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SUBJECT - NONCAPITAL PROJECT PAPER (PROP)

REFERENCE -

DATE SENT Sept. 19- 1969

Country: NICARAGUA Project No. 524-11-780-025.2

Submission Date: September 18, 1969 Original X Revision No ____

Project Title: TAX AIMINISTRATION REFORM (Tax Administration Modernization)

U.S. Obligation Span: FY-1964 through FY-1972

Physical Implementation Span: FY-1965 through FY-1972

Gross life-of-project financial requirements:

U.S. Dollars	$ 1,339,000
Cooperating Country Contribution	(in-kind)
Total	$ 1,339,000

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A. SUMMARY

The AID/IRS Foreign Tax Assistance Staff PASA Program was conceived in August 1961 at the Punta del Este meeting in Uruguay, where representatives of Latin America and the United States met to draft the charter for the Alliance for Progress. Under this charter the Latin American Nations pledged an all out tax reform effort. The Secretary of Treasury promised to support this effort by making available IRS Advisors to Latin American countries that asked for help. The first such project was started in Chile in 1962.

The Tax Administration Modernization Program for the Government of Nicaragua (GON) started with a survey of the tax system in September 1963. A Team Leader arrived in February 1964 but a full team did not arrive and begin functioning until early 1965. The team has consisted of a Team Leader and tax advisors in the areas of Audit, Collection and Property Taxes; other short term assistance has been provided as needed. (See PAR dated 12/26/68 for review of progress). It is planned to continue advisory services through FY-1972 and to expand such assistance to include a Data Processing Advisor and an Indirect Tax Advisor.

Significant results have been achieved in a number of program areas that have resulted in increased tax collections. The income tax burden per capita rose from $1.91 in 1962 to $4.18 in 1968 and income taxes rose from 7.6 percent of total revenue to 11.2 percent. The property taxes burden per capita rose from $0.85 in 1962 to $3.30 in 1968. While income taxes increased by 3-fold from 1962-1968, and property taxes rose by more than 4-fold, the Gross National Product only rose by 75 percent.

Costs of collections have declined gradually from 6.66% in 1962 to 3.63% in 1967 which is a reliable indication of the improvements being attained in tax administration.

The project goals and targets of this program are set forth in some detail in the annual work plans and the semi-annual progress reports submitted under the IMPACT reporting system of the IRS/FTAS PASA Team. The objectives and projects outlined therein summarize the concept of achieving fundamentally sound and permanent improvements in tax administration and the institutionalization of collection, audit, etc. procedures.

B. ENVIRONMENT

The economic environment of Nicaragua is fundamentally agricultural with a slow transition to industrialization. There is a gradually evolving middle class and the income tax burden per capita while rising is still quite nominal. It has increased, however, from less than $2.00 per capita in 1962 to $4.98 in 1968 as compared to a federal income tax per capita rate in the United States of about $500 in 1967. However, of the Central American Republics, only Honduras and Costa Rica had higher per capita income tax burdens. Nicaragua's total tax burden per capita was the second highest in the CACM.

BEST AVAILABLE

Although internal taxes have increased considerably since 1962, the decline in import duties resulting from formation of the Common Market has caused considerable fiscal stringency in Nicaragua. It is exceedingly difficult to accelerate and institutionalize changes and improvement in the direct tax area in order to compensate for the above-mentioned decline, for a number of reasons. These include such factors as the limited educational standards achieved; the low number of, and marginal, accounting schools in the country; and the calibre of the accounting practice in general. Another obstacle is the chronic practice of tax evasion which exists in Latin America. This has been abetted by the generally apathetic tax administration structure which was provided with no effective punitive measures and little initiative or incentive to change this attitude. The personnel system, or lack of one, is another major obstacle in attaining stability and progress in the tax program.

Progress in institutionalizing tax data is being made through the computer processing activities and the cadastral program. In establishing a computer controller master file of taxpayer accounts and transactions, the computer should continue to weave an effective web of information within the country. The cadastral program concurrently will establish a comprehensive record of properties and ownership. As this data is accumulated and eventually becomes public it should produce a substantial popular force for more equitable and uniform enforcement irrespective of the political environment or subjectivity of the acts of administration.

The GON has become aware of the fiscal problems it faces. It instituted a series of indirect taxes in 1968 and 1969 in an attempt to increase internal tax collections. The Government recently has allocated additional funds and personnel to both the tax office and the cadastral program in an effort to increase collections from these sources. Nevertheless, both of these areas required continued efforts and the IRS/PTAS tax program is directed towards ensuring that further improvements are made.

Exogenous factors also inhibit increased tax collections despite GON efforts. For example, a considerable amount of revenue is foregone in Nicaragua as a result of fiscal incentives. Any attempt to reduce or eliminate portions of such incentives awaits CACM action through enactment of the Fiscal Harmonization Protocol. Unilateral action cannot, and should not, be taken in this area at this time. Thus regional fiscal harmonization, and in the long run, tax harmonization, are essential to ensure that Nicaragua, as well as other CACM countries, continue to improve their tax position.

C. STRATEGY

This program aims to develop an effective and efficient institution in the Ministry of Finance that will be able to administer a comprehensive direct tax program as well as to improve administration and collection of indirect taxes.

The ~~Fundamental~~/tax administration assistance program contemplates a continuing review of the tax structure, identification of problems, recommendations of the solution of these problems and assistance in the implementation of those recommendations. The areas of interest and assistance are manyfold and encompass the whole range of tax administration but with principal emphasis on such high impact areas as audit procedures,

collection efforts, training of personnel, and taxpayer assistance providing taxpayer information and education. Assistance will also be given in such areas as organization and management; statistics; personnel administration; facilities management; manual preparation, codification of regulations and tax laws; taxpayer compliance programs; data processing procedures; budgeting and related areas.

This program is only one of the tools the Mission has to deal with the tax situation in Nicaragua. Under the Cadastral Loan, the Mission is dealing with improvement in the administration, valuation and collection of property taxes. The Basic Crop Loan stipulated specific fiscal conditions and has brought the Mission more actively into the Government's fiscal posture and structure. These three programs, thus, have given the Mission the means to effect at least some portion of the Government's overall tax policy, particularly in the direct tax area.

D. PLAN, TARGETS, RESULTS AND OUTPUTS

Each phase of the tax program is initiated and carried out with a view towards desirable institutional stability and self-sufficiency that will enable a phase-out of the assistance program at some identifiable future date. While progress towards this horizon varies at times, there is substantial evidence of real and concrete progress. The political stability of the country has been a contributing factor in these achievements. The turn-over of personnel and tax directors has been lower probably than in most other LA countries and happily to date the replacement of the latter appear to be more competent and dedicated than their predecessors.

As indicated above, the accomplishments and evaluations of the tax program cannot readily be quantified. The specific targets of this program deal with development of effective and efficient procedures and administration in the specific areas discussed below.

AUDIT

Achieve an effective and equitable audit program with maximum economic and geographic coverage. Develop programs to obtain maximum performance and to improve the audit capability of the technical employees. Plan procedures to insure maximum production consistent with uniform and equitable application.

COLLECTION

Develop an effective collection program to supplement the 'Salvania' system. Establish a master file of accounts and purify the delinquent account registries. Provide for and train revenue officers. Provide for personal contacts with delinquent taxpayers to encourage payment. Follow-up with reference of cases to fiscal attorneys for enforced collection if necessary. Use all measures possible to continue to reduce the cost of collection per unit of revenue.

TRAINING

Provide for permanent training capability in the tax organization.

Provide training guidance for the individuals who are to operate this section. Send participants to the United States and to third countries for training. Obtain course materials, text books, training aids, etc.

PUBLIC INFORMATION

Provide for taxpayer assistance and education so they will know their rights and responsibilities. Prepare and publish tax calendars to facilitate cooperation. Promote use of all available media to inform and advise taxpayers.

PROPERTY TAX

Continue to expand efforts under the cadastral and other programs to identify and tax properties not declared. Determine and revise values on properties declared. Integrate new valuations determined by the cadastral program into the property tax billing system. Improve registries and maintenance of values determined.

APPEAL AND PROTEST

Provide for an impartial review of taxpayers appeals and protests to insure uniform and equitable application of the law and regulations. Institutionalize determinations made under the procedures.

DATA PROCESSING

Promote more effective computer usage in the tax system. Insure protection of records through "grandfather" tapes, safes, off-site storage and other devices. Provide for training of systems analysts to permit more effective cooperation between computer section and the units serviced. Purify accounts maintained in the computer and accelerate billings procedures.

CODIFICATION OF LAWS AND REGULATIONS

Assist in clarifying laws and regulations through codification where practicable. Provide instructions and guidelines for tax personnel and taxpayers. Assist in simplification of status to facilitate administration.

STATISTICS

Assist in the development of improved statistical reporting to provide essential management data and reliable statistical information. Assist in the coordination of statistical reports between the using agencies

GENERAL MANAGEMENT

Assist in the development and publication of procedures manuals. Improve the internal communications procedures within the Tax Department. Review and improve forms and establish effective controls of declarations and files. Improve the personnel program including recruitment, employment, orientation, evaluation, training, control

and related matters. Assist in the planning and execution of the tax department budget. Promote delegation of authority to the lowest levels practicable. Develop internal control systems and checks. Provide adequate space for operations. Consider, develop and assist in such related areas as circumstances warrant.

E. COURSE OF ACTION

The PASA arrangement with the Treasury Department, United States Internal Revenue Service, Foreign Tax Assistance Staff that presently provides for four long term advisors in tax administration will be continued and may be expanded if conditions warrant. It is anticipated that this arrangement and Tax Team composition will be continued through FY-1972 depending upon the availability of funds and the availability of such advisors from the IRS. In addition to the long term team members, short term advisors in various specialties will be used from time to time as the need arises.

It is contemplated that the GON will give due consideration and priority to the projects covered under this program and will assist in the effective implementation of reforms and that it will provide office space and equipment for the tax team to the extent practicable. The GON recently has made additional funds and space available to the tax office and has agreed to double the size of its budget in 1970.

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NONCAPITAL PROJECT FUNDING (OBLIGATIONS IN $000)

Country: NICARAGUA Project Title: TAX ADMINISTRATION REFORM (Tax Administration Modernization)

PROP DATE Original Mo/Day/Yr X
Rev. No.
Proj. No. 524-11-730-025.2

Fiscal Years	AP	L/G	Total	Personnel Serv. AID	Personnel Serv. FASA	Personnel Serv. CONT	Participants US Agencies	Participants CONT	Commodities Dir US Ag.	Commodities CONT	Other Costs Dir & US Ag.
Prior Through Act. FY-69	AG	G	437		375						62
Oper. FY-1970	AG	G	247		165		70				12
Budg. FY-1971	AG	G	296		209		70				17
B + 1 FY-1972	AG	G	238		209		14				15
B + 2 FY-1973											
B + 3 FY-1974											
All Subs.											
Total Life			1,047		958		154				106

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