



OFFICIAL USE ONLY

R2016-0262/1

December 27, 2017

**Closing Date: Tuesday, January 17, 2017
at 6 p.m.**

FROM: Vice President and Corporate Secretary

Guatemala - Transparency and Efficiency in Fiscal Management

Attached is the Project Appraisal Document regarding a proposed loan to Guatemala for the Transparency and Efficiency in Fiscal Management (R2016-0262), which is being processed on an absence-of-objection basis.

Distribution:

Executive Directors and Alternates

President

Bank Group Senior Management

Vice Presidents, Bank, IFC and MIGA

Directors and Department Heads, Bank, IFC and MIGA

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank Group authorization.

Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No: PAD1384

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF

US\$55 MILLION

TO THE

REPUBLIC OF GUATEMALA

FOR A

TRANSPARENCY AND EFFICIENCY IN TAX ADMINISTRATION PROJECT

DECEMBER 21, 2016

Governance Global Practice
Latin America and the Caribbean

<p>This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.</p>
--

CURRENCY EQUIVALENTS

(Exchange Rate Effective November 18, 2016)

Currency Unit = Guatemalan Quetzal (GTQ)

US\$1 = GTQ7.51

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

FM	Financial Management
GDP	Gross Domestic Product
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technology
IDB	Inter-American Development Bank
IMF	International Monetary Fund
IPF	Investment Project Financing
IRR	Internal Rate of Return
LAC	Latin American and the Caribbean
IT	Information Technology
M&E	Monitoring and Evaluation
MINFIN	Ministry of Public Finance (<i>Ministerio de Finanzas Públicas</i>)
NPV	Net Present Value
OM	Operational Manual
PDO	Project Development Objective
PC	Project Coordinator (<i>Coordinador del Proyecto</i>)
PIU	Project Implementation Unit (<i>Unidad Ejecutora del Proyecto</i>)
PPSD	Project Procurement Strategy for Development
SAT	Tax Administration Superintendence (<i>Superintendencia de Administración Tributaria</i>)
SICOIN	Integrated Accounting System (<i>Sistema de Contabilidad Integrada</i>)
TAL	Technical Assistance Loan
TCA	Taxpayer Current Account
TRIBUTA	Tax and Customs Administrative Tribunal (<i>Tribunal Administrativo, Tributario y Aduanero</i>)
VAT	Value Added Tax
WB	World Bank

Regional Vice President:	Jorge Familiar
Country Director:	J. Humberto Lopez
Senior Global Practice Director:	Deborah Wetzel
Practice Manager:	Arturo Herrera Gutierrez
Task Team Leaders:	Alberto Leyton and David Santos Ruano

GUATEMALA
Transparency and Efficiency in Tax Administration
TABLE OF CONTENTS

	Page
I. STRATEGIC CONTEXT	1
A. Country Context.....	1
B. Sectoral and Institutional Context.....	1
C. Higher Level Objectives to which the Project Contributes	4
II. PROJECT DEVELOPMENT OBJECTIVES	5
A. PDO.....	5
B. Project Beneficiaries	5
C. PDO Level Results Indicators.....	5
III. PROJECT DESCRIPTION	5
A. Project Components	5
B. Project Cost and Financing	9
C. Lessons Learned and Reflected in the Project Design.....	10
IV. IMPLEMENTATION	11
A. Institutional and Implementation Arrangements	11
B. Results Monitoring and Evaluation	11
C. Sustainability.....	12
V. KEY RISKS	13
A. Overall Risk Rating and Explanation of Key Risks.....	13
VI. APPRAISAL SUMMARY	14
A. Economic and Financial Analysis.....	14
B. Technical.....	15
C. Financial Management.....	16
D. Procurement	16
E. Social (including Safeguards)	16
F. Environment (including Safeguards)	17
G. World Bank Grievance Redress.....	17
Annex 1: Results Framework and Monitoring	18

Annex 2: Detailed Project Description.....	24
Annex 3: Implementation Arrangements	36
Annex 4: Implementation Support Plan	46
Annex 5: Economic and Financial Analysis	49
Annex 6: Project Implementation Timeframe	53
Annex 7: Support to SAT from Other Donors.....	49

PAD DATA SHEET

Guatemala

Transparency and Efficiency in Tax Administration (P153366)

PROJECT APPRAISAL DOCUMENT

LATIN AMERICA AND THE CARIBBEAN

Governance Global Practice

Report No.: PAD1384

Basic Information			
Project ID P153366	EA Category C - Not Required	Team Leader(s) Alberto Leyton	
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints []		
	Financial Intermediaries []		
	Series of Projects []		
Project Implementation Start Date 17-Jun-2017	Project Implementation End Date 31-Mar-2023		
Expected Effectiveness Date 17-Jun-2017	Expected Closing Date 30-Jun-2023		
Joint IFC No			
Practice Manager/Manager Arturo Herrera Gutierrez	Senior Global Practice Director Deborah L. Wetzel	Country Director J. Humberto Lopez	Regional Vice President Jorge Familiar
Borrower: Ministry of Public Finance			
Responsible Agency: Superintendencia de Administración Tributaria			
Contact: Telephone No.: 502-2362-7111	Ernesto Ramirez	Title: Email:	Project Management Leader jeramire@sat.gob.gt
Project Financing Data(in US\$, millions)			

<input checked="" type="checkbox"/> Loan	<input type="checkbox"/> IDA Grant	<input type="checkbox"/> Guarantee					
<input type="checkbox"/> Credit	<input type="checkbox"/> Grant	<input type="checkbox"/> Other					
Total Project Cost:		55.00			Total Bank Financing:		55.00
Financing Gap:		0.00					
Financing Source				Amount			
Borrower				0.00			
International Bank for Reconstruction and Development				55.00			
Total				55.00			
Expected Disbursements (in US\$, millions)							
Fiscal Year	2018	2019	2020	2021	2022	2023	
Annual	4.48	11.93	19.84	9.81	7.65	1.29	
Cumulative	4.48	16.41	36.25	46.06	53.71	55.00	
Institutional Data							
Practice Area (Lead)							
Governance							
Contributing Practice Areas							
Proposed Development Objective(s)							
The project development objective is to increase levels of compliance with tax and customs obligations.							
Components							
Component Name					Cost (US\$, millions)		
Component 1. Transparency, Integrity and Institutional Development in Superintendence of Tax Administration (SAT)					23.52		
Component 2. Strengthening of Tax Collection Functions in Internal Revenues and Customs					27.66		
Component 3. Strengthening of Integrated Tax Intelligence and Tax Enforcement					3.68		

Systematic Operations Risk- Rating Tool (SORT)		
Risk Category	Rating	
1. Political and Governance	High	
2. Macroeconomic	Moderate	
3. Sector Strategies and Policies	Substantial	
4. Technical Design of Project or Program	Substantial	
5. Institutional Capacity for Implementation and Sustainability	High	
6. Fiduciary	Substantial	
7. Environment and Social	Low	
8. Stakeholders	Substantial	
9. Other		
OVERALL	Substantial	
Compliance		
Policy		
Does the project depart from the CAS in content or in other significant respects?	Yes []	No [X]
Does the project require any waivers of Bank policies?	Yes []	No [X]
Have these been approved by Bank management?	Yes []	No [X]
Is approval for any policy waiver sought from the Board?	Yes []	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No []
Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		X
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12		X
Safety of Dams OP/BP 4.37		X

Projects on International Waterways OP/BP 7.50			X
Projects in Disputed Areas OP/BP 7.60			X
Legal Covenants			
Name	Recurrent	Due Date	Frequency
Establish, Maintain and Operate the Project Implementation Unit and Management Committee in SAT		Three months after effectiveness	
Description of Covenant			
Schedule 2. Section I.A.1. No later than three (3) months after the Effective Date, the Borrower shall cause the Implementing Entity-SAT to establish, and thereafter operate and maintain, throughout Project implementation, a Project Implementation Unit (the PIU), and a Management Committee; with functions responsibilities, staffing and budgetary resources, all acceptable to the Bank and as set forth in the Operational Manual.			
Name	Recurrent	Due Date	Frequency
Hire Project Coordinator and Fiduciary Specialists		Three months after effectiveness	
Description of Covenant			
Schedule 2. Section I.A.2. No later than three (3) months after the Effective Date, the Borrower shall cause Implementing Entity-SAT to appoint a project coordinator, a financial management specialist and a procurement specialist, all in a manner, with qualifications, experience and under terms of reference acceptable to the Bank.			
Name	Recurrent	Due Date	Frequency
Establish, Maintain and Operate the Steering Committee		Three months after effectiveness	
Description of Covenant			
Schedule 2. Section I.A.3. For purposes of providing general Project oversight and coordination, the Borrower shall cause the Implementing Entity-SAT, not later than three months after the Effective Date, to establish, and thereafter operate and maintain throughout the implementation of the Project, a committee (the Steering Committee), with functions, responsibilities and composition including representatives of the Ministry of Public Finance and the Implementing Entity-SAT, all acceptable to the Bank and as set forth in the Operational Manual.			
Conditions			
Source Of Fund	Name		Type
IBRD	Additional Events of Suspension		Suspension
Description of Condition			

Article 4.01. The Additional Events of Suspension consist of the following:

- (a) The SAT's Legislation has been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely, in the opinion of the Bank, the ability of the Implementing Entity-SAT to perform any of its obligations under the Subsidiary Agreement.
- (b) The Implementing Entity-SAT has failed to comply with any of its obligations under the Subsidiary Agreement.

Source Of Fund	Name	Type
IBRD	Additional Conditions of Effectiveness	Effectiveness

Description of Condition

Article 5.01. The Additional Conditions of Effectiveness consist of the following:

- (a) The Subsidiary Agreement has been executed on behalf of the Borrower and the Implementing Entity-SAT.
- (b) The Operational Manual has been adopted by the Implementing Entity-SAT in a manner and with contents acceptable to the Bank.

Source Of Fund	Name	Type
IBRD	Additional Legal Matter	Effectiveness

Description of Condition

Article 5.02. The Additional Legal Matter consists of the following, namely, that the Subsidiary Agreement has been duly authorized or ratified by the Borrower and Implementing Entity-SAT and is legally binding upon the Borrower and the Implementing Entity-SAT in accordance with its terms.

Team Composition

Bank Staff

Name	Role	Title	Specialization	Unit
Alberto Leyton	Team Leader (ADM Responsible)	Lead Public Sector Specialist		GGO16
Monica Lehnhoff	Procurement Specialist (ADM Responsible)	Procurement Specialist		GGO04
Lourdes Consuelo Linares Loza	Financial Management Specialist	Sr Financial Management Specialist		GGO22
Ana Cebreiro Gomez	Peer Reviewer	Senior Economist		GGO28
David Santos Ruano	Team Leader	Public Sector Specialist	Information Systems	GGO16
Enrique Fanta Ivanovic	Peer Reviewer	Senior Private Sector Specialist	Customs Administration	GTC04

Karina Ramirez Arras	Team Member	Research Analyst	Internal Revenue Systems	GGO16	
Mariela Mena	Safeguards Specialist	Social Development Consultant		GWADR	
Marinus Verhoeven	Peer Reviewer	Lead Economist		GGO28	
May Cabilas Olalia	Team Member	Sr Public Sector Spec.		GGO16	
Rajul Awasthi	Peer Reviewer	Senior Public Sector Specialist		GGO28	
Tatiana Cristina O. de Abreu	Finance Officer	Finance Officer		WFALA	
Gabriela Grinsteins	Counsel			LEGLE	
Extended Team					
Name	Title	Office Phone	Location		
Juan Jose Bravo	Customs Specialist/Consultant		Washington DC		
Locations					
Country	First Administrative Division	Location	Planned	Actual	Comments
Guatemala	Guatemala	Guatemala City		X	

I. STRATEGIC CONTEXT

A. Country Context

1. Guatemala is among the countries with the highest poverty rate in Latin America and the Caribbean (LAC), and change in shared prosperity has been very limited in recent years.

From 2006 to 2014, the poverty rate (US\$4 per day poverty line) increased from 53 to 60 percent, in striking contrast to the decline in poverty in LAC. Between 2000 and 2014, the poorest 40 percent experienced a decline in income, again in contrast to most LAC countries. High poverty is also reflected in the country's social indicators, such as stunting rates for children under-five, affecting in particular the poor (66 percent), rural dwellers (59 percent), and Indigenous groups (61 percent).

2. The country's stable macroeconomic framework has not translated into high growth or poverty reduction.

The country is the largest economy in Central America, with a Gross Domestic Product (GDP) of US\$63.8 billion (2015). Since 1990, economic volatility was less than half the regional average, and the country experienced less of an economic deceleration during the 2009 recession than most LAC countries. Much of Guatemala's economic stability can be attributed to prudent macroeconomic policies that have kept fiscal deficits and public debt low. However, given that Guatemala has one of the lowest tax burdens in the world, low fiscal deficits were achieved by modest spending on social sectors and public services.

3. Guatemala is at a historic juncture, following a political and institutional crisis in 2015, a newly elected Government is starting to take on deep-rooted development problems.

The crisis was triggered by the uncovering of a corruption scheme that permeated the Tax Administration Superintendence (SAT) and the highest political levels. Subsequently, a massive social uprising demanded the resignation of the President and the strengthening of governance. In October 2015, the new administration assumed office with a platform against corruption. The Administration took office in January 2016 and, during its first three months, developed its 20/20 Vision for Guatemala, building on the K'atun 2032 National Development Plan. A key priority of the Government is combating corruption and improving transparency.

B. Sectoral and Institutional Context

4. Guatemala has one of the lowest levels of tax revenue in LAC and the world.

The modest gains in revenue mobilization of 2013 were lost amidst high-level corruption in the customs administration¹. After reaching 11 percent in 2013, the tax-to-GDP ratio fell to 10.8 percent in 2014 and to 10.2 percent by end 2015, below the 13 percent target foreseen in the tax reform of 2012 and significantly below the LAC average of 16.9 percent. Guatemala's tax effort² is also the lowest in the region and among its lower-middle income peers. Low levels of revenues are due to narrow bases and low rates of certain taxes, but also to widespread tax evasion, lack of transparency, weak monitoring and controls, Value Added Tax (VAT) revenue leakages due to fraudulent invoicing, and high levels of informality.

¹SAT, Proyección del incumplimiento de pago del Impuesto al Valor –IVA- en Guatemala, Periodo 2016-2018

² The tax effort is defined as the ratio of actual revenues to potential revenues.

5. **Indirect taxation accounts for over half of total revenues, with around 50 percent from VAT.** Despite the relative importance of VAT in revenue collection, VAT rates are among the lowest in LAC, with numerous exemptions and loopholes. A decrease in VAT revenues from 3 percent of GDP in 2013 to 2.6 percent in 2015 was the main contributor to the persistent decline in the tax-to-GDP ratio during the same period. Direct taxation amounts to 30.9 percent of total revenue, of which only 2.9 percent is from personal income tax, and is hampered by a small tax base, excessive exemptions, and widespread evasion and informality. Furthermore, the current framework is regressive: a fiscal incidence analysis based on the 2009-2010 National Survey of Family Income and Expenditures revealed that current tax system and transfers do not reduce inequality and poverty overall or along ethnic and rural-urban lines.³

6. **Modest tax collection is also due to persistently low levels of tax compliance.** Low tax compliance is mainly caused by institutional weaknesses in tax administration and a lack of a tax culture⁴ in the country. The former is a result of structural problems linked to SAT's weak internal governance framework, outdated core business and support processes in tax administration, and weak controls and enforcement procedures for both internal revenues and customs. A lack of a tax culture stems from the perception of weakness and lack of transparency of public institutions in general, and a lack of trust in SAT in particular. The prevailing public perception that compliance is costly, tax administration is inefficient, and the tax structure is regressive limits the scope for voluntary compliance. In 2015, Guatemala ranked 123 out of 168 countries in the public sector corruption perception index.⁵ High levels of tax evasion erode the tax base and continue to undermine both vertical and horizontal equity in the tax system. An estimated 74.5 percent of the economically active population is part of the informal economy, and informalities relating to contraband and fraudulent customs activities are estimated to cause a loss of revenue of around 2.8 percent and 4.4 percent of GDP, respectively.⁶

7. **Customs operations in Guatemala has also been characterized by limited transparency, lack of cross-control mechanisms, and costly and inefficient clearance procedures.** Although Guatemala made some progress in aligning its trade facilitation practices with international standards in recent years, a large number of physical inspections are still conducted at the border, negatively affecting the time for cargo to be released by customs. In addition, efforts to mitigate contraband have failed repeatedly due to high levels of discretion by customs officers, lack of infrastructure and supporting equipment for controlling merchandise transit in customs offices, and a fragmented risk management model.

8. **While it is critical to expand the tax base and raise certain tax rates, a prerequisite for building political and public support for such fiscal reforms is to strengthen the regulatory framework to enhance tax collection and re-build trust in SAT.** The 2015 political and institutional crisis exposed the extent of SAT's underlying structural problems. Revenue administration capacity deteriorated significantly in recent years as SAT fell behind in keeping up with the institutional and technological requirements needed to maintain its operations at

³ Cabrera Mynor, Lusting Nora and Moran Hicias E. (2015); Fiscal Policy, Inequality, and the Ethnic Divide in Guatemala; Center for Global Development, Working paper 397, March 2015.

⁴ This refers to the "culture of compliance" based on rights and responsibilities, in which citizens see paying taxes as an integral element of their relationship with the Government.

⁵ Transparency International, 2015.

⁶ World Bank, Guatemala Economic Diagnostic for National Action, 2015.

international standards. Several diagnostic assessments by international development partners, including the World Bank (WB), United States Treasury, International Monetary Fund (IMF), and the Inter-American Development Bank (IDB) found that SAT suffers from (i) disintegrated and inefficient tax administration processes; (ii) a dysfunctional governance structure that lacks transparency and is characterized by weak internal controls and ineffective information sharing between units; (iii) fragmented and vulnerable information systems; and (iv) lack of a human resource strategy.

9. The new Administration has given priority to mobilizing revenue through strengthening SAT's core operations and its legal and institutional framework, as demonstrated by the approval of the amendments to SAT's Organic Law. The Government sees the current context as an opportunity to reverse SAT's poor performance through the implementation of a comprehensive reform. The reform plan includes critical changes in the institutional and legal framework along with short-, medium- and long-term actions for improving SAT's operations and transparency. To this end, the Government approved the amendments to SAT's Organic Law (*Ley Orgánica de la SAT-Decree 1-98*) to address critical governance issues in the existing organization of the Administration. Important features of the reform are: (i) separation of administrative tax appeal functions with the creation of the Tax and Customs Administrative Tribunal (TRIBUTA), an administrative tribunal in SAT, to eliminate the risk of conflict of interest of the Board of Directors; (ii) limit in political influence in SAT nominations through the modification of appointments procedures for the SAT Superintendent, the Board of Directors and TRIBUTA members; (iii) revision of roles and responsibilities of the Board of Directors and SAT's administrative units; (iv) creation of a specialized internal investigation unit in SAT with the capacity to detect and investigate corruption and conflict of interest practices; and (v) regulation of financial confidentiality provisions granting SAT the authority to access taxpayers' bank information for auditing and investigation purposes.

10. In addition, the Government has implemented a number of short-term measures aimed at improving tax collection. These include, among others: (i) hiring and training of new staff; (ii) authorization and closure of gates in Puerto Quetzal, one of the main import and export points, to reinforce security and merchandise controls; (iii) implementation of a monitoring system in ports; (iv) improvement of container controls from arrival to release in customs; (v) strengthening of controls of ramps in customs; (vi) establishment of an internal investigations unit, its protocols and training; (vii) acquisition of hardware infrastructure needed to avoid disruptions in SAT's existing information systems; and (viii) completion of a data warehouse to support early tax intelligence initiatives in SAT. All these measures are expected to gradually contribute to increasing tax revenue collection. They will be complemented by structural institutional changes in SAT and by medium- and long-term reforms to restore the institution's credibility and capability to perform its role in an effective and sustainable way.

11. The Government has successfully mobilized and coordinated efforts of development partners to support the implementation of SAT's integrated reform plan. Several international organizations and donors, including the IDB, IMF, the German Technical Cooperation Agency (GIZ), United States Treasury, and WB, have agreed to align their technical assistance and support programs around a common reform plan. The Government has established areas of priority for each organization, as presented in Annex 7. As part of these efforts, the IMF

produced a comprehensive report⁷ on the various aspects of tax administration, which includes both recommendations on restoring levels of collection in the short- and medium-term strategies to reinstate full control and credibility in SAT.

12. **In particular, the Government has requested the WB to support medium- and long-term reforms related to SAT.** Drawing on IMF recommendations as well as previous analyses and diagnostics, the proposed Project seeks to both tackle the structural problems causing operational inefficiency in tax administration and address SAT's governance issues to realign incentives for a more effective tax administration and restore the credibility of SAT to help rebuild taxpayer confidence and thus improve the tax culture in the country as a whole. Issues and shortcoming related to the existing tax policy framework and elements linked to quality of transparency in the expenditure side of the fiscal management are beyond the scope of the proposed Project.

13. **The proposed Project is part of a broader package of lending and analytical instruments to support the country's reforms on governance of public resources.** It complements policy and institutional actions that are being supported through the First Improved Governance of Public Resources and Nutrition (US\$250 million; P160667⁸) Development Policy Financing, the objective of which is to support the Government's efforts to strengthen the regulatory and institutional framework to improve governance of public resources and accountability. These efforts will be accompanied by analytical instruments, including technical assistance on using behavioral insights to motivate citizens to pay taxes, and on improving transparency and anti-money laundering systems, and an analysis to better understand the challenges related to the high levels of informality.

C. Higher Level Objectives to which the Project Contributes

14. **The proposed Project is fully consistent with the Country Partnership Framework (CPF) FY17-20⁹ in which transparency of tax and customs administration is a key priority.** The CPF supports the Government's commitment to improving transparency and accountability of the State and includes an objective that focuses on improving public resource management and accountability. The proposed Project is expected to increase compliance with tax and customs obligations, in turn boosting revenue collection, strengthening the Fiscal Policy and enabling the Government to invest in public services, in particular, to address persistently high poverty rates and improve shared prosperity. Moreover, based on preliminary findings, climate co-benefits are estimated at 10 percent of the Project amount. Enforcement of VAT and import duties of products typically associated with environment degradation (e.g. fuels) is expected to translate into higher effective taxation, indirectly contributing to the climate change agenda.

⁷ IMF (2016), Katherine Baer, Antonio Ansón, Nicolás Bonilla, Mónica Calijuri, Selvin Lemus, Guatemala: Measures for the Recovery of SAT (*Medidas para la Recuperación de la SAT*).

⁸ Approved on November 17, 2016

⁹ Report No. 103738-GT discussed by the Board of Executive Directors on November 17, 2016.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

15. The Project Development Objective (PDO) is to increase levels of compliance with tax and customs obligations.

B. Project Beneficiaries

16. Guatemalan taxpayers¹⁰ would benefit directly from lower compliance costs, improved assistance to taxpayers, and from increased SAT transparency. A more reliable institutional framework, including streamlined processes, standardized procedures and appropriate human resource management policies, would enable SAT to have a more effective decision-making process and improve productivity, administrative efficiency and transparency. Reforms supported by the Project would help reduce discretionary practices of tax officials mitigating the risk of corruption through more efficient and streamlined processes. Improvements in the business climate would be also reinforced by trade facilitation improvements through the simplification and increased quality of customs procedures. The proposed Project would capture beneficiary feedback through perception surveys for measuring taxpayer's satisfaction with SAT's services and perception of transparency. Direct beneficiaries include around 200,000 business taxpayers and 1.7 million individual taxpayers.

C. PDO Level Results Indicators

17. Achievement of the PDO will be measured with the following indicators:

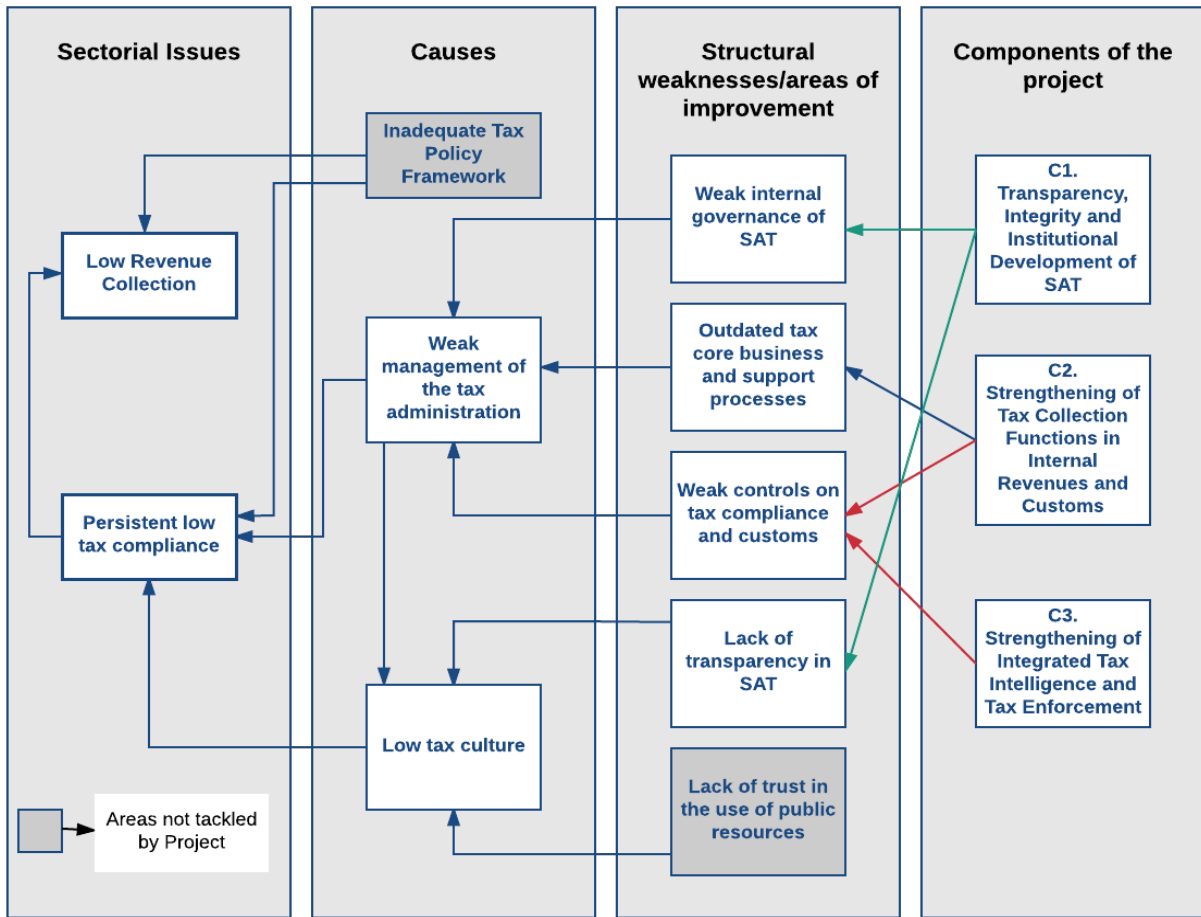
- (a) Increased compliance with domestic taxes, measured through the reduction in VAT gross compliance gap; and
- (b) Increased effectiveness of customs controls, measured through the increased ratio of effectiveness of customs inspections.

III. PROJECT DESCRIPTION

A. Project Components

¹⁰ Current active business taxpayers are 199,849 and individual taxpayers: 1,704,574.

Figure 1. Project Structure and Intervention Logic



18. **The Project has been designed to help address structural weaknesses and targets areas for improvement that are linked to the main causes of weak tax administration and the lack of a tax culture in the country.** SAT's weak internal governance framework, outdated core business and support processes, weak controls on tax compliance and customs, and lack of transparency, are being specifically targeted as areas of intervention for the proposed Project. As presented in Figure 1, three Components will finance vertical and transversal interventions to strengthen SAT's overall governance framework and increase its effectiveness. Each of the three Components is designed to tackle structural weaknesses in the Guatemala's tax system that contribute to low tax compliance and therefore, low revenue collection. While Component 2 is designed to support vertical interventions to strengthen internal revenues and customs functions, Components 1 and 3 include crosscutting interventions aimed at strengthening SAT's governance framework as well as developing integrated tax intelligence and enforcement procedures to enhance its effectiveness. Annex 2 provides a more detailed description of the nature and scope of activities to be supported under each Component and sub-component.

Component 1. Transparency, Integrity and Institutional Development in SAT (US\$23.52 million)

19. **The objective of this Component is to help improve SAT's governance, by supporting the implementation of the recently approved amendments to SAT's Organic Law of SAT and strengthening its internal capacities.** Areas to be targeted for capacity building include strategic planning, human resource management, institutional integrity, information governance, and information and communication technology (ICT). Activities to be supported by this Component are organized under the following three sub-components:

20. **Managing the SAT Reform.** This sub-component will develop and implement a reform strategy in SAT through, *inter alia*, the design and implementation of: (a) strategic planning and monitoring & evaluation (M&E) tools; (b) an ICT governance model; (c) a change management strategy including a communications campaign program to support the reform process; and (d) the provision of support to SAT for the carrying out of Project management, including, *inter alia*: (i) the carrying out of Project audits; (ii) the carrying out of training; (iii) the provision of technical support on procurement, safeguards and financial management (FM) requirements; and (iv) the financing of Operating Costs.

21. **Strengthening Human Resource Management and Institutional Integrity.** This sub-component will strengthen human resource management and institutional integrity through, *inter alia*, the development and implementation of: (a) an integrated human resource management strategy, including: (i) the update of staffing plans for internal revenues and customs services; (ii) the establishment of a performance management framework; (iii) a rigorous screening process for staff recruitment; and (iv) an internal capacity development and knowledge management program for SAT staff; and (b) a transparency and institutional integrity strategy, including: (i) the establishment and implementation of the new internal investigation unit; (ii) the strengthening of the internal audit functions; and (iii) the design and implementation of an industrial security plan for SAT staff at all levels, including protocols for physical and legal protection based on the nature of their functions and associated risks, but excluding from the security plan and protocols any activity which may require the participation of security forces. The above activities will be carried out in line with international experiences and norms.

22. **Upgrading and Integrating the ICT Platform.** This sub-component will support upgrading of the ICT platform and align it with the SAT reform strategy to ensure sustainability through, *inter alia*: (a) the design of a new organizational model for the ICT department within SAT; (b) the improvement of SAT's ICT planning capacity; (c) the design of a comprehensive software architecture ensuring the integration of all of SAT's functions; (d) the upgrading of the ICT infrastructure to support SAT's reform process, including the improvement of information security and the establishment of a data recovery center.

Component 2. Strengthening of Tax Collection Functions in Internal Revenues and Customs (US\$27.66 million)

23. **The objective of this Component is to strengthen the core processes of the primary tax collection and control functions in both internal revenues and customs.** This is expected

to enhance taxpayer voluntary compliance, taxpayer satisfaction and SAT's efficiency and will be supported through two sub-components.

24. **Strengthening Internal Revenue Collection Processes.** This sub-component will focus on the redesign and implementation of an integrated tax compliance model through, *inter alia*: (a) the redesign and improvement of the taxpayer registration system (*Registro Tributario Unico*); (b) the redefinition and implementation of a new model for the Taxpayer Current Account (TCA), including the centralization and storage of all taxpayers' fiscal obligations;¹¹ (c) the strengthening and expansion of an e-invoice initiative and the use of other third-party sources of information for effective collection control; (d) the implementation of tools and methodologies to improve effectiveness of administrative collection and tax arrears recovery, including the carrying out of activities to foster compliance and deter omission practices, through behavioral economic approaches; and (e) the development and implementation of a comprehensive strategy to improve taxpayer services, including improvements in the face-to-face services provided in regional offices, the expansion of electronic services, and the implementation of a taxpayer satisfaction survey.

25. **Strengthening Customs Services.** This sub-component will strengthen customs services through, *inter alia*: (a) the implementation of a risk-based management model for merchandise controls, including ex-post documental controls and the implementation of a trusted operator program;¹² (b) the development and implementation of streamlined and automated customs procedures and mechanisms, including a joint administrative inspection model with the Government's border control agencies; (c) the implementation of non-intrusive technologies and electronic tracking devices for merchandise control at the customs entrances, exits and transits; (d) the strengthening of controls over special customs regimes, including free zones; (e) the facilitation of information exchange with national and international agencies, through the application of international conventions and the development of regional and bilateral agreements; and (f) increasing transparency and predictability in customs services by: (i) improving and implementing modern valuation methodologies and tools; (ii) implementing standardized application of norms and procedures at customs offices; (iii) improving the availability and quality of customs information to SAT staff, trade operators and other users; (iv) creating consultation and feedback mechanisms between traders and customs; and (v) improving transparency of the VAT's refund process.

Component 3. Strengthening of Integrated Tax Intelligence and Tax Enforcement (US\$3.68 million)

26. **The objective of this Component is to strengthen SAT's tax intelligence and enforcement capabilities.** The Component will promote an efficient use of tax information sources to support the auditing, control and enforcement functions through the adoption of an integrated compliance risk management model, the promotion of a culture of information analysis

¹¹ Refers to the taxpayer current account with 360° approach which involves the centralization and storage of all taxpayers' fiscal obligations, including customs and domestic taxes.

¹² This program would certify third party trusted operators to safeguard the application of security standards of the international supply chain and provide enhanced services, such as simplified customs procedures and reduced customs intervention. The program would apply, but not be limited, to authorized economic operators.

within SAT, and the strengthening of tax auditing and legal services for a more effective detection of evasion and tax fraud practices as well as an effective collection of disputed taxes. The risk management model will cover both internal revenues and customs in order to deter existing silo-based practices and increase effectiveness of the tax intelligence function through improved access and use of all available information. The Component supports three sub-components:

27. **Strengthening Tax Intelligence and Tax Audit.** This sub-component will strengthen the tax intelligence and tax audit units within SAT through, *inter alia*: (a) the creation and establishment of a new tax intelligence unit; (b) the design and implementation of an integrated risk-based management model covering internal revenues and customs; (c) the construction of a unified data warehouse and related business intelligence tools; (d) the design and implementation of a comprehensive auditing strategy and related tools based on taxpayer segmentation and risk analysis for both internal revenue collection and foreign trade areas; and (e) the carrying out of capacity building activities for auditors, including on transfer price processes.

28. **Strengthening Legal Services and Tax Appeals Procedures in SAT.** This sub-component will strengthen SAT's legal services and tax appeal procedures through, *inter alia*: (a) the creation of a strategy and the development of analytical tools to support tax litigation, and the carrying out of capacity building activities for SAT's Legal Department; (b) the identification of areas of opportunity to improve existing regulations that hinder SAT's ability to collect tax debts; and (c) the implementation of a new tax appeals framework and of TRIBUTA through, *inter alia*: (i) the development of organizational manuals and procedures; (ii) the analysis of staffing capacity and requirements; (iii) the carrying out of training for relevant TRIBUTA staff; (iv) the development of tools to record and monitor appeal cases; and (v) the carrying out of dissemination and communication activities to inform taxpayers of the new tax appeals procedures and protocols.

B. Project Cost and Financing

29. **The total Project cost is estimated at US\$54.86 million.** This Investment Project Financing (IPF) would be financed by an IBRD loan in the amount of US\$55 million, including financing of the front-end fees.

Table 1: Project Cost and Financing

Project Components	Project cost (Million US\$)	IBRD (Million US\$)	% Financing
1. Transparency, Integrity and Institutional Development of SAT	23.52	23.52	100
2. Strengthening of Tax Collection Functions in Internal Revenues and Customs	27.66	27.66	100
3. Strengthening of Integrated Tax Intelligence and Tax Enforcement	3.68	3.68	100
Total Project Costs	54.86	54.86	100
Front-End Fees	0.14	0.14	100
Total	55.00	55.00	100

C. Lessons Learned and Reflected in the Project Design

30. The proposed Project builds on the experience of previous WB tax administration projects and specifically from the IBRD-financed SAT Technical Assistance Loan (TAL)¹³ Project (P048654¹⁴, IBRD-42250¹⁵). Key lessons learned from previous projects and their relevance to the proposed operation include:

- (a) ***When stakes are high, it is important for the WB to remain engaged, even in the face of a highly challenging Project.*** The experience from the SAT TAL illustrates that the challenges faced in the implementation of tax reforms are not only technical and institutional but also political in nature. Guatemala's experience shows that, in times of adversity, the involvement of international organizations helps catalyze and push reform efforts forward through providing neutral and technically sound advice and creating space for stakeholders to channel their expectations. The WB's role in the case of the SAT TAL was not only in providing technical advice and international experience, but also in serving as the neutral broker amongst the various stakeholders, highlighting the importance of the WB's convening role to create consensus. This is particularly relevant in the current circumstances in Guatemala.¹⁶ After a major political crisis that directly impacted the tax administration institutional framework, the Government needs the support and accompaniment of credible partners to develop confidence and trust.
- (b) ***Mitigation measures need to be considered in Project design to address institutional factors that could hinder the sustainability of tax administration reforms.*** During Project design, it is important to assess possible resistance to the reforms being introduced, as well as the degree of top management support to the reform and likelihood of continuity in management. Political factors that hinder the sustainability of tax administration reforms include pressure from powerful stakeholders with vested interests, lack of understanding on the part of lawmakers, and lack of political will. Given the relevance of these factors in the Guatemalan context today, they have been addressed in Project design through the explicit inclusion of activities to support the implementation of the SAT reform, including change management and communication strategies. Building credibility and coalition for change is a necessary condition for success and developing a proactive communication plan as part of the Project is one of the distinctive features of Project design.
- (c) ***Integrity of SAT personnel is a fundamental cornerstone in the development of sound tax administration.*** Given the current circumstances, the design of the operation emphasizes developing institutional integrity.
- (d) ***While technology can be both a facilitator and a driver of change, it is not a substitute for the development of sound institutional, organizational and operational systems.*** A well-balanced strategy is needed to ensure changes are institutional in nature rather than simply

¹³ World Bank, Implementation Completion and Results Report (IBRD-42250), Report No.: ICR574

¹⁴ Approval date August 28, 1997

¹⁵ Approval date November 2, 2007

¹⁶ The 1998 SAT TAL that supported the creation of SAT stemmed from a major corruption case that led the Government to intervene in the then Department of Customs.

instrument-driven. While investments in technology are significant, the Project is designed in a way that the institutional and functional changes are the actual drivers of the reform process.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

31. **The proposed Project will be implemented by a Project Implementation Unit (PIU, *Unidad Ejecutora del Proyecto*) within SAT.** The PIU, which will be established administratively within SAT's Planning Management Unit, will manage technical aspects in coordination with various SAT units, and will carry out administrative and fiduciary functions for the Project. The PIU will also ensure adequate actions to support the change management of the SAT reform are implemented and in alignment with the overall reform process. The PIU will be led by a Project Coordinator (PC, *Coordinador del Proyecto*), who will report directly to the Superintendent and liaise with other SAT units.

32. **At the strategic level, a Project Steering Committee and a Management Committee will be established to oversee Project implementation.** The Project Steering Committee, which will be chaired by the Minister of Finance (MINFIN) and include members of SAT's Board of Directors, the Vice-Minister of Finance and the Superintendent of SAT, will monitor progress on Project implementation and provide strategic direction and policy advice. A Management Committee will be established in SAT to oversee supervision of Project implementation, make operational decisions, allocate human and financial resources, and resolve any organizational issues. The Management Committee will be chaired by the SAT Superintendent and include all four *Intendents*¹⁷ and the PC.

33. **The MINFIN will also play an important oversight role.** A subsidiary agreement will be signed between MINFIN and SAT prior to effectiveness to ensure that MINFIN makes proceeds of the loan available to SAT and that SAT carries out the Project in accordance with the Loan Agreement, Anti-Corruption Guidelines, the Procurement Regulations, and the Operational Manual (OM). The OM, detailing the institutional and implementation arrangements for the Project, will be adopted by SAT prior to effectiveness. Details on Project implementation are included in Annex 3.

B. Results Monitoring and Evaluation

34. **The PIU will be responsible for monitoring expected outcomes, including the Results Framework in Annex 1.** A monitoring system will be put in place for the Project to keep records on implementation and generate semi-annual Project progress reports focusing on the actual implementation of Project plans and the achievement of expected results. Progress reports will be prepared by the PIU, approved by the Management Committee, and presented to the Project Steering Committee and to the WB. The OM includes a detailed description of how Project activities will be monitored and evaluated, including responsibilities in SAT for data collection, analysis, reporting, evaluation and use within certain time frames. Sources of data include SAT budget reports, the Taxpayer Registry, audit reports, perception surveys, among others. The

¹⁷ Intendents are managers of the core operational areas in SAT: tax collection, customs, tax audit, and legal services.

proposed Project will also finance the implementation of surveys to assess taxpayer satisfaction and perception of SAT services. The first survey will be completed during the first year of implementation of the Project and will be used to establish a baseline for improved satisfaction of taxpayers. The survey will seek to disaggregate data by sex to capture gender differences.

C. Sustainability

35. **Commitment to tax administration reforms is strong and represents a solid foundation for achieving sustainable results.** The Government's ownership of the tax administration reform agenda is demonstrated by the approval of the amendments to SAT's Organic Law. The proposed Project is considered by the Government as an important intervention for improving the efficiency, effectiveness and transparency of tax administration in Guatemala. More importantly, Government perceives the proposed Project to be contributing to higher-level government policy objectives, such as creating fiscal space to increase much needed social spending. In this regard, the Project's emphasis on creating the appropriate incentives for tax payment should lead to increased resources for public investment and social sector spending, generating constituencies for more vigorous enforcement of tax collection and changing the tax culture in the country.

36. **Mobilization of private sector support and partnership is important to ensure sustainability.** Discussions, in particular with private sector organizations, have highlighted a genuine interest of many in supporting reforms to increase transparency in tax administration. The proposed Project will help enhance SAT's accountability to its key stakeholders and develop transparent feedback mechanisms to establish permanent communication with private sector organizations and other groups. This should ensure that private sector concerns and ideas are taken into consideration in the implementation of the SAT reform program, thus reinforcing its sustainability.

37. **Improving human resources management and developing in-house capacity in SAT would further ensure sustainability.** The proposed Project is expected to strengthen human resource management by ensuring more effective recruiting processes, introducing performance evaluation methodologies, and professionalizing SAT staff, among others. The Project will also implement a capacity development and knowledge management program for SAT staff to ensure continuous learning and skills enhancement and enable staff to understand and apply internal control procedures in their everyday work. As a result, SAT is expected to become a strong institution that may last across political cycles.

38. **An intensive communications campaign will accompany Project implementation.** Public support will be critical to ensure the sustainability of Project activities and results. The proposed Project includes actions geared towards ensuring buy-in among a broad base of constituencies, including the private sector, civil society, Congressional leaders and SAT staff.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

39. **The overall risk to achieving the PDO is assessed as substantial.** The identified risks and relevant mitigation measures are as follows:

40. **Political and governance risk is high.** Successive Guatemalan Administrations have been characterized by low levels of transparency, accountability and participation, and persistent corruption cases. Moreover, the Government is attempting to tackle some complex and highly sensitive reforms in tax and customs administration in the proposed Project. Vested interests and the highly polarized political climate could undermine the authorities' ability to pursue these reforms. As such, the relevant legislation may not be approved, could be reversed or reforms could be watered down. To mitigate these risks, the WB is closely working with other development partners to ensure a holistic approach and complementarity of activities. Lastly, Government commitment is strong as evidenced by the approval of the amendments to the SAT Organic Law.

41. **Risks related to sector strategy and policies are substantial.** In the past, frequent change in policy, strategic priorities, and ministerial and technical staff delayed implementation of development projects and hindered the ability to sustain and institutionalize policies over time. The Administration has a strong mandate to improve transparency and restore confidence in the tax and customs administration, in particular in the context in which more Guatemalans demand change in how the State manages public funds. The Project Steering Committee will be headed by the Minister of Finance to ensure articulation and implementation of a comprehensive medium-term reform strategy for SAT.

42. **Risks associated with institutional capacity are high and substantial with respect to technical design.** The proposed Project supports activities that are essential for the creation of conditions to enable SAT to operate as an effective and efficient tax and customs administration. As such, the Project is comprehensive in scope but may prove challenging to implement due to existing information silos and organizational fragmentation within SAT. Limited capacity and potential resistance to change in SAT may further thwart implementation. To mitigate this risk, Project implementation arrangements are designed to secure consistent commitment and management attention from the highest level of Government, and institute mutual accountability for progress. Moreover, the creation of a technical team within the PIU is expected to ensure better coordination by employing one full-time professional staff from each unit within SAT to lead the execution of his or her respective activities and be in charge of coordinating and aligning the processes across SAT. Furthermore, SAT experts are already working closely with external senior experts provided by other development partners in preparing for the implementation of SAT reforms, and such on-going technical assistance would facilitate Project implementation. The Project will also provide technical assistance and training to ensure smooth implementation of new processes and use of systems as well as support the implementation of a communications campaign that will highlight and reinforce the benefits from reforming and modernizing the SAT. Lastly, the Project will ensure the proper sequencing of activities to facilitate achievement of the desired outcomes and their sustainability.

43. **Fiduciary risks are considered substantial.** SAT is a well-established entity with basic FM and procurement arrangements in place, and with some experience with WB policies and procedures. However, the entity's capacity and overall internal control environment have been affected by the recent institutional crisis. The Project Procurement Strategy for Development (PPSD) provided some vital information on procurement risks. Certain procurement processes (large ICT related procurement and contracts of large scale) might encounter delays due to the lack of trust in the institution that might reduce competition and limit bidder participation. In addition, public sector internal processes and procedures in Guatemala tend to be lengthy and cumbersome, causing delays in implementation. To mitigate these risks, SAT is putting in place: i) defined clear roles and responsibilities in SAT for fiduciary tasks, both for bodies to be established for Project purposes, including the PIU and administrative unit with qualified and experienced staff; ii) designed streamlined processes and procedures that support smooth and agile Project implementation; iii) strengthened key internal controls and transparency mechanisms ; and iv) completed the PPSD to mitigate identified procurement risks.

44. **Stakeholder risk is also substantial.** Taxpayer compliance depends on, among other things, the perception of fairness and efficiency of tax administration. Tax non-compliance has traditionally been high in Guatemala, as a result of many Guatemalans' perception of the unfairness of the tax system, and in particular, how the State manages taxes. Breaking this perception will take time and requires actions to improve quality and transparency not just in tax administration but also in public financial management. To mitigate this risk, the proposed Project includes specific activities designed to restore SAT's credibility and transparency. Moreover, the Steering Committee will receive business and strategic advice from an Advisory Board made up of representatives of the private sector, academia and civil society, and from a Donors Consultative Group, integrated by donor representatives who are participating in supporting the strategic development of SAT at various levels. This arrangement is expected to serve as a sounding board for the reforms as well as build buy-in and support. The Government is also implementing parallel initiatives to enhance transparency and efficiency of public expenditures, for example, by further modernizing its FM and public procurement systems and its overall fiscal transparency framework.

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

45. **The proposed Project is economically feasible with an internal rate of return (IRR) of 15 percent, and financially feasible, with a financial IRR of 172 percent.** An economic and financial analysis of the proposed Project was carried out to quantify the impact of the likely Project costs and benefits both for taxpayers and the SAT. The analysis employed an incremental approach, which, by design, compares the scenario without the Project (counterfactual scenario) and the scenario with the Project. In the economic analysis, all financial transfers are excluded (i.e. transfers from taxpayers to the Government) and only those economic welfare-enhancing benefits are included in the model: (i) reduction in administrative costs of collecting taxes for SAT; and (ii) reduction in compliance cost for the taxpayer. Other indirect benefits including those from trade facilitation resulting from simplified customs operations were not included due to the complexity of their calculation and attribution. The results indicate that the Project is economically feasible with an economic IRR of 15 percent, and a real economic Net Present Value (NPV) of US\$61.17 million at 13 percent discount rate in real terms. Results of the financial analysis show that the

Project is financially feasible, with a financial IRR of 172 percent, and the financial NPV at 9.6 percent discount rate in real terms is US\$1.18 billion. Annex 5 presents a detailed description of the modeling and findings.

B. Technical

46. **The proposed Project is focusing on increasing the tax compliance and strengthening the SAT governance model.** This will be done through: (i) updating the normative framework for tax and customs administration; (ii) enhancing and upgrading existing business processes and information systems; and (iii) implementing actions to deter corruption practices and foster transparency and integrity across SAT management and staff.

47. **Consistent with international good practice, the proposed Project will adopt a risk-based approach to increase tax compliance and improve effectiveness of control mechanisms in SAT, which is seen as a key factor for increasing tax and customs compliance.** A risk-based approach seeks to identify key risks –sectorial or by type of taxpayer - based on analysis of business trends and patterns of tax elusion and avoidance. The selection of taxpayers to be audited, as well as other types of controls, is based on the assessment of risk and the development of risk-based selection techniques. Taxpayer characteristics are used in risk-scoring systems to identify and assess the risk of noncompliance. This allows appropriate prioritization of audit and taxpayer services, and enables the allocation of resources to high-risk groups.

48. **The Project also supports the adoption of internal revenue and customs initiatives that have been proven successful in other countries and internationally accepted and promoted as good practices.** For example, in customs, these initiatives include an ex-post documental control or “yellow channel” for low risk operations, Trusted Operator Programs, and non-intrusive technologies and electronic tracking devices in Customs to improve control and release procedures. In internal revenue, these include TCA with a 360 degree approach and e-invoice in internal revenue administration to improve information on taxpayers.

49. **In the past, SAT has implemented tax and customs management modernization projects.** SAT successfully combined internal and local expertise with international experiences through the support of specialized consulting firms, cooperation agencies and individual consultants. This has led to increased internal capacity of technical staff over the years and thus the proposed Project is expected to apply the same approach and will rely on building in-house expertise complemented by external consultants. In this context, SAT has already recruited local experts who are leading the technical preparation of the reform and are working closely with the external senior experts provided by other development partners. Technical assistance is ongoing, focusing on tax administration, tax audit, customs administration and information technology aspects, all critical areas fundamental for defining the new business model, processes and information systems to be supported by the proposed Project.

50. **Improving tax compliance is a long-term reform effort and proper sequencing of activities is critical.** Accordingly, to ensure achievement of the Project’s expected outcomes and ensure their sustainability, it is essential to pay close attention to the sequencing and interdependence of Project activities (Annex 6). Moreover, the Project includes a sub-component

to manage the reform process, including technical, SAT reform management and sustainability aspects.

C. Financial Management

51. **While SAT is considered to be a well-established entity that has in place basic FM arrangements, the recent institutional crisis has weakened the internal control environment.** The FM assessment carried out to evaluate the adequacy of SAT's FM arrangements found that the recent institutional crisis has weakened the internal control environment, and the existing cumbersome and lengthy internal processes and procedures used by public sector entities in Guatemala.

52. **To mitigate this issue, there is a need to ensure strong operational arrangements within SAT that can support smooth, agile and transparent Project implementation.** In this regard, a PIU in SAT will include an administrative team with qualified and experienced FM staff for the Project. The administrative team is expected to coordinate with SAT's Administrative and Finance Unit which is responsible for the basic FM functions in SAT. Mitigation measures include the clear definition of responsibilities for Project implementation, as well as the design of streamlined procedures and definition of the specific content and format for financial reports, all of which is reflected in the OM. On the basis of this, the proposed FM arrangements are considered acceptable to the WB. Basic arrangements to ensure proper control, recording, and reporting are further described in Annex 3.

D. Procurement

53. **The PIU will be responsible for any procurement under the Project.** SAT has limited experience and procurement capacity required to implement this Project. Even though SAT had experience in implementing WB projects prior to 2006, the expected number of procurement processes exceeds available staff capacity, expertise and resources. To address the limited experience and lack of procurement capacity, the PIU will strengthen its staffing and implementation procedures by: (i) recruiting additional staff as required to implement this Project, including procurement specialists; (ii) outlining roles and responsibilities in the OM; (iii) ensuring that the procurement procedures are aligned with "World Bank Procurement Regulations for Borrowers under Investment Project Financing" (July 2016) ("Procurement Regulations"); and (iv) strengthening tools, records and internal controls for different procurement tasks, including contract management. A procurement plan for the first 18 months of Project implementation has been prepared based on the PPSD and agreed with the WB. More details on procurement are provided in Annex 3.

E. Social (including Safeguards)

54. **The proposed Project will not finance activities which could cause any social risks or negatively affect Guatemala, and thus does not trigger any social safeguard policies.** The proposed Project is expected to generate social benefits by increasing levels of compliance with

tax and customs obligation, in turn, improving revenue collection and creating the fiscal space necessary for social and economic investments. There are no discernible gender differentiated impacts and/or risks associated with the Project.

F. Environment (including Safeguards)

55. **The Project is rated as Category C.** The proposed Project does not trigger any environmental safeguard policies and does not require an Environmental Impact Assessment. Replacement of equipment and retrenchment are not part of the Project.

G. World Bank Grievance Redress

56. **Communities and individuals who believe that they are adversely affected by a WB-supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WBG's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the WB's attention, and WB Management has been given an opportunity to respond. For information on how to submit complaints to the WB's corporate GRS, please visit. For information on how to submit complaints to the WB Inspection Panel, please visit www.inspectionpanel.org.

Annex 1: Results Framework and Monitoring

Country: Guatemala

Project Name: Transparency and Efficiency in Fiscal Management (P153366)

Results Framework

Project Development Objectives

PDO Statement

The project development objective is to increase levels of compliance with tax and customs obligations.

Project Development Objective Indicators

1. Increased compliance with domestic taxes, measured through the reduction in VAT gross compliance gap;
2. Increased effectiveness of customs controls, measured through the increased ratio of effectiveness of customs inspections.

Indicator Description

Project Development Objective Indicators												
Indicator Name	Unit of Measure	Baseline	Cumulative Target Values (by WB Fiscal Years)						Frequency	Data Source / Methodology	Responsibility for Data Collection	Description (indicator definition etc.)
			2018	2019	2020	2021	2022	2023				
Indicator One: Increased compliance with domestic	Percentage change	34.2%	33%	31%	29%	28%	27%	26%	Annual	SAT Tax Records	SAT	Reduction in VAT gross compliance gap ¹⁸

¹⁸ Methodology developed by SAT in document “Proyección del incumplimiento de pago del Impuesto al Valor Agregado –IVA- en Guatemala, 2016-2018, August 2016

taxes through reduction in VAT gross compliance gap												
Indicator Name	Unit of Measure	Baseline	Cumulative Target Values						Frequency	Data Source / Methodology	Responsibility for Data Collection	Description (indicator definition etc.)
			2018	2019	2020	2021	2022	2023				
Indicator Two: Increased effectiveness of customs controls/inspections	Percentage	6.3% (2015)	6.3%	8%	10%	12%	13%	14%	Annual	Inspections Statistics, SAT	Customs, SAT	Total adjusted declarations / Total declarations subject to physical inspection (red) in the period analyzed

Intermediate Results Indicators

Component 1: Transparency, Integrity and Institutional Development of SAT												
1.1. Implementation of the Internal Affairs Unit		The Internal Affairs Unit was incorporated into SAT's	Internal Affairs Unit is partially staffed and	Internal Affairs Unit is fully staffed and equipped					Annual	SAT Reports	SAT	Internal Affairs Unit fully equipped, staffed, and operational

		organizational structure in 2016 but is not operating	equipped									
1.2. Availability of the Technology Platform	Percentage	99.47% (2015)	99.48 %	99.49%	99.50 %	99.51%	99.52%	99.52 %	Monthly	Internal and External IT Statistics	IT Department, SAT	Total time of available monthly minutes of IT platform / Total monthly minutes ¹⁹
1.3. ICT disaster recovery timeframe	Hours	No equipment for simulation in place	N/A	<40	<24	<16	<8	<8	Annual	Disaster recovery drill report	IT Department, SAT	Hours needed to activate the Alternate Data Recovery Center with the latest transactions
1.4 SAT staff Organizational	Percentage	No perception is measured	Baseline Survey	Perception improved by 10%		Perception improved by 20%		Perception improved by 30%	Biannual Survey	Survey	Human Resources Department	Perception indicator

¹⁹ The increase of 0.05% of the availability of Technology Platform represents around 21 minutes monthly. The average black-out of technology platform is around 10 minutes. A window of 5 minutes daily are needed for scheduled maintenance. This indicator almost eliminate the unscheduled black-out of the technology platform. Other bigger scheduled maintenance are not included.

Environment Perception				against baseline		against baseline		against baseline				
1.5 Strengthened credibility of the country's tax administration system	Percentage	No SAT perception credibility measured	Baseline survey		Increased by 10% against baseline		Increased by 20% against baseline		Biannual	Survey	SAT	Improved perception by taxpayers on the efficiency and transparency of SAT operations
1.6 Reduction of Tax Administrative Cost	Percentage	1.81% (2015)	1.81%	1.79%	1.76%	1.74%	1.72%	1.72%	Annual	Budget execution reports, Tax collection reports	SAT	Current Executed Budget of SAT (millions of quetzals) in period N / Executed budget on tax administration in period N (millions of quetzals) ²⁰
Component 2: Strengthening of Internal Revenues and Customs												
2.1. Reduction of stop-filers	Percentage	14.49%	13.49 %	12.49%	11.49 %	10.49%	10%	9.49%	Monthly	SAT	SAT	Number of Taxpayers with at least one missing VAT declaration in

²⁰ The reduction of 0.09% Tax Administrative Cost represents around US\$ 6.16 million yearly.

												period N / Number of taxpayers obliged to issue VAT declaration in period N (each tax counts as 1)
2.2. Use of virtual taxpayer services	Percentage	26.2%	26.2%	34%	35%	36%	36.5%	37%	Annual	SAT Statistics	Taxpayer Assistance Department, SAT	Virtual taxpayer assistance transactions issued in period N/ total taxpayer assistance (physical, virtual) in period N
2.3. Use of e-invoice business to business	Percentage	0.5%	0.5%	1%	5%	50%	75%	100%	Annual	SAT Statistics	SAT	Taxpayers issuing e- invoice business to business / total taxpayers that issue invoice (physical and e- invoice)
2.5. Clearance time of	Days	2.81 (2015)	2	1.8	1.7	1.6	1.5	1.5	Annual	Customs Operations	Customs, SAT	Measure in days from customs

definitive import declarations										ns Statistics		acceptance of import declaration until Single Customs Declaration confirmation
Component 3: Strengthening of Tax Intelligence and Tax Enforcement												
3.1. Effectiveness of Tax Audits	Percentage	40.93 % (2015)			75%	75%	80%	80%	Annual	Audits Reports	Tax Audits Department, SAT	Audits with fiscal interest ²¹ / Total fiscal audits executed
3.3. Effectiveness of appeal procedures	Percentage	TRIBUTA is not operative	80.5%	81%	81.5%	82%	82.3%	82.5%	Annual	SAT statistics	SAT	Tax cases solved by TRIBUTA/ Tax cases presented to TRIBUTA

²¹ A fiscal audit is the verification of taxpayer compliance with formal tax obligations. A fiscal interest audit is a fiscal audit with adjustments or fines after its verification.

Annex 2: Detailed Project Description

GUATEMALA: Transparency and Efficiency in Tax Administration Project

1. **The proposed Project seeks to support the Government to increase levels of compliance with tax and customs obligations.** To do so, the Project will finance three Components to be implemented over a six-year period. The first Component will focus on governance-related aspects of tax administration, including actions to support management of the reform process, enhance the human resource management function, build institutional integrity and strengthen the overall information and ICT governance and supporting functions, services and infrastructure. The second Component will strengthen internal revenue and customs administration by reviewing and optimizing core tax administration processes, strengthening merchandise controls and clearance procedures, and updating and upgrading critical elements of existing information systems. The third Component will provide support to strengthen business intelligence and tax enforcement practices through the adoption of integrated risk management models to better inform tax audits and appeal procedures and strengthen tax enforcement capabilities in tax administration.

Component 1: Transparency, Integrity, and Institutional Development in SAT

2. **Several diagnostic assessments carried out by international development partners in recent years identified institutional weaknesses that affect SAT performance.** The WB carried out an analysis of institutional performance in the areas of tax and customs administration in 2014 using the standardized Integrated Assessment Model for Tax Administration and the Customs Assessment Trade Toolkit. The analysis found that in comparison with international good practices, low performance was noted in the following strategic dimensions of SAT: the effectiveness of strategic planning, the use of information as a strategic resource, the effectiveness of human resource management, internal controls, and the auditing function, among other factors. According to the most recent IMF technical report on SAT (*Medidas para la Recuperación de SAT*, April 2016), the human resource management and ICT areas were identified as critical aspects that need to be strengthened in the short run to create adequate conditions for implementation of technical and operative medium- and long-term reforms within SAT. Otherwise, the existing weakness would jeopardize the effectiveness of SAT reforms.

3. **The objective of this Component is to address weaknesses in SAT's governance model and transparency practices.** It will do so by supporting the implementation of the recently approved amendments to SAT's Organic Law and strengthening internal capacities of SAT, including human resource management, strategic planning, internal control, information governance, and ICT services, as well as supporting a change management strategy and communications initiatives to ensure successful implementation of the proposed reforms. This Component will finance the activities described under the following sub-components. Expected results from this Component include an improved perception and overall trust in SAT to be perceived as a competent, credible, fair and transparent institution. This implies the professionalization of staff at both managerial and operational levels as well as the existence of effective internal control functions, proper monitoring and evaluation practices, as well as secure and reliable information systems.

Sub-component 1.1: Managing the SAT Reform

4. **The lack of strategic vision in SAT has resulted in low impact projects, institutional fragmentation, and poor sustainability.** SAT requires a comprehensive strategic vision to articulate objectives and projects, prioritize their implementation, assign resources and responsibilities to administrative units within SAT, and define performance indicators for M&E of the reform process. While short-term actions (defined in a recent IMF report of April 2016) are very relevant at this stage in SAT's recovery, the absence of a comprehensive strategic vision and M&E tools could jeopardize the effectiveness and success of the overall reform initiative.

5. **To effectively manage the reform process and evaluate its results and impact, SAT requires resources to strengthen its strategic planning skills and its M&E tools, not only at the operational but also at the strategic level.** This is a requirement for the definition and integration of a long-term vision, the development of a road map, and the effective and timely engagement of the different stakeholders involved in its implementation. At the same time, SAT needs to design and implement an effective and comprehensive change management strategy to effectively communicate and share, internally and externally, the strategic management vision, actions, and results in order to build the support needed for the successful implementation of the reform efforts.

6. **Another key institutional weaknesses of SAT lies in the existence of information silos and organizational fragmentation, limiting the use of the available information for effective decision-making and operations.** Typical reasons for using incomplete information include lack of reliability of information, limited access to fragmented databases, existence of isolated systems, limited skills to interpret and use the existing information, or lack of functional capabilities to process information for specific uses. To allow the operation of an integrated information system and eliminate data silos among units, an ICT Governance Model is required and would include the definition of: (a) conceptual and operational coordination instruments, such as steering committees, technical coordination committees, etc.; (b) information governance roles and procedures; (c) information security policies; and (d) access to information and dissemination protocols, among others.

7. **Currently, SAT manages more than seventy separate information systems, most of which are fragmented by organizational areas.** This situation prevents the effective use of the 360° vision²² of the taxpayer, which in turn, limits the ability of SAT to ensure effective tracking and control of taxpayer obligations. A strategy for an integrated system²³ to enable more effective and efficient performance of SAT becomes therefore urgent and unavoidable. However, an 'integrated system' does not necessarily mean a 'unique software' or a 'single database'.

8. **The digital solutions' vision in strategic planning is highly relevant to efficiently achieve the institutional goals and promote information usage.** A small organizational department in charge of ICT strategic aspects is needed within SAT. Commonly this kind of unit

²² The 360° vision of the taxpayer refers to a model that allows the analysis of the taxpayer as a single entity considering all their tax and customs obligations, including all existing fiscal audits and legal procedures.

²³ An integrated system is one that meets at least three basic principles: (a) harmonized concepts; (b) unified processes; and (c) single information entry. Although the integration of information systems is reflected in the software, the foundation for the integration resides in conceptual and functional aspects.

is headed by a Chief Information Officer. This is different from the ICT Unit, which performs ICT related technical and operational support functions.

9. This sub-component will focus on the development and implementation of a reform strategy in SAT, by implementing, among other things, the following activities:

- (a) the implementation and institutionalization of strategic planning and M&E tools;
- (b) the design and implementation of an ICT governance model, including the establishment of the Chief Information Office;
- (c) the design and implementation of a change management strategy to support the reform process, including the design and implementation of a short- and medium-term communications campaign; and
- (d) the provision of support to SAT to carry out Project management, including the carrying out of Project audits; the carrying out of training; the provision of technical support on procurement, safeguards and financial management requirements; and the financing of Operating Costs.

Sub-component 1.2: Strengthening Human Resource Management and Institutional Integrity

10. SAT requires human resource management policies to be designed and institutionalized over strong fundamentals and tools to allow the institution to transcend Administrations. The absence of institutional policies for management of career development, lack of a comprehensive capacity development plan, ineffective recruiting processes, lack of performance evaluation methodologies, and lack of appropriate remuneration for high-risk jobs and technical posts (i.e. customs inspectors) have led to a gradual and continuous infiltration of fraudulent groups within all of SAT's organizational divisions that led, in turn, to the deterioration of overall working conditions, weakened controls, and increased corruption practices.

11. SAT internal control systems and procedures proved to be overall weak and affecting core tax management functions. Ineffective internal controls were seen, for example, at the operational level in customs where staff is able to take discretionary decisions without proper accountability, or in tax auditing and enforcement activities, where it is difficult to determine whether staff is interacting with taxpayers in a proper and fair manner. This is further complicated by the fact that staff is not familiar and aware of internal control procedures and therefore, is unable to follow a due process nor document their actions in a way that would make them traceable and transparent. All this leads to an environment of lack of compliance with internal control procedures and a situation which heightens the risk of systemic corruption and fraud. Moreover, SAT does not protect its personnel against decision-making and security risks, leading to an extremely vulnerable situation for staff that results in a passive and reactive tax administration, risk aversion behaviors, and extremely formalistic and bureaucratic culture within the institution. SAT employees are also hesitant to report what they see or suspect as corruption practices due to real threats of retaliation. The Internal Complaints Unit within the Legal Affairs Department is not independent from SAT management, and as such, the existing institutional arrangement does not provide for a credible recourse for those employees and taxpayers who are willing to report on institutional problems.

12. **In order to address these issues, the recently approved amendments to SAT's Organic Law established new strengthened arrangements for internal control and institutional integrity.** The new arrangements include the creation of an Internal Investigation Unit, which will report directly to the Board of Directors, providing it with the necessary independence to perform its controlling functions. The Internal Audit Unit, will continue reporting to the SAT Superintendent and performing the administrative and financial controls established by law. The new Unit will not only establish procedures to assess risks and perform investigations over SAT staff but would be also in charge of institutional integrity prevention policies within SAT.

13. **To achieve this objective, this sub-component will support, among other things, the following activities:**

- (a) the development and implementation of an integrated human resource management strategy in SAT including updating the staffing plans for both internal revenues and customs services consistent with SAT's strategic plan, establishing a performance management framework, developing and implementing a more rigorous screening process for all staff recruitment, and designing and implementing an internal capacity development and knowledge management program for SAT staff; and
- (b) the development and implementation of a transparency and institutional integrity strategy, including establishment of a new Internal Investigation Unit, strengthening the internal audit functions, and design and implementation of an industrial security plan for SAT staff at all levels, including protocols for physical and legal protection based on the nature of their functions and the associated risks, but excluding from said security plan and protocols any activity which may require the participation of security forces, all following international experiences.

Sub-component 1.3: Upgrading and Integration of the Information Technology Platform

14. **ICT is a critical function for effective tax administration.** Since its establishment in 1998, SAT has made important investments in developing information systems and implementing technology infrastructure. The software strategy has been based on an in-house software development model executed by a mix of internal SAT personnel and external consultants. As a result of weak long-term institutional planning, however, there has been no continuity in the long-term strategy for technological development.

15. **SAT's ICT system hampers the ability for comprehensive data analysis and complicates data administration.** SAT's information systems cover most tax administration business processes. These, however, are implemented on heterogeneous platforms that use different software technologies, architectures, and standards. Currently, around 45 percent²⁴ of existing information systems are based on a client-server technology without technical support, which represents a high risk for the systems to collapse. The rest of the systems are web-based, built on heterogeneous architectures, which are insufficiently segmented (logically and physically) and obsolete. Furthermore, although significant investments were made in 2014 to upgrade the hardware platform, they have not been sufficient, generating degradation in the performance of the information systems, and negatively affected the efficiency of electronic services for both internal

²⁴ Around 1,900 functional screens and 1,400 reports are on client-server technology.

SAT users and taxpayers. In addition to this, in recent years, SAT has been exposed to an increasing number of cyber-security attacks, which have caused several suspensions of ICT services and reduction in performance of SAT operations. Additionally, SAT does not have a data recovery center, representing an important business continuity risk.

16. Within this context, the main objective of this sub-component is to strengthen SAT's hardware platform and software architecture. This is expected to comprehensively, effectively, and efficiently support its current and future functional and analytical requirements (tax collections, customs operations, tax intelligence, tax audit, legal enforcement, and others), under an ICT strategy and governance model that ensure information integrity, information security and investment sustainability.

17. To achieve this objective, this sub-component will include, among other things, the following activities:

- (a) designing of a new organizational model for the ICT department;
- (b) improving ICT planning capacity;
- (c) designing of a comprehensive software architecture ensuring integration of all of SAT's functions; and
- (d) upgrading the ICT infrastructure to support the reform process, including improving information security and establishing a data recovery center.

18. This sub-component will provide the required investment on an ICT platform aligned with SAT priorities to be implemented under a well-structured ICT strategy. This should ensure the financial and technical sustainability of all ICT initiatives. The sub-component will be implemented, in principle, in two phases: the first phase will be oriented to enhancing the current hardware and software infrastructure and security platform for improved performance and availability of current information systems, reducing the risk of ICT collapse and electronic services suspension. The second phase will be focused on increasing ICT platform capacity to support the implementation of new electronic services and data recovery functions to support improvements envisaged under the SAT reform.

Component 2: Strengthening of Tax Collection Functions in Internal Revenues and Customs

19. This Component will focus on strengthening the two main core functions of SAT, internal revenue collection and customs. In general, both core functions face challenges related to ineffective control instruments and inefficient processes, negatively impacting internal revenue and customs compliance. As described below, each area demands a different approach and instrument to address the underlying challenges. Expected results under this Component include an improved and more accurate management of taxpayer registration and their obligations, improved taxpayer services for easy compliance, implementation of more effective and smart compliance models, implementation of customs control mechanisms based on risk management tools, simplification and modernization of customs procedures supported by robust and sustainable information systems.

Sub-component 2.1: Strengthening Internal Revenue Collection Processes

20. **The SAT taxpayer registry lacks accuracy and reliability, resulting in deficiencies in collection and enforcement processes and, subsequently, in higher administrative and compliance costs.** Monitoring compliance requires the establishment and maintenance of taxpayer current accounts (TCAs) with a 360 approach. SAT has a TCA in operation but its model has important weaknesses that limit information accuracy²⁵ and full implementation. The e-invoice initiative (*Factura Electronica I*) was supposed to be the main source of information for TCA and cross-cutting information analysis, but the original design limited its use. The implementation of the new e-invoice model will support the enhancement of the information quality for the TCA.

21. **As a result of improved taxpayer registry as well as improved quality and integration of information, SAT will be able to detect in a more accurate and rapid manner the potential existence of tax obligations omissions or presumptive omission practices from taxpayers.** Appropriate selection criteria would allow a differentiated taxpayer treatment and a more focused approach for these cases, this allows to detect undue behaviors by taxpayers by taking immediate and massive actions using available information and technology, and thus increasing taxpayer's perception of risk fostering voluntary compliance. These actions will also help increase effectiveness on fiscal credit collections and reduce the need for triggering costly auditing procedures.

22. **Over the past years, SAT has made significant improvements in developing modern service delivery channels to improve taxpayer services and reduce compliance costs for taxpayers.** These efforts, however, have been made as isolated initiatives without a long-term comprehensive strategic vision aligned with SAT's institutional goals. As seen in several other countries, a taxpayer service strategy can significantly improve tax administration efficiency and provide taxpayers with more appropriate solution for conducting their tax-related operations aligned to each taxpayer segment needs (i.e. large, medium, and small taxpayers and others types of taxpayer segmentations). The taxpayer service strategy should include an analysis of the demand for each type of service channel to taxpayers (mobile apps, internet, call centers, etc.) and develop modernization initiatives for the delivery of services in each channel. The strategy should also consider specific initiatives for the simplification of processes and procedures for small and medium enterprises, oriented to help foster formality and compliance in this segment.

23. **The objective of this sub-component is to improve internal revenue compliance.** This will be done through the redesign and implementation of processes and reliability of the taxpayer registry and TCA information, as well as to provide SAT with more strategic and efficient tools to follow up on tax omissions, due taxes, and other tax receivable accounts. This sub-component will include, among other things, the following activities:

- (a) redesigning and improving the taxpayer registration (*Registro Tributario Unico*);
- (b) redefining and implementing a new model for the TCA, including the centralization and storage of all taxpayers' fiscal obligations;
- (c) strengthening and expanding the new e-invoice initiative and the use of other third-party sources of information for effective collection control;

²⁵ SAT authorities estimate that approximately 75 percent of the debt registered in the TCA is uncollectable.

- (d) implementing tools and methodologies to improve effectiveness of administrative collection and tax arrears recovery, including activities to foster compliance and deter omission using behavioral economic approaches; and
- (e) developing and implementing a comprehensive strategy for improving taxpayer services, including improvements in the existing face-to-face services provided in regional offices, the expansion of electronic services, and the implementation of a taxpayer satisfaction survey.²⁶

Sub-component 2.2: Strengthening of Customs Services

24. **In customs, there are poor quality control mechanisms that fail to monitor or ensure that centrally established risk criteria are applied uniformly at the operational level.** This has led to significant officer discretion, long release timeframes, increasing the opportunity for corruption, and therefore incentivizing the contraband. Furthermore, there are no specific procedures to control those operations which require only documental review, only *green* and *red* channels operate in Guatemala generating high level of physical inspections with extremely low level of efficiency. The implementation of ex-post documental controls, internationally known as the ‘*yellow channel*’ is an important instrument for the revision of low risk operations.²⁷ Physical inspections should only be reserved for high-risk cargo.

25. **Complex and redundant procedures, lack of information and manual controls in customs processes, lead to long release timeframes.** In this regard, there is a need to simplify, standardize and automate clearance and release processes, including the promotion of joint inspection and information exchange with other border agencies. Additionally, most of the controls for inspection, entrances, exits, and tracking of merchandises are based on discretionary human controls, increasing the risk of corruption, representing a gap of security. The use of well integrated technologies and systems such as non-intrusive devices, tracking devices, radio frequency devices, and electronic gates with Optical Character Recognition technologies, could significantly improve the efficiency of controls in the whole foreign trade cycle. In order to develop secure, yet expedite, procedures for international trade, this Project will create a trusted operators program,²⁸ certifying third party trusted operators to be in charge of safeguarding the application of security standards in the whole international supply chain. This program will provide enhanced services such as simplified customs procedures and reduced customs intervention.

26. **The use of free zones and inward regimes is particularly high in Guatemala,²⁹ and there is evidence that abuses could be occurring when using these facilities, constituting a way of fiscal defrauding.** A comprehensive model of control over these special regimens including specialized audit programs and enhanced current account controls, could help reduce the incentives for misuse of the special regimens facilities. Another important issue is the chronic problem of undervaluation of merchandise coming into the country, which is believed to have led

²⁶ This survey will include gender and other relevant demographic variables.

²⁷ Origin classification, valuation, and other agency authorizations, among others.

²⁸ Trusted Operator Program would include, but is not limited to, authorized economic operators.

²⁹ The import of inputs for special regimens represented 23 percent of the total of imports during 2015, and the exports of represented the 38 percent of the total of exports.

to the massive fraud recently discovered in SAT and customs. Proper valuation is essential to determine the VAT and other duties to be paid on imported goods.

27. **Legitimate exporters claim that the refund of VAT is cumbersome, unpredictable and opaque.** The time that it takes to make the refunds effective is also uncertain, which defeats its purpose of serving as a fiscal incentive. Lack of effective controls and monitoring in these processes open doors to abuse and high levels of discretion including the authorization of fraudulent and illegitimate refund claims.

28. **Guatemalan traders continuously complain about the limited and outdated information that is available both physically and published on the Internet.** Importers, brokers, carriers, and users of the one-stop shop for exports (*Ventanilla Unica de Exportaciones*) expressed the same concern. The lack of communication between users and customs has led to a perception of unresponsiveness. As seen in most other countries with effective trade facilitation mechanisms, private traders should be informed about the norms, criteria and level of service which each port is operating. International good practices also include the existence of private sector feedback mechanisms as well as the conformation of trade facilitation committees as required by the World Trade Organization Trade Facilitation Agreement.

29. **By implementing better clearance procedures in line with updated control guidelines in a transparent manner, this sub-component will help improve the mobility of goods and merchandise safely and expeditiously across borders and ports, lowering freight and transaction costs, reducing time and improving services to traders.** This sub-component will focus, among other things, on the following activities:

- (a) Implementing a risk-based management model for merchandise controls, including ex-post documental controls and the Trusted Operator Program;
- (b) developing and implementing streamlined, standardized and automated customs procedures and mechanisms, including a joint inspection model with all the various border control agencies;
- (c) implementing non-intrusive technologies and electronic tracking devices for merchandise control at the customs entrances, exits and transits;
- (d) strengthening controls over special customs regimes (free zones and others);
- (e) facilitating information exchange with other national and international agencies by applying international conventions and developing regional and bilateral agreements with neighboring countries; and
- (f) increasing transparency and predictability in Customs by improving and implementing modern valuation methodologies and tools; implementing standardized application of norms and procedures at customs offices; improving availability and quality of customs information to SAT staff, trade operators and other users; creating meaningful consultation and feedback mechanisms between traders and customs; and improving transparency of the VAT's refund process.

Component 3: Strengthening of Integrated Tax Intelligence and Tax Enforcement

30. **Information management, as the key input for many tax administration activities, becomes an essential requirement for effective revenue collection.** In this sense, focusing on

improving the gathering, processing, and use of information allows for higher returns on investments, in that it can affect most processes of the tax collection cycle, particularly the auditing and enforcement functions.

31. Even though SAT has implemented several information systems over time, information remains fragmented and managed by silos, limiting the enormous potential of such systems to strengthen SAT's ability to conduct strategic decision making and effective dispute resolution. In addition, the tax dispute resolution function is also affected by weaknesses on SAT's legal services and framework and the lack of coordination among the various SAT departments. The need for a comprehensive and integrated risk management model, based on cross-checking information and supported by strengthen legal services and framework, becomes fundamental to increase the effectiveness and efficiency of tax and customs auditing and enforcement processes.

32. The main objective of this Component is to promote an efficient use of tax information sources to support the auditing and control functions, through the adoption of a comprehensive compliance risk management model and the promotion of a culture of information analysis within SAT. At the same time, the Component seeks to improve SAT's enforcement capacities by the strengthening of its legal services. Expected results from this Component would include a strengthened capacity in SAT to analyze and use information for business intelligence purposes; more accurate selection of auditing cases resulting in more effective detection of tax fraud and evasion practices; and a more effective appeals and enforcement procedures.

Sub-component 3.1: Strengthening Tax Intelligence and Tax Audit

33. The existence of data silos within SAT departments has limited the use of information for decision making at a strategic and operational level. A culture of information analysis within SAT is almost inexistent, whereby the main product of all the investment on information systems and institutional procedures is futile. The creation and implementation of a specific department in charge of information analysis and the production of decision-making reports is indispensable to promote the information analysis culture, enhance the tax audit function, improve internal SAT management, and support decision making.

34. In addition, the development of risk-based management models and the adoption of risk-based management tools is also necessary to better inform auditing practices and improve their effectiveness. Implementation of such processes in SAT should be carried out in a cross-cutting manner and include both internal revenue management and customs, a feature that so far has not been present in SAT practices.

35. Tax audit is a key tool used by tax administrations to increase compliance. It is used to detect and address individual cases of noncompliance and gather information on the health of the tax system and the evasion techniques used by taxpayers. The current tax auditing strategy is not explicitly derived from risk analysis methods nor from segmentation of taxpayers. The current strategy is based on a mass taxpayer selection, which covers only 1.6 percent of all tax declarations and with low efficacy. Additionally, the foreign trade audit function is very weak and is not linked with the rest of taxpayer auditing processes. SAT has collected a huge and relevant amount of

information, but the existence of information silos within SAT and the low quality of the data has limited the ability to perform integral analysis and cross-checking of this information. It is still necessary to take advantage of taxpayer current account information for the tax audit process.

36. **The main objective of this sub-component is to support the development of effective enforcement-related strategies to detect, deter, and address noncompliance based on the use of information and risk management approaches, which involves both internal revenue collection and foreign trade areas.** The use of TCA with a 360 vision will be the main pillar for this Component. This sub-component will strengthen the tax intelligence and tax audits in SAT through, among other things, the following activities:

- (a) creation and implementation of a new Tax Intelligence Unit;
- (b) design and implementation of an integrated risk-based management model covering both internal revenues and customs;
- (c) construction of a unified data warehouse and related business intelligence tools to support decision-making processes;
- (d) design and implementation of a comprehensive auditing strategy and related tools³⁰ based on taxpayer segmentation and risk analysis for both internal revenue collection and foreign trade areas; and
- (e) building capacity of auditors, including on transfer price processes.

Sub-component 3.2: Strengthening Legal Services and Tax Appeal Procedures in SAT

37. **SAT's collection process for unpaid liabilities is ineffective, lengthy and often unproductive.** Currently, only around two percent of adjusted revenue from audits was effectively collected. This is mainly the result of SAT's internal dispute resolution mechanism, which rejected many of the appealed audits before they reached the Board or Courts, with internal dispute resolution reducing audit adjustments by approximately 80 percent. This high rate of rejection is presumably due to two factors: the lack of qualified and experienced personnel resulting in a high rate of audit errors, and the inability to obtain corroborating information from bank accounts. When the internal dispute resolution is passed, in the case of large adjustments, usually it is appealed to the Board. The Board has rejected around 30 percent of the cases it received on appeal. The few cases that survive internal and Board review are usually appealed to the courts, which in turn reject the vast number of cases presented for judicial review.

38. **Collection actions are not readily available to SAT.** Modern tax administrations use a wide range of aggressive measures to enforce collection of tax arrears. These measures range from reminder notices, visits at taxpayers' premises, seizure of bank accounts, off-setting of money owed to taxpayers from other public departments, the issuance of third-party demands to major customers, and temporary closure of business, to the seizure and sale of the physical assets of taxpayers. For SAT, the decision on the exercise of these coercive procedures can be appealed creating collection processes that can take years to reach a conclusion. In the meantime, the taxpayer is not required to deposit any part of the appealed assessment.³¹

³⁰ Methodologies, information systems, among others.

³¹ Under Article 28 of the Constitution, payment cannot be required pending the outcome of litigation.

39. **Since the establishment of SAT, administrative tax appeal processes have been a responsibility of the Board of Directors.** Such arrangement evidently implied a conflict of interest given the nature and composition of this management instance. This aspect was brought to public attention in the context of the recent institutional crisis in SAT and was one of the important aspects reformed by the amendments to the SAT Organic Law by the creation of TRIBUTA whose mandate is to review and resolve administrative tax appeals. TRIBUTA will be made up of multidisciplinary members exclusively appointed to perform this role, therefore preventing the risks of conflict of interest observed in the previous model.

40. **The main objective of this sub-component is to improve quality of legal services and the collection of disputed taxes.** This sub-component will support, among other things, the following activities:

- (a) Creation of a strategy and development of analytical tools to support tax litigation processes and strengthening capacity of the legal department;
- (b) Identifying areas of opportunity to improve existing regulations that hinder SAT's ability to collect tax debts; and
- (c) support implementation of the new tax appeals framework and TRIBUTA, through development of organizational manuals and procedures, analysis of staffing capacity and requirements, training for TRIBUTA staff, development of supporting tools to record and monitor appeal cases, and dissemination and communication activities to inform taxpayers of the new tax appeals procedures and protocols.

41. Table A.2.1 shows the planned disbursements as detailed in the Loan Agreement, and Table A.2.2. Summarizes the costs by Components and sub-components.

Table A.2.1 Disbursements as detailed in the Loan Agreement

Category	Amount of the Loan Allocated (expressed in USD)	Percentage of Expenditures to be financed (inclusive of Taxes)
(1) Goods, non-consulting services, consulting services, Training and Operating Costs for the Project	54,862,500	100%
(2) Front-end Fee	137,500	Amount payable pursuant to Section 2.03 of the Loan in accordance with Section 2.07 (b) of the General Conditions
TOTAL AMOUNT	55,000,000	

Table A.2.2. Project costs by Component and sub-component

Project Components	Project cost (Million US)
1. Transparency, Integrity and Institutional Development of SAT	23.52
1.1. Management of SAT Reform	2.91
1.2. Strengthening Human Resource Management and Institutional Integrity	2.36
1.3. Upgrading and Integration of the Information Technology Platform	18.25
	27.66
2. Strengthening of Tax Collection Functions in Internal Revenues and Customs	3.48
2.1. Strengthening of Internal Revenue Collection Processes	24.18
2.2. Strengthening of Customs Services	3.68
	2.48
3. Strengthening of Tax Intelligence and Tax Enforcement	1.20
3.1. Strengthening of Tax Intelligence and Tax Audit	
3.2. Strengthening of Legal Services and Tax Appeals Procedures in SAT	
Total Costs	
	Total Project Costs 54.86
	Front-End Fees 0.14
	Total 55.00
Total IBRD Financing Required	55.00

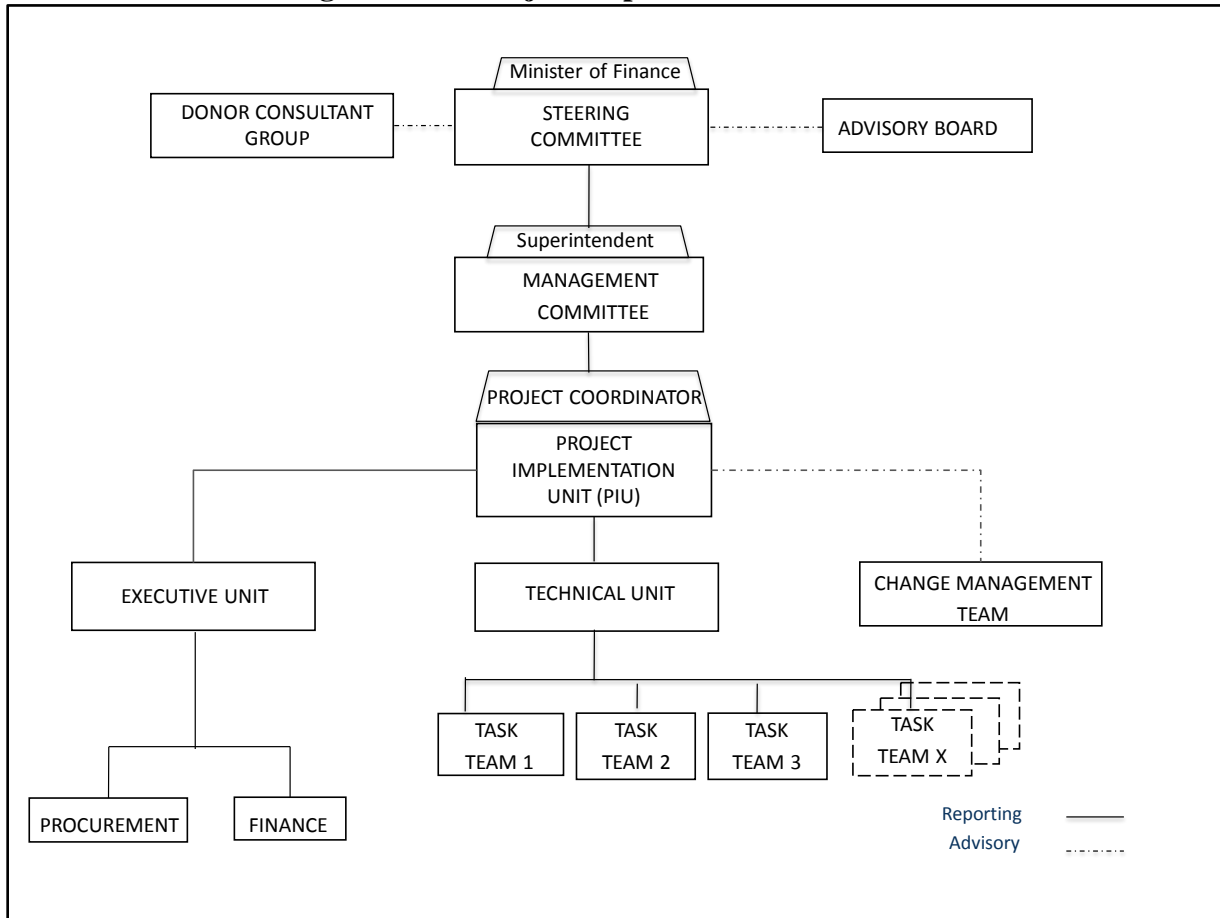
Annex 3: Implementation Arrangements

GUATEMALA: Transparency and Efficiency in Tax Administration Project

Project Institutional and Implementation Arrangements

1. **The proposed Project will be implemented by SAT.** The Project management structure has been designed taking into consideration the current Guatemalan context and SAT's organizational structure, as well as best practices from previous WB experiences (Figure A.3.1).

Figure A.3.1. Project Implementation Structure



2. **A PIU will be established administratively within SAT's Planning Management Unit, responsible for the day-to-day management of the Project.** This includes such functions as, *inter alia*: (i) managing administrative tasks; (ii) carrying out procurement and FM; (iii) monitoring implementation and evaluating progress towards achievement of the PDO, including identifying bottlenecks and risks, and recommending corrective actions; (iv) coordinating closely with relevant SAT units on technical aspects of the various Project activities; (v) liaising with units working on other SAT reform initiatives; and (v) managing the business process transformation

and change management aspects of the Project. The PIU will be responsible for ensuring compliance with WB policies and procedures that are applicable to the Project, including on procurement and FM. The formal establishment of the PIU will need to be approved by the SAT's Board of Directors and is expected, together with the appointment of the PC, no later than three months from the Loan's effectiveness date.

3. **Within the PIU, three teams will be established to execute administrative/fiduciary, change management, and technical coordination functions, which will each have their own team leaders who report to the PC.** *The administrative team* will be in charge of procurement, FM, and monitoring and evaluation, among others. With respect to its fiduciary functions, the administrative team will report to the PC, who will then coordinate with SAT's Administrative and Planning Units for the required follow up. *The change management team* will advise the PC/PIU on and facilitate the development and implementation of the strategy for managing and communicating the changes and reforms introduced under the Project. With respect to the technical aspects of the Project, *a technical team* will help integrate and coordinate task teams that will be in charge of reviewing, designing and implementing solutions for specific processes or services (e.g. customs, internal revenue, human resources, etc.) *The task teams* will be led by task leaders who will be appointed to manage full-time teams made up of the most experienced officers possible for those needs. The task leaders will report to the PC, who will coordinate and align the execution of other Project activities and work in coordination with critical implementation areas within SAT, including IT, Human Resources, Procurement and Finance. The OM details the formal implementation arrangements for oversight of these task teams.

4. **The PIU will also have a quality assurance consultant to assist the PC in creating and monitoring change control procedures.** The consultant will help build and maintain the Project library and other critical documentation as well as provide ongoing assistance to the task teams at every stage of the Project, participating in reviewing technology proposals, monitoring contract deliverables and the use of insurance and guaranties, and evaluating physical contract implementation milestones.

5. **The staff of the PIU, as well as the task teams, will be incrementally strengthened as Project implementation progresses.** Staff in these specific task teams will receive further training during preparation and implementation. Technical and administrative support will also be provided under sub-component 1.1 of the Project. Technical consultants will be hired to work with task team leaders as required.

6. **A Management Committee will be put in place to oversee supervision of Project implementation and make operational decisions.** The Management Committee will be chaired by the SAT Superintendent and made up of all SAT *Intendents*³², the manager of SAT's Planning Management Unit, the Superintendent's Projects Advisor and the PC, who will serve as the Secretary. It will meet regularly, at least twice a month at the beginning of the Project, and once a week as the Project enters into the implementation phase (detailed procedures are defined in the OM). The Committee will be responsible for, *inter alia*, monitoring Project progress, prioritizing

³² Intendents are managers of the core operational areas in SAT: tax collection, customs, tax audit, and legal services.

activities, and proposing changes in Project scope or specifications; making operational decisions; allocating human and financial resources; and resolving organizational issues. It will also review the status of procurement processes and the budget, take risk mitigation steps and guide the preparation of progress reports and proposals for approval by the Steering Committee. On behalf of the PC, the PIU will prepare agendas and record minutes of the meetings. The formal establishment of the Management Committee will need to be approved by the SAT's Board of Directors and is expected no later than three months from the Loan's effectiveness

7. **A Project Steering Committee will monitor progress on Project implementation, providing strategic direction and policy advice.** The Steering Committee will be chaired by the Minister of Finance and include members of SAT's Board of Directors, the Vice-Minister of Finance and the Superintendent of SAT, and meet at least twice a year. The meetings of the Steering Committee will focus on assessing Project progress and review strategic alignment issues, budget requirements, regulation of modifications, proposals of Project modifications, and interagency coordination. On behalf of the SAT Superintendent who is the Secretary of the Committee, the PIU will prepare agendas and record minutes of the meetings. Through specific meetings, the Committee will receive business and strategic advice from an Advisory Board comprised by representatives of the private sector, academia and civil society; as well as from a Donors Consultative Group, integrated by donor representatives (OTA, IMF, IDB, GiZ) who are participating in supporting the strategic development of SAT at various levels. The formal establishment of the Steering Committee is expected no later than three months from the Loan's effectiveness.

8. **Details on the institutional and implementation arrangements for the proposed Project, including roles and responsibilities, are included in the OM.** The OM includes, inter alia: (a) a detailed description of the Project activities and institutional arrangements for the Project; (b) the Project administrative, accounting, auditing, reporting, financial (including cash flow aspects in relation thereto), procurement and disbursement procedures; (c) the monitoring indicators for the Project; (d) the institutional and administrative mechanisms established to ensure institutional coordination; and (e) the functions, responsibilities and composition of the Steering and Management Committees. The OM will be adopted by SAT prior to Loan effectiveness.

FM, Disbursements and Procurement

9. **The WB carried out an assessment to evaluate the adequacy of FM arrangements of SAT, as the implementing entity of the proposed Project.** The FM assessment reviewed the specific arrangements to ensure proper control, recording, and reporting of Project expenditures. The basic staffing structure, financial recording system and financial reporting, cash flow, audit arrangements, internal control system and asset management are included in the OM.

10. **Overall, SAT is a well-established entity that has in place basic FM arrangements.** It is expected that the proposed Project will benefit from those existing arrangements and supplementing or strengthening them as needed. Based on the Project description, the proposed activities do not require complex operational arrangements. However, the recent institutional crisis has, to some extent, led to a deterioration of the internal control environment. In addition, internal processes and procedures used by public sector entities in Guatemala are in most cases

cumbersome and lengthy, causing delays in implementation. On this basis, the overall fiduciary risk has been defined as substantial.

11. **To mitigate these risks, there is need to secure strong operational arrangements within SAT that can support smooth, agile and transparent Project implementation.** This will require the definition of clear responsibilities for both SAT units and the entities to be established under the Project as well as streamlined processes and procedures, including the strengthening of key internal controls and transparency mechanisms. To this end, SAT will establish a PIU, which will include the necessary fiduciary staff to carry out Project activities with efficiency and transparency. As such, SAT has: i) prepared the terms of references of key fiduciary staff that will be financed with loan proceeds; ii) streamlined processes and procedures included in the OM; iii) defined the responsibility for, and mechanism to support adequate, contract management within the PIU; and iv) defined the specific content and format of financial reports. Based on progress made, proposed FM arrangements are considered acceptable to the WB. The hiring of a FM specialist is expected no later than three months from the Loan's effectiveness. The FM arrangements are outlined below, including critical mitigating measures.

12. **Organization and staffing. Within SAT, the Administrative and Finance Management Unit has the responsibility for basic FM functions in terms of budgeting, accounting and treasury.** However, the PIU will maintain an administrative team including a FM team to be responsible for the administration of loan proceeds in coordination with the Administrative and Finance Management Unit as needed. Such a team will include a FM specialist, an accounting officer and a budget officer and terms of reference for these positions are defined in the OM. In accordance with local regulations, to be granted with signing authority (*cuentadancia*), the FM position will be financed with SAT's proceeds. Recruitment of other FM staff will be carried out in accordance with WB procedures.

13. **Programming and budgeting. Project programming and budget will be governed by public sector regulations, as applicable to autonomous entities, and other specific procedures adopted by SAT.** In compliance with those procedures, the roles and responsibilities defined for Project implementation, and following the budget structure used for the public sector (*Estructura Programatica*), it was agreed that the Project budget would be recorded as a specific "Program" assigned to the *Gerencia de Planificacion y Desarrollo Institucional*, as the budget administrative unit, and reflecting Project Components as activities. For budget preparation, SAT will coordinate with MINFIN the allocation of required financial resources within the National General Budget for project operation to be presented and approved in Congress. Based on the approved National Budget, the detailed Project budget will be prepared by the PIU in coordination with the participating technical units, and then submitted to the Administrative and Finance Management Unit to be incorporated into SAT's institutional budget, which has to be approved by SAT's Board of Directors before the beginning of the fiscal year. Any budget modification also has to be approved by the Board. The Project budget will also be processed, recorded and executed through *SICOIN*, the country's integrated FM system.

14. **Accounting and financial reporting. Project transactions will be accounted for in SICOIN following the Government's accounting policies and practices.** As mentioned above, Project Components and cost categories will be reflected as separate activities in *SICOIN* to facilitate the preparation of financial reports. SAT will also keep digital auxiliary records in United

States dollars that complement SICOIN records to prepare Statements of Expenditures and financial reports. Periodic reconciliation mechanisms between SICOIN and Excel records will be put in place to ensure the integrity of the financial information. The PIU, through the administrative team, will be responsible for preparing financial information on a semi-annual basis and submit it to the WB as Interim Financial Reports containing: i) the sources and uses of funds, reconciling items, and cash balances, with expenditures classified by Project Component and cost category; ii) a statement of uses of funds reporting the current semester and the accumulated operations against ongoing plans, as well as footnotes explaining the important variances. The reports will be prepared in local currency and United States dollars following the format defined in the OM. The Interim Financial Reports will be submitted for the WB's review no later than 45 days after the end of each semester. On an annual basis, SAT, through the PIU and in coordination with the Administrative and Finance Management Unit, will also prepare Project financial statements including cumulative figures, for the year, and as of the end of the fiscal year (December 31). All documentation for consolidated Statements of Expenditures will be maintained for post review and audit purposes for up to three years after the closing date of the Project, or for 18 months after receipt by the WB of an acceptable final financial audit, whichever is the later.

15. ***Processes and procedures (including internal controls).*** In compliance with local regulations, SAT has in place basic procedures for the processing of payments, mainly covering the accounting in SICOIN and issuance of checks or bank transfers. Based on those basic procedures, SAT has produced tailor-made “*flujogramas*” that reflect roles and responsibilities of different parties involved in Project implementation, including procedures for the preparation of the annual operating plan, as well as approval and payment of goods, products and services. Additionally, the OM includes the procedures related to the control and management of fixed assets to be financed under the Project. These procedures: i) provide for clear roles and responsibilities (including those for technical units), adequate segregation of duties in terms of authorization, and recording and approval of payments; ii) allow for some simplification although there is still space to seek some delegation; and documentation required; and iii) ensure that supporting documents are filed in a timely manner and safeguarded, by differentiating those related to procurement process, and those required for payment processing. Given the nature of activities to be financed it was agreed that for Project purposes, SAT would strengthen its mechanisms for contract management, by: i) putting in place a single and comprehensive record of contracts, including amount, terms, amendments, amount paid, outstanding balances; and ii) having clear roles and responsibilities for the timely update of the record.

16. ***External audit.*** An external, independent, private audit firm, acceptable to the WB under defined terms of reference approved by the WB, will be contracted by SAT for the entire life of the Project no later than six months after the Loan's effectiveness and financed under the Project. The audit firm will review and provide an opinion on the Annual Financial Statements of the Project. The audited financial statements shall be presented to the WB no later than six months after the end of the fiscal period. According to the WB's policy on access to information, Audited Financial Statements will be made public. Specific audit requirements include:

Audit type	Due date
Project financial statements	June 30
Management Letter	June 30

17. **Flow of funds.** Following the general practice of the current portfolio, the following disbursement methods may be used to withdraw funds from the Loan: (a) advances, and (b) direct payments, with advances the primary method of disbursement. Under the advance method, a Designated Account will be opened as a *Cuenta Secundaria*, under the Multilaterals' Single Treasury Account-MSA system in MINFIN in United States dollars, to be used exclusively for deposits and withdrawals of Loan proceeds for eligible expenditures. The maximum amount that may be advanced to the Designated Account is US\$4 million. Overall disbursement arrangements will follow standard disbursement policies and procedures established in the Disbursement Guidelines for Investment Project Financing and in the Disbursement Letter of the Project. The PIU will report on the use of advances and reimbursement requests through simplified Statements of Expenditures and eventual direct payments will be documented by copy of the invoices. Documentation of eligible expenditures paid out of the Designated Account is expected to be on a quarterly basis. The supporting documentation requirements to document Project expenditures, as well as the minimum value of application for direct payments and reimbursements, is outlined in the Disbursement Letter.

Table A.3.1 Action Plan for SAT

Action	Responsible	Target Timeframe
1. Draft OM reflecting agreed FM procedures	SAT	Completed
2. Define the specific format and content of financial reports to be prepared based on the information provided by SICOIN	SAT/WB	Completed
3. Contract external auditor based on terms of reference and short list satisfactory to the WB	SAT	Six months after effectiveness
4. Recruit key fiduciary staff within the administrative unit	SAT	Three months after effectiveness
5. Provide specific training in FM & Disbursements for Project FM Staff	WB	Before effectiveness

18. **FM action plan and supervision plan.** An Action Plan to ensure that adequate FM systems are in place before Project implementation begins is currently being undertaken by SAT (Table A.3.1). It is expected that WB FM Specialist will closely work with SAT's FM staff during the first year of the Project to support the effective implementation of all required arrangements. After effectiveness, the FM Specialist will review the annual audit report and the financial sections of the semiannual Interim Financial Reports, and perform at least two complete supervision missions per year. This supervision strategy will be reviewed periodically and adjusted based on performance and risk.

19. **Procurement.** Procurement will be carried out in accordance with the "World Bank Procurement Regulations for Borrowers under Investment Project Financing" (July 2016) ("Procurement Regulations"). A PPSD, prepared by SAT, describes how procurement in this operation will support the PDOs and deliver value for money using a risk-based approach. The

PPSD provides adequate supporting market analysis for the selection methods detailed in the Procurement Plan. Mandatory Procurement Prior Review Thresholds detailed in Annex I of the WB's Procurement Procedure are applied. All procurement procedures, including roles and responsibilities of different participating entities and units, are defined in the OM.

20. ***Procurement plan.*** In accordance with paragraph 5.9 of the Procurement Regulations, the WB's Systematic Tracking and Exchanges in Procurement system will be used to prepare, clear and update Procurement Plans and conduct all procurement transactions for the Project. The Procurement Plan for the first 18 months has been prepared by SAT in accordance with the results of the PPSD. A summary of the PPSD, including recommended procurement approach for higher value contracts, is presented in Table A.3.2. SAT has already been trained on how to use the Systematic Tracking and Exchanges in Procurement system.

21. ***Civil works.*** Infrastructure and/or civil works are not foreseen to be financed with Project funds.

22. ***Goods.*** Goods to be financed under this Project include an ICT system, software, office equipment, and customs equipment (scanners, video cameras, etc).

23. ***Non-consulting services.*** The Project will finance services related to data collection, communications, publicity services, and other services.

24. ***Selection of consulting services.*** Consulting services to be financed under the Project will be focused on M&E services, external auditing and software development, designing and streamlining of processes, including control systems based on risk concepts, enhancing the use of importer/exporter information, and monitoring and evaluating services.

25. ***WB's Standard Procurement Documents.*** Standard Procurement Documents shall be used for all contracts subject to international competitive procurement and those contracts as specified in the Procurement Plan tables in the Systematic Tracking and Exchanges in Procurement system.

26. ***Operating costs.*** Operating costs refer to reasonable recurrent expenditures that would not have been incurred by the implementing agency in the absence of the Project. The Project will finance operating costs, such as office supplies, communication and advertising costs, computers and equipment maintenance, per diems for local and international staff, among other operational expenses. The Project will also finance costs of training course, travel and per diem of trainers and trainees, and rental of facilities.

27. ***OM.*** All procurement procedures are described in detail in the OM, and agreed with the WB. The OM includes non-standard documents expected to be used in the implementation of this Project.

28. ***Procurement capacity and arrangements.*** The WB carried out a procurement capacity assessment in June 2016 to evaluate the adequacy of procurement arrangements of SAT. The assessment focused on how the entity was organized to procure using external funds. The basic staffing structure, procurement record system, internal controls, evaluation committees' roles and responsibilities, contract signing, and contract administration were reviewed as part of the assessment. At the entity level, while SAT has a well-defined structure and procedures, it has

limited experience with externally-financed operations. For example, SAT implemented a WB-financed project more than ten years ago, and during the last five years, SAT has been mainly financed with national funds and carrying out procurement processes of lesser value than the ones planned under this Project. All procurement for the proposed Project will be carried out by the PIU, which includes an administrative unit with a procurement team. The procurement team within their administrative unit has not carried out procurements using WB funds nor has experience with external funds regulation. Therefore, SAT will need to strengthen its procurement staffing. To this end, in accordance with local regulations a procurement specialist will be financed with SAT's proceeds and will be granted signing authority (*cuentadancia*). In addition, the Project will finance the hiring of supporting experienced procurement staff with terms of reference and qualifications acceptable to the WB. The number of procurement staff will be defined based on the amount of contracts foreseen within the PPSD and the Procurement Plan. Technical aspects of the planned procurement activities will require expertise and will be contracted using individual consultants, as necessary. Details on the procurement arrangements as well as definition of roles and responsibilities are included in the OM. The procurement risk rating is substantial.

29. ***Frequency of Procurement Supervision.*** In addition to prior review supervision to be carried by the WB office, the capacity assessment of the implementing agencies recommends annual supervision missions to visit the field to carry out post review of 1:5 procurement actions.

30. ***Summary of PPSD (recommended procurement approach for higher value contracts*).*** The Summary of the PPSD is included in table A.3.2.

Table A.3.2 PPSD Summary

Description	Estimated costs in US\$	Prior / Post Review	Market approach	Selection method
Goods:				
Technological infrastructure and data center alternative	8,400,000	Prior	International - Open	Request for Bids (post- qualification)
IT equipment (replacement of obsolete equipment)	5,100,000	Prior	International - Open	Request for Bids (post- qualification)
Non-intrusive information technology for customs (X-rays, GPS)	6,000,000	Prior	International - Open	Request for Bids (post- qualification)
IT technology for future demand	2,900,000	Prior	International - Open	Request for Bids (post- qualification)
Kiosks for call centers (furniture)	800,000	Prior	International- Open	Request for Bids (post-qualification)
Software upgrade	250,000	Prior	Direct contract	--
Non-consulting services:				
Adaptation and Implementation of Information Systems	15,000,000	Prior	International - Open	Request for Proposals
Training				
Training	3,475,000	Post	National-Open	Request for Bids
Consultant services:				
Modernization and streamlining processes, including control and tributary systems designs	5,700,000	Prior	International-Limited	Request for Proposals
Communications strategy	1,200,000	Prior	International - Limited	Request for Proposals
Software design	1,200,000	Prior	International-Limited	Request for Proposals
Design of SAT's legal strengthening	500,000	Prior	International-Limited	Request for Proposals
Technology strategy	465,000	Post	International - Limited	Request for Proposals
External audit services	100,000	Post	Limited	Request for Proposals
Individual consultants:				
Specialized consultancies in Tax Administration (8 international experts)	2,352,000	Prior	International – Limited	Individual consultants
Specialized consultancies in Tax Administration (8	757,600	Post	National – Limited	Individual consultants

national experts)				

(*) Procurement packages and WB's prior review as defined in procurement plan accordingly

Annex 4: Implementation Support Plan

GUATEMALA: Transparency and Efficiency in Tax Administration Project

Strategy and Approach for Implementation Support

1. **The Implementation Support Plan has been developed based on the nature of the Project and its risk profile.** The purpose of the Plan is to ensure that implementation support to the client is more flexible and efficient, and focuses on addressing the main identified risks and includes the agreed risk mitigation measures. The implementation arrangements and the OM will be fundamental tools to achieve this objective.

Implementation Support Plan

2. **Given the complexity of the Project, close supervision during implementation will be required to ensure all the Components are being executed as planned.** Task team leadership, as well as fiduciary and technical aspects, will be managed from the WB's Washington office. The WB team will provide regular implementation support to the PIU, Management Committee and the Steering Committee, and will regularly supervise progress towards the PDO and results. The OM outlines coordination and reporting mechanisms between the technical coordinators and the WB.

3. **Each of the Components will have at least one technical specialist that will closely supervise and support the implementation of the proposed activities.** Each of the Components is highly technical and requires the technical specialist to be in close contact with the technical coordinators. To support supervision of some of the more complex activities, the WB will engage international experts when necessary to round out the skills mix of its implementation support team.

4. **This kind of modernization Project involves complex and strategic procurement processes, which will require information technology and specialized procurement advice.** In addition to the indicated technical experts, the WB team will include i) a procurement specialist with specific knowledge on information systems, procurement processes and long consulting services contracts; and ii) an IT specialist with experience on tax and customs information systems and technologies. Including these specialist positions in the WB's team will contribute to the success of the Project and prevent delays during the procurement and implementation stages.

5. **The team will maintain continuity and a regular dialogue with Government counterparts on all relevant operational, technical and policy issues.** At least two formal implementation support missions of the entire team are expected per year. For some of the Components, sectoral experts may need to travel to Guatemala more frequently during the first two years to ensure implementation is progressing as expected.

6. The table below shows the timeframe, skills mix and resources needed for implementation support:

Time	Focus	Skills Needed	Resource Estimate per year	Partner Role
First twelve months	Advise on designing of tax & customs administration model Advise on designing of bidding documents for Tax & Customs Administration redesign consulting, Information Systems and ICT Platform	Task Management Tax and Customs Management Specialist IT Specialist FM Specialist Procurement Specialist with focus on IT and Large Consulting Services	US\$200,000	Prepare implementation reports and Participate in Implementation support missions
	Advise on designing Change Management and Communication Strategy	Task Management Tax Administration Specialist Customs Administration Specialist		
	FM and Procurement Training	FM specialist Procurement specialist		
Second year	Supervise the procurement processes (related to consulting services, information systems and ICT platform)	Task Management Tax Administration Specialist Customs Administration Specialist Procurement Specialist (Focus on Large Consulting Services)	US\$200,000	Prepare implementation reports and Participate in implementation support missions
	Advise on new information systems and ICT platform deployment	Task management IT specialist Procurement Specialist (Focus on IT)		
	Dialog with client on operational and technical aspects including	Task Management Tax Administration Specialist		

Time	Focus	Skills Needed	Resource Estimate per year	Partner Role
	monitoring of the change management and communication strategy	Customs Administration Specialist IT Specialist		
	FM and Procurement supervision	Task Management FM Specialist Procurement Specialist		
Third to Sixth years	Advise on implementation of new tax and customs administration concepts, processes and information systems	Task Management Tax Administration Specialist Customs Administration Specialist IT Specialist	US\$200,000	Prepare implementation reports and Participate in implementation support missions
	Advise on implementation of Change Management and Communication Strategy	Task Management Tax Administration Specialist Customs Administration Specialist		
	FM and Procurement supervision	Task Management FM Specialist Procurement Specialist		

Skills Mix Required

Skills Needed	Number of Staff Weeks/ year	Number of Trips	Comments
Task Management	8 weeks	2 per year	
Customs Specialist	8 weeks	2 per year	
Tax Administration Specialist	8 weeks	2 per year	
IT Specialist	8 weeks	2 per year	
Procurement Specialist with focus on IT and Large Consulting Services	8 weeks	2 per year	
FM Specialist	2 weeks	None	

Annex 5: Economic and Financial Analysis

GUATEMALA: Transparency and Efficiency in Tax Administration Project

1. **The economic analysis suggests that this Project is economically feasible, with a NPV of US\$61.17 million and an IRR of 15 percent (Table A.5.1).** The economic analysis attempts to quantify the impact of the likely Project costs and benefits both for taxpayers and the SAT. The analysis employs an incremental approach, which, by design, compares the scenario without the Project (counterfactual scenario) and the scenario with the Project. It draws on the following sources of information:

- Project costs and disbursement calendar as defined in the appraisal document;
- SAT administrative records on the number of active taxpayers (firms);
- SAT annual reports for information on revenues;
- The 2016 Doing Business Report for the average time to comply with taxes. The indicator is reported for a hypothetical medium-sized company, which needs, on average, about 256 hours/year (or 32 days) to comply with major types of taxes and contributions in Guatemala; and
- The National Institute of Statistics in Guatemala, to ascertain the remuneration of accountants. In 2015, average remuneration of an accountant was estimated at 3,662 Q/month (US\$470 per month).

Table A.5.1. Project Economic Benefit (US\$ million)

Project Year	1	2	3	4	5	6	7
INFLOW							
Effect on Compliance Cost reduction	-	12.03	22.86	33.68	39.70	40.90	40.90
Effect on Administrative Cost reduction	-	1.37	3.43	4.80	6.17	6.17	6.17
Total Inflows	-	13.40	26.28	38.48	45.87	47.07	47.07
OUTFLOW							
Investment WB	4.48	11.93	19.84	9.81	7.65	1.29	
Fron-End Fees	0.14						
Operative and Maintenance Cost	1.05	2.84	4.87	5.85	6.91	8.05	6.96
Total Outflows	5.67	14.77	24.71	15.66	14.56	9.34	6.96
Net Economic Benefit (NCF)	-5.67	-1.37	1.58	22.83	31.31	37.73	40.11
NPV	61.17						
IRR	15%						

2. **The proposed Project is expected to generate both tangible and intangible benefits for the taxpayers and the SAT.** While Project costs are typically easy to define and quantify, measuring certain benefits and defining causal linkages between certain outcomes, including behavioral responses, is not straightforward. The analysis of the economic benefits might underestimate the actual benefits to the extent that some dimensions might not be included (i.e.,

trade facilitation), also, the economic analysis does not cover individual taxpayers,³³ although the Project is expected to reduce compliance costs of individual taxpayers as well, thus enhancing the economic feasibility of the Project. This economic analysis focuses on:

- *Tax Compliance Cost*: The major economic benefits for taxpayers include reduction in the time to comply with taxes; it will be achieved mainly through the simplification of tax legal and normative framework, simplification of processes and procedures and implementation of virtual services for the taxpayers.
- *Tax Administrative Cost*: The major economic benefits for SAT, is associated with optimized business processes within the service, the use of risk-based approach for tax audit and customs clearance and the implementation of new technologies and information systems. Most of the benefits generated at the level of the SAT will be in enhanced operational efficiency and effectiveness of services provided, that is “more” and “better” will be done with the same resources.

3. **Key assumptions of the economic analysis include:**

- a. The number of active taxpayers (only firms) (as of December 31, 2015³⁴) will not change significantly in the medium-term;
- b. The main driver of compliance costs for taxpayers is the time spent by firms and their accountants in dealing with tax matters;
- c. The time necessary for the preparation of tax returns will start decreasing from the second year of the Project, and the target indicator (reduction by 24 percent on average for companies);
- d. The current tax administrative cost of SAT is 1.81 percent and will start to decrease from the second year of the Project. The target is 1.72 percent;
- e. The discount rate used for this analysis is 13 percent;³⁵ and
- f. The timeframe of the analysis is seven years from Project approval date.

4. **Results of the financial analysis also show that the Project is financially feasible (Table A.5.2).** The financial IRR is 172 percent, and the financial NPV at 9.6 percent discount rate in real terms is US\$1.18 billion (at the exchange rate of 7.8 Q/US\$). For the financial analysis, the methodology considers actual revenues (growth of revenues) and expenditures (original investment and maintenance cost) and is based on the increase of tax compliance (voluntary and enforced) translated into higher tax revenues as a result of improvement in tax administration efficiency and effectiveness as well as reduction of tax arrears. The analysis only considers the VAT collection and VAT compliance, because there is no official methodology to estimate income

³³ The Doing Business is the only official data source that can be used to calculate tax compliance cost. However, this can only be done for companies, not individual taxpayers.

³⁴ Last data available

³⁵ Represents the Economic Opportunity Cost of Capital Funds for the Government = Real interest rate as a proxy for the real financial cost of capital by the Government + Economic externality of capital funds (EECF) estimated at 3%. EECF are the external costs of raising added public funds, namely the combined economic efficiency costs, administrative and compliance costs of an added unit of revenue.

Calculation methodology followed: Graham Glendayf, Economic Analysis Guidance for Governance and Public Sector Management Operations in Select Areas of Public Financial Management, Duke University, prepared for Public Sector & Governance, PREM, World Bank, 2015.

tax compliance and other taxes. The analysis employs an incremental approach, comparing the scenario without the Project (counterfactual scenario) and the scenario with the Project.

Table A.5.2. Project Financial Benefits (US\$ million)

Project Year	1	2	3	4	5	6	7
INFLOW							
Improved VAT collection w Financing	52.38	142.05	243.31	292.25	345.30	402.48	463.76
Total Inflows	52.38	142.05	243.31	292.25	345.30	402.48	463.76
OUTFLOW							
Investment WB	4.48	11.93	19.84	9.81	7.65	1.29	
Front-End Fees	0.14						
Operative and Maintenance Cost	1.05	2.84	4.87	5.85	6.91	8.05	9.28
Total Outflows	5.67	14.77	24.71	15.66	14.56	9.34	9.28
NCF, w Project (Improvements)	46.71	127.28	218.61	276.60	330.75	393.14	454.49
NPV w Project (Improvements)	1181.53						
IRR	172%						

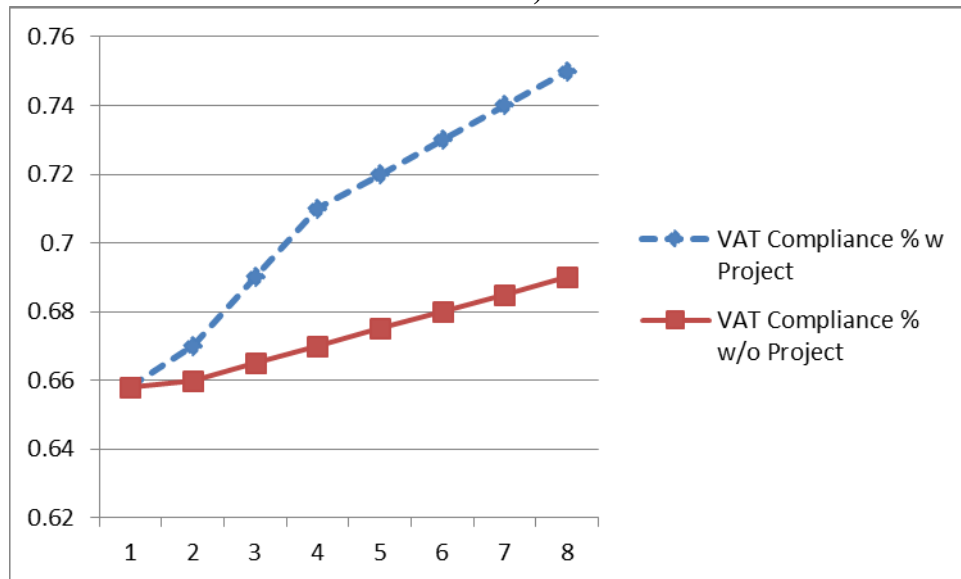
5. Key Assumptions of the financial analysis are:

- The current VAT compliance ratio is 65.8 percent. The projected VAT compliance ratio goal in seven years is 75 percent with the Project (since approval date), while it is 69 percent without the Project (see Figure A.5.3).
- The difference between the increase of VAT compliance with the Project and without the Project is a direct result of the Project intervention. The experience of Bulgaria with the implementation of a similar Project³⁶ shows substantial improvements in compliance rates.
- Nominal GDP growth is forecasted by the Guatemalan Central Bank for 2016-2018 and assumes the same growth for the following years. (2016: 7 percent; 2017: 7.5 percent; 2018: 7.8 percent).
- The discount rate used for our analysis is 9.6 percent.³⁷

³⁶ Revenue Administration Reform Project, P073427, World Bank. During the implementation of the Project, the compliance rate for VAT, for example, went up from 77 percent in 2002 to 92 percent in 2008. Approval date: June 5, 2003.

³⁷ Estimated with as the real interest rate from IMF data. Source: <http://datos.bancomundial.org/indicador/FR.INR.RINR?locations=GT>

Figure A.5.3. Comparison VAT Compliance Ratio Growth with/without Project (US\$ million)



Annex 6. Project Implementation Timeframe

GUATEMALA: Transparency and Efficiency in Tax Administration Project

Component	Stabilization and Preparation Short-term (1 year)	Redesign Medium-Term (2-3 years)	Consolidation Medium-Long Term (4-6 years)
I. Transparency, Integrity and Institutional Development of SAT	<ul style="list-style-type: none"> - Strategic Plan - Change Management Strategy and Communications Campaign program (Phase I) - Transparency and institutional integrity strategy - Hardware to close current gaps on information systems - Development of Human Resource Management Strategy - Constituency of Internal Affairs Unit - Design of new organizational model for the ICT department 	<ul style="list-style-type: none"> - M&E management tools - Change Management Strategy (Phase II) - Implementation of Human Resource Management Strategy, HR policies and professionalization of staff - Implementation of Internal Affairs Unit - Implementation of Industrial Security Plan - Implementation of Information Governance Model - Hardware and IT solutions to improve quality and services on information systems 	<ul style="list-style-type: none"> - Change Management Strategy (Phase III) - Hardware to cover new and future demands - Data Recovery Center equipment and Adaptation
II. Strengthening of Tax Collection Functions in Internal Revenues and Customs	<ul style="list-style-type: none"> - Cleaning of the taxpayer registry - Development of taxpayer services strategy - Strengthening current taxpayer services channels 	<ul style="list-style-type: none"> - Implementation of new revenue collection model based on a new taxpayer registry and TCA model with 360 vision - Implementation of e-invoice - Implementation of new virtual taxpayer services channels - Redesign of customs processes and controls - Customs system (Implementation) - Training for customs officials (Phase I) 	<ul style="list-style-type: none"> - New revenue collection model (Consolidation) - Training for customs officials (Phase II) - Customs system (Consolidation)

Component	Stabilization and Preparation Short-term (1 year)	Redesign Medium-Term (2-3 years)	Consolidation Medium-Long Term (4-6 years)
		- Implementation of non-intrusive customs controls	
III. Strengthening of tax intelligence and tax enforcement	-Design of Audit and enforcement strategy -Creation of a Fiscal Intelligence Unit -Taxpayer Segmentation -Strategy to support tax litigation processes -Strengthening capacity of the SAT's legal department	-Implementation of new enforcement processes -Tools for information analysis (business Intelligence) - Development of risk models -Specialized training to auditors by sectors and taxpayer segmentation - Supporting tools to record and monitoring tax appeals cases - Tax appeals framework implementation - Tax appeals dissemination and communications activities - Support operationalization of TRIBUTA	-Specialized training to auditors by sectors and taxpayer segmentation

Annex 7: Support to SAT from other Donors

GUATEMALA: Transparency and Efficiency in Tax Administration Project

Support Area	IMF	IDB	German Technical Cooperation	United States Treasury
<i>Revenue Collection</i>	Comprehensive diagnostic and recommendations report on short-term measures to restore collection and medium-term strategies for SAT reform	Technical assistance for the implementation of the e-invoice	Implementation of a system for taxpayers complaints and tax education	Just-in-time technical assistance on income tax collection and enforcement procedures <i>(Support ends in 2019)</i>
<i>Customs</i>				Just-in-time technical assistance on customs control processes <i>(Support ends in 2019)</i>
<i>Audit and Enforcement</i>		Design of cross-mass information mechanisms for audit selection	Developing audit and enforcement tools	
<i>Human Resources and Internal Ethics</i>		Support on staffing requirements and recruiting of new SAT staff	Internal procedures and norms for strengthening transparency and SAT's personnel ethics	Support for the establishment of the Internal Investigation Unit