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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

GUATEMALA

TAX MANAGEMENT AND TRANSPARENCY PROGRAM

(GU-L1096)

LOAN PROPOSAL

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CONTENTS

Annexes	
Annex I	Summary Development Effectiveness Matrix (DEM)
Annex II	Policy Matrix

Electronic Links

Required

1. Policy Letter
2. Means of Verification Matrix
3. Results Matrix

Optional

1. Economic Analysis of the Program
2. Monitoring and Evaluation Plan
3. Safeguards Policy Filter
4. Política Fiscal para el crecimiento con equidad en Guatemala (2016) [Fiscal policy for growth with equity in Guatemala (2016)]
5. Guatemala. Plan de gestión para control tributario con alto impacto de recaudación [Management Plan for Tax Control with High Tax Collection Impact] (Mauro Andino) 2016
6. Tax Investigation Office – Tax Intelligence (May 2016)
7. Enhancing the IDB's Borrowing Member Countries' Work on Transparency and Accountability. Midterm Review of the Regional Technical Cooperation Operation "Strengthening the Integrity of Financial Systems: Improving the Capacity to Prevent Money Laundering and Terrorist Financing" (RG-T2224; ATN/AA-13696-RG)

ABBREVIATIONS

CICIG	Comisión Internacional Contra la Impunidad en Guatemala [International Commission against Impunity in Guatemala]
COPRECLAFT	Comisión Presidencial de Coordinación de Esfuerzos contra el Lavado de Dinero u Otros Activos, el Financiamiento del Terrorismo y el Financiamiento de la Proliferación de Armas de Destrucción Masiva [Presidential Commission for the Coordination of Efforts against the Laundering of Money or Other Assets, Terrorist Financing, and the Financing of the Proliferation of Mass Weapons of Destruction]
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
IMF	International Monetary Fund
MINFIN	Ministry of Finance
PAPTN	Plan de la Alianza para la Prosperidad del Triángulo Norte [Plan of the Alliance for Prosperity in the Northern Triangle]
PBL	Policy-based loan
PCR	Project Completion Report
MP	Ministerio Público [Attorney General's Office]
RTU	Registro Tributario Único [Master taxpayer registry]
SAT	Superintendencia de Administración Tributaria [Office of the Superintendent of Tax Administration]
SIB	Superintendencia de Bancos de Guatemala [Office of the Superintendent of Banking of Guatemala]
VAT	Value-added tax

PROGRAM SUMMARY

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Financial Terms and Conditions				
Borrower: Republic of Guatemala			**Flexible Financing Facility**[a]	
			Amortization period:	20 years
Executing agency: Ministry of Public Finance			**Original WAL:**	12.75 years
			Disbursement period:	2 years
			Grace period:	5.5 years
Source	**Amount (US$)**	**%**	**Inspection and supervision fee:**	[b]
IDB (Ordinary Capital)	250,000,000	100	**Interest rate:**	LIBOR-based
			Credit fee:	[b]
Total	250,000,000	100	**Currency of approval:**	U.S. dollars from the Ordinary Capital

Program at a Glance
Program objective/description: The program's objective is to improve the tax management and transparency of Guatemala's financial sector, through policy measures aimed at increasing tax revenues and strengthening asset laundering prevention. The program is structured as a multiple-tranche policy-based loan, the proceeds of which will be disbursed in two tranches of US$125 million each.
Special contractual conditions precedent to the disbursement of each tranche of the loan: The disbursement of each of the two loan tranches will be subject to fulfillment of the policy reform conditions established for each tranche, in accordance with the Policy Matrix (Annex II) and the conditions set forth in the respective loan contract (paragraph 3.3).
Exceptions to Bank policies: None.

Strategic Alignment			
Challenges[c]:	SI ☐	PI ☑	EI ☐
Crosscutting themes[d]:	GD ☐	CC ☐	IC ☑

[a] Under the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

[b] The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

[c] SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

[d] GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. PROGRAM DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 **Macroeconomic and social context.**[1] Guatemala has maintained stable growth rates over the last 10 years, with an average increase of 3.7% over the 2006-2015 period, which is above the average in Latin America and the Caribbean (3.2%). However, per capita income has lagged behind the rest of the region, due to the high population growth rate.[2] This has contributed to the rise in the incidence of poverty, from 51% in 2006 to 59.3% in 2014, and the sustained high level of inequality, which is one of the highest in the region.[3]

1.2 The external sector has shown favorable growth. The current account deficit was 0.5% and 0.7% of gross domestic product (GDP) in 2014 and 2015, respectively, lower than the figures recorded in previous years (between 2001 and 2013, the current account showed an average deficit equivalent to 2.9% of GDP). This decrease is largely explained by the surge in remittances from abroad and the lower cost of oil on international markets. Moreover, net international reserves stood at US$7.751 billion, equivalent to 4.2 months of imports and 1.7 months of short-term external liabilities.

1.3 The decrease in oil prices also had a moderating effect on inflation, which was 2.95% in 2014 and 3.07% in 2015, respectively, near the lower limit of the 3%-5% target range set by the monetary authority. Inflation has increased in 2016 because of food prices, which rose an average of 4.4% for the 12-month period ending in June. Nevertheless, the medium-term expectation is that inflation will remain at around 4% (International Monetary Fund (IMF), World Economic Outlook, April 2016).

1.4 **Fiscal position**. Between 2007 and 2015, government revenue fell by 2.1 percentage points of GDP, standing at only 10.8% of GDP, the lowest in Latin America,[4] due primarily to the increase in tax evasion, given that there was no significant tax reduction.[5] The central government's primary balance improved from a deficit position of 1.8% of GDP in 2010 to near fiscal balance in 2015 (-0.1% of GDP). As a result, public debt remained relatively stable, at levels that did not exceed 25% of GDP. Fiscal balance was achieved at the expense of a reduction in primary public spending, which was 10.7% of GDP in 2015 (12.8% in 2007). The result is that Guatemala has public investment and social expenditure levels that are among the lowest in the region.[6] This situation puts significant limits on the

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1 FMM-CDC Technical Note: Fiscal Policy for Growth with Equity in Guatemala (2016).

2 Between 2011 and 2014, per capita income rose at a rate of 1%, on average, which is only 39% of the average in Latin America and the Caribbean.

3 The Gini Index for Guatemala was 52.4 in 2011, the fifth highest among 15 Latin American and Caribbean countries, and higher than the average of 49.05 (*World Bank Data*).

4 In the previous two decades, public revenue was around 12% of GDP.

5 Non-payment of value added tax (tax evasion) increased from 1.8% of GDP in 2012 to 2.14% of GDP in 2014. Although income tax rates decreased under the 2012 reform, the low tax ratio is due primarily to the drop in VAT revenue.

6 Spending on education and health was only 2.6% and 2.4% of GDP, respectively, far below the average in Latin America and the Caribbean (4.4% and 4.2%). Public investment in Guatemala was 1.3% of GDP in 2015, the lowest level in Latin America and the Caribbean, which has an average public investment rate of 5.6% of GDP.

government's ability to close wide social gaps[7] and achieve greater growth with inclusion.

1.5 **Problems and their causes**. Due to a lack of institutional capacity, the Office of the Superintendent of Tax Administration (SAT) is not able to collect taxes in an efficient and effective manner. This problem is in turn compounded by insufficient transparency in the financial sector and the significant risk of asset-laundering activities and the financial crimes that come with it.[8]

1.6 The tax ratio in Guatemala was only 10.2% of GDP in 2015, one of the lowest tax efforts in the region, which accounts for less than 40% of its tax-paying capacity (the maximum tax revenue the country could achieve, given its level of development, openness of the economy, income distribution, and perception of corruption).[9] Although tax rates in Guatemala are not high, the low tax ratio is primarily the result of inefficiency in the collection of taxes, which is in turn caused by high rates of tax evasion and the lack of efficiency of SAT employees, as described in paragraph 1.9.

1.7 With regard to asset-laundering activities and financial crimes, the 2015 Anti-Money Laundering Index produced by the Basel Institute on Governance estimates that Guatemala has a medium risk (77th out of 152 countries) and was one of the four countries that had the greatest increase in risk in 2015, higher than the risk in other countries of the region such as Mexico, El Salvador, Colombia, and Peru. The index measures the money laundering risk level based on an aggregation of 14 indicators that assess the strength of the institutional framework for combating money laundering and corruption, as well as financial transparency and rule of law. One of these indicators is based on the assessments made by the Financial Action Task Force (FATF).[10]

1. SAT management of tax and customs revenue and coordination with the *Ministerio Público* [Attorney General's Office] (MP)

1.8 The Office of the Superintendent of Tax Administration (SAT) was created as a legal entity in 1998 by Congressional decree. It is a decentralized government agency with functional, economic, financial, and administrative autonomy and its own assets and resources. Its outdated regulatory framework vis-à-vis economic changes and the increase in organized crime over time has prevented the SAT from having an appropriate organizational structure for effective and rigorous control over the integrity of its employees, and from improving the oversight of tax collection, which are necessary in order to reduce tax evasion and improve the institution's efficiency. The SAT's powers and duties are complemented by those of the MP, which is responsible for criminal investigation activities related to tax fraud.

1.9 The SAT has experienced serious corruption problems in recent years. In April 2015, the country faced one of the biggest political crises in recent history, which involved

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[7] Among the worst social problems are the high rates of infant chronic malnutrition (50%), maternal mortality (140 deaths per 100,000 live births), low secondary education coverage (65%), and a high proportion of young people who do not study or work (28%).

[8] Returns or transactions on which taxes are not paid are typically hidden from the tax authorities, and then need to be reintroduced into the legal economy through an asset-laundering process so they can be used.

[9] Fenochietto and Pessino (2013), IMF, Working Paper 13/244.

[10] In another indicator, *Moody´s Investors* gives Guatemala a low negative rating in the area of Institutional Strength, where corruption control has a weight of 25%.

the highest levels of government.[11] Some of the identified problems are: (i) the SAT governance model, which has a strong private sector presence on its Board of Directors, thereby creating a potential conflict of interest;[12] (ii) low coverage of comprehensive employee evaluation and control;[13] (iii) the fragmentation of investigation, risk analysis, and tax intelligence functions in second-tier organizational units;[14] (iv) the low, declining level of integrity and productivity of SAT employees;[15] (v) poor management of large tax gaps;[16] (vi) the outdated master taxpayer registry (RTU);[17] (vii) ineffective macro processes for collecting value-added taxes (VAT), income taxes, and customs duties;[18] and (viii) the highly vulnerable state of its control technology at ports and airports, including weaknesses in invoice control.[19]

1.10 The number of tax fraud cases filed by the SAT has been decreasing in recent years, from 322 cases in 2013 to 122 in 2014, and 110 in 2015 (Source: SAT annual reports for those years), making it difficult to combat tax fraud. The SAT is responsible for initiating administrative proceedings, which are subsequently transferred to the MP, where substantive criminal investigations are conducted. The main causes of this problem also include weaknesses in the MP, such as a lack of proper coordination with the SAT and a lack of institutional architecture that would provide sufficient autonomy and independence to deal with criminal prosecution, particularly in high impact cases involving strong political and financial interests.[20] This situation gave rise to the reform of the Act Establishing the Attorney General's Office, in order to

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11 In April 2015, the MP and the International Commission against Impunity in Guatemala (CICIG) announced an investigation of corruption in the tax administration (the "La Línea" tax fraud network). The investigation found serious instances of corruption in the SAT and numerous cases of fraud in VAT refunds, invoicing, inspection and ports, and money laundering, among others, which implicated the SAT's principal executives.

12 The SAT Board of Directors rules in first instance on the acts of the administration, including tax claims, which constitutes a potential conflict of interest. More than 50% of the members of the Board represent the private sector.

13 In the last four years, less than 20% of SAT officials submitted sworn declarations of assets.

14 This fragmentation is reflected in 265 information technology systems that do not communicate with each other. The SAT estimates that the impossibility of cross-referencing VAT data for checking fraudulent requests alone could be costing the tax authority around 600 million quetzales a year (1.2% of the amount collected annually).

15 The total average tax revenue collected per SAT employee fell 7.3% in real terms between 2013 and 2015. Source: SAT.

16 VAT evasion was 29.9% in 2014, an increase of more than 4 percentage points since 2012 (25.6%). The SAT estimates tax evasion in 2015 to be 34.2%. Management of the deficit is weak due to the fact that the calculation is only done for the VAT and not for income taxes and other revenue. In addition, the VAT gap that is calculated is not used as feedback to improve tax intelligence activities.

17 There is a high incidence of taxpayers who cannot be located, unreliable data on the economic activity performed, and a very high percentage of inactives (25%). Source: IMF.

18 Current macro processes and their procedures manuals make it possible, for example, for ranges of VAT invoicing to be authorized with no physical inspection of the establishments or studies on the volume of activity. In addition, the lack of requirements and control of GEFASES (electronic billing companies) makes it possible for one invoice to be used as credit by several firms.

19 The VAT on imports is nearly 60% of total VAT revenue collected in the country, and fell by 0.3% of GDP in 2015, primarily due to the tax fraud case that was investigated in "La Línea."

20 Attorney General's Office of Guatemala, "*Plan Estratégico del Ministerio Público de Guatemala 2015-2019*."

establish clear criteria for removing the Attorney General, thereby giving the institution greater political independence.

1.11 The foregoing, in addition to compromising the credibility of the SAT as an institution, has affected the level of tax collection, which had reached its maximum level in 2007 when it represented 12.1% of GDP. In 2015, it fell to its lowest level in the last decade, i.e. 10.2% of GDP (see Table 1). Between 2014 and 2015 the tax ratio decreased by 0.6% of GDP, whereas GDP increased 4.1%.

Table 1. Tax Revenues, 2007-2015 (% of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Tax revenue	12.1	11.3	10.3	10.4	10.9	10.8	11.0	10.8	10.2
Direct taxes (income, property, etc.)	3.3	3.3	3.2	3.1	3.4	3.4	3.8	3.9	3.6
Indirect taxes	8.8	8.0	7.2	7.3	7.4	7.4	7.2	6.9	6.6
Value-added tax	5.9	5.5	4.9	5.1	5.3	5.3	5.2	5.1	4.8

Source: Ministry of Finance of Guatemala, IMF.

1.12 The current government, which came into office in early 2016, has been taking decisive steps to restructure, strengthen, and replace SAT human resources. To this end, hiring, training, and onboarding processes were strengthened. Of the approximately 4,500 employees the agency had in 2015, around 1,100 were eliminated in 2016 and are being replaced by new, better-trained personnel. The SAT has been improving staff training by developing an intensive training plan and monitoring its implementation. Of the 200 courses included in the plan, 93 were offered between January and August of 2016, in contrast with the average of 14 hours of training hours per employee in 2015. The institution plans to increase the number of training hours in coming years. The current SAT leadership was selected based on demanding integrity and competency checks.

2. Money-laundering control

1.13 The problem of the SAT's insufficient institutional capacity to reduce tax evasion is related to illicit financial flows and asset laundering activities in the country. In general, tax evasion is one of the main crimes associated with lack of financial transparency and money laundering, due to the fact that returns or transactions on which the applicable taxes were not paid are hidden from the tax authorities and must then be reintroduced into the legal economy through an asset-laundering process, so they can then be used. Guatemala in particular has been recently affected by several scandals, including accusations of laundering of assets[21] that filtered through the country's financial system. In some of these cases, which appear

[21] Asset laundering is defined as the transfer of money and other assets between individuals or legal entities, which were obtained through illegal activities (bribes, tax evasion, contraband, drug trafficking, etc.), in order to hide them from the tax authorities and later reintroduce all or part of them into the legal economy. This activity relies on a two-fold undue advantage: one, with respect to its origin, and two, in terms of the re-use of "legitimized" resources, which creates unequal competition and distorts incentives for legal investment. D. Kar and D. Cartwright-Smith. 2008. "*Illicit Financial Flows from Developing Countries*, 2002–2006." *Global Financial Integrity (GFI)*, Washington, D.C.

in the "La Línea" investigation, assets from fraud schemes in the context of the SAT's operations were laundered.

1.14 The organization Global Financial Integrity (GFI) produces annual estimates of illicit financial flows[22] for a significant number of countries. In Guatemala, GFI estimates that illicit financial flows between 2004 and 2013 averaged US$2.179 billion per year, for a total of US$21.793 billion over that period.[23]

1.15 In turn, the magnitude of illicit flows is related to the level of financial secrecy of a country's financial sector. The organization *Tax Justice Network* publishes the *Financial Secrecy Index,* which measures, among other things, the level of financial sector secrecy in approximately 100 countries. In this index, Guatemala is among the countries with relatively high secrecy, with a score of 76 (100 represents the highest financial secrecy).

1.16 In the case of Guatemala, one of the principal causes of secrecy in the financial sector is the apparent use of offshore financial mechanisms (financial activities located outside the country of residence of their beneficiaries) to facilitate asset laundering.[24] Although in principle these mechanisms can be used legitimately, inadequate regulations or their abuse may reinforce the evasion and asset laundering cycle.[25] The lack of transparency of Guatemala's offshore sector is clear from the FATF reports and the IMF's Financial Sector Assessment Program (FSAP) documents.

1.17 The FATF is the international organization that develops and governs the standards[26] that countries must adopt and implement to combat asset laundering and terrorism financing. The latest assessment of Guatemala in terms of compliance

[22] According to recent studies, it is clear that illicit financial flows are a major obstacle to development and economic growth, in that they reduce the capital available for investment as well as investor confidence. They decrease the availability of public resources, by disincentivizing the payment of taxes, and lastly, they undermine the quality and accountability of democratic institutions. Alessandra Fontana, Martin Hearson, *Illicit financial flows and measures to counter them: An introduction. U4 Anti-Corruption Resource Center*, *Norway*, 2012.

[23] The magnitude of illicit financial flows at the international level is an area of discussion. Murphy (2008) argues that estimates of loss vary. Christian AID (2008) indicates that transfer pricing manipulation and abuses related to this practice result in a corporate tax revenue loss in the developing world of at least US$160 billion a year. Raymond Baker (2005) proposes that total annual illicit financial flows may be as high as US$1 trillion. Of this amount, Baker estimates that around US$500 billion per year flows from developing countries and those in transition. Source: Richard Murphy*, Accounting for the Missing Billions,* in *Draining Development?: Controlling flows of illicit funds from developing countries*, edited by Peter Reuter, *World Bank* 2008.

[24] According to a recent analysis conducted by the International Consortium of Investigative Journalists (ICIJ), with 444 financial intermediaries involved, Guatemala is the sixth largest user of the services of the law firm Mossack Fonseca, which was at the center of the "*Panama Papers*" scandal.

[25] As the *Bank for International Settlements* points out, the transparency of information produced by banks is essential for a country's financial sector: "As public disclosure increases certainty in the market, improves transparency, facilitates valuation, and strengthens market discipline, it is important that banks publicly disclose information on a regular basis that enables market participants to make informed decisions about the soundness of their liquidity risk management framework and liquidity position." *Bank for International Settlements*, Proposed enhancements to the Basel II framework, 2009.

[26] Formally known as FATF Recommendations – International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation. In this document, we will simply refer to "the Standards".

with FATF standards is from 2010.[27] With regard to the regulation of offshore banking operations, the FATF's 2010 evaluation of Guatemala underscores the lack of availability of information on these entities. The lack of any updates to Guatemalan legislation in the area of asset laundering could at a minimum lead to an FATF finding of possible technical noncompliance with the Standards. This involves the possibility that the organization could classify the country as a jurisdiction with technical deficiencies, with the ensuing reputational and economic costs.[28]

1.18 In view of these problems, Guatemala has undertaken to step up its efforts to update its principal legal instruments related to financial transparency and demonstrate their effectiveness. Anticipating this point, the IMF's 2014 Article IV Consultation report indicates that the country's authorities should comply with the FSAP recommendations, with emphasis on a gradual introduction of the Basel III rules, thereby strengthening the consolidated supervision and regulation of offshore banks. This essentially involves adapting legislation to current FATF standards.

3. The Bank's experience in the country and in the sector, and lessons learned

1.19 **The Bank's experience in the country**. The K'atun Nuestra Guatemala 2032 National Development Plan identifies evasion, avoidance, contraband, tax expenditures, and informality as the problems that have impeded tax burden growth, since they represent imbalances in the tax system, weakening its equity and neutrality, having a drastic impact on the population's most vulnerable segments, and causing strong fluctuations in social spending and investment. As a result of the above, the National Development Plan identifies fiscal policy—an engine of stability and inclusive economic growth—as a priority, recognizing that continuous and sustained economic growth is a prerequisite for generating the revenue necessary to address social situations that generate poverty and exclusion.

1.20 Accordingly, the government headed by President Jimmy Morales designed its 2016-2020 Government Plan based on an approach the premise of which is to improve the standard of living of Guatemalans and reduce poverty. To this end, the government is implementing a plan based on two main themes—participatory democracy and territorial management—that include five components: Transparency, Health, Education, Economic Development, and Citizen Security. On the basis of those five components, 12 priorities have been identified that will chart

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[27] In 2012 the FATF adopted a new version of the Standards. The new evaluation of Guatemala, based on the new Standards and the new evaluation methodology, is expected to be completed in late 2016. Importantly, the FATF's new evaluation methodology is more demanding, since it not only asks the countries to comply with the implementation of a legal framework aligned with the Standards, but also to demonstrate the framework's effectiveness.

[28] Several authors have pointed out the negative effects of being listed by the FATF as a noncompliant country, such as Masciandaro "Is the Anti Money Laundering Compliance Convenient? International Capital Flows and Stigma Effect in Latin America: The Case of Paraguay," Inter-American Development Bank 2013. In the same vein, after analyzing 36 Latin American and Caribbean jurisdictions between 1960 and 2010, Arruda and Farias found that poor institutional performance by a jurisdiction (AML rankings, black lists with non-cooperating countries, and corruption indicators) negatively affects the investment-GDP ratio, the foreign direct investment-GDP ratio, and financial development (Relationship between credit markets and GDP). Maria Elisa Farias and Monica Arruda De Almeida, "Does Saying 'Yes' To Capital Inflows Necessarily Mean Good Business? The Effect of Antimoney Laundering Regulations in the Latin American and Caribbean Economies," ECONOMICS & POLITICS, Volume 26 March 2014.

the current administration's path. It is important to emphasize that the priorities of Open and Transparent Government and Fiscal Sustainability seek to strengthen public finance through a series of actions to increase public revenue and improve the efficiency of expenditure.

1.21 Based on the foregoing, since early 2016, the Bank has been supporting the current government administration through a process to modernize the SAT. In this context, the Bank coordinates technical assistance activities with the Office of Technical Assistance (OTA) of the U.S. Department of the Treasury, and has an ongoing dialogue with the IMF, which seeks to identify recommendations for the sector. It also coordinates with the World Bank, which is preparing a future investment loan to support the SAT, and a multisector policy-based loan that would include certain aspects of the fiscal sector.[29] The OTA's priority is to support the modernization of Puerto Quetzal, an activity that is included in the policy actions of this program and was coordinated between both institutions. The Bank's Fiscal and Municipal Management Division (FMM) has been supporting the SAT through a number of technical assistance operations to define a medium-term strategic plan and a short-term action plan for its modernization, including the preparation of an investment loan to support the SAT (GU-L1162), which may include additional technical-cooperation funding.

1.22 In terms of the country's fiscal management, the Bank supported the approval of a tax reform in 2012 with the Fiscal Consolidation Program for Guatemala (2764/OC-GU), which sought to increase tax collection and expand the tax base. The reforms promoted include the approval of the Anti-tax Evasion Act II, which introduced measures to strengthen tax management, and the Tax Update Act. These measures helped increase tax revenue by 0.2 percentage points of GDP between 2012 and 2013, which was less than expected (1 percentage point).[30] There were also improvements in tax system equity. In particular, the expansion of the tax base subject to income taxes, the reduction of tax exemptions, and the simplification of income taxes for workers made for a more progressive system.

1.23 Guatemala has received technical assistance from the Bank on the prevention of asset laundering (ATN/AA-13021-GU). The Bank is also preparing an operation to support the Attorney General's Office (GU-L1095), the general objectives of which complement those of this program, particularly in terms of modifying the current case management system and standardizing the stages of crime investigation and prosecution, in order to make the solving of corruption crimes more efficient.

1.24 **The Bank's experience in the sector**. The Bank has supported several reforms of tax administrations in the region in recent years, with very positive results. The current operation takes into account the tax management strategies implemented in other countries, such as the one in Ecuador in 1998-2003 (1062/OC-EC), which enabled the Internal Revenue Service to increase tax collection from 6% to 11% of GDP; or the Fiscal Reform Support Program in Honduras (2452/BL-HO), which

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[29] The Bank's project team and the World Bank coordinated the inclusion of the SAT Act in GU-L1096 as well as eventually in the World Bank's multisector policy-based Loan, given the importance of this reform, which warrants acknowledgement by both institutions.

[30] After the Act was approved, the Constitutional Court found evidence of unconstitutionality in some of the articles, while the government made additional adjustments to the Act, all of which affected the original scope of the reforms.

helped increase tax collection by 2.3% of GDP in 2010-2011; and the Program for the Institutional Strengthening of the Internal Revenue Service of the Dominican Republic (1902/OC-DR), which increased tax collection by 2.1% of GDP over the 2006-2013 period (Source: Project Completion Reports for these loans).

1.25 In the area of financial transparency, the Bank also has extensive experience supporting the countries, primarily in terms of the development and implementation of a financial transparency technical assistance program (ATN/AA-13696-RG, ATN/AA-15291-RG, and ATN/AA-13021-GU), which were financed by the Bank's Transparency Fund. This program is based on three pillars: (i) national risk assessments and national strategies to combat money laundering; (ii) institutional capacity building for the agencies that regulate the anti-laundering framework, and support for legal reforms that comply with the FATF Standards; and (iii) generation and dissemination of knowledge. This program has supported 12 countries in the region in their efforts to strengthen their institutional frameworks to combat money laundering. The program has achieved significant results, for example, by providing support to four countries (Ecuador, Nicaragua, Panama, and Paraguay) in their successful efforts to be removed from the FATF "Gray List" (list of countries with strategic deficiencies for which they have developed an action plan with the FATF), and introducing legal reforms in six countries. The Bank has also supported the inclusion of financial integrity components in loan operations. For example, policy program 3146/OC-PN included a component on Strengthening Financial Transparency, which incorporated policy measures for passing a bill.

1.26 **Lessons learned**. This program took into account the lessons learned by the Bank in the three loans mentioned in paragraph 1.24 (see Project Completion Reports for loans 1062/OC-EC, 2452/BL-HO, and 1902/OC-DR). Of note is the need for the Bank and the executing agency to connect on all critical issues that arise during program execution, through frequent meetings and direct consultations, as necessary. In addition, the program was designed based on the priorities in the diagnostic assessments performed by the government, the Bank, and other involved institutions, such as the IMF and the World Bank, with the guaranteed participation of other public institutions. As with all PBLs, the sustainability of the improvements must be promoted. In this case, in order to minimize risk, the design of the reforms considered Guatemala's recent history (primarily loan 2764/OC-GU) and prioritized the inclusion of a greater number of actions with less risk and high impact, largely depending on the institutions that are directly involved—the SAT, the Office of the Superintendent of Banking of Guatemala (SIB), and the Ministry of Public Finance (MINFIN)—and have a solid core staff with technical and managerial leadership and strong political support from the government.

1.27 In addition, the program design incorporated the lessons learned from the Bank's work on financial integrity issues, including the principal conclusions of the midterm evaluation of the financial integrity technical assistance program (ATN/AA-13696-RG). Of particular importance is the need to: (i) ensure coordination between the different entities responsible for the regulation and oversight of the anti-laundering framework; (ii) implement a comprehensive institutional strengthening approach for the sector; (iii) design a sound framework for measuring results; and (iv) consider sustainability issues during the early phases of the program. Diagnostic assessments conducted by the government, the FATF, the Bank, the IMF, and other relevant institutions were used and in cooperation with these organizations, based on a working model already tested for the Bank's financial integrity technical assistance program in Guatemala (ATN/AA-13021-GU, Information Tools to Improve Capacity for the Prevention of Asset Laundering).

1.28 **Strategic rationale for the program**. Under the first tranche of the operation, policies are expected to be designed along with the development of the regulatory instruments required for their approval, in order to reduce tax evasion and increase tax collection, as well as to achieve better and more extensive financial sector regulation and oversight, thereby increasing its transparency and protecting it from potential asset laundering threats. Under the second tranche of the operation, complementary actions or actions related to the implementation of the policies defined in the first tranche are expected to be carried out, thereby increasing the institutional capacity of the principal organizations involved in this operation (the SAT, the SIB, and the MP) and achieving the program objectives. The value added by the Bank in this process was to provide technical assistance to the country in the policy-making process, taking into account the Bank's experience in the country and in the respective sectors, and helping to build consensus and achieve alignment with other activities currently in progress.

1.29 **Strategic alignment**. This program is aligned with the sector priorities of the Country Strategy with Guatemala 2012-2016 (document GN-2689), through the fiscal management sector pillar, and is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008). It is aligned with the productivity and innovation development challenge, by updating the taxpayer registry, with a view to increasing the formality of microbusinesses. It is also consistent with the crosscutting area of institutional capacity and rule of law, through the institutional strengthening of public agencies such as the SAT and the MP and the improvement of the regulatory framework for the financial system and the fight against corruption. Moreover, with respect to the 2016-2019 Corporate Results Framework (document GN-2727-6), the program contributes to the indicator of tax revenue as a percentage of GDP, and the number of government agencies benefiting from programs that strengthen technological and management instruments aimed at improving public service delivery. The program is also aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2), by improving public finance management, is consistent with the Fiscal Policy and Management Sector Framework Document (GN-2831-3), and is included in the 2016 Operational Program Report (document GN-2849).

1.30 In addition, the challenges addressed by this program were identified as priorities under the institutional strengthening pillar of the Plan of the Alliance for Prosperity in the Northern Triangle (PAPTN), which seeks to increase tax revenues in order to improve the delivery of health and education services and the effectiveness of public spending and transparency in government operations. The PAPTN was created in 2014 and includes Guatemala, Honduras, and El Salvador. Its objective is to address the causes of migration by minors to the United States, through investment in four strategic areas: (i) productive sector; (ii) human capital; (iii) transparency; and (iv) citizen security. All of these PAPTN priority actions require resources to finance them. This program supports an increase in tax collection, which will help provide the investments needed for the PAPTN.

B. Objectives, components, and cost

1.31 **Objective**. The program's objective is to improve the tax management and transparency of Guatemala's financial sector, through policy measures aimed at increasing tax revenues and strengthening asset laundering prevention. The program is structured as a multiple-tranche policy-based loan, the proceeds of which will be disbursed in two tranches of up to US$125 million each.

1.32 The policy actions included in the first tranche primarily relate to the design and formulation of policies and the development of regulatory instruments for their approval, whereas those under the second tranche are related to complementary actions or to their implementation and operation.

1.33 **Component I. Macroeconomic stability**. The objective of this component is to ensure a macroeconomic context that is consistent with the program objectives, as set out in the Policy Matrix.

1.34 **Component II. Improving efficiency and effectiveness in tax collection**. The objective of this component is to strengthen the SAT in order to increase tax and customs duty collection. The policy actions under this component for the first tranche are:

a. Definition of a new governance model in the SAT, which modifies the composition and functions of the Board of Directors and creates the lower administrative court for tax and customs matters, through the preparation and submission of a bill to the Guatemalan Congress.

b. Expansion and institutionalization of comprehensive evaluation and control of SAT employees, through an Internal Affairs Unit created by means of the approval of an agreement by the SAT Board of Directors.

c. Institutionalization of a new tax intelligence and risk management model for tax and customs enforcement, through the creation of a Tax Investigation Office in the SAT. The institutionalization of a new tax intelligence model will promote the integration of the SAT's information systems, which will in turn lead to improved cross-referencing of information. In addition, a survey and review of the SAT's principal macro processes will contribute to the updating of several information systems.

d. Reengineering of SAT staff, including a review of the types of professional and technical profiles required, the design of employee career paths, and the availability of approximately 450 job positions (new or vacant).

e. Identification and publication of VAT gaps for 2015 and setting of VAT collection targets for 2016. An improvement in the SAT's capacity to calculate and publish tax gaps, along with the institutionalization of a new tax intelligence model, will make it possible to improve the quality of auditing plans, which will promote an increase in collection. Meanwhile, collection targets set by both MINFIN and the SAT will create incentives for achieving this objective. The publication and monitoring of tax gaps is another mechanism to ensure the SAT's accountability.

f. Cleanup and improvement of the taxpayer registry (RTU), by approving a modernization plan that includes reviewing the identification of taxpayers and customs users. The SAT has been working on a proposal to update and identify individual taxpayers through a single individual identification code. The RTU Modernization Plan will include an analysis of strategic alternatives, as well as a detailed explanation of how it will be implemented and financed and the respective timeframes.

g. Survey and review of the SAT's principal VAT and customs macro processes, including the identification and assessment of operational risks and strategies to mitigate them. For example, an improved comprehensive management process for the VAT with better forms and obligations for the taxpayer, with cross-referencing of information for greater control of VAT credits and improved quality of the entire electronic billing process. The SAT's Institutional Planning and Development Office leads the process reengineering and review processes, in coordination with the specific VAT, customs, and income tax units, as well as the Tax Intelligence Office that will be created.

h. Formulation of a comprehensive control plan for goods held in bonded merchandise storage areas during the customs clearance process, with an emphasis on Puerto Quetzal, which was selected because of its relevance as the port that generates 34% of total VAT revenue collected on imports and customs duties in the country (2015 data). The plan will include actions such as the use of smart seal facilities; motion cameras and sensors in ports; the implementation of entry protocols for people and vehicles; the purchase of telemetry equipment for taking measurements in gas tanks and measuring other liquids and bulk imports; scale calibration and control inspections; analysis of the area around the port that could provide logistics and security support as well as support for the management of illegal activities; greater diligence on the part of the MP to bring legal action against customs facilitators and agencies as well as other operators involved in criminal offenses; and analysis of key port stakeholders, with a view to gaining collaboration from the port company, unions, cargo operators in the port, workers, security, carriers, customs facilitators, and agents.

i. Institutionalization of a framework for collaboration on criminal investigations of tax evasion and fraud, through a cooperation agreement between the SAT, the MP, and the CICIG,[31] pursuant to the mandate assigned to the latter by the United Nations.

j. Strengthening of the MP, through approval by the Congress of a reform of the Act Establishing the Attorney General's Office, contributing to better coordination with the SAT and to the expansion of criminal investigations of tax evasion, contraband, and customs fraud.

1.35 The policy actions under this component for the second tranche are:

a. New SAT governance model and lower administrative court established through passage of a law to strengthen SAT fiscal transparency and

[31] The CICIG was ratified by the Guatemalan Congress in 2007. It is an independent international agency whose objective is to support the MP, the National Civil Police, and other government institutions in the investigation and disruption of crimes committed by members of illegal security forces and clandestine security organizations. The CICIG has a mandate until September 2017, and the current government has requested an extension to 2019.

governance. In this new governance model, fiscal transparency will be strengthened by developing mechanisms to end bank secrecy of taxpayers in order to improve tax auditing.

b. The SAT Internal Affairs Office, in operation, reviews and monitors the personal integrity statements of SAT employees by implementing a comprehensive staff audit protocol.

c. The SAT Tax Investigation Office, in operation, prepares information for the formulation of audit plans. Tax intelligence activities may include, for example, an analysis of probable inflated-price exports and overestimated volumes (the increase in VAT refunds in recent years is not commensurate with actual economic activity or currency revaluation). Another example is the identification of illegal imports (contraband), with an analysis of the difference between estimated domestic demand, based on average per capita consumption, and the recorded legal domestic supply, as in the case of gasoline consumption.

d. Hiring of approximately 800 employees in 2016-2017 and completion of initial staff training.

e. Identification and publication of VAT gaps for 2016, development of a methodology for measuring gaps in income tax collection and initial estimates thereof, and setting of income and value-added tax collection targets for 2017.

f. Implementation of the taxpayer registry (RTU) modernization plan, including cleanup of information and identification of taxpayers, and monitoring of outcomes.

g. Survey and review of the SAT's income tax macro process, including the identification and assessment of operational risks and strategies to mitigate them.

h. Comprehensive inspection plan for goods held in bonded merchandise storage areas during the customs clearance process, which is currently being implemented in Puerto Quetzal, with plans to extend the plan to all ports with customs inspection processes.

i. Criminal investigations of tax evasion and tax fraud, in progress.

j. Expansion of the territorial presence of the Office of Economic Crimes Prosecution, through strengthening via the opening of an agency specializing in the crimes of contraband and customs fraud.

1.36 The program-supported policy measures will result in the comprehensive reengineering of the SAT and better coordination between the SAT and the MP, which will help upgrade SAT staff and improve control over its employees, institutionalize a tax intelligence model in the entity, clean up the taxpayer registry, review the principal VAT, customs, and income tax macro processes, and participate in the inspection of goods at Puerto Quetzal, which will help reduce tax evasion and increase tax collection.

1.37 **Component III. Improving transparency in the financial sector and offshore activities**. The objective of this component is to strengthen the prevention of asset laundering activities through regulation, disclosure, and sharing of information, as well as alignment with international standards. The policy actions under this component for the first tranche are:

a. Improve financial sector regulation and supervision, particularly of offshore entities, requiring additional capital from entities that provide financing in foreign currency to borrowers that do not generate it, eliminating the exception in the article related to non-generators of foreign currency. To this end, a Monetary Board Resolution would amend the regulations on the capital adequacy of offshore entities, brokerage firms, companies specializing in financial services, bonded warehouses, and exchange offices, that are part of a financial group, and credit card issuers that are not part of a financial group. The main objective of this measure is to increase the minimum amount of equity required for exposure to exchange risks (gradually increasing the capital of these entities from 20% to 40%), since it applies to foreign currency obligations for borrowers that do not generate foreign currency.

b. Improve the disclosure of information on financial indicators related to the sector's historical information, particularly offshore entities, firms specializing in financial services, and others rated by the Monetary Board that are part of a financial group, and exchange offices, authorizing the supervisory body to request updated information. The main categories of information to be published include average weighted interest rates, monthly financial statements, financial indicators identified by the SIB, and annual financial statements, condensed balance sheet, condensed income statement, statement of changes in net worth, and cash flow statement. The proposed policy measure will expand these transparency requirements with respect to frequency, publication deadline, and/or quantity of historical records required.

c. Strengthen the asset laundering prevention system in Guatemala, following the 2010 FATF recommendations and evaluation methodology, by means of a National Strategic Plan that complies with the FATF Standards adopted by the Presidential Commission for the Coordination of Efforts against the Laundering of Money or Other Assets, Terrorist Financing, and the Financing of the Proliferation of Weapons of Mass Destruction in Guatemala (COPRECLAFT).[32]

d. Improve the sharing of information between the COPRECLAFT member and guest agencies with responsibility in the prevention of asset laundering and tax management, through the adoption of an interagency coordination framework

[32] COPRECLAFT formulates and adopts the National Strategic Plan. The commission was created by means of Government Decision 132-2010, issued by the President of the Republic and amended by Government Decision 145-2014 to expand its mandate, effective period, and members. Its objective is to coordinate efforts and cooperation between the government institutions involved in asset laundering prevention, enforcement, and sanctioning. COPRECLAFT is chaired by the Vice President of the Republic and its members are the Minister of Foreign Affairs, the Minister of Government, the Minister of National Defense, the Minister of Economy, the Secretary of Strategic Intelligence of the State, the Secretary General of the Department of Appropriation, the General Director of Civil Intelligence, the Superintendent of Tax Administration, and the Superintendent of Banking. Regular guests of COPRECLAFT are: the Chief Justice of the Judiciary and Supreme Court of Justice, the Attorney General of the Republic and Head of the Attorney General's Office, and the President of the Monetary Board and the Bank of Guatemala. When preparing the National Strategic Plan, COPRECLAFT has in the past invited other government agencies, in addition to its members and guests, to collaborate in the process. The Superintendent of Special Verification attached to the Office of the Superintendent of Banking acts as the Commission's Technical Secretary.

agreement and the sharing of information among these entities, including the SAT.

e. Strengthen asset laundering prevention regulations by preparing a bill to strengthen the system for the prevention and repression of asset laundering, terrorist financing, and proliferation of weapons of mass destruction, which includes reforms of the principal laws related to this subject.

1.38 The policy actions under this component for the second tranche are:

a. Verification by the SIB of compliance with the resolution issued by the Monetary Board requiring additional capital from entities that provide financing in foreign currency to borrowers that do not generate it.

b. Verification by the SIB of compliance with the resolution issued by the Monetary Board to improve the disclosure of information on financial indicators, through enforcement measures aimed at entities in the system.

c. Adapt the National Strategic Plan to Combat Asset Laundering, Terrorist Financing, and Financing of the Proliferation of Weapons of Mass Destruction to the results of the National Risk Assessment and Mutual Evaluation Report of the FATF regional groups (FATFLAT-Latin America and FATFC-Caribbean), which should be published in late 2016 or early 2017.

d. Implement a system for members and guests of COPRECLAFT to share statistical information through a technology platform designed for that purpose.

e. Submit a bill to the Congress of the Republic of Guatemala to strengthen regulations on the prevention and repression of asset laundering and terrorist financing and the proliferation of weapons of mass destruction.

1.39 Supporting these policies will result in better and more extensive regulation and oversight of the financial sector, thereby increasing its transparency, protecting it from potential asset laundering threats, and increasing the ability of the main institutions involved in this operation—the SAT, the SIB, and the MP—to coordinate their efforts to detect, prevent, and sanction irregular practices.

C. Key results indicators

1.40 **Expected outcomes**. An expected impact of the operation is an increase in net tax collection from 10.2% of GDP 2015 to at least 11% of GDP in 2018, and a 5% improvement in Guatemala's score in the Money Laundering Index (produced by the Basel Institute on Governance) in 2018. The expected outcomes are: (i) the SAT becomes more efficient, with an increase in annual collection/active SAT staff from 11.6 million quetzales per year over the 2014-2015 period to 12.5 million quetzales per year in 2018; and (ii) Guatemala is rated in the 2016-2017 FATF results as having "met" the recommendation regarding internal controls and foreign branches.[33] Other outcomes and outputs are described in the Results Matrix.

1.41 **Economic and financial analysis**. A general economic analysis of the reforms included in the program was conducted. Although the program is broader and includes another component (transparency of the financial sector), the economic

[33] Recommendation 22 of 2010 will become Recommendation 18 in 2016, under the new version of FATF standards published in 2012.

analysis essentially focuses on the component of efficiency and effectiveness of tax collection. The methodology that was used is known as static scoring and seeks to estimate the effect of the proposed actions on tax collection, assuming there is no feedback between the taxes collected and general economic activity.

1.42 The Economic Analysis conducted shows that, even under very conservative assumptions on the improvement of tax management, financial results may be substantial. If VAT evasion is reduced by 10% and institutional capacity is maintained over a five-year period, the program could generate nearly US$505 million in present value dollars in 2017. Another US$140.7 million would be collected if the planned interventions in the country's customs system are able to reduce contraband by 10% over a five-year period. Assuming the cost of the reforms is US$33.4 million in 2017 present value, the net result would be US$613.6 million at the end of the five-year period. All present values in this paragraph were calculated using a 12% annual discount rate.

1.43 **Internal and external validation**. The program and the authorities' view is that before a structural tax reform is considered, it is more important to build the SAT's institutional capacity as well as its technical and administrative capacity to efficiently and effectively perform its function. A tax reform with an institutionally weak SAT would only lead to a scaling of current tax evasion levels. This position is consistent with the idea put forth by Casanegra de Jantscher (1990),[34] who argues that, in developing countries, tax administration is tax policy.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 This program is structured as a multiple-tranche policy-based loan, the proceeds of which will be disbursed in two tranches. This modality was selected in order to promote the design and implementation of policies, regulations, and management instruments over the medium term, which will make it possible to address the SAT's lack of institutional capacity and increase transparency in the financial sector. Pursuant to document CS-3633-1, paragraph 3.27, subsection (b), the size of the operation is warranted based on the country's financing needs, as well as the complexity and magnitude of the reforms, which are necessary to address development challenges and, according to the economic analysis conducted, will have a much greater impact than the size of the loan. The PBL modality was selected because the details of the essential measures of the proposed medium-term reform process are already well known, and the government wants to use the conditions of the operation to communicate its determination to carry out the medium-term policy reform and institutional change program and adhere to the execution timetable.

2.2 **Program amount**. The amount of the Bank's financing will be a maximum of US$250 million, which is expected to be disbursed in two tranches of US$125 million each, starting in 2017. By granting this PBL, the Bank will help finance 22% of the central government's estimated fiscal deficit in 2017 (14% of gross financing needs),

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[34] Casanegra de Jantscher (1990): "Administering the VAT," in M. Gillis, C. Shoup and G. Sicat (eds.) Value-Added Taxation in Developing Countries, World Bank, Washington DC, p. 179.

which complies with the terms of the document "Policy-based Loans: Guidelines for Preparation and Implementation" (document CS-3633-1, paragraph 3.27).[35]

B. Social and environmental risks

2.3 Since the operation will support the formulation of policies, regulations, management tools, and other institutional strengthening actions, no social or environmental risks are anticipated. In accordance with Directive B.13 of Operational Policy OP-703, no classification is required.

C. Fiduciary risks

2.4 The fiduciary risk associated with the operation is considered low, since the financial instrument does not include procurement and provides unrestricted funds that will be disbursed once the policy reform conditions established in the loan contract are met. The executing agency has the financial management tools and control systems needed to meet those conditions.

D. Other program risks

2.5 **Macroeconomic**. There is a risk that the expected fiscal stability levels will not be reached due to weaknesses in the management of economic policies or the occurrence of external factors such as natural disasters, fluctuations in the price of the country's exports, and international financial crises that could negatively affect Guatemala's macroeconomic conditions. Although this is a risk that cannot be totally controlled, the country has continuously demonstrated fiscal responsibility in recent years, which will help mitigate the risk (Low Risk).

2.6 **Development**. The Legislative Branch's ratification of the program may be delayed. To mitigate this risk, MINFIN has provided for a timetable for tracking the Congress of the Republic (High Risk). **Sustainability**. Based on previous experience with this type of program in Guatemala and other countries, there is a risk that some of the reforms will not be sustainable over time. To mitigate this risk, the program will maintain an ongoing dialogue with the authorities so that as much consensus as possible is reached on the reforms and the reforms are institutionalized in legal or other instruments and are sustainable over time. In addition, the new government recently began its term and has sufficient time to institutionalize the reforms. The strategy adopted in the program has been not to focus on a few reform actions, but rather prepare a complete set of actions which separately will meet less political resistance but have a big impact as a whole (Medium Risk).

III. Implementation and Action Plan

A. Summary of implementation arrangements

3.1 The borrower is the Republic of Guatemala and the executing agency for the program will be MINFIN, which will coordinate with the SAT, the MP, and the SIB as necessary to put in place the means of verification for the disbursements.

[35] The country's estimated gross financing needs average US$2.031 billion per year for the 2016-2020 period, which, based on the macroeconomic stability recorded in recent years, the country has been able to cover by accessing domestic and international capital markets, including sources of multilateral financing.

3.2 The executing agency is responsible for: (i) coordinating between the different institutions charged with implementing the measures to fulfill the disbursement conditions of their agencies; (ii) monitoring and providing evidence of the fulfillment of the agreed upon policy conditions; (iii) preparing the required reports within the timeframes agreed upon with the Bank; and (iv) consolidating the information needed to evaluate the program's outcomes. MINFIN's coordination with the SAT will take place with the understanding that MINFIN is the SAT's supervisor, under the Office of the Vice Minister of Revenue and Fiscal Assessment; and MINFIN's Office of Public Credit, as the Bank's counterpart, will continuously coordinate the agreed upon policy actions with the SIB and the MP.

3.3 **Special contractual conditions precedent to the disbursement of each tranche of the loan: The disbursement of each of the two loan tranches will be subject to fulfillment of the policy reform conditions established for each tranche, in accordance with the Policy Matrix (Annex II) and the conditions set forth in the respective loan contract.**

B. Summary of results monitoring arrangements

3.4 **Monitoring**. A monitoring and evaluation plan has been prepared to monitor the program's outcomes. The key parameters used for its preparation were the following: (i) Policy Matrix; (ii) Results Matrix; and (iii) Means of Verification. MINFIN and the Bank will hold regular meetings to monitor the outcomes of the operation and to anticipate and resolve any technical difficulties associated with its implementation. MINFIN will give the Bank any information required to ascertain fulfillment of the program conditions and will furnish timely information on the progress made.

3.5 **Evaluation**. The evaluation will be based on the measurement of results, which will use the Monitoring and Evaluation Plan. The program will be evaluated based on the annual targets and indicators for the outputs and outcomes that make up the program's results framework, and a project completion report will be prepared at the end of the execution period.

IV. POLICY LETTER

4.1 The Policy Letter reiterates the Guatemalan government's commitment to the objectives and actions included in the operation as a whole. The Bank and the Guatemalan government have agreed on a Policy Matrix that describes the policy actions of this operation.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	Aligned		
Development Challenges & Cross-cutting Themes	-Productivity and Innovation -Institutional Capacity and the Rule of Law		
Regional Context Indicators			
Country Development Results Indicators	-Percent of GDP collected in taxes (%) -Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)		
2. Country Strategy Development Objectives	Aligned		
Country Strategy Results Matrix	GN-2689	Improve the tax structure.	
Country Program Results Matrix	GN-2849	The intervention is included in the 2016 Operational Program.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	Evaluable	Weight	Maximum Score
	8.1		10
3. Evidence-based Assessment & Solution	8.4	33.33%	10
3.1 Program Diagnosis	3.0		
3.2 Proposed Interventions or Solutions	2.4		
3.3 Results Matrix Quality	3.0		
4. Ex ante Economic Analysis	10.0	33.33%	10
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	4.0		
4.2 Identified and Quantified Benefits	1.5		
4.3 Identified and Quantified Costs	1.5		
4.4 Reasonable Assumptions	1.5		
4.5 Sensitivity Analysis	1.5		
5. Monitoring and Evaluation	6.0	33.33%	10
5.1 Monitoring Mechanisms	2.5		
5.2 Evaluation Plan	3.5		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	Medium		
Identified risks have been rated for magnitude and likelihood	Yes		
Mitigation measures have been identified for major risks	Yes		
Mitigation measures have indicators for tracking their implementation	Yes		
Environmental & social risk classification	B.13		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External control, Internal Audit.	
Non-Fiduciary			
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	The Bank has supported the country through technical cooperations for financial integrity and prevention of money laundering (ATN/AA-13021-GU, ATN/AA-13696-RG).	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The general objective of the project is to improve the tax administration, and transparency of the financial sector in Guatemala. The specific objectives are to increase the tax revenues and to strengthen the prevention of money laundering.

The document presents the problems to be addressed by the project as well as the factors causing them. The project's beneficiaries are clearly spelled out. However, the project does not present adequate evidence of neither internal nor external validity of the proposed solutions.

The project´s vertical logic is clear and well specified. The Result Matrix is adequately constructed and contains the required elements for monitoring the project. The program includes a monitoring and evaluation plan. However, the detailed work proposal has not been adequately specified.

The program includes a cost-benefit analysis (CBA) where the economic benefits have been clearly quantified and the costs reflect real resource costs to the economy. The assumptions used are clearly presented and a sensitivity analysis has been performed undertaking variations in key assumptions.

The program's overall risk is rated Medium. Mitigation measures were identified with appropriate monitoring indicators.

POLICY MATRIX

Project objective:	Improve the tax management and transparency of Guatemala's financial sector, through policy measures aimed at increasing tax revenues and strengthening asset laundering prevention.

Component I. Macroeconomic Stability	
Policy Commitments First Tranche	**Policy Commitments Second Tranche**
1. Ensure a macroeconomic context that is consistent with the program objectives, as set out in the Policy Matrix.	1. Ensure a macroeconomic context that is consistent with the program objectives, as set out in the Policy Matrix.
Component II. Improving the Efficiency and Effectiveness of the SAT	
Policy Commitments First Tranche	**Policy Commitments Second Tranche**
1. Definition of a new governance model in the SAT, which modifies the composition and functions of the Board of Directors and creates the lower administrative court for tax and customs matters, through the preparation and submission of a bill to the Guatemalan Congress.	1. New SAT governance model and lower administrative court established through passage of a law to strengthen SAT fiscal transparency and governance.
2. Expansion and institutionalization of comprehensive evaluations and control of SAT employees, through an Internal Affairs Unit created by means of the approval of an agreement by the SAT Board of Directors.	2. The SAT Internal Affairs Office, in operation, reviews and monitors the personal integrity statements of SAT employees by implementing a comprehensive staff audit protocol.
3. Institutionalization of a new tax intelligence and risk management model for tax and customs enforcement, through the creation of a Tax Investigation Office.	3. The SAT Tax Investigation Office, in operation, prepares information for the formulation of audit plans.
4. Reengineering of SAT staff, including a review of the types of professional and technical profiles required, the design of employee career paths, and the availability of approximately 450 job positions (new or vacant).	4. Hiring of approximately 800 employees in 2016-2017 and completion of initial staff training.
5. Identification and publication of VAT gaps for 2015 and setting of VAT collection targets for 2016.	5. Identification and publication of VAT gaps for 2016, development of a methodology for measuring gaps in income tax collection and initial estimates thereof, and setting of income and value-added tax collection targets for 2017.
6. Cleanup and improvement of the taxpayer registry (RTU), by approving a modernization plan that includes reviewing the identification of taxpayers and customs users.	6. Implementation of the taxpayer registry (RTU) modernization plan, including cleanup of information and identification of taxpayers, and monitoring of outcomes.
7. Survey and review of the SAT's principal VAT and customs macro processes, including the identification and assessment of operational risks and strategies to mitigate them.	7. Survey and review of the SAT's income tax macro processes, including the identification and assessment of operational risks and strategies to mitigate them.

Policy Commitments First Tranche	Policy Commitments Second Tranche
8. Formulation of a comprehensive control plan for goods held in bonded merchandise storage areas during the customs clearance process, with an emphasis on Puerto Quetzal.	8. Comprehensive inspection plan for goods held in bonded merchandise storage areas during the customs clearance process, which is currently being implemented in Puerto Quetzal, with plans to extend the plan to all ports with customs inspection processes.
9. Institutionalization of a framework for collaboration on criminal investigations of tax evasion and fraud, through a cooperation agreement between the SAT, the MP, and the CICIG, pursuant to the mandate assigned to the latter by the United Nations.	9. Criminal investigations of tax evasion and tax fraud, in progress.
10. Strengthening of the *Ministerio Público* [Office of the Attorney General] (MP) through congressional approval of a reform of the Act Establishing the Attorney General's Office.	10. Expansion of the territorial presence of the Office of Economic Crimes Prosecution, through strengthening via the opening of an agency specializing in the crimes of contraband and customs fraud.
Component III. Improving transparency in the financial sector and offshore activities	

Policy Commitments First Tranche	Policy Commitments Second Tranche
1. Improve financial sector regulation and supervision, particularly of offshore entities, requiring additional capital from entities that provide financing in foreign currency to borrowers that do not generate it, eliminating the exception in the article related to non-generators of foreign currency.	1. Verification by the SIB of compliance with the resolution issued by the Monetary Board requiring additional capital from entities that provide financing in foreign currency to borrowers that do not generate it.
2. Improve the disclosure of information on financial indicators related to the sector's historical information, particularly offshore entities, firms specializing in financial services, and others rated by the Monetary Board that are part of a financial group, and exchange offices, authorizing the supervisory body to request updated information.	2. Verification by the SIB of compliance with the resolution issued by the Monetary Board to improve the disclosure of information on financial indicators, through enforcement measures aimed at entities in the system.
3. Strengthen the asset laundering prevention system in Guatemala, following the 2010 FATF recommendations and evaluation methodology, by means of a National Strategic Plan that complies with the FATF Standards.	3. Adapt the National Strategic Plan to Combat Asset Laundering, Terrorist Financing, and Financing of the Proliferation of Weapons of Mass Destruction to the results of the National Risk Assessment and Mutual Evaluation Report of the FATF regional groups (FATFLAT Latin America and FATFC Caribbean), which should be published in late 2016 or early 2017.
4. Improve the sharing of information between the COPRECLAFT member and guest agencies with responsibility in the prevention of asset laundering and tax management, through the adoption of an interagency coordination framework agreement and the sharing of information among these entities, including the SAT.	4. Implement a system for members and guests of COPRECLAFT to share statistical information through a technology platform designed for that purpose.
5. Strengthen asset laundering prevention regulations by preparing a bill to strengthen the system for the prevention and repression of asset laundering, terrorist financing, and proliferation of weapons of mass destruction, which includes reforms of the principal laws related to this subject.	5. Submit a bill to the Congress of the Republic of Guatemala to strengthen regulations on the prevention and repression of asset laundering and terrorist financing and the proliferation of weapons of mass destruction.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/16

Guatemala. Loan ____/OC-GU to the Republic of Guatemala
Tax Management and Transparency Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Guatemala, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a tax management and transparency program. Such financing will be for the amount of up to US$250,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on __ ____________ 2016)

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