. There is some ongoing enforcement, such as garnishing taxpayers' funds on deposit in commercial banks. However, seizure and sale of property for non-payment of taxes is rarely undertaken because of conflicts with common law or other laws.
- There are still no provisions to require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file.
- The tax code/tax procedures code provide for fines, penalties, and/or possible incarceration for tax fraud/evasion. However, the tax administration uses these provisions mainly to raise revenue rather than to encourage voluntary compliance by setting examples of the consequences of non-compliance.
- There are now legal provisions in the tax laws that provide the Ministry and the Head with the option of using banks for receipt of tax returns and payments. However, the Ministry and Head choose not to exercise this option and continue their cashier function.
- Provisions for e-filing and electronic signatures now exist, and there is a fair degree of e-filing, including that of large taxpayers, whose e-filing is still optional in the law.
- There is now a statutory provision that allows exemptions only by a law of general application. Therefore, the Minister of Finance and/or other officials do not have discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 4

Key word: "Model Tax Law"

- A comprehensive tax code is in place.

- There is almost 100 percent consistency in the provisions of the law for violations of any type of tax, and the application of these provisions by the tax administration is highly and consistently accurate.
- Self-assessment is the established principle of taxation in the law, and the degree of voluntary compliance determined by reliable compliance studies is consistently above 85 percent each year.
- Regulations which interpret the tax laws are regularly prepared and issued, including advance rulings requested by taxpayers, and their timeliness and quality are excellent.
- The tax code officially creates the tax administration with a functional structure and gives authority to the Head of the tax administration, with concurrence by the Ministry of Finance, to make future changes, as necessary. These are, in fact, made periodically, with very good results.
- All the rights of taxpayers and responsibilities of the tax administration cited above are incorporated in the tax code and are realized regularly by both parties.
- A Large Taxpayer Office (LTO) for control of large taxpayers, mandated in the tax code, is established and the tax administration and taxpayers are both satisfied with the LTO's operations.
- Required tax treaties and exchange of information agreements authorized by the tax code have all been negotiated and are updated periodically.
- Most, if not all, of the compliance and enforcement provisions critical for successful operations of the tax administration are part of the tax code and fully applied by the tax administration.
- Provisions in the tax code require banks or other third parties to regularly provide information about payments to taxpayers to the tax administration for matching with its master file, and the tax administration enjoys a very successful matching/compliance program.
- The tax code’s provisions for sanctions, including possible incarceration, for tax fraud/evasion are vigorously applied, and convictions and prison sentences are widely publicized.
- Under tax code provisions, banks handle 10-15 percent of filings of tax returns and 45-60 percent of tax payments for the tax administration, under contracts negotiated by the Ministry and the Head.
- Provisions for e-filing and electronic signatures in the tax code have helped the tax administration accomplish a 60-70 percent e-filing rate by general taxpayers, and a 100 percent rate by large taxpayers, as required by law.
- A statutory provision that allows exemptions only by a law of general application has been part of the tax code for several years.

3.4. Latin America and the Caribbean

With respect to many aspects of the overall legal framework for tax administration, several countries in Latin America – Argentina, Brazil, Chile, Colombia, and Mexico, for example – have sophisticated tax administrations. Overall, LAC countries generally are at the third level of maturity above. In a few very important features of their legal frameworks, however, almost all LAC countries are at the second level of maturity. Examples of legal features of LAC countries at the second level of maturity are:

- Almost all Latin American countries now have and are required to follow a tax code as their sole, respective legal authority for tax administration[20], but some Caribbean countries still have their legal framework for taxation dispersed across a series of tax laws, each with its own set of provisions for tax administration, together with the usual assortment of regulations, executive instructions, and ad hoc decisions issued from a variety of sources. With some exceptions in countries like Chile, Colombia, and Mexico, there is a general absence of implementing regulations;
- Some principles of taxation, several rights of taxpayers, and several responsibilities of the tax administration are either not part of the tax code or tax laws or are vague and widely dispersed;
- Substantial provisions to enhance compliance, which should be granted to the tax administration in the laws, are lacking. For example, there are generally no legal requirements in the tax codes or tax laws of LAC countries for financial institutions and other payers to routinely and regularly provide information about payments to taxpayers in order to match such information with the tax administrations' files.[21] For example:
    - Judicial authorization is required for the tax administrations to access financial information from banks in eight Latin American countries;
    - Bank information can be requested individually only on case-related investigations in seven countries; and
    - Only three countries – Colombia, Chile and Peru – can access bank information that is not case-related;
- Separately, bank secrecy laws, which further thwart compliance with tax laws, are widespread throughout the region;
- Since tax legislation does not provide authorization to Ministries of Finance and tax administrations of many countries to enter into agreements with banks or other financial institutions to receive tax payments and tax returns on behalf of the tax administration, many continue to operate antiquated cashier functions, which are not only inefficient and risk-prone, but are also sources of dissatisfaction and frustration for taxpayers and their legal representatives, particularly because of long queues and delays required simply to file tax returns, make tax payments, and generally comply with tax obligations;
- There is limited authority to compel testimony or summons persons and documents and to conduct criminal investigations for tax fraud and evasion (the latter is, on occasion, vested in other agencies). Sanctions in the law for tax evasion/fraud consist mainly of monetary fines;
- Garnishment, seizure, and sale of personal and real property are very limited under the tax laws of most LAC countries, and provisions are often in conflict with other national laws of the country. For example, in Latin America,[22] the tax administrations of Brazil, Costa Rica, Guatemala, Honduras, and Paraguay have no authority to enforce collection of delinquent taxes; judicial review before enforcement is required in Argentina, Nicaragua, and Paraguay;

[20] Inter-American Center for Tax Administrations (CIAT) et al. (2012), p. 31.
[21] Ibid., p. 33.
[22] Ibid., p. 8, 15.

and the tax administrations of Chile and El Salvador have no legal authority whatsoever to collect delinquent taxes;

- Generally, throughout the LAC region, the use of sanctions to deter non-compliance is weak. For example, sanctions are low in number and not rigorously applied, which "renders this enforcement tool an ineffective instrument as a deterrent to non-compliance";[23]
- In most LAC countries, there is no authority to administratively report tax arrears accounts as uncollectible, even in bankruptcy "no-asset" cases, no-asset death cases, etc. Coupled with weak enforcement provisions, the lack of write-off authority swells the stock of tax arrears, of which many are old and uncollectible, throughout the LAC region. For example, the percentage of tax arrears inventory or stock older than 5 years in Latin American countries is quite high, ranging as high as 86 percent (Peru), with an average of 42.37 percent for countries in Latin America;[24]
- Almost universally in the tax codes or tax laws of most LAC countries, there is a general absence of formal delegation of authority to the lowest appropriate levels in order for decisions on cases and administrative issues to be promptly made, rather than to be routed to upper levels of management for decisions; and
- With regard to the current prominence of international taxation issues, and specifically to exchange-of-information and double taxation agreements, the maturity level of the legal framework in LAC countries is mixed, as evidenced in part by the number of double taxation agreements in the various countries. For example, in Latin America, three countries have no double taxation agreements at all, four have only one each, and three other countries have only 10 in total among them.[25]

Of particular concern, in almost all LAC countries, legal sanctions for tax fraud/evasion are either very weak and/or are seldom applied to the full extent of the law. In developed countries, every so often, authorities pursue felony cases of tax fraud, which may receive a high profile in the news media and serve to highlight for the general public consequences for tax non-compliance. In the developing world, many countries have made tax fraud a criminal offense only recently. In some cases, despite having the laws in place, these sanctions are seldom applied. In El Salvador, which enacted its tax fraud felony legislation about ten years ago, for example, only a handful of cases have been brought to courts for enforcement in recent years – none between 2006 and 2009 and only 3 cases in 2010. Generally, "the number of convictions for tax fraud/evasion in too many Latin American countries is very low, while there have been no convictions at all in other countries of the region during the last 5 years."[26]

However, there are promising developments. For example, the Inter-American Center of Tax Administrations (CIAT) has drafted a model tax code to help member countries that are interested in further improving their current legal frameworks, particularly those at the second level of maturity described above. Also in the region, Jamaica, one of the few countries that do not have a tax code,

[23] Ibid., p. 36.
[24] Ibid., p. 52.
[25] Gomez Sabaini et al. (2012), p. 56-57.
[26] Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 38-41, 73.

drafted a tax procedures code in 2011, which is being considered for possible enactment. There are also positive developments with regard to collaboration with commercial banks to assist tax administrations with the receipt and preliminary processing of tax returns and tax payments. Guatemala and El Salvador, among other countries, have negotiated contracts with commercial banks and developed software for processing payments that they provide to the banks free of charge. Under this arrangement, commercial banks receive and process tax declarations, together with payments, and provide taxpayers with receipts for tax declarations and payments received.[27]

Furthermore, LAC countries have led the way with regards to developing legislation for the establishment of SARAs. The oldest SARA was established in Peru in 1988,[28] and, as of 2010, Argentina, Barbados, Bolivia, Colombia, the Dominican Republic, Ecuador, Guatemala, Guyana, Mexico, Peru, and Trinidad and Tobago had Revenue Authorities.[29]

3.5. Key Benchmarks and Guidelines

The key benchmarks for the legal framework of tax administrations are very similar to the fourth level of maturity described in Section 3.3:

- A comprehensive tax code has been enacted and there is 100 percent consistency in the provisions of the law for violations of any type of tax, and the application of these provisions by the tax administration is highly and consistently accurate. If a tax code has not been enacted, a tax procedures code which consolidates all the administrative provisions from the various tax laws has been enacted;
- Self-assessment is the established principle of taxation in the law, and the degree of voluntary compliance determined by reliable compliance studies is consistently above 85 percent each year;
- Regulations which interpret the tax laws are regularly prepared and issued, including advance rulings requested by taxpayers, and their timeliness and quality are excellent;
- The tax code officially creates the tax administration with a functional structure, and it gives authority to the Head, with concurrence by the Ministry of Finance, to make future changes, as necessary;
- All the rights of taxpayers and responsibilities of the tax administration cited in section 3.1.2. above are incorporated in the tax code;
- Most, if not all, of the compliance and enforcement provisions critical for successful operations of the tax administration cited in Section 3.1 are authorized in the tax code or the tax procedures code;
- Provisions in the tax code require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file, and the tax administration enjoys a very successful matching/compliance program;

[27] Gallagher et al. (2009), p. 69.
[28] Kidd et al. (2006), p. 11.
[29] USAID's Collecting Taxes database (http://egateg.usaid.gov/collecting-taxes).

- The tax code includes provisions for sanctions, including possible incarceration, for tax fraud/evasion and authorizes publicity for convictions;
- Under tax code provisions, commercial banks are authorized to handle filings of tax returns and tax payments for the tax administration, under contracts negotiated by the Ministry and the Head;
- The tax code/tax procedures code authorizes e-filing and electronic signatures and requires 100 percent of large taxpayers to file electronically;
- A statutory provision that allows exemptions only by a law of general application is included in the tax code/tax procedures code; and
- Required tax treaties and exchange of information agreements authorized by the tax code are all negotiated and are updated, as required.

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