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Doing It Right for Tax Administration Reform: *(Semi-) Autonomous Revenue Authority Anyone?*

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With the continuing slide in the country's tax effort[1] being blamed largely for the rising fiscal deficit and tight financial position of the national government, it is inevitable that the Philippines' major tax collection agency—the Bureau of Internal Revenue (BIR)—is placed at the center of the storm, so to speak.

Add to this the long-standing and deep-seated problems in tax administration as well as the perceived corruption that plagues the agency, and it is no wonder that calls for the restructuring and even possible replacement of the BIR have been in the frontline in recent months.

The call for a change and possible replacement of the country's tax collection agency is not exclusive, however, to the Philippines. In the last 15 years or so, there appears to have been a trend among developing countries towards the creation of semi-autonomous revenue authorities (RAs) to replace their existing tax collection agencies. From Latin America (Bolivia in 1987, Argentina and Peru in 1988, Colombia in 1991, Venezuela in 1994, Mexico in 1997, Guatemala and Guyana in 1999) to Africa (Ghana in 1985, Uganda in 1991, Zambia in 1993, Kenya in 1995, Tanzania in 1996, South Africa in 1997, Rwanda in 1998 and Malawi in 2000) to Southeast Asia (Singapore in 1992 and Malaysia in 1994) and even to Europe (Spain in 1991), semi-autonomous RAs have been created with the intention of radically improving revenue performance in a landscape of numerous problems.

But will the creation of a semi-autonomous RA to replace the BIR in the Philippines help improve the tax collection in the country? Will it bring about a radical improvement in tax administration and arrest the decline in the country's tax effort?

Two bills are currently pending in the Philippines' House of Representatives seeking to establish a semi-autonomous internal revenue administration to replace the BIR. House Bill 5054 proposes to create the Internal Revenue Manage-

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[1] See R. Manasan. Explaining the decline in tax effort. *PIDS Policy Notes No. 2002-14*.

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ment Authority (IRMA) while House Bill 5465 calls for the organization of the National Authority for Tax Administration (NARA). More recently, too, a substitute bill calling for the establishment of the National Internal Revenue Authority (NIRA) has passed third reading at the House's Committee on Ways and Means.

To help in enlightening the debate and discussion on these proposed bills and BIR restructuring, this *Policy Notes* will review the experiences of other countries that have set up semi-autonomous RAs and see what lessons may be drawn from their experiences so that the risks and opportunities that accompanied their establishment may be carefully studied amid the Philippine background.

The rationale for change

What brought about the demand for change in the first place?

Tax experts have suggested that in countries where the tax gap (or the difference between the tax that should be paid according to tax statutes and the tax that is actually collected) is large, i.e., 40 percent or more of the potential tax, there is an imperative for radical changes in the tax administration.

Because tax administration in these countries was inefficient and perceived to be corrupt due to existing budgetary and personnel regulations, the argument put forward was to make the structure and system of tax administration more "business-like" and free of the financing and personnel rules that governed the public sector. This would thus reduce the motive for corruption by giving emphasis to performance-linked budgets and compensation schemes that would accompany the proposed creation of semi-autonomous tax administration bodies.

In addition, tax scholars have also argued that turning tax administration over to an independent body would help depoliticize tax collection and minimize the risks that politicians will undo the reform at a later date. In this sense, for the establishment of the autonomous tax authority to be viewed by the public as a means of helping politicians make a credible commitment to reform, it should be anchored on specific bureaucratic features of the new tax administration. For instance, the fact that taxpayers know that the revenue authority's budget is a function of revenues collected, that its officials are trained professionals operating in a meritocratic organization, and that it is headed by someone who is free from political interference signals to taxpayers that the new RA has solid incentives to maximize revenue by detecting noncompliance on the part of taxpayers.

Key design features of semi-autonomous RAs

More specifically, what are the key design bureaucratic features that define semi-autonomous RAs and that make their structure acceptable and credible? There are five key elements, namely:

- ***legal character***. While all the semi-autonomous RAs in other countries were created by law and situated within the public sector, they nonetheless took different forms. For instance, Peru's RA is a decentralized public organization while that of South Africa is a public sector organization outside the public service. That of Kenya is a government corporate body whereas Venezuela's agency is an autonomous institute.

  Except for Venezuela's RA, all of these bodies have their own separate legal character and can own assets which strengthen their managerial autonomy. Without their legal character, the RAs would have been more subordinate to the ministries of finance.

- ***governance structure***. Semi-autonomous RAs may follow either one of two governance models: the chief executive officer (CEO) model or the board of directors (BOD) model.

  In the CEO model, the commissioner or superintendent is appointed by the president of the republic although in some cases, he may also be appointed by the minister of finance. His appointment may be for a fixed or variable number of years.

  Under the BOD model, on the other hand, the board is responsible for overseeing the RA's management but does not intervene in the day-to-day activities. The boards vary in size, composition and appointing authority.

In terms of size, it may be advisable to keep the number small because a large board tends to be more unwieldy in terms of managing schedules. With regard to membership, meanwhile, opening the board to representatives from the private sector may enhance the RA's customer service orientation but this may also give rise to potential conflicts of interest and breach of taxpayer confidentiality. As to the appointing authority, studies by the World Bank (2002) indicate that presidential appointment of the commissioner is a mechanism that seems to increase autonomy especially if accompanied by a fixed-term appointment for the commissioner.

▶ ***financing***. Semi-autonomous RAs generally receive budgets that are set as fixed or variable percentages of their actual collections. Clearly, having the RA budget as a fixed percentage of actual tax collections is autonomy-enhancing. The practice also tends to enhance revenue performance since it provides the authority with more incentive to collect taxes efficiently.

At the same time, however, how the funds are released to the revenue authority also determines to a large extent, the autonomy of the authority. Needless to say, a system whereby formula-based funding is released automatically to the RA would be the most autonomy-enhancing procedure.

▶ ***personnel systems***. Autonomy in hiring, firing, rewarding and motivating the staff is viewed by many as perhaps the most critical feature of semi-autonomous RAs. The semi-autonomous RA of Peru, for instance, was given by law the authority to adopt a nonpublic sector personnel regime where it can set its own salary structure, and appoint and remove employees without the need to consult with any other public sector entity. As such, it worked well in the Peruvian context.

▶ ***accountability mechanisms***. Based on the principle that the best strategy against corruption is a combination of both positive and negative incentives, greater administrative and financial independence should therefore be accompanied by the establishment of accountability mechanisms in the semi-autonomous RAs. The components of a good accountability system are: (1) code of ethics for all employees of the RA, (2) a strong internal audit unit with a high profile within the authority, (3) independent external audit of the revenue authority itself, and (4) clear reporting relationships to other government agencies.

The experiences of other countries: not all semi-autonomous RAs are created equal

On the basis of the above features, what has been the experience of other countries in terms of the creation of semi-autonomous RAs?

On the one hand, a survey conducted in 1998-1999 in four countries in Latin America by Taliercio (2000) shows that semi-autonomous revenue authorities have had uneven impact not only in combating corruption (Table 1) but also in improving taxpayer services (Table 2). On the other hand, the record of these semi-autonomous RAs in improving tax effort is mixed.

In some countries, the tax-to-GDP ratio rose dramatically with the establishment of the new revenue authority. This is the case in Peru where the ratio rose from nine percent in 1987 to 15 percent in 1997 and in Uganda where tax effort surged from four percent of GDP in 1990 to 11 percent in 1996.

In other countries like Venezuela and South Africa, however, the increase in tax effort was more modest with the tax-to-GDP ratio rising by two to three percentage points of GDP

Table 1. Proportion of respondents opining on whether there is more or less corruption in the tax agency than before the reform (in percent)

	Much less	Substantially less	Slightly less	No change	Slightly more	Substantially more	Much more
Peru	52	33	10	0	0	0	4
Mexico	4	17	34	36	6	0	2
Venezuela	8	18	53	18	0	0	4
Bolivia	2	6	18	48	16	6	4

Table 2. Proportion of respondents opining on whether overall quality of services provided by the tax agency is better or worse than that provided before the reform (in percent)

	Much worse	Generally worse	Slightly worse	No change	Slightly better	Generally better	Much better
Peru	0	0	2	2	25	44	27
Mexico	0	2	2	38	42	16	0
Venezuela	0	0	8	4	40	35	13
Bolivia	0	0	6	28	46	18	2

after the reform. In yet other countries, the improvement was marginal as in Mexico and Argentina where the ratio rose by about one percentage point of GDP only. Meanwhile, in some countries like Zambia, the new RA appeared to have no tangible impact on tax effort at all.

Perhaps noteworthy to mention is the fact that even in many of the countries that have shown some degree of success in their RAs, the gains in revenue performance seem to have been eroded after some time. The experiences of Bolivia, Mexico, Peru and Venezuela show that the semi-autonomous RAs have been less sustainable than expected.

What seems to be the reason for this trend and for the mixed review of experiences of the various countries that have set up semi-autonomous RAs?

The general conclusion is that the *success of these RAs declines as their autonomous features are undermined*, if not totally eliminated. Taliercio (2001) claims that the main challenge to the autonomy of the RA has been the government itself (working through the ministry of finance) inasmuch as the very design of these RAs gives rise to the "dynamics of conflict and competition between the government and the RA."[2]

Lessons for the Philippines: doing it right through the proposed bills

As shown in the experiences of other countries, some RAs perform better than others. And the more successful ones appear to be those that have a higher degree of autonomy (as defined in the key design features of the semi-autonomous RAs) and have sustained such through the years.

With the proposed bills at the Philippines' House of Representatives creating the semi-autonomous RA in the country, it is imperative to take stock of the experiences of other countries and "do it right" insofar as the adoption of an autonomous RA model for the Philippines is concerned.

"Doing it right" implies that the new tax agency should be vested with strong autonomy-enhancing features and accountability mechanisms. Using this framework, Table 3 reviews the provisions of the three alternative bills pending in Congress to replace the BIR and suggests certain areas, including new features, for improvement as ideal.

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[2]He notes that the reform vests "the minister of finance with high costs, yet provides little in the way of benefits. From a political perspective, the main benefit of reform is greater revenues. Yet, it is largely the president, not the minister, who benefits politically from greater expenditures. The main costs of the RA reform are lost patronage opportunities, less political control of the tax agency, and less influence over tax policymaking. The minister is affected by all these costs as the RA reform removes a large percentage of ministerial employees from his control (which results in a substantially decreased budget), reduces his political control over the tax administration, and reduces his tax policy control by establishing another center of tax policy expertise. According to this simple cost-benefit analysis, ministers should generally have incentives to oppose the reform (even while presidents support it). Thus, on both administrative and political grounds, finance ministers are likely to oppose semi-autonomous RAs.

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Table 3. Key features of alternative house bills proposing to create new revenue authority

Key design feature	House Bill 5054	House Bill 5465	Substitute bill	Ideal
New agency name	Internal Revenue Management Authority (IRMA)	National Authority for Tax Administration (NARA)	National Internal Revenue Authority (NIRA)	
Legal features				
Legal character	separate legal character	separate legal character	separate legal character	separate legal character
Patrimony	can own assets and create liabilities	can own assets and create liabilities	can own assets and create liabilities to be used solely for the improvement of its capital and infrastructure needs	can own assets and create liabilities to be used solely for the improvement of its capital and infrastructure needs
Governance structure				
Governance model	board of directors model	board of directors model	board of directors model	board of directors model
BOD membership	4 government representatives (*ex officio*) and 3 private sector representatives	5 government representatives (*ex officio*) and 4 private sector representatives	4 government representatives (*ex officio*) and 3 private sector representatives	3 *ex officio* government representatives (DOF, DBM and NEDA) and 4 full time private sector representatives; Commissioner as nonvoting member
Appointment of BOD members	appointment by president for a period of 3 years with possibility of reappointment once	appointment by president for a period of 3 years with possibility of reappointment once	appointment by president for a period of 3 years with possibility of reappointment once	appointment by president for a period of 5 years with possibility of reappointment once
Appointment of commissioner	appointment by board for a period of 3 years with possibility of reappointment depending on performance but limited to a maximum of 3 terms	appointment by board for a period of 3 years with possibility of reappointment depending on performance but limited to a maximum of 3 terms	appointment by board for a period of 4 years with possibility of reappointment depending on performance; no term limit	appointment by Board for a period of 5 years with possibility of reappointment depending on performance once
Functions of the board				board tasked with making policies governing the operations of the authority
Functions of the commissioner				commissioner tasked with implementing policies set by the board and administering day-to-day operations of the revenue authority
Financing mechanism				
Source of funds	between 1% and 2% of actual tax collections; 5% of excess over target	between 1% and 2% of actual tax collections; 5% of excess over target	2% of actual tax collections in the previous year plus 5% of annual collection in excess of its target	1.5% of actual collections in the previous year

Key design feature	House Bill 5054	House Bill 5465	Substitute bill	Ideal
Transfer of funds	congressional appropriation	congressional appropriation	automatic appropriation/ release	automatic appropriation/ release
Personnel system establishment of human resource management system and oversight of the same	Own human resource management system (hiring, transfer, promotion, dismissal, pay and position classification) promulgated by commissioner; final appellate authority in cases involving promotion, transfer, assignment rests with board	Own human resource management system (hiring, transfer, promotion, dismissal, pay and position classification) promulgated by commissioner; final appellate authority in cases involving promotion, transfer, assignment rests with Board	organizational structure, compensation/position classification scheme, qualification standards and performance-based management system governing selection, hiring, appointment, transfer, promotion and dismissal of personnel set by the board; appointment and deployment of personnel in accordance with Civil Service Law	Own human resource management system (hiring, transfer, promotion, dismissal, pay and position classification) promulgated by board and administered/implemented by commissioner; final appellate authority in cases involving promotion, transfer, assignment
Recruitment of employees of new tax agency	no preferential or prior right shall be given to BIR employee	preferential absorption of BIR employees	preferential absorption of BIR employees	no preferential or prior right shall be given to BIR employees
Accountability mechanisms Strong internal audit unit	yes	yes	yes; deemed deputized by Office of Ombudsman; tasks to conduct periodic lifestyle checks of personnel	yes; deputized by Office of Ombudsman; to conduct periodic lifestyle checks of personnel
External audit	no mention	no mention	no mention	Periodic third party performance audit by entity to be identified by the Board; financial audit by COA
Code of ethics	no mention	no mention	no mention	Board should establish and implement a written code of ethics for all employees
Clear reporting rules	as indicated in Section 20 of NIRC	as indicated in Section 20 of NIRC	in addition to requirements indicated in Section 20 of NIRC, submission of annual and semi-annual report to Senate and House of Representatives and to Congressional Oversight Committee; in the first 3 years from effectivity of the Act, Joint Congressional Revenue Commission to review reports and evaluate implementation of Authority	in addition to requirements indicated in Section 20 of NIRC, submission of annual and semi-annual report to Senate and House of Representatives; abolish Congressional Oversight Committee; no to Joint Congressional Revenue Commission
Separation benefits	gratuities and benefits under existing laws	separation incentives over and above gratuities and benefits under existing laws	separation incentives over and above gratuities and benefits under existing laws; package equal to 3 months for every year of service	separation incentives over and above gratuities and benefits under existing laws; package not to exceed 1.5 months per every month of service
Transitory provision	all incumbent personnel in BIR as of date of approval of act shall continue to exercise their duties and function as personnel of the Authority	all incumbent personnel in BIR as of date of approval of act shall continue to exercise their duties and function as personnel of the Authority	all incumbent personnel in BIR as of date of approval of act shall continue to exercise their duties and function as personnel of the Authority	pending the organization of new Authority, all incumbent personnel of BIR shall continue to exercise their duties and functions as personnel of BIR (not as personnel of Authority)