PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC18911

Project Name	Revenue Administration Modernization Project (P153366)
Region	LATIN AMERICA AND CARIBBEAN
Country	Guatemala
Sector(s)	General public administration sector (100%)
Theme(s)	Tax policy and administration (50%), Trade facilitation and market access (50%)
Lending Instrument	Investment Project Financing
Project ID	P153366
Borrower(s)	Ministry of Public Finance
Implementing Agency	Superintendencia de Administracion Tributaria
Environmental Category	C-Not Required
Date PID Prepared/ Updated	17-Dec-2014
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Concept Review Decision	Track I - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Guatemala has made significant development progress in the aftermath of a 36 year civil war in the mid-1990s. The Peace Accords signed in 1996 allowed for improvements in consolidating peace, building democratic institutions, and ensuring political and economic stability. It has also made progress in improving a number of human development outcomes (figure 1).

Economic growth in Guatemala has been weak despite prudent macroeconomic and fiscal management. Since 1990, real GDP growth per capita in Guatemala has averaged about 1.2 percent, around 3/4 of a percentage point less than the rate in the rest of Latin America and the Caribbean (LAC) and significantly less than other middle-income countries. But, volatility has been much lower than elsewhere in LAC due to prudent macroeconomic policies that have kept inflation and public debt at manageable levels, while avoiding fiscal imbalances that plagued much of the region . This helped Guatemala to avoid going into recession in 2008-09 but continue growing at an average rate of 2.8 percent during 2008-2012, recording 3.7 percent in real GDP growth in 2013 .

The country is still challenged by marked poverty and remarkably unequal distributions of income, resources and opportunities. Guatemala's human development index scores among the five lowest in Latin America and the Caribbean (LAC) , with 62.39 percent of the 15 million citizens living on less than US$4 a day in 2012 (Figure 2). From 2000 to 2011 extreme poverty ($1.25 USD a day) increased by around 16 percent. It is also one of the most unequal countries in LAC with a Gini coefficient of 0.52. Over the past decade, shared prosperity in LAC increased by 5 percent, yet in Guatemala it declined by 1 percent (see Figure 3), being the only country in the region where income fell for the population as a whole, although incomes for the bottom 40 percent fell less. The country has one of the highest child malnutrition rates in the world of 49.8 percent (2008/2009), which is particularly pervasive among the indigenous population.

To address existing development challenges, the current administration outlined an ambitious development agenda. The administration was elected on a platform based on five pillars: (1) democratic security and justice; (2) competitive economic development; (3) productive and social infrastructure for development; (4) social inclusion; and (5) sustainable rural development. The government has emphasized promoting transparency and reducing crime and violence, as these are considered the prime obstacles to development in Guatemala.

Guatemala continues working on improving its business climate, advancing the structural reform agenda. Its ranking on 2015 Doing Business has improved to 73rd position of 189 countries from 93rd position in 2013 Doing Business Report, with notable improvements of 12 positions on paying taxes from 66th to 54th position. However, in trading across borders in spite of a modest annual improvement of two positions, its rank of 102nd out of 189 countries remains quite low. As export-oriented and foreign-owned firms based in Guatemala City exhibit the strongest job growth rates, facilitation of cross border trade through more efficient custom and logistic services is important for boosting both economic growth and job creation.

Measures aimed at increasing revenues and improving the quality of expenditures are critical for boosting economic growth and achieving shared prosperity. Institutional strengthening of the revenue administration (SAT) is considered by country leadership, social partners and development agencies as a key element towards improving tax compliance, reducing fraud and corruption in customs, as well as improving the quality of business environment through reducing obstacles for efficient international trade and transit of goods through Guatemala. Increasing revenue collections through efficient tax and customs administration will help finance government social programs and strengthen service delivery to the vulnerable population thus enabling improve development outcomes for the citizens of Guatemala.

Sectoral and Institutional Context

Guatemala has one of the lowest revenue to GDP collection rates in the world relative to the size of its economy. Low revenue levels severely limit fiscal space to achieve its development objectives. With 10.7 percent of GDP in 2012, Guatemalan tax-to-GDP ratio is well below the LAC average of 15.7percent . While other countries with similar low levels of tax-to-GDP ratios have significant non-tax revenue sources, Guatemala does not (non-tax revenues are only 0.2 percent of GDP). Several attempts over the last two decades, including the recent comprehensive fiscal reform approved by Congress in February 2012, have not yielded significant improvements in the level of revenue collection. Instead of the expected increase of tax revenues by 1 percentage point of GDP, the tax reform resulted in a revenue increase of only 0.2 percent of GDP.

The low revenues severely constrain public investment and social sector spending with a significant impact on poverty alleviation and shared prosperity. Recent fiscal consolidation let to a cut in public spending, with Guatemala recording the smallest fiscal deficit since the 2008-09 financial crisis, albeit at the cost of significant cuts to public investment (only 3 percent of GDP in 2012) and the lowest social expenditure as a share of GDP in Central America (5 percent) . Without a substantial and sustained increase in domestic revenue collection public investment will remain inadequate to address Guatemalan infrastructure deficit and boost its economic competitiveness. Public debt remains low, at around 24 percent of GDP in 2012 , although it is in an upward trend and high in relation to tax revenues (221 percent), further highlighting the importance of mobilizing revenues .

The low revenue collection reflects both an unbalanced structure of the tax system and deficiencies in tax administration. The tax system remains highly unbalanced in its structure, with a bias towards indirect taxation. Indirect taxes account for over half of total tax revenues while direct taxes comprise only 27.9 percent. Of total direct (income) taxes, personal income tax is only 2.9 percent. VAT rates are among the lowest in Latin America, with numerous exemptions and loopholes. Direct taxes remain hampered by small tax bases, numerous exemptions, rampant evasion and widespread economic informality.

Tax revenues are not only low but also regressive. Fiscal incidence analysis based on the 2009-2010 National Survey of Family Income and Expenditures shows that the tax system and transfers do little to reduce inequality and poverty overall or along ethnic and rural-urban lines. Consumption taxes are regressive enough to offset the benefits of cash transfers as poverty after taxes and cash transfers is higher than market income poverty .

Much of the Guatemalan economy is informal. An estimated 74.5 percent of the economically active population represents an informal sector, thus contributing to low tax collection. Informality related to contraband and customs fraud accounts for estimated additional loss of government revenue of the order of 2.8 percent and 4.4 percent of GDP, respectively.

The World Bank financed and supported the implementation of tax reforms through Technical Assistance Loan during 1998-2008. The project supported the post-Peace Accords broad public sector reform agenda focusing specifically on improving the effectiveness and efficiency of tax and customs administration and increasing tax revenue. In spite of multiple challenges that included uneven political commitment, resistance to the reform agenda from vested interest, and frequent changes in senior administrative leadership, the project helped create an autonomous and professional Superintendency of Tax Administration (SAT), improve revenue collection by around 17 percent – from 8.8 to 10.3 percent of GDP between 1996 and 2006, and improve taxpayer's compliance. The new SAT, an institution that employs around 4,600 persons today, has strengthened strategic planning, professional internal audit, and human resource management functions. It also introduced streamlined business processes supported by the new information system, including the electronic filing of tax returns, and improved services to taxpayers through a network of client service centers. Although the project disbursed only 68percent of the total loan of $28 million, its performance was evaluated as satisfactory in the ICR.

The fiscal reform approved by Congress in February 2012, set the legal framework to tackle evasion and simplify tax compliance. The reform included two main components. First, anti-evasion laws to further strengthen the role of the SAT to control and audit VAT payments and personal income tax. The new legal framework includes measures to reduce the informal economy by incorporating small VAT taxpayers into the system. The second component includes reforms to both corporate and personal income tax, eliminates VAT credit, reduces deductions and includes transfer pricing. The reform also strengthened the capacity of the customs authority to fight contraband and customs fraud, and introduced changes to the custom administration that require the application of regional regulations. However, the positive effect of these reforms in 2013 was offset by a simultaneous decline in the collection of value-added taxes on imports. The shortfall in customs duties in spite of the increased volume of taxable trade suggests the deteriorating enforcement.

Presently tax revenue efforts are hindered by various constraints such as the high level of non-compliance, tax delinquency, and restrictive Constitutional provisions. The gains of the previous project in administrative capacity and in voluntary compliance have been only partially sustainable, due to the impact of vested interest and partial politicization of employment, especially at the senior levels. High levels of tax evasion that erode the tax base continue undermining both vertical and horizontal equity in the tax system, which is aggravated by the insufficient tax administration capacity to control tax payments and obligations. The Constitution and the legal framework include provisions that hinder the SAT enforcement capacity to collect taxes.

Driven by the imperative to increase revenues for government programs, and having exhausted the legislative space for tax policy reform, the Government asked the Bank to assess factors underpinning strengths and weaknesses of the SAT in revenue administration. In 2014, the Bank performed evaluations of the tax administration and customs procedures using its IAMTAX and CATT instruments. The IAMTAX qualified SAT as an average performer as benchmarked against international good practices. The CATT found that with some notable advances the Customs (Intendencia de Aduanas) still performs below the median global level, the finding supported by the Doing Business 2015 position on international trade (102/189).

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Jointly, IAMTAX and CATT reflect the following systemic strengths and weaknesses. While the legal and regulatory framework and strategic vision are ranked by IAMTAX slightly below 50% compliance with good practice, the operational performance is below the bottom of average performance with only 38% compliance. Especially low scores received such business management aspects as segmentation of taxpayers, quality and use of information, communication and cooperation with other public entities. Only slightly better fared the quality of tax audit and investigation, collection enforcement, and human resources management. With regard to efficiency of custom procedures, which impact trade facilitation, Guatemala has a wide margin for improvement. As of now the export/import operations last 17/16 days compared to an average of 10 days in OECD. The Customs continue to rely strongly on physical inspection of cargo (in 40 percent of cases, with important findings in only 3.5 percent of inspections) in place of a more effective application of risk analysis and management based on risk. Importantly that there is no comprehensive control strategy that would be designed based on the assessment of risks and involve various entities within a single logical casual chain. Efforts from the control of compliance unit (fiscalización) are independent from operational risk management, and auditing of domestic taxpayers is isolated from auditing of export/import operations, creating systemic inefficiencies.

Information management is of paramount importance for efficiency of tax administration. However, the IT systems in SAT reflect the fragmentation at the operational level, whereas the use of information is not well embedded in business processes. For example, Customs make very limited use of information on exporters from countries that are main trade partners regarding the cargo entering Guatemala. Cross checking of customs and tax compliance information, needed for better enforcement, is restricted due to the fragmentation of information systems. Investments in the information infrastructure have been neglected during the period of 2010-2013, and part of professional IT team has been lost to natural attrition. Capacity to analyze information is also limited. The operational capacities of the IT systems that were installed during the first Bank project have not been fully utilized. Information security is at risk because of unreliability of the systems, due to the recurring “blackouts”.

The Bank diagnostics identified the following areas for strengthening the tax administration: (i) streamlining, integrating and mapping business processes related to operations, risk-based controls and audit; (ii) aligning and strengthening information systems around a single information registry to support business processes and enable effective and efficient use of information; (iii) strengthening internal coordination among various SAT units (intendencias, gerencias) based on a common business strategy and supported by the access to a shared information database; (iv) improving merit based human resource management procedures, including better selection, career management, performance appraisals, training and professional development; (v) developing a strong cadre of modern managers for various SAT divisions that improve cooperation and coordination within the institution.

The proposed operation aims to address some of these core constraints to improve effective revenue administration, obtain buy-in from the technical staff and enhance the credibility of government reform efforts.

The Government of Guatemala is committed to strengthening the tax and customs administration and it is keen to enter a partnership with the World Bank. The Government aims to increase fiscal space so as to support an inclusive growth agenda. The Government and the Bank have maintained a direct and regular dialogue in 2014 and both partners have a clear understanding of the objectives and challenges of this cooperation, particularly on the political economy of the country. On this basis, the Government requested from the Bank to prepare a lending operation in support of the above outlined priorities. The Presidency of Guatemala attaches a priority importance to the requested project, so do and the Ministry of Public Finance and the SAT. Representatives of the private sector associations are interested in and supportive of Bank engagement aimed at improving SAT performance, as well as expect better services and more transparency, efficiency, professionalism and integrity from SAT officials.

However, the political economy of the country continues posing a challenge to further advancing with the fiscal and customs reform agenda. The difficulties in reaching agreements between the executive and the legislative branches of government had profound consequences in the past for the timely approval of new Government borrowing as well as for approval of domestic legislation. Coordination between the Executive and Legislature is likely to remain a challenge under the new administration that is expected to arrive following the general elections in September 2015. The absence of a simple majority in Congress and the fragmented nature of Guatemalan party system, pose challenges for garnering political support for the continuation of the administration’s reform.

Relationship to CAS

The CPS FY13-FY16 emphasizes the need to increase state capacity in order to enhance the

Guatemala long-term growth potential and move toward a more equitable society. Limited state capacity has been detrimental to long-term growth prospects as it has resulted in lower public investment, lack of modern infrastructure as well as limited spending on building the human capacity of the country . The CPS pursues two strategic objectives: (i) strengthen public policies for social development; and (ii) promoting inclusive and sustainable economic growth.

The project is aligned with CPS FY13-FY16 strategic framework and the Government development agenda for implementing the fiscal reform, boosting competitiveness and enhancing security. The proposed operation will support both pillars of the CPS and the Government efforts to create fiscal space by mobilizing more sources of revenue for addressing country economic and social constraints. The project also intends to boost competitiveness and ensure security by targeting trade facilitation through enhancing performance of border crossing and endeavor to help set the country on a higher growth trajectory.

Project objectives are strongly backed by the current administration and enjoy broad support from the civil society. Assessment of impact of the political cycle will be an important aspect of project design and dialogue with political factions and the private sector will be practices to enhance the likelihood of approval and implementation of the operation, given the risky political environment.

The Bank is well placed to support the reform agenda, having been an active contributor in previous fiscal policy and tax administration reforms in Guatemala, including the creation of the SAT in 1998. The Bank team draws from the rich global experience with supporting tax and customs reform globally.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The principal project stakeholder is the Superintendencia de Administración Tributaria (SAT). SAT stands to benefit from (i) strengthening its organizational, managerial and technical capability, and (ii) upgrading and integrating its information management systems that support SAT business needs. Other important stakeholders are the Ministry of Public Finances (MPF) and the Government as a whole that expect improvements in revenue collection. And finally, the private sector, including importers and exporters, expects improved service provision to tax payers and the commerce community.

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The development objective of the proposed operation is threefold: (i) to increase tax compliance while reducing its cost for taxpayers through fair and transparent application of the tax law; (ii) to improve efficiency of revenue administration; and (iii) to facilitate cross-border commerce.

Key Results (From PCN)

Indicators:

A.Customs Performance indicators

a. Performance in trade facilitation
• Reduced cost of compliance. Reduce customs release time
• Reduced number of documents required for border/customs clearance to less than 5. Source: agency records, administrative data, survey

- Reduced average customs clearance time to less than 6 hours. Source: Doing business, agency records, administrative data, and client surveys.
- Increase in the number of export/import declarations processed per staff. Source: agency records, administrative data.
- Real time tax and customs information

b. Accountability and Transparency
- Improved perception of traders and other stakeholders regarding the quality of service, responsiveness to complaints, and integrity of customs administration. Source: client and staff surveys
- Fairness: Reduced number of complaints/Improved perception of fairness

c. Compliance strategy using risk management
- Amount of adjustments made as a result of post-clearance audit. Source: administrative data

B. Tax and policy administration indicators

a. Performance using risk-based criteria for compliance management
- Reduced cost of tax compliance. Number of hours to comply with the tax obligations (for large and medium businesses)
- Number of tax declarations processed/ number of tax administration staff. Source: agency records, administrative data
- Reduction in the VAT gross compliance gap. Source: agency records, administrative data
- Increased % of tax compliance. Indicator: Reduce the tax gap Source: SAT records
- Amount of adjustment made during audit per auditor. Source: agency records, PEFA
- Value of total arrears at end of fiscal year / total tax collected for fiscal year (average %)
- Reduce the cost of administration per Quetzal collected

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b. Accountability and transparency
- Public perception of integrity in all aspects of the tax administration. Source: client surveys
- Fairness: Reduced number of complaints/Improved perception of fairness

c. Voluntary compliance
- Number of returns filed / number of returns to be filed according to the law
- Number of tax declarations received on time / total number of tax declarations filed
- Average time to comply (in hours). Source: Doing Business survey
- Improvement in perception of taxpayers regarding the quality of service provided by the tax administration

III. Preliminary Description

Concept Description

The proposed project would support the strategy of the Government for a comprehensive modernization of the tax and custom administration system and improve trade facilitation. Substantive tax administration initiatives would seek to address the major shortcomings in tax administration by expanding the tax base, modernizing collection processes, fostering voluntary compliance, and strengthening tax enforcement procedures.

The proposed operation is an IPF for a tentative amount of $40.0 million. The implementing agency will be the SAT, with the Planning and Institutional Development Unit playing the Project Coordination role. The operational and fiduciary capacity of a project implementation unit, placed in SAT, will be strengthened through the proposed operation. Various SAT divisions will be responsible for technical implementation, while the Ministry of Public Finances (Ministerio de Finanzas Públicas, MFP) will play an important supporting and oversight role. A Steering Committee will be set up to facilitate inter-agency coordination; and an Operational Manual will define roles, responsibilities, coordination and procedures for project implementation, monitoring and reporting results.

The project would consist of the following five components, as described below. The proposed components deal with the core processes of tax administration and customs with particular focus on gathering, processing and using information as the main tool to enhance compliance. Additionally, the project will target strengthening institutional, managerial and technical capabilities of the SAT core divisions and decentralized entities.
Component 1: Strengthened institutional framework of revenue administration

Subcomponents:
a. Modernization of SAT based on a Functional and Organizational Review that covers legal, organizational, managerial, business processes, information management, internal controls, financial, and personnel (HR) management aspects. (HR management includes HR planning, selection, professional development, capacity building, rotation and career progression)
b. Strengthening the capacity for tax policy analysis and revenue forecasting
c. Enhancing SAT enforcement capabilities
d. Strengthening the organizational capacity for tax intelligence
e. Strengthening the litigation and legal defense capacity of the Legal Unit within SAT

Component 2: Strengthening Customs Performance at Selected Maritime and Land Border Crossings

This component would support the modernization of the customs administration, focusing primarily on improved customs procedures, information management, and human resources management. The component will also support upgrading the IT infrastructure of Customs to facilitate better administration of the selected maritime and land border crossing areas.

Subcomponents:
a. Modernizing Custom Infrastructure (incl. provision of Scanners, Video cameras, upgrading Physical Infrastructure)
b. Redesigning (streamlining) custom processes, including strengthening control systems based on risk concept, and enhancing the use of importer/exporter information
c. Building Personnel Technical and Management Capacity and align HR Management with Business Needs
d. Implementing an Information Technology System in the Customs as part of an integrated SAT system (jointly with component 3)

Component 3: Managing information and integrating IT systems

The primary objective of this component is to reduce evasion of paying taxes and custom duties and increase voluntary compliance with tax laws through modernization of the IT function. To this end, subcomponents seek to enhance the core task of information gathering and accessing through a revamped IT infrastructure, and integration of subsystems around a common data warehouse. Particular attention will be devoted to the modernization of customs information systems.

Subcomponents:
a. Developing analytical capacities to use collected information effectively
b. Implementing an integrated information management system on a single platform

Component 4: Setting the foundations for transparency and fair application of tax legislation

The main objective of this component is to make information available to all stakeholders, establish a two-way dialogue between the SAT authorities and private sector contributors to share information and exchange feedback on legal and operational aspects of SAT operations, and monitor adherence to the legal and normative framework, as well as agreements between the Government and the private sector.

Subcomponents:
a. Revising the legal framework to enable public access to fiscal information
b. Implementing online publishing of tax regulations and relevant fiscal information
c. Setting up a Participation Council to enhance the dialogue between SAT and its clients

Component 5: Project Coordination and Strategy Development

This component would support all necessary project coordination, execution, and monitoring and evaluation activities at SAT and related entities.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		✖	
Natural Habitats OP/BP 4.04		✖	
Forests OP/BP 4.36		✖	
Pest Management OP 4.09		✖	
Physical Cultural Resources OP/BP 4.11		✖	
Indigenous Peoples OP/BP 4.10		✖	
Involuntary Resettlement OP/BP 4.12		✖	
Safety of Dams OP/BP 4.37		✖	
Projects on International Waterways OP/BP 7.50		✖	
Projects in Disputed Areas OP/BP 7.60		✖	

V. Financing (in USD Million)

Total Project Cost:	40.00	Total Bank Financing:	40.00
Financing Gap:	0.00		
Financing Source			**Amount**

Borrower	0.00
International Bank for Reconstruction and Development	40.00
Total	40.00

VI. Contact point

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