

## CHANGES IN THE ORGANIZATION

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### INTRODUCTION

1. One of the problems that has permanently hindered the possibilities of development of the Peruvian economy has been the trend toward tax unbalance.
2. A quick examination of the Public Treasury Accounts corresponding to the last decade allow for observing a persistent and acute deterioration in the attainment of tax revenues.

TAX PRESSURE (% of GDP)	
1980	15.6
1981	13.1
1982	13.0
1983	10.8
1984	11.5
1985	13.2
1986	11.4
1987	8.6
1988	8.5
1989	5.8
1990 I Sem.	4.9

3. The coexistence of a complex tax system and a chaotic administration explains the dramatic downfall which experienced its most critical point at the closing of the first semester of 1990.
4. Within the context of the stabilization program implemented in August 1990, the elimination of the fiscal deficit was determined as a basic objective. To this end, it was decided -among other measures-, to undertake a reform of the entities in charge of tax administration. These are the National Superintendency of Tax Administration (SUNAT) which collects 85% and the National Superintendency of Customs (SUNAD), which contributes the remaining 15%.

5. The purpose of this report is to describe SUNAT's structural reform process which began in March 1991, within the framework of a program designed with the support of international organizations, to be executed in a 36-month period.

## **II. THE EX ANTE SITUATION**

In the case of internal taxes, Central Government revenues were administered until December 1988 by the General Directorate of Contributions, which was a line entity of the Ministry of Economy and Finance. Act 24829 of June 8, 1988, provided for the establishment of the National Superintendency of Tax Administration (SUNAT) as a decentralized institution of the Economic Sector with functional, technical, financial and administrative autonomy.

In practice, the aforementioned act only implied a change of name of the General Directorate of Contributions. Deterioration persisted in aspects dealing with organization and functions, economic and human resources.

### **A. ASPECTS OF ORGANIZATION AND FUNCTIONS**

1. The General Directorate of Contributions had a vast number of offices subordinate to the General Director. The problem worsened with Act 24829. This gave way to two (2) coexisting structures: that corresponding to SUNAT at the upper levels and the other to the General Directorate of Contributions, at the intermediate levels. The normative and operational functions were indistinctly carried out by units of varied hierarchical levels.
2. The specific responsibilities of the Tax Administration continued to be fulfilled by another institution. Enforced collection of taxes and the payment of taxes in installments were the responsibility of Banco de la Nación.
3. The Tax Administration continued without access to banking information for carrying out the verification programs.
4. With regard to the computerized infrastructure, another critical situation was worsened: the lack of a system of its own for processing information. The Tax Administration had partial support from the informatic office of the Ministry Economy and Finance. The requirements of the Tax Administration were handled according to the priorities determined by another institution.
5. Medium-term projects had been relinquished. Taxpayers perceived that the risk for tax noncompliance continued to decrease year after year. Maintenance and updating of the taxpayer file had been abandoned. The legal framework determined the monopoly of tax collection by Banco de la Nación. This

generated inefficiencies that became evident in the broad margin of error at the level of information input and the lack of mechanisms for balancing of cash and conciliation.

## **B. ECONOMIC RESOURCES**

6. The General Directorate of Contributions was dependent on the scheduling of Public Treasury funds. This situation implied restrictions that were dependent on the availability of fiscal resources. Financial limitations thus affected the quality of the service.
7. Act 24829 granted SUNAT 2% of resources collected. This allocation, on the one hand, was affected by the decrease in collection and, on the other, was diluted by the combined effect of hyperinflation and lack of an institutional financial policy.
8. The Tax Administration could not use those revenues to solve the salary problem either. In Peru, there are two (2) labor systems, that of the Private Sector activity (Act 4916) and of the Public Sector activity (Legislative Decree 276). The Tax Administration workers were subject to the Public Sector system. Likewise, the payment of bonuses via a tax fund was inapplicable, given that a benefit in favor of SUNAT staff, apart from the fact that it was neither a fixed or permanent amount and had to be negotiated every time it had to be paid, arose protests and turmoil on the part of the Ministry of Economy employees, part of whose premises were occupied by SUNAT.

## **C. HUMAN RESOURCES**

9. At the end of 1990, the Tax Administration had 3,025 workers. Of this, 65% corresponded to the main headquarters (Lima) and 35% to the regional offices. It must be noted that of the aforementioned total, only 8%, that is, 242 employees were devoted to verification tasks.
10. Between 1971 and 1987, the number of Tax Administration employees more than doubled. However, there was no increase neither in the number of taxpayers or in collection. The uncontrolled growth of staff and budgetary restrictions implied a decrease in actual remunerations of almost 70%.

	Remuneration Expense (Index)	Number of Employees (Index)	Average Salary (Index)
1971	100	100	100
1972	102	105	97
1981	71	123	58
1982	82	123	66
1983	58	152	38
1984	51	167	31
1985	43	184	24
1986	51	202	25
1987	73	222	33

11. In February 1991, average monthly remuneration was US\$50. This salary level made employees look for additional sources of revenue.
12. The lack of selection processes for hiring new staff as well as adequate training programs worsened the critical situation existing at the level of human resources.
13. The insufficient salary level caused periodic suspensions. In some cases, even up to five (5) of the twelve (12) months of the year were affected. This further worsened inefficiency and discredited the tax authority.

#### **D. SYNTHESIS**

The previously described scenario allowed evasion to become a regrettable national reality. Thus, there arose the need for a tax system reform and a structural reform of the Tax Administration.

## **II. THE STRUCTURAL REFORM**

The process began in March 1991. A team of Peruvian professionals- basically from the Central Reserve Bank- with the support of the technical missions from the IMF, IDB and CIAT determined the diagnosis and the pertinent goals. Then the strategy was designed for establishing a modern and honest Tax Administration in a 36-month period.

## **A. ASPECTS OF ORGANIZATION AND FUNCTIONS**

1. A basic criterion adopted was the independence of normative tasks from the operational ones. Four normative areas (National Intendencies) were established: Tax Development, Systems, Legal, and Administration.
2. Ten operational areas were identified and Regional Intendencies were established throughout the country- three (3) in the capital city. The criterion used for this decision was the number of actual and potential taxpayers, the latter estimated on the basis of the level and type of economic activity. The basic structure of each regional intendency endeavors to reflect the logical basis of tax processing: collection, verification and legal affairs.
3. SUNAT's new bylaws defined the general functions of these Intendencies. Generic profiles and the number of professionals were determined for each of them.
4. Given the importance of human resources, the structure provides for the instrumentalization of the Tax Administration Institute. The latter is the place of admittance and training of the new professional staff as well as of currently existing staff. Training is of a global nature covering such subject matters as economics, systems, legal-tax, and ethics. It is anticipated that every three years, the permanent staff devote a quarter exclusively to familiarizing themselves with updates in new administration techniques (Sabbatical quarter).
5. Of the three (3) regional Intendencies in the capital, one of them is in charge of controlling large taxpayers. The number of auditors has been significantly increased, and has come to represent 50% of the staff.
6. Functions previously being carried out by Banco de la Nación, have been transferred to SUNAT; such as, enforced collection and installment payments.
7. As for information technology support, SUNAT is attributing a special role to the information processing system. With the support of IMF, IDB and CIAT, a modern system is being developed in a modular fashion, which is compatible with small, medium and large equipment. The operational system used by this equipment is UNIX. The nature of this equipment allows for the decentralization of data processing at SUNAT. Each regional Intendency will be self-sufficient, in terms of hardware. However, the development of software is centralized.
8. The main functions carried out by the computerized system are:
  - a. Taxpayer master file system,
  - b. Receipt of returns and payments,

- c. System for controlling noncompliers,
  - d. Tax audit system,
  - e. Information crosscheck system,
  - f. System for controlling enforced collection,
  - g. Statistical system.
9. The first module, for large taxpayers is currently in the test period and toward the end of 1992, the system will also be applied in the four most important cities in the country's inland.
  10. Additionally, prior to December 1992, there will be at the central level, equipment that will handle the totality of the RUC, will validate the returns and payments sent by the home offices of the banks on magnetic media and will control management of the regional intendencies.
  11. The informatic support will allow for efficiently operating the collection system through the banking network. This collection system will allow for sound competition for the benefit of the service rendered to the taxpayer. The first agreement has been signed for collection, transfer of funds and processing of returns. SUNAT will pay for the collection and transfer of fund service (a percentage of the amount collected), as well as for the processing of documents.
  12. In the past twelve (12) months, SUNAT has prioritized the expansion of the tax base: the number of active taxpayers has increased considerably. This was the result of several actions that are described below.
  13. The review of the list of large taxpayers subject to direct control of Regional Intendency I: it was increased from 1200 to 2000 economic agents. The criteria applied was volume of sales, taxes paid and social capital. The minimum volume of sales of the companies included in this list is US\$300,000 annually.
  14. The establishment of the Regional Intendency II which controls the direct payment of 1000 taxpayers. On extending the collection system to the entire banking network, this Intendency will be capable of controlling 30,000 medium taxpayers. In the rest of the country, the Regional Intendencies and zone offices supervise 1600 taxpayers.
  15. Verification emphasizes the general sales tax. This tax showed the highest level of evasion. A special group of 130 young auditors works an average of 5,200 verifications per month, at the rate of 2 verifications per capita daily. Verifications are intended to determine:

- whether the taxpayer registered the invoices issued,
  - whether the taxpayer declared the amounts registered in the books,
  - whether the taxpayer paid the declared amount.
16. The capability for verifying enterprises contrasts with that of the General Directorate of Contributions that carried out integral verifications at the rate of 700 per year.
  17. The system of fines and sanctions is being revised so that it may be just and sufficiently compelling for the taxpayer. A first step was the simplification of sanctions for taxpayers who fail to issue invoices, it being determined that the only sanction would be the closing of the establishment. Likewise, in the month of May, the Penal Code was modified, and imprisonment was established as a sanction for those who evade taxes.
  18. Another program that has turned out to be effective is that carried out by the attesters. A team of 100 university students sanction the nonissuance of invoices with the closing of the establishments. Since May 1991 to date, an average of 600 establishments have been closed.
  19. Toward the end of 1991, special operations were begun, aimed at controlling the payment of the GST and at curbing smuggling and "informal sales". These actions were part of the "Spring Plan". Spring I- undertaken in a neighborhood which is known for the sale of merchandise illegally entering the country-, endeavoured to transmit a clear message with respect to the end of impunity of smuggling in Peru. Spring II centered its action on an educational task that resulted in the incorporation of 3000 peddlers of well-known areas in the simplified general sales tax system. Spring III consisted in disseminating 200 auditors for a week in a very dynamic commercial zone with doubtful tax compliance. Over 6000 establishments were registered and are now subject to monthly follow-up of their sales.
  20. The purpose of SUNAT's structural reform is to increase collection so that the State may comply with its basic functions in education, health, security and infrastructure. Tax pressure which was at 4.9% of GDP in the first semester of 1990, registered 7.7% in 1991 and the goal is 9.0% for 1992.

## **B. ECONOMIC RESOURCES**

21. Starting in the first semester of 1991, recovery of the actual levels of tax collection became evident, thus generating more revenues for SUNAT.

22. SUNAT, in its capacity of Decentralized Public Institution, is subject to the legal provisions of public expenditure execution. It is autonomous with regard to its budget and the Superintendent of Tax Administration is responsible for its approval. Its magnitude depends on its own resources (2% of collection), part of which will be used for paying costs generated as a result of Collection Agreements to be signed with banking system entities.
23. In formulating its budget, SUNAT has established as criterion that the remunerations of its staff represent, as limit, one third of its revenues.
24. Resource management has been based on the policy of maintaining the funds required for executing the operational budget in demand deposits, while funds devoted to the execution of the capital budget are placed in time deposits in those banking entities that provide the best return.
25. The availability of resources and adequate financial management have allowed it to acquire its current premises, the renewal of equipment and financing of logistics required for verification operations. These actions have brought about a change of the institutional image before society as well as the workers themselves.
26. The financial policy is oriented toward guaranteeing the necessary funds for the acquisition of premises at the national level for the Regional Intendencies and Zone Offices, for the adequate supply of equipment to all offices, especially in relation to application programs that contribute to compliance with the goals of collection and verification, as well as for the maintenance of the operational programs.

### **C. HUMAN RESOURCES**

27. The basic principle of the reform is that the fundamental element of an honest and effective Tax Administration is the quality of its human resources.
28. Morals, discipline, professional qualification, institutional identification and number of workers, among others, represented the main constitutive factors of the diagnosis in the personnel area, whose conclusions called for an in-depth labor reform.
29. The legal base for carrying out this action was Legislative Decree 639 published on May 18, 1991. This provision stipulated the reorganization of the Tax Administration and suspended the permanence of workers who had to choose between a voluntary retirement program or subject themselves to a series of tests whose results would determine their continuity at SUNAT.

30. Although labor union resistance had been an anticipated obstacle, its influence on the workers and the consequences were greater than expected. In spite thereof, the adoption of several measures, from direct dialogue to security, allowed for solving this problem with relative success.
31. The continuous and reiterated unsuccessful attempts at restructuring the Tax Administration undertaken on previous occasions, implied an understandable initial scepticism on the part of the workers, vis-a-vis the reform.
32. Staff rationalization resulted in the dismissal of 2.034 persons. There was a significant reduction in the area of verification where there was a high index of corruption.

### STAFF REDUCTION

		Lima	Provinces	Total
<b>A.</b>	<b>Staff through 12.31.90</b>	1988	1037	3025
	- Voluntary resignations according to Public Sector Program (April)	629	214	843
	- Voluntary resignations according to SUNAT Program (July)	529	232	761
	- Staff not passing the evaluation	136	294	430
<b>B.</b>	<b>Staff through 12.30.91</b>	694	297	991

33. The staff evaluation was made on the basis of examination through psychological tests covering the following aspects:
  - Personality
  - Intelligence
  - Aptitudes
  - Moral Judgment

It also covered tests of a technical nature for measuring the level of knowledge, reasoning, professional criterion. The personal interviews reinforced or corrected the results achieved and expanded concepts on each of the workers not covered

in the tests. An additional element of judgment were the reports requested to the institutions, from whose registries relevant information was obtained for determining the ethical and oral behavior of the workers. (Comptroller General's Office, Public Registries, District Attorney's Office).

34. The total cost of the incentives program for voluntary retirement was US\$1,450,000. Additionally, the global amount for the payment of compensation for years of service was US\$857,000.
35. The reform included the modification of the labor system. Following pertinent procedures, Legislative Decree 673 was approved and published on September 28, 1991. There it was provided that SUNAT was subject to the private activity system and the trial period regarding the worker's permanence was modified.

The new system allows the Tax Administration to establish its own remunerations policy. It is based on the productivity-salary relationship. It thus becomes a solid basis for institutional effectiveness and morals.

36. Tax Administration professionals went from a level of US\$50 monthly to US\$1,000 at present. The policy applied provides for a permanent evaluation of the behavior of the salary market in order to make adjustments to the salary structure and keep it competitive.
37. Following the application of the program, SUNAT ended up with a smaller number of employees than that required by the new institutional structure. New staff is being incorporated on the basis of strict technical selection processes, in coordination with the most prestigious universities devoted to the training of economists, auditors, administrators and attorneys.
38. The staff hiring policy aims to guarantee human resources that will make the presence of SUNAT felt in society, which must perceive that there is an increasing risk in tax noncompliance.

#### **IV. CONCLUSIONS**

- A. The success of a stabilization program requires the recovery of tax pressure. To this end, one requires, on the one hand, the adoption of a simple tax system, of massive application, with moderate rates and that will not distort the allocation of resources. This task is currently underway.

On the other hand, reorganization of the tax administration is required. The structural reform of SUNAT had been hoped for a long time and until a year ago, its accomplishment was difficult to believe. We are currently

facing the tremendous challenge of establishing a institution characterized by honesty and professionalism.

- B. This crucial task involves an in-depth change and necessarily requires a reasonable time frame for its implementation. Time is required for developing and implementing the new methodologies and procedures, as well as for training the staff that will be using them. One must learn to wait patiently.

It is time to accept that medium term goals must be given consideration over short term pressures.

- C. There are no unique solutions that can be universally applied for improving the administration of taxes. The most convenient strategy depends on the particular circumstances of each case.
- D. It must be pragmatically accepted that the recovery of revenues is a medium term process. To hope for spectacular results within short term is to postulate Utopias. In the Peruvian case, the starting point was a tax pressure of 4.9% observed in the first semester of 1990. In 1992, the pressure was around 9%. The reform's program contemplates 11% for 1993, 13% for 1994 and 15% for 1995.
- E. It is important to await results without becoming impatient or resorting to alternative solutions that would hinder the working processes related to the reform of the basic structures of the Tax Administration. During the recovery period, the fiscal equilibrium should also center its attention on public expenditure.
- F. The joint work of the national team and the external consultants and the strong political support are allowing for the establishment of a solid and respectable institution. There has been significant progress in one year, but there is yet much to be done. Those of us who are in one way or another committed to this task, hope that it will be consolidated so that we may thus contribute to restore credibility and hope in Peru.