IV Conclusions

Beginning in the 1980s, the IMF has recommended that member countries facing revenue crises establish an LTU as a means to strengthen tax administration. In addition, establishment of an LTU has allowed many countries with scarce resources to begin implementing reform measures for immediate and visible results.

Advantages of Establishing an LTU

In many developing and transition countries, establishing a specialized operation to control the large taxpayers has had positive results in terms of increased large taxpayer compliance and improved effectiveness of tax administration. In addition, it has helped tax administrations focus their efforts on relatively few taxpayers that account for a large percent of total tax collection. Many of the countries surveyed reported that establishment of an LTU helped them address major operational weaknesses in tax administration and visibly improve core tax administration functions, resulting in (1) improved identification and knowledge of the large taxpayers and their operations; (2) more timely and accurate return filing and payment by the large taxpayers;[48] (3) earlier detection of taxpayers' noncompliance with filing and payment obligations; (4) more effective audits targeted by economic sector and performed by better-trained auditors; (5) a reduced stock of arrears, and therefore more targeted efforts by collection enforcement officers; and (6) better-trained staff able to deal with more complex tax issues, provide higher quality services to taxpayers, and detect irregularities and corrupt practices.

In many of the developing and transition countries surveyed, the LTU has been a vehicle for the tax administration to begin introducing important reforms subsequently extended to the rest of the taxpayers, such as self-assessment of taxpayer liabilities, a single taxpayer masterfile, a unique taxpayer identification number, an organizational structure based on the main tax administration functions, electronic filing, and new or improved computerized information systems. In some countries (Benin, Burkina Faso, Togo) the establishment of an LTU has been the starting point for introducing a new tax, the VAT, or for integrating separate VAT and income tax administrations (Kenya, Uganda). In fact, in many countries where the LTU has been successfully established (e.g., Benin, Bolivia, Hungary, Peru), it has been part of an overall tax administration reform strategy to introduce long-term tax administration improvements.

The move to establish LTUs in developing and transition countries is similar to the trend in the tax administrations of several developed countries (e.g., Australia, France, the Netherlands, New Zealand, the United Kingdom, and the United States). Tax administrations in these countries have reorganized their operations around segments of the taxpayer population (especially according to taxpayer size) because they have observed that diverse segments present distinct revenue risks and require different compliance strategies.

Risks Associated with LTU Establishment

As experience in several of the developing and transition countries surveyed shows, however, establishing an LTU poses challenges that tax administrators and other public finance officials need to consider.

If the LTU is only partly established (i.e., the LTU does not administer all large taxpayers, does not perform all major tax administration functions, or lacks appropriate staffing or resources), it will not reach its potential for improving the operations of the tax administration and increasing large taxpayer compliance. Impediments to the effective establishment of an LTU take different forms, the primary one being weak government support for LTU

[48] This has been facilitated by better prefiling advice to taxpayers and by simplified filing and payment procedures such as electronic filing, automatic bank debiting, and in-house bank branches.

operations, in particular when it comes to enforcing large taxpayers' liabilities. Others include a lack of appropriate financial and staff resources assigned to the LTU's operations, failure to grant full responsibility to the LTU for the major tax administration functions vis-à-vis the large taxpayers, absence of staff training in specialized areas such as audit and collection enforcement, and resistance from local offices to the transfer of the large taxpayers under their control to the LTU. If the LTU is not well implemented, an important opportunity for reform is lost; moreover, the LTU loses credibility as an effective vehicle for modernizing tax administration. Unfortunately, several such examples exist among the transition countries.

Another major issue is the sustainability of the reforms introduced through the LTU. In several Latin American countries, for example, LTUs established in the 1980s and early 1990s were initially successful in introducing a new organizational structure, more effective procedures that led to improved tax administration performance (e.g., fewer late and nonfilers, quick follow-up of noncomplying taxpayers, reduction of tax arrears), new computerized information systems, and better-trained and higher-paid staff. However, without steady political and management support, as well as the needed financial and staff resources, the initially successful LTUs can quickly succumb to problems that existed before their implementation. They can also fall prey to problems that continue in the rest of the tax administration: incomplete identification of large taxpayers, poor compliance by the large taxpayers with basic filing and payment obligations, a growing stock of tax arrears, insufficient audit coverage and ineffective audits that prevent the tax administration from detecting taxpayer noncompliance, poor taxpayer services, and inadequate computerized systems.

Several factors may contribute to this lack of sustainability. A country's tax policy and tax administration may suffer general worsening (characterized, for example, by the introduction of multiple tax incentives, special tax treatments, and distortionary taxes, the politicization of the tax administration, and the proliferation of tax amnesties). The tax administration may lack an overall reform strategy that spells out clearly how the modernization effort introduced through the LTU will be extended to the rest of the tax administration (and the medium-size and small taxpayers). Furthermore, government commitment to achieving a permanent improvement in large taxpayers' compliance may be weak or lacking altogether.

There are also risks more specific to the operations of the LTU itself including, for example, overemphasizing the administration and control of the largest taxpayers and ignoring the medium-size and small taxpayers; failing to install specific controls (e.g., to ensure compliance with return filing and payment obligations) for the large taxpayers; assigning too many taxpayers to the LTU, rendering LTU operations less effective; and allowing irregular or corrupt practices by LTU officials who are not properly supervised. For an LTU to be effective and credible vis-à-vis the government and the taxpaying public, public finance officials need to be particularly sensitive to this last risk, and install strong safeguards against it (e.g., internal audit function, inspector general).

Related to this risk, for tax administrations interested in setting up an LTU, a major challenge is to attract and retain LTU staff of sufficiently high caliber, able to (1) administer complex operations such as sectoral tax audits and audits involving transfer pricing issues, as well as difficult enforcement and appeals cases, particularly as large taxpayers tend to have considerable resources to spend in these areas to reduce their tax liabilities; (2) provide large taxpayers with accurate and up-to-date information about all aspects of their tax liabilities; and (3) create a professional atmosphere that discourages tax officials from considering the possibility of accepting bribes from, or improperly negotiating with, the large taxpayers.

Finally, to gauge the effectiveness of the LTU's operations and changes in large taxpayer compliance, tax administrations need to focus on identifying and compiling performance indicators,[49] which are the basis for any effective management reporting system.

Lessons Learned

Against this background, what are the lessons to be learned, both for public finance officials in developing and transition countries and for IMF technical assistance policies in tax administration?

- For the LTU to be effective and for the large taxpayers' compliance to improve significantly, *the government must be fully committed to setting up the LTU, providing it with the necessary resources (staffing, physical infrastructure, computers, etc.), and supporting auditing and enforced collection efforts for the largest taxpayers.* This is likely to be a major challenge in many countries where the largest taxpayers wield significant political and economic power. Active support for the LTU is needed from the

[49]These include, for example, the rate of nonfilers and delinquent taxpayers, stock of tax arrears, audit coverage, audit productivity, timeliness of VAT refunds, and so forth.

tax administration's management and from the highest levels of government, including the minister of finance, prime minister, or president. An important manifestation of this support is the consistent application of the tax laws vis-à-vis the largest taxpayers. Barring this, the general compliance of the large taxpayers may suffer, and a clear signal that the tax laws are enforced only for certain taxpayers will be given to the taxpaying public.

- *The long-term effectiveness and credibility of the LTU depends on the government's ability to incorporate the LTU into a broader tax administration reform* also aimed at improving the administration of the medium-size and small taxpayers. Thus, while an LTU may be established as a pilot program to introduce fundamental tax administration reforms (recognizing that reforms cannot be implemented at once throughout the entire tax administration), the pilot program should not be an isolated administrative reform effort. This should prevent the LTU from being perceived as a "parallel" tax administration, a risk inherent in the establishment of a separate office focused only on the large taxpayers. Also, reform efforts targeting only the large taxpayers may lead to resentment by large taxpayers that they are bearing too much of the tax burden and to the general perception that only one group of taxpayers is being targeted to improve their compliance and collection performance.[50]
- Furthermore, *the IMF needs to ensure that the LTU is part of a broader tax administration reform aimed at improving the entire tax administration's effectiveness.* This is an area where the IMF could improve follow-up of the initial LTU reform effort. However, the fact must also be recognized that projects to establish an LTU have finite time frames and are often undertaken in the context of IMF programs, whereas building new organizational structures and implementing new procedures in the rest of the tax administration take much longer.
- To assist with broadening the reform efforts, *it is crucial for the tax administration to apply the lessons learned from the LTU to the rest of the tax administration.*
- *The LTU needs to continue being reformed and modernized, like the rest of the tax administration, to remain effective and to keep up with changes in the economy and the taxpaying population.* The LTU may be the first area to weaken, especially if the overall tax administration is suffering from lack of government support, poor management, and lack of resources. The LTU is not a one-time innovation, and tax officials should not become complacent. Establishment of an LTU can initially "limit the damage" to revenue performance and yield short-term improvements in tax collection and arrears performance. However, it will not succeed over the medium term without continuous modernization and improvements in the rest of the tax administration.
- For an LTU to be effective, there are *certain minimum requirements that it must meet* (many of which are also applicable to the overall tax administration), including
  - A *sound legal framework* that gives the tax administration, and also the LTU, the proper powers to enforce the tax laws effectively, but also specifies taxpayers' rights vis-à-vis the tax administration.
  - *Clear and simple criteria for selecting large taxpayers,* and guidelines for determining which taxpayers should remain classified as large taxpayers, to prevent the fragmentation of large taxpayer operations in order to reduce their tax liabilities.
  - *Standard and transparent procedures* for all large taxpayers.
  - *The administration of all the large taxpayers by the LTU* or network of LTUs. The differentiated treatment of large taxpayers by sector or region (e.g., some administered by LTU, others by local tax offices, etc.) should be avoided.
  - *The administration of all national-level domestic taxes by the LTU*. This eliminates the need for the large taxpayers to go to any tax office other than the LTU to deal with their tax affairs.
  - *LTU performance of all core tax administration functions* (e.g., returns and payment processing, audit, enforcement, taxpayer services, taxpayer appeals). Making the LTU a "full-service" unit is the only way to enable the LTU to have a more integrated compliance strategy vis-à-vis the large taxpayers. The fragmentation of responsibilities for large taxpayers across government agencies (which is the case in several transition countries where the LTU does not have full power to enforce tax arrears of the largest taxpayers) will undermine LTU effectiveness.

[50]Then again, in several countries large taxpayers have welcomed the establishment of an LTU as a way to increase the degree of transparency in tax administration, introduce greater standardization in the treatment of large taxpayers, and improve the quality of taxpayer services.

- *Clear reporting lines* between the LTU and the tax administration headquarters office (e.g., to a specialized headquarters unit in charge of managing LTU operations), and between the LTU and the field offices (e.g., regional and local tax offices).

- *Appropriate job grading and remuneration of LTU staff*, such that (1) the unit can attract and retain well-qualified and motivated staff who will be able to administer and provide services effectively to large taxpayers with complex operations, and (2) LTU staff will operate in a professional atmosphere that discourages corrupt practices.

- *LTU staff training* (e.g., in areas such as sectoral audits, transfer pricing issues), especially in the poorest countries.

- *Identification and regular compilation of key performance indicators*, which are the basis of a management reporting system and will assist tax administrators to gauge the effectiveness of the LTU, and of tax administration, in general.

- Even if these conditions are met, *the establishment of an LTU cannot by itself strengthen large taxpayer compliance and generate additional revenue when there is a prolonged downturn in the economy.*

- The experience of the transition countries with LTUs suggests that *a positive relationship exists between the successful implementation of an LTU and progress in macroeconomic stabilization and other structural reforms,* including tax policy reforms.

- *The most effective LTU operations are based on a high level of centralized supervision of operations and a limited number of units to be supervised.* By contrast, the least effective LTUs seem to be those that have a highly decentralized structure.