# USAID'S STRENGTHENING PUBLIC FINANCIAL MANAGEMENT IN LATIN AMERICA AND THE CARIBBEAN (PFM-LAC)

# Paraguay Public Financial Management and Tax Administration Desk Assessment

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# List of Acronyms and Abbreviations

| Acronym | Definition |
|---|---|
| CC | Spanish acronym for Procurement Code |
| CGR | Comptroller General of the Republic |
| CDP | Spanish acronym for Budget Availability Certificate |
| CIAT | Spanish acronym for Inter-American Center of Tax Administrations |
| DGCP | Spanish acronym for Directorate General of Public Accounting |
| DGP | Spanish acronym for Directorate General of the Budget |
| DNCP | Spanish acronym for National Procurement Directorate |
| EC | European Commission |
| EU | European Union |
| FMIS | Financial Management Information System |
| GoP | Government of Paraguay |
| IFRS | International Financial Reporting Standards |
| IDB | Inter-American Development Bank |
| IMF | International Monetary Fund |
| IT | Information Technology |
| LAC | Latin America and the Caribbean |
| LTU | Large Taxpayer Unit |
| MDA | Ministries, Departments, and Agencies |
| MOF | Ministry of Finance |
| MTF | Medium-Term Framework |
| MTBF | Medium-Term Budgetary Framework |
| MTEF | Medium-Term Expenditure Framework |
| MTFF | Medium-Term Fiscal Framework |
| PAC | Spanish acronym for Annual Procurement Plan |
| PEFA | Public Expenditure and Financial Accountability |
| PFM | Public Financial Management |
| PFM-LAC | USAID's Strengthening Public Financial Management in Latin America and the Caribbean Project |

| Acronym | Definition |
| --- | --- |
| PIT | Personal Income Tax |
| PSDPL | World Bank Public Sector Development Policy Loan |
| SET | Spanish acronym for Tax Sub-Secretariat of the State (MOF) |
| SIAF | Spanish acronym for Integrated Financial Management System |
| SICO | Spanish acronym for Integrated Accounting System |
| SIPP | Spanish acronym for Integrated Budget Programming System |
| SITE | Spanish acronym for Integrated Treasury System |
| SSEAF | Spanish acronym for State Sub-Secretariat for Financial Management (MOF) |
| SSEI | Spanish acronym for State Sub-Secretariat for Economy and Integration (MOF) |
| TIN | Taxpayer Identification Number |
| WB | World Bank |

*Note: Where applicable, the Spanish acronym is utilized.*

# Introduction

This desk study constitutes the first phase of a two-phase process with the objective of strengthening public financial management (PFM) and tax administration in Paraguay. The first phase consists of analyzing gaps in PFM and tax administration in Paraguay when compared with leading practice. The results of the desk study will facilitate the joint selection by USAID/Paraguay and the Government of Paraguay (GoP) of priority areas for strengthening, followed by the development of an action plan for how to improve these priority areas. Thereafter, specific activities within the action plan will be selected for further support under the USAID Strengthening Public Financial Management in Latin America and the Caribbean (PFM-LAC) Project.

This desk study first provides a broad overview of PFM practices and then takes a more in-depth review of tax administration processes. The first section, Strengthening Public Financial Management, which builds on a prior nine-country desk study[1] of PFM practices in the LAC region, describes leading practices in six different dimensions, provides a high-level overview of current practices in each dimension, and presents a gap analysis of current versus leading practices. The second section provides a more detailed review of tax administration practices through an overview of recent tax administration reforms and a comparison of current practices versus leading international practices.

PFM and tax administration have been key focus areas for GoP during the past decade. The government enacted important reforms to improve the efficiency, effectiveness, and transparency of public expenditures following two Public Expenditure and Financial Accountability (PEFA) evaluations in 2008 and 2011. Over the past decade, efforts to strengthen revenue mobilization and tax administration in Paraguay have included the simplification of the tax system by reducing the number of taxes, modifying the tax legislation to broaden the tax base and focus on indirect taxation, a modernization of the tax administration, and improved tax collections.

Despite progress in strengthening PFM and tax administration, there remains significant opportunity to close gaps between leading practices and the current state identified by this report. The second phase of this activity will utilize the action plan suggested in this report to facilitate the selection of potential interventions to be executed with the support of the PFM-LAC Project.

[1] *Public Financial Management Practices in Latin America and the Caribbean: A Review of the Trends, Challenges, and Opportunities for Improvement*

# Strengthening Public Financial Management

## Introduction

In order to compare current PFM practices in Paraguay to leading PFM practices, this assessment focuses on six (6) core PFM dimensions:

1. Medium-term Frameworks (MTF) in Budget Planning,
2. Budget Execution,
3. Public Procurement,
4. Financial Reports,
5. External Audit Reports, and,
6. Legislative Scrutiny of the Budget.

Based on publicly available information, and building on a previous USAID desk assessment of PFM practices in Latin America and Caribbean (LAC) countries, this assessment compares current PFM practices in Paraguay with leading practices, highlighting potential areas for improvement. GoP is continuously reforming its PFM practices, so the most current information may not be readily available without in-country research and interviews. Strengthening the aforementioned six core PFM dimensions will help GoP to ensure financial compliance and promote efficiency and effectiveness in service delivery to its constituents. These dimensions were previously identified by the Ministry of Finance (MOF) as priority reform areas and align with the government's reform agenda. They are also critical elements of a well-functioning PFM system (see Figure 1 below).

**Figure 1 – Relationship between Core PFM Practices[2]**


## 1. Medium-Term Frameworks (MTF) in Budget Planning

### Leading Practices

A national budget is the financial mirror of a country's economic and social priorities. Leading practices in budget preparation have shifted away from making the budget an annual planning exercise to budgeting for a multi-year time horizon in line with national strategic priorities. Multi-year budgets take a

[2] Adapted from USAID, *Public Financial Management Primer*, 2013

forward-looking approach by prioritizing spending and enabling public expenditure to be directed to best serve established policy objectives. The starting point for multi-year budget preparation centers on having accurate estimates of revenue and consistent medium-term macroeconomic projections to frame the preparation of the annual budget. This framework disciplines the formulation of subsequent spending options and makes tradeoffs explicit.[3]

Many governments begin their transition to a multi-year budgeting process with the development of a medium-term fiscal framework (MTFF), before moving to a medium-term budgetary framework (MTBF), and eventually to a medium-term expenditure framework (MTEF). Figure 2 below illustrates how each of these tools builds on each other in order to facilitate a multi-year planning process.

An MTFF introduces policy constraints into projections; debt and deficit targets are established using model-based debt sustainability analysis, and revenue forecasts are based on models from the tax administration agency. An MTBF goes a step beyond MTFF, using disaggregated revenue and expenditure projections to inform the process. MTEF, the most complex planning framework, incorporates expenditure projections by program and results projections. Regardless of the framework, central authorities—usually a Ministry of Finance—also typically prepare a background paper on macro-fiscal objectives as part of the budget documentation to inform ministries, departments, and agencies (MDAs), as well as the legislature, during the decision-making process.[4]

**Figure 2 - Fiscal, Budgetary, and Expenditure MTFs[5]**

<table>
<tr><th>Projections</th><th colspan="3">Level</th></tr>
<tr><td>GDP Projections</td><td rowspan="4">MTFF</td><td rowspan="7">MTBF</td><td rowspan="9">MTEF</td></tr>
<tr><td>Inflation Projections</td></tr>
<tr><td>Aggregated Expenditure Projections</td></tr>
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<tr><td>Expenditure Projections by Program</td><td></td><td></td></tr>
<tr><td>Results Projection</td><td></td><td></td></tr>
</table>

## Current State

GoP has struggled to adopt a multi-year perspective in fiscal and expenditure planning despite introducing several initiatives in recent years.[6] The 2011 Public Expenditure and Financial Accountability (PEFA) Report suggests that the government has been unable to link economic and financial projections with key development needs despite the availability of a multi-year budget, a results-based annual budget, and two national strategies.[7, 8] Evaluators from PEFA and USAID's PFMRAF Stage I Appraisal cite limited technical ability to prepare medium-term economic and financial analyses at all government levels, including at the MOF,[9] line ministries, departments, and agencies (MDAs), and the budget committees of the Legislature. Specific issues identified with the multi-year planning process include the lack of forward estimates of fiscal aggregates, weak or non-existent sector strategies with incomplete costing of

[3] Shah. "*Budgeting and Budgetary Institutions*," World Bank, 2007
[4] World Bank. "*Beyond the Annual Budget*," p. 25
[5] Adapted from Filc and Scartascini. "*Is Latin America on the Right Track? An Analysis of Medium-Term Frameworks and the Budget Process*," IDB, 2010
[6] Multi-Year Budget (Presupuesto Plurianual) since 2006 and Results-Based Budget (Presupuesto por Resultados) since 2011.
[7] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, p. 16
[8] Strategic Economic and Social Development Plan (PEES) and Public Policy for Social Development (PPDS)
[9] MOF is comprised of three technical State Sub-Secretariats: Economy and Integration, Financial Management, and Tax

investments and recurrent expenditures, and no linkages between investment budgets and forward expenditures estimates. MOF has identified MTF as an area for improvement in its 2012-2015 Action Plan for Improving PFM.[10] The 2011 PEFA noted that GoP was in the process of creating a Macro-Fiscal Unit within the State Sub-Secretariat for Economy and Integration (SSEI) with responsibility for creating medium-term economic and fiscal forecasts, and for conducting a fiscal sustainability exercise at least once a year,[11] but as of this report, it is unclear whether the unit is operational.

## 2. Budget Execution

### Leading Practices

In a decentralized model, leading practice in this area centers on empowering the MDAs with sufficient flexibility and authority to manage their annual budget. MDAs should be intimately involved with forecasting monthly/quarterly expenditures in accordance with annual appropriations and then executing their budget in line with these monthly/quarterly expenditure plans. Internal controls are preferred to ex ante controls performed by a central agency.[12] Well trained MDA staff, with the requisite technical competencies, are involved in setting targets that contribute to the effective use of public funds. Leadership generally makes use of comprehensive management systems so that MDAs measurably and continuously improve performance (financial and organizational).

MDAs should have effective integrated financial management systems to execute the budget properly, maintain spending controls, and comply with policy and regulations. The use of financial management systems provides access to real-time information regarding funds availability and adherence to cash plans and budget ceilings. The systems capture and disseminate information so that reporting on budget execution is reliable and accurate, and citizens and civil society have sufficient access to public information on the use of national resources.

### Current State

GoP budget execution operates within a model of regulatory centralization (MOF coordinates) and operational decentralization (the MDAs administer and use resources through Financial Management Units). Financial and cash planning[13] is coordinated by the Directorate General of the Budget (DGP) and Treasury. MDAs prepare individual draft budgets and annual procurement plans (PACs) to inform the budget preparation process; once the budget is approved, monthly cash plans establish expenditure limits throughout the fiscal year. The budget is executed using Paraguay's Integrated Financial Management System (SIAF), which is comprised of a set of sub-systems with centralized and decentralized operations, including the Integrated System for Budget Programming (SIPP), the Integrated Treasury System (SITE), and the Integrated Accounting System (SICO).

SIAF coverage is incomplete; various social security institutions, public enterprises, and financial institutions,[14] which together accounted for 39% of the central government budget in 2011, use their own systems to execute and track expenditure, and then staff manually inputs data into SIAF. This may reduce the quality, transparency, and comprehensiveness of data in SIAF, as manually entered data may be inaccurate, incomplete, or delayed. Additionally, despite the fact that the annual procurement plans are mandatory for all central government entities, entering commitments using the SIPP (budget system) is

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[10] Paraguay MOF. "*Plan de Acción para la mejora de la Gestión de las Finanzas Publicas en Paraguay 2012-2015*," pp. 11-14,

[11] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, p. 55

[12] Shah. "*Budgeting and Budgetary Institutions*," World Bank, 2007

[13] Monthly financial plans are the maximum amount of payment obligations that can be incurred in a given month and are based on the approved budget. Requested cash plans and approved cash plans represent, respectively, requests by MDAs arising from procurements and the monthly allocation as adjusted by the Treasury.

[14] There are five official financial institutions: National Development Bank, *Crédito Agricola de Habilitación*, Livestock Fund, Ministry of Defense Loan Fund, and Financial Development Agency.

only done at 22 of 23 central entities and 45 of the 62 decentralized entities, creating potential cash flow and overspending risks.[15]

The 2011 PEFA highlights the frequent passage of budgets that include higher expenditure estimates than anticipated revenue estimates, which usually leads to the subsequent application of strict financial and cash management constraints.[16] Cash is rationed so that agencies receive less than appropriated, on a schedule that is difficult to predict.[17] This is evident when approved budgets, quarterly cash plans, and execution levels are compared; MDAs execute at lower levels than what should be available according to the approved budget or what is initially requested in quarterly cash plans.[18]

Constraints on budget implementation are also closely related to the management of payment arrears. During the latest PEFA assessment, payment arrears comprised between 2% and 10% of total GoP expenditure, with no significant reduction from the previous assessment. Treasury's information on outstanding payment arrears and age of the arrears at the central level includes 22 of the 23 entities that submit information through SICO (the accounting module) and SITE (the Treasury system); however, arrears information from decentralized entities is less reliable, because many of these entities send monthly information only on payments made through their respective systems.[19] Data on the stock of arrears for these decentralized entities is available in aggregated terms only, with no information on the arrears' age profile. The inability to fully track arrears that are not posted in SIAF may affect payment prioritization and sustained arrears levels from one fiscal year to the next.

The budget realignment process has a hierarchical approval process with approvals required from the President, MOF, or the Legislature depending on the type of realignment. These adjustments can be made by law in the case of a request for an increase or a reallocation of expenditure among MDAs; by presidential decree in the case of reallocations within the same MDA, but across programs; and by a resolution of MOF, by lower ranking officials, in the case of reallocations within the same program. Modifications related to the civil service (such as the creation of positions or salary changes) require a change by law.

## 3. Effectiveness of Transparency of Public Procurement

### Leading Practices

Leading practice in public procurement is guided by advanced and methodical planning. MDAs prepare procurement plans (ideally on a multi-year basis) which direct action plans, cost estimates, and subsequent budget allocations. To accomplish such forecasting, procurement officers need relevant technical and management skills to prepare accurate estimates and price analyses, and thereafter to manage the procurement process.

In general, the public procurement lifecycle is administered through a financial management information system (FMIS), either through an integrated module, or using a system that interfaces the procurement and financial management systems. To achieve a connection between procurement planning and the delivery of goods or services (and budget planning and execution), procurement information systems require transactional capabilities and links to budget execution systems, for example, via modules for contract, asset, and inventory management. This allows MDAs to follow proper contract management procedures, from the tender process, to payments, to contract closeout.

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[15] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, pp. 107-109
[16] Ibid., p. 39
[17] Lapido et al. "*Accountability in Public Expenditures in Latin America and the Caribbean*," World Bank, 2009, p. 38
[18] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, p. 96
[19] Ibid., p. 42

## Current State

Public procurement in Paraguay is codified as a decentralized process carried out primarily by MDA procurement units. Each institution must include projected procurement in the national budget, preparing annual procurement plans (PACs) to inform the process. PACs are based on needs and objectives and budget allocations established by the national budget, and approved by the procurement regulator, the National Procurement Directorate (DNCP).

It has been observed that MDAs employ a baseline approach to preparing their PACs, where a specific year's PAC is based the previous year's plan with an incremental increase.[20] The simplistic nature of procurement planning could be due to a variety of factors, including limited technical capacity to plan and manage the procurement process. . For instance, poor price analysis has led to instances of collusion between bidders to pre-determine pricing for goods and services, resulting in higher costs for public entities.[21] Without proper price analysis there is also heightened risk that procurement units could direct bids toward specific vendors and reduce competition. A new procurement law[22] was implemented in 2007 to address regulatory gaps and low technical capacity, providing procurement staff with relevant training and creating a DNCP certification.

DNCP oversees the implementation of procurement laws and publishes all notices of competitive bidding and invitations to tender on the Public Procurement Information System (SICP), a web-based e-procurement platform for government users (procuring entities) and external users (suppliers and civil society). SICP currently includes information on business opportunities and regulations, but does not have fully established transactional capabilities with links to budget execution systems.[23] Instead, procurement is executed via SIAF using manual verification processes.

An MDA initiating a procurement request through the SICP must first confirm budget availability electronically against the annual procurement plan. Once confirmed, a budget availability certificate (CDP) is generated and provided to the DNCP for approval to proceed with the procurement. Once DNCP confirms the CDP, it issues a procurement code (CC) which the MDA uses to enter a commitment into SIAF, thereby establishing a budgetary reserve.[24] DNCP then authorizes payment. The use of annual procurement plans, CDPs, and CCs provide some control and enforce planning, but for institutions not connected to SIAF there is no real-time control over budget availability, increasing the risk that funding will not be available when payment is due, and limiting the capacity to monitor expenditures.[25]

Procurement planning is affected by unrealistic national budgets (which are generally under-executed) and cash rationing imposed throughout the year. MDAs do not consistently prepare accurate PACs, basing procurement projections instead on the previous year's plan. Approved and actual allocations frequently deviate, which likely reduces the quality of the PACs. The 2012 Stage I Rapid Appraisal highlights a culture of "use or lose" in spending, where funds are used even if not for intended purposes and frequent procurement exceptions are utilized at the end of the year.[26] Poor contract management exacerbates inaccuracies in planning. Violations of contract terms, poor monitoring and evaluation leading to overruns, and ineffective reporting and communication can all affect an MDA's ability to plan.

PFM assessment teams have found that the contract management process has weak controls and little monitoring and oversight in regards to payments, due dates, or verification of goods or services received.

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[20] USAID. "*PFMRAF Stage I Rapid Appraisal for Paraguay.*" 2012, p. 20

[21] Ibid., p. 29

[22] Act 3439/07 reformed Public Procurement in Paraguay. Under the new law, the former Directorate General of Procurement became the National Procurement Directorate (DNCP), an independent and autonomous body under the Presidency.

[23] Lapido et al. "*Accountability in Public Expenditures in Latin America and the Caribbean*," World Bank, 2009, p. 9

[24] IDB, WB. "*Update of the Country Procurement Assessment Review,*" 2007, pp. 28-29

[25] Ibid., p. 7

[26] USAID. "*PFMRAF Stage I Rapid Appraisal for Paraguay,*" 2012, p. 4

After a procurement request is initiated by the responsible unit and then approved by DNCP, the MDA awards a contract to the selected vendor. The overall contract administration process, including the guidelines for vendor management, process for contract termination and remediation, and contract liquidation however, are not clearly delineated in the regulations. Specifically, procurement manuals do not specify which entity or entities are responsible for key elements of contract management – such as payment verification or validation of goods or services.[27] This lack of clarity over responsibilities risks delays in processing payments,[28] and the lack of defined roles and responsibilities between the MDAs and the DNCP weakens the accountability for the whole procurement cycle. In addition, there is no established asset or inventory management process. GoP has attempted to address some of these shortcomings; according to the 2012 Stage I Rapid Appraisal, the DNCP is in the process of implementing a contract execution monitoring module;[29] however, it is not clear if a robust system for asset tracking is currently in place.

## 4. Timeliness and Accuracy of Financial Reports

### Leading Practices

Leading practices entail the existence of national accounting standards based on internationally-accepted financial regulations and procedures that guide the recording and reporting of financial information for the public sector. MDAs and public entities generally abide by the same standards in order to ensure consistency across financial reports. Management and staff in charge of reporting functions should be qualified to produce consistently high quality, timely reports and identify inconsistences or potential issues. This can be achieved through targeted training and strengthened information systems.

FMIS facilitates the reporting process, because MDAs use the system to execute and record all transactions involving public and external funds. An effective FMIS extends to all central level MDAs and public entities, and integrates processes that have implications on budget execution, including procurement, asset management, debt management, and payroll. This allows for comprehensive financial reporting.

### Current State

In Paraguay, financial reports are prepared according to general guidelines established by MOF in the annual budget law and documented in a manual provided to each MDA. However, these accounting guidelines only partially adhere to international standards for the public sector.[30] MOF included a goal for eventually aligning national accounting standards to the International Public Sector Accounting Standards (IPSAS) in its 2012-2015 Action Plan to Improve PFM.[31]

The Directorate General of Public Accounting (DGCP) is in charge of systems and procedures related to public accounting, consolidating annual financial reports from MDAs, overall reporting, and advising and supervising the institutional accounting units at MDAs. Records and status reports on budget execution are consolidated by DGCP based on information prepared by individual MDAs. The budgetary and accounting classifications are equivalent and use the same degree of disaggregation.

Individual MDAs prepare monthly reports as well as annual financial reports on revenues, expenditures, and financial assets and liabilities, which DGCP then consolidates. State-owned public enterprises also prepare financial reports, but because they use different accounting standards, conversion tables are used to facilitate incorporation into the annual report. Annual financial statements lack information on financial

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[27] Paraguay DNCP. "*Manual de Procesos de Contrataciones Públicas*," 2013
[28] USAID. "*PFMRAF Stage I Rapid Appraisal for Paraguay,*" 2012, p. 29
[29] Ibid., pg. 5
[30] EC, IDB, WB. "Paraguay PEFA Report, Repeat Assessment," 2011, p. 74
[31] Paraguay MOF. "*Plan de Acción para la mejora de la Gestión de las Finanzas Publicas en Paraguay 2012-2015*," p. 18

assets from state-owned enterprises and have inadequate disaggregation (i.e. data at the program level). In addition, SIAF, which includes both SIPP and SICO (budget programming and accounting systems), only covers 22 of 23 central entities and 45 of the 62 decentralized entities, thus creating a data gap.[32]

## 5. Audit Reports (External Audit)

### Leading Practices

Audit reports are not an end in themselves, but rather a key part of the accountability process. Leading practice dictates that supreme audit institutions (SAIs) belong to the International Organization of Supreme Audit Institutions (INTOSAI) and leverage international best practices codified in INTOSAI audit standards to increase the effectiveness of audits. External audit scope can vary depending on the legal mandate; while some SAIs are required to audit all government entities each year, others are only required to produce one overall annual report on the use of the national budget, or have discretion as to how many individual entities to audit each year. INTOSAI standards recommend that audit reports assess both financial accuracy of transactions in a public entity and the effectiveness of the MDA's operations (value for money). To be fully effective, these reports should be produced and reviewed in a timely manner, according to a clearly established calendar, and include a systematic approach to implementing recommendations.

Because the quality of audit reports affects how interested stakeholders will view and use audit findings and recommendations, it is important that audit reports clearly show what needs to change, why it must change, and how improvements can be made, using plain language whenever possible. To be effective, recommendations presented in audit reports need to be achievable, measurable, and affordable, and the topics relevant for the government or MDA.[33] External audit reports should be reviewed by the legislature on a recurring and consistent basis and external audit report findings should be prioritized during this process. Finally, the implementation of audit findings should be monitored and documented.

### Current State

The Comptroller General of the Republic (CGR), the SAI in Paraguay, performs financial audits, programmatic audits, and budget audits based on an annual plan, and it follows the national audit manual (*Tesarekó*). Audits performed are almost exclusively transactional verifications, and the scope of external audit activities only covered 59% of the national budget in 2009[34] and 80% in 2012[35] despite CGR's mandate to cover all central, regional, departmental, and decentralized public entities and state-owned enterprises.

Due to understaffing[36] and underfinancing, CGR performs audits with a three to four year delay, and most municipalities are not audited. CGR does not have authority to criminally investigate, prosecute, or impose sanctions. Since 2009, the practice of follow-up to audit recommendations was formally incorporated into the audit process. All audited entities have a 30 day deadline to send an action plan to implement audit recommendations. The Sector Analysis Unit of the CGR collects the action plans, and requires proof of compliance by the following year in order to avoid a re-audit. As of the 2011 PEFA, it was not yet possible to verify the effectiveness of the new procedure.

Audits do not focus on potential systemic issues, and audit reports and their findings are not always prioritized by the Legislature or by audited entities.[37] Legislative scrutiny of the audit reports generally

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[32] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, pp. 107-109
[33] INTOSAI. "*How to increase the use and impact of audit reports*," 2010
[34] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, p. 76
[35] USAID. "*PFMRAF Stage I Rapid Appraisal for Paraguay,*" 2012, p. 73
[36] The CRG website lists over 850 employees, though at the time of the Stage I Rapid appraisal, only 400 were auditors (http://www.contraloria.gov.py/index.php/categorias-de-archivos/category/3503-nomina-de-funcionarios-cgr)
[37] EC, IDB, WB. "*Paraguay PEFA Report, Repeat Assessment*," 2011, p. 76

takes more than 12 months to complete, if at all. When completed, the Legislature makes recommendations, but there is no follow-up to verify implementation or any penalties for non-compliance. Legislative hearings on key findings are only held with MOF. CGR cannot impose sanctions, and there are no regulations defining a code of penalties for irregularities associated with the management of public resources. Without the authority to prosecute or sanction, there is increased risk that MDAs will not prioritize the correction of legal norm violations related to financial management.

## 6. Role of the Legislature in Scrutiny of the Budget

### Leading Practices

Leading practice in budget scrutiny dictates that the legislature makes use of all available budget documents to effectively examine individual budget requests and align these with national strategic development priorities. The level of influence that a legislature can have during the budget preparation process can vary. Legislatures can be well-informed but have no influence on budget policy, they can develop full-fledged internal capacity for budgeting, or they can enter into cooperative partnerships with MDAs to shape medium-term frameworks and budgets.[38]

The degree of legislative scrutiny and influence depends, in large part, on the level of technical capacity on the part of legislators and their ability to utilize and understand forecasting techniques. There are various technical committee models that a legislature can employ to effectively scrutinize the budget. Legislative budget committees can be comprised of legislators with degrees in economics, finance, public administration, or those with relevant budgetary experience. Governments can also develop technical budget offices to assist lawmakers in scrutinizing the budget in the form of independent budget offices, public accounts committees, or legislative research institutes.[39]

### Current State

GoP has a bicameral legislature comprised of a Senate and a Chamber of Deputies. There are specialized budget review committees within the Legislature: a Bicameral Commission is formed annually for discussing the budget prior to its approval; the Senate has a permanent Commission of Finance, Budget, and Accounts; and the Chamber has an advisory Commission on the Budget.

Legislators do not have access to technical expertise to analyze budget requests, even in the specialized committees, and politicization of economic policy often overshadows more technical considerations during budget discussions. There have been previous attempts to build legislative technical capacity, but with limited success. USAID/MCC's Threshold program in 2007 included a component to provide the Legislature with technical assistance to improve analysis of budget information, but the program was not successful according to the implementing partner, likely because budget formulation and budget execution are seen as segregated processes.[40]

Although there is compliance with national budget calendar, the scope of legislative scrutiny in Paraguay has been limited by the quality and level of detail of the information received. Legislative review currently covers details of expenditure and revenue only once individual MDA proposals have been finalized, and not during the negotiations phase. According to PEFA evaluators, multi-year considerations are also excluded from legislative scrutiny because of the nascent status of multi-year budgeting.

Paraguay's amended Constitution assigns power over the national budget to the Legislature. To this end, the Legislature has been criticized for its eagerness to increase public expenditure before approving the budget, and passing budgets that cannot be executed, because they assume higher revenue forecasts than

[38] Wehner. "*Strengthening Legislative Financial Scrutiny in Developing Countries*," p. 19.
[39] Straussman and Renoni. "*Establishing a Parliamentary Budget Office as an Element of Good Governance*."
[40] USAID. "*PFMRAF Stage I Rapid Appraisal for Paraguay*." 2012, p. 58

what is realistic or do not identify matching revenues for expenditure increases.[41] The Legislature also has the ability to independently increase the salaries of civil service staff.[42] Legislative oversight during execution, however, is minimal.

## Gap Analysis and Opportunities for Strengthening PFM

### Medium-Term Framework

GoP needs to improve its technical capacity to produce medium-term economic and financial analyses, at all government levels, on an annual basis. The government has been unable to link economic and financial projections with key development needs despite the availability of a multi-year budget, a results-based budget, and two national strategies.

Introducing simplified multi-year economic and fiscal planning in Paraguay requires increased capacity to implement planning techniques, and appropriately linked information systems to inform budget decision-making. It also requires dedicated staff with highly technical, financial, and economic expertise at SSEI. Upgrading staff capacity for forecasting using technical groups, such as the Macro-Fiscal Unit, can help GoP produce more useful multi-year budgets. Additionally, increasing the coverage of SIAF to all public entities would help to ensure that relevant reports and projections are compiled from accurate information on the national budget, helping to inform subsequent budget planning.

### Budget Execution

Approved budgets have consistently been under-executed in Paraguay due to several factors. Technical budgeting capacity throughout all levels of government is uneven. GoP approved budgets are generally unrealistic and revenues are often lower than planned expenditures. Cash is rationed on a schedule that is difficult to predict, hindering consistent execution and reducing the value of budgets. Payment arrears are monitored for MDAs that use SIAF, but this excludes a large portion of the government, and creates the likelihood that many outstanding transactions never enter the system. SIAF coverage is incomplete, which can lead to risks with the quality and scope of data, and potential cash flow and overspending risks. MDAs have limited flexibility to make budget realignments and even changes within the same program require a resolution by MOF.

Improving technical capacity requires proper training for financial managers on cash flow and budget management. Additionally, increasing SIAF coverage and scope to all public entities could allow GoP to solidify recent PFM reforms and help the government improve its budget execution practices. This could also result in improvements to internal controls and better administration to avoid payment arrears.

### Public Procurement

Provision of relevant training by DCNP to MDA procurement staff has been inconsistent, and training and certification of procurement staff is not compulsory, which may contribute to gaps in technical capacity. MDAs do not prepare accurate annual procurement plans. Instead, MDAs employ a baseline approach, where a specific year’s annual procurement plan is based on the previous year’s plan. This lackadaisical approach to procurement planning likely stems from the overall weak budget preparation process and the fact that MDAs do not anticipate getting their approved budgets fully funded. The contract management process has weak controls and provides for little monitoring and oversight with regard to payments, due dates, or verification of goods or services received. The e-procurement system, SICP, includes information on business opportunities but does not have transactional capabilities with links to budget execution systems. While procedures indicate DNCP should authorize payments, it is not

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[41] Ibid.

[42] WB, IDB and EU. “*Paraguay: Integrated Fiduciary Assessment.*” 2008, p. vii, 10

clear how this step is taken, or whether it is necessary. There is also no established asset or inventory management process.

Paraguay could benefit from increased FMIS integration and the full implementation of procurement management modules, such as the contract execution monitoring module. Information systems would be further improved with the implementation of asset and inventory management systems. The segregation of duties between MDAs and the DNCP should be reviewed with a view towards making sure that MDAs have a reasonable level of autonomy but with checks in place to ensure they comply with procurement legislation. The DNCP should take steps to clarify procedures and responsible parties in contract management, as current manuals do not include who is responsible for or how much responsibility is given over procurement administration, contract oversight, or vendor management. GoP can also take further steps to enhance the professionalism of procurement officers by providing specialized training on procurement administration, their responsibilities under the MOF Code of Ethics and Code of Good Governance, project management, and risk management, and by making certification by the DNCP mandatory.

### Financial Reports

Accounting and reporting standards only partially adhere to international standards for the public sector. Financial statements lack information on financial assets from state-owned enterprises, listing of programs, and estimates on budgetary impact. There is no comprehensive data collection or reporting on resources to service delivery units across all major sectors. SIAF systems extend to a majority of central government entities, but coverage is not yet universal, posing a potential risk that part of the budget can be executed outside of official systems and procedures.

As Paraguay's MOF moves to adopt international accounting and reporting standards, the accounting and comptrollership communities in the country require better understanding of the standards and a process to build technical capacity. National information systems also require increased integration so that budget preparation, budget execution, accounting, and procurement can all be administered and reported on uniformly.

### External Audit Reports

CGR audits are almost exclusively transactional verifications. Audits do not focus on identifying systemic issues, and audited reports and their findings are generally not prioritized by the Legislature or by audited entities. Due to understaffing and underfinancing, CGR performs audits with a three or four year delay and most municipalities are not audited. CGR does not have authority to criminally investigate, prosecute, or impose sanctions, and follow-up to audits are limited or non-existent.

While timeliness in producing reports can be improved with additional financial and human resources, CGR staff may also require additional technical training to ensure that both financial and value for money audits are performed effectively. Introducing risk-based auditing and ensuring that audit reports follow leading practices can help GoP continue its transition to conducting more effective external audits. Additionally, the effectiveness of audit reports could be substantially improved with the adoption of a formal system to monitor the status of audit recommendations and ensure follow-up.

### Legislative Scrutiny of the Budget

The politicization of economic policy often overshadows more technical considerations during budget preparation discussions. Legislators do not have access to technical expertise to analyze budget requests, even in the specialized committees, but they have significant budget responsibilities. The Legislature has been criticized for passing non-credible budgets because they include unrealistic revenue forecasts. This can be addressed by improving budget skills internally to improve legislators' ability to debate technical issues.

# Strengthening Tax Administration

## Introduction

This section focuses on opportunities to strengthen tax administration in Paraguay. To set the context, it first introduces the Paraguayan tax system and highlights some of the major tax reforms since 2010. Next, the section explains the major functions of tax administration and proposes nine (9) key dimensions for strengthening in Paraguay.

The Tax Sub-Secretariat of the State (SET), a dependency of MOF, is the body responsible for the collection and administration of most taxes for the GoP. Figure 3 shows Paraguay's main taxes, of which personal income tax, corporate income tax, farming income tax, small business income tax, value added tax, and excise taxes are administrated by SET. Local governments levy taxes on property and stamp duties, while the National Customs Directorate manages the customs duties.

**Figure 3 – Paraguay: Main Taxes**

| *Type of tax* | *Name of tax* |
|---|---|
| Direct Taxes | Personal Income Tax (IRP)<br>Corporate Income Tax (IRACIS)<br>Farming Income Tax (IMAGRO)<br>Single tax/Small Business Income Tax (Tributo Unico)<br>Property Tax |
| Indirect Taxes | Value Added Tax (IVA)<br>Excise Taxes<br>Custom Duties<br>Stamp Duties |

Source: Adapted from the Ministry of Finance

Over the past decade, efforts to strengthen revenue mobilization and tax administration in Paraguay have included measures to simplify the tax system by reducing the number of taxes from approximately 150 to nine, modify the tax legislation to broaden the tax base and focus on indirect taxation, modernize the tax administration, and improve tax collections.[43] The following sub-sections highlight, in brief, two major reforms enacted since 2010, discuss relevant tax administration measures, and detail ongoing technical assistance planned for the country's tax system.

## Major Tax Reforms since 2010

### Introduction of the Personal Income Tax

The personal income tax in Paraguay was finally implemented in August of 2012. The law's passage in 2004 was highly controversial and spurred public protests, which prompted the legislature to postpone implementation until 2012.[44] The personal income tax bill institutes a 10% rate on taxable income in excess of 10 times the monthly minimum wage, and a rate of 8% when income is below 10 times the monthly minimum wage. The new tax will contribute to tax equity by shifting towards a more progressive tax system and foster the formalization of the economy over the coming years.[45]

[43] USAID, *Paraguay Revenue Brief*, 2014
[44] Ferrario. "Tax Systems and Tax Reforms in Latin America: Paraguay.", 2006.
[45] IMF. "Paraguay 2012 Article IV Consultation," Country Report 12/211, 2012.

### Introduction of New Agricultural Sector Taxes

In 2012, the new administration also pushed through new agricultural taxes intended to address the low contribution to tax revenue of the dominant agricultural sector. In 2011, agriculture accounted for about 20% of GDP, but just 0.5% of total revenue collection, despite record high prices for soft commodities, including soybeans.[46] The tax changes extend the value-added tax to primary production and introduce a new 10% profit tax on all commercial farmers and agricultural firms, including those involved in ancillary agricultural activities. It is planned that 10% of the revenue raised from the new taxes will be distributed to municipalities for infrastructure investment and a similar amount to the Ministry of Agriculture for promoting small-scale production. The rest will be used to support the central government's budget.[47]

### Tax Administration Measures

Since the 2004 reform, SET has engaged in a variety of administrative reform measures to increase the efficiency of its organization and increase tax revenues. Measures such as the adoption of information technology (IT) platforms, enhanced taxpayer services, training of personnel, and improving audit capabilities, have contributed to strengthening the administration. Most recently, the focus has shifted toward improving the Large Taxpayer Unit (LTU) due to the large proportion of revenue it collects (the 500 largest taxpayers contribute nearly 80% of total tax collection).[48] The results are ongoing and significant progress has been achieved in the number of audits performed, specialized training of auditors, and issuance of tax compliance certificates since 2010.

In August of 2013, the Minister of Finance appointed a new vice-minister, Dr. Marta Gonzalez Ayala. Since taking office, Dr. Gonzalez Ayala has made a commitment to increase transparency and efficiency in the administration, and has invested in the organization’s talent through training and other capacity-building efforts.[49]

### Ongoing Donor Support to the Tax System

In 2012, the World Bank (WB) granted a Public Sector Development Policy Loan (PSDPL) in the amount of $100 million to support fiscal management and public sector reforms in the country. The program is focused on three components: (i) state-owned enterprises; (ii) public sector financial control (Central Administration); and (iii) the tax system.

Key outcome indicators for the tax component of the World Bank program span across three major improvements to the tax system: (i) increasing the tax-to-GDP ratio to remain above 13.8%; (ii) targeting stop-filers among large taxpayers and maintaining stop-filer levels below 3%; and (iii) increasing the ratio of audits of large taxpayers such that additional audit assessments exceed 70%.[50]

## Tax Administration Dimensions

Paraguay has significantly reformed its revenue policy and administration over the last decade by reducing the number of taxes, implementing a low uniform statutory rate of 10% for personal income, corporate income, and value-added taxes, and strengthening tax administration. Between 2003 and 2012, central government revenues increased by 3.6% of GDP, largely due to improved tax collections, high productivity of the taxes, and a strengthened administration.

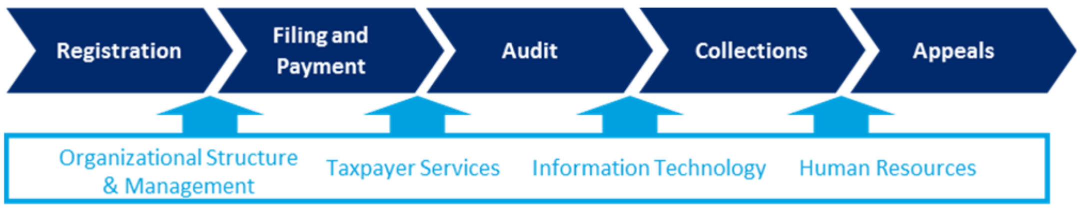
The following sub-section will highlight leading practices across nine (9) key dimensions of modern tax administrations and perform an initial gap analysis for each dimension by comparing the current state of each for Paraguay. Discussion in this section draws largely from three key source documents: (i) a recent

[46] Economist Intelligence Unit, Paraguay Country Report, 2013.
[47] Economist Intelligence Unit, Paraguay Economy: “Cartes successfully pushes revenue-raising tax reform” 2013.
[48] World Bank Estimates
[49] Paraguayan SET. “Boletin Informativo Nº 21-13,” August 21, 2013.
[50] WB. “Paraguay – Public Sector Development Policy Loan Program.” 2011.

study from the Inter American Center of Tax Administrations (CIAT) on the state of tax administration in Latin America; (ii) a recent book developed under USAID entitled "Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean"; and (iii) World Bank Public Sector Development Policy Loan documents referenced in the prior section.

Figure 4 below outlines the nine key dimensions of a modern tax administration that are addressed in this paper. Five of the dimensions comprise the core functions of a tax administration system, followed by four cross-cutting areas that are critical supporting dimensions to a well-functioning tax administration.

**Figure 4 – Tax Administration Key Dimensions**




## 1. Organizational Structure and Management

### Leading Practices

Over the past decade, many Latin American countries have granted their tax administrations a significant level of autonomy in an effort to facilitate improvement of their functions and collections performance, coupled with flexibility to manage human resources, staffing policies, and in some cases, even modify salary scales (e.g., in the cases where the tax administration's legal status is changed to that of a Revenue Authority). While political or other considerations may keep a country from adopting the Revenue Authority model, there are leading practices that can help promote productivity, reduce staff turnover, and eliminate redundancies in the tax administration. One such practice is the formal delegation of authority to the head of the tax administration to modify organizational structures to meet changing needs (e.g. introduction of new taxes), and formal, written delegations of authority from the head of the tax administration to field managers to make appropriate decisions on technical issues. Stability of top-level leadership through guaranteed terms is also an important leading practice as a means to providing institutional stability and professional credibility among the staff, tax professionals, and the general public.

Respective roles of the headquarters office and regional/local offices must be clearly defined and practiced. The headquarters office provides planning, support, and normative guidance for all field operations, but does not actually carry out any of those operations in dealings with taxpayers. The principal role of regional/field offices and staff is simply to execute the annual work plans developed by the headquarters office. Taxpayer segmentation (e.g., large taxpayers, medium taxpayers, small taxpayers) for control by special organization units of the tax administration) has been ongoing for several years. The most prominent special organization units of tax administrations all around the world are those for control of large taxpayers, as they often account for a large percentage of revenue collected by the government. Leading practices here include prioritizing and fully staffing LTUs; intensive training programs about large-case issues (e.g., transfer pricing and specific economic sector expertise) for LTU auditors; the use of multiple selection criteria for inclusion of taxpayers in the large taxpayer program (e.g. tax liability, sales volume, number of employees, economic sector, etc.); and the constant maintenance of the large taxpayers assigned to the LTU for entry and exit from the program, based on LTU criteria.

### Current State

As a unit functionally dependent on the MOF, SET has limited autonomy or flexibility to manage its own budgetary resources, change its organizational structure, or manage its own staffing policies. Instead, adjustments to budget allocations require appropriate approval from the Executive, the MOF, or the Legislature. The highest SET authority, the Vice-Minister, is appointed by the President of Paraguay.

In terms of organizational structure and respective roles, SET has 17 regional offices around the country – 3 Type 1 (large); 2 Type 2 (medium); and 12 Type 3 (small) - and is headquartered in Asunción. Limited information is publicly available about the capacity, collection efficiency, and breadth of services offered by the regional offices. From a quick review of the organization charts of the regional offices as of 12/31/2013, it seems that all regional offices have only two functions: (1) filing and processing of tax returns and payment, and (2) collection. Looking ahead, SET has identified decentralization of the administration and improvement of the regional offices as two important projects to implement in the future.

In recent years, taxpayer segmentation has become a focus area for SET, with special attention paid to increasing the efficiency of its LTU office. While SET has made some progress in improving its LTU function over the past decade, challenges remain, such as inadequate auditor training, maintenance of large taxpayers assigned to the LTU, collections, manual return filings of large taxpayers, and control of this segment. The LTU is comprised of only 99 agents (less than 10% of total SET workforce)[51] and has 978 large taxpayers under its jurisdiction. Recent progress in this area includes implementing training programs for auditors,[52] increasing the number of large taxpayer audits from 20 in 2008 to 40 in 2009 and 32 in 2010, and a joint resolution to allow the audit of financial institutions as large taxpayers for the first time in the history of tax administration in Paraguay.

Given the significance of the LTU tax base (nearly 80% of the total tax collection), focus on this segment would allow for further increases in tax revenues in the medium term. Potential exists for pilot programs to be introduced and, if proven successful among the large taxpayers, to be rolled out to other parts of the tax base—such as medium-sized taxpayers—and into the regional offices.

## 2. Taxpayer Registration

### Leading Practices

Taxpayer registration is one of the basic core operations of a tax administration since it is the means by which the administration can identify, track, and ultimately 'know' its taxpayers. It becomes very difficult for the administration to manage its taxpayers if it does not know who they are, where they are located, and whether they are active or inactive.[53]

Leading practices in the registration function revolve around a simplified registration process. A single, integrated registration process for all taxes can reduce costs for the administration and reduce burden on the taxpayer, while allowing the administration to have a complete picture of the taxpayer. To lessen the number of taxpayers obliged to file returns, the introduction of income filing thresholds, and automatic tax withholdings on salaries, interest, and dividends are often implemented. Leading practice requires the use of a unique taxpayer identification number (TIN) to manage obligations and track the status of the taxpayer, as well as to limit duplication and ease compliance through information matching.

Leading practice also involves maintenance and supervision of the taxpayer registry database. Automation and secure data warehousing of the information with controlled access is essential to the integrity of the registry. At the same time, constant vigilance and maintenance of the taxpayer registry is important to ensure that new registrants are added appropriately, active taxpayers are tracked and categorized, and inactive taxpayers who are no longer economically active are removed.

[51] 2010 figure
[52] Diaz and Pecho. "*State of the Tax Administration in Latin America (2006-2010),*" IDB, CARTAC, CIAT, 2013
[53] USAID. "Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean" 2013. p. 92.

### Current State

In Paraguay, taxpayer registration is managed at both the headquarters and regional offices, under the direction of the General Collection Directorate. Taxpayers must register in person (on-site) and are assigned a unique identification number which enables SET to classify, organize, assign, and interpret the information available for each taxpayer. One of the major goals listed in the Ministry of Finance's 2012-2015 Action Plan is to integrate biometric information into the taxpayer registry and update the registry database for corporate taxpayers by requiring online account maintenance for businesses.

Data updates to the registry are manual and result from voluntary statement/notification directly from the taxpayer. Without automatic updating mechanisms, it is difficult for the administration to manage the process of how and when it receives notifications to change the registry, resulting in less than optimal taxpayer registry management. In addition, access control is weak across the registry database, as no authorization mechanisms are present to prevent public servants from accessing the taxpayer registry, posing risks for integrity of information. Despite these circumstances, the taxpayer registry is available in real-time, across an integrated platform, and is able to provide a breakdown of total tax registrants by active/inactive categories. The system is also able to provide auto-detection of stop-filers.

Recent figures for 2010 show that the number of registered taxpayers in the country amounted to 557,944 (455,157 active) – which is a substantial increase of 45% from the 2006 figures. Much of this was due to improvements to the taxpayer registry system after the 2004 fiscal reform.

## 3. Taxpayer Services

### Leading Practices

Taxpayer services play a critical role in maximizing voluntary compliance by providing taxpayers with the information and assistance they need to enable them to meet their tax obligations efficiently. Taxpayer services curb compliance costs by providing programs that enable taxpayers to fulfill their obligations more easily, thereby minimizing the need for the tax administration to expend more costly resources to enforce compliance.[54]

In recent years several trends have emerged, including use of taxpayer feedback / involvement, increased focus on the use of technology, and analyzing the root cause of service demands to determine the appropriate service delivery channels. Leading practices include establishing self-service channels and enhanced online features that include a frequently asked questions section, as well as providing training to enable employees to deliver improved customer service.

### Current State

While SET's vision includes "high orientation to the taxpayer" as a goal, it appears that there is a mismatch between staff allocation and priority-setting in this critical function of tax administration in Paraguay. SET's Taxpayer Services Division has limited resources to fully execute the support functions that are necessary to maximize voluntary compliance and assist the taxpayer. According to a recent survey of the tax administration, only 3% of SET staff is allocated to the taxpayer orientation and assistance function (as compared to an average of 12% in Latin America).[55] Furthermore, in 2006, these responsibilities were transferred from the Taxpayer Services Department to the Collections Department,[56] thereby removing taxpayer services as a core function under SET's organizational chart, and placing it as part of the Support Directorate together with administration, financial management, human resources, and

[54] Ibid,. p. 105.
[55] Diaz and Pecho. "*State of the Tax Administration in Latin America (2006-2010),*" IDB, CARTAC, CIAT, 2013. p. 441, Response to Question 22
[56] Ibid., p. 452, Response to Question 115.

other functions. At the regional level, regional office organizational charts show no unit for taxpayer services either.

Despite the low staffing numbers dedicated to taxpayer orientation and assistance, services to the taxpayer have improved steadily over the past decade, following the 2004 reform, due to the implementation of telephone call centers and stronger online support and availability of information on SET's website. In 2010, SET answered over 115,000 calls, a dramatic rise from 18,000 calls in 2006. Also, with the recent implementation of the new Personal Income Tax in 2013, SET developed and offered citizens online videos to address questions and provide orientation to the taxpayer on managing the new tax.[57]

## 4. Filing and Payment

### Leading Practices

The requirement to file a tax return generally specifies that all persons who are taxpayers are required to file a return and remit payment on the tax imposed to the government. Filing and payment processing is an essential dimension of tax administration that results in obtaining and storing information that is used across other functions of the administration, such as collections, audit, revenue reports, and tax analysis.

Filing and payment is largely dependent on the tax administration's ability to promote and ensure compliance with taxpayer obligations. Tax administrations are increasingly devoting resources to behavioral research, re-examining proven approaches to gaining compliance through the use of compliance certificates, and applying technology such as data mining that is being used to combat fraud in other areas of government and successfully adapting it to detect non-filers and stop-filers.

Many countries in the region have gradually introduced electronic filing and electronic payments through public awareness campaigns and improved internet and banking infrastructure in the region. Tax administrations are moving away from manual filing systems that are prone to data entry errors and impose large time and financial burdens on the administration. Instead, they are using data entry checks, pre-filling of return forms, case management systems for stop-filers, and auto-notifications. Other leading practices include tax simplification through improved form design, establishing minimum thresholds, withholding systems, and effective use of sanctions and penalties to encourage compliance.

### Current State

In Paraguay, paper filing is the predominant method for filing tax returns. Figures for 2010 show that, of the 4.8 million returns filed that year, 92% of returns were paper-based.[58] Internet filing has increased gradually since it was first introduced in 2007 (from 0.61% of total returns in 2007, to 6.94% of total returns in 2010).[59] As improvements have been made in taxpayer registry, services, and returns processing, the number of active taxpayers filing returns more than doubled in a four year span (from 2.1 million in 2006, to 4.8 million in 2010).[60] Submission channels for returns include banks, the internet, and in person.

Due to the predominance of paper-based returns requiring manual entry into the tax system, a large majority of the returns received by SET are outsourced for information capturing, which could potentially create data entry and integrity risks as the administration lacks full oversight on the third-party vendors. SET has attempted to manage this by making an exception for those taxpayers categorized as Large Taxpayers, for which SET completely manages the returns internally. However, manual filing is still dominant, even for large taxpayers, while the international benchmark for e-filing for large taxpayers is

[57] SET Website, "La SET pone a disposición de la ciudadanía videos en internet para consultas sobre el IRP".
[58] Diaz and Pecho. "*State of the Tax Administration in Latin America (2006-2010),*" IDB, CARTAC, CIAT, 2013, p. 463, Response to Question 122
[59] Ibid.
[60] Ibid.

100%. Limited information is available on non-filers. Up until 2009, the tax administration made very limited use of sanctions for non-payment. However, the application of sanctions has increased since then. For example, whereas the tax administration only applied sanctions for non-payment in 159 cases in 2009, this figure rose to 1,625 in 2010.

In 2009-2010, the government enacted a new tax compliance certificate program as a required pre-condition for doing business with the public sector. The authorities issued 122,609 certificates in 2009 and another 280,105 in 2010.[61] An important feature of the certificates is that stop-filers, taxpayers with payment arrears, or those with delayed submissions of tax returns are not eligible for the certificate and cannot compete for public sector contracts until they come into compliance with their tax obligations. However, the high frequency of manual (as opposed to electronic) filing and payment calls into question the accuracy of compliance certificates which are likely based, in some cases, on an inaccurate "Taxpayer Current Account." Further automation would much improve the filing and payment function of the tax administration. Automatic detection mechanisms exist for failures to file by the taxpayer, and automatic validation mechanisms are now in place for data entry on behalf of the taxpayer, although the timeliness of postings is a major problem.

## 5. Audit

### Leading Practices

Audit is a core function of the tax administration and is essential to helping carry out the task of monitoring tax compliance and, thus, collecting the total tax liabilities due to the government. A key differentiator for leading tax administrations is the establishment of a strong training program for its audit staff. In terms of training, leading practices taken into account such elements as the number of taxes involved, the type of taxpayer activity, the size of taxpayer, taxpayer compliance, etc., to decide on how best to organize and train the resources available. These resources range from teams of specialist auditors for large or complicated taxpayers (e.g., auditors with a high level of training and exposure on transfer pricing of multi-national corporations and specific sectors), to single generalist auditors operating in remote areas and dealing with all aspects of taxation for small or medium taxpayers.

Leading practices in the audit processes also include the use of an audit strategy for the organization, an annual audit plan, and audit manuals and policy documents, all of which operate together. Risk-based audit selection systems and a case management system are used for tracking complaints and monitoring the progress of audit cases. The use of modern audit tools and techniques should be leveraged to access taxpayer accounting systems. Leading tax administrations have been known to commission economic studies on specific at-risk sectors in their countries, such as tourism, lotteries, and manufacturing in order to provide its auditors with specialized, in-depth knowledge around the complexities, legalities, and opportunities for evasion across each area.

### Current State

According to the World Bank, the audit and control functions in Paraguay have traditionally been weak. A review of the organizational structure shows that the audit function in SET's headquarters organization structure is a sub-structure of the Control Coordination Department, and none of the regional office organization charts show an audit function.

On the other hand, recent focus on the LTU has opened an important window to effectively begin addressing gaps for this core function of tax administration. For example, prior to 2008, there were several years of zero LTU audits due to lack of transparency and trained auditors. Progress was made between 2008 and 2009, when SET was able to double the number of audits from 20 to 40, respectively. [62]

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[61] WB. "*Paraguay: Public Sector Development Policy Loan Program*." 2011.
[62] Ibid.

In 2010, SET also implemented a training program for LTU auditors, who lacked specialized training in advanced audit methods, international taxation, and particular sectors such as mining and agriculture.

SET's taxpayer audit selection is based on a variety of information sources, such as information crossing with accounting statements and external financial reports and information from respective economic sectors. Other sources of audit selection, though very small quantitatively, include random selection criteria, used to compare against conventional and more sophisticated systems on selection quality and results, and third-party general complaints received by the Headquarters Office. SET's Taxpayer Auditing Plan is updated annually, and resources are assigned based on strategic priorities. Although limited audit software exists, data warehousing of taxpayer information is available to the tax auditors, and SET has established internal rules that regulate roles and responsibilities for its auditors in order to maintain independence.

In terms of audit procedures and structure, there is room for improvement in risk-based selection and case management of audits. SET auditors are not specialized by sector or by type of audit. Instead, cases are assigned on the base of capacity and the experience of the auditors. There is no system for registration, classification, and control of external complaints/tips received from third parties, and no electronic invoicing system exists. Furthermore, SET's audit function does not perform field audits, which is a serious gap in operations.

## 6. Collections

### Leading Practices

Within the collections unit, leading practice establishes an effectively organized and separate unit that is fully empowered to manage debt collection. This involves the authority to make decisions about penalties and interest, select cases based on risk parameters, and the ability to provide specialized training for staff. Coordination between the audit, fraud investigation, and LTUs is also good practice.

Leading practices in tax collection also require proper organizational structure, modern legislative provisions, an IT system that provides users with the necessary information, and modern management principles. Facilitating taxpayer compliance through enhanced taxpayer services and improving the ease of paying taxes are also important practices that can lead to a rise in collection figures. As such, the tax reporting and payment systems should be simplified to reduce the cost and increase the accuracy of tax collection. Rapid identification of tax arrears through automation becomes important, as collection of debt often proves more difficult as it ages. Automation systems are also important for notifying taxpayers of outstanding tax obligations and for the selection and distribution of cases to the tax collectors.

### Current State

SET has a separate division focused on collections within its organizational structure. At headquarters, it is divided into sub-units focused on procedures and regulations, coordination between authorized collecting entities, information management, and regional office coordination. Each regional office has a collections function. SET does not hold the power to enforce collections; instead another area of MOF, the office of the Attorney General holds this power.[63] While SET is not in charge of enforced collections, it does have an electronic program for follow up and tracking of amounts owed. Although enforced collection is managed by the Attorney General, seizure and sale of property is one of the methods that SET can use to recover debt for the government. Seizure measures that can be taken to ensure payment include seizure from: bank accounts, real estate, personal property, interest income, credits/bonds, and other sources. Seizure from salaries is limited, and pensions cannot be seized. Limited information is available on the number of seizures implemented and amounts recovered by SET.

[63] Diaz and Pecho. "*State of the Tax Administration in Latin America (2006-2010)*," IDB, CARTAC, CIAT, 2013. p. 210, Response to Question 176.

In terms of delinquent tax debt, in 2010 SET registered delinquent debt of $188 million Guarani across 2,852 taxpayers, of which it was able to recover Gs32 million across 996 taxpayers.[64] When examining the age of the delinquent debt, approximately 75% of debt outstanding is more than five years old, approximately 16% is aged between two and five years, and roughly 9% is less than two years old . As mentioned in a previous section, SET has taken steps towards curbing delinquent debt and improving collections through the use of improved auditing practices and the issuance of tax compliance certificates.

## 7. Appeals

### Leading Practices

The appeals process is an important institutional arrangement that helps to ensure taxpayer rights, lends credibility to the overall tax system, and helps keep the tax authorities under constant review. All administrative decisions that impose obligations or deny rights to taxpayers should be subject to an objections and appeals process. National laws generally provide mechanisms for taxpayers to appeal administrative decisions, through a specialized unit in the tax administration, specific tax courts, or within the judicial system. Administrative provisions in the law and units in the tax administration are imperative to minimize the number of cases which get backlogged in judicial bodies and take many years to resolve. An effective appeals system is important, as it encourages trust in the tax system and fosters greater compliance and tax morale.

Leading practice deems that the right of the taxpayer to object is clearly defined and that established procedures for handling objections and appeals are in place. These might include the use of standardized forms, established timing rules, and access to information. Independence between appeals officers, internal reviewers, and legal bodies is a necessary precondition for any credible appeals system.

### Current State

The tax law in Paraguay grants the taxpayer the option to appeal for reversal or review within 10 days of notification on a resolution. SET does not have a specialized unit for appeals, and a separate tax administrative court does not exist; rather, the appeals process is managed in the judicial system in the Court of Accounts. In recent surveys, limited to no figures were made available for recent years on tax appeals, administrative appeals, or law court appeal numbers. In terms of appeals processing, SET prioritizes case selection according to case submission dates. More information is needed on this core function of the tax administration in Paraguay before potential interventions can be identified.

## 8. Information Technology

### Leading Practices

Leading tax administrations effectively leverage IT to improve the performance and efficiency of their core functions, enabling them to gather and analyze information, manage workloads and resources, provide standardization, and facilitate taxpayer compliance. Leading practices in IT establish a formal registration database system, integrated across other platforms (e.g., filing/audit), with the ability to provide sufficient management reports for tracking and maintenance. Leading practice dictates that tax administrations maintain accurate taxpayer accounts in real time with the ability to automatically update when the taxpayer makes changes to his/her account or when filing or payments are made.

In terms of taxpayer services, IT supports this function through the use of multiple channels (e.g., telephone, online) and vehicles (e.g., FAQs, brochures, automated hotlines) to accurately and uniformly provide information to the taxpayer. The staff of the administration should also be exposed to continuous training on IT systems that are required for their respective functions.

[64] Ibid., p. 482, Response to Question 180.

### Current State

In Paraguay, SET's modernization in 2004 involved adopting an IT platform that supported core tax administration processes, such as taxpayer registry, single taxpayer accounts, and tax returns processing. This platform was subsequently rolled out to regional offices and included improvements in taxpayer services, such as online access and telephone assistance, which contributed significantly to a near doubling of taxpayer registration in the second half of the decade. Data interconnectivity exists between the regional offices and headquarters, and the administration relies on a centralized database for its operations. Access is controlled by functional profile levels.

SET has a Technological Coordination Strategic Plan that covers its main priority areas of: operations, security, information management, monitoring, and business continuity. The IT Department is its own separate unit in the organizational structure, and is financed through the SET budget and by donor support from the Inter-American Development Bank and the United Nations.

In terms of supporting the core tax administration, some limitations exist that have been mentioned in previous sections. The use of electronic registration, filing, and payment is an opportunity for further strengthening, as the majority of these transactions are performed manually and in person. According to UN statistics data, 27.1% of the country has access to the Internet, which may limit progress in this area. Automation and case management systems are also limited within the audit and appeals functions.

## 9. Human Resources

### Leading Practices

Staffing levels of tax administrations in Latin America vary tremendously in size when compared across the region. Countries such as Argentina, Brazil, and Mexico have staffing levels upwards of 20,000, while smaller countries such as Costa Rica, Panama, and Paraguay have levels below 1,000. The human resources function should consistently and efficiently support the tax administration's fundamental need to utilize high performing employees effectively.[65] Trends in overall staffing levels have declined since 2004 as tax administrations have gained more operational efficiencies through increased reliance on electronic transactions and information flow, improved workplace technology, increased automation, and reorganizing workflows along functional lines.[66]

Leading practices in human resources begin with sound policies and procedures around recruitment, selection, and placement of resources. Once the right candidates are in place, emphasis on training and staff development is essential in order to develop the workforce necessary to carry about the organization's mandate. Retaining employees through commensurate compensation with the private sector and maintaining a code of conduct contributes to a satisfied workplace and promotes a motivated tax administration.

### Current State

While many other tax administrations in the LAC region have slowly been increasing in size, SET has instead seen a sharp reduction of approximately 35% of its staff between 2006 and 2010 (from 1,508 to 953).[67] In terms of capacity, approximately 40% of its staff holds a university degree (compared to the regional average of 56%), while the remaining 60% hold technical/vocational and administrative training. SET has an internal training unit that delivered over 2,000 training hours to 799 attendees in 2010. The compensation system for SET staff is within approximately 10-15% of the commensurate private sector

[65] USAID. "*Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean,*" 2013, p. 349
[66] Ibid, p. 367.
[67] Diaz and Pecho. "*State of the Tax Administration in Latin America (2006-2010),*" IDB, CARTAC, CIAT, 2013. p. 429, Response to Question 20.

salary, by function, and includes performance-based pay. There is no public administration career for SET employees.

## Gap Analysis and Opportunities for Strengthening Tax Administration

As noted in recent reports by USAID and various other donors, particularly the World Bank, SET has made much progress in recent years on its overall efforts to generally strengthen and increase the efficiency and effectiveness of tax administration. Nevertheless, from this desk review of pertinent documents about the current state of SET's organization, operations, and current practices, as compared to leading international practices described above, there are several actual and potential gaps in SET's implementation of tax reform measures.

### Organizational Structure and Management

The respective roles played by SET's Headquarters office (normative – setting objectives, norms, manuals, etc.) and its regional offices (operations - execution of plans and exclusive dealing with taxpayers) may not be defined nor practiced. A system of formal, written delegations of authority to permit field officials at various levels to make decisions and to promote efficiency and effectiveness, as well as prevent backlogs on audit, collection, and other types of cases, does not appear to exist.

As noted earlier, two of the three key indicators of the World Bank's program to improve GoP's tax system focus on large taxpayers (i.e., targeting and keeping stop-filers among large taxpayers to a level below 3%; and improving audit selection systems/methods of large taxpayers to ensure that at least 70% of cases actually audited result in additional assessments). However, the following gaps and observations may prove to be obstacles to SET's attainment of the two objectives cited and other desirable objectives of large taxpayer programs.

1) The optimum number of large taxpayers to include/control by the LTU has not been determined
    a. There are 978 LTU taxpayers in the program; yet, only 500 of these taxpayers pay 80% of the country's tax collections; and only 100 of these taxpayers pay more than 50% of all tax collections.
    b. At least 478 (978 minus 500) - and maybe more - should not be classified as LTU taxpayers and should be reclassified as medium taxpayers.
    c. The criteria used to select taxpayers for inclusion in the LTU program does not appear to be clearly defined.
    d. There are no criteria defined to deselect (exit) taxpayers from the LTU program, whose changed economic situations, for example, might make them ineligible for the program.
    e. There is no ongoing monitoring to induct new taxpayers who qualify for the LTU program.
2) The staffing level of the LTU is inadequate to carry out SET's/LTU's objectives
    a. The LTU Office has a very low staffing level of 99 auditors (10% of SET's workforce). This is inadequate considering that the large taxpayers return nearly 80% of the total tax collection to the GoP.
    b. With such low staffing levels, the LTU is nowhere near the international standard which is to audit 30% of large taxpayers - which would be 293 audits of 978 taxpayers (or 150 of 500 taxpayers) - actual audits were 32 in 2010 (3%) and 40 in 2009;
    c. In addition to audit staff, other staff – collection, taxpayer service, etc. – are at very low levels
    d. With such low staffing, effective and timely monitoring and control to keep the stop-filer level below 3% (WB key indicator) is highly unlikely.

3) The LTU has not devised and, thus, does not use risk-based, mathematical formulae for selecting large taxpayer cases for audit.
    a. Manual and subjective methods for audit selection are not sufficiently effective to identify cases in priority order (e.g., prioritizing those with the greatest potential risk for revenue loss) and often result in no additional taxes, which is a waste of resources for both the tax administration and taxpayers.
    b. The World Bank's key indicator that at least 70% of audited large taxpayer cases result in additional tax assessments will be very difficult, if not impossible, to meet without risk-based systems for selection.
4) Electronic filing by Paraguay's large taxpayers is either minimal or non-existent.
    a. The strong and timely control measures required to protect 60-80% of the country's tax revenue cannot be accomplished manually.
    b. The international standard for electronic filing by large taxpayers is 100%.

### Taxpayer Registration

With manual registration by taxpayers in person both at Headquarters and in regional offices, backlogs in updating the taxpayer registry are inevitable. Since there are 558,000 taxpayers (about 455,000 active) and changes are done manually, the taxpayer registry is certain to be unreliable at any given time. Also, it is unlikely that taxpayer deregistration procedures are in place, as they should be. With introduction of the Personal Income Tax (PIT) and the agricultural tax in 2012, there is a great danger that SET staff will be overwhelmed by thousands of new taxpayers.

### Taxpayer Services

Rather than being treated as a core tax administration function, SET has included the taxpayers services function as part of the broader Administrative Services in its Headquarters organizational structure, an unorthodox placement. In regional offices, the taxpayer services function is not its own core function but, rather, is a part of the collections function. While there is a Taxpayer Service Call Center at Headquarters, it is unknown if SET has identified the most frequently asked questions and provided corresponding training and procedure manuals for those answering calls from taxpayers. In view of the introduction of the new PIT and agricultural tax, all the above may represent serious gaps to start the new tax programs successfully.

### Filing and Payment

With paper filing at 92% (2010) in Paraguay, and with filing both at Headquarters and at 17 Regional Offices throughout the country, data-entry and posting backlogs are a significant challenge. Some payments are made at banks and others at SET offices. In either case, wholesale postings of payments to the Taxpayers' Current Accounts (Cuenta Corriente) are not likely to be timely, which would make the Taxpayers' Current Accounts unreliable. With neither the taxpayer registry nor the Taxpayer Current Account up to date at any given time due to severe posting backlogs, the accuracy of the new program for issuance of Taxpayer Clearance Certificates may be difficult to maintain. With the introduction of the PIT and the agricultural tax in 2012, the challenges to carry out filing and payment responsibilities by SET staff may be overwhelming. There is no centralized processing center for filing and payment, where mass processing techniques can be employed.

### Audit

There is no audit function shown in any of the regional office organizational structures. Further, there is no organizational unit which conducts audits on the business premises of taxpayers, which are much more effective than desk audits (it is not clear whether this policy/practice applies even to LTU taxpayers). There are no risk-based formulae for selection of cases for LTU audits (see discussion above). In view of the introduction of the PIT and agricultural tax, the lack of auditors in regional offices and the absence of field audits could represent serious gaps in operations.

### Collections

SET's collections staff has no enforcement authority for the collection of tax arrears. For reasons stated below, it is highly unlikely that regional collections staff even perform "persuasive" efforts with taxpayers to collect tax arrears.[68] A major challenge in collections is that the enforcement of tax arrears in GoP is the responsibility of a legal section at the Ministry level and is conducted through judicial means. Furthermore, the tax arrears inventory of GoP which is 5 years or older is 75%, the highest in Latin America.

### Appeals

There seems to be no organizational entity in SET for administrative appeals. Judicial channels are the only avenues for taxpayers' objections and/or appeals, resulting in severe multi-year backlogs.

### Information Technology

Successful execution of every function of a modern tax administration requires the effective use of computers, automation, and data networking systems. To perform their respective jobs well, employees in all core and support functions rely heavily on information, and unless this information is accurate and complete and can be retrieved in a timely manner, the information becomes virtually meaningless. All levels of management rely on automated management information systems to monitor progress on strategic and annual objectives and report monthly and annual progress on objectives within the tax administration and to the MOF. SET does not have the financial resources to establish IT systems which meet international leading practices. Therefore, implementation of many important tax reform initiatives is extremely challenging.

### Human Resources

As noted earlier, SET is severely understaffed. There seems to be no developed systems for the distribution of staff based on international leading practices, e.g. X% to Headquarters vs. X % to LTU; X % to field operations; X% to Audit; X % to Collection; X% to taxpayer service: X % to managers vs. X % technical employees; etc.

[68] "Persuasive" efforts are meetings with taxpayers to determine their ability to pay voluntarily and to secure and implement installment-payment agreements, if appropriate

# Summary Table of Gap Analysis

## Public Financial Management

| Dimension | Leading Practices | Gap Analysis | Opportunities for Strengthening Systems |
|---|---|---|---|
| MTF | • Budgeting for extended time horizon rather than one year<br>• Alignment to national strategic priorities<br>• Use of MTF tools (e.g., MTFF: GDP and inflation projections, aggregated expenditure and income projections; MTBF; MTEF) | • Budgeting does not make use of existing multi-year tools<br>• No link between economic and financial projections and development needs<br>• Low technical capacity to build MTFF projections | • Build technical capacity to improve forecasting at SSEI<br>• Increase coverage of SIAF to produce relevant reports and projections<br>• Build technical capacity to link policy with economic forecasts<br>• Operationalize the Macro-Fiscal Unit |
| Budget Execution | • MDAs manage monthly/quarterly cash needs in accordance with appropriation<br>• MDA management employs performance management tools<br>• FMIS facilitates budget execution; provides access to all relevant information; incorporates strong controls; integrates all expenditure categories | • Cash rationing employed<br>• Lack of oversight over payment arrears<br>• SIAF coverage is incomplete; quality of information can be unreliable, controls are weak, scope are limited to covered entities | • Build technical capacity to improve cash flow projections to increase predictability<br>• Increase coverage of SIAF to all public entities<br>• Improve internal controls<br>• Integrate platform to monitor payment arrears |
| Public Procurement | • Regulatory agency provides oversight to ensure compliance with the legislation<br>• MDAs prepare accurate procurement plans (ideally multi-year)<br>• Procurement staff have technical capacity to perform accurate forecasts, price analyses, and cost estimates<br>• MDAs announce tenders on e-procurement platforms<br>• FMIS integrates procurement and treasury functions | • Procurement plans are drafted using baseline approach<br>• Procurement staff receive some training, but not all are certified by the DNCP<br>• E-procurement platform exists, but only for announcing business opportunities; robust data collection of historical specifications and quantities, but no link to transactional or budget preparation processes<br>• No asset or inventory management systems<br>• In the process of implementing contract monitoring module | • Build technical capacity to improve accuracy of PACs<br>• Provide additional training to procurement staff at MDAs<br>• Review segregation of duties<br>• Integrate e-procurement platform with SIAF<br>• Implement asset management system<br>• Implement inventory management system |
| Financial Reports | • Adoption of international standards (e.g., IFRS, IPSAS)<br>• FMIS coverage extends to all government entities for across-the-board reporting and comparison | • Annual accounting and financial guidelines partially adhere to international standards<br>• SIAF and SICO coverage is incomplete; quality of reports is weak, scope limited to covered entities | • Build technical capacity in the accounting and comptrollership community<br>• Support adoption of international standards and provide technical assistance<br>• Increase coverage of SICO to all public entities |
| Audit Reports | • Adoption of INTOSAI international standards<br>• Introduce risk-based audits | • CGR performs transactional verifications almost exclusively<br>• CGR produces audit reports | • Support adoption of international auditing standards<br>• Build technical capacity at |

| Dimension | Leading Practices | Gap Analysis | Opportunities for Strengthening Systems |
|---|---|---|---|
| | • Transaction and value for money audits performed<br>• High quality reports include audit findings and recommendations in plain language<br>• Recommendations are achievable, measureable, affordable, and relevant | with a three or four year delay<br>• CGR does not have authority to prosecute or apply sanctions on violations detected during audits | CGR for risk-based auditing and value for money audits<br>• Build technical capacity to produce high-quality audit reports<br>• Promote adoption of a system to monitor the status of audit recommendations |
| Legislative Scrutiny of the Budget | • Legislators use all available budget documents to inform decision-making<br>• Legislators have access to technical financial management knowledge | • Legislative review occurs after the negotiations phase and after MDA proposals have been finalized<br>• Legislators do not have access to technical expertise to analyze budget requests | • Build technical capacity of budget committee legislators and staff<br>• Operationalize the Macro-Fiscal Unit or provide Legislative access to technical expertise |

## Tax Administration

| Dimension | Leading Practices | Gap Analysis | Opportunities for Strengthening Systems |
|---|---|---|---|
| Org. Structure and Mgmt | • Clear division of roles and delegation of authority<br>• Taxpayer Segmentation, including Large Taxpayer Units | • Undefined roles between Headquarters and regional offices<br>• Delegation of authority lacking, which impacts efficiency and effectiveness<br>• Inadequate staffing levels at LTU to carry out objectives<br>• Risk-based, mathematical formula for audit of large taxpayers have not been devised and are not in use | • Establish normative and operational roles and responsibilities and delegations of authority between the organizational structures in SET<br>• Strengthen LTU through additional staff<br>• Strengthen selection process for audits of large taxpayers |
| Taxpayer Registration | • Simplified registration process<br>• Maintenance and supervision of the taxpayer registry database<br>• Unique taxpayer identification numbers | • Manual registration is predominant<br>• Backlogs in registration and maintenance of the taxpayer registry | • Automate the taxpayer registration process at the regional and national levels |
| Taxpayer Services | • Strong attention to taxpayer orientation to facilitate compliance<br>• Telephone call centers and online support | • Taxpayer orientation appears to be a low priority in SET<br>• Taxpayer services is not a core function in the organization divisions | • Formalize the taxpayer services function<br>• Strengthen taxpayer services through training and additional staff |
| Filing and Payment | • Electronic filing and payment systems<br>• Sanctions for non-payment<br>• Maintenance of a taxpayer current account | • Tax returns are filed manually (92% of returns)<br>• Data entry backlogs<br>• Unreliable taxpayer current accounts | • Develop a centralized processing center for filing and payment<br>• Develop an electronic filing program and encourage taxpayers to e-file |
| Audit | • Specialized training for | • No field audits taking place | • Strengthen the auditing |

| Dimension | Leading Practices | Gap Analysis | Opportunities for Strengthening Systems |
|---|---|---|---|
| | auditors<br>• Risk-based audit selection<br>• Case management systems | • No risk-based audit selection | function<br>• Build capacity of auditors and roll out a field audit division |
| Collections | • Rapid identification of tax arrears<br>• Enforced collections and seizures | • No enforcement authority to collect tax arrears<br>• Tax arrears backlog for debt greater than 5 years is highest in Latin America | • Increased focus on taxpayer arrears<br>• Review collection procedures and enforcement policy with judicial system |
| Appeals | • Standardization and established timing rules and access to information<br>• Independence between legal bodies and appeals officers | • No organizational entity for administrative appeals<br>• Multi-year backlogs | • Establish a taxpayer objection and appeals processes within SET |
| Information Technology | • Management information systems, integrated platforms<br>• Real-time reporting capability | • Limited automation and linking of data networks | • Develop an automated management information system |
| Human Resources | • Recruitment and retention programs<br>• Formal training and development of employees | • Severely understaffed<br>• No developed system for distribution of staff | • Build capacity of SET workforce through training and recruitment |

# Next Steps

This paper analyzed a series of 15 key dimensions across public financial management and tax administration in Paraguay. The results suggest that Paraguay has multiple dimensions that need to be strengthened in order to narrow the gap between leading practices and the current state in Paraguay.

As a next step, the PFM-LAC Team proposes working with USAID/Paraguay and GoP to conduct a benchmarking exercise and establish short-term action plans to improve the effectiveness and efficiency of PFM and tax administration in Paraguay. Development and implementation of a targeted action plan to improve specific dimensions will assist GoP in narrowing the gap between current state and leading practices, and will help establish goals and specific targets for improvement and modernization. The benchmarking exercise will be used not only to compare Paraguay's PFM and tax systems with regional norms and internationally recognized leading practices, but also to measure performance over a period of time, using a milestone approach and/or tracking evolution of the benchmark or indicators over a number of years.

The following figure breaks down the next steps required to conduct a benchmarking exercise and to develop action plans for PFM and tax administration strengthening in Paraguay.

**Figure 5 – Next Steps for Developing Short-Term Action Plans**


The first step is to review the gap analysis presented in this paper with USAID and GoP in order to select the key priority areas that have the most potential for targeted performance improvement and gap-closing measures. This approach will allow USAID and GoP to provide commentary and feedback on the gaps presented and discuss any ongoing technical assistance or interventions already in play across the outlined dimensions.

Upon selection of the priority areas for intervention, an in-country validation exercise is required to confirm the current practices presented in the paper and to identify the relevant stakeholders and decision-makers across the priority dimensions. This is a critical point, as commitment from the authorities and key stakeholders will have lasting impact on the success of the targeted interventions and execution of the action plans.

Next, benchmarking workshops with the relevant stakeholders are required to gain a deeper understanding of the identified gaps and priority areas in order to identify target benchmarks for improved performance. The stakeholders will lead the establishment of performance targets for those dimensions identified as priorities and set roles and responsibilities for targeted interventions set forth in an action plan. Workshop facilitators will work with the stakeholders to drive consensus on where capacity needs to be built to achieve agreed-upon target performance levels and/or to narrow gaps between internationally recognized leading practices and the current state.

The final delivery of the action plans will clearly outline steps and milestones required to strengthen the key priority areas identified by GoP and USAID. It will draw directly on the performance targets and benchmark indicators selected by GoP authorities in the in-country workshops. The action plans will assist USAID/Paraguay to engage in constructive policy dialogue with national authorities on PFM and tax administration reforms, as well as support future technical programming by USAID, including select activities that can be undertaken under PFM-LAC.

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# Annex 1: Paraguay Revenue Brief

**LAC/RSD, Strengthening PFM in LAC Project January 2014**

# Paraguay

## Summary

- Over the 2003 to 2012 period, Paraguay's total tax revenue increased by 3.6% of GDP due to an ambitious government reform program to address public sector weaknesses, including improving tax collections and strengthening the tax administration. Paraguay's tax structure shifted to rely more heavily on taxes on income and profits and on goods and services, which increased by 1.1% and 2.8%, respectively.
- A recent study[69] found Paraguay's tax effort[70] to be on par with other countries in Latin America and the Caribbean (LAC). Paraguay's tax effort is 59.3% of tax capacity, whereas the average of the surveyed LAC countries is 61.1%. The country's tax capacity, at 25.8% of GDP, is moderately lower than the average tax capacity of all other surveyed LAC countries, which is 33.5%.
- Personal income tax (PIT) revenue effort and productivity figures in Paraguay are not available, as the PIT regime was only established in 2012. The maximum personal income tax rate is well below the regional, income group, and world averages.
- Paraguay's corporate income tax revenue effort is modestly below the regional, income group, and world averages, while its productivity figures are significantly above the averages. The corporate income tax rate is significantly below the regional, income groups, and world averages.
- Revenue effort for the value added tax (VAT) is broadly in line with the income group and world averages and slightly below the regional average, while VAT productivity figures are significantly above the regional, income group, and world averages. The VAT rate is slightly below all comparator groups.
- Suggested areas for further investigation include:
  - The impact of the newly implemented personal income tax of 2012.
  - The impact of the agriculture fiscal reform of 2012.
  - The high productivity of corporate and value added taxes.

[69] Pessino, Carola and Ricardo Fenochietto (2010), "Determining countries' tax effort", *Hacienda Pública Española / Revista de Economía Pública,* 195-(4/2010): 65-87, Instituto de Estudios Fiscales. "Tax capacity" is the maximum tax revenue that can be generated given the country's economic, social, institutional, and demographic characteristics. "Tax effort" is the ratio of actual revenue to tax capacity.

[70] The definition of "tax effort" employed in the aforementioned study differs from the definition of revenue effort employed further below in this paper.

## Major Developments and Features of Current Tax System

### Evolution of Revenue

Paraguay's total tax revenue increased by 3.6% of GDP between 2003 and 2012. This was primarily due to comprehensive tax reform in the mid-2000's. Revenue from taxes on income and profits, as well as on goods and services, both showed gains over the past decade.

- Revenue from taxes on income and profits increased by 1.1% of GDP over the period.
- Revenue from taxes on goods and services increased by 2.8% of GDP.
- Revenue from taxes on international trade decreased by 0.1% of GDP.

**Paraguay Government Current Revenue**
(% of GDP)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| Taxes on Income & Profits | 1.5% | 1.8% | 1.8% | 1.6% | 1.8% | 1.9% | 2.8% | 2.2% | 2.4% | 2.6% |
| Taxes on Goods and Services | 5.4% | 6.2% | 6.4% | 6.5% | 7.0% | 7.3% | 7.5% | 8.1% | 8.1% | 8.2% |
| Taxes on International Trade | 1.6% | 1.9% | 1.5% | 1.5% | 1.2% | 1.3% | 1.2% | 1.6% | 1.6% | 1.5% |
| Other Taxes | 0.3% | 0.4% | 0.5% | 0.8% | 0.2% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| **Total Tax Revenue** | **8.7%** | **10.3%** | **10.1%** | **10.5%** | **10.1%** | **10.7%** | **11.6%** | **12.0%** | **12.1%** | **12.3%** |

**Source:** Economic Comission for Latin America and the Caribbean, CEPALSTAT

### Summary of Reforms

Over the past decade, Paraguayan tax reforms have attempted to increase tax revenues by favoring taxes that are easier to collect and have larger tax bases, reducing the corporate income tax rate, and addressing internal aspects of the tax administration.[71] Major reforms in 2004 simplified the system by reducing the number of taxes from approximately 150 to 9, rearranging tax legislation, and shifting the focus of taxation toward indirect taxation.

- In 2004, the Fiscal Adjustment Law broadened the VAT tax base by introducing a tax on services, rentals, and transportation, and reduced exemptions on basic goods and oil products.
- The 2004 reforms introduced a new personal income tax and lowered the corporate income tax rate from 30% in 2004 to 20% in 2005, and to the current rate of 10% by 2006. The reform also established a new small business tax of 10% and a 1% property tax.[72] The law's passage was controversial and spurred protests, prompting the government to postpone implementation until 2013.
- In addition, several special tax regimes were abolished through the 2004 reform, such as the elimination of a five-year tax holiday on first-time investment, and elimination of dividend, profit, and bond exemptions.
- Following the 2004 reform, the tax administration focused on modernizing procedures and operations, improving control over goods and revenue collection, and addressing key human resource issues.

[71] Ferrario, Caterina. Tax Systems and Tax Reforms in Latin America: Paraguay. Società Italiana di Economia Pubblica, August, 2006. http://www-3.unipv.it/websiep/wp/548.pdf
[72] Ibid.

- In August 2012, the government enacted the long-delayed personal income tax bill, instituting a 10% rate on taxable income in excess of 10 times the monthly minimum wage. A differential tax rate of 8% is applied when income is below 10 times the minimum monthly wage.
- In 2012, the government approved a major fiscal reform directed toward the dominant agriculture sector, which in 2011 accounted for 20% of GDP, but only 0.5% of total revenue collection. The reform extended the VAT to primary production and introduced a 10% profit tax on commercial farmers, as well as new agricultural taxes.[73]

## Tax System Profile (2010-11)

The tables in Annex 1 provide a high-level description of Paraguay's tax system and draw comparisons with the Latin America and Caribbean (LAC) region, low-middle-income (LMI) countries,[74] and the rest of the world. The data in this section are from the 2012-2013 release of USAID's Collecting Taxes database.[75] **The most recent comparative data in this section are from fiscal year 2011 and do not reflect the most recent reforms or data discussed above.**

### Revenue Effort

- "Revenue Effort" is the amount of revenue as a share of GDP.
- Paraguay's overall tax revenue effort is 12.1% of GDP, which is below the income group and world averages of 16.4%, and 17.9%, respectively, and significantly below the LAC regional average of 19.5%.
    - While tax revenues have been growing in recent years, Paraguay's overall tax revenue effort remains one of the lowest in Latin America.
- An estimate of Paraguay's personal income tax revenue effort is not available, as Paraguay's personal income tax regime took effect only recently, in August 2012.[76]
- Corporate income tax revenue effort, at 2.4% of GDP, is below the LAC regional, income group, and world averages of 3.7%, 3.6%, and 3.3% respectively.
- The revenue effort from VAT, at 6.2% of GPD, is in line with the corresponding comparator group averages, which lie between 6.0% and 6.4%.

### Tax Structure

- The maximum personal income tax rate, at 10%, is significantly below the LAC regional, income group, and world averages, which are in the 27% to 28% range.
- Paraguay's corporate income tax rate, at 10%, is significantly below the LAC regional, income group, and world averages, which are in the 24% to 27% range.
- The VAT rate, at 10%, is moderately below the regional, income group, and world averages, which are in the 13% to 14% range.

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[73] Economist Intelligence Unit, Paraguay Country Report, 2013.
[74] Derived from the World Bank's Country and Lending Group classifications, http://data.worldbank.org/about/country-classifications/country-and-lending-groups
[75] USAID's Collecting Taxes Database, http://egateg.usaid.gov/collecting-taxes
[76] KPMG Flash: Paraguay. http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/flash-international-executive-alert/Documents/flash-international-executive-alert-2012-213-nov.pdf

- The tax wedge on labor income, at 23%, is broadly in line with the world average of 22.4% and slightly above the regional and income group averages of 20.1% and 19%.

## Revenue Productivity

- “Revenue productivity” measures the revenue share of GDP mobilized for each point of the tax rate. An estimate of Paraguay's personal income tax productivity is not available, as Paraguay's personal income tax regime became effective only recently, in August 2012.
- Corporate income tax productivity, at 0.24, is well above the regional, income group, and world averages, which range from 0.15 to 0.17.
- Paraguay’s VAT productivity, at 0.62, is significantly above the regional, income group, and world averages of 0.47, 0.44, and 0.42, respectively.

## Tax Administration Structure

- The *Subsecretaría de Estado de Tributación* (SET) is responsible for administration of taxes in Paraguay. SET is a division of the Ministry of Finance. Customs duties are collected by the General Customs Service.
- Tax administration in Paraguay is organized along functional lines and includes a Large Taxpayer Unit (LTU).
- SET’s ratio of active taxpayers to staff, at 478 taxpayers per staff, is above the income group average of 349 taxpayers per staff, but significantly below the LAC regional and world averages of 982 and 677, respectively.

## Taxpayer Burden and Corruption Evidence

- The 2010 World Bank Enterprise Surveys indicated that the percentage of Paraguayan business taxpayers “expected to give gifts in meeting with tax officials” was 14.6%, which was significantly above the LAC regional average of 6.1%, and in line with the world average of 14.1%.
- The 2014 World Bank Doing Business survey estimates that the average time to pay taxes expended by a medium-sized company in Paraguay amounted to 384 hours per year, which is in line with the LAC regional average of 369 and above the world average of 285 hours per year.

## ANNEX 1-A: Paraguay's Collecting Taxes 2011 Indicators

| Total Tax Revenue | TAXY[77] |
|---|---|
| | Tax Revenue as % of GDP (%) |
| Paraguay | 12.1 |
| Latin America and the Caribbean[1] | 19.5 |
| Low-Middle-Income Economies[2] | 16.4 |
| World | 17.9 |

| Company Income Tax | CITR | CITY | CITPROD |
|---|---|---|---|
| | Tax Rate (%) | Revenue as % GDP (%) | Revenue Productivity |
| Paraguay | 10.0 | 2.4 | 0.24 |
| Latin America and the Caribbean[1] | 27.2 | 3.7 | 0.15 |
| Low-Middle-Income Economies[2] | 24.7 | 3.6 | 0.17 |
| World | 24.1 | 3.3 | 0.15 |

| Income Taxes on People | PITMINR | PITMAXR | PITMINL | PITMAXL |
|---|---|---|---|---|
| | Minimum Tax Rate (%) | Maximum Tax Rate (%) | Minimum Income Level (Multiples of GDP per capita) | Maximum Income Level (Multiple of GDP per capita) |
| Paraguay | 8.0 | 10.0 | 4.51 | 5.63 |
| Latin America and the Caribbean[1] | 13.4 | 27.5 | 0.52 | 3.58 |
| Low-Middle-Income Economies[2] | 10.4 | 27.3 | 0.44 | 7.04 |
| World | 10.9 | 27.8 | 0.40 | 6.38 |

[77] A glossary of terms for the selected indicators is found in Annex 2.

| Personal Income Tax | PITY | PITPROD | SSR | WEDGE |
|---|---|---|---|---|
| | Revenue as % GDP (%) | Revenue Productivity | Mandatory Combined Social Contribution Rates (%) | Combined Rate of Personal and Labor Taxation (%) |
| Paraguay | N/A | N/A | 23.0 | 23.0 |
| Latin America and the Caribbean[1] | 4.1 | 0.15 | 17.1 | 20.1 |
| Low-Middle-Income Economies[2] | 4.6 | 0.17 | 18.1 | 19.0 |
| World | 5.5 | 0.22 | 20.8 | 22.4 |

| Value Added Tax | VATR | VATY | VATGCR | VATPROD | THRESHOLD |
|---|---|---|---|---|---|
| | VAT rate (%) | Revenue as % GDP (%) | Gross Compliance Ratio (%) | Revenue Productivity | Mandatory registration/ filing (annual turnover in USD) |
| Paraguay | 10.0 | 6.2 | 79.1 | 0.62 | 0 |
| Latin America and the Caribbean[1] | 13.5 | 6.4 | 66.2 | 0.47 | 34,149 |
| Low-Middle-Income Economies[2] | 13.1 | 6.0 | 69.3 | 0.44 | 56,881 |
| World | 13.8 | 6.1 | 65.9 | 0.42 | 57,598 |

| Tax Administration | Tax Staff | Payer to Staff | Function | LTU | Customs |
|---|---|---|---|---|---|
| | Tax staff per 1000 population | Number of tax payers per tax staff | Functional Organization (1 = Yes, 0 = No) | Large Taxpayer Unit (1 = Yes, 0 = No) | Customs and Tax Administration Combined (1 = Yes, 0 = No) |
| Paraguay | 0.14 | 478 | 1.00 | 1.00 | 0.00 |
| Latin America and the Caribbean[1] | 0.33 | 982 | 0.80 | 0.78 | 0.30 |
| Low-Middle-Income Economies[2] | 0.35 | 349 | 0.91 | 0.89 | 0.22 |
| World | 0.65 | 677 | 0.88 | 0.81 | 0.30 |

Footnotes:

1. LAC countries include: Anguilla, Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bermuda, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.
2. Low-Middle-Income Countries include: Armenia, Bhutan, Bolivia, Cameroon, Cape Verde, Congo, Rep, Cote d`Iviore, Djibouti, Egypt, El Salvador, Georgia, Ghana, Guatemala, Guyana, Honduras, India, Indonesia, Kiribati, Kosovo, Lao P.D.R, Lesotho, Mauritania, Micronesia, Moldova, Mongolia, Morocco, Nicaragua, Nigeria, Pakistan, Papua New Guinea, Paraguay, Philippines, Samoa (Western), Senegal, Solomon Islands, Sri Lanka, Sudan, Swaziland, Syrian Arab Republic, Timor-Leste, Ukraine, Uzbekistan, Vanuatu, Vietnam, West Bank/Gaza, Yemen, Rep, and Zambia.

## ANNEX 1-B: Collecting Taxes Indicators Glossary

***CITR*** is the general rate applied for the corporate income tax. In most countries, only one corporate income tax is applied to corporate profits. In most countries, business enterprises that are owned by sole proprietors or unincorporated partnerships pay tax under the personal income tax system.

***CITY*** is the level of corporate income tax collections as percentage of GDP.

***CITPROD*** represents how well the corporate income tax does in terms of revenue collection, given the tax rate. CITPROD is the portion of GDP in revenue that is mobilized for each point of CIT rate.

***PITMINR*** is the lowest non-zero positive tax rate applied to the lowest income group in the personal income tax system.

***PITMINL*** is the lowest level of income at which the lowest marginal personal income tax rate (PITMINR) is imposed, expressed as a multiple of per capita GDP.

***PITMAXR*** is the highest tax rate applied under the personal income tax system.

***PITMAXL*** is the lowest level of income at which the top marginal personal income tax rate is imposed, expressed as a multiple of per capita GDP.

***PITY*** is the level of personal income tax collections as percentage of GDP.

***PITPROD*** provides an indication of how well the personal income tax in a country does in terms of producing revenue. PITPROD is the portion of GDP in revenue that is mobilized for each point of the average PIT rate.

***SSR*** is the combined rate for employer and employee social security contributions.

***WEDGE*** is an estimate of the overall taxation of labor income, represented as a percentage of gross salary. It combines social contributions with personal income tax. The tax wedge represents the ratio of total labor taxes to total labor costs to the employee.

***VATR*** is the general rate at which most goods and services are taxed under the value added tax system. Most countries have a variety of reduced rates for certain basic goods, such as basic food stuffs. Also, all countries have a zero rate on exported goods.

***VATY*** is the level of VAT collections as a percentage of GDP.

***VATGCR*** is the VAT gross compliance ratio which is the ratio of potential VAT collections—if all final household consumption had been taxed at the standard rate--to actual VAT collections.

***VATPROD*** is a measure of how well the VAT produces revenue for the government, given the VAT rate. It is the portion of GDP in revenue that is mobilized for each point of VAT rate.

***Threshold*** indicates the amount of annual turnover, in US $ terms above which taxpayers must register for VAT and file regular VAT returns.

***Functional Organization*** is a binary indicator where 1 indicates that the tax administration is organized along functional lines.

***Large Taxpayer Unit*** is a binary indicator where 1 indicates that there is a large taxpayers unit.

***Customs and Tax Administration Combined*** is a binary indicator where 1 indicates that revenue is administered jointly by a single customs and tax administration.

## ANNEX 1-C: Paraguay Tax Highlights

# Paraguay Highlights

**Currency:** Paraguayan Guaraní (PYG)

**Foreign exchange control:** No

**Accounting principles/financial statements:** Paraguayan GAAP, based on IAS/IFRS. Financial statements must be prepared annually.

**Principal business entities:** These are the corporation, limited liability company, partnership and branch of a foreign corporation.

### Corporate taxation:

Residence – Residence is determined in order of priority according to: (1) the place of a company's management or direction; (2) the place where a company's main activities are carried out; and (3) the location of a company's representative address.

Basis – Corporate income tax is levied on a territorial basis. Tax is due, with some exceptions, on business income derived from activities performed, property situated or economic rights used, in Paraguay, regardless of the domicile, residence or nationality of those participating in the operations or where contracts are concluded.

Taxable income – Taxable income is the difference between total earnings from commercial, manufacturing and service activities less expenses incurred to derive the income.

Taxation of dividends – Dividend distributions are subject to a 5% corporate income tax.

Capital gains – Capital gains derived from the sale of fixed assets, immovable property and securities are taxed as ordinary income at the standard corporate rate.

Losses – The carryforward and carryback of losses is not permitted.

Rate – 10%

Surtax – No

Alternative minimum tax – No

Foreign tax credit – No

Participation exemption – No

Holding company regime – No

Incentives – Companies operating in free zones benefit from reduced taxation. A maquiladora regime also exists.

### Withholding tax:

Dividends – Dividends distributed to a nonresident are subject to a 15% withholding tax.

Interest – Interest paid to a nonresident is subject to a 30% withholding tax, which is imposed on 50% of the payment, resulting in an effective rate of 15%. The rate on payments to a financial institution is 6%.

Royalties – Royalties paid to a nonresident are subject to a 30% withholding tax imposed on 50% of the payment, resulting in an effective rate of 15%.

Branch remittance tax – Profits remitted to a head office are subject to a 20% withholding tax, in addition to the 10% corporate tax, resulting in an effective rate of 30%.

### Other taxes on corporations:

Capital duty – There is no capital duty per se, but certain fees (e.g. registration and publication) are levied on the formation of a company.

Payroll tax – No

Real property tax – Real property is subject to an annual tax collected by the local authorities at a rate of 1% (0.5% for certain rural property) of the cadastral value. Various real estate surtaxes also apply for specific types of property, and there is a 0.3% tax on the transfer of immovable property (calculated on the higher of the transaction price or the cadastral value of the property).

Social security – The employer's contribution to social security is 16.5% of an employee's total salary (including bonuses, premiums, etc.). The employer also must withhold the employee portion (9%).

Stamp duty – No

Transfer tax – No

Other – Some small and agricultural businesses fall under special regimes other than the corporate income tax regime.

### Anti-avoidance rules:

Transfer pricing – No

Thin capitalisation – No

Controlled foreign companies – No

Other – No

Disclosure requirements – No

### Administration and compliance:

Tax year – The tax year generally coincides with the calendar year, but certain industries are required to use specific tax years.

Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

Filing requirements – A company must make 4 advance payments based on the previous tax year's liability. A return and balance sheet, at a minimum, must be filed for corporate income tax purposes. In general, the return is due within 4 months of the end of the taxpayer's tax year, but the taxpayer's identification number determines the exact due date.

Penalties – Penalties range from 4% to 14% of the total tax due, plus monthly interest at 1.5%.

Rulings – A taxpayer may request a ruling from the tax authorities on the tax consequences of a proposed transaction.

### Personal taxation:

Basis – Tax is levied on Paraguayan-source (net) income from services and certain investments, provided the taxpayer's income exceeds the monthly minimum wage by a certain amount (i.e.108 times for 2011, to be reduced by 12 per year until the factor reaches 36 in 2017). The personal income tax, however, is suspended until 1 January 2013.

Residence – An individual is resident in Paraguay if he/she is in the country for more than 120 days in a calendar year or in the previous 12-month period.

Filing status – Joint filing is not permitted. Each person is subject to tax if his/her individual income exceeds the relevant threshold.

Taxable income – Income from services and certain investments are taxable. These items include: personal services income; benefits in kind; dividends, profits and share price surplus (50% if derived from a resident company/enterprise subject to corporate or agricultural income tax and 100% if the resident company/enterprise is not subject to corporate or agriculture income tax); certain capital gains (see under "Capital gains"); and interest, commissions and other income that has not been subject to the corporate or agriculture income tax. A nonresident that derives business or professional income in Paraguay is subject to withholding tax at an effective rate of 15% (30% of 50%) on the gross amount.

Capital gains – Capital gains from the disposal of real property located in Paraguay and shares of Paraguayan companies are subject to individual income tax if they are occasional; otherwise, the gains are subject to the corporate, agricultural business tax or small business tax. Capital gains derived by a nonresident are subject to tax at an effective rate of 15% (30% of 50%) on the gross amount.

Deductions and allowances – If directly related to the taxable activity generating domestic-source income, both domestic and foreign-source expenses are deductible. The taxpayer and his/her dependents are also entitled to personal deductions (education, health, clothing, recreation, charitable, etc.). A deduction of 15% of annual gross income is allowed if invested in certain entities where the taxpayer does not contribute to the social security system.

Rates – The rate is 10% if the income exceeds 120 times the minimum wage; otherwise, the rate is 8%.

## Other taxes on individuals:

Capital duty – No

Stamp duty – No

Capital acquisitions tax – No

Real property tax – Real property is subject to an annual tax collected by the local authorities at a rate of 1% (0.5% for certain rural property) of the cadastral value. Various real estate surtaxes also apply to specific types of property and there is a 0.3% tax on the transfer of immovable property (calculated on the higher of the transaction price or the cadastral value of the property).

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – The employee contribution is 9% (3% applicable to pension and retirement), based on total remuneration (including bonuses, premiums, etc.) and is withheld by the employer.

## Administration and compliance:

Tax year – Calendar year

Filing and payment – The annual income tax liability must be paid when the annual tax return is filed (i.e. in June of the year following the tax year).

Penalties – Penalties range from 4% to 14% of total tax due, plus monthly interest at 1.5%.

## Value added tax:

Taxable transactions – VAT is levied on the supply of goods and services, and the import of taxable goods and services.

Rates – The standard rate is 10%, with a lower 5% rate applying to supplies of basic foodstuffs, pharmaceutical products, interest and commissions on loans, and the transfer of the right to use goods or immovable property. Exports are zero-rated. Exemptions include raw farm products, some fuels, foreign currency, books and newspapers.

Registration – VAT registration is compulsory for all companies and unincorporated businesses whose taxable turnover exceeds a certain amount.

Filing and payment – VAT filing and payments are due monthly, with the due date determined according to the taxpayer's registration number.

**Source of tax law:** Law No. 125/91 on Tax Reform (including all fiscal taxes), Law No. 2421/04 of Administrative Reordering and Fiscal Adequacy

**Tax treaties:** Paraguay has 1 tax treaty.

**Tax authorities:** *Subsecretaría de Estado de Tributación*

**International organisations:** Union of South American Nations, Mercosur, OAS (Organization of American States)

**SOURCE**: Deloitte International Tax Source: Tax Highlights, http://www.deloitte.com/taxguides.