Assessment of Organization Structure and Operations Dirección General de Ingresos Internos (DGII) El Salvador

PROYECTO DE POLITICA TRIBUTARIA & REFORMAS ADMINISTRATIVAS (TPAR) EL SALVADOR

Septiembre 2005

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Assessment of Organization Structure and Operations Dirección General de Ingresos Internos (DGII) El Salvador

TAX POLICY & ADMINISTRATION REFORM (TPAR) PROJECT
EL SALVADOR

September 2005

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1. Background

The Tax Policy and Administration Reform Project (TPAR) in El Salvador, financed by USAID/El Salvador, and administered by Development Alternatives, Inc. (DAI), is supporting the Minister of Finance in the implementation of the fiscal reforms enacted in 2004; strengthening controls to monitor compliance of taxpayers with the tax laws; modernizing internal information technology systems; designing an integrated case-selection system for selection of taxpayers for audit; strengthening the functional areas responsible for monitoring and enforcing taxpayer compliance; and re-structuring the taxpayer service and education programs; and other tasks.

2. Terms of Reference

The Terms of Reference allowed nine (9) workdays to make an assessment of the organization structure of the DGII and the operations of its functional components, although the DGII’s offices and all government offices were closed 2 of the 9 work days for a national holiday. The objective was to identify principal shortcomings of the DGII’s organization structure and its operations and to make general recommendations about necessary changes needed to address those shortcomings. Work to develop specific recommendations to address the shortcomings is scheduled within the next few weeks.

The DGII’s counterpart staff provided excellent support for gathering pertinent information requested; for facilitating interviews enjoyed with numerous top and mid-level management level officials of the DGII (see Annex 1, List of Officials Interviewed); and for touring of work areas. This report could not have been produced without the excellent support of the DGII’s counterpart staff, particularly from Mr. Carlos Girón, manager of the DGII’s counterpart group.
3. **Best International Practices - Base Criteria Used for this Assessment** -

The criteria and standards we used on which to base our observations and general recommendations for this assessment are grounded on best international experiences and practices. The international “model” for functional organization structures is described, and the DGII’s structure is described in comparison to the model.

As noted above, the Terms of Reference directed assessments of the DGII’s organization structures and to its compliance and service operations. Nevertheless, this assessment also offers a few general observations about the quantity and quality of human and financial resources made available each year to the DGII for its operations. One of the most important lessons learned by international donor and other organizations such as USAID, the World Bank, and the IMF in administering/overseeing tax-administration reform projects all over the world during the last 20 years or longer is that “piecemeal” reform projects have generally not been very successful anywhere. In other words, projects which focus only on improving operations of one function such as the Audit or the Taxpayer Service function, or even those which focus on improving all of the compliance functions and even providing modern computerization equipment may have some value but not lasting value. Invariably, in any developing country, the Tax Administration’s human, financial, and automated resources systems; the country’s public service pay systems; its tax laws and tax policies; and several other factors which will address root causes of shortcomings must be added to the inter-related mix of tax administration reform-project variables which need to be addressed almost simultaneously for the successful design and implementation of effective and **lasting** tax administration reform.

Of course, “holistic” projects require substantial investments for services of different types of international and local experts; substantial computer and communications equipment, etc. Nevertheless, there is ample international experience to suggest that a comprehensive or “holistic” reform and investment in a country’s tax administration can result in substantially more tax collections over time. A useful benchmark was revealed in an IMF-sponsored study of the Latin American countries\(^1\) over the period 1965 to 1985. For these countries, a 1-percent increase in spending on tax administration improvements led to an increase in tax revenues of 0.56 percent. In addition, for one of the countries surveyed, VAT receipts increased by more than 50 percent over a 3-year period.

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simply from a change in audit strategy. In another country, certain systems improvements increased income tax and sales tax revenues by as much as 10 percent over a 3-year period.

As reported later in this report, a substantial investment to bolster the DGII’s financial and human resources would likely bring substantial tax revenue and collections to El Salvador’s national treasury over time because the DGII generally enjoys a staff of highly motivated, dedicated, hard-working and talented personnel who have been achieving much with very limited resources for several years and could achieve much more in terms of revenue production, given adequate resources.

4. Best Features of Functional Organization

Tax Administrations around the world are organized in several different ways. The main ones are:

- By type of tax or tax law (e.g. Income Tax; VAT; etc.)
- By type of taxpayer/client (e.g. large enterprises; small/medium enterprises and self-employed; wage and salary; exempt organization; etc.), and
- By functions performed (e.g. Taxpayer Audits; Collection of Tax Arrears; etc.).

Each of the 3 ways has advantages and disadvantages. The most prevalent and most successful organization structure for many years has been by functions performed (commonly referred to as “functional organizations”). There have been some notable moves in recent years away from the functional organization to the “client type” including Australia, New Zealand and the United States. Nevertheless, modern Tax Administrations in most Western countries and in several other countries around the world are still organized on a functional basis. The management, staffing, programs, activities and annual work plans of the Tax Administration are continually and consistently designed and executed around the core functions. In effect, the core functions define the allocation of staffing and the main activities of the organization.

The core functions under the jurisdiction of successful Tax Administrations are:

- Taxpayer Audits;
- Collections of current taxes (Recaudación) and of tax arrears (Cobranzas);
- Taxpayer Registration;
- Taxpayer Services;
• Receipt & Processing of Tax Declarations;
• Taxpayer Objections (Administrative Appeals); and
• Investigation of Tax Fraud

In support of the managers and technical employees who execute all the core functions, modern and effective organization units must also be established for support functions of

• Integrity Investigations and Internal Audits
• Planning, Monitoring and Evaluation
• Legal Services
• Human Resources – Personnel Management & Training
• Budget Administration
• Computerization and Data Networking
• Administrative Services

4.1 Levels and Roles of Hierarchy in Functional Organizations

If the country's Tax Administration has a large number of employees (several thousand), the organization usually establishes at least a 3-level hierarchy, i.e. a Central Office, Regional Offices, and District Offices. Complementary/counterpart support functions to the core functions, each with a different role, are usually established at each of the three levels of the organization. In countries with smaller Tax Administrations in terms of overall staffing (as is the case of El Salvador's DGII, which has a staff of around 1,000), the principal roles of the Central Office and Regional Offices described below are combined, and the monitoring and control of the execution of work plans are added to the directive and normative responsibilities of the Central Office staffs. The respective roles of the 3-levels are:

• The Central Office plans, directs and evaluates all tax administration programs in the country. The Central office develops strategic and annual work plans for all functions. Furthermore, it also establishes policy and designs methodologies and standards for work performed at all levels, i.e. the normative role;
• The Regional Offices (2nd level) monitor and control the execution of annual work plans at District Offices (3rd level) and provides functional guidance to functional counterpart units in District Offices, i.e. the functional-support role.
• District Offices (3rd level) represent the operations role of the Tax Administration, and thus implement and execute all programs and work plans developed by the Central Office.
Clear policies and methodologies established by the normative staffs at the Central Office guide the consistent application of tax laws, tax policies and administrative policies at the execution level. The need for consistent application of tax laws and policies throughout the country stems from many sources, but high among them is the requirement of any Tax Administration for a fair, transparent and predictable tax system in order to stimulate the high levels of domestic and foreign investment required for economic growth. Therefore, the normative role of the Central Office is critical for operations.

4.2 Decentralization of Operations and some Support Functions

As noted above, the Central Office personnel of most successful Tax Administrations engaged in normative roles do not also carry out core tax administration operations, such as taxpayer audits, directly with taxpayers. Instead, operations associated with the core functions in a given geographical area are the overall responsibility of operations offices at Regional Offices (smaller countries) or District Offices (larger countries) and their respective sub-offices in defined territorial areas at various locations. Since Central Offices of most countries are always located in the capital city, where many enterprises and individual taxpayers have their offices and residences, a “separate” organization structure in the capital is also established in the capital – responsible to the Director General in the chain-of-command structure – to conduct operations with taxpayers of all the core functions in the capital and surrounding area. The required “separate” structure established is often a “Regional” office in the capital – preferably but not necessarily with premises at a different physical location than the Central Office.

There are some exceptions in various countries to the practice of decentralization of functions, usually due to the varying sizes of the Tax Administration in terms of staffing and the number of taxpayers/cases in special categories. Operations exclusively for large taxpayers and for tax fraud investigations are examples. The number of taxpayers involved in smaller countries in these programs may dictate operations based at only one or two sites, from where the specialists travel throughout the country to conduct audits and investigations.

For most core functions of tax administration, however, the practice of geographic decentralization and dispersion is very important, as explained further in Section 4.3.

4.3 Specialization and Allocation of Operations and Support Staffing

Full, functional organizations need to be staffed with 3 categories of personnel - management, technical, and administrative-support personnel – each category organized around their respective, specialized functions of tax administration. The 3 categories of staff are recruited and specifically trained to specialize in the performance of their respective roles and responsibilities, and they are expected
to continually dedicate their time exclusively to the performance of those roles and responsibilities on a daily basis. For example, Collection and Audit technicians and managers do not each perform dual roles of Collection and Audit functions nor switch from one type of work to another periodically.

To the maximum extent possible, each of the core tax administration functions and the support functions (Legal, etc) are staffed with full teams/groups of management, technical (inspectors, auditors, etc) and administrative support (analysts, lawyers, etc.) personnel at centralized locations, as described below in conjunction with centralized staffing. The term “full teams/groups” relates to management span-of-control – groups large enough under each manager to permit specialization and efficiency but small enough to be manageable. One manager to 8-12 specialists is a good span-of-control.

Another integral concept of functional organizations is “centralized staffing” i.e. sufficient staffing is provided at strategic locations throughout the country, where each of the core functions of tax administration – taxpayer service, taxpayer registration, audit, collection, etc. – can be carried out efficiently and effectively. The central geographic locations and sub-offices established are accessible to a high percentage of the taxpayers in that tax jurisdiction, even where multiple cities and towns are involved. The office locations are also those where most taxpayers in the wider geographic area will still “feel the presence” of the tax authorities. To have the “tax-authority presence” felt by taxpayers in sites remote from the various offices, technical personnel travel from offices to remote sites periodically and perform their audits, collect tax arrears, hear taxpayer appeals, etc. Very small staffs (two or three) are installed to receive tax declarations and to provide service and assistance to taxpayers at offices very remote from central and larger sub-offices. Modern toll-free telephone and electronic systems are also installed at centralized sites and linked to remote locations to supplement limited, on-site service.

The functional organization and centralized staffing practices for Regional (or District) operations Offices and their sub-offices facilitate the practices of job specialization and specialized training. For example, Audit organization units at each Regional Office have full groups of well-trained auditors (8-12) who specialize in various types of taxpayer audits. All of the auditors, with their respective managers, are under one Audit Division/Section Head at that office. The chain-of-command and application of formal delegations of authority place each Division Head under his/her respective Regional (or District) Office Director.

4.4 Delegations of Authority

In the most successful Tax Administrations, the 3 (or 2) main levels of the hierarchy - the Director General at the Central Office; and the Regional Directors
or District Directors (if any) responsible for the daily execution of the basic tax administration operations are given sufficient authority and resources from the Ministry of Finance and higher levels of government to make and carry-out technical and administrative decisions. They run their respective organizations with a high degree of independence, while being held fully accountable for the tax administration’s results and other expectations agreed upon.

In fact, modern organizations rely heavily on a cascading system of delegations of authority – with some limitations, of course (e.g. for official decisions on tax cases with high $ values; purchases of capital equipment; etc.) reserved for successively higher levels of the hierarchy. In the traditional chain-of-command of 2-tier hierarchies, the Director General, who receives his delegations of authority from the Minister of Finance, formally delegates authority to Regional Directors. In turn, Regional Directors make similar delegations of authority of a lesser but still substantial degree to their functional Division Heads of Audit, Collection, etc Division Heads, in turn, delegate to Coordinators and Supervisors; and finally, Supervisors delegate to technical personnel. Given sufficient authority, respective levels are able deal with most operations, personnel, and administrative matters expeditiously with a high degree of independence and get their annual work plans done efficiently and effectively – and productively.

Through modern management information systems, on-site reviews, internal audits and other activities, the Central Office continually monitors the proper exercise of authority at all levels of the organization.

4.5 Control of Large Taxpayers

Over the years, more and more Tax Administrations have established organization units which differentiate treatment/control of taxpayers based on their revenue potential for the government – specifically, to establish Large Taxpayer Programs to exclusively handle the 4-5% of total taxpayers who contribute usually between 60% - 80% of the Government’s total tax revenues in many countries. The criterion used for identification and selection of “large taxpayers” for inclusion in the program varies among countries’ tax administrations. In some countries, “size” of taxpayers is simply determined by the amount of tax liability of the taxpayer in a given period. However, a single criterion usually proves unreliable because fluctuation in tax liabilities over several taxable periods usually distorts the classification. For the latter reason, “size” for inclusion or exclusion of large taxpayers is more often now determined by multiple factors, e.g. value of assets; gross/net income; multi-national entities; and amount of tax liability for the various types of taxes for which the taxpayer is liable.
4.6 Budgets for Internal Operations

Management and technical officials in modern, successful Tax Administrations throughout the world must be given the necessary human and financial resources to perform their principal core and support operations. They are also given a high degree of certainty that the allocated resources each year are or will be available as the expenditures become necessary day-to-day or month-to-month. Furthermore, officials are given a high degree of authority to manage their own budgets and are held accountable for results.

4.7 Computerization and Data Networking

Successful execution of every function of a modern Tax Administration requires effective use of computer systems and data networking systems. To perform their respective jobs well, employees in all core and support functions rely heavily on information, and unless this information is accurate and complete and can be retrieved in a timely manner, the information is rendered virtually meaningless.

Needless to say, not only Tax Administration employees but taxpayers depend on availability and effective use by the tax authorities of modern computer and data networking systems for timely processing and service of all their needs in order for them to comply with the country’s tax laws.

4.8 Summary Description of Best Functional Organizations

In short, the best functional organizations around the world are those which:

(1) define and communicate clear roles for each normative, functional-support and operations levels of the organization hierarchy;
(2) provide clear communication channels among different levels and among interdependent units;
(3) direct the allocation of the bulk of its resources to the front-line functions and to those support functions directly related to tax compliance, enforcement and to taxpayer service;
(4) encourage development and application of technology in all functions, including internal management information systems; and
(5) provide functional and management training, career opportunities and a work environment to help attract and retain a high caliber career workforce.

5. General Assessment of the DGII’s Functional Organization Structure

The DGII’s current organization structure is shown in Annex 2-A (English) and in Annex 2-B (Spanish).
At first glance, Annex 2-A seems to represent the structure of a functional organization. However, after close examination of the DGII’s structure; interviews with all top-level and several lower-level DGII officials; and quick analyses of much data gathered, our assessment is that the DGII’s organization structure does not conform to those of best international practices in many respects:

- In comparing Annex 2-A to the lists of functions in Section 4, above, two core and one support tax administration functions are not within its jurisdiction and are not performed by the DGII
  - The core function of Collections of current taxes and tax arrears (Recaudación & Cobranzas), is within the jurisdiction of the DGT - Dirección General de Tesorería – or Treasury Department, directly under the Minister of Finance – and not that of the DGII;
  - The core function of Investigation of Tax Fraud, is carried out by another level of government rather than by the DGII (The operations of this function are not addressed in this assessment and will be handled for the TPAR by a consultant from the U.S. Treasury Department, Alfredo Bellamy)
  - The support function of Integrity Investigations and Internal Audits are not conducted by the DGII (These functions will also be addressed by U.S. Treasury Consultant Alfredo Bellamy)
- Compliance and service operations with taxpayers, roles reserved for Regional offices, are in fact being performed by the Central Office, in addition to its directive, evaluation and normative roles;
- The decentralization of operations shown in Annex 2-A falls short of international best practices. There are two Regional Directors shown, both under the Director, Audit, but neither Regional Director West or East is responsible for personnel and operations of all the functions represented at those sites;
  - Instead, the Regional Directors West and East report to the Director, Audit at the Central Office, and are responsible for only the Audit staff on-site
  - The Legal and Taxpayer Service staffs on-site report directly to superiors in the Central Office, as shown in Annex 2-A;
  - The Collections function also operates at each of the two Regional Offices, but the Collection staffs are under the jurisdiction of the DGT and not under the Regional Director of the DGII, nor even of the DGII, as noted above;
  - Other, permanent compliance functions of the DGII have not been decentralized and do not have a presence at Regional Offices (e.g. control of non-filers, a function of the Taxpayer Control Division (“DICOT” - División Control de Obligaciones Tributarias)
- The high degree of functional specialization suggested by international best practices is not practiced by the DGII because the severe inadequacy
of the DGII’s overall staffing forces continual switching of functional technical specialists, e.g. Audit and Legal, to support other functions, particularly Taxpayer Service (explained further in the Operations Assessment, later in this report);

- Significant delegations of authority for operations and especially for decisions related to budget and necessary expenditures are not in enjoyed by the DGII (see Operations Assessment later in this report)

- While the DGII began to identify and control Large Taxpayers several years ago and currently has 2530 under control, the control is fragmented under 3 different managements and dilutes the special attention necessary to protect the government’s greatest source – and loss-risk - of tax revenue, even though the 3 managers are all under the Director, Audit
  
  o 1890 of the 2530 are controlled at the Central Office by the Deputy Director, Large Taxpayer
  
  o 322 of the 2530 are controlled at the Regional Office West; and
  
  o 323 of the 2530 are controlled at the Regional Office East;

- The DGII is allocated its budget from the Ministry of Finance each year, and its budget has been woefully inadequate – in fact, it has decreased successively for several years. The DGII really has minor, insignificant control of decisions with regard to its Human and Financial Resources

- While some significant gains have been made in recent years in terms of computerization and data networking systems, and many initiatives are now underway, the current systems fall way short of those of modern, effective tax administrations (see Operations Assessment later in this report)

In conclusion, there are several, significant shortcomings of El Salvador’s organizational structure, as compared with structures endowed with the features suggested by international best practices. Therefore, El Salvador does not currently enjoy a complete function organization.

The absence of a complete functional organization – one without all the core functions and necessary support functions under its jurisdictional authority; without clear roles from top (Central Office) to bottom (Regional Operational Offices) and vice versa; without sufficient decentralization and dispersion of operations; without adequate budgets and human resources; and without sufficient, effective information technology equipment and systems - will not permit the efficiency gains in operations traditionally enjoyed by the best functional organizations around the world. Current operations of the DGII are described below.
6. Assessment of the DGII’s Operations

Table 1, below, presents some statistics about the tax environment in El Salvador which can help visualize the scope and some of the challenges for the DGII’s operations:

Table 1: Selected Features of El Salvador’s Tax Administration

<table>
<thead>
<tr>
<th>Feature</th>
<th>Number or %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Approximate national population, 2005</td>
<td>6,800,000</td>
</tr>
<tr>
<td>1. Data base of Taxpayer Identification Numbers (TIN) issued to natural persons (NIT, in El Salvador)</td>
<td>3,708,535</td>
</tr>
<tr>
<td>2. Data base of TINs issued to corporations</td>
<td>57,607</td>
</tr>
<tr>
<td>3. Registered taxpayers, Income Tax</td>
<td>350,509</td>
</tr>
<tr>
<td>4. Registered taxpayers, VAT</td>
<td>108,278</td>
</tr>
<tr>
<td>5. % of tax revenues 2004</td>
<td></td>
</tr>
<tr>
<td>- VAT</td>
<td>53%</td>
</tr>
<tr>
<td>- Income Tax</td>
<td>30%</td>
</tr>
<tr>
<td>6. Taxpayers under DGII control</td>
<td></td>
</tr>
<tr>
<td>- Large*</td>
<td>2,530</td>
</tr>
<tr>
<td>- Medium</td>
<td>7,033</td>
</tr>
<tr>
<td>- Small</td>
<td>95,000</td>
</tr>
</tbody>
</table>

*Generally, taxpayers with revenue of $1+ million

The VAT, at 53%, provides the greatest amount of tax revenue. However the VAT evasion rate is estimated to be almost 41% - much higher than the Central American benchmark of 25% and much, much higher than the international benchmark of 10%.

Taxpayers make payments and file tax declarations with payments at commercial banks or at Collectorates of the DGT (Treasury). Basic data – e.g. name, type of tax and period, NIT - is transcribed by those institutions and provided to the DGII for input to each taxpayer’s current account – usually late one month or longer. Tax declarations without payments are filed with the DGII at various offices throughout the country, where data is transcribed on-site by Taxpayer Service personnel, students and personnel detailed in from Audit, Legal and Compliance functions. A small percentage of tax declarations are filed through the internet and by means of diskettes at various Taxpayer Service sites.
6.1 Staffing

The DGII is one of five (5) Directorates of the Ministry of Finance (MOF). The DGII has a total staff of approximately 1,063 organized around the different functions shown on Annex 2-A, as follows:
Table 2: DGII Permanent Staffing

<table>
<thead>
<tr>
<th>Function</th>
<th>Quantity of Staff</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Director General, Deputy and Staff</td>
<td>6</td>
</tr>
<tr>
<td>2. Planning &amp; Evaluation Unit (UPET)</td>
<td>44</td>
</tr>
<tr>
<td>3. Quality Management Unit</td>
<td>12</td>
</tr>
<tr>
<td>4. Information Technology &amp; Support Unit</td>
<td>23</td>
</tr>
<tr>
<td>5. Director, Audit</td>
<td>434</td>
</tr>
<tr>
<td>6. Legal Division</td>
<td>117</td>
</tr>
<tr>
<td>7. Taxpayer Service Division</td>
<td>226</td>
</tr>
<tr>
<td>8. Taxpayer Compliance Division</td>
<td>149</td>
</tr>
<tr>
<td>9. Director, Administrative Services</td>
<td>52</td>
</tr>
<tr>
<td>10. Total</td>
<td>1063</td>
</tr>
</tbody>
</table>

As stated in Section 3, the DGII seems to generally enjoy a staff of highly motivated, dedicated, hard-working and talented personnel who have been achieving much with very limited resources for several years. Its 649 college graduates constitute 61% of their permanent staff – much higher than the 40% Central American benchmark and not much below the international benchmark of 70%. Without exception, all officials interviewed for this assessment projected a high degree of professionalism, and it was clear that almost all technical and management personnel work several more than 8 hours per day, every work day to try to get the job done and have been doing it for several years.

Salaries vary among the different functions. Our understanding is that among the lowest salaries are those in the Taxpayer Service Division. Audit has the best monthly salaries (averages):

- $770 – Auditor
- $1100 – Supervisor
- $1220 – Coordinator

It is said that the auditors of Customs earn more than DGII’s auditors, even though their work is not as difficult in terms of legal and accounting complexity. There has not been a Cost of Living Allowance (COLA) increase for DGII employees for at least 5-6 years.

Since 2003, the DGII has been able to supplement its staffing with hundreds of college students (300 in 2003; 500 in 2005; plan for up to 700 in the future) who are assigned to the support the various functions, particularly the Audit, Taxpayer Service and Taxpayer Compliance functions. To graduate, college students in El Salvador are required to spend one year of public service. The DGII has capitalized on the public-service requirement by recruiting seniors majoring in...
economics, accounting, law and related fields. The students recruited are given training for 3 days on tax law; on the functional tasks they will perform; and on some task techniques such as verification of records regarding taxpayers’ compliance. The cost to the DGII (government) is only $8 per diem per day for each student. Their cost/benefit ratio has been very favorable but the overall quality of their work has been poor, understandably, as explained in the Audit Section of this report.

The support of DGII permanent staff by students has been fortunate. Otherwise, the DGII’s operations and the accomplishments the DGII has enjoyed the last two years would have been impossible. A few examples of extremely low permanent staffing in relation to functions performed are:

- The Taxpayer Service Telephone Call Center has only 8 employees – 5 for all taxpayers and 3 for internal inter-function communications;
- Particularly on “peak days” (due-dates of tax declarations; payments), taxpayer waiting lines in Taxpayer Service facilities throughout the country are extremely long, and personnel from Audit (even Large Taxpayers Audit), Legal, Taxpayer Compliance and students have to be detailed to help. This is a recurring problem;
- The Internal Procedures Unit, under the Director, Audit began to conduct quality review duties of completed Audit cases, before they are transmitted to the Taxpayer Objections Unit (UAAP) in the Legal Division, but the Unit only has 3 auditors to conduct this work for the entire Audit function; and
- The Quality Management Unit, which performs much of the normative role of the DGII and monitors and evaluates quality throughout the organization, has a total staff of only 12.

6.2 Administrative Services

The Director of Administrative Services has a staff of 50 divided among two departments – Finance Dept. (12 employees) and General services Department (38 employees). The meager staff of 12 for Budget, Human Resources and Training, Supplies and Equipment and “Petty Cash Fund” (actually, this is a revolving cash fund) is a clear indication of the skeletal financial and human-resources support made available to the DGII by the national government and the MOF.

It is very clear that the DGI’s budget and related policies and procedures for its internal operations fall extremely short of international best practices, which call for an adequate budget; authority to manage its budget; and be held accountable for results. If the DGII’s budget is measured in terms of its ratio to GDP, the ratio has steadily been declining from 0.12% in 1996; to 0.07% in 2004. To aggravate its declining strength, the DGII’s volume of work has already at least tripled as a result of the tax reform legislation of 2004, according to some officials’ estimates. For example, Tax Clearance Certificates (“Solvencias”) were
required by the 2004 reform starting in 2005 for various financial transactions which affect many thousands of people. The volume of business became so large and unmanageable that some amendments were hastily made to lessen the volume. Effective 01 Jan 2006 the requirement applies only to loans of $20,000 or more from financial institutions or credit cards with lines of credit above $3,500. Nevertheless, the volume is still huge and will remain so. The Current Account Section of the Tax Compliance Division (see Annex 2-A) is responsible for issuing the Tax Clearance Certificates to certify that the applicant has met all his tax obligations, and the Section cannot keep up with the demand.

The Taxpayer Service Division has also experienced a many-fold increase of work during the last few years. Yet, the Division has not been authorized to hire any additional staffing in the last 10 years. On the other hand, the DGII was authorized to hire about 200 new auditors during the last two years, but training for them has been insufficient and/or inadequate. The lack of adequate training and other reason have impacted very negatively on the quality of Audit work, which is described below.

Furthermore, the Director, Administrative Services has very limited authority to purchase even basic office supplies, much less make capital improvements desperately needed in facilities throughout. He was finally able to secure $57,000 placed in a revolving fund for emergency purchases of supplies, repairs, etc. Nevertheless, the meager amount is insufficient for basic operational needs of a 1,000-person organization. Many facilities for taxpayers and employees lack modern conveniences, such as air conditioning. At interviews and walking tours of work areas, it was obvious that all organization functions are in dire need of basic supplies and equipment to do their work – paper for printers; print cartridges; toner; etc. Equipment such as printers, office furniture, etc. in good condition is in extremely short supply. Motor vehicles for transport of technical personnel are extremely scarce and in poor repair. Contracts for repairs of motor vehicles are centralized, and repairs have to be requested and scheduled through the MOF.

Even the printing of tax declaration forms is outside of the control of the DGII. Contracts for printing made at the MOF level have often been given to small firms, which have produced very poor products in terms of ink and color quality – not to mention lack of timeliness.

The premises occupied by the Document Control Section of the Taxpayer Compliance Division are an example of a catastrophic accident waiting to happen. There are millions of tax returns and other documents dating back to the 1960s stored there. Rain water leaks onto the premises. Security is nonexistent. There is no alarm system. There is an unsealed area through which anyone could enter the premises (in fact, the Section Chief has done it to prove the point, and stray cats are often unwelcome visitors). The electrical wiring system has been patched and re-patched many times and the wiring and
switchboxes heat up every day. Repeated requests for funding to make lasting repairs have not been successful.

In short, the DGII does not enjoy the budgets for internal administration, as described for the international model in Section 4.5.

6.3 Annual Work Planning and Quality Management

Operations of the DGII are governed to a very large extent by the tax revenue goals assigned to the DGII by the MOF each year, goals which are based on the strategic plan developed at the national level of government. The DGI does not have its own strategic plan. The DGII has very limited input on the revenue goals it is assigned, although historical performance plays an important part.

Based on the DGII’s revenue goals assigned by the MOF, annual operating plans are prepared by the Planning & Evaluation Unit (UPET) for all organization units of the Director, Audit and for other compliance units, such as the Non-Filers & Collection Section of the Taxpayer Compliance Division. UPET is directly under the Director General. UPET selects and assigns the cases to be audited and establishes revenue goals and time standards for all Audit and other compliance/enforcement activities. For selection of cases to be audited, UPET uses approximately 30 criteria – e.g. historical compliance experience with the taxpayer; revenue risk to the government; – of which some indicators are automated. UPET closely monitors progress on objectives monthly or, in some cases, more often. For a variety of reasons described later in this report, most work processes – audit and other technical work and information gathering to monitor progress on objectives – have to be performed by very paper-intensive and labor-intensive methods.

The Quality Management Unit, also directly under the Director General shown on Annex 2-A, manages the portions of the national government’s and MOF’s 5-year strategic plan assigned to the DGII. With the support of the Quality Committee, the Unit performs a large part of the normative role of the Central Office. The Quality Committee is comprised of the Director General and Deputy Director General; Director, Audit; Director Administrative Services; Director, Legal Division; and Head of the Quality Management Unit. Also with help of technical experts from the operations and support functions, the Quality Unit develops and maintains policy and procedural manuals, and it monitors the quality of work performed by all functions in terms of established policies and procedures. Policy and procedures manuals have been developed for the core functions and are in varying stages of currency. For example there are 14 Audit manuals and sub-manuals of which some are in the process of revision. Some manuals are made available electronically.
6.4 Information Technology

This assessment report does not evaluate computerization and data networking from a technical standpoint. This task is being addressed by TPAR Consultant Salvador Rivera, an expert in the field. However, from the standpoint of needs of users in tax administration operations, the following observations are noted.

Computerized applications in tax administration provide tools to tax department staff to be more effective and efficient in the performance of their jobs. The ultimate objective is to provide information on virtually every aspect of tax administration as well as information needed for policy decisions. There are many capabilities that make a well-designed computer application so important to tax administration, the primary ones being:

- the provision of accurate and complete records of financial transactions (assessments, payments, etc.) of taxpayers that are virtually impossible to maintain and prepare in a manual environment;

- the rapid and easy retrieval of taxpayer records for one or more tax periods by authorized tax administration personnel;

- the ability to identify in a timely manner all taxpayers who are not in compliance (non-filers, late payments, etc.);

- timely reports, whether weekly, monthly or quarterly, and ad-hoc on-demand reports that show total assessments, total collections, total taxes delinquent, and other important tax-related information that would be impossible in a manual system;

- the ability to use historical data stored in the computer system to select taxpayers for potential audit using audit criteria developed by audit specialists;

- the provision of security and internal control to eliminate unauthorized changes to financial data and internal audit trails to identify the source of unauthorized changes;

- the ability to reconcile totals from external (manual) records (cash books, batch headers, etc.) with computer-maintained and produced totals on a regular basis; and

- the easy and timely generation of customized reports requested by tax administrators.

Tax administrators and support personnel must feel that there are great benefits provided by the use of a computerized system if it is to be accepted and viewed
as being successful. Unless a computerized tax system simplifies the job of tax administration, provides faster access to information, identifies taxpayers who are not in compliance, and produces reports in a timely manner than did the manual system, then there are certainly few, if any, reasons to use a computerized system. The primary role of a computerized system for tax administration can only be accomplished if there is a careful and detailed definition of the requirements for the application.

There are a few computerized systems in place and many others are being developed or have been developed and are in partial use, e.g. SAF, SICOGF which will be addressed by Salvador Rivera, but from an operations standpoint the computerized systems in place are inadequate and those in use generally are not very reliable.

6.5 Taxpayer Compliance Division (DICOT)

The Taxpayer Compliance Division has two departments – (1) Taxpayer Control Dept. (68 employees) in the sections of Taxpayer Current Account; Non-filers and Collection and Document Control; and (2) Taxpayer Claims Dept. (79 employees) in the sections of Income Tax Refunds; VAT Refunds; and Formal Claims.

Assessments of operations are described below only for the organization sections which have the greatest impact on overall operations of the DGII.

6.5.1 Taxpayer Current Account Section

In all modern tax administrations, the quality with which the Taxpayer Current Account is designed, implemented and maintained constitutes one of the main “pillars” on which all compliance and service operations depend – and succeed or fail – not just from the standpoint of the tax administration but from the standpoint of each taxpayer as well.

A taxpayer current account is really an accounting system for each taxpayer by which the tax administration tracks liabilities owed and payments made by each taxpayer for all types of taxes. All debit and credit transactions must be recorded in a very timely manner – no matter where the activity takes place - to track all financial activity (liabilities and payments, respectively) on a taxpayer account. Thus, current-account automated systems designed and implemented must be able to track and record tax declarations filed by the taxpayer through the banking system; or at the tax administration offices anywhere in the country; or through the internet; etc. Tax payments made at any of the latter locations similarly must be very timely recorded on the taxpayers account. . There must
be audit trails with debit and credit transactions to track all financial activity (liabilities and payments, respectively) on a taxpayer account.

A given taxpayer’s current account is first established at the time the taxpayer registers with the tax administration and is given a unique taxpayer identification number (TIN), (or NIT, in El Salvador). The NIT for each taxpayer is the “electronic address” where all transactions are recorded. At time of registration, the particular taxpayer’s tax obligations are entered in his own current account with unique NIT in the Tax Administration’s Master File database of taxpayers. The particular current account for that taxpayer lists the types of tax declarations for which the taxpayer is liable (VAT, Income Tax, etc.) and the due dates of each tax return. Thereafter, the automated system monitors the taxpayer’s current account for compliance or non-compliance with his tax obligations. If the taxpayer does not file any of the required declarations by the due date, a non-filer case is issued soon thereafter by the automated system to the appropriate compliance unit for contact with the taxpayer (by mail, telephone, or in the field). Similarly, if the taxpayer does file but does not pay all or part of the tax due, the automated system issues a tax-arrears case to the appropriate division for contact with the taxpayer. Penalties and interest assessed for each tax and period; tax deficiencies assessed, after audit; each payment made for each tax and period; and refunds made must be timely recorded in the taxpayer’s current account. The taxpayer’s physical address for tax purposes – or that of his legal representative – must continually be updated for issuance of official notices.

In short, all tax-declaration and financial activity must be entered and tracked in a very timely manner in order for the tax administration to determine instantly through automated access of the taxpayer’s current account the status of all of the taxpayer’s tax obligations – net debit, or credit amount and compliance or non-compliance with filing of all tax declarations.

In the DGII, the Taxpayer Current Account Section is under the Taxpayer Compliance Division. See Annex 2-A. The DGI’s Current Account operations falls way short of meeting the international standards described above:

- There is no computerized link to establish a taxpayer’s tax obligations immediately upon initial registration
- There is no on-line monitoring of taxpayer’s compliance or non-compliance and related follow-up actions to assign non-filer or non-payment cases, as described above
- Filing, payment, and tax assessment activity which must be timely posted to the current account takes place at many different locations throughout the country many times per year – Taxpayer Service; Legal Division; Appeals tribunal; banks, the DGT, etc. – and the information is not timely submitted by the respective entities for posting to the current account;
• Taxpayers' addresses of records are not maintained on a current basis (the 2004 tax reform requires taxpayers to notify the DGII about changes of addresses, and more than 200,000 have been received so far);
• A great deal of the work in the Section is done manually and is very labor-intensive and paper-intensive.

Also, see Section 6.2 above about the tax reform requirements for issuance of Tax Clearance Certificates which have further overwhelmed the Current Account Section.

6.5.2 Non-Filers and Collections Section

The name of this Section is a misnomer because collection of tax arrears is not a function this Section performs. It did perform this function before Collection was transferred to the DGT (Treasury), and the name stayed as is. The function it does still perform is to secure tax returns from non filers. It has a staff of 20, with an average workload of 100 cases per technician. Some technicians do their work in the office, and 12 technicians work in the field.

Unfortunately, the organization structure and the available computerized systems make timely detection of non-filers impossible. Furthermore, the Section is overwhelmed with volume of work. UPET periodically sends the Section lists of new cases, but the Section is not able to handle its on-going volume of work.

6.5.3 Document Control Section

Section 6.2, above, describes the state of disrepair of this Section's premises. Despite the obstacles, the Section Head maintains what seems a very efficient and neat operation in custody and control of documents. There are millions of records dating back to the 1960s. The Section also maintains huge numbers of diskettes of documents submitted the last several years. About 4 million records are waiting for final approval to be retired.

Despite the Section Head's best efforts, the Section does not meet international standards:

• The entire storage operation is huge and paper bound – very labor and space intensive;
• Operations of Audit and Legal functions mandate original documents accompany case assignments; so massive files have to be extracted and transported from place to place in a sequence of steps over a period of many months or even years – which makes control of documents difficult and repeated transfers expensive;
• Microfilm is not employed;
There is no policy for destruction of those records which no longer have any tax significance (statute of limitations has expired, for example); and Lack of security and state of disrepair of the premises could possibly cause a catastrophic loss of all vital records for tax administration.

### 6.5.4 Taxpayer Claims Department

As shown on Annex 2-A, the department has 3 sections – Income Tax (32 employees), VAT (28 employees), and Formal Claims (17 employees). The work of all sections is heavily based on paper cases and is very labor intensive. Again, the workload is too heavy for the staffing and computerization support available.

### 6.6 Taxpayer Service Division

The Taxpayer Service Division has 226 employees and handles telephone and walk-in service to taxpayers; taxpayer registration; receipt and processing of tax returns; and taxpayer complaints.

As stated earlier, the division has not hired new employees in over 10 years. Training for current employees is ad hoc, despite many changes in the tax laws. The Division Director estimates that the division’s work has at least tripled in the last 2 or 3 years, and the division’s staff is insufficient to handle the volume of work well. On peak days (due-dates of returns and payments, for example) taxpayer lines at service centers all over the country are very long. Auditors, legal staff, compliance personnel, and student-employees are detailed in to assist several days a month.

Among the many repeated complaints received from taxpayers over the years are:

- Where to go for service at the Central Office is confusing, since there are 3 tall buildings (towers), and the DGII services are dispersed among the buildings and on many different floors, and there are no visible directories to direct traffic;
- Parking is totally inadequate and some facilities are not air conditioned;
- Service employees are often not well versed in the areas in which taxpayers need assistance; and
- There are very excessive delays in waiting lines and in final resolution of their cases.

### 6.6.1 Taxpayer Ombudsman

The Taxpayer Ombudsman, directly under the Division Director, handles taxpayer complaints. According to international standards, this office should be directly under the Director General. Taxpayer complaints anywhere in the world
are mostly about poor quality or timeliness of service and about overdue tax refunds; about audit or collection acts by officials; etc. Therefore, placement of the Taxpayer Ombudsman under any of the operating divisions, against which some complaints are lodged, detracts from the credibility and objectivity of the Tax Administration.

6.6.2 Taxpayer Registration and Exempt Machinery Section

As shown in Table 1, above, El Salvador’s current population is estimated at 6.8 million and NITs have been issued to 3.7 million natural persons and to 57,600 corporations. Unfortunately, the NITs are required for a great variety of purposes which have nothing to do with tax registration and compliance. For example, a NIT is required before anyone can obtain a driver’s license and before anyone can enroll in a college or university. The DGII has a taxpayer registration module available in its computerized systems, but the volume of NITs makes it impossible to maintain on a current basis by de-listing of non-taxpayers, deceased taxpayers. Furthermore, the tax reform of 2004 requires taxpayers to inform the DGII about changes of address, and more than 200,000 have been received so far.

The massive activities involved makes it impossible for 16 employees of the Taxpayer Registration and Exempt Machinery Section to maintain the taxpayer registration files current. This is unfortunate because Taxpayer Registration, like Taxpayer Current Account, is another of the main pillars of any Tax Administration anywhere in the world. The taxpayer registration module is the basis for first establishing a taxpayer’s filing and payment requirements; monitoring for compliance and non-compliance; issuance of official, legal notices from the tax authority; assignment of cases for Audit, collection of tax arrears; etc.

Clearly, the DGII’s taxpayer registration system does not meet international standards.

6.6.3 Tax Declarations Receipt and Processing

As stated earlier in this report, tax declarations are received by Taxpayer Service staff (and people detailed to help them) at mini and express service centers all over the country; by the internet; at banks; and at DGT Collectorates. There is some data-entry for inputting tax declaration information into the system at all of these sites, of which some data is received by the DGII weeks late. Control of errors on the input of key data at many different sites by various organizations is just impossible; so the reliability of data is very questionable.
Similar to the Taxpayer Current Account and Taxpayer Registration functions, timely and accurate receipt and processing of tax declarations “feeds” all tax administration functions to enable them to do their audits, compliance and service work. As it currently exists, the function of tax declarations receipt and processing represents a serious deficiency in the DGII’s operations. Unlike all successful international models, the DGII does not even have a separate organization structure and management for processing tax declarations.

6.6.4 Taxpayer Services Section

To its credit, the DGII has truly decentralized services. Besides call-center and walk-in services provided at the Central Office location, Express Service Centers and Mini Service Centers have been established throughout the capital and throughout the country as well. See Annex 2-A for sites. However, the staffing and lack-of-formal-training problems have already been cited. The division’s Call Center’s staffing and equipment is inadequate. It only has 5 telephone assistors for all taxpayers in the country and 3 assistors to handle the very considerable inter-division work.

6.7 Audit

With a staff of 434, the Audit function is the largest organization within the DGII and has been growing in the last two years. There are two Deputy Directors – one for Large Taxpayers (122 employees) and another for medium and small taxpayers (195 employees). Additionally, Audit has two Regional Directors who report to the Director, Audit – West (48 employees) and East (59 employees). All but the Regional Director East were interviewed for this assessment. Those interviewed well represent the professionalism and hard work cited earlier which seems to pervade the DGII.

However, despite Audit’s best efforts, their operations reflect numerous problems. The estimated high evasion rate of VAT (41%) was previously noted. Furthermore, the quality of audit work is generally poor. The latter assessment is made from the fact that 100% of un-agreed, proposed deficiency cases – all of which must go to the Taxpayer Objections Section (UAAP) of the Legal Division for review – have legal or accounting flaws in the work papers and must be returned for correction, oftentimes more than once, according to the Head of the UAAP. On many cases, the 3-year statute of limitations is close to expiration on cases submitted to Objections, and there is much frenzied work between UAAP and Audit field offices to avoid statute expiration. Often, UAAP staffs have to participate with auditors to help guide the necessary corrections in the field.

Within the last 2 years, about 200 new auditors have been hired. From an operations standpoint the shallow experience base of more than 50% of the DGII’s total auditor staff, which the new auditors represent, obviously has a negative impact on quality of work. As explained in Section 6.3, UPET prepares
Audit's annual work plan and assigns revenue targets from the MOF. To meet challenging revenue targets each year with relatively inexperienced staff, a high percentage of mass audits are performed rather than in-depth, "integrated" audits which yield significant experience and have a much greater impact on taxpayer compliance. Several other consequences of a high percentage of mass audits include the fact that depth of institutional experience remains stagnant; many new auditors lose interest in the occupation which offers very narrow professional experiences and leave for the private sector; and the Audit pool for assignments to Large Taxpayers and management ranks remains very small.

New auditors are given one month of training, 8 hours per day 6 days per week. Topics include tax law, accounting and auditing. While the quantity of new auditors contracted in the last 2 years is impressive, the training they are given seems to be inadequate. However, training will be addressed separately from this assessment for the TPAR by Consultant Lee Niederman.

On the plus side, it is also very worthy to note that, among 13 categories of “representatives”, the auditors of the DGII are considered 2nd most honest representatives of government and of the private sector in El Salvador, 2nd only to the President of the Republic (Ref: Instituto Universitario de Opinión Pública, Press Bulletin No.1, Year XX -"Transparency in El Salvador, Perspective of the Business Sector" – based on opinion survey of 350 business enterprises conducted between November-December 2004).

### 6.7.1 Large Taxpayers

As explained in Section 4.5 the DGII began to identify and control Large Taxpayers several years ago (1992) and currently has 2530 under control, but the control is fragmented under 3 different managements and dilutes the special attention necessary to protect the government’s greatest source – and loss-risk - of tax revenue, even though the 3 managers are all under the Director, Audit

- 1890 of the 2530 are controlled at the Central Office by the Deputy Director, Large Taxpayer
- 322 of the 2530 are controlled at the Regional Office West; and
- 323 of the 2530 are controlled at the Regional Office East;

The organization in the capital San Salvador has premises at a separate location from the Central Office and consists of 3 Coordinators; 4 supervisors; 8-9 auditors per supervisor – with a combined total of 110 auditors. The average salary of auditors in Large Taxpayers is $850, as compared to the $770 average for all auditors. Their audit plan calls for 300 in-depth, integrated audits for the year, of which 48% should have proposed deficiencies. The objective is $80,000 deficiency per case, and average time per case targeted is 238 hours. They maintain a high currency rate, which is highly desirable – 173 cases are for the 2005 annual work plan; 35 for 2004; and only 1 for 2003.
Through June 2005, they had proposed $9.8 M in deficiencies, compared to $8.9 for the same period in 2004. However, to increase their audit coverage their audit plan also calls for mass audits of 2% of Large Taxpayers. Mass audits – e.g. single issue; or on-site observation for irregularities with VAT invoicing; etc. – are not normally part of large taxpayer programs.

The prior project (USAID-Bearingpoint) assisted in obtaining 100 laptops currently assigned to Large Taxpayers.

According to the head of the Taxpayer Objections Unit (UAAP), Large Taxpayer audits are also of poor quality. The premises also have a Taxpayer Service Center; a DGT Collectorate; and a bank facility. Large Taxpayer auditors and students assigned there support Taxpayer Service on peak periods several times each month.

6.7.2 Medium and Small Taxpayers

This organization has a total staff of 195 and is located at different premises than the Central Office. There are also a Taxpayer Service Center; a DGT Collectorate and a bank facility on the premises, and auditors and students support Taxpayer Service on peak periods several times each month.

The DGII controls a total of 7000 Medium Taxpayers and 76,000 Small Taxpayers. Of the 7,000 Medium, 3991 are controlled from the San Salvador office. There are 4 Coordinators; 23 Supervisors; and 159 total auditors. They also have 300 students to support their operations.

Among some of their accomplishments so far in 2005 are:

- Secured 1102 delinquent tax declarations from 2793 non-filer cases with $7 million in tax liabilities;
- Accomplished twenty-six (26) businesses closures (through judicial order) for taxpayer non-compliance issues;
- Amnesty of 2004, which impacted mostly medium and small taxpayers, yielded $40 million, of which about $20 million was paid immediately and $20 million is being paid in installments.

6.7.3 Regional Office West

The Regional Office West was established in June 1996 in Santa Ana (same year as Regional Office East, which we did not visit for this assessment). It started with a staff of 50 auditors. It is now down to 38. It covers 3 departments – Ahuachapán, Santa Ana and Sonsonate. It’s “portfolio” of taxpayers is as follows:
Table 3: Taxpayers Controlled by Regional Office West

<table>
<thead>
<tr>
<th>Category</th>
<th>Ahuachapán</th>
<th>Santa Ana</th>
<th>Sonsonate</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>20</td>
<td>191</td>
<td>90</td>
<td>301</td>
</tr>
<tr>
<td>Medium</td>
<td>90</td>
<td>489</td>
<td>226</td>
<td>805</td>
</tr>
<tr>
<td>Small</td>
<td>1826</td>
<td>7082</td>
<td>3787</td>
<td>12695</td>
</tr>
</tbody>
</table>

The Regional Director has 1 Coordinator and 4 Supervisors. There are 38 auditors; 5 administrative staff; 100 students; 4 legal staff; 18 Taxpayer Service staff; and 5 DGT staff on the premises. The legal, Taxpayer Service and DGT staffs are under management of the respective divisions in San Salvador. However, everyone pitches in during peak periods to help Taxpayer Service. In fact, the entire office staff June- Sep has been assisting the Taxpayer Service Division with data-input work for processing of 115,000 tax declarations from San Salvador.

The premises of the Regional Office West are the best of all we visited. The Regional Director is obviously very proud of the premises and facilities for taxpayers and for employees. Still, the office also suffer like everyone else from severe shortages of equipment and supplies (only 3 motor vehicles; only one printer; very limited number of workstations with internet/network access; only 17 laptops for 38 auditors; etc etc.).

The Offices accomplishments are numerous and impressive, including:

- Between 2002 and 2005 (thru 13 September), they have exceeded their proposed deficiency goals every year, for a total cumulative of $14.9 million vs. $12.2 million goal, or +21.6%.
- The cost/benefit ratio during that period has been a very positive 451%;
- About 80% of their audits have produced proposed deficiencies, and 40% of those have been agreed cases; and
- The 100 students assigned to the office so far in 2005 have produced $450,000 in proposed deficiencies on mass audits (observation on-site of VAT invoicing by business taxpayers; etc.), in relation to their cost of only $46,000.

6.8 Legal Division

The Legal Division has a total staff of 117. The departments/units we visited for this assessment were the Taxpayer Objections (UAAP); the Notification Department; the Tax Assessments Department; the Taxpayer Resolutions Department.

The work of the UAAP has already been described in various sections, but particularly in Section 6.7, above. It is worthy to add that its review work of Audit
cases is always conducted by team pairs – one auditor and one lawyer. This work is unusual in two ways as compared to international best practices (1) quality review work of completed Audit cases is almost always done by the Audit function itself rather than by an “external” unit, and (2) lawyers are not usually involved except by exception on proposed deficiency cases because their expertise is not necessary in 97-99% of cases – usually only on cases which are going to a judicial level.

The lawyers of the Notification Department follow very painstaking review processes and procedures to issue official notices to taxpayers. Much of the work is done manually – some in long-hand, in fact.

Similarly, the work of the Tax Assessments Department is very painstaking and thus requires slow, methodical and very time-consuming efforts for each case.

The legal staff of the Taxpayer Resolutions Department handles non-monetary issues with taxpayers, e.g. approval of special, unique forms proposed by the taxpayer which might otherwise incur a penalty for “inadequate accounting records”.

In all cases, original tax declarations, attachments, Audit work papers, correspondence and other documents comprise massive files which move from department to department within the Legal Division.

Overall, most of the DGII’s technical Audit and Compliance work is heavily invested in legal reviews, processes and procedures, which are extremely time consuming and costly. The excessive Legal oversight is not consistent with best international practices.

7. **General Recommendations**

As stated in Section 2, above, the objective of this assessment was to identify principal shortcomings of the DGII’s organization structure and its operations and to make general recommendations about necessary changes needed to address those shortcomings. Work to develop specific recommendations to address the shortcomings is scheduled for next month.

The DGII’s most significant shortcomings emanate from the lack of authority and resources to perform its work efficiently and effectively. Therefore, the most significant recommendation from this assessment is that the Ministry of Finance and the Central Government authorize the reconfiguration of the DGII as a semi-autonomous Revenue Authority (RA).

RAs are defined as tax administrations that have greater than usual autonomy along several organizational design dimensions, including: legal character,
financing, governance, personnel policy, procurement policy, and accountability relationships. Each dimension of autonomy has the potential to provide the RA with greater flexibility and control over managerial decision making. The sum of an RA’s organizational design features results in an autonomy profile.

During the next phase of work, an outline of key organizational design features, focusing on legal, governance, financing, personnel, and accountability issues for the proposed RA should be presented.

There are numerous organization and operations recommendations as a result of this assessment which will be fully developed during the next phase of work, including:

- The DGII should develop its own Strategic Plan;
- The Collection function should be transferred from the DGT to the DGII;
- The Taxpayer Ombudsman should be placed directly under the Director General;
- The overall organization structure of the DGII should be reconfigured, and the current decentralization should be reconfigured as well;
- The Large Taxpayer Program should be re-organized under one Deputy Director;
- A new Telephone Call Center with modern equipment and adequate staffing is needed;
- A separate organization should be established to process tax declarations;
- Top priority for computerized systems should be given to the Taxpayer Current Account and to Taxpayer Registration;
- Significant investments must be made in the DGII’s human resources – recruitment, training, and compensation systems; and
- Significant increases must be made in the DGII’s financial resources for investment in property, equipment and supplies required to do its work.

The volume and substance of recommended changes, if accepted, will clearly present vary major challenges for the entire DGII organization. Fortunately, the DGII’s management clearly demonstrates that they are ready to take on the challenges.
Annex 1

List of Officials Interviewed
Annex 1: List of Officials Interviewed

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Lic. José David Lopez</td>
<td>Deputy Director, Audit, Large Taxpayers</td>
</tr>
<tr>
<td>2. Lic. Santiago Miranda</td>
<td>Deputy Director, Audit, Medium Taxpayers</td>
</tr>
<tr>
<td>3. Lic. Luis Fernando Diaz</td>
<td>Regional Director, Audit, West</td>
</tr>
<tr>
<td>4. Lic. José Antonio Molina</td>
<td>Head, Internal Procedures Unit, Audit</td>
</tr>
<tr>
<td>5. Lic. José Antonio Perez</td>
<td>Head, Taxpayer Objections, Legal Division</td>
</tr>
<tr>
<td>6. Lic. René Cortez</td>
<td>Head, Taxpayer Resolutions, Legal Division</td>
</tr>
<tr>
<td>7. Lic. Gustavo Manzano</td>
<td>Head, Tax Assessments, Legal Division</td>
</tr>
<tr>
<td>8. Lic. Sergio Bueno</td>
<td>Head, Notifications Dept, Legal Division</td>
</tr>
<tr>
<td>8. Lic. José Noe Cerón</td>
<td>Head, Taxpayer Service Division</td>
</tr>
<tr>
<td>9. Lic. Andres Solano</td>
<td>Head, Taxpayer Current Account Section, Taxpayer Compliance Division</td>
</tr>
<tr>
<td>10. Mr. Salvador Callejas</td>
<td>Head, Document Control Section, Taxpayer Compliance Division</td>
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</tbody>
</table>
ANNEX 2-A (English)

ORGANIZATION STRUCTURE
DIRECCIÓN GENERAL DE IMPUESTOS INTERNOS

ANNEX 2-B (Spanish)

ESTRUCTURA ORGANIZATIVA
DIRECCIÓN GENERAL DE IMPUESTOS INTERNOS
Annex 2-A Organizational Structure – DGII
(English)
Annex 2-B Organizational Structure – DGII (Spanish)