

AIRGRAM

DEPARTMENT OF STATE

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FROM: U.S.A.I.D./San Salvador

SUBJECT: Noncapital Project Paper (PROP)

REFERENCE

Country: El Salvador Project No. 519-11-740-032.1

Submission Date: 1 September 1969 Revision No. 1

Project Title: Tax Administration Improvement

U.S. Obligation Span: FY 1965 through FY 1972

Physical Implementation Span: FY 1965 through FY 1972

Gross Life-of-Project Financial Requirements:

U.S. Dollars -----	\$ 674,000
Cooperating Country Cash Contribution-----	In kind
Other Donor -----	None

BRIEF Description

The Tax Administration Improvement project was initiated during the early part of fiscal year 1965. The principal objective of the project is to assist in increasing tax revenue through:

- 1. Modernization of tax administration procedures and techniques, and

PAGE OF PAGES
1 OF 8

ORIGINATION BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
IRS/PASA:PECoates:yem	Tax		9/11/69	Actg. Dir: A.J. Linstad

PO:RAV:her:ll

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CON: TLeonhardy, CIAI

2. Improvement of the capabilities of tax administrators and technicians.

Since its inception, the primary thrust of the project has been directed toward two of the principal tax enforcement and collection agencies of the government. These agencies have the following responsibilities and numbers of personnel.

A. Direct Tax Office

1. Direct Tax Office, a branch of the Ministry of Finance, is responsible for the administration and enforcement of all direct taxes including income, real and personal property, estate, gift, property transfer, and others. Direct Tax revenue represents about 31% of total tax revenue.

2. Personnel - 450.

B. Indirect Tax Office

1. The Indirect Tax Office, a branch of the Ministry of Finance, is responsible for the administration and enforcement of all indirect taxes including taxes on consumers' products, services, commercial activities, legal transactions and other. Indirect tax revenue represents about 33% of total tax revenue.

2. Personnel - 160.

Other governmental organizations, with activities relating to tax administration, that have received attention include:

1. Organization and Management Section of the Ministry of Finance.

2. Automatic Data Processing Division of the central accounting office in the Ministry of Finance.

3. Tax collection agencies in the Ministry of Finance and in the various departments of the country.

The Tax Administration Improvement program includes technical advice and training in El Salvador, the United States (including the INTAX program operated by the Foreign Tax Assistance Staff of the Internal Revenue Service) and third countries.

Environment

One of the most pressing problems facing the Government is a shortage of funds for public investment. Given a need for a higher level of these funds the GOES is faced with four options: (1) to increase tax revenues; (2) to decrease current expenditures; (3) to increase foreign or domestic borrowing; or (4) a combination of the preceding.

The GOES realizes the political difficulties in either raising tax rates or decreasing current expenditures. Increased borrowing from international agencies is also difficult without an increase in public savings. Therefore increased collections under existing taxes and domestic borrowing (which has become popular) are the only routes remaining. However, vigorous collection under existing taxes can also cause political problems and the government has moved slowly in this area.

The potential for increasing direct tax collections appears great. Of the 40,106 income tax returns filed in 1968, only 15,208 (37.9%) were taxable. Compared to total population this means that only 1.3% of the population filed income tax returns and less than $\frac{1}{2}$ of 1% actually reported an income tax liability. Property tax compliance during the same period is very similar.

In terms of gross national product, GOES total tax revenue during 1968 amounted to 9.5% of GNP. During the same period in the United States national government tax revenue alone amounted to 17.6% of GNP.

Strategy

The efforts of the Tax Administration Improvement project have been primarily directed toward the development of able tax technicians, supervisors and managers, and the introduction or improvement of existing:

1. Organization structures
2. Delinquent returns systems
3. Work flow, control and reporting systems
4. Classification and selection procedures
5. Processing procedures
6. Statistical reporting and interpretation of statistical results procedures
7. Appellate procedures.

Direct technical assistance and training are the two most important and basic operations of the Tax Administration Improvement project. Working through the Director General and the various department chiefs, from offices located within the Ministry of Finance and the Direct Tax Office, the IRS-FTAS Team observes and studies existing procedures, recommends improvements and monitors previously implemented projects on a daily basis. Moreover, from this vantage point the tax team is in an excellent position to identify training requirements and the type of training needed.

The tax technicians also function as a reminder and goal for improvements needed in tax administration.

Progress to Date

After preliminary studies the original IRS-FTAS Tax Team identified several high priority projects. Included among these was a complete reorganization of the Audit Division and related activities, training of technicians and administrators, improving taxpayers relations and compliance through a public information program, improved procedures for the reception of returns and improved accounting techniques.

During the early years of the project, officials of the Direct Tax Office and Ministry were reluctant, for alleged political reasons, to implement the Audit Division reorganization; however, they did support many of the other recommendations. Accordingly, between 1964 and 1967 twenty-six in-country, United States, and third country training courses were conducted for almost 500 participants. A public information program was initiated, procedures for the reception of returns were improved, a master list of taxpayers was established and automatic data processing was employed in taxpayer billings. These objectives were important and helped lay the ground work for things to come.

In late 1967 the Audit Division reorganization was implemented by the IRS-FTAS Tax Team. Some of the more important reforms initiated in connection with this reorganization included:

1. The auditors were assigned to groups, of ten to twelve employees, under the direct supervision of a first line supervisor.

2. The supervisors, through classroom training, on-the-job training and regular staff meetings, with the IRS-FTAS advisors, learned to interpret reports and statistical data, identify problems, and take necessary corrective actions.

3. Classification procedures were established for the purpose of selecting a workload with high tax potential.

4. A delinquent returns program was designed and implemented.

5. Control procedures on returns selected for examination were established.

6. Auditors' reporting systems were established to provide management with information relative to the time spent on each case examined, productivity per case examined, percentage of total man hours available spent on direct examination work and other related activities, number of cases completed, etc.

A comparison of some of the more important accomplishments, during the past three years, which can be partially attributed to improved tax enforcement and administration follows:

	<u>1966</u>	<u>1967</u>	<u>1968</u>
<u>Returns Filed:</u>			
Income	33,985	37,134	40,106
Property	<u>33,985</u>	<u>37,134</u>	<u>40,106</u>
Total	67,970	74,268	80,212
<u>Additional Assessments from Audits (000 Colones)</u>			
Income	2,232	2,156	7,484
Property	144	113	256
Estate	1,093	2,891	3,146
Gift	<u>685</u>	<u>421</u>	<u>372</u>
Total	4,154	5,586	11,257
<u>Returns Examined</u>			
Income	2,836	2,779	3,682
Property	1,448	1,202	1,364
Estate	861	827	828
Gift	<u>490</u>	<u>502</u>	<u>422</u>
Total	5,635	5,310	6,307
<u>Total Direct Tax Revenue (Millions of Colones)</u>			
Income	34.7	38.7	43.2
Property	5.2	5.7	15.4
Other	<u>4.0</u>	<u>5.8</u>	<u>5.7</u>
Total	<u>43.9</u>	<u>50.2</u>	<u>66.3</u>

The increase in 1968 property tax revenue resulted primarily from increased tax rates. Income tax in 1967 and 1968 includes, respectively, \$4.5 and \$6.5 million collected in prior years, held in reserve, and not previously reflected in revenue.

Course of Action

In the future the IRS-FTAS Tax Team will continue to employ a mix of technical assistance and training to accomplish the remaining objectives of the Tax Administration Improvement project.

In addition to routine monitoring of previously initiated reforms, some of the more important projects planned during the remaining life of the project include:

1. Establish an informal conference program designed to resolve contested deficiencies before assessment.
2. Establish an on-the-job visitation program for supervisors of field auditors.
3. Develop standardized audit report forms and report writing guide.
4. Develop an improved system for a more realistic and uniform method of real estate valuation in net worth tax investigations.
5. Study the mix, source and productivity of recent workloads to determine modifications required in the present classification and selection system.
6. Develop reporting system for office auditors designed to provide better management information.
7. Review present procedures and recommend changes necessary for a more vigorous delinquent returns program.
8. Study methods presently employed in extracting statistics from income and property tax returns and make recommendations for doing the job more efficiently and with less time.

In the training area, the tax team will continue on-the-job training of the group supervisors and audit division chief. Home study courses in accounting will be widely used among the auditors during the next fifteen months. In addition, the Director General of the Direct Tax Office will be encouraged to send participants

to the following Internal Revenue Service INTAX seminars:

1. **Supervision - Tax Administration**
2. **Management - Tax Administration**
3. **Administrative Services**
4. **Property Tax Administration**
5. **Organization and Management.**

The above course of action is to be implemented in the course of FY 1970 and FY 1971. USAID will fund two (2) Tax Advisors (PASA) through December 1969 and one (1) thereafter through March 1971.

The funds appearing in the FY 1971 budget submission under this project for contract services are for the support of a projected "financial cadaster" beginning in FY 1971 and ending in FY 1972. If the FY 1971 aid level, as projected, is sufficient to accommodate this activity, a separate PROP will be prepared and forwarded at that time.

LEONHARDY

NONCAPITAL PROJECT FUNDING (OBLIGATIONS IN \$000)

Table 1
Page 1 of 1
COUNTRY: El Salvador

Project Title: Tax Administration
Improvement

PROP Date: 9/1/69
Rev. No. 1
Project No. 510-11-740-032.1

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Fiscal Years	Ap	L/G	Total Cont ^{1/}		Personnel Services		Partici- pants		Commodities	Other Costs	
					AID	PASA	CONT	U.S. Agenc.	CONT	Dir. U.S.Ag.	CONT
Prior through Act FY <u>69</u>	AG	G	418	81	270	81	31				36
(Oper. FY <u>70</u>			71		43		11				17
Budg. FY <u>71</u>			110	65	25	40	5			15	25
B / 1 FY <u>72</u>			75	70		40	5				30
B / 2 FY _____											
Total Life			674	216	338	161	52			68	55

^{1/} Memorandum (nonadd) column.

San Salvador TOAID A-264

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CONTINUATION

POST	NO.	CLASSIFICATION	PAGE	PAGES
San Salvador	AIDTO A	UNCLASSIFIED	2 OF	2

5. Since it is highly probable that the Mission has access to similar figures and could readily develop similar targets it is suggested that the current PROP be amended to include such targets which can then be used to measure project progress and effectiveness. It is hoped that this amendment can be completed in time for necessary FY 71 funding.

ROGERS

Attachment

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FROM - U.S.A.I.D./San Salvador

SUBJECT - Noncapital Project Paper (PROP)

REFERENCE -

Country: El Salvador Project No. 519-11-740-032.1

Submission Date: 26 June 1970 Revision No. 2

Project Title: Tax Administration Improvement

U.S. Obligation Span: FY 1965 through FY 1972

Physical Implementation Span: FY 1965 through FY 1972

Gross Life-of-Project Financial Requirements:

U.S. Dollars -----	\$ 644,400
Cooperating Country Cash Contribution	In kind
Other Donor -----	None

Summary Description

The tax Administration Improvement project was initiated during the early part of fiscal year 1965. The principal objective of the project is to assist in increasing tax revenue through:

- 1. Modernisation of tax administration procedures and techniques, and**

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PAGE 1 OF PAGES

DRAFTED BY KFeifarek, IRS/PASA	OFFICE Tax	PHONE NO	DATE 6/25/70	APPROVED BY DIR:L. Paul Oechsli
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2. Improvement of the capabilities of tax administrators and technicians.

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A. Direct Tax Office

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2. Personnel - 450.

B. Indirect Tax Office

1. The Indirect Tax Office, a branch of the Ministry of Finance, is responsible for the administration and enforcement of all indirect taxes including taxes on consumers's products, services, commercial activities, legal transactions and other.

2. Personnel - 160.

Other governmental organizations, with activities relating to tax administration, that have received attention include:

1. Organization and Management Section of the Ministry of Finance.

2. Automatic Data Processing Division of the central accounting office in the Ministry of Finance.

3. Tax collection agencies in the Ministry of Finance and in the various departments of the country.

The Tax Administration Improvement program includes technical advice and training in El Salvador, the United States (including the INTAX program operated by the Foreign Tax Assistance Staff of the Internal Revenue Service) and third countries.

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One of the most pressing problems facing the Government is a shortage of funds for public investment. Given a need for a higher level of these funds the GOES is faced with four options: (1) to increase tax revenues; (2) to decrease current expenditures; (3) to increase foreign or domestic borrowing; or (4) a combination of the preceding.

The GOES realizes the political difficulties in either raising tax rates or decreasing current expenditures. Increased borrowing from international agencies is also difficult without an increase in public savings. Therefore increased collections under existing taxes and domestic borrowing (which has become popular) are important to the Government. However, vigorous collection under existing taxes can also cause political problems and the government has moved slowly in this area.

The potential for increasing direct tax collections appears great. Of the 40,106 income tax returns filed in 1968, only 15,208 (37.9%) were taxable. Compared to total population this means that only 1.3% of the population filed income tax returns and less than 1/2 of 1% actually reported an income tax liability. Property tax compliance during the same period is very similar.

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Strategy

The efforts of the Tax Administration Improvement project have been primarily directed toward the development of able tax technicians, supervisors and managers, and the introduction or improvement of existing:

1. Organization structures
2. Delinquent returns systems
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4. Classification and selection procedures
5. Processing procedures
6. Statistical reporting and interpretation of statistical results procedures
7. Appellate procedures.

Direct technical assistance and training are the two most important and basic operations of the Tax Administration Improvement project. Working through the Director General and the various department chiefs, from offices located within the Ministry of Finance and the DirectTax Office, the IRS-PTAS Team observes and studies existing procedures, recommends improvements and monitors previously implemented projects on a daily basis. Moreover, from this vantage point the tax team is in an excellent position to identify training requirements and the type of training needed.

The tax technicians also function as a reminder and goal for improvements needed in tax administration.

Progress to Date

After preliminary studies the original plan was to identify several high priority projects. One of these was a complete reorganization of the Audit Division, including activities, training of technicians and procedures for handling taxpayers relations and compliance. This project included a reorganization program, improved procedures for handling taxpayers relations and improved accounting techniques.

During the early years of the project, efforts were made in the Direct Tax office and Ministry of Finance. Due to political reasons, to implement the audit division reorganization; however, they did support many of the other recommendations. Accordingly, between 1964 and 1967, a number of projects were initiated, procedures for the reception of returns were improved, a master list of taxpayers was established and electronic data processing was employed in taxpayer billings. These projects were important and helped lay the ground work for the reorganization.

In late 1967 the Audit Division reorganization was implemented. Some of the more important reforms initiated in connection with this reorganization included:

1. The auditors were assigned to groups of the same type of employees, under the direct supervision of a single supervisor.
2. The supervisors, through continuous training, on-the-job training and regular staff meetings with the IRS-PTAS advisors, learned to interpret reports and statistics, to identify problems, and take necessary corrective actions.

3. Classification procedures were established for the purpose of selecting a workload with high tax potential.

4. A sequant returns program was designed and implemented.

5. Control procedures on returns selected for examination were established.

6. Auditors' reporting systems were established to provide management with information relative to the time spent on each case examined, productivity per case examined, percentage of total man hours available spent on direct examination work and other related activities, number of cases completed, etc.

Course of Action

The course of action is projected through FY 1972. Goals will be accomplished through a mix of technical assistance and participation in on-site training. The USAID will fund two tax advisors (PASA) through July 1970 and one thereafter through June 1972.

Planned Targets, Results and Objectives

Planned targets consist of a time schedule for introducing new methods to the organization and results expected from these improvements. Emphasis is to be on direct taxes since this seems to be the area of greatest potential and while some activities are contemplated by the Internal Tax Office, the Central Accounting Office and Collection Agency of the Ministry of Finance, at the moment GATS case has not met the great need for assistance in these areas. Therefore, the following goals are applicable to the Director's Office only.

Qualitative Goals - Collection Building

1. A fully operational internal system to identify problem areas in the Direct Tax Office and establish projects to resolve them and to provide for their control by June 30, 1970.

2. A fully operational statistical reporting system to assist the Director in evaluating performance by December 31, 1970.

3. A fully operational informal appeals system by December 31, 1970.

4. Formal supervisors guidelines by June 30, 1971.
5. Formal audit technique guidelines by June 30, 1971.
6. An expanded cadaster section with appropriate procedures to conduct a complete fiscal cadaster. Expansion of this section to accomplish this is expected by December 31, 1971 and the cadaster is expected to take place over a period of three years.
7. Development of an effective system for identifying new taxpayers by December 31, 1971.
8. Development of a management review system by December 31, 1971.
9. Development of a systematic approach for detecting employee irregularities by December 31, 1971.

B. Quantitative Goals

See attached exhibit A.

~~Future activity in this field will be financed by a~~
~~fiscal bond issue to be completed before FY 1971.~~

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EXHIBIT A - QUANTITATIVE GOALS

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	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>
Tax Assessments (000s) (**)							
Income and Profit Net Worth and Transfers	13,638	15,446	18,090	13,943	22,000	25,000	28,000
Returns Filed (1)	3,680	4,596	3,436	9,523	11,500	13,000	15,000
Returns Audited	67,970	74,268	80,712	92,164	102,000	113,000	125,000
Returns Audited	5,685	5,310	6,307 (1)	4,542	6,000	6,900	8,000
Audit Recommendations (000s) †	1,662	2,234	4,504 (2)	8,193	8,000	9,500	10,500
Appeals as a % of Audit	95%	95%	95%	95%	75%	50%	40%
Delinquent Return Contacts	None	1,319	995 (3)	104	1,500	3,000	4,000
Number of Delinquent Returns	None	419	554	84	600	1,200	1,600
Delinquent Return Assessments (000s)	None	Unknown	Unknown	Unknown	600	1,200	1,600
Employees trained locally	197	84	73	100	60	60	60
Participants in INTAX	0	2	0	0	5	8	6
Third Country Training	0	0	0	1	1	3	3

* U.S.\$1 = ₡2.50

(1) Fewer returns audited in 1969 because of diversion of effort to an emergency tax because of Honduran-Salvadoran war and elimination of low yield returns. Improved selection procedures are expected to keep total audits down, but should yield better results than past years.

(2) 1969 is not used as a base for additional assessments because of a small number of high yield examinations. (See footnote (1).)

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San Salvador TOAID A- 129

- (3) Delinquent return activity abolished in 1969, started again in 1970. Lower yield per contact is expected because of higher rate of contact and use of random selection methods. High 1967-8 results due to contacts only in obvious delinquent cases.
- (4) Both an income tax return and a net worth tax return required of each taxpayer, consequently the number of returns indicated is double the number of income tax returns received.

NONCAPITAL PROJECT FUNDING (OBLIGATIONS IN \$000)

Table 1

Page 1 of 1

COUNTRY: El Salvador

Project Title: Tax Administration
Improvement

PROP Date: 6/26/70

Rev. No. 2

Project No. 519-11-740-032.

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Fiscal Years	Ap	L/G	Total Cont ^{1/}		Personnel Services			Partici-		Commodities		Other Costs	
					AID	PASA	CONT	U.S. Agenc.	CONT	Dir. U.S. Ag.	CONT	Dir. & CONT U.S. Ag.	
Prior through Act FY <u>69</u>	AG	G	418	81	270	81	31						36
Oper. FY <u>70</u>			79.4		74		5.4						
Budg. FY <u>71</u>			82		45		20						17
B / 1 FY <u>72</u>			65		38		20						7
Total Life			644.4	81	427	81	76.4						60

^{1/} Memorandum (nonadd) column.

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SUBJECT - Tax Administration PROP, 519-11-740-C32.1

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The omission of total collections was not an oversight. Figures shown for "Tax Assessments" in original Exhibit A were used in lieu of collections since assessments are deemed to be a more accurate measure of project results. Assessments approximate actual collections, ~~and~~ which historically have averaged about 95% of assessments for Income and Profits, and about 85% for Net Worth and Property Tax. Also, data on actual collections is not maintained on a current basis so the tax project relies principally on "Tax Assessment" figures.

While we believe that total collections are important basic measures, we do not feel that they should be used as the most basic output target for this project, since there are too many factors that affect total collections, such as economic conditions, changes in tax rates, political factors affecting collection policy, etc., which fall outside of the Tax Administration Project's area. A PAR now being prepared will cover this point.

Notwithstanding the foregoing, figures are being provided in the attached addendum since we recognize that they do have significance in measuring overall progress.

PAGE 1 OF 3 PAGES

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Figures for collections from audit activities were not included in the original goals. However, since estimates can be made with some degree of accuracy, they are also being included in the attached addendum.

We have also noted that original Exhibit A of the PROP shows "Tax Assessments" and "Audit Recommendations" as being in Colones (Cs). These items, as well as "Delinquent Return Assessments" (not designated) are, in fact, stated in \$US.

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