# Commonwealth of Puerto Rico:
# *Tax Reform Project*

## Prioritized Opportunities for the Target Operating Model Design

October 31, 2014

# Table of Contents

1. Background
2. About this report
3. Approach
4. Opportunities to be considered for TOM design

KPMG's role is limited to the services and deliverables articulated in the Contract for Professional Services dated March 18, 2014 as subsequently amended (the "Engagement Contract"). It is understood that any actions taken by the Government of the Commonwealth of Puerto Rico related to these services and deliverables may involve numerous factors that are outside of the Contract's scope. KPMG's services and deliverables cannot take such factors into account and, therefore, recommendations for such actions are not implied and should not be inferred from these services and deliverables. Further, while such deliverables may include analyses of certain legislative initiatives, no service described in the Engagement Contract and/or subsequent amendments will involve advising the Department regarding lobbying or other public policy advocacy activities related to legislation or regulation, including evaluating the likelihood of enactment of any proposed initiative or providing advice to the Department as to methodologies to ensure enactment. KPMG cannot undertake any role in connection with the Contract services that could be deemed lobbying, public policy advocacy, or impair the independence of KPMG as an auditor for the Department of the Treasury such as drafting legislation and engaging in implementation assistance.

# 1. Background

KPMG assessed the Puerto Rican tax structure to develop alternative scenarios for the Department of Treasury (Department) to evaluate how an improved tax administration will provide improved compliance rates and tax revenues through a more streamlined and effective system combined with a more effective oversight.

KPMG met with the Department to discuss the parameters to be considered during the execution of this engagement. The Hacienda stated the goals are to:

- Increase revenue to reduce or eliminate the deficit
- Increase Puerto Rico's economic competitiveness
- Have an equitable distribution of the tax burden
- Create a more efficient tax administration

The methodology used to assist the Department in achieving these goals required an understanding of how the Department currently operates and performs. The understanding of the current state allows us to recommend actionable and implementable improvement scenarios taking into consideration the Department's existing capabilities.

# 2. About this Report

**Purpose of this Deliverable**

The "Prioritized Opportunities for the Target Operating Model (TOM) Design" presents to the Internal Revenue Area (IRA) a series of operational improvement opportunities to be used as the input to design and develop the future TOM.

Considering the goals of this project, the opportunities were formulated to obtain the benefits stated in the "3-03 Current Operating Model Assessment" report:

- Operational focus on performance and primary outputs and deliverables
- Improved organizational structure, governance and capabilities in support of an organizational change that enables the administration to achieve their Tax Reform strategy as well as to obtain increased and sustainable levels of compliance rates and tax revenues
- Focus on performance, business constraints and business priorities
- Improved, standardized and consistent business processes which would allow for better measurement and continuous improvement
- Clear link between Tax Reform goals and operational measurements across the Department
- A motivated organization with ambitious, yet realistic goals

**Report Scope**

The scope of this report is to identify and detail improvement opportunities within the IRA's operational components that will support a more efficient tax administration. Work products related to the legislative or taxation changes related to the Tax Reform's stated goals are not included in this report. This report presents five opportunities that will be used as the basis for our recommendations for the future IRA's Target Operating Model.

# 3. Approach

The TOM methodology is designed to change the IRA operating performance and structure by:

- Analyzing and assessing the current operating model using external comparators (see the Comparable Jurisdictions Operating Model deliverable) to identify opportunities for improving the IRA's organization, processes and technology; and
- Designing a new operating model designed to sustain the Department's vision and goals.

According to the Target Operating Model (TOM) methodology, this report completes the "Assess" phase and creates the input for initiating the "Design" phase.

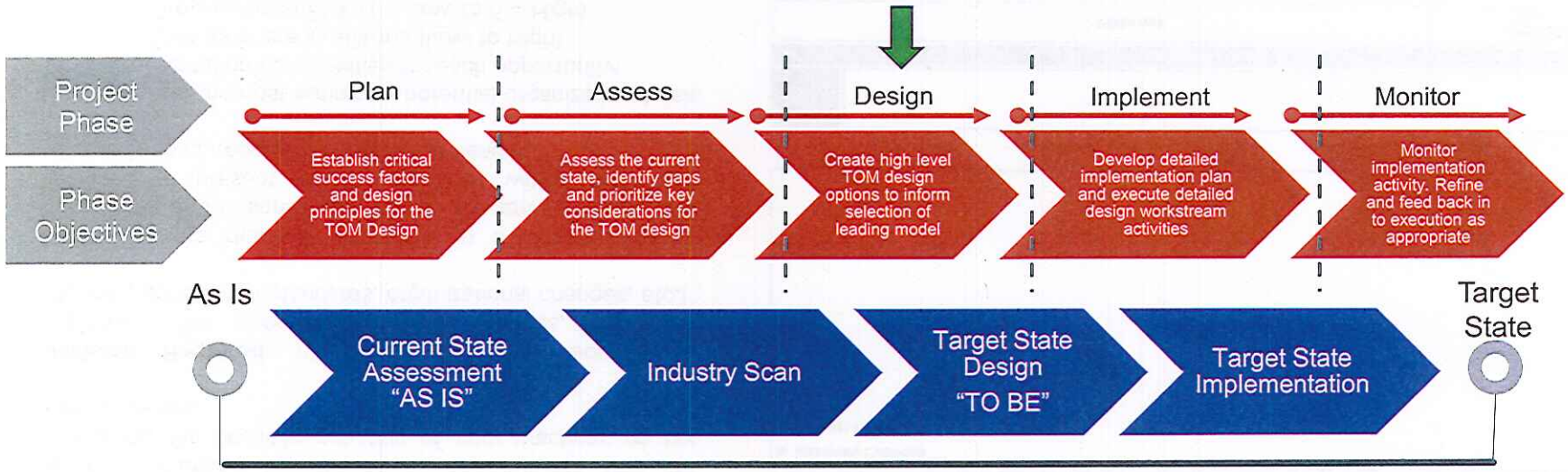



*Figure 1: Target Operating Model Phases*

Methodologies such as Fact Based Consulting (FBC) and Sustainable Value Improvement (SVI) were used in developing the opportunities for improving operations within the IRA.

# 3. Approach (Continued)

The template used to document each opportunity includes the following sections:

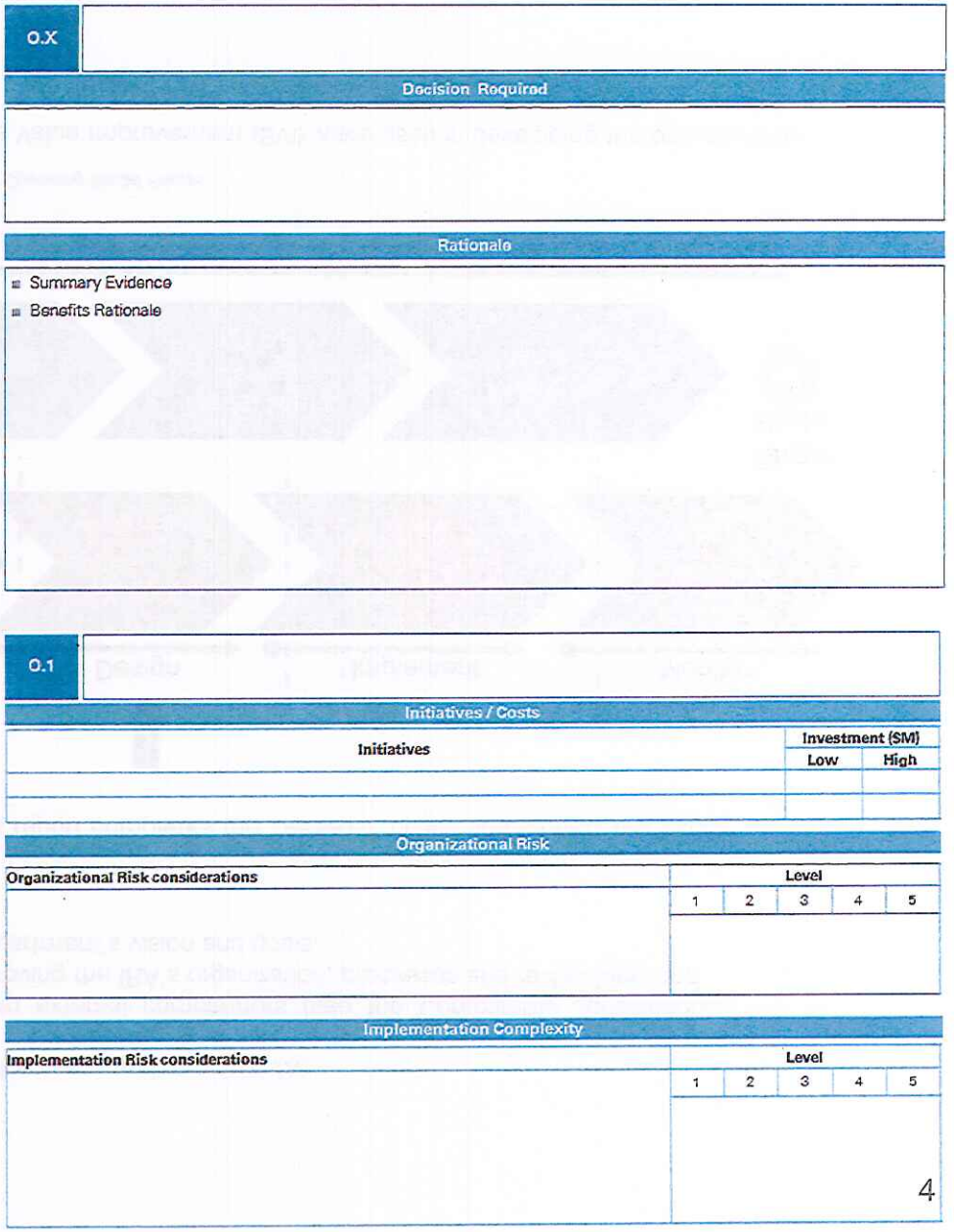
- **Opportunity Number (O.X):** is a restatement of the original hypothesis asserting its validity. In some cases, it may be the result of merging hypotheses or opportunities that are supporting the possible adoption of new practices on tax administration.

- **Decision Required**: notes the decisions required to implement the opportunity (policy changes, legislation changes, adoption of standards, organizational changes, etc.)

- **Rationale**: the rationale described in the corresponding hypothesis, and in some cases there are some comparators specified to present leading practices within other tax administrations, regarding similar experiences.

- **Options**: lists the cost estimate, potential organizational risk and implementation complexities for each opportunity:
    - Cost estimate in millions (Low to High)
    - Organizational Risk (1 = Low to 5 = High)
    - Implementation Complexity (1 = Low to 5 = High)

- **Organizational Risk:** Rate the risk for each opportunity from a score of 1=Low to 5=High based on the scoring definitions below:
    5. Very significant risk (unlikely to be implemented)
    4. Significant risk (hard to see how it could be implemented without substantial loss or damage)
    3. Some risk (could conceivably be implemented but carries some risk)
    2. Minimal risk (can be implemented with minimal risk)
    1. Little to no risk to the organization



| O.X | |
|---|---|

**Decision Required**

**Rationale**

- Summary Evidence
- Benefits Rationale

| O.1 | |
|---|---|

**Initiatives / Costs**

| Initiatives | Investment ($M) | |
|---|---|---|
| | Low | High |
| | | |
| | | |

**Organizational Risk**

| Organizational Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| | | | | | |

**Implementation Complexity**

| Implementation Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| | | | | | |

# 3. Approach (Continued)

**Complexity Scoring:** indicates the level of complexity based on considering the following separate dimensions. Each dimension was scored and the average of the four dimensions indicates the complexity score

*Level of Organizational Change*

5. Significant impact on the organization, highly focused management effort required, complex interdependencies
4. Large impact on organization, close/continuous management effort required, complex interdependencies
3. Some impact on organization, some management effort required, some interdependencies
2. Isolated impact on organization, occasional management effort required, few interdependencies
1. Minimal impact on organization, minimal management effort required, no significant interdependencies

*Availability of technology*

5. Technology yet to be created/developed
4. Technology currently only exists outside the organization
3. Application requires significant development of the organization's current technology
2. Application requires incremental development of the organization's current technology
1. Initiative uses currently available technology

*Skilled staff availability*

5. Resource unlikely to be available within or external to the organization within time-frame of the project
4. Resources require significant external sourcing
3. Resources require re-deployment within organization with potential for significant disruption
2. Resources require re-deployment within organization with minimal disruption
1. Resources currently available within current capacity constraints

| Implementation Complexity | | | | | |
|---|---|---|---|---|---|
| Implementation Risk considerations | Level | | | | |
| | 1 | 2 | 3 | 4 | 5 |
| | | | | | |

*Availability of knowledge/information*

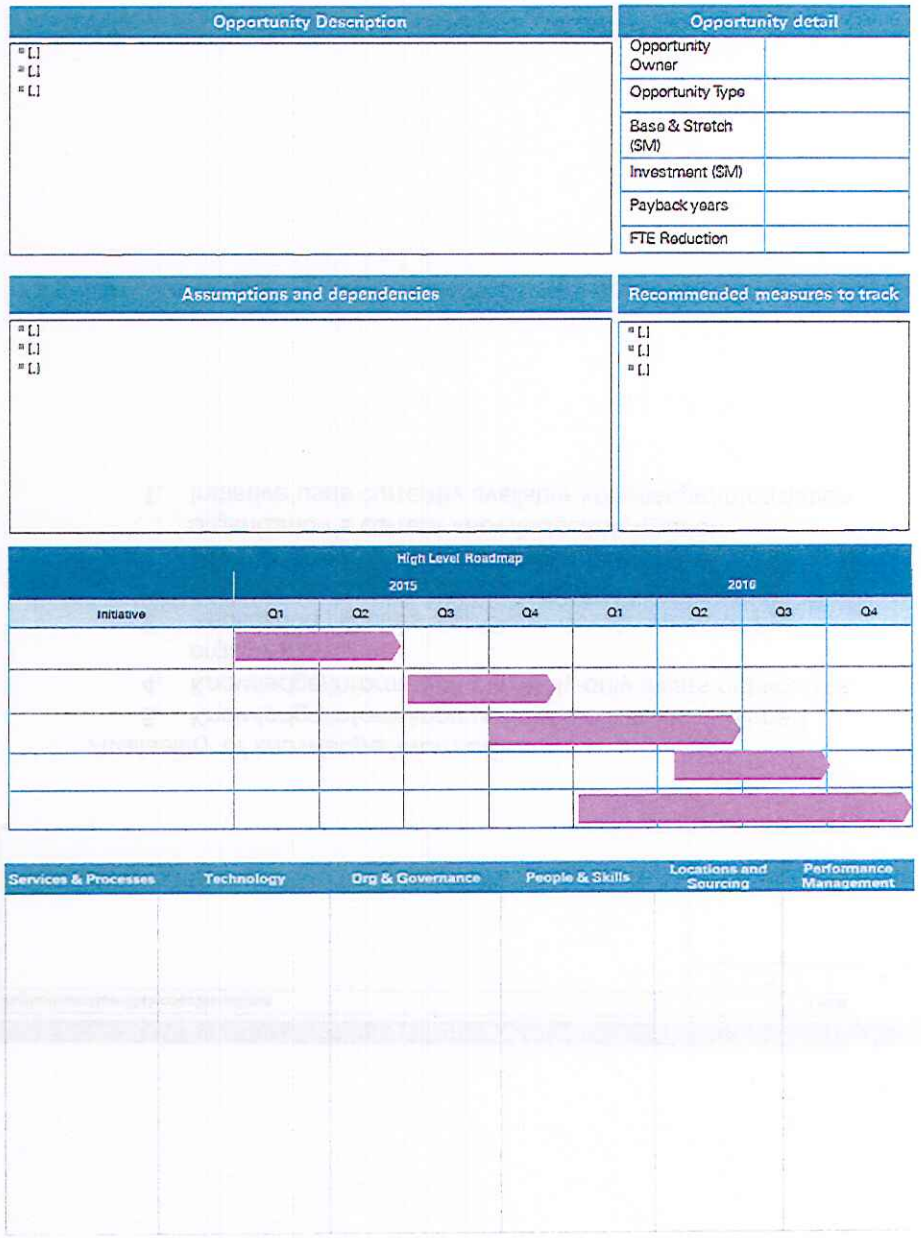
5. Knowledge/information yet to be collated/developed
4. Knowledge/information currently only exists outside the organization
3. Application requires significant development of the organization's current knowledge/information
2. Application requires incremental development of the organization's current knowledge/information
1. Initiative uses currently available knowledge/information

# 3. Approach (Continued)

- **Opportunity description:** defines the opportunity activities or initiatives that may be required to obtain benefits.
- **Opportunity detail:** notes facts regarding the opportunity owner, opportunity type, estimated base goals and stretch goals defined in the hypotheses, initial estimated implementation costs, estimated payback years, and staff reductions, if applicable.
- **Assumptions and dependencies:** notes the premises and constraints that should be considered, solved or mitigated to in the execution of activities defined in the opportunity description section.
- **Recommended measures to track:** identifies the key performance indicators that should be monitored.

- **Timetable:** initial project plan. Further synchronization of the initiatives that are resulting from each opportunity will show an integrated timetable.

- **TOM Elements Impact:** identifies and defines the impacts towards the operational components, that will be reflected on the design of the TOM:
  - Services and Processes
  - Technology
  - Organization and Governance
  - People and Skills
  - Locations and Sourcing
  - Performance Management



## 4. Summary of Opportunities to include in the TOM Design

| | Opportunity | Decision Required | Benefits | Estimated Costs *TBC |
|---|---|---|---|---|
| O.1 | Implement an Integrated Tax Administration IT System | ▪ Replace existing tax administration systems with a new, integrated tax administration system based on a commercial off-the-shelf solution (COTS) | TBD | $146 - 188M |
| O.2 | Improve the current taxpayer services and the corresponding service channels | ▪ Modernize a new taxpayer assistance service strategy and emphasize e-commerce service delivery channels to the taxpayer | $2 - 3M | $3 - 4M |
| O.3 | Tax Simplification will reduce costs and improve operational efficiency | ▪ Improve and gradually modernize the current e-filing process environment to minimize data entry errors and implement pre-filing tax returns.<br>▪ Reduce the number of tax expenditures to simplify tax compliance and decrease tax administration resources. | $4 - 5M | $6 - 7M |
| O.4 | Implement a function oriented organizational structure to reduce costs | ▪ Restructure the revenue body to a function oriented organization.<br>▪ Determine timing of Public Law 70 | $2 - 8M | $9- 12M |
| O.5 | Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance | ▪ Implement a broad-based Goods and Services Tax (GST) | $2,500 - 3,500M | $22 - 28M |
| O.6 | Adopting a risk based compliance management will improve enforcement and optimize tax collections | ▪ Implement an enforcement scheme based on Compliance Risk Management | $318 - 427M | $6 - 7M |
| O.7 | Adopting of a Semi Autonomous Revenue Agency will improve Puerto Rico's revenue authority operations | ▪ Transform the Internal Revenue Area (IRA) into a Semi Autonomous Revenue Agency (SARA) | $0 - 1M | $30 - 40M |

# 4. Opportunities to Include in the TOM Design

## Opportunity 1

## Implement an Integrated Tax Administration IT System

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Decision Required

- Replace existing tax administration systems with a new, integrated tax administration system based on a commercial off-the-shelf solution (COTS)

## Rationale

**Summary Evidence:**

- Unreliable and inaccurate data in systems supporting the Collection, Taxpayer Services and Enforcement processes result in insufficient integrations of systems, which have produced:
  - Unnecessary collection efforts on taxpayers who have complied or don't have collectable debts.
  - Scheduling difficulties for collection visits to taxpayers due to outdated or inaccurate addresses.
  - Sub-optimal collection efforts in specialized economic sectors or industry segments
  - Increased volume of consultations/requests for debt certifications and other services within Taxpayer Services Centers.
- Insufficient functionality to support Enforcement and Compliance processes, including:
  - Lack of automation of a comprehensive tax payer accounts receivable listing
  - Lack of automation in the case management system, including the selection and assignment of audit/collection cases to tax technicians and issuance of notifications to taxpayers.
  - Public Service employees' and contractors' Deductions on Wages sub-process requires completion and approval of hard copy forms. This impacts the ability to effectively execute this collection method.
- Lack of functionality to support the risk-based compliance management function
- Lack of functionality to support the GST processing and validation rules

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Rationale (Cont.)

- Lack of centralized reviews or controls for user access which may result in the following:
  - Inappropriate employee segregation of duties (e.g., correct forms, award payment plans, approval of refunds, etc.), which could increase the risk of fraud, waste and abuse or misappropriation in revenue collections.
  - Detection and correction of unauthorized access in a timely manner.
  - The inability to control system administrators may allow opportunities for users to perform inappropriate activities or modify configuration settings, which could increase the risk of system overrides and security controls.
- The current tax systems are difficult to manage current tax administration because the system:
  - Is operationally complex
  - Requires manual intervention
  - Is cumbersome to implement changes in tax rules and legislation
- Current systems are batch-oriented, which require nightly updates and impact operational flow and efficiency for decision making in a timely manner, also limiting the ability to support enforcement (tax evasion and fraud detection) using incoming returns information due to the lack of reliable historical information on returns and taxpayer accounts.
- The IRA uses as many as 12 different computer applications to administer and collect approximately 22 separate taxes. The fragmentation and lack of integration of these systems limit the Department's ability to effectively process and calculate end-of-year adjustments. Furthermore, there is a large number of cases under review resulting in an increased workload for the Department.
- The current system environment does not provide a holistic and complete view of the tax liability of a taxpayer, hence limiting the capacity of the IRA to enforce voluntary compliance. The limitations of a system encouraging voluntary compliance dramatically increases the cost of tax administration The current system environment does not:
  1) Automatically identify total universe of taxpayers
  2) Automatically identify audit leads
  3) Automatically initiate the billing process which encourages voluntary compliance
- The lack of reliable system generated historical information on returns and taxpayer accounts limits the ability to support enforcement including tax evasion and fraud detection.

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Rationale (Cont.)

- The current system is inefficient in providing taxpayer assistance, information and self-help. Taxpayers must register for tax obligations in person at a Taxpayer Assistant Center or mail paper forms to Intendente Ramirez Tower.
- The Department can't net taxpayer obligations for different taxes, fees and obligations owed to the government. IRA staff assigned to different tax systems have to work with taxpayers separately for each tax owed. Overpayments and underpayments for the same taxpayer, for different taxes, can not be reconciled accurately across tax systems, which increases unnecessary outflow to the taxpayer.
- Current systems require specialized technical resources that are becoming scarce and more expensive.
- Nature of current systems' implementation of business rules require customization and changes to the source code for every new legislative of policy change. This is expensive and creates difficulties in incorporating changes into the processing systems because of the significant number of tests needed to ensure quality.

### Benefits Rationale:*

- In **Australia** the Tax Agent Portal is the main channel for tax agents to interact with the ATO (Australian Transaction Office). Its provides tax agents with rapid online access to a range of information, services and functions including:
  1) refunds and transfers;
  2) income tax, activity statement and fringe benefits tax account information;
  3) view and update a range of client details including name and addresses
  4) add or cancel income tax withholding and GST tax types; a client directory that lists all their clients;
  5) a range of reports containing specific information about clients;
  6) the ability to prepare and log activity statements online and view details of previous activity statements; and messaging facilities that allow them to send enquiries and receive answers from the Tax Office
- The much bigger challenge of the Change Program has been for the ATO to move to an integrated IT environment with enterprise-wide processes focused on meeting the needs of taxpayers. The program, estimated to cost AU$720 million, In the first stage, a new Client Relationship Management (CRM) was introduced in 2006, collecting and centralizing all information about a particular taxpayer. In Stage 2, the existing 180 case management systems were replaced with a single Case Management System, and a new Work Management System was also introduced. Stage 3 involved the delivery of a new Integrated Core Processing (ICP) system to replace 75 existing systems and manage all of the processing work undertaken by the ATO for all types of taxes.

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Rationale (Cont.)

- **Finland's** use of electronic tax administration through the Internet to help lower government costs, provide useful services to taxpayers, and encourage private sector growth. Finland created a web-based system for taxpayers to use to adjust their income tax withholding services, which has helped reduce tax administrator staffing by 11% over 6 years. By making government services more efficient, Finland can free up more of its labor force to be privately employed. Previously, six to eight weeks were required to complete processing of monthly returns. The agency was still working one month's returns several weeks after the next month's were due. Now, return exceptions are resolved within two to three weeks. Thanks to the new system's case management and automated processes (including collection staging and automatic filing of liens), the average time required to complete due process desk work on a collection case has dropped from 160 to 78 days. The backlog of annual withholding reconciliation returns has been eliminated. Previously, the average annual backlog was 15,000 to 20,000.
- The **Idaho State Tax Commission** moved the processing and administration of all the 17 tax types for which it has authority from a 25-year-old "legacy" system to a modern technology architecture and application in less than 2 years (3 months ahead of schedule), and for under $15 million (about $200,000 under budget). The agency migrated from a single-tier proprietary technology architecture – where the user interface, application logic and the database itself all reside on a single platform – to a multi-tier (sometimes called "n-tier") architecture - where the user interface, application logic and the database itself reside on independent platforms. As the project acronym ("CATS" stands for Convert All Tax Systems) implies, the conversion of all independent tax systems to a new fully-integrated tax system was the objective.
- Large scale systems integration (**Ireland**) Revenue´s Income Tax and Corporation Tax Assessing Systems were incorporated into its integrated taxation system (ITS) in 2008 and 2009 respectively. This is a major milestone for revenue in achieving a fully integrated assessing and collection system. The associated benefits to customers included:
  - Customer service staff now have all corporation tax assessing and collection data available within the one system, facilitating faster responses to customer queries and;
  - The notice of assessment is presented in a new and improved format, incorporating a covering letter, summary calculation information and is more fully detailed

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Rationale (Cont.)

- In 2000, federal agencies estimated they saved at least $900 million annually through data sharing initiatives. The Internal Revenue Service (IRS) can use data from taxpayers and third parties to better ensure taxpayers meet their obligations.
- In July 2004, it was reported that data sharing between IRS and the United States Citizenship and Immigration Services (USCIS) has the potential to improve tax compliance as well as immigration eligibility decisions.

* Source: OECD: Tax Administration 2013 - Comparative Information on OECD and Other Advanced and Emerging Economies

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

## Initiatives / Costs

| Initiatives | Investment ($M) | |
|---|---|---|
| | Low | High |
| Define business (functional and system) requirements | $10M | $16M |
| Select vendors, including software and hardware | $20M | $23M |
| Implementation of an Integrated Tax Administration System | $110M | $139M |
| Ongoing maintenance and operations | $6M | $10M |

## Organizational Risk

| Organizational Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| The implementation of an Integrated Tax Administration System will have a significant risk on the organization due to the following topics:<br>• Requires sponsorship from important stakeholders (Governor, Political Parties)<br>• Requires collaboration from existing IRA employees during the requirements gathering phase<br>• May encounter organizational change management resistance by existing IRA and ATI staff<br>• Requires senior management commitment to implement process changes for the new system | | | | 4 | |

## Implementation Complexity

| Implementation Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| To successfully implement an Integrated Tax Administration System, the Department must:<br>• Continuously manage the current operations while designing and implementing the new system<br>• Retain existing employees and retrain in the new environment with minimal disruptions of the operations<br>• Accurately complete a complex and costly legacy data conversion<br>• Maintain legacy systems to complete tax administration on old tax years while simultaneously implementing the new system for current and future years<br>• Effectively manage and rely on multiple vendors for successful implementation<br>• A successful implementation will require significant development of the organization´s current knowledge. | | | | | 5 |

| O.1 | Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations |
|---|---|

## Initiatives description

**Define the business and technology requirements for the new Integrated Tax Administration System**

- Business (functional) and technology requirements should be linked to business needs.
- Conduct meetings and workshops to document and validate the current business process flows and system flows to gain additional input and stakeholder buy-in from the business teams on the high-level current business processes, the future-state business processes and the functional needs of the to-be system. A Case for Change may be required based on changes to the business or system needs, if applicable.
- Document User Design Requirements that can take many forms from process improvements through to the definition of key reports or required information
- Document Information and/or data requirements with the objective of selecting a business process/system that supports the specified requirements. If the use of data is key to the business process/system and the data relationships are complex, a further more detailed analysis may be necessary

**Prepare a cost-benefit analysis of a new Integrated Tax Administration System**

- The financial analysis should address both the business benefits and associated costs that will help define the budget and resources required for the evaluation and implementation of the new tax system

**Select vendor for Integrated Tax Administration System**

- Consider tax administration system procurement options: software and hardware with a system integrator or separate procurements
    - Conduct vendor forum to analyze procurement options
    - Determine software/hardware procurement, if applicable
- Prepare a Request For Proposal (RFP) or similar procurement for the new tax system
    - Establish the evaluation criteria
    - Issue the RFP or similar procurement
- Evaluate the business, technical and cost proposal responses for the new tax system
- Negotiate a vendor contract

**Additional items to consider:**

- Negotiate and execute required maintenance contracts with the selected vendor
- Define the Project Management and Quality Assurance (Independent Verification & Validation) teams for the implementation: select and hire vendors

## O.1 Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations

### Assumptions and dependencies

- Availability of budget to initiate the transition to the new platform
- Establishment of a suitable team to plan, design and implement the new integrated system
- Current IT personnel will need to be trained in the new technology, application and data architecture that will support the new operating model
- Data centers, telephony and processing centers are sufficient to support the computing requirements for a new tax system
- The new tax administration system will be implemented according to the Department's IT Strategy, including the progression of the capabilities evolution
- The adoption of this opportunity will depend on the Department's approved budget allocations

### Opportunity detail

| | |
|---|---|
| Opportunity Owner | TBD |
| Opportunity Type | N/A |
| Base & Stretch ($M) | N/A |
| Investment ($M) | $146M - $188M |
| Payback years | TBD |
| FTE Reduction | TBD |

### Recommended measures to track

- Service Level Performance
- Agility to adapt to new requirement
- Data availability and quality

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

**High Level Roadmap**

| Initiative | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 | 2016 Q3 | 2016 Q4 | 2017-2021 |
|---|---|---|---|---|---|---|---|---|---|
| Define business (functional and system) requirements | | | | | | | | | |
| Select vendors, including software and hardware | | | | | | | | | |
| Implementation of an Integrated Tax Administration System | | | | | | | | | |
| Phase I: *Excise Taxes* | | | | | | | | | |
| Phase II: *Individual Taxes and Additional Functions* | | | | | | | | | |
| Phase III: *Corporate Taxes* | | | | | | | | | |
| Phase IV: *GST* | | | | | | | | | |
| Phase VI: *Post-Go Live Support* | | | | | | | | | |
| Ongoing maintenance and operations | | | | | | | | | |

| O.1 | **Implementing an Integrated Tax Administration System will improve Puerto Rico´s revenue authority operations** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Requirements gathering process must include documentation of to-be services and processes that are supported by a new integrated tax system<br><br>▪ New processes must also reflect the legislative changes | ▪ Assuming that a COTS solution will be selected, the current technology infrastructure will require gradual replacement and must provide for integration with the new system until full replacement is achieved.<br><br>▪ Legacy databases must be cleansed to help ensure a smooth transition to the new system (significant effort and cost) during data conversion phase | ▪ IT organizational structural and governance changes will be required to help ensure expected service levels are documented, measured and achieved | ▪ IT staff must be knowledgeable in the new technologies that the new system operates under<br><br>▪ Customer service staff must be trained on new system processes, requirements, and reporting<br><br>▪ The Department must develop and maintain a robust help desk and web-based self service for internal users and external clients | ▪ Existing support contracts should be kept until the legacy systems are replaced<br><br>▪ Thereafter the proper mix of in-house/contracted staffing levels must be determined to ensure appropriate support of the new system | ▪ Adoption of Business Process Management (BPM) practices and technologies will support performance management objectives |

# 4. Opportunities to Include in the TOM Design

## Opportunity 2

## Improve the current taxpayer services and the corresponding service channels

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

## Decision Required

- Modernize a new taxpayer assistance service strategy and emphasize e-commerce service delivery channels to the taxpayer

## Rationale

### Summary Evidence:

- Currently IRA offers the following taxpayer assistance services through the web channel: electronic payments, debt certifications, e-filling (individuals only), tax returns, excise tax calculation and anonymous complaints
- The current web channel does not provide sufficient and reliable information to the taxpayers or to IRA's personnel that provide the services
- Client requests and inquiries are recorded in two different systems increasing duplication of effort and data entry errors: Q-Matic to assign the sequential number to the case, and PRITAS to record high level information about the nature of the request and its resolution.
- For example, in 2013 the number of inquiries increased approximately 21%, possibly due to inaccurate information in operational systems
- Fiscal stamp purchases account for 44% of transactions, only 19% of which are completed online, which results in a sub-optimal use of web services and provides an opportunity for the application of e-commerce.

### Benefits Rationale:

- *Service diversity*: Modern tax administrations provide support to taxpayers across all tax administration functions, tailor information to different types of taxpayers and taxes, provide both accessible and complex information, and use multiple channels, including the web, paper brochures, and telephone inquiries
- *Reduction of the number of telephone calls*: **Australia** seen a reduction in the number of telephone calls. For example in 2004-05 the Tax Office received just under 11 million telephone calls which represented a drop of around 4% from the previous year. The introduction of the Tax agent Portal and the ability for agents to view their clients' details has resulted in a marked reduction in the number of these types of calls. Further strategies to reduce calls have included the further development of Self Help Interactive Voice Response (IVR) applications. For example, an automated publications phone ordering system has recently been introduced.
- *Time saving strategies*: In **Canada**, transforming the in-person service from a walk-in service to a service-by-appointment is part of the Revenue Agency's long-term service goal to migrate Canadians to more affordable, accessible, and equitable service channels. 33% of public enquiries are handled electronically through the use of technological solutions such as IVR and click-to-talk web/phone integration.

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

## Rationale (cont)

**Benefits Rationale:**

- *Reducing un-necessary contact:* **Canada** has conducted studies of telephone profile of inquiries with the purpose to gaining a better understanding of what taxpayers are calling about and implemented the necessary actions to respond this demand
- *Functionality*: Implementing a integral and scalable system with the potential benefits of instant viewing, full contact history, accountability, knowledge management, provide statistics and the ability to archive data
- *New channels*: Mobile phones have also become an important additional electronic service delivery channel that has grown rapidly over the past 5-10 years.
- *New services*:
  - E-payments have been implemented in 82% of the surveyed bodies by the **OECD** in 2010 where 5 revenue bodies achieved fully electronic payment volumes in excess of 80%.
  - Similarly, in revenue bodies surveyed by the **OECD** in 2010 the E-invoice system has increased significantly since its launch in 2004. In December 2008, there were some 400,000 users who issued 900,000 invoices. The system delivers many benefits for users. For example, taxpayers do not have to visit revenue body offices to obtain new invoices etc., invoices are sent automatically (and free) to service recipients, users have an automated record of their transactions, and use of the data for pre-filling annual tax returns significantly reduces the burden of taxpayers.

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

## Initiatives / Costs

| Initiatives | Investment ($M) | |
|---|---|---|
| | Low | High |
| Conduct a survey to identify key issues for taxpayers | $1.0M | $1.4M |
| Define a new taxpayer assistance service strategy and corresponding service channels | $1.3M | $1.7M |
| Compile taxpayer common issues to build a Knowledge Management repository | $0.6M | $0.8M |

## Organizational Risk

| Organizational Risk consideration | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| Improving taxpayer services and service channels will have a medium impact on the Department; in order to implement this opportunity the Department may consider:<br>◦ Defining an integrated taxpayer assistance service strategy and the required service channels across multiple bureaus, divisions and municipalities<br>◦ Require significant management effort to align the Department with a service strategy<br>◦ Availability of high quality data and centralized data repositories for manual and electronic processes to handle taxpayer inquiries, requests or complaints. | | | | | |

## Implementation Complexity

| Implementation Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| The complexity level was assigned on the efforts required, To successfully implement new assistance services and the corresponding service channels the Department will need to:<br>◦ Leverage from the current capacity of employees and provide the possible new service strategy<br>◦ Develop a knowledge management repository<br>◦ Incrementally develop the current IT Platform<br>◦ Manage taxpayer expectations through transition to a more web-focused taxpayer portal<br>◦ Leverage taxpayer knowledge of web-service portals (i.e. mobile banking, credit card payments, etc.)<br><br>Applying this opportunity it would be require an incremental development of the organization´s current knowledge/information toward new services. | | | | | |

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

## Initiatives description

**Conduct a survey**

- Determine the correct statistical sample that includes all the districts, municipalities, type of taxpayers and type of tax collected; which will result in the definition of the Customer Segments. The use of segmentation models varies according to purpose, but most revenue bodies divide users into individuals and companies, where companies are further divided into large companies and small and medium sized enterprises, and tax agents.
- Identify the communications channels (i.e.: print, personal, telephone, Department's website, Department's Social Media, Third Party's website, focus groups) that will support the execution of the survey. Currently Puerto Rico's taxpayer is exposed to thousands of marketing messages each day, which is why it is critical to understand how, when, and where taxpayers will be really engaged.
- Obtain approval for the required staffing and budgetary resources to execute the survey. Revenue bodies have started to approach their users more proactively, by conducting surveys and analysis on users' communication preferences, and their perception of the communication. The insights from this research are then used as input to provide better service.
- Assign a team in the Department (IRA) to analyze the collected data. In addition to collecting the right data, it is important to convert it into actionable insights— and then distribute insights to anyone with customer interface. Using regression analysis, artificial intelligence tools, and basic indicators leading companies continually refine their results and feed them back to different levels of the organization.

**Define a new taxpayer assistance service strategy**

- Conduct meetings with the objective of determining IRA's customer segment for the new Operating Model. A segment should be categorized by mutually exclusive and statistically valid groupings. Within each grouping customers will have similar responses to services and treatments and between the different groups, customers will have significantly different needs and responses to services and treatments.
- Analyze what the customer segment perceives as *valuable* (which is often described in terms of meeting taxpayers' needs and making the contact with revenue bodies easier, faster and more efficient).
- Develop a Customer Centric strategy where the IRA will seek to meet taxpayer needs in every opportunity and is always close to the taxpayer.
- The Department should define the channels that effectively meet the customer segment preferences, give customers increased access to high value-added services and lower cost to customers in using the selected channels; including: reduced need for contact, reduced time spent in contact and lower direct costs of using channels are attractive to customers
- Establish performance management indicators that provide, in a reliable and consistent way, information on the efficiency of the channel strategy. New procedures for performance and cost reporting must be established
- Create a roll-out plan that integrates key personnel from all the bureaus because the introduction of new channels and refocusing of existing channels will change the way tax staff interact, cooperate and meet taxpayers.

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

## Initiatives description (Cont.)

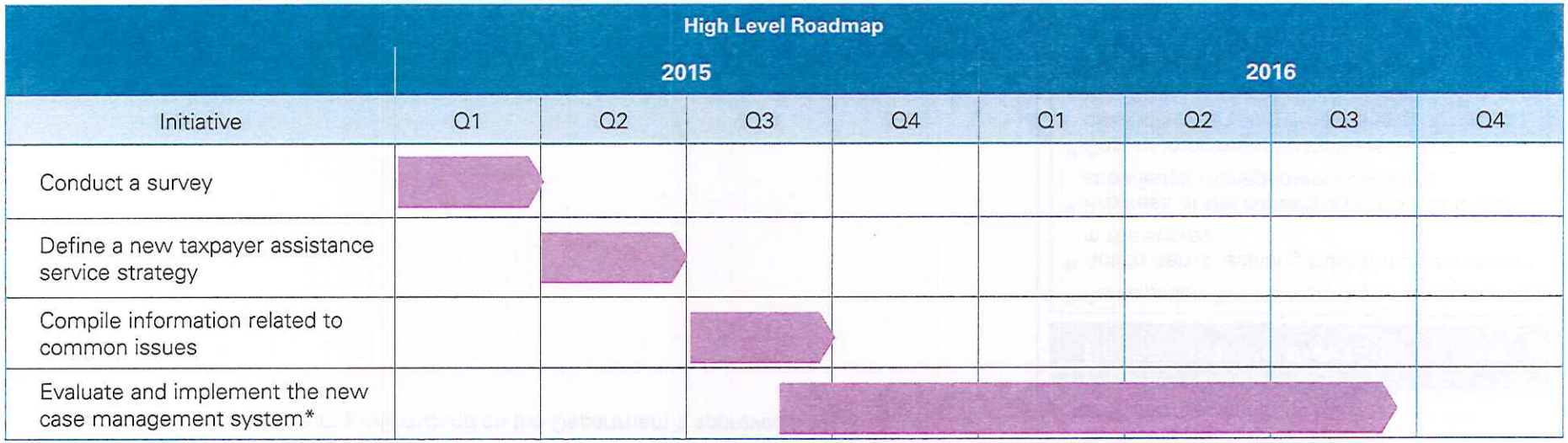
**Compile current information related to common issues**

- Determine data that should be migrated from current IMS (Q-Matic or PRITAS) and decide how to migrate the data
- Identify the project team from IT and Taxpayer Assistance and Specialized Consults (NACSE)
- Analyze and define the following teaming schemes for the project:
    a. Team Lead and IRA personnel support
    b. IRA Team Lead with external provider support
    c. External Provider Lead with IRA personnel support
- Determine how the information will be compiled, evaluated and communicated

**Evaluate and implement the new case management system (See opportunity O.1 for details)**

- Prepare a Request For Proposal (RFP) or similar procurement for the case management system
    - Identify the business, technology and data requirements
    - Establish the evaluation criteria
    - Issue the RFP or similar procurement
    - Evaluate the business, technical and cost proposal responses
    - Negotiate a vendor contract
- Implement the new case management system with the corresponding IRA project team and selected external provider
- Migrate the information compiled from the common issues in the new case management system that allows IRA to manage cases and build knowledge about the resolutions

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|




**The high level implementation roadmap of the case management system can follow O.1 Integrating a Tax Administration System roadmap if included in scope*

## O.2 Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance

### Assumptions and dependencies

- The new assistance service strategy must be a simple system that a broad array of taxpayers will embrace and use
- The case management system is scalable and cost effective
- IRA's strategy must "pull" taxpayers' participation on the new assistance channels
- The volume in high cost channels (i.e.: paper, telephone) will not decrease proportionally due to fixed costs which will decrease over time
- IRA may reorganize operations as a result of a new assistance service strategy
- IRA has to define metrics to measure the benefits of implementing the new assistance service strategy, the corresponding channels and supporting the case management system (see recommended measures to track box on the right)
- The adoption of this opportunity will depend on the Department's approved budget allocations

### Opportunity detail

| | |
|---|---|
| Opportunity Owner | TBD |
| Opportunity Type | Cost Reduction |
| Base & Stretch ($M) | $2 - 3M |
| Implementation Cost ($M) | $2.9 - $3.9M |
| Payback years | TBD |
| FTE Reduction | TBD |

### Recommended measures to track

- Participation % of the survey
- Action items resulting from the data analyzed in the survey
- Progress of the content and artifacts of the knowledge management repository
- Cost of implementing new e-services channels
- Execution and progress of system's implementation plan

| O.2 | **Improving the current taxpayer services and the corresponding service channels will increase efficiency and increase compliance** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Reduction of requests for extensions to file Income Tax Returns<br><br>▪ Definition, development and implementation of alternative channels<br><br>▪ Increase in anonymous complaints or inquiries<br><br>▪ Simpler tax returns will decrease the volume of inquiries | ▪ Adopt technology that supports the new service strategy and case management system | ▪ The organizational structure should support the new strategy and the services that will be provided<br><br>▪ The span of control of key personnel will be more specific | ▪ Phased reduction or reassignment of Department personnel<br><br>▪ Specialized training to manage cases<br><br>▪ Reduction of the time spent interacting with taxpayers on traditional service channels<br><br>▪ Customer service staff must be trained on new system processes, requirements, and reporting<br><br>▪ The Department must develop and maintain a robust help desk and web-based self service for internal users and external clients | ▪ Phased reduction of the number of collection centers across Puerto Rico<br><br>▪ Phased reduction of sourcing costs | ▪ Adopt mature key performance indicators |

# 4. Opportunities to Include in the TOM Design

## Opportunity 3

## Tax Simplification will reduce costs and improve operational efficiency

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

## Decision Required

- Improve and gradually modernize the current e-filing process environment to minimize data entry errors and implement pre-filing tax returns.
- Reduce the number of tax expenditures to simplify tax compliance and decrease tax administration resources.

## Rationale

### Summary evidence

- In 2012, only 44% (out of 1,265,784) individual tax returns were filed electronically, while in 2014, 52% (out of 1,222,222) individual tax returns were also filed electronically, representing an increase of 8% in e-filing.
- Currently taxpayers (individual and corporations) that use tax expenditures (deductions) allowed by the Puerto Rico Tax Code must present supporting evidence for the deductions claimed. The supporting documentation must be submitted on paper and attached to the paper tax return forms, since the electronic filing system does not allow any attachments. The Department will not reduce the number of paper tax returns submitted if hard copy documentation requirement remains.
- Taxpayers earning $50,000 or less in adjusted gross income receive a benefit of free electronic filing by the Department with the support of five (5) service providers transmitting tax prepared returns, however this subsidy is absorbed by the Department at a total cost of $1.5M annually. The Department incurs additional expenses to test and certify tax law changes that are entered in the system from service providers.
- Paper filings must be manually entered into the tax system by Department personnel, resulting in data entry errors.
- The Department of Finance incurs in annual tender preparation and selection of service providers for electronic filing which requires legal and internal staff effort.
- The Department invests approximately $1.5M with five service providers to prepare electronic forms to individuals at no cost

### Benefits rationale*

- E-filing minimizes staff workload and operational cost due to the submission of tax returns in a paperless environment. E-filing also reduces the cost of processing, storing and handling of tax returns. In addition, it allows administrative resources to be reallocated to other tasks such as auditing, taxpayer services and tracking non-compliance.
- The e-file program verifies tax returns for common errors before the returns are processed. Verification provides the e-filer the opportunity to correct the return and avoid a failure to comply notice. The error rate for paper returns is approximately 10%, while e-file returns have an error rate of less than 1%. Providing pre-filled personal tax returns will reduce taxpayers return preparation time and increase the accuracy of the filed returns.

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

## Rationale (Cont.)

### Benefits rationale*

- There are potential cost savings resulting in reductions of FTEs associated with a reduction in returns submitted and processing.
- Improving the in-house e-filing platform will allow the Department to reduce data entry errors and other concerns about tax data processing. E-filing provides taxpayers with pre-filled forms.
- **Chile** is one of the few economies that have managed to approach nearly 100% use of electronic systems and continuously upgraded its electronic system and offered prefilled electronic forms to simplify the process for taxpayers. It also introduced ambitious initiatives to overcome connectivity shortages by creating a public-private network of more than 880 e-filing centers, providing more than 30,000 connectivity points. In addition, it made arrangements with internet cafes so that taxpayers could use their equipment for free and trained operators at access points. It even developed a mobile training and awareness unit that traveled to different parts of the country to help people file taxes online.
- In **Malaysia**, e-filing has lowered the initial cost of processing returns. The FTB (Franchise Tax Board) estimates that the average cost to the department to process a corporation paper filed return is $6.00 (includes complex and smaller taxpayer returns), as opposed to 36 cents (primarily based on smaller taxpayer returns) for an e-filed return.
    - The FTB (Franchise Tax Board) could process an e-filed return quicker than a paper return. Time saved in processing translates to quicker refunds.
    - Generally within 24 to 48 hours the FTB (Franchise Tax Board) provides an acknowledgment that the corporation's return has been received and accepted.
- Elimination of the annual process of preparing tenders and selection of new service providers for electronic filing will reduce costs associated with the RFP preparation and testing of supplier e-filing process.
- A tax expenditure is a government spending program through the tax code. They are usually implemented as exemptions, deductions or credit that a select group of taxpayers receive according to the needed requirement fulfillments. Tax expenditures are not reviewed annually and the only way to remove them is trough tax legislation. Reducing tax expenditures will simplify compliance, reduce tax burdens and simplify tax administration.

** Sources: Analysis of original bill in Franchise Tax Board – Assembly Revenue and Taxation Committee, March 24,2014*
*Implementing electronic tax filing and payments in Malaysia, Doing Business 2014*

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

## Option & Initiatives / Costs

| **Options/Initiatives** | Estimate Investment ($) | |
|---|---|---|
| | Low | High |
| Increase electronic filing | $2.2 M | $2.8 M |
| Create pre-filled tax return | $2.5 M | $3.2 M |
| Reduce the number of tax expenditures | $0.3 M | $0.4 M |
| Staffing outplacement and retraining | $0.8 M | $1.0 M |

## Organizational Risk

**Organizational Risk considerations**

Tax simplification will represent some risk on the organization due to the following topics:

- System reliability will require 24/7 monitoring
- Online security in an electronic environment presents operational risks, such as exposure to viruses and identity theft
- Privacy and confidentiality
- Integrity of the data transferred

| Impact/Risk | | | | |
|---|---|---|---|---|
| 1 | 2 | **3** | 4 | 5 |

## Complexity Risk

**Implementation Risk considerations**

Implementing a Tax simplification initiative must consider the following:

- Significant investments in technology and organizational capabilities.
- Develop a detailed transition strategy to address the concerns of mandatory electronic filing, which will require significant knowledge transfer supported by external experts.

| Impact/Risk | | | | |
|---|---|---|---|---|
| 1 | **2** | 3 | 4 | 5 |

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

**Initiative description**

**Increase electronic filing**

Improving current platform and using a component supported by third parties initiative will continue to provide individual taxpayers with a method of preparing their own returns by completing tax forms on a secure web site and electronically submitting (e-filing) their completed tax returns directly to the Department for free or with third party involvement

The implementation of this initiative will be as following:

- Develop a business case:
  - Assess the functional value provided by the back-office systems:
  - Determine the systems capabilities to support new web-based functionalities
- Review third party contracts:
  - Renegotiate the contracts already in place, if needed
  - Negotiate with new possible providers, if applicable
- Data purging and cleanup to facilitate integration
- Design implementation plan:
  - Identify hardware and software configurations needs to comply with new approach in a full e-filing environment
  - Identify the capabilities of third party involving transmission protocols.
- Execute implementation plan
- Testing period
- Marketing and Training:
  - Develop awareness campaigns through various channels of communication
  - Execute in-door trainings to taxpayer on how to use the system.
  - Provide incentives and services to encourage e-filing.

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

**Initiative description (Cont.)**

**Create pre-filled tax return** is one prepared by the revenue body for the taxpayer by using information reports provided by a third party and other sources of information. By providing completed or largely completed tax returns for their taxpayers, revenue bodies can simplify the tax filing process to the taxpayers, reducing their compliance costs and helping them to meet their obligations. In this case, the pre-filled tax return will be sent electronically, using the web portal. The implementation of this initiative will involve the following activities:

- Verify Legal Framework:
  - Identify law implication on sharing confidential data from employers, banks, insurance companies, utilities' providers and other government agencies to provide reporting information about the taxpayers.
- Technical Background:
  - Develop an interface that matches the information from taxpayers provided by other companies with the information that the Department already manage.
  - Debug and update the taxpayer database
- Define Taxpayer Target group:
  - Identity the target group of taxpayers to start the implementation of this practice.
- Testing Period prior to implementation:
  - Run a pilot project before implementing, with a voluntary group of taxpayer that can take part after signing a cooperation agreement with the Department.
  - Organize meetings and consultations to receive feedback from the voluntary participants
- Implementation:
  - Perform a communication strategy focused on the Department employees and Taxpayers.
  - Go live with pre-filled tax returns.
- Monitor and upgrade:
  - Send survey to each taxpayer after they finish checking their pre-filled tax return.
  - Analyze the survey results in order to find areas of improvement.
  - Determine, which types of taxpayer should be considered for pre-filled tax returns for the next fiscal year.

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

**Initiative description (Cont.)**

**Reduce the number of tax expenditures***

This could be implemented as follows:

- Analyze Legal Framework:
  - Implement a reform to eliminate or reduce tax expenditures from the current tax legislation based on the proposed changes from the revision of the current Code and related laws.
- Marketing:
  - Implement a communication campaign directed to all taxpayers in order to understand the changes that would be made to the new tax returns filing forms and provide information about the expenditures that are being eliminated.

**Specific details on the reduction of tax expenditures will be discussed by the tax design workstream and will be dependent on the approval of the overall tax reform.*

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

## Assumptions and dependencies

- The Department will draft and seek approval of amendments to the tax code to enable tax simplification
- The Department will review current tax expenditures (deductions, credits and exemptions) and amend the legislation to eliminate them.
- The Department will have a tax administration system that fully supports the submission of electronic tax returns – which will include data automatically populated from historical returns and employer payroll informative submissions, enhanced taxpayer security requirements for protected data transmission and reception and promote a reliable and protected environment
- The number of individual income tax filings will decrease as a result of reducing the universe of individual tax filers. The income thresholds are at the discretion of the Legislature and not included in this report.
- The adoption of this opportunity will depend on the Department's approved investment budget

## Initiative detail

| | |
|---|---|
| Initiative Owner | TBD |
| Initiative Type | Cost Reduction |
| Base & Stretch | $3.5M - $4.9M |
| Implementation Cost | $5.8M – $7.4M |
| Payback years | TBD |
| FTE Reduction | TBD |

## Recommended measures to track

- Number of taxpayers that will be affected by the elimination or reduction of expenditures.
- % of *e-filers* accomplished per year
- % of non conforming data reported by the night systems validation jobs.
- Taxpayer survey satisfaction
- Number of issues presented per year related with system functionalities reported by internal and external users.
- Estimate time of processing of the e-filed returns vs paper returns.

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

**High Level Roadmap**

| | 2015 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| Initiative | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Increase electronic filing | | | | | | | | |
| Create pre-filled tax return | | | | | | | | |
| Reduce the number of tax expenditures | | | | | | | | |

| O.3 | **Tax Simplification will reduce costs and improve operational efficiency.** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Location & Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Simpler tax return processing<br><br>▪ Reduced effort in in validating returns<br><br>▪ Additional volumes of submissions expected due to increased compliance<br><br>▪ Simpler tax returns will lower the volume of inquiries | ▪ Implement rules-based deduction checking to minimize manual intervention<br><br>▪ Provide electronic content management to enable taxpayers supporting documentation capabilities (ECM) | ▪ Phased reduction of personnel needed to validate and verify tax return data<br><br>▪ Phased reduction of personnel in returns processing and refunds | ▪ Retooling and retraining of staff to increase risk based focus on enforcement, audits, compliance and taxpayer services in data analytics<br><br>▪ Initiate outplacement process of staff | ▪ The existing services contract for e-filing services companies needs to be reviewed and tied to service level agreements | ▪ Recommendations to implement performance measurements around the effectiveness of e-filing considering the number of e-filers and the costs associated with e-filing |

# 4. Opportunities to Include in the TOM Design

**Opportunity 4**

**Implement a function oriented organizational structure to reduce costs**

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

## Decision Required

Restructure the revenue body to a function oriented organization.

Determine timing of Public Law 70

## Rationale

**Summary evidence:**

- A functional organization structure is a Tax Administration structure based on the type of work performed rather than the tax type or taxpayer structure (example: Registration, Collection, Audits, Enforcement, Taxpayer services, etc). It´s implementation is based on the idea that by grouping together activities that require similar skills or specialties, efficiencies can be realized due to the increased depth of knowledge in core areas and process optimizations. This type of structure will enable units to focus on primary activities with an increased efficiency, it also enhances control and accountability and it is highly effective for introducing a new tax, because it requires minimal future changes to the organizational structure.
- This opportunity will focus mainly on taxpayer services, audit and consumption tax, which is now being managed by a separate unit
- Each initiative will require a series of activities, focused on implementing a functional structure by minimizing risk

**Benefits rationale:**

- A function oriented structure reduces duplication of efforts caused by the type of tax structure that can be grouped by the tax type: sales tax, individual income tax, corporate tax, etc.
- Permits standardized processes among tax types and streamlines interaction with taxpayers as it provides a single access point for services
- Simplification of procedures, which taxpayers are required to follow
- Permits greater uniformity across the organization and promotes greater efficiency and higher productivity of the overall tax administration
- Allows enhanced specialization, cross-training and career development among Department staff and also facilitates work process automation
- Costs and staff can be reduced by eliminating duplicate positions and functions and optimizing processes by grouping the structure according to the type of function performed.

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

## Initiatives / Costs

| Initiatives | Investment ($K) | |
|---|---|---|
| | Low | High |
| Review organizational legislation and sourcing contracts | $0.3M | $0.4M |
| Create blueprint and develop an implementation plan | $0.8M | $1.0M |
| Implement communication plan | $0.3M | $0.4M |
| Conduct training plan | $1.6M | $2.0M |
| Execute implementation plan | $5.4 M | $7.1M |
| Implement outplacement strategy | $0.3M | $0.4M |
| Develop and implement monitoring plan | $0.3M | $0.4M |

## Organizational Risk

| Organization Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| The implementation of a Function Oriented Structure will have a medium impact on the organization because the Department:<br>• May encounter change management resistance from personal or represented labor<br>• May require enhanced personnel training (or cross-training) due to new skillsets and potential high turn over<br>• Will require significant management effort to implement organizational change<br><br>This opportunity could conceivably be implemented; however, will carryout some resistance from employees and unions due to downsizing. | | | | | |

## Implementation Complexity

| Implementation Risk considerations | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| To successfully create a Function Oriented Organizational Structure the Department may consider:<br>• Continuously manage the current operations and adopt a new structure based on Skilled staff availability.<br>• Transition employees whose functions are no longer required, without affecting the current operation.<br><br>Applying this opportunity will require incremental development of the organization´s current knowledge/information. | | | | | |

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

## Initiatives description

**Review Organizational Legislation**

- Determine if any legislative action is required to establish organizational changes.

**Review Sourcing Contracts**

- Revise contracts with existing sourcing providers in order to determine if and how the contracts can be modified or renegotiated.

**Create blueprint and develop implementation plan**

- Create a detailed design of the "to-be" organizational structure, taking into consideration the proposed staff for each area
- Design the new processes for each function, detailing roles that would be responsible and accountable. Draft new procedures for each process, if applicable.
- Identify the level of personnel needed to support function-oriented organizational structure
- Design the implementation plan to include:
    - Roadmap for implementation, detailing dates, activities and owners
    - Design the communication plan based on the communication strategy and change management strategy
    - Design a training and development plan.
    - Create an outplacement strategy (analyze timing for Public Law 70)

**Implement communication plan**

- Deliver the key messages to the determine audience, utilizing the available channels
- Monitor effectiveness of the communication plan by requested feedback from the involved audience

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

## Initiatives description (Cont.)

**Conduct training plan**

- Develop training materials of new processes, procedures and roles
- Conduct training sessions
- Provide post training assessments to measure and track the effectiveness of the training sessions
- Update training materials, as needed, to incorporate known gaps in procedures and processes
- Reinforce the knowledge gaps identified on the post training evaluations, that required further assistance

**Execute implementation plan**

- Implement the new functions and processes; deliver new procedures to all Department personnel
- Realign various bureaus within the Department to follow the new Function-Oriented Organizational structure
- Monitor implementation progress; schedule and conduct Department meetings as needed

**Implement outplacement strategy**

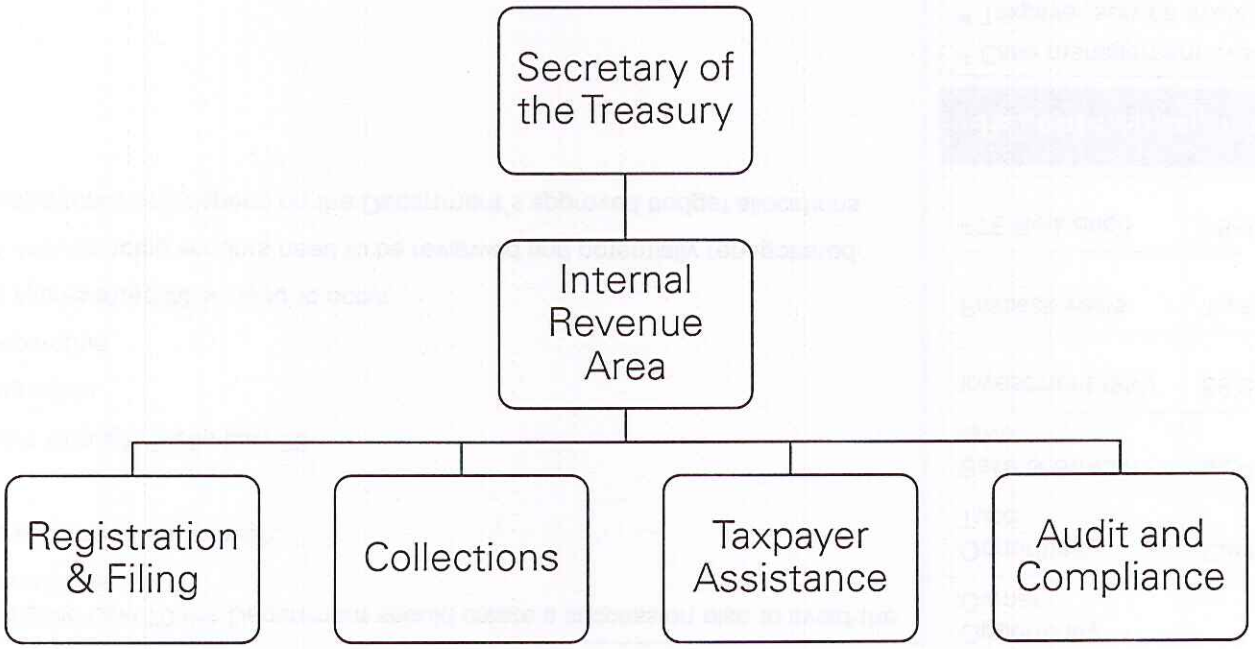
- Conduct sessions to help employees search career opportunities
- Provide training on general subjects to provide individuals with the knowledge and skills needed to pursuit a career opportunity
- Provide individuals with information on Public Law 70 for early retirement options and community service activities

**Develop and implement monitoring plan**

- Monitor key performance indicators after the implementation phase
- Reinforce and retrain in areas where gaps have not been closed yet.
- Recommend activities for further improvement.

**O.4** **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.**

**Proposed organizational structure**



| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

## Assumptions and dependencies

- Before implementing Public Law 70 the Department should create a succession plan to avoid the loss of institutional knowledge.
- Outplacement can be accomplished through:
  - Retirement
  - Early retirement through Public Law 70
  - Voluntary resignation
  - Involuntary separation
- Negotiations with the represented labor need to occur
- Contract agreements with sourcing vendors need to be reviewed and potentially renegotiated
- The adoption of this opportunity will depend on the Department's approved budget allocations

## Opportunity detail

| | |
|---|---|
| Opportunity Owner | |
| Opportunity Type | Cost and staff reduction |
| Base & Stretch ($M) | $2.4 - 8.4M annually |
| Investment ($M) | $9.0M - $11.7M |
| Payback years | 1 year approximately |
| FTE Reduction | 15% to 25% |

## Recommended measures to track

- Case management average resolution time
- Taxpayer service average response time per request
- Tax audit cases average resolution time

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

**High Level Roadmap**

| Initiative | 2015 Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Review organizational legislation and sourcing contracts | | | | |
| Create blueprint and develop implementation plan | | | | |
| Implement communication plan | | | | |
| Conduct training plan | | | | |
| Execute implementation plan | | | | |
| Implement outplacement strategy | | | | |
| Develop and implement monitoring plan | | | | |

| O.4 | **Implementing a function-oriented organizational structure can reduce costs and increase efficiencies.** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Implementation of a function oriented structure that will avoid duplication of efforts and will provide an optimization of processes.<br><br>▪ Procedures will be rewritten and constantly updated. | ▪ A new tax administration system will be implemented at the same time with restructuring takes place.<br><br>▪ The simplification of process could lead to function automation that will need to be supported by the new tax administration system. | ▪ Streamlined organization due to the transformation to a function oriented structure that will provide a more efficient use of the resources of the IRA.<br>▪ Introduction of accountability and governance structures. | ▪ All personnel needs to be trained in order to perform new functions, following the new orientation of the IRA.<br><br>▪ Personnel leaving the organization will have to transfer their knowledge to the ones who will continue within the IRA. | ▪ Field Locations will be decreased, since the new structure provides more centralized services, allowing the entity to depend less on field offices tough out the island.<br><br>▪ Sourcing contracts need to be analyzed, specially the ones involving CTS and Kelly, who's services might no longer be needed. | ▪ A functional structure will provide a more efficient performance management process, since processes will be optimized, type of tax will not be handled separately, duplicated processes will be eliminated and taxpayer services will be centralized. |

# 4. Opportunities to Include in the TOM Design

## Opportunity 5

**Adopting a broad based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance**

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

## Decision Required

- Implement a broad-based Goods and Services Tax (GST)

## Rationale

### Summary Evidence

- There were meetings with 25 groups and individuals at the Hacienda to present their perspectives on consumption tax – general excise tax, sales and use tax (IVU) and the goods and services tax (GST).
- While there was no consensus on preference of a single consumption tax, several respondents favored a broad based GST with no exemptions.
- The current system is a hybrid consumption tax, with elements of a retails sales tax (the IVU) and a VAT/GST (the IVA) with exemptions that narrow the base and increase the complexity of the system. Further, the taxation of certain business inputs can distort production decisions.
- **Puerto Rico Tax Revenue Sources -** Puerto Rico's sources of tax revenue, as seen on the table below, have changed significantly from 2007 to 2013, particularly becoming more reliant on the revenue from Law 154.

| Tax | 2007 | 2007 Share of total tax revenue | 2013 | 2013 share of total tax revenue |
|---|---|---|---|---|
| Individual Income Tax | $3.1 Billion | 38.6% | $2.1 Billion | 27.3% |
| Corporate Income Tax | $2.0 Billion | 25.0% | $1.3 Billion | 16.9% |
| Sales and Use Tax | $0.6 Billion | 7.5% | $0.6 Billion | 7.8% |
| Excise Tax | $1.1 Billion | 13.6% | $2.6 Billion | 33.8% |
| Total | $8.0 Billion | | $7.7 Billion | |

*Source: The Case for Change; The View of the Stakeholders. May 2014.

** Source: The Case for Change; Sources of tax revenue. May 2014.

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

## Rationale (Cont.)

**Benefits Rationale:**

- The capacity of a GST to raise revenue in a neutral and transparent manner has drawn most OECD member countries to adopt this broad-based consumption tax.
- GST* has been implemented by more than 150 jurisdictions. The increasing importance of VAT as a source of government revenue is likely to continue as countries deal with fiscal consolidation pressures in the wake of the economic crisis while seeking to restore growth.
- **New Zealand's** adoption of a GST considered three important components: 1) Acceptance campaign, 2) Cost for administration and compliance, and 3) social security and tax.
- ***New Zealand** has been chosen as a comparative regime to Puerto Rico, as it is widely regarded as having the gold standard of consumption tax regimes, with the following key features: one single rate, GST on goods and services and on importation, limited exemptions, low compliance costs for businesses and government, neutrality between businesses, and transparency in respect of its administration.
- *** In New Zealand, preparation for a GST required 24 months to prepare and implement GST, including staffing, preparing the organization, preparing IT platform and educating taxpayers on GST. Additionally, time will be required to develop and test forms and develop and test new return processing systems. **New Zealand** experience emphasized on educating taxpayers on the new GST to improve taxpayer compliance. This public campaign was also designed to help with the public's acceptance and understanding of the tax.
- * In 2012, GST average rate within OECD countries increased from 18.7% to 19%, as a result of rate changes in Czech Republic (from 20% to 21%); Finland (from 23% to 24%; Israel (from 16% to 17%); Netherlands (from 19% to 21%); Poland (from 23% to 24%) and Spain (from 18% to 21%. It's important to note that major differences exists in standard rates between OECD countries, ranging from 5% rates (Japan) to 25% rates (Denmark, Iceland, Norway and Sweden) or even 27% rate (Hungary).
- *VAT is globally third in importance behind personal income taxes (25%) and social security contributions (27%) but far above corporate income tax (8%); specific consumption taxes (11%) and property taxes (5%). These ratios vary between countries, but in 27 of the 33 OECD countries with VAT, the tax accounts for more than 15% of total taxation.

[*] Source: OECD Consumption Tax Trends Report – 2012.
[**] Source: International Fund Monetary - Fiscal Affairs Department - Revenue Administration: Performance Measurement in Tax Administration
[***] Source: Analysis of Current Tax Structure and Optional Tax Strategies – Project Deliverable – Sept. 2014.

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

## Rationale (Cont.)

- *Australia implemented its GST in 2000. In its original Regulation Impact Statement ("RIS"), the Government estimated the recurrent social compliance costs of the GST in 2001/02 at $1.91 billion*. Another study estimated that the introduction of the GST would impose recurrent social tax compliance costs in the order of $2.2 billion annually. The estimated implementation costs of the GST seemed to be high, both in absolute terms and relative to the estimated recurrent operating costs of the GST. Various estimates suggest that the implementation costs of the GST ($4.5 billion) are almost twice as large as the first-year operating costs of the GST ($2.5 billion). This ratio is high and not consistent with the limited international evidence available to date, which suggests implementation costs are lower than one full-year recurrent costs.

- **Under GST Administration Performance Agreement Schedule B, 2013–14 GST administration costs are estimated at $698.6 million. The estimate includes funding from the 2010–11 Budget for the program 'Working together to improve voluntary compliance'. According to Australian Taxation Office reports, GST administration expenditure totalled $336.4 million between 1 July and 31 December 2013. This was $1.3 million (0.4%) under the estimate for the period.

*Source: The Implementation Costs of GST in Australia: Concepts, Preliminary estimates and Implications.
** Source: Australian Taxation Office website; Key performance summary to 31 December 2013.

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

## Option / Costs

| **Options/Initiatives** | Estimate Investment ($) | |
|---|---|---|
| | Low | High |
| Obtain statutory approval for GST | $ 0.7 M | $0.9M |
| Implement GST (people, process and technology) | $ 5.6 M | $7.3 M |
| Create GST communication and education strategy | $ 13.5 M | $17.7 M |
| Implement GST training program | $2.0 M | $ 2.7 M |
| Administer the GST* | - | - |

* GST administration cost not included.

## Organizational Risk

| **Organization Risk considerations** | Impact/Risk | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | **4** | 5 |
| Implementing a broad based GST based on a invoice/credit mechanism will represent a significant risk on the Department due to the following topics:<br>▪ The GST system will require an enforcement scheme to avoid frauds.<br>▪ New service channels should be available to face possible reactions and consults from the taxpayers.<br>▪ There are limited existing experienced personnel and IT resources to initiate GST operations. | | | | | |

## Implementation Complexity

| **Implementation Risk considerations** | Impact/Risk | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | **4** | 5 |
| Implementing a broad based Goods and Services Tax (GST) based on a invoice/credit mechanism will have a significant impact on the Department, considering the following:<br>▪ Significant management effort will be required to lead the transition process between IVU and GST.<br>▪ Extensive public awareness and media campaigns will be required to ensure overall acceptance and understanding on the GST.<br>▪ Resources will require support and knowledge transfer from external experts<br>▪ The Department must implement alternative service channels to comply with GST payments, implying significant investments on technology. | | | | | |

## O.5 Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.

### Assumptions and dependencies

- Obtaining statutory approval is required before initiating a transition to GST
- Adoption of a GST will require a migration plan from the current IVU system
- A registration and de-registration process will be required to be implemented
- A Compliance Risk Management model should be implemented to focus the enforcement effort on high risk tax payers, particularly in the first few periods where refund claims would need to be closely scrutinized. (see O.4 of this report)
- Organizational changes to support a GST tax within the Department are necessary to facilitate a revised tax structure
- Implementation of alternative service channels to comply with GST payments may be required (see O.2)
- GST should be implemented at the time the following functions are operational: taxpayer registration, return and payment processing, accounting, stop-filing control, taxpayer current account, and selection of taxpayers for audit.
- Early adoption of cross-database data analytics capabilities to discover compliance issues between GST filers and income tax filers.
- The Department must decide to maintain or change the existing IVU machines in order to manage GST invoices
- The adoption of this opportunity will depend on the Department's approved budget allocations

### Opportunity detail

| | |
|---|---|
| Opportunity Owner | TBD |
| Opportunity Type | Revenue Increase |
| Base & Stretch | $2.5 B – $3.5 B per year, based on a 50%-70% compliance rate. |
| Implementation Cost (startup costs) | $22M - $28M |
| Payback years | TBD |

### Recommended measures to track

- Progress on the definition of legal framework.
- Progress on registration activity
- Number of taxpayers registered to file GST
- Tax filing frequency per taxpayer segment.
- Progress on the implementation of IT solutions to support GST
- Progress on selection process of GST staff.
- Overall acceptance and buy-in from taxpayers during transition process.

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

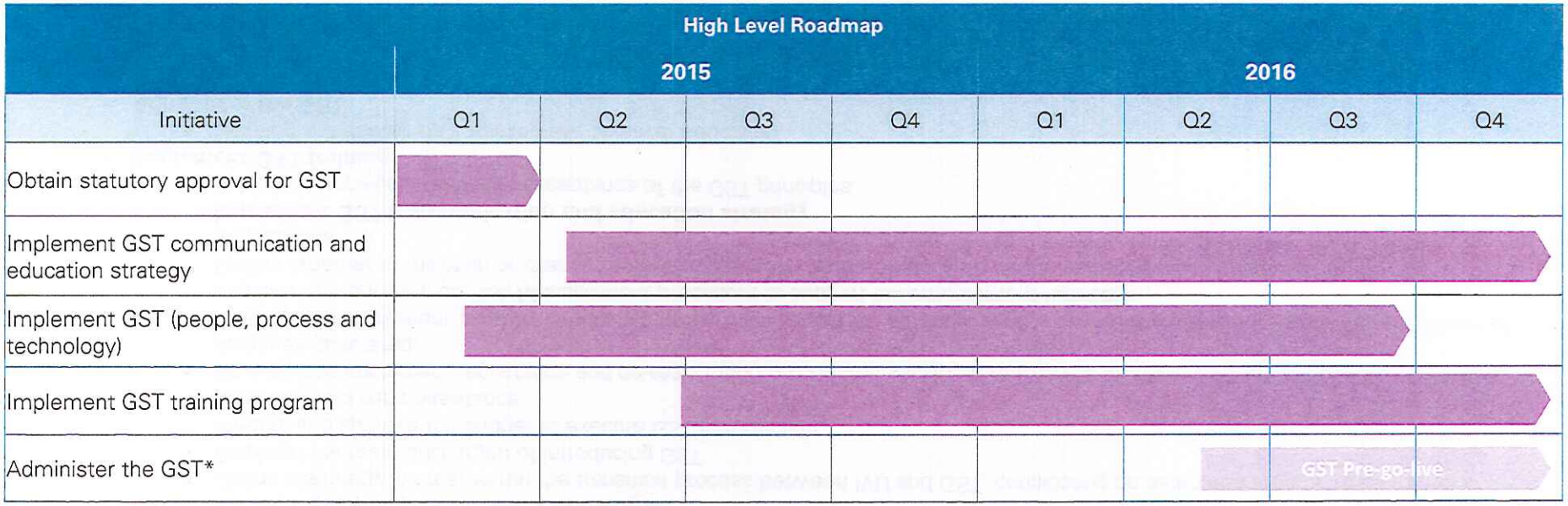
## Opportunity description

- Capital and other economic resources would be allocated more efficiently under a GST, making the nation's output more valuable to society, making more capital available to the economy, which would improve labor productivity.
- GST and Property Tax are considered those taxes that if enforced correctly could have a significant impact on tax revenues. Adopting a GST, will improve compliance rates by taxpayers, understanding that GST allows collecting taxes to the extent that value is added to a good as it moves forward in its value chain.
- The adoption of a simple and cost-effective GST implies that the following actions will have to be leaded by IRA´s offices before GST goes live:

  - **Obtain statutory approval for GST**
  - **Implement GST (people, process and technology)**
    - Define a strategy in order to run the transition process between IVU and GST, considering an estimated time of 18-24 months.
    - Establish the team uncharged of introducing GST
    - Prepare and approve the budget to execute GST introduction.
    - Consider third party assistance
    - Develop and implement registration and de-registration procedures, based on registrants profiles and their compliance costs vs. revenues generated.
    - Develop and implement taxpayer assistance procedures trough the different service channels (e-payments, consults, notifications)
    - Implement a Compliance Risk Management procedure to support tax enforcement functions.
    - Decide whether to maintain or change the IVU machines in order to help enforce the issuance of GST invoices for B2C type transactions.
    - **Implement GST communication and education strategy**
    - Publicity campaigns to ensure acceptance of the GST principles.
  - **Implement GST training**
    - Develop and deliver staff training and taxpayer education
  - **Administer the GST**

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

**High Level Roadmap**




Timeline projection considers going live on January 2017.

| O.5 | **Adopting a broad-based Goods and Services Tax (GST) based on a invoice/credit mechanism will increase tax revenue and tax compliance.** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ GST filing frequency may impact on submission process and workloads<br><br>▪ GST should include an enforcement scheme based on Compliance Risk Management, including fraud prevention | ▪ A new registration system will facilitate the validation of income tax returns information collected from GST returns and vice-versa.<br><br>▪ Better compliance due to the requirement to file returns at each step of the value chain<br><br>▪ Compliance Audit cases will be easier to identify and process due to the availability of cross tax checking data and GST returns up and down the value chain. (See opportunity O.6 of this report)<br><br>▪ Early adoption of cross-database data analytics capabilities will enable better enforcement | ▪ An implemented GST will require capabilities to monitor taxpayer compliance along the value chain<br><br>▪ Migrating to a GST tax system will require public awareness and media campaigns to help ensure overall acceptance | ▪ Will require knowledge transfer regarding the Compliance Risk Management Model<br><br>▪ New services channels must be available before the GST tax structure is implemented (O.2) | ▪ Will require an optimal organization of enforcement workforces<br><br>▪ Tax payer outreach, including a communication, training and education strategy must be developed and implemented | ▪ A GST will enable automation within performance measurement through system data<br><br>▪ The ability to measure throughout the value chain, using the invoice/credit mechanism, will provide data and Information that is currently not available |

# 4. Opportunities to Include in the TOM Design

## Opportunity 6

**Adopting a risk based compliance management will improve enforcement and optimize tax collections**

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Decision Required

- Implement an enforcement scheme based on Compliance Risk Management

## Rationale

### Summary Evidence

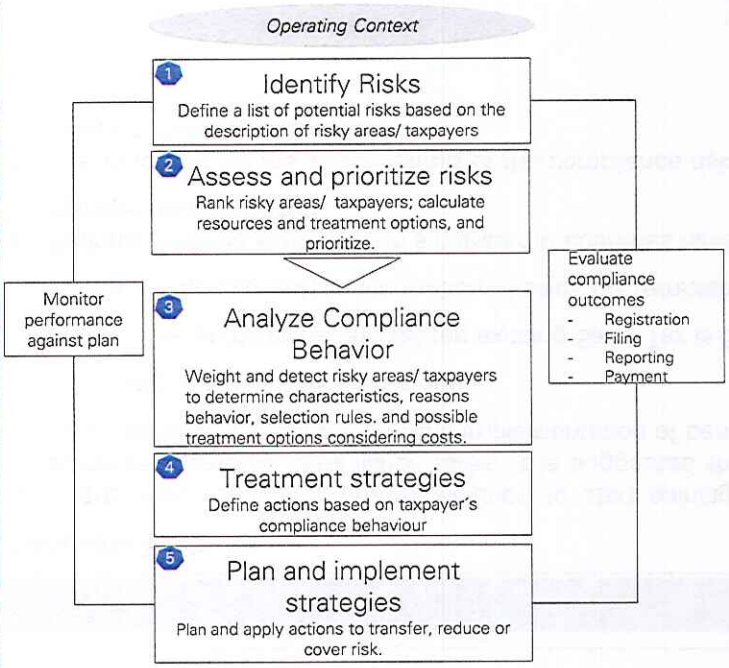
- Puerto Rico requires a prompt solution to start gaining more revenues to face current debts and financial obligations. Considering operational evidence regarding compliance rates, it is suggested that a scheme based on Compliance Risk Management may be gradually adopted, initially considering as a major priority, the implementation of best practices that may lead to significantly increase revenue collections.
- According to the KPMG CGE model,
  - The compliance rate for the existing Sales Tax is 55%.
  - There is a high concentration of sales tax remittances with 4% of the merchants remitting 90% of the collected sales tax.
- National revenue authorities in a number of countries have given considerable attention to the development and evolution of a compliance risk management practices
- It is important for the effectiveness of the compliance risk management methodology to be central to organizational reporting governance and decision-making processes

**Source: KPMG CGE model.*

**O.6** **Adopting a risk based compliance management will improve enforcement and optimize tax collections**

## Rationale (Cont.)

- The diagram below illustrates a suggested Compliance Risk Management Process with correlating five stages:




| Stage | Description |
|---|---|
| 1 | In stage 1, risks must be identified based on categories of non-compliant behavior, type of risks and amount of tax involved to determine the level of risk. By exploring potential high-risk taxpayers, a variety of treatments could be given to different categories of taxpayers. |
| 2 | In stage 2, risks which have been identified are assessed to separate major and minor risks. Prioritization of risks is necessary since the tax administration may not be able to address all risks; therefore advises priority be given to treat major risks that may affect the tax administration to achieve its objectives. |
| 3 | In stage 3, the taxpayer compliance behavior is analyzed to identify economic factors, namely, "financial burden, the cost of compliance, disincentives and incentives"; considering "individual differences, perceived inequity, perception of minimal risk and risk taking" |
| 4 | In stage 4, the tax authority identifies strategies to treat the risks. The tax authority must have policies to ensure that it treats taxpayers respectfully and fairly to gain respect and trust from them. |
| 5 | In stage 5, the tax authority must develop and carry out its risk based strategies . The adoption of strategies to increase compliance should include field audits, investigations, higher penalties and prosecution for serious non-compliance. After these five processes are implemented, the outcome of the treatment strategy should be measured to evaluate its success; thus determining the effectiveness of the compliance program. |

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Rationale (Cont.)

- The chart below shows countries that have implemented technology tools to support the **Risk Management Process**.

| Country | Description |
|---|---|
| Netherlands | **The National Risk Database (RDB)** is a computerized method for recording and considering risks in the fiscal process. The RDB application is available for all staff members of the tax administration. In the RDB the whole 'lifecycle' of a risk is recorded. |
| Australia | **APPLE** (Application to fight against tax evasion) is an IT tool that allows detection of non-compliant taxpayers by crossing information on their taxable capacity and data declared in the tax returns. |
| Denmark | **"Risk analysis on new VAT numbers"** is an application set up in order to improve the preventive fight against VAT frauds. The software contains and automatically processes personal data, income and property information on taxpayers who, on their own or as legal representatives of a company, obtain a new VAT identification number. The result of the processing is a "risk profile". All VAT numbers are analyzed and not only those ones which refer to a risky activity sector<br>**3rd party data matching and return pre-filling —"eDec system"** The Danish tax system is based on registration, source deduction and third party reporting by employers, banks, insurance companies, foundations, trade unions and public institutions on wages, earnings, benefits, grants, savings, debts and deductible expenses. |
| Netherlands | **Xenon**, a web robot, has been developed by the Netherlands tax administration and is in use since 2004. XENON detects unknown taxpayers as well as other probable non-compliant events such as the unauthorized use of brand names or illegal diversion of trade. Xenon is a sophisticated "spider" program that collects data from surfers without their knowledge. The program downloads Web pages where financial transactions occur–auction sites, gambling sites, online stores–and dumps the information they contain into massive databases that only the tax-collecting governments get to see |
| Ireland | **REAP- Risk Evaluation Analysis and Profiling:** REAP was developed in order to maximizing the value of the data held by Revenue for risk assessment purposes. |
| Germany | **Qualified new registrations by using checklists**: Since 2005, every taxpayer applying for a VAT registration for the first time is checked using uniform national checklists which are designed to identify high-risk cases as early as possible.<br>The chief objective is to identify high-risk cases at the earliest possible stage and to forestall VAT fraud. |

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Rationale (Cont.)

### Benefits rationale

- Implementation of a risk-based compliance system yields numerous benefits, all of which may increase voluntary compliance and a more efficient means of tax collection
- Focusing risk compliance and audits methods may increase collections as a result of focused audits on high-risk cases
- Some benefits of applying a risk based compliance (RBC) include:
  - Creating deliberate strategies and actions that mitigate the negative impacts of risk
  - Providing assurance that an effective use is being made of the organization's resources by focusing them on the most significant risks
  - Creating fairness and equal treatment of taxpayers by assessing the organization's risks
  - Focusing the burden of audit to non-compliant taxpayers
  - Prioritizing the organization's available resources: personnel, financial and technical resources
  - Increasing the level of voluntary compliance of taxpayers

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Rationale (Cont.)

- The chart below shows how countries have applied initiatives according to The Compliance Risk Management Process (OECD) to increase taxpayer compliance (Individual and Corporations including GST).

| Country | Description |
|---|---|
| New Zealand | ▪ **Online Tax Registration with NZ Registrar of Companies and Agency Arrangement with NZ Automobile Association for IRD Number Applications** New Zealand has also recently launched a new service in conjunction with the Register of Companies that enables business taxpayers at the time of completing a new company registration to also apply online and receive an Inland Revenue (Account) Number within minutes of registration. The use of technology in this example is reducing the risk of non-registration, manual processes and is providing increased services to taxpayers.<br>▪ **New Zealand Website and Information Service Design Awards**: Along with a number of revenue bodies, the New Zealand Inland Revenue has made a significant investment in redesigning its Internet site and services. This has resulted in the agency winning several national awards for best Government Department/Agency website.<br>▪ **Outcome Measurement Framework for Taxpayer Audit:** New Zealand has developed a new outcome measurement Framework to assess the impacts of a revised risk based audit activity. |
| Canada | ▪ **Web-based Online Education Programme:** Canada has developed an online course to help individuals to understand the fundamentals of the Canadian tax system and to show them how to file a basic tax return. The course also includes information on completing tax returns. The course is free taking between 1-2 hrs to complete.<br>▪ **Enhanced online services** —My Business Account! Canada has expanded its suite of e-services to provide business owners with convenient and secure on-line access to their personalized business account information through a new on-line service called My Business Account. |
| Australia | ▪ **Small Business Assistance Programme** Australia has conducted research that consistently indicates those entering business for the first time, or facing a significant change in their business (such as taking on employees for the first time) are at greater risk of non-compliance with a range of taxation obligations. In response, it has developed a broad Small Business Assistance Program consisting of a number of component strategies to ensure small businesses have the capability to meet their obligations or claim their entitlements, voluntarily comply and thereby maintain community confidence.<br>▪ **SME Text Message Reminders for Filing of Business Activity Statement:** Australia has also had previous success in using new technology and contact channels with its SMS (short message system) text reminder messages to targeted taxpayer groups in relation to pending filing obligations.<br>▪ **Aggressive Tax Planning New Promoter Penalties:** The use of complex tax structures and tax havens to promote tax exploitation schemes is on the increase. In an effort to mitigate the risks posed by the promoters of tax exploitation schemes, Australia has introduced a new civil penalty regime (promoter penalty laws). |

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Option & Initiatives / Costs

| Options/Initiatives | Estimate Investment ($) | |
|---|---|---|
| | Low | High |
| Develop a risk management approach (Risk Management Framework) | $2.0M | $2.5M |
| Develop and conduct training plan | $1.5M | $2.0M |
| Develop human resource plan | $0.3M | $0.4M |
| Execute implementation plan | $1.6M | $2.0M |
| Monitor Risk Based Compliance progress | $0.3M | $0.4M |

## Organizational Risk

| Organizational Risk considerations | Impact/Risk | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| A risk based compliance management system will represent some risks for the organization due to the following topics:<br>• The Department should establish a Compliance Risk Management Office<br>• The Department should implement technology tools to optimally support enforcement operations, regarding the identification, analysis, prioritization, treatment, and evaluation, supported by the following technology solutions: Data Analytics, Case Management, Customer Relationship Management, Performance Monitoring, and Social Media. | | | | | |

## Complexity Risk

| Implementation Risk considerations | Impact/Risk | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| A risk based compliance management system will have some impact during its implementation, considering that the establishment of a Compliance Risk Management Office will require acquiring and deploying several technology tools including: Data Analytics, Case Management, Customer Relationship Management, Performance Monitoring, and Social Media, which will require the development of the organization´s current know-how, and continuous management effort. | | | | | |

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Initiatives description

**Develop a risk management approach (Risk Management Framework)**
- Develop a Formal Risk Management Structure
- Develop a Risk Matrix including management information system
- Risk Assessment Summary
- Develop new policies, procedures and limits
- Define internal control

**Develop and conduct training plan**
- Develop training materials of new processes, procedures and roles
- Conduct training sessions
- Provide post training assessments to measure and track the effectiveness of the training sessions
- Update training materials, as needed, to incorporate known gaps in procedures and processes
- Reinforce the knowledge gaps identified on the post training evaluations, that required further assistance

**Develop human resource plan**
- Recruitment of specialize personnel needed to implement the new scheme

**Execute implementation Plan**
- Implement the new functions and processes; deliver new procedures to all Department personnel
- Performing Examination Procedures
- Realign the organization to follow the new Risk base scheme

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

## Initiatives description

**Monitor Risk Based Compliance progress**

- Monitor key performance indicators after the implementation
- Reinforce and retrain in areas where gaps have not been closed yet
- Report findings and recommendations and follow-ups
- Recommend activities for further improvement.

**O.6** **Adopting a risk based compliance management will improve enforcement and optimize tax collections**

## Assumptions and dependencies

- Enforcement functions within Consumption Tax Bureau and Fiscal Audits Bureau should be merged on a Compliance Risk Management Office, in order to concentrate efforts regarding compliance tracking and monitoring
- Suggested technology tools, such as data analytics software may require debugging internal databases, and integration efforts with third parties to guarantee optimal results
- New software will require data cleansing prior to importing data
- Technology needs are included in the opportunity #1
- Obtain access to other external data sources
- Contract agreements with sourcing vendors need to be reviewed and potentially renegotiated, if applicable
- The adoption of this opportunity will depend on the Department's approved budget allocations

## Opportunity detail

| | |
|---|---|
| Payback Years | TBD |
| Opportunity Owner | TBD |
| Opportunity type | Revenue increase |
| Base / Stretch | $ 318.5 M / $ 427.8 M |
| Implementation Cost | $6 M - $7 M |

## Recommended measures to track

- Progress on the implementation of IT components supporting the Compliance Risk Management Process.
- Effectiveness of training program to support all necessary skills regarding the Compliance Risk Management Process, by monitoring IRA's personnel performance on the knowledge process.

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

**High Level Roadmap**

| Initiative | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 | 2016 Q3 |
|---|---|---|---|---|---|---|---|
| Develop a risk management approach (Risk Management Framework) | | | | | | | |
| Develop and conduct training plan | | | | | | | |
| Develop human resource plan | | | | | | | |
| Execute implementation plan | | | | | | | |
| Monitor Risk Based Compliance progress | | | | | | | |

| O.6 | **Adopting a risk based compliance management will improve enforcement and optimize tax collections** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Tracking of registered taxpayer's submission compliance<br><br>▪ Detect audit requirement by cross checking information submitted by the taxpayers in other taxes<br><br>▪ Reduction of field audits or inspections as a result of focused risk areas or cases<br><br>▪ Enforcement actions to be determined by the level of risk identified in the cross checking<br><br>▪ Use of other sources of information (i.e. other municipalities, financial institutions, etc.) to determine potential compliance issues | ▪ Implementation of risk assessment tools such as data analytics and appropriate case management functionality<br><br>▪ Adoption of cross-database data analytics capabilities to discover compliance issues between GST filers and income tax filers | ▪ Reduction in number of staff involved in executing tax audits and inspection | ▪ Appropriate staffing for the enforcement function will be needed<br><br>▪ Additional personal skills training may be required to compliment compliance based risk management structure | ▪ Change in statutory requirements to empower tax compliance may be required to take enforcement actions | ▪ Implementation of mature key performance indicators to measure the performance of the risk-based compliance strategy |

# 4. Opportunities to Include in the TOM Design

## Opportunity 7

## Adoption of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

## Decision Required

- Transform the Internal Revenue Area (IRA) into a Semi Autonomous Revenue Agency (SARA)

## Rationale

**Summary Evidence:**

- Leading Revenue Authorities of Comparable Jurisdictions have implemented a function oriented SARA that has a dedicated unit for Large Taxpayer (LTU). A function oriented tax administration is based on a model that consolidates all activities related to a particular phase (submission, collections, audit, etc.) in the interaction with the tax payer, independent of the tax type. LTU stands for Large Tax Payer Unit, which is a specialize team dedicate solely to the large tax payers.
- The table below shows the comparable jurisdictions and their corresponding tax structure.

| Jurisdictions | FUNCTION | SARA | LTU |
|---|---|---|---|
| Canada | 🟢 | 🟢 | 🟢 |
| Chile | 🟢 | 🟢 | 🟢 |
| Denmark | 🟢 | 🟢 | 🟢 |
| Estonia | 🟢 | 🔴 | 🔴 |
| Ireland | 🔴 | 🟢 | 🟢 |
| Korea | 🟢 | 🟢 | 🔴 |
| New Zealand | 🟢 | 🟢 | 🟢 |
| Portugal | 🟢 | 🔴 | 🟢 |
| Singapore | 🟢 | 🟢 | 🔴 |
| Puerto Rico | 🔴 | 🔴 | 🔴 |

🟢 Revenue Authority has the characteristic

🔴 Revenue Authority does not has the characteristic

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

## Rationale (Cont.)

### Benefits rationale

- The experiences of several developing countries that have adopted the growing trend toward establishing a SARA to operate its tax administration system showed a greater degree of results when having the autonomy to administer its own internal processes and retain its talent pool. Some key benefits include:
  - Improve revenue collections
  - Reduce related corruption and evasion
  - Improve taxpayer services.
- The following summarize the conceptual and practical arguments that have been put forward in favor of establishing a SARA:
  - Public revenue enhancement reflected in higher tax ratios and real revenue growth
  - Greater efficiency in public resource utilization via financial and administrative independence/autonomy
  - De-politicization of tax administration
  - Reduced corruption, thereby improving the credibility of taxation in particular and the government in general
  - Improved taxpayer services and reduced taxpayer compliance costs
  - Transform the organizational culture to a more transparent, proactive, less bureaucratic and more services focused
  - Comprehensive accounting for all tax revenues
  - Integration of tax and taxpayer-related databases
  - Improved compliance results because the tax administration will benefit from a complete view of taxpayer behavior across all tax types. The administration is able to identify trends in noncompliance and act more quickly to address these trends
- Other jurisdictions with a self-financing mechanisms vary from strongly autonomous to discretional: direct deposits of a given percentage of revenue collections into a special SARA account (Peru, Guatemala); a given percentage of collections released periodically by the Ministry of Finance (Ecuador); legislative (annual) budget appropriations (Mexico, South Africa, Tanzania, Uganda); or a given percentage of estimated collections plus the difference between actual and estimated revenues (Kenya).

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

## Initiatives / Costs

| Initiatives | Investment ($K) | |
|---|---|---|
| | Low | High |
| Design and formalize the organizational framework for the SARA | $0.3M | $0.4 M |
| Define and formalize statutory requirements | $0.3M | $0.4 M |
| Implement a human resource plan | $1.5M | $2.0M |
| Implement a transformation program | $5.0 M | $9.6 M |
| Implement SARA's operations | $22.5 M | $27M |

## Organizational Risk

| Options/Initiatives | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| The creation of a Semi-Autonomous Revenue Authority (SARA) will have a high impact on the organization. To mitigate inherent risks, the Department should:<br>• Need sponsorship from important stakeholders (Governor, Political Parties) that will facilitate the implementation of a SARA<br>• Align the organization with a new assistance service strategy<br>Not considering these risks the Department might face possible reactions and resistance from personnel and representative labor. | | | | | |

## Implementation Complexity

| Options/Initiatives | Level | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| To successfully create a SARA the IRA will have to:<br>• Continuously manage the current operations while transforming IRA<br>• Redeploy and rehire existing employees within the organization with minimal disruptions of the operations<br>• Leverage from the current capacity of employees to provide information creation of the SARA<br>• Incrementally develop the current IT Platform. | | | | | |

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

## Initiatives description

**Design and formalize the organizational framework for a SARA**

- Obtain statutory authority, if required, to establish the SARA
- Establish a Board of Directors (BoD) with public and private sector participation and create a clear description of responsibilities for the BoD and the SARA's Director
- Create an independent governance structure within SARA to minimize outside influence

**Design and formalize statutory requirements**

- Formalize the governance structure that will support the SARA's operations. Structuring a unified semi-autonomous body with board: Tax administration functions, along with necessary support functions (e.g. information technology, human resources) are carried out by a unified semi-autonomous body, the head of which reports to a government minister and oversight body/board of management comprised of external officials
- Determine whether regulations will be required to define roles and responsibilities with the objective of establishing effective accountability mechanisms that avoid outside influence
- Identify an appropriate self-financing mechanism to permit SARA the ability to meet all the obligations under the statutory requirements.

**Implement a human resource plan**

- Define a recruitment plan that SARA can use for competitive entrance examinations (including psychometric tests) under the management of its own human resources division
- Establish salary scales and compensation plans for professional staff to match those offered in the private sector, especially in such key areas as tax audit and enforcement, information technology, legal affairs, and top management positions
- Implement transparent career and retirement plans that are supported by the statutory requirements defined in the creation of the SARA.

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

## Initiatives description (Cont.)

**Implement a transformation program**

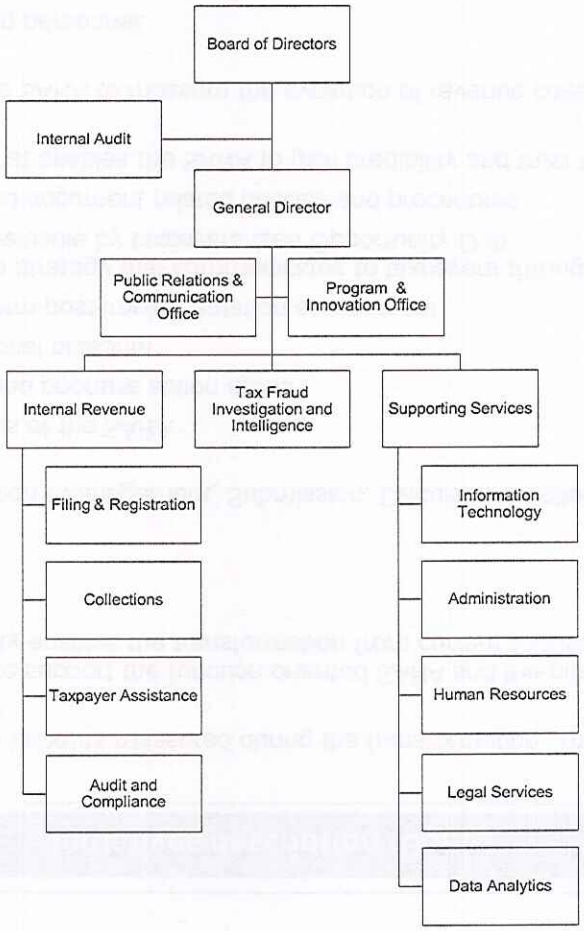
- Establish a program management team to track the benefits measured during the transformation. The program management team is responsible for the efficient and effective execution of each project
- Define building and/or facilities needs are required to support the function oriented SARA and the primary and supplemental locations from where SARA will provide services. Having a separate facility enables the transformation from current to future state and also helps with the external and internal branding of the new operating model

**Implement SARA's operations**

- Structure the SARA as a function oriented organization (Management, Submission, Calculation, Collection, Enforcement, Assistance) through the following activities:
  - Establish vision, goals and desired outcomes of the SARA
  - Assess current organization, identify gaps and prioritize action items
  - Create detailed macro and micro organizational blueprint
  - Execute pilot and implement plan and perform post-implementation assessment
- Develop and implement taxpayer assistance service strategy that communicates to taxpayers through specific channels, creates a friendly and services oriented interaction and it is perceived as valuable by taxpayers (see Opportunity O.4)
- Model the core business processes of the SARA and document related policies and procedures
- Develop and implement an enforcement program that enables the SARA to gain credibility and trust from the public and other institutions (See Opportunity O.3)
- Determine how performance will be managed in the SARA to measure the evolution of revenue collection, taxpayer registration, enforcement programs and taxpayer services through KPIs
- Develop and outplacement process for the departing personnel.
- Acquire and implement Infrastructure and Facilities
  - Terminate current lease contracts
  - Establish lease contracts of the new facilities
  - Purchase of new furniture

**O.7** **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.**

## Proposed organizational structure for SARA



**O.7** **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.**

## Assumptions and dependencies

- The SARA will have the information technology capabilities to provide required reporting needs to external organizations, such as the Governor's Office, Hacienda and other applicable outside entities
- SARA management will remain autonomous in all SARA operations (management decisions, reporting, etc.) and will not take influence from external organizations, resulting in transparent and competent treatment.
- The Department will provide commitment to help achieve buy-in for the creation of a SARA
- Create an organizational structure that is flexible to respond to ever-changing administrative needs
- Personnel from Department bureaus may be transition into a SARA. The outplacement process outlined in the assumptions of O.4 may be considered in the SARA organizational structure process based on SARA roles and responsibilities personnel needs.
- Sourcing contracts may have to be reviewed to determine the impact of sourcing contracts on SARA

## Opportunity detail

| | |
|---|---|
| Opportunity Owner | TBD |
| Opportunity Type | Revenue Increase<br>Cost Reduction |
| Base & Stretch ($K) | $350K – $690K |
| Investment ($M) | $29.6M - $39.4M |
| Payback years | TBD |
| FTE Reduction | TBD |

## Recommended measures to track

- Benefits of creating the SARA (Business Case)
- Political and Social reactions during the creation and implementation of the SARA
- Outplacement actions items
- Continue Sponsorship and Commitment from key stakeholders

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

**High Level Roadmap**

| Initiative | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 | 2016 Q3 | 2016 Q4 |
|---|---|---|---|---|---|---|---|---|
| Design and formalize the organizational framework for the SARA | | | | | | | | |
| Define and formalize statutory requirements | | | | | | | | |
| Implement a human resource plan | | | | | | | | |
| Implement a transformation program | | | | | | | | |
| Implement SARA's operations | | | | | | | | |

| O.7 | **Adopting of a Semi Autonomous Revenue Agency (SARA) will improve Puerto Rico´s revenue authority operations.** |
|---|---|

| Services & Processes | Technology | Org & Governance | People & Skills | Locations and Sourcing | Performance Management |
|---|---|---|---|---|---|
| ▪ Implementation of a Project Management Office that will create, validate and update all processes and procedures<br><br>▪ Implementation of a function oriented structure that will avoid duplication of efforts and will provide an optimization of processes | ▪ Creation of a dedicated IT department providing service exclusively for the tax administration systems and applications<br><br>▪ Before implementing SARA, it is important to determine the new Technology, Data and Application Architecture | ▪ The SARA will have a Board of Director/Advisors and a General Director that will enable the entity to have a semi-autonomous governance structure, allowing them to make independent decisions on strategic and operational matters<br><br>▪ Strong statutory requirements are necessary to support to the SARA and the BOD through the formalized framework | ▪ Creation of a more competitive job description manual and a performance based compensation system will enable the SARA to attract developed and specialized talent needed for transformation success<br><br>▪ The current employees of the IRA and Tax Fraud Investigations Area may participate in the recruitment process in order to employ qualified and skilled personnel<br><br>▪ Creation of a focalized HR department with specialized training and career development strategy for tax administration | ▪ The number of field locations may decrease as the new structure may provide centralized services | ▪ SARA departments will develop a performance management system tied to performance based compensation system. Generating a higher rate of service and operational efficiency, and at the same time, increased the level of motivation among the staff. |