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Title : An Evaluation of the 1999 IRS Reform

The purpose of this paper is to collect and analyze the evaluations of the IRS organizational reform from the viewpoint of the taxpayers, the employees, the CPA's and academia.

The rationale for this survey is the growing concern one can observe in modern western societies about the efficiency and effectiveness of public goods and services provided by the governments. In Brazil, in particular, tax administration shall be under great stress if Brazilian Congressmen succeed in reforming our Tax Code. Our current tax legislation puts a heavy burden on our production and consumption and is very damaging to our export efforts, but they are not difficult to collect. On the other hand, fair and effective tax legislation will probably be more difficult to collect. Simple tax legislation makes it easier to collect and to comply with the law, but it tends to be unfair because it treats equally those in different situations.

1. The organizational structure of the IRS prior to the reform (1952-1998)

a. Mission

The IRS mission was written in the 1960s and was in effect until 1998. Actually, the statement reflected the way the public used to see the agency and the way it saw itself.

"The purpose of the Internal Revenue is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness."

Since it was created, the IRS was very successful in achieving the goals that were proposed for the agency. The agency collects more than US$ 2.0 trillion in gross revenue that corresponds to 95% of the US government's revenues and handled more than 200 million returns from individuals in 2001. Also, it is adequately insulated from political influence and corruption cases are few and vigorously investigated.

Nonetheless, the agency has been subject to a great deal of criticism in the past years. The main focus of concern was the poor service it was delivering to taxpayers. There were also concerns about inadequate and outdated technological resources, reports of violations of taxpayer rights and lack of training and resources for IRS employees. These facts ultimately led to the "IRS Restructuring and Reform Act of 1998" enacted by Congress in an attempt to correct the problem.

b. Organization structure

The organization structure of the IRS was basically functional. The main characteristic of this type of structure is that the employees are grouped based on an organization's key functions or work process. This model is usually applied by arranging separate departments to perform each administrative work process, each department covering all types of taxes collected by the agency. Among other divisions, the IRS had then a collection and an examination divisions which respectively dealt with issues on collecting arrears for example and with auditing tax returns. The organization also had a geographically - based jurisdiction type structure comprising 33 districts and 10 service centers. Above these districts there were four regional and one national office. Each of these 43 units was responsible to deliver service, examine and administer a variety of different taxes and for every kind of taxpayer, large and small, business or individuals.

According to Vehorn and Brondolo (1999) this organizational structure has three main benefits. First, it helps tax administrations improve compliance with tax laws by establishing one specific department to address each major form of noncompliance: underreporting (examinations division), arrears (collection) and unintentional mistakes (taxpayer services). This arrangement tends to strengthen these work processes since senior officials can be assigned with specific responsibility. The authors point out that this type of structure may be particularly useful in developing countries and economies in transition where, most times, compliance levels are low and tax administrations are not adequately empowered.

A second benefit derived from this model is that it enables tax administration to increase staff productivity and reduce administrative costs originated from the economies of scale brought by work division in a Taylorist-type management.

A third advantage is that it reduces the scope for collusion arrangements among staff and taxpayers because the separation of functions provide a better system of checks and balances than organizations divided by type of tax.

The main weakness of this structure is that the fragmented nature of the organization often results in poor service to taxpayers. This problem arises because each division tends to focus on a narrow aspect of taxpayers' needs. Also, very frequently, employees' expertises tend to concentrate in only one division leading to poor performance when dealing with issues and problems cut across division boundaries.

1.2 The IRS Restructuring and Reform Act of 1998

The roots of the Restructuring and Reform Act of 1998 (RRA 1998) can be found in 1995 when Congress established the National Commission on Restructuring the IRS in response to concerns about the efficiency, responsiveness and accountability of the IRS. Following that, the 1997 Senate Finance Committee hearings presented abuses by the IRS and dramatically exposed public's frustrations.

The message sent by Congress was clear: the IRS must do a better job in meeting the needs of taxpayers.

a. New mission

"Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."

This mission is explained in detail in the IRS Blueprint 2000: “This mission statement describes the role of the IRS, as well as the public’s expectations as to how the IRS should perform it. The United States Congress passes tax laws and requires taxpayers to comply with them. It is the role of taxpayers to understand and meet their tax obligations, and most do since roughly 98 percent of the taxes collected are paid without active intervention by the IRS. It is the role of the IRS to help the large majority of taxpayers who are willing to comply with the tax law, while seeing to it that the minority who are not willing to comply are not allowed to burden their fellow taxpayers. The IRS must perform this role to a top quality standard, which means that all of its service should be seen by the people who receive them as comparable in quality to the best they get elsewhere.”

b. New organizational structure

Background

The objective of the organizational reform was to provide better service to taxpayers and the main impact on the agency structure was a shift from a primarily functional type structure to a new one based on the type of taxpayer. Also, although The Secretary of the Treasury maintain authority over tax policy and the IRS still operates within the Department of Treasury, in order to improve accountability, an independent oversight Board of Directors was created to provide the IRS with long-term strategic direction and to hold agency’s management accountable.

This type of organizational structure is the client-based model where employees are assigned to divisions that focus on specific groups of customers. It has become increasingly popular among private-sector companies and some public entities.

The Australia Taxation Office was among the first tax administrations to implement this new structure in 1994. Also, in April 1998 the Brazilian Federal Revenue Secretariat established two new tax offices: one specialized in financial institutions and another specialized in international affairs. The São Paulo State Tax Office Specialized in Financial Institutions is in charge of all financial corporations within the State of São Paulo. It delivers service, audits and collects taxes from banks, brokerage houses, financial exchange markets, insurance companies and pension funds, within the State of São Paulo. In 2001 this tax office recorded the highest amount of tax among Brazilian tax administration collecting some 15% of Brazilian federal tax revenue. The International Affairs Tax Office was created in response to growing concerns about tax evasion through intercompany price fixing and revenue shifting to tax havens.

The client-based model has two major advantages. First, this model stresses the accountability for achieving organizational outcomes because it establishes a direct link between each division and its segment of taxpayers.

A second benefit of this structure is that it enables tax administration to perform a more tailor-made resource allocation that has a tendency to improve its allocation. For example, tax administration can allocate resources consistent with the risk of tax evasion, specific expertise needed by the industry, size of business and etc. Also, tax administration can develop specific and more effective enforcement and educational programs according to different groups of taxpayers. This integrated approach tends to promote better service delivery and closer monitoring of each kind of taxpayer resulting in higher levels of compliance.

One of the major disadvantages of this model is that it may lead to an increase in administrative cost since part of the economies of scale derived from the division of work is lost. Also, the successful implementation of this type of structure usually requires the availability of highly skilled managers and technical staff and this can also imply higher costs. This is due to the fact that to take full advantage of this model, employees should be well trained to deal with high-end and large size taxpayers and this is usually associated with higher salaries to attract and maintain this personnel.

Finally, this model can result in inconsistent application of tax laws across different groups of taxpayers and can also make the organization more vulnerable to corruption. A strong internal audit division and external oversight is strongly recommended to mitigate this problem.

The new IRS organizational model

The new organizational model of the IRS comprises basically three types of units: operating divisions, shared services and functional units. The operating divisions are the key operational units and are charged with full responsibility for serving a set of taxpayers, namely: Wage and Investment, Small Business and Self-Employed, Large and Mid-Size Business and Tax Exempt and Government Entities. These operational units will share the services provided by two service divisions: Agency Wide Information and Systems Services and Agency Wide Shared Services (facilities, personnel, procurement etc). Also, two of the functional units will provide nationwide separate specialized and independent channels to taxpayers: Appeals and National Taxpayer Advocate. The third functional unit will be the Criminal Investigation Unit which will be responsible for investigations of criminal violations. The Chief Counsel provides tax advice, guidance and legislative services to all divisions of the IRS and a National Office Staff will provide broad policy, review plans and goals of the operating units. An organization chart can be found in Appendix 1 – figure 1.

The operating divisions

Some key differences among the groups of taxpayer are shown in the figure 2 below:

Figure 2 - Taxpayer Characteristics

	Wage & Investment	Small Business & Self-employed	Large & Mid-Size Business	Tax Exempt & Government Entities	Total
Number of filers (million)	88	45	0.21	2.4	135.6
Percent	65%	33%	0.2%	1.8%	100%
Total tax liability (billions)	$ 380	$ 790	$ 466	$ 103	$ 1,739
Percent	22%	45%	27%	6%	100%
Gross cash paid (billions)	$ 46	$ 915	$ 712	$ 221	$ 1,894
Percent	2%	48%	38%	12%	100%
Average tax liability per filer	$ 4,310	$ 20,231	$ 2,231,274	$ 42,698	
Avg. # of transactions w/ IRS per filer/year	1-4	4-60	+60	+60	
Percent preparing own returns	59%	20%	-	-	

Source : 2000 IRS Organization Blueprint

By establishing dedicated units with full end-to-end responsibility for serving each set of taxpayers, the organizational structure will reflect the shift to new business practices and strategic goals, as determined by the Congress.

The Wage & Investment Division serves approximately 116 million individual taxpayers and deals with some 88 million returns. Although the number of taxpayers is very high, the amount collected through cash is not proportionally significant mainly because most of these taxpayers pay their taxes through withholding by their employers. Also, compliance issues are focused on a limited range of issues and they typically need to contact the IRS a few times per year. On the other hand, most of them prepare their own returns and that, for example, tends to lead to many mistakes during tax return season.

The Small Business and Self-employed Division serves taxpayers with more complex issues relative to the group discussed above. This group also usually needs a higher number of contacts and pays the IRS directly some $ 915 billion or roughly 48% of total cash collected. This amount includes personal and corporate income taxes, excise taxes, withholding taxes and employment taxes. This variety of taxes results in more complexity in compliance and in increased possibilities of errors and lack of information.

The Large and Mid-Size Business Division was introduced in 2000 to serve corporations with assets over $ 5 million. This group comprises about 210,000 filers generating approximately US$ 712 billion in taxes collected. The main issues found in this group are related to tax laws interpretation, accounting and regulations changes and international matters. In an attempt to build greater expertise and improve service, this division is divided into five specific industry groups. Also abandoning previous geographically - based jurisdiction, these sections are headquartered near the regions where the industries are concentrated. The sections are: 1 – Financial Services and Healthcare, 2- Communications, Technology and Media, 3 – Heavy Manufacturing, Construction and Transportation, 4 – Retailers, Food and Pharmaceuticals and 5 - Natural Resources.

1 – The Financial Services and Healthcare section is headquartered in Manhattan and serves nearly 46,000 companies. It is responsible for industries such as insurance, health care, commercial banking, securities, savings and loans and other financial services.

2 - Communications, Technology and Media. This section is headquartered in the San Francisco Bay Area and is responsible for approximately 14,000 businesses. It comprises telecommunications, broadcasting, publishing, software and hardware development, sports franchises, hotels, gaming, and other entertainment and recreational services.

3 – The Heavy Manufacturing, Construction and Transportation section's headquarter is located in New Jersey to serve approximately 103,000 businesses in the areas of air and ground transportation, shipping, construction and real estate, automotive and aerospace industries.

4 - Retailers, Food and Pharmaceuticals. Headquartered in Chicago, this section serves nearly 29,000 companies in the areas of retailing, food and beverage, agricultural commodities, farm industries and pharmaceutical industry.

5 – The Natural Resources section is located in Houston and serves some 17,000 taxpayers dealing in the areas such as petroleum, forest products, chemical engineering, mining and utilities.

The Tax-exempt and government entities group includes pension plans, exempt organizations and government entities. Regarding this group, the IRS is responsible for dealing with detailed and complex provisions of law that are usually intended to ensure that these organizations follow policy guidelines that enables them to maintain their tax-exempt status. This division was the first to be launched in December 1999.

c. The IRS Oversight Board

The RRA 1998 also created a nine-member Oversight Board to provide direction, focus and private sector management skills to the agency. In order to pursue these responsibilities, the Board has authority to control actions within the IRS and is responsible for the overall governance of the agency. Although it has no involvement in specific matters like interpretation or enforcement of tax laws, among other powers the Board reviews and approves IRS budget and strategic plans; recommends Commissioner candidates and reviews Commissioner's selection, evaluation and compensation of IRS senior executives. The Board's members serve five-year terms and must have expertise in at least one of the following subjects: federal tax laws, management of a large service organization, customer service, information technology, taxpayer needs, organization development and small business concerns. The Board consists of six persons from the private sector, the Secretary of the Treasury, The IRS Commissioner and a representative from the IRS employees.

d. The National Taxpayer Advocate

The Taxpayer Advocate Service is an IRS program that provides an independent system to assure that tax problems are fairly handled. Each state and campus has at least one local Taxpayer Advocate, who is independent of the local IRS office and reports directly to the National Taxpayer Advocate.

The goals of the Taxpayer Advocate Service are to protect taxpayer rights and to reduce their burden. The Taxpayer Advocate should independently represent taxpayers' interests and concerns within the IRS by identifying issues that increase burden or create problems for taxpayers and by bringing those issues to the attention of IRS management and making legislative proposals where necessary.

e. The Treasury Inspector General for Tax Administration (TIGTA)

This new independent position replaces the IRS Office of Chief Inspector. This enhanced position is a presidential appointment and reports to the Secretary of the Treasury, the Oversight Board and to the Congress. In order to be eligible for this position, the individual must not have been an IRS employee in a period of 2-year prior to the appointment, nor can he or she be one following termination, during a period of 5 years after. Another requirement for this position is proven ability to lead large and complex organizations. His or her roles are: to audit, investigate and evaluate the IRS programs and operations, including the Board. Another role is to detect and deter fraud and abuse in the IRS programs and operations and to evaluate the adequacy and security of IRS technology.

f. The IRS Chief Counsel

This position is also a presidential appointment and has four basic responsibilities: provide legal basis for IRS rulings; prepare, review and assist in proposed tax regulations; determine whether to litigate certain cases; and represent the Commissioner in tax court cases.

g. Performance Measures

Another attempt to improve accountability was the evaluation of agency's programs and employees performances. Performance measurement has received extensive attention in the new law and should be used to grant employee awards, set merit pay increases and to guide other personnel actions. The Act specifically prohibits the use of tax enforcement statistics to evaluate employees or to set production goals, rather, the balanced performance measurement system will be focused on three elements: 1. customer satisfaction, 2. employee satisfaction and 3. business results. Also, organizational and individual performance measures should be harmonized to ensure that employees are stimulated to actively contribute to organization's goals. (Please refer to appendix 2 – figure 3 for a detailed table of the performance measure system)

The first vector of the system will be assessed through customer satisfaction surveys of a statistically valid sample of cases. Taxpayers will be asked whether they received courteous service and if they were informed of their rights. The second vector will be measured by a survey in which employees will anonymously provide feedback to IRS management about work environment including the adequacy of training programs. Finally to measure business results, the agency will use an approach including both quality and quantity measure. Quality measures will be conducted on statistically valid samples of cases handled by an operational unit where the timeliness of service, the correct application of the tax law and protection of taxpayer rights will be assessed. With respect to quantity measures, the agency intends to measure: number of cases closed, work items completed, hour expended in some programs and other items.

h. Information technology

A key issue addressed in the RRA 98 is the modernization of information technology in tax administration. Experts rate this problem and the complexity of the Tax Code as the main sources of agency's problems. The main system used to provide taxpayer account information was developed in the 1960s using very large tape files. Also, the size and complexity of IRS's database and diversity of computer programs needs are comparable to the largest in the world. This problem developed over the years by installing technologies without a guiding blueprint and strategic planning.

The first step in this direction was taken in 1999 by issuing a blueprint reflecting the new plan for organization and business practices and to set guidelines on how to decide on the major priorities for implementation given limited capacity. Also, the management of information systems was centralized under the Chief Information Officer. The major challenge faced is agency's capacity to design and develop new business practices and systems, while making changes in the legacy systems needed to support ongoing operations and temporary integration with new systems.

Electronically filed returns have two major advantages: improve service for taxpayers and boost productivity by reducing error, speeding refunds and reducing handling costs. The RRA 98 requires that the IRS encourage electronic filing of returns and established a goal of 80 percent electronically filed returns by the year 2007.

2. Evaluation of the reform

2.1 General

All of these changes mandated by the RRA 98 were not expected to be implemented immediately. These problems have developed over many years and also the IRS is a huge organization, with its 100,000-people workforce that deal directly with more Americans than any other institution.

According to an article published in the May 2002 edition of the magazine Government Executive (see bibliography), Commissioner Rossotti compares the IRS's transformation to refueling a jumbo jet in mid-flight – the agency must continue collecting taxes every day while installing new computer systems and new business procedures. The article was a review on the status of the IRS reform and it summarizes the situation in this phrase: "Citizens are happier with the tax collector than they were four years ago, but enforcement is down and employees are tiring of reform."

The magazine rated the agency B -, up from a C in 1999. Overall service has improved but still callers to the IRS telephone service get busy signals or give up 40 percent of the time and wait an average of five minutes to talk to someone when they manage to get through. Also, they get wrong answers to their tax laws questions 24 percent of the time. The magazine also mentions that the IRS sometimes is unnecessarily threatening. In a recent incident, some 60,000 military personnel who served in combat zones (and were thereby entitled to special tax treatment) received letters warning them that: "If you don't answer this letter, we will update your account to show no combat zone service." In my opinion, what the IRS should have done is to communicate directly with the

Defense Department to crosscheck the information directly with them, instead of getting this piece of information from each individual taxpayer.

The article stresses that the origin of IRS main problem has to do with (IT) information technology modernization. Surprisingly or not, the IRS still operates with 1960's magnetic tape systems and it will be years before it is totally free of this technology. The system allows updates only once a week and taxpayers often get computer-generated warnings after they have already solved the problems by phone. The magazine cites two main reasons: the complexity of the modernization effort and the personnel turnover. According to IT specialists, the IRS contract is one of the largest and more complicated civil contract ever seen. The delay in the IT modernization also impacts in the financial management since new cost accounting systems are required to enable issuance of more informative financial statements.

The agency has made some progress in developing a culture of strategic planning and performance measurement. One of the major instruments is a results-based pay system that reaches four levels down into the agency. Executive bonus payments are tied to achievement of agreed-upon results. Executives are tying senior managers' bonuses to lower-level results, and so forth. On the other hand, the agency has not been able to improve the method to assess tax compliance. Current method is based on random audits of 50,000 taxpayers to estimate the amount of taxes that people are and aren't paying. Many critics say it's not an appropriate method of measuring it and also, in the past, these audits tarnished the agency's reputation and fueled the resentment of taxpayers.

Among employees popular opinion about the effect of reforms is mixed. According to the agency's 2001 employee climate survey, 42 percent of them answered that organizational changes have had a negative impact on them, compared to only 24 percent who reported positive effects. 34 percent reported no effect. IRS officials argue that these numbers are to be expected since the organization is going through a major revamping and not everyone agrees with it.

With its resources focused on customer service and organizational reform, not surprisingly this path resulted in significant reduction in enforcement and collection. Hundreds of tax auditors and revenue agents have been moved into customer service positions resulting in a 17 percent drop in the number of agents and auditors from 1998 to 2001. Also, officers have spent less time in the enforcement activities with enhanced training sessions that have taken place recently. Although quantity has improved, employees are not satisfied with the quality of training, which is perceived not to be properly tailored to their needs. This enhanced service orientation may have contributed to improve IRS's image. In 1997, the Roper survey had found that two in three Americans didn't trust the agency. A survey conducted in 2001 detected a reversal of opinion, now two-thirds of those polled reported confidence in the tax agency.

Enforcement, however, is down. The percentage of individual and corporate tax returns audited declined 63 and 60 percent, respectively, an the percentage of delinquencies closed by telephone and field collection declined by 15 and 45 percent, respectively from 1996 to 2001. This is the result of the combined effect of lower employee productivity (due in part to more training programs) and to less personnel assigned to enforcement activities.

Observers worry that reduced enforcement may lead more people to cheat on their taxes. The voluntary compliance system depends upon taxpayer willingness to comply and the confidence one has that their counterparts, friends or business competitors are paying their share of taxes. A survey requested by the Oversight Board asked taxpayers how much, if any, they thought was an acceptable amount to cheat on their income taxes. In 1999, 87 percent answered not at all while in 2001 this number was down to 76 percent.

2.2 The U. S. General Accounting Office Evaluation Report

The latest thorough report prepared by the GAO was issued on May 14, 2002. The report highlights are:

a. Improvements made

New organizational structure

The agency managed to transition to the new organizational structure with no serious disruption of the filing seasons despite a 10 percent increase in workload measured by returns filed and a 14 percent decrease in aggregate staff, between 1995 and the end of 2001. Nonetheless, since the transition was complete during fiscal year 2001, GAO believes it is still too early to judge the impact that the reorganization has had in improving service.

New budgeting and planning system

A new strategic planning, budgeting and performance management process was implemented during fiscal year 2002. This new process provides IRS senior management with a means to deal with competing priorities faced with available resources and was expected to redirect about 2,300 staff positions to higher-priority areas.

New employee evaluation system

Since February 2000 and October 2001, IRS has implemented new evaluation systems for its managers and for front-line personnel respectively. Although the systems were created to align agency's strategic goals to performance expectations for managers and employees, the agency recognizes that it may take a while before these new systems achieve the intended results. The main concern is the major cultural change the agency is facing. Balancing the goals of meeting taxpayers needs while at the same time enforcing tax laws may seem to conflict to many managers and employees and, thus, it may take some time for them to better understand what the new expectations means in their day-to-day work.

Business Systems modernization

Major progress has been made in establishing the infrastructure systems that will provide the platforms upon which business applications will run in the future. In terms of systems application, the agency launched two important systems: Customer Communications 2001 and Customer Relationship Management Exam. The first system, for example, was developed to improve customer service telephone system by routing taxpayer calls with common questions to automated menu driven information services, thus freeing representatives to answer more complex inquiries.

An updated version of the Business Systems Modernization blueprint was issued. This is an important tool to guide and constrain the acquisition and development of the computer systems by providing a high-level roadmap to manage and control business and technological change.

Overall the nature of improvements achieved thus far should be viewed as a prerequisite and be evaluated in terms of laying the necessary foundations from which the benefits of future applications can be derived. Unfortunately, thus far, the level of tangible benefits derived from the progress cannot be measured against cost incurred.

Financial reporting

GAO considered that, for two consecutive years, IRS financial statements has been fairly in conformity with U.S. generally accepted accounting principles. This unqualified opinion though was achieved at the expense of extraordinary efforts of IRS's senior management and staff to compensate for deficiencies in internal control systems.

b. Risks to continued modernization

Compliance and collection declines

A major source of concern is the decline in compliance and collection activities. As a result of this, the likelihood that taxpayer noncompliance would be detected and pursued by the IRS declined. Also the likelihood that delinquent taxpayers would experience enforced collection such as through levies placed on their wages and bank accounts declined about 64 percent from 1996 to 2001. Taken together these changes reduced the incentives for voluntary compliance and may represent a major hazard to the tax system.

Business systems modernization risks

According to the GAO report, the IRS is not where it committed to be in terms of BSM development and implementation. The report says that the main cause is that the IRS is giving too much emphasis in getting systems, which have direct anticipated benefits to taxpayers up and running, at the expense of establishing proper managerial controls over the process. Thus compromising the balance between controls and project pace and workload. The report stresses the fact that these risks are amplified as the modernization moves forward because interdependencies among ongoing projects and the complexity of associated work activities tend to increase as projects move to the latter stages of development.

Performance management risks

Risks in this vector are associated with three basic problems: 1. comparability of performance measures, 2. better evaluations of programs and business practices, 3. further link budget requests with program results. As part of the agency's ongoing efforts to pursue reform, IRS continues to revise and develop new measures to appraise its performance. Although improving measurement contributes to better management, frequent changes interrupt the possibility of comparing performance between periods and compromise the very reason these indicators are created for: numerically assessing changes in performance. Also, the GAO report mentions several programs that need more and better evaluations to identify ways to more effectively use resources and improve services. Finally, the report identified weaknesses in the IRS's ability to link its budget requests with program results.

Financial management risks

As mentioned in the improvement section, progress in financial management was achieved through the commitment of significant staff resources and time to compensate for systems deficiencies. The report lists a series of weaknesses and the solution for them basically is dependent upon the modernization in information technology that is being conducted.

3. Conclusion

3.1 Suggestions for an improved Brazilian tax administration

Brazilian tax system is almost unanimously recognized to need a reform. To name only a few deficiencies, current system is complex, less progressive than most countries and puts excessive burden in production and exports. Not only a major tax system reform would certainly bring about new challenges to tax administration managers, but also in order to improve efficiency and effectiveness of tax administration agency, the following suggestions are made.

Recent turmoil observed in the fluctuation of our exchange rate gave us alert signals of the importance to pursue policies that enhance macroeconomic stability. In order to support much-needed primary surplus in Brazilian fiscal balance, tax administration can play an important role in this scenario.

In the case of Brazil, it is well known and recognized that the "formal" (organized) sector of the economy already has a heavy burden in terms of taxation, so although we should provide good service to this sector, priority must be given to curb the "shadow" side of our economy. Given our current macroeconomic situation one cannot be cautious enough, so at this point in time we should put more effort in narrowing the "tax gap" by focusing in the enforcement side.

a. Short term measures

Two short-term measures require changes in our tax legislation that could really help enforcement: 1. although tax evasion is considered a crime, one can escape criminal charges if he or she pays owed amount and 2. judiciary system is slow to collect arrears. These two problems would not require a major change in our tax laws and could have a tremendous effect in curbing noncompliance. Since this would probably mean enhanced power to our tax auditors and collectors, tax administration managers should be very careful in dealing with these enhanced powers in order to prevent misuse and abuse of power.

Brazilian taxation system requires that all sales be registered through the issuance of a receipt for fiscal purposes. In the past, the most common strategy to avoid taxation was not issuing such receipt. Afterward, since big companies (big supermarkets, department stores) were more heavily audited and thus required smaller companies to present fiscal receipts, many of them begun to issue phony receipts. With the advance of computerization of tax administrations, it is possible to crosscheck the receipts and since forging documents is a criminal offense, this practice has diminished. Recently, since tax evasion, if paid out later, is not considered a crime, there is an incentive to play the “audit lottery”. Another common strategy is to issue the receipts, recognize that you owe that tax amount and play on the slowness of the judicial system. It can take several years before an asset is seized and another couple of years before this asset is finally sold in an auction.

Changes in the organizational and administrative level should involve enhancing internal affairs office powers and means, and revamping career structure and payment levels allowing more flexibility to hire workers for clerical activities.

b. Medium to long term measures

In most developed countries, local government and local taxes play the most important role in the lives of their citizens. Also, federal government (the most “far” from the citizen) usually is heavily dependent on taxes collected on *personal* income. Brazilian taxation structure, on the other hand, is characterized by the fact that it is heavily dependent on indirect taxes and the biggest portion of tax collected is collected from corporations at the federal level. These two characteristics contribute to a low level of awareness by the citizen of their taxpayer role. Also, these indirect taxes are excise and v.a.t. (value added tax) type taxes that are not transparent to the general public at the moment of purchase.

The two factor discussed in the last paragraph contribute to a “relaxed” sense against tax evasion. Most people do not see that if a businessman is not complying with tax laws, somebody will have to pay more to make “ends meet” in the public budget spending. This also contributes to some degree of tolerance of politicians who are known to steal public money but “delivering” public goods. Since our income tax threshold is relatively high compared to our per capita GDP, many low-income people believe they are not taxpayers and do not understand that the politician is stealing money that was collected from them when they consume goods. So to many low-income people, politicians are “good” when spending money.

In order to correct this situation, longer-term measures include 1. introduction of mandatory public budget principles in public and private education, 2. a major overhaul of the taxation system.

The introduction of mandatory public budget principles should start at high school level all the way until college. One should be very cautious, however, not give this subject a too formal treatment. This subject tends to be seen as “unpleasant” and very boring to many people. The objective of this is to improve taxpayer role awareness and to develop the idea that all public goods have a price and that this price is paid by them, their families and friends as taxpayers.

In 1998 the Brazilian Federal Revenue Secretariat designated a group of employees to study and design a plan to introduce the National Fiscal Education Program.

Also, a major overhaul of the taxation system should include more taxation power to the municipal and state governments. The guiding principle should be: “tax people where and when you deliver the service”. So if the municipal government is responsible to deliver some public service, it should also have the power to create the tax to support this service. Also, a specific tax is better than a general kind of tax, for example, a toll is better than a tax on gasoline consumption to finance road recovery because you can charge only the ones who directly get the benefit.

At the federal level, income taxation focus should shift towards the individual rather than corporations. I believe we can not yet achieve the situation of a developed country like the US where individuals accounted for 50% of tax collected while corporations accounted for only 10% in fiscal year 2000. This is because in developing countries multinational companies whose owners are not under our jurisdiction represent a big portion of the economy. Still improvements can be made in collecting income tax from individuals. Maximum individual taxation rate currently at 27.5% can be increased to around the level of 35%.

An excellent source of guidance in designing a tax administration reform can be found in Silvani and Baer (1997). The paper points out four basic guiding principles which provide basis for successful tax administration reforms: reducing tax system’s complexity, encouraging taxpayer’s voluntary compliance, differentiating the treatment of taxpayers by their revenue potential and ensuring the reform’s effective management. In order to determine the level of changes needed in tax administration, the paper suggests that countries may be divided into four groups according to the level of taxpayers noncompliance or the “tax gap”. The larger the tax gap, the more radical the change needed.

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Appendix 2 - Figure 3: Measuring Performance at the IRS

Goals	Strategic Management Level	Operational Management	Front-Line Employees
Service to each Taxpayer · Make filing easier · Provide first quality service to each taxpayer needing help with his or her return or account · Provide prompt, professional, helpful treatment to taxpayers incases where additional taxes may be due	· Overall customer satisfaction with service/treatment · Customer dissatisfaction (complaints) · Customer satisfaction compared to other organizations	· Satisfaction with particular service · Dissatisfaction with particular service	· Service to taxpayers and treatment of taxpayers incorporated in critical elements
Service to all Taxpayers · Increase fairness of compliance · Increases overall compliance	· Overall compliance percentage · Increase in compliance · Uniformity of compliance · Allocation of compliance resources-dollars vs.resources	· Quality of particular cases/events (EQMS/CQMS) · Quantity of particular cases/events	· Case quality and time management incorporated in critical elements
Productivity through a quality work environment · Increase employee job satisfaction · Hold agency employment stable while economy grows and service improves	· Overall employee satisfaction with working environment · Overall workload vs. size of workforce	· Employee satisfaction with particular working environment	· Future: Teamwork contributes to improving work environment (TQO)

Source :IRS Organization Blueprint 2000

Appendix 1 Figure 1 – New IRS organization chart