TUNISIA TAX AND CUSTOMS REFORM PILOT ACTIVITY

PHASE I FINAL REPORT

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.

TUNISIA TAX AND CUSTOMS REFORM PILOT ACTIVITY (TCP)

A PILOT ACTIVITY UNDER THE ASIA AND MIDDLE EAST ECONOMIC GROWTH BEST PRACTICES PROJECT (AMEG)

PHASE I FINAL REPORT

Contract No. GS-23F-0127P, **Task Order No.** AID-OAA-M-12-00008

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ACRONYMS

AfDB	African Development Bank
AMEG	Asia and Middle East Economic Growth Best Practices Project
CIT	Corporate Income Tax
CNSS	National Social Security Administration
DGCPR	General Directorate of Public Accounting and Recovery
DGELF	General Directorate of Legislative and Fiscal Studies
DGD	General Directorate of Customs
DGI	General Directorate of Taxes
FAU	Fiscal Analysis Unit
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GOT	Government of Tunisia
IMF	International Monetary Fund
LTO	Large Taxpayers Office
MOF	Tunisia Ministry of Finance
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
TCP	Tax and Customs Reform Pilot Activity
TFA	Trade Facilitation Agreement
TTN	Tunisia Trade Net
USAID	United States Agency for International Development
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization

EXECUTIVE SUMMARY

In 2014, Tunisia held its first free and democratic elections, completing a transition of nearly four years. Tunisia's peaceful transition to a democratic government offers promise, yet the newly formed government faced high economic and social expectations and a deteriorating socioeconomic situation.

TAX POLICY REFORM

When the Tax and Customs Reform Pilot Activity (TCP) launched in October 2014, the Tunisian government was poised to address significant barriers to investment, broad-based economic growth, employment generation, and an equitable distribution of the tax burden through comprehensive tax policy reform. Using a combination of analytical modeling and microsimulation tools and a capacity building approach within the General Directorate of Legislative and Fiscal Studies (DGELF), TCP worked with the Ministry of Finance (MOF) to launch a tax policy reform steering committee as a consultation mechanism for gaining consensus on priority activities. TCP supported the MOF to propose multiple reform-oriented tax policy laws to the Assembly of the People's Representatives related to the value added tax (VAT), excise taxes, and customs duties. Of the proposed laws, six were approved by the Assembly and will be included in the 2016 Budget Law. To institutionalize MOF's capacity to develop its own statistical models and economic analysis for ongoing fiscal policy reform, TCP helped establish a Fiscal Analysis Unit (FAU) within the DGELF in February 2016, and provided a robust 22-module technical training program to ensure capacity building. In the final months of Phase I, TCP initiated a review of the current state of operationalization of Tunisia's decentralization law to provide options for USAID and assembled a working group to conduct a study of the local tax system.

KEY RESULTS UNDER PHASE I

Tunisia Tax and Customs Pilot Activity (TCP) Phase I (November 1, 2014 – April 30, 2016) accomplishments include:

Tax Policy Reform

- Change in World Bank Doing Business Paying Taxes ranking: Tunisia was ranked 84th in 2015, moving to 81st in 2016
- 6 new tax policy laws adopted by the Government of Tunisia, addressing customs duties, VAT, and excise taxes
- Reduction in number of VAT rates used for specific sectors
- Established a Fiscal Analysis Unit within the MOF to institutionalize fiscal policy analysis

Tax Administration Reform

- Implementation of the Taxpayer Compliance Improvement Plan
- Launch of the Audit Criteria Selection System, providing the Tax Administration with mechanism to transparently select cases for audit

Customs Reform

- Tunisian Customs accepts proposed methodology and principles for an Advance Rulings program on tariff classification and origin
- Reduction of import process steps at Port Rades by 35 percent, eliminating 18 of the original 52 steps in the import process
- Initiated a new activity to support Tunisia's implementation of a single window for trade facilitation

TAX ADMINISTRATION REFORM

To build General Directorate of Impots (DGI) capacity for sustaining reforms to its operations and overall tax administration procedures, TCP helped develop a Taxpayer Compliance Improvement Plan (TCIP) as part of a larger initiative aimed at institutionalizing a risk-based approach to reform. Under the TCIP, working groups prioritized and implemented reforms to risk management, simplification, registration, verification, filing, and payment strategies. TCP supported DGI to survey its 27 regional offices to identify additional tax administration risks and helped establish a Risk Management Unit to house all risk-based compliance reform efforts outlined under the TCIP. DGI saw an increase in voluntary compliance, enhanced revenue generation, and is taking concrete steps to address fraud and evasion under Phase II. TCP provided technical assistance to develop a new Audit Criteria Selection System (ACSS), which will ensure a more robust procedure for flagging high-risk cases for audit while minimizing selection bias. During the ACSS pilot test, TCP found that less than 10 percent of the highest scores were audited within the past 10 years. TCP supported DGI to strengthen taxpayer service activities and tax registration programs, which will broaden the tax base to generate additional revenues for maintaining a revenue-neutral budget position. TCP positioned DGI to develop targeted communication strategies based on taxpayer demographics to monitor compliance and broaden outreach efforts to increase the share of tax filers and increase revenue collected.

CUSTOMS ADMINISTRATION REFORM

TCP worked with Customs to assist in the implementation of specific areas of the WTO Trade Facilitation Agreement (TFA) signed in Bali in 2013. Under Phase I, the Tunisian Customs Administration (DGD) accepted TCP's proposed methodology and principles for an Advance Rulings program on tariff classification and origin. The proposed program also included recommended procedures and application forms to ensure compliance with the Bali WTO TFA Articles 3 (Advance Rulings) and 4 (Procedures for Appeal or Review). TCP also provided technical assistance in business process mapping, supporting DGD to reduce its import process steps at Port Radès by 35 percent, eliminating 18 of the original 52 steps in the import process. Building upon progress made in this area, TCP initiated a new activity focused on advancing Tunisia's trade facilitation efforts through a single window system under Phase II. To strengthen ties between Customs and private sector stakeholders, TCP supported activities designed to bring together key constituents from Customs and the private sector to address barriers to Tunisia's import/export supply chain. TCP also facilitated an introduction between the Tunisian and American custom administrations. An official collaboration is under consideration to include information sharing and training.

SECTION I

TCP OBJECTIVES AND BACKGROUND

In 2014, Tunisia held its first free and democratic elections, completing a transition of nearly four years. Tunisia's peaceful transition to a democratic government offers promise, yet the newly formed government faces high economic and social expectations and a deteriorating socioeconomic situation. It inherits a host of challenges, including:

TCP is a pilot activity under the Asia and Middle East Economic Growth Best Practices (AMEG) Project, implemented by prime contractor Chemonics International, with implementation support from The Pragma Corporation.

- A state-centered development model affected by corruption with economic gains owned by a privileged few, fueling a sense of denied opportunities among the rest of the population
- High unemployment, especially among youth (about 25 percent in 2014)
- Pronounced economic and social disparities across various regions in Tunisia
- The dichotomy between the favored, highly incentivized offshore regime and the tightly controlled onshore sector
- Investment incentives that favor low value-added industries, many of which are intensive in unskilled labor

Although some measures have been taken by the transitional government to promote employment and regional development, longer-term, carefully crafted reforms must be pursued to strengthen the confidence of domestic and economic agents to boost productivity, create employment and attract private investment. Toward this end, the transitional government embarked on a comprehensive economic recovery program in 2014 intended to be implemented over five years. The proposed recovery program is articulated around five strategic pillars: the gradual recovery of macroeconomic balance; boosting growth and employment; economic reform; regional development; and solidarity and social inclusion.[1] Of these pillars, the gradual recovery of macroeconomic stability is necessary for strong and sustainable economic growth. This pillar consists of a set of measures aimed to first, control the evolution of public expenditure and, second, to increase state revenues while ensuring that all sectors of society bear the effort required equitably. Reforming the taxation policy is a priority activity to improve fairness, returns, and economic efficiency. Further, reform of the organization and

[1] 'Tunisia: A country, a vision, a future" a document prepared by an inter-ministerial work led by Head of Government Mr. Mehdi Jomâa for the International Conference "Invest in Tunisia: Start-up democracy" in Tunis, September 8, 2014.

procedures of the tax and customs system is aimed at increasing recovery and reducing fraud and tax evasion.

In October 2014, under the auspices of the Asia and Middle East Economic Growth Best Practices Project (AMEG), USAID supported an inaugural mission to Tunisia to initiate discussions with Government of Tunisia (GOT) counterparts and representatives of the private sector and civil society to introduce the proposed activity, discuss the GOT's fiscal reform agenda, and support initial work plan development for Phase I of TCP. A goal of the mission was to lay the groundwork for determining technical assistance and related training needs to support the sustainable adoption of best practice compliant reforms in tax policy, tax administration, and customs that align with GOT priorities. The TCP activity was designed to align with this reform agenda to develop an equitable tax system and modernized tax and customs administration processes that are more transparent, efficient, equitable, and supportive of investment. The broader development objective of TCP is to improve tax and customs policy and the institutional environment to promote broad-based sustainable growth and private investment in Tunisia. Under Phase I, TCP comprised three technical components: tax policy reform, tax administration reform, and customs administration reform.

> **TCP helped us to adopt a global vision for our tax reform. For example, we used to consider indirect taxes from VAT and excises in siloes. Now we look at reforms to different taxes and their impact on each other.**
>
> **— MR. IMED ZAIR, DIRECTOR OF INDIRECT TAXES, DGELF**

Tax policy reform

Consistent with the government reform agenda outlined above, TCP supported the GOT adopt best practice-consistent tax policy. Specifically, TCP provided expert tax policy analysis to support the GOT's readiness to propose reforms and adopt a reform agenda. After the tax reform agenda is approved, TCP will support its execution through the development of analytical tools and working papers to steer the adoption of the reforms and help the GOT gain support for new tax measures from the Parliament and key private sector stakeholders. In parallel, TCP strengthened the institutional capacity of key GOT agencies to perform best practices in policy reform through one-on-one mentoring and supported the development of a Fiscal Analysis Unit (FAU) within the MOF.

Tax administration reform

TCP collaborated closely with GOT's efforts to modernize the tax administration, establish internal consistency, and improve efficiency and transparency in tax administration. Activities focused on improvements to analytical and decision-making capacity, strengthening audit processes, identifying opportunities to enhance taxpayer outreach and services, simplifying taxpayer registration, and reviewing organizational processes to streamline and integrate processes.

Customs administration reform

In alignment with GOT reform objectives, TCP's activities in this component aimed to facilitate improvements to customs operations to strengthen consistency with international best practices and advance Tunisia's implementation of the World Trade Organization (WTO)'s Trade Facilitation Agreement (TFA). Assisting the GOT to advance toward full implementation of the TFA will bring Tunisia closer to globally recognized best practices in cross-border trade. In addition, TCP facilitated improvements to key customs business processes and customs compliance management.

TCP Customs Advisor, Sergio Riveros (right), meets with the new Customs focal points for the project at the General Directorate of Customs (DGD). Photo: Adel Lagha

Cross-cutting objectives

Sustainability and gender considerations are integrated in the design of TCP activities. Institutional capacity building is integrated in implementation as a key component to increase the knowledge and skills needed for effective policy analysis and effective administration of tax and customs procedures. For example, a key intermediate result of the tax policy component is to facilitate the establishment of a Fiscal Analysis Unit. For all components, TCP works to strengthen outreach and communication mechanisms between the government and private sector.

Counterparts

The Tunisia TCP Activity was implemented in close collaboration with the GOT's Ministry of Finance (MOF) and specific units within the Ministry of Finance that focus on tax policy and administration and customs administration. In addition, TCP collaborated selectively with key stakeholders in the Tunisian parliament and the private sector, and with donors and multilaterals, including the European Union, International Monetary Fund (IMF), World Bank, and the Organization for Economic Cooperation and Development (OECD), among others. TCP also collaborated, where appropriate, with other United States Government (USG) agencies, including the U.S. Department of State, U.S. Department of Treasury, and the United States Trade Representative.

SECTION 2

STRENGTHENING MOF'S CAPACITY TO DEVELOP AND MANAGE TAX POLICY

KEY RESULTS FOR PHASE I

TCP's tax policy reform work emphasized strengthening MOF's capacity to develop and manage tax policy.

- Change in World Bank Doing Business Paying Taxes ranking: Tunisia was ranked 84th in 2015, moving to 81st in 2016.
- 6 new tax policy laws adopted by the Government of Tunisia, addressing customs duties, VAT, and excise taxes (see Exhibit 1)
- Number of VAT rates used reduced for specific sectors

Intermediate Result 1. Tax Policy Reform

Under Phase I, TCP aimed to simplify Tunisia's system of taxation, increase the level of fairness, and to lower tax rates and broaden tax bases. To achieve results under Phase I, TCP focused technical assistance on strengthening capacity within DGELF. The goal was to provide Tunisia's policymakers with navigational instruments to develop a three year Tax Reform Roadmap to transform high level reform objectives into concrete changes in tax rates and bases that will be legislated and implemented in a phased manner over the medium term. TCP capitalized on existing tools for microsimulation modeling for the major taxes (VAT, PIT, and CIT), incidence analysis tools, and Statistics of Income (SOI) analysis to advance DGELF capacity and skill in these critical models.

Overall background and approach

When TCP launched in October 2014, the Tunisian government was poised to address significant barriers to investment, broad-based economic growth, employment generation, and an equitable distribution of the tax burden through comprehensive tax policy reform. Foreign and domestic analysts, business people, and policymakers recognized the need for comprehensive reform of Tunisia's tax regime. At the same time, the combination of vested institutional interests and ongoing political volatility created a continuing need to further expand the awareness and understanding of policymakers and the broader public regarding the optimal composition of a tax reform program which meets core efficiency, equity, and fairness goals. TCP was developed in response to these conditions to promote efficient adjustments and fine-tuning of the reforms in the context of shifting institutional alliances and public policy priorities.

With total fiscal revenues of about 22 percent, a fiscal deficit of about 7 percent of GDP in 2013, and economic growth stagnant in the 2-3 percent range over the preceding years, reform of the tax policy framework was a priority both for improving revenue buoyancy and driving renewed investment and job-creating growth. High tax rates, base complexity, and the excessive administrative burden – along with a special regime of tax incentives that favored a privileged few large companies and an associated low level of 'tax certainty' – made Tunisia a difficult environment for foreign direct investment.

TCP counterparts in the MOF were eager to build upon the strengths in their tax regime while addressing its deficits. The overall framework of the fiscal system's main revenue engines in terms of fundamental design and definition were basically sound. Similarly, revenue collection for major taxes was largely organized around a system of withholding at source and advance payments that is largely consistent with best practices, and a tax administration information technology (IT) system was in place and worked on a basic level.

TCP's approach to tax policy reform used two parallel but related tracks:

- Track One: Use and Expansion of Analytical Tools
    - Expansion of existing microsimulation models updated with new taxpayer data and made more sophisticated in response to nuanced tax policy analysis needs.
    - Phased improvement of incidence analysis models and analytical tools, including Statistics of Income and Tax Expenditure Budget analysis.
    - Use of supplemental macro-economic tax-by-tax forecasting tools as appropriate.
- Track Two: Institutionalizing Tax Policy Analysis within the MOF
    - Builds on the capacity building efforts under the prior USAID project, using recommendations from counterpart institutions on the staffing and organization of a tax analysis unit.

Government readiness to adopt tax policy reforms strengthened

Formal consultation with the Ministry of Finance. In early 2015, soon after a new Minister of Finance took office following the 2014 elections, TCP worked closely with the MOF to form a Steering Committee, headed by the Minister of Finance, to ensure a formal body through which TCP could present findings from technical assistance, gain consensus on MOF's priorities with regard to tax reform initiatives, and discuss new opportunities. TCP reported directly to the Minister of Finance for guidance and implementation support.

Advancing progressive tax reform. TCP assisted the DGELF to outline a revenue-neutral reform package to address deficiencies in multiple areas of the tax code. DGELF prioritized impact analysis of reforms addressing personal income tax (PIT), the value added tax (VAT), customs duties and excise taxes. While performing microsimulation models and detailed analysis for these reform areas, TCP supported the MOF to propose multiple, reform-oriented tax policy laws to the Assembly of the People's Representatives related to VAT, excise taxes, and customs duties. Of the proposed laws, the Assembly approved six, which will be included in the 2016 Budget Law (see

Exhibit 1). Additional proposals are under consideration for the 2017 Budget Law, addressing PIT and further VAT reform.

EXHIBIT 1. SUMMARY OF TAX REFORMS ENACTED*

LAWS COVERING:	DETAIL OF LAW'S COVERAGE
CUSTOMS DUTIES	Reduction of Customs duties to two rates: 0% (primary products, e.g. equipment, raw materials, semi-finished products, and spare parts) and 20% (consumption products, e.g. household appliances, cleaning products, food, furniture, and electronics)
VAT ON EXEMPTED PRODUCTS	Law imposes 6% VAT on 19 previously exempted products, such as sugar (out of 50 previously exempt products)
REDUCTION IN VAT RATES	Law passed limiting usage of temporary decrees on VAT reductions
EXCISE TAXES	Elimination of excise taxes on more than 32 products, and reduction of multi-rate excises on alcohol to two rates
VAT ON MEDICATION	Law imposes a 6% VAT rate on medications (wholesale and retail)
VAT ON WITHHOLDING TAX	Law reducing the withholding tax for transactions between the private and public sectors from 50% to 25% to reduce outstanding VAT credit to the national treasury.[2]

*Policy laws approved by the Assembly of the People's Representatives and included in the 2016 Budget Law.

Assessing the revenue impact of VAT and personal income tax (PIT). TCP prioritized MOF's tax reform agenda related to a simpler VAT regime and forecasting revenue impacts of proposed PIT reforms. TCP focused technical assistance on providing income and expenditure account models and detailed analysis of the VAT system to produce reliable scenarios to the MOF on the economic impact of reducing the number of VAT rates and exemptions in current use. TCP also updated MOF's microsimulation model for PIT, which MOF uses to analyze the revenue impact of PIT reform scenarios. TCP recommended broadening the VAT base and addressing inefficiencies in tax collection to yield more sufficient revenue for mobilizing future reforms to the larger tax system.

At the end of Phase I, TCP finalized the VAT expenditure estimates of VAT-exempt goods and services proposed by the 2016 Budget Law. TCP worked with MOF on PIT proposals to the Assembly for potential inclusion in the 2017 Budget Law, particularly to

[2] The passage of the law reducing withholding tax by half is a significant milestone for Tunisia. Prior to this law, when a private firm sold its products to the government or a public enterprise, the company would invoice the full amount of VAT on the sale. However, the government was required to pay only 50 percent of the VAT due, considering the other 50 percent as a credit for the firm. This VAT credit could be used to pay other VAT due to the Treasury or could be reimbursed by the Treasury, which takes up to one year for processing and payment to the firm. If the company already had a previous VAT credit, it would accumulate a tax credit with the Treasury, creating financial barriers for the firm's overall development. Reducing the VAT withholding rate by half, from 50 percent to 25 percent, accelerates the reduction of a firm's potential VAT credit, and contributes to the simplification of the VAT system.

widen tax brackets to ease the tax burden for lower income earners and to accommodate future inflation.

Institutional capacity to implement tax policy analysis enhanced

Establishment of the Fiscal Analysis Unit. To institutionalize MOF's capacity to maintain statistical models and conduct economic analysis for ongoing fiscal policy reform, TCP proposed the establishment of a Fiscal Analysis Unit (FAU). The FAU provides the MOF with policy analysis, revenue estimates, and analysis of revenue developments. Inaugurated by the Minister of Finance in February 2016, the FAU is staffed by tax policy specialists and headed by a chief economist. While the discrete functions of an FAU had existed previously within separate departments of the MOF, the formalized FAU consolidated functions from within DGI and DGELF into one office. To design the FAU based on best practices, TCP analyzed MOF staffing data, such as individual job functions and skill levels of current employees, to develop guidance on optimal staffing and training requirements. During Phase I, TCP developed and implemented a rigorous technical training program for FAU staff, as well as participants from DGI, the Directorate General of Resources and Balances (DGRE), and the General Directorate of Tax and Financial Benefits (DGAFF) (see text box). TCP also provided in-depth coaching for select DGI and DGELF employees on the VAT and PIT micro-simulation models. TCP supported all trainees in honing their analytical and presentation skills, particularly when any data analysis or models are prepared for internal dissemination. To date, 15 MOF employees have completed all training modules.

INAUGURAL TRAINING PROGRAM FOR THE FISCAL ANALYSIS UNIT

TCP supported the establishment of an FAU within the MOF to build capacity to generate robust financial modeling and simulations to inform fiscal policy development. TCP's training program consists of 22 modules, covering topics such as:

- Characteristics of a Tax System
- Basic Concepts in Tax Policy
- Introduction to Statistics
- Introduction to STATA software
- Microsimulation modeling
- Principles of Value Added Tax (VAT)
- IMF, OECD, and Tunisian Tax Classification
- Statistics of Income Analysis
- Excise Systems
- Code of Investment
- Tax Expenditure Analysis
- Special Treasury Funds

Fiscal decentralization and local finance options advanced

While progress has been made in reducing regional economic and social disparities in Tunisia over the past several years, economic activity is still highly concentrated in coastal regions of the country. Roughly two-thirds of Tunisia's total population lives in the country's towns and cities. Inequalities in living standards between regions are large.

Under the highly centralized decision-making system of the Ben Ali regime, municipalities had limited responsibilities and played a relatively minor role in local development. Tunisia's new constitution however, has clear commitments to decentralization. A central focus of the Government's five-year, US$770 million municipal investment plan is to reform the management of, and responsibility for, public funds destined for municipalities.

In this context, the MOF requested TCP's technical assistance in assessing the local tax system to help inform the decentralization process. In the final months of Phase I, TCP initiated a review of the current state of operationalization of Tunisia's decentralization law to provide options for USAID and other donors to support the GOT to enhance and speed progress. Additionally, the MOF assembled a working group to conduct a study of the local tax system. Under Phase II, TCP will support the working group to craft a study to address the information needs of the Ministry and to inform recommendations for reform.

SNAPSHOT

A GLOBAL VISION FOR TAX REFORM

TCP uses tools to demonstrate the usefulness of tax reform as a package rather than as individual taxes. The interconnectedness of tax policy reform is helping the GOT reach its goal of fair and transparent reforms that remain budget neutral.

PHOTO: *TCP archives*

TCP's fiscal economist, Mohamed ben Abdallah, working on an impact estimation scenario at DGELF.

The Arab Spring revealed inequalities in access to economic opportunities and resulted in the rejection of a government that could not respond to rising social and economic challenges. In the post-revolution era, the Government of Tunisia (GOT) recognized that key structural reforms were necessary, particularly to the tax system that had not been reformed in 30 years. In this context, the GOT's Ministry of Finance (MOF) collaborated with USAID to reform the tax system.

USAID's first investments in tax policy reform began in 2012 to 2014 through the USAID Tunisia ICT Competitiveness project, which worked closely with the MOF to equip the tax policy and administration departments with micro-simulation models for personal income tax (PIT), value added tax (VAT), and corporate income tax (CIT). USAID's Tax and Customs Reform Pilot Activity, TCP, expands and strengthens these initiatives.

"TCP helped us to adopt a global vision for our tax reform," commented Mr. Imed Zair, Director of Indirect Taxes at the General Directorate of Legislative and Fiscal Studies (DGELF). "For example, we used to consider indirect taxes from VAT and excises in siloes. Now we look at reforms to different taxes and their impact on each other." He dubbed this the 'Audi approach' – referring to the similarity of the overlapping circles of the Audi logo and the integrated lens through which his team now examines reforms. "It took time for us to see how this works, and it helps a lot that USAID works with us, on a daily basis, in our office. They are part of our team," he added.

SECTION III

ENHANCING EFFICIENCY AND TRANSPARENCY FOR TAX ADMINISTRATION

Intermediate Result 2. Tax administration reform

During Phase I, TCP provided support to the Direction Generale des Impots (DGI), a unit in the MOF which oversees the majority of tax administration functions. TCP's approach to tax administration reform assumes that comprehensive tax reform requires a thorough review and upgrading of the existing tax administration functions. The starting point for such reforms rests on providing taxpayers with top quality service by helping them understand and meet their tax responsibilities while enforcing the tax laws with integrity and fairness to all. Under Phase I, TCP prioritized:

KEY RESULTS FOR PHASE I

- Implementation of the Taxpayer Compliance Improvement Plan
- Launch of the Audit Criteria Selection System, providing the Tax Administration with mechanism to transparently select cases for audit.
- Established 3 working groups to implement a Taxpayer Compliance Improvement Plan (TCIP)

- Increasing capacity for systemic analysis and decision-making
- Facilitating adjustments to audit procedures to be consistent with risk-based compliance best practices
- Strengthening nationwide taxpayer services programs
- Simplifying and integrating taxpayer registration, filing, and payment procedures
- Facilitating conformity of tax administration, organization, and mission to international best practices

Overall background and approach

Tunisia's system of tax administration was devoloped with heavy influence from the French system, long regarded as inefficent. Since that time, the government acquired an automated revenue management system to provide storage and retrieval, archiving, and some sharing of information between departments, including automated case processing control. The DGI has responsibility for most tax administration functions. DGI is organized by tax function, including departments for information technology, fiscal control, registration, and services. Each department deals with all national-level taxes, including the value added tax, corporate profits tax, personal income tax,and turnover tax. The tax collection function, however, is the responsibility of the Public Accountability Department (DGCPR).

While the system is centrally organized by function, taxpayers interact with the tax administration based on their locality. However, DGI's existing core tax administration practices and procedures limit the efficiency, cost-effectiveness, and transparency of operations. For example, specific tax regimes such as the Regime Forfaitaire (the "off-shore" regime for exporters) and the "normal" regime for other companies all provide significant incentive for tax avoidance. At the same time, recent advances by the Large Taxpayer Office (LTO) in the areas of electronic registration, filing, and payment demonstrate that Tunisia is in a strong position to address concerns around transparency and efficiency, particularly for small businesses and self–employed taxpayers.

DGI WORKING GROUPS TACKLE VOLUNTARY COMPLIANCE AND TAXPAYER REGISTRATION

The TCIP's working group on voluntary compliance focused on income taxation on movable capital. The working group identified the group of taxpayers most likely to be concerned about this issue, and developed a pilot communications strategy to appeal to that subgroup. After implementing the pilot, the DGI will roll it out to all 27 regional offices to more effectively promote voluntary compliance among this particular taxpayer subgroup.

The taxpayer registration working group similarly assessed challenges in accessing taxpayer identification information. The working group concluded that the most significant barrier to DGI's ability to identify non-registered taxpayers is lack of access to the Ministry of Interior's National Identity Number (CIN) database. The working group is collaborating with DGI on a solution to this issue.

TCP's approach is based on collaboratively defined interest areas with scheduling based on the counterparts' priorities, including the maximum participation of DGI staff. TCP incorporated risk-based best practice implementation techniques in all tax administration work, including building capacity, and transferring technical expertise and experience to counterparts to increase the success rate and sustainability of the interventions. TCP's activities are mapped directly to the DGI's plan for modernization.

Capacity for analysis and decision-making increased

TOWARD MORE TRANSPARENT AUDIT SELECTION

In response to DGI's need to increase efficiency and transparency in their audit functions, TCP designed an Audit Criteria Selection System (ACSS). Using the ACSS, DGI is able to objectively determine if a taxpayer is likely to evade tax, based on the assigned numerical using 21 selection criteria.

To generate the ACSS score, taxpayers are divided into groups by activity, turnover, and type (business or individual). Each tax declaration is compared against the average for their group. The score is assigned based on their deviation from the average. The higher the score, the greater the potential for tax evasion. Using a system like the ACSS allows DGI to flag declarations for audit more transparently.

To build DGI's capacity for sustaining reforms to its operations and overall tax administration procedures, TCP worked with DGI to develop a Taxpayer Compliance Improvement Plan (TCIP) as part of a larger initiative aimed at institutionalizing a risk-based approach to reform. The TCIP is a framework for designing and implementing new operational procedures within DGI through multiple working groups that focus on topics such as taxpayer registration, verification, audit selection, and simplification of procedures. Under the TCIP, the DGI established a risk management working group responsible for prioritizing and implementing reforms to risk management, simplification, registration, verification, filing, and payment strategies (see text box above).

DGI also developed risk registers to aim risk-based corrective interventions toward improving taxpayer compliance and understanding taxpayer service needs. To inform its future compliance initiatives, DGI surveyed its 27 regional offices to identify additional tax administration risks. DGI is also creating a Risk Management Unit to house all risk-based compliance reform efforts outlined under the TCIP. As a result of these efforts, DGI saw an increase in voluntary compliance, enhanced revenue generation, and is taking concrete steps to address fraud and evasion under Phase II.

Tax Administration Advisor, Robert Uhar (left), and Tax Administration Specialist, Zohair Bouchaddakh (right), discuss the Institut Arabe des Chefs d'Entreprises (IACE) Regime Forfaitaire report findings at the TCP office. Photo: Adel Lagha

Audit procedures consistent with risk-based compliance best practices

To increase efficiency and transparency in DGI's audit function and to increase revenues, TCP provided technical assistance to develop a new Audit Criteria Selection System (ACSS). Under DGI's previous audit selection protocols, there were no consistent criteria for selecting audit cases, resulting in the potential for selection bias and unchecked fraudulent tax declarations. A robust ACSS applies a wider number of selection criteria to cases to ensure stronger verification protocols are in place (see text box above). DGI worked with TCP to analyze tax declaration data from previous years to inform the development of appropriate case selection criteria and provide a snapshot of historical case audit prevalence. TCP supported DGI to analyze the available data and to design the initial ACSS scoring system for testing in early 2016. TCP also provided additional training to DGI to build internal capacity to use the ACSS, run pilot tests, and promote the benefits of transparent case selection protocols.

As part of the pilot testing of the ACSS, TCP reviewed 100 of the highest-scoring tax declarations for each available year's data set to analyze frequency of audits initiated by DGI using prior declaration assignment protocols. TCP found that less than 10 percent of the highest scores were audited within the past 10 years (see Exhibit 2). Implementing the ACSS within the Tax Department ensures a more robust procedure for flagging high-risk cases for audit while minimizing selection bias.

EXHIBIT 2. TAX DECLARATION AUDIT PRELIMINARY ANALYSIS, 2012-2014

	2012	2013	2014
DECLARATIONS WITH SCORES >500*	2,342	2,280	2,526
TOP 100 SCORED DECLARATIONS NEVER AUDITED	79	92	93
NUMBER OF DECLARATIONS AUDITED IN PREVIOUS 10 YEARS	21	8	7
NUMBER OF DECLARATIONS AUDITED SINCE 2011	11	3	4

*Total declarations scored from all three years: 313,874

Updating information technology (IT) and capacity for risk-based compliance management. TCP also addressed DGI needs related to outdated IT equipment and software, as well as effective application of IT solutions for risk-based compliance. TCP worked with the MOF's Computer Centre (CIMF) to ensure its software synced with the new ACSS system to facilitate DGI access to tax data on its Oracle platform. TCP provided technical assistance to make necessary corrections in the DGI's server and the CIMF Oracle codes. The DGI and the CIMF now have unified data access to the ACSS files, allowing for more timely and transparent case selections and assignments. The DGI also has the required backups and updated documentation codes and scripts for the server databases.

Nationwide taxpayer services program enhanced

TCP supported DGI to strengthen taxpayer service activities, helping DGI to explore the feasibility of critical issues such as digitizing tax payments, simplifying declaration forms, developing electronic signature systems at the national and municipal levels, and developing a more user-friendly web portal. TCP also supported DGI to develop a joint tax law harmonization process with the DGELF to resolve tax administration inconsistencies. Additionally, TCP supported DGI to implement new data analysis techniques for identifying non-filers, stop filers, and de-registered taxpayers. As a result, DGI is poised to increase collected revenue through targeted communication strategies based on taxpayer demographics to monitor compliance and broaden outreach efforts. Through a local think tank, TCP supported DGI to conduct a market research survey to collect data on regime forfaitaire (off-shore) demographics.

TCP worked closely with DGI to address priority tax registration program reforms to maintain a revenue-neutral budget position via broadening the tax base to generate additional revenues. These reforms include strengthening remote services, such as implementing paperless registration and tax filing procedures, as well as enhanced registration training programs for tax officials. TCP is also supporting DGI to develop a strategic communication program on tax compliance awareness. The program will be implemented within the school system, at economic fairs, and at civil society events organized by tax-oriented organizations. DGI will also use mass media outlets to encourage greater registration by all segments of the taxpayer population.

SECTION IV

IMPROVING EFFICIENCY AND TRANSPARENCY OF CUSTOMS

Intermediate Result 3. Customs Reform

The objective of this component is to modernize customs administration, with a focus on facilitating improvements to customs operations that strengthen consistency with international best practices, and improving efficiency and transparency. Specifically, TCP activities in this area support the following:

- Advancing Tunisia's implementation of the WTO Trade Facilitation Agreement (TFA)
- Improving key customs business processes
- Improving customs compliance management
- Establishing and strengthening formal consultation between Customs and the private sector

KEY RESULTS FOR PHASE I

- Tunisian Customs accepts proposed methodology and principles for an Advance Rulings program on tariff classification and origin
- Tunisian Customs approves reduction of import process steps at Port Rades by 35 percent, eliminating 18 of the original 52 steps in the import process
- Initiated a new activity to support Tunisia's implementation of a single window for trade facilitation

Overall background and Approach

The approach for this component and selected activities have been informed by existing research, by direct input from the Tunisian customs authorities, and the private sector. During the initial scoping mission undertaken in October 2014, TCP conducted meetings with the DGD, including the Director General and department heads. These meetings were aimed at explaining the project objectives and intended activities and consulting the DGD on priority areas for technical assistance, which coincided with the initial scope of work provided by USAID. Proposed activities emphasized the following:

- Compliance with specific areas of WTO TFA (Bali, 2013), particularly in relation to advance rulings and expedited shipments
- Simplification of import/export processes and publication of relevant information for traders on these processes
- Improvement in *a posteriori* management, underpinned by the application of risk management and the identification of compliance and non-compliance

TCP worked with Customs to assist in the implementation of specific areas of the WTO TFA signed in Bali in 2013, which the Director General of Customs and TCP scoping mission identified as priorities. The simplification of import/export processes was prioritized by both the Director General of the DGD and by private sector stakeholders. These activities focus on assisting Customs to improve their business processes to make them simpler and more business friendly without compromising acceptable controls. To improve Customs' management of importer/exporter compliance in preparation for a transition to a more robust Post Clearance Audit regime (*a posteriori* control), TCP assumed the adoption and implementation of a systematic and credible risk management regime. TCP's activities related to building a consultation mechanism between Customs and the private sector and sought to formalize meetings that previously occurred on an ad-hoc basis.

Tunisia's implementation of the WTO TFA advanced

TCP collaborated with the DGD to review and make recommendations on an Advance Rulings regulatory framework for tariff, classification valuation, and origins to support Tunisia's compliance with the TFA. To advance DGD's progress toward the TFA requirements, TCP provided guidance to DGD on multiple aspects of Advance Ruling development procedures, such as best practices in flowchart processes. TCP demonstrated the benefit of documented procedures for declaration of goods using Port Radès, Tunisia's largest and busiest port, as an example. TCP worked with DGD to map the port's goods declaration processes to draft a procedure manual for Port Radès. TCP was then able to develop amendments to Tunisia's Customs Code articles 80 and 100 to introduce an Advanced Manifest for the advanced declaration of goods. TCP encountered challenges and slow progress toward intended reforms as a result of periodic changes in DGD's leadership. However, by the end of Phase I, TCP had supported several critical steps toward Tunisia's compliance with the TFA (see text box above).

ADVANCING TUNISIA'S COMPLIANCE WITH THE WTO'S TRADE FACILITATION AGREEMENT

Tunisian Customs worked closely with TCP to address priority aspects of Tunisia's implementation of the WTO TFA. As a result of TCP's efforts during Phase I, the Tunisian Customs Administration accepted TCP's proposed methodology and principles for an Advance Rulings program on tariff classification and origin. The proposed program included recommended procedures and application forms to ensure compliance with the Bali WTO TFA Articles 3 (Advance Rulings) and 4 (Procedures for Appeal or Review). TCP will support a pilot implementation plan mid-2016.

Key Customs business processes improved

TCP provided DGD with technical assistance in business process mapping during Phase I to provide DGD with a current snapshot of Port Radès import and export clearance processes. TCP's process mapping approach included developing graphic and narrative process descriptions, followed by validation through in-person observations and discussions with key stakeholders. TCP presented its findings to the DGD in late 2015, recommending adjustments to DGD's current import and export processes to create more efficient operations at the port. TCP supported DGD to reduce its import process steps at Port Radès by 35 percent, eliminating 18 of the original 52 steps in the import process. DGD also verbally approved a revised Port Radès Procedures Manual, incorporating TCP's recommendations for continued efficiencies and reduction in process steps for the port's overall import and export procedures. Building on this work, TCP was invited to work with a broader coalition of GOT counterparts to conduct a more comprehensive diagnostic of external commerce procedures to facilitate the strengthening and increased use of a single window system (see below).

Customs risk management improved

Risk management framework. TCP worked closely with the DGD's Risk Management Directorate to develop and propose a risk management framework for Tunisian Customs, including organizational policy directives, process models, standard terminology, and proposed risk management activities. At the end of Phase I, the DGD adopted and disseminated a risk management policy consistent with best practices as proposed by TCP. The DGD also updated the organizational structure of its Risk Management Directorate to conform to the risk management framework requirements, while introducing model risk registers in DGD's main operations, covering two Port Radès offices and customs intelligence. The Customs Administration also adopted a centralized customs intelligence gathering function linked to the centralized risk management committee (see Snapshot).

Training in risk management principles. TCP collaborated with counterparts at DGD to design a four-session complementary training course to support the implementation of the risk management framework across the agency. The training courses provide DGD staff with the opportunity to apply new risk management processes, more fully understand methods for risk identification, and to enhance practical skills around developing risk registers and risk management plans for their respective operational sections (see text box). A total of 80 staff from DGD participated in the Level I training series, which required them to later present completed risk registers and action plans to TCP and DGD stakeholders as part of the course's conclusion.

TRAINING PROGRAM IN RISK MANAGEMENT

TCP supported the implementation of the Customs Agency's first risk management program, complemented by a four module Level I training course with content as follows:

- Risk Management Concepts
- Risk Management Case Study
- Risk Management Operations
- Policy Development and Implementation

Based on demand from participants, TCP will develop a Level II series to cover more advanced topics and to provide opportunities for practical skill development.

Consultation between Customs and the private sector established

To strengthen ties between Customs and private sector stakeholders, TCP implemented activities designed to bring together key constituents from both sides to address barriers to Tunisia's import/export supply chain. TCP drafted a paper for the DGD proposing a formal consultative mechanism between the private sector and customs. In parallel, the MOF conducted official meetings with private sector associations to identify and validate key concerns across the wider import/export business sector, including the Tunisian Union of Industry, Commerce and Handicrafts (UTICA) and the American Chamber of Commerce in Tunisia (AmCham Tunisia). Private sector constituents highlighted their primary reform concerns related to IT systems, customs checks, cargo unloading, perceived monopolies at the port of Radès, Tunisia Post's monopoly in express mail traffic, and certificates and permits on controlled goods.

Short-term Customs Specialist, Vianney Gemme, delivers a presentation on Customs "data gathering/ intelligence" at the General Directorate of Customs attended by the General Controllers and key DGD staff. Photo: Adel Lagha

Advancing Trade Facilitation under a Single Window

The delay in the release of goods at ports remains one of Tunisia's most significant barriers to external commerce. The indicators for the delays in the release of goods vary from one port to another and are challenging to quantify and validate as the indicators vary depending upon which organization or agency involved in the process reports on them. Building upon business process mapping activities, TCP was approached by the MOF to embark on a more comprehensive diagnostic of external commerce procedures during Phase II. This diagnostic, to be conducted hand in hand with Tunisie Trade Net (TTN), a quasi-governmental institution overseeing implementation of Tunisia's single window, will conduct a diagnostic of "as-is" procedures, procedures as documented in the electronic "single window" system, and procedures as dictated by law. Under Phase II, TCP will support TTN to develop the necessary indicators to optimize the use of the single window system for trade facilitation.

SNAPSHOT

MANAGING RISK AT TUNISIAN CUSTOMS

With TCP's assistance, Tunisian Customs approved and adopted its first risk management policy and established a risk management committee to monitor implementation.

PHOTO: *TCP archives*

Mohamed Hédi Safer, director overseeing DGD's risk management operations, reviewing the risk registers developed during the risk management training courses at his office in the General Directorate of Customs.

During Phase I, TCP collaborated with the Risk Management Directorate within the Tunisian Customs agency (DGD) to develop a comprehensive framework for risk management. Based on the World Customs Organization's own standardized process model, the DGD's risk management framework delineates clear responsibilities, tools, and training programs necessary for DGD to fully integrate risk management best practices in its operations.

To develop the framework, TCP provided the Risk Management Directorate with guidance and input on best practices related to risk management policy and procedures. The new policy document clearly defines the role of risk management, strengthens DGD's organizational structure to incorporate risk management, and reinforces collaboration between centralized risk management and customs intelligence functions. The Director General of the DGD approved and adopted the new policy in February 2016. The DGD also established a centralized Risk Management Committee, responsible for standardizing strategic risk-related decision-making.

To complement the framework, TCP designed and implemented four training modules for 80 of the directorate's core program, operations, and customs intelligence staff. The training program reinforced best practices principles from the risk management framework. As a result of the training program, DGD developed individual risk registers to identify key risks, assign an intensity rating per risk, and delegated monitoring and oversight responsibilities to trained staff members to institutionalize the new approach. To ensure ongoing professional development on these issues, TCP provided DGD with an advanced risk management training curriculum.

During Phase II, TCP will support the DGD to continue implementing the risk management policy until DGD has the resources and capacity to manage and sustain their risk management practices.

ANNEX A. TCP PHASE I ACCOMPLISHED IMPACT

TAX POLICY REFORM	
Advancing progressive tax reform	Six policy laws approved by the Assembly of the People's Representatives (APR) and included in the 2016 Budget Law:
	• Reduction of Customs duties to two rates: 0% (primary products) and 20% (consumption products) • Imposition of a 6% VAT rate on 19 previously exempted products (out of 50 of table A) • Suppression of temporary decrees permitting the reduction of VAT rates and imposition of 6% or 12% VAT rates on some previously exempted products • Elimination of excises for more than 32 products, and reducing the multi-rate alcohol excises to two rates • Imposition of 6% VAT rate on medicines at both wholesale and retail levels • Reduction of VAT rate on withholding tax "retenue à la source" for transactions between the private and public sectors from 50% to 25% to reduce outstanding credit to the national treasury
	TCP made the following proposals to the Ministry of Finance which the GOT will review for the 2017 Budget Law: • A proposed new schedule for the elimination of the "frais professional" (10% of the salary) and cancellation of family allowance that will reduce the effective rate to 15.5%. • A proposed reduction in the number of VAT rates from four: 0%, 6%, 12%, and 18% to three rates: 0%, 6%, and 18%. (In addition, TCP proposed a redistribution of products presently taxed at 12% to new proposed rates of 6% and 18%.) • A proposed revision of the tax brackets for the personal income tax to ease the tax burden on lower incomes and accommodate inflation (widen the tax brackets).
Strengthening Ministry of Finance capacity to conduct policy analysis, revenue estimates, and analyze revenue developments to inform the tax reform agenda.	• A Fiscal Analysis Unit (FAU) of a Chief and 4 tax specialists was established at the MOF with the recommendation of the TCP project. TCP informed the job descriptions of the Unit and a training curriculum of more than 20 modules. During Phase I, TCP initiated the delivery of the training curriculum and will complete the program before June 2016.
TAX ADMINISTRATION REFORM	
Reforming administration of audits	The Tunisian tax administration developed a new Audit Criteria Selection System (ACSS) designed by TCP. Testing is in process to assess criteria scoring capacity, utility, and functionality. The reformed system is designed to increase efficiency and transparency in the audit function and increase revenues.
Strengthen taxpayer services strategy	Non-filer, stop filer, and de-registered taxpayer data analysis techniques revised with input from TCP. The result is to refine communication strategies based on taxpayer demographics, monitor compliance, and broaden outreach. TCP also conducted a market segment research survey to measure regime forfaitaire compliance demographics in collaboration with a local think tank. The survey results will be disseminated in 2016.
Strengthening integration of risk management in tax administration	The Tunisian tax administration approved a Taxpayer Compliance Improvement Plan (TCIP) proposed by TCP in 2015. Working groups were created to prioritize and implement reforms, risk management, simplification, registration, verification, filing, and payment strategies. Risk registers were developed to direct risk-based corrective intervention efforts to improve taxpayer compliance and understand taxpayer service needs. The result of these efforts is to increase voluntary compliance, enhance revenue generation, and address fraud and evasion.
CUSTOMS ADMINISTRATION REFORM	
Reforming Advance Rulings on Tariff Classification and Origin	The Tunisian Customs Administration accepted the methodology and principles for an Advance Rulings program, as proposed by TCP, on tariff classification and origin, related

	new procedures, and application forms, which will ensure compliance with WTO TFA (Bali) Articles 3 and 4. This program will be piloted through an implementation plan starting in June 2016.
Simplifying Customs Business Processes	The Tunisian Customs Administration approved a mapping of the import/export procedures at Port Radès conducted by TCP in 2015. The Customs Administration also approved a reduction in import process steps at Port Radès – from 52 to 34 - eliminating manual steps. The Tunisian Customs Administration also verbally approved a revised Manual of Procedures for Import/Export Procedures at Port Radès developed by TCP and integrated the reformed procedure.
Strengthening Customs Risk and Intelligence Gathering Management	The Tunisian Customs Administration adopted and disseminated a Risk Management Policy informed by TCP integrating a best-practice-consistent risk management framework, supporting structure, process model, responsibilities, and standard terminology. The Internal Risk Management Directorate organizational structure was adapted to the risk management framework requirements and "model" Risk Registers were introduced in three operational areas (2 Port Radès offices and Customs Intelligence). The Customs Administration accepted a TCP proposal of a centralized "customs intelligence gathering function" with links to the centralized risk management committee. TCP made the following proposals to the Tunisian Customs Administration. A response is outstanding: • Proposed recommendations to reform expedited shipments procedures based upon a situational analysis conducted by TCP in 2015. Simplifying procedures will speed the release of air shipments, facilitating operation of the courier industry and trade.

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