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Topic 3.1

**BENEFITS AND COSTS IN THE APPLICATION OF A SEGMENTED
TAXPAYER APPROACH IN THE LATIN AMERICAN TAX ADMINISTRATIONS**

**Internal Revenue Service
Chile**

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Summary

The application of the segmented focus at the Internal Revenue Service (SII, in Spanish) of Chile is the answer to the internal diagnostic stating that the high success rate tax attained from revenue paid voluntarily and the deterrence power of potential evaders resulted in the depletion of the control model that was being implemented.

Therefore, a new model of Attention, Support and Examination focusing on taxpayer groups is established in 2007 and a model for this change is also established, which promotes the coordination of efforts and provides Taxpayers service excellence in Attention, Support and Examination processes.

The change to the new model, starts in 2008 and covers the areas of Attention and Support, Examination, Legal and Regulatory Framework, Information Systems, Training, functional structure, as well as the adequacy of the areas of control and assistance at the National Directorate (Central Unit), in order to give appropriate support to this new form of operation, and the intervention of 100% of the regional offices of the SII.

Implementing the above brings about significant costs to the taxpayer and this is related to the transition or mutation from one model to another; i.e., increased noise at front desk offices or disorientation due to the temporary transfers of departments as a result the readjustment of facilities. The tax administration has also undertaken significant costs; i.e., temporarily reduce the number of taxpayers audited, through to Selective Examination, thanks to specialized and targeted training.

The gradual implementation of the new model, meant that the application was concluded mid 2009; however, it already displays significant benefits for the taxpayer and the tax administration; as for example, the number of times that a taxpayer must come in person to finish processing declined from 1.8 times, before applying the model to 1.2 times with the implementation of the new model, which increases by more than 35% control coverage for some segments and increases in over 40% the effectiveness of controls, measured in audit performances.

1. Introduction

One of the key elements in the success of the Tax Administrations is applying a business model that allows the reduction of their taxpayers' evasion rates, minimizing at the same time the cost of compliance.

In the case of the Chilean Internal Revenue Service (SII), the "Taxpayers Segmentation" draft project status showed that it was successful and with a strong emphasis on control: the high rate of tax revenues paid voluntarily and the great capacity to deter potential evaders are evidence of this.

However, the internal diagnosis aimed at a depletion of the model. The control processes were designed for an "average taxpayer" that did not consider the different characteristics of the businesses, and the need to maintain incentives to taxpayers that correctly pay their taxes is detected, giving an excellence service level.

The Taxpayers Segmentation project developed at the SII, is the answer to the previous diagnosis; where a management model is established focusing on taxpayer groups and not on the processes as it used to be.

2. General Background

Even though 97.7% of tax revenues are collected voluntarily, this achievement is largely based on the fact that the SII has been able to "dissuade" 67% of the Taxpayers that have a relative disposition to comply with the payment of taxes (Figure No.1), which proves the relevance of managing evasion risk perception among Taxpayers.

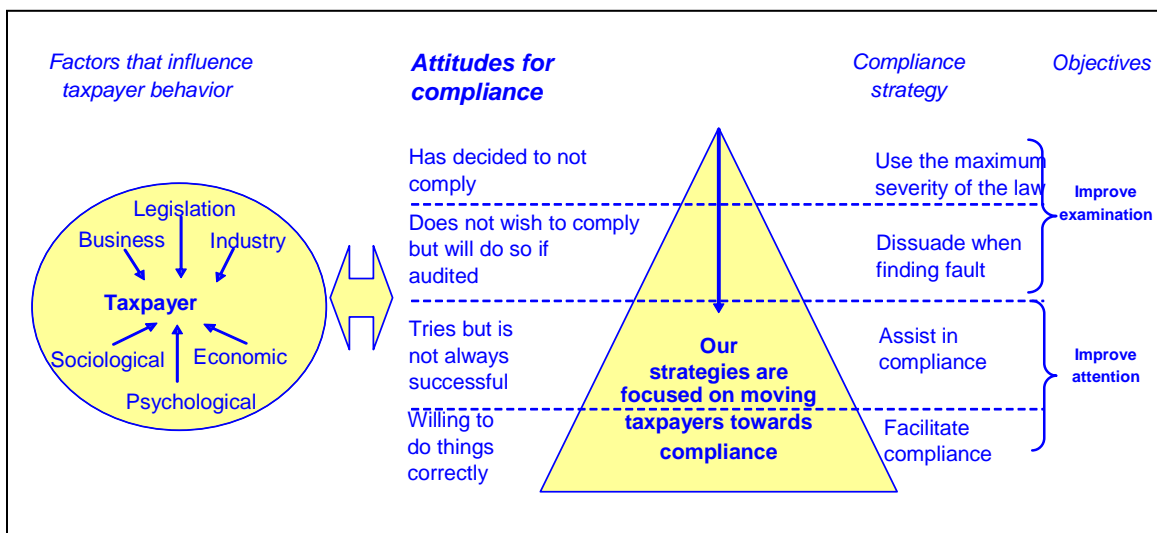


Figure No.1: Taxpayers' Tax Behavior

Segmentation is grouping Taxpayers according to similar Attention, Assistance and Examination characteristics and thus offer a quality service implementing specialized and differentiated treatments for these segments.

A first effort to group Taxpayers, carried out by the Internal Revenue Service, took place in 2001 with the creation of the Large Taxpayers Directorate (DGC) but, for the other Regional Offices, it was as of the segmentation Project, in 2007, where a change model was established aimed at segments in order to provide a greater quality in the attention, assistance and examination processes. Complementarily, this change involves an adaptation at the National Directorate (Central Unit) to provide adequate support to this new operation modality.

In this way, at the end of 2008 the SII changed its actions and moved from processes based on or associated to taxes (Operation Revenue, Operation VAT, Selective Examination, Preventive Examination) to an attention, assistance and examination scheme, where privilege is given to the coordination of efforts for the identified segments.

3. Segmentation Criteria

Segmentation criteria were obtained from the collection of the information carried out from the SII Database and whose preliminary result organized Taxpayers in five clusters: Natural Persons, Micro Enterprises, Small Enterprises, Medium Enterprises and Large Enterprises.

i) Criteria for Attention and Assistance

Taxpayer Attention and Assistance, for the five segments, are centrally managed by the Taxpayer Attention and Assistance Department of the National Directorate; and is executed at each Regional Office, by a specialized Department with the same name.

ii) Criteria for Examination

Taxpayer examination is centrally managed by two functional Departments; the Persons, Micro and Small Enterprises Department and the Medium and Large Enterprises Department of the National Directorate. Audits and revisions are executed by the specialized Departments with the same name at the Regional Offices; therefore, a taxpayer must be served only by the group or team it belongs to by segment brand.

iii) Criteria for Determining Segment

The cutoff criteria used for Natural Persons is to not be subject to income tax and not be an individual entrepreneur. For enterprises, cutoff criteria are shown in Figure No. 2.

Segment	Annual Sales Amount (US\$)	Annual Purchases Amount (US\$)	Own Capital Amount (US\$)
Large Taxpayers	Greater than or Equal to 4,000,000	Greater than or Equal to 4,000,000	Greater than or Equal to 20,000,000
Medium Taxpayers	Greater than or Equal to 1,000,000	Greater than or Equal to 1,000,000	Greater than or Equal to 5,000,000
Small Taxpayers	Greater than or Equal to 100,000		Greater than or Equal to 95,000
Micro Taxpayers	Less than 100,000		Less than 95,000

Figure No. 2: Segmentation Cutoff Criteria

The current results, from the application of the foregoing criteria, show the following results:

Persons Segment: These are Taxpayers that are not subject to capital income tax. They represent 58% of total taxpayers and 73% are only dependant workers or retirees.

Micro and Small Enterprises Segment: These are most taxpaying enterprises (97%) and represent 41% of total Taxpayers. The most frequent tax regime is Full Accounting and they have the highest number of Attention and Examination actions. 97% filed Income through the Internet and 96% monthly VAT returns. They represent 9% of sales and 13% of total tax revenues.

Medium Enterprises Segment: The segment represents 0,6% of total Taxpayers. 92% of these filed Income through the Internet and only 17 issue electronic documents. Only 20% of the taxpayers have been Examined by the Service, 3% requests Exporters VAT refund and 2% refund for change of taxpayer.

Large Enterprises Segment: It is 0,4% of total Taxpayers and carry out more complex and diversified businesses. They carry out tax planning, use franchises, carry out reorganizations, there is transference prices risk and count with tax advisors. They interact with others abroad, in what respects to businesses and enterprise property, presence in several jurisdictions and a high volume of information and documents. Only 1,361 of these Taxpayers are responsible for 73% of tax revenues and of sales at the country level.

4. Segmentation Scopes

At the SII central administration level (National Directorate), the segmentation scope is 100% and involves the totality of the staff of the Examination areas and incorporates other support areas such as those related to the administration of human and technological resources. At the Regional Offices level, the scope is 100% of them and involves 80% of the staff.

Furthermore, the development of differentiated treatment strategies, procedures and products per type of taxpayer is considered, as well as control indicators, attention quality, assistance and examination targets, and composition of specialized work teams, infrastructure adaptation, training and dissemination.

- i) Attention and Assistance: Give quality attention and assistance, through efficient use of protocols, tools and communication channels; attention can be in person, virtual or through the telephone.
- ii) Examination: Differentiated treatment by taxpayer type; maximizing coverage through Mass and Preventive Examination for the Persons, Micro and Small Enterprises Segment; and applying audit techniques, examination guidelines and audit work sheets; through Selective Examination for Medium and Large enterprises.
- iii) Legal and Regulatory Scheme: Efficacy and simplification in the communication and Access to the regulatory scheme, pursuant to the degree of complexity of the tax operations that the taxpayer carries out.
- iv) IT Systems: Provide new computer systems that promote taxpayers' self-attention and better access to the information property of the tax administration. Similarly, inside the SII, tools that allow a better analysis of the information during the examination are incorporated, standardizing processes and improving their quality.
- v) Training: For the groups that serve or control Persons, Micro and Small Enterprises, geared towards the use of IT systems for mass attention and training in issues of greater tax complexity (for example mergers and tax planning) for Medium and Large Enterprise groups.
- vi) Functional Structure and Allocation: In the attention and assistance areas, the restructuring of groups and the generation of specialized teams in taxpayer attention and assistance. In the control area, quick solution examination teams for Persons, Micro and Small Enterprises taxpayers; and the composition of multitask teams for Medium and Large Enterprises.

The abovementioned scopes, have different degrees of complexity for the implementation of the segmented focus. Figure N°3, shows the degree of complexity of the most important scopes described:

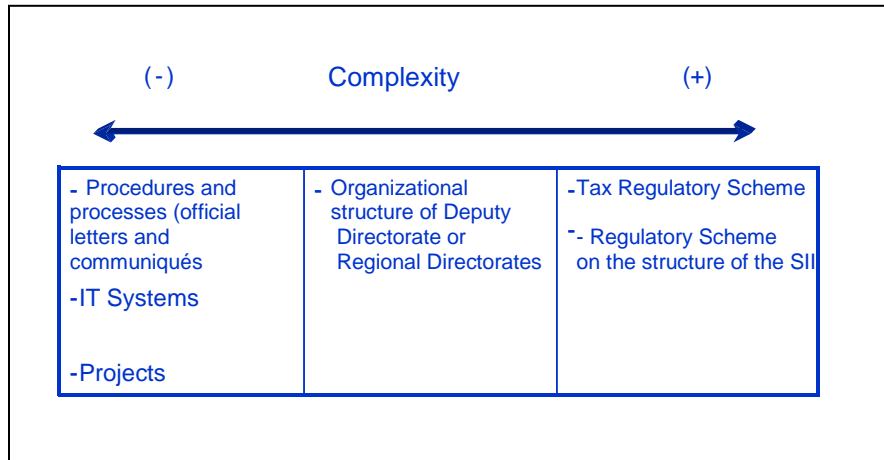


Figure N°3: Scope of Segmentation and Degree of Complexity

According to the above figure (Figure N°3), we are at a lower level of complexity for the IT Systems scope, medium level complexity for the Functional Structure and Allocations and a high level of complexity to make changes at the Tax Regulatory Scheme level.

5. Benefits of the Segmented Scheme

Hereinafter, the most important benefits from the application of the segmented focus:

i) Benefits for the Taxpayer.

Attention and Assistance

- Timely Attention and Assistance: A 30% drop in waiting time for attention, due to the increase of taxpayer attention and self-attention points at the Regional Offices.
- Response Quality: Increase in the quality of responses delivered to Taxpayers; due to the incorporation of specialized officers that may respond to any consultation or request.
- Tax Information: Increase in the quantity and quality of the information the SII makes available to the Taxpayer; to know the status of procedures as well as of revisions and Audits.

- Procedure Simplicity: Increases transparency towards the Taxpayer; through the incorporation of a standard procedure, where all the procedures are carried out in a single place in the Regional Office.
- Lower Compliance Cost: Lowers tax compliance cost for the Taxpayer; due to the incorporation of new technological support tools aimed at self-attention and the incorporation of training on its use by officers from Attention and Assistance.

Examination

- Attendance to Audits: The amount of times the taxpayer must attend to the SII at the summons of the tax administration is reduced; because an attention is carried out that is comprehensive and independent from the process.
- Tax Refund Request: The challenge and refund process is sped up, because focus may be applied for some processes on those higher-risk index petitions.
- Procedure Standardization: Increase in transparency for the taxpayer, because the Audit procedure is standardized and new technological tools are incorporated for each taxpayer segment.
- Documentation Required: Elimination of requesting history from the taxpayers that is already in the hands of the SII through other revision processes. This is thanks to the coordination of focalized revisions and management aimed at taxpayers.

ii) Benefits for the Tax Administration

Human Resources

- Team Creation: Creation of work team specialized in attention and with the necessary competencies for the Taxpayers examined.
- Quality of Work Life: Improves quality of life inside the Service, due to changes and reconditioning of current spaces and furniture used by the officers.
- Institutional Identity: The officers' commitment is strengthened with SII's work, when perceiving that the institution is important for the country, given the magnitude of the investment aimed at improving operations.
- Allocation of Examiners: An increase in the allocation of Examiners for Attention, assistance and examination is achieved.

Attention and Assistance

- Procedures in Offices: Lowers congestions in procedures at Regional Offices and more time is devoted to attention per taxpayer and best work practices are shared and replicated.
- Points of Attention for Procedures: The amount of points of attention for procedures are increased at all Regional Offices.
- Taxpayer Assistance: An area specialized in Assistance is established at the Regional Offices, Internet contents are redesigned and improvements are made to the Help Desk.
- Integration of Attention with Examination: Increase in the degree of integration of Attention and Assistance with Examination; because if there is a procedure in Attention and Assistance that requires Control, it is immediately passed on to another instance for its resolution.

Examination

- Feeling of Control: The feeling of control increases in the Taxpayer, because specialized teams are set up, Mass Examination products are implemented that allow increasing coverage and increase the degree of coordination between the internal areas of the Service.
- Control according to Taxpayer characteristics: Differentiated controls are implemented that have, as consequence, a greater effectiveness in examination. For Persons, Micro and Small Enterprises examination is aimed at Mass Examination and Examination Presence. For Medium and Large Enterprises controls are aimed at Selective Examination. Knowing the Taxpayer: Business knowledge is increased due to the specialization of officers for adequate controls to each taxpayer segment.
- Examination Quality: A greater quality Examination is implemented and the degree of tax certainty increases; because the teams specialized in Audits incorporate professionals of different specialties who participate from the beginning of the examination.
- Regional Vision: Knowledge about each Office's reality is substantially improved at the central level; given that the examination plans and programs adjust to variables that consider the specific characteristics of each Region of the country; for example, main businesses per season in the region and/or amount of attention posts at the Regional Office.
- Communications and Generation of Networks Inside the SII: Communications and feedback are strongly increased within the Regional Office, between

Regional Offices and between these and the National Directorate (Central level).

- **Central Coordination:** Coordination increases between the Legal, Standards and Examination areas; which allows increasing tax quality and certainty of Audits and revisions.
- **Collaborative Work;** Collaborative work is encouraged between officers of the same and different groups; because efforts and processes must be integrated for the Taxpayer's benefit. (Replacement teams, Group meetings to identify situations to be improved, development of Workshops and Internal Training, etc.).
- **Planning, Management and Control:** Regional planning and management efficiency is increased, because a vision per taxpayer segment allows to adapt the workload of all processes that involve the segment. This allows a more strategic vision of the use of the control and Assistance processes.
- **Continuous improvement:** The revision, results analysis and general assessment process is incorporated as a permanent practice of all business processes carried out by the tax administration, which allows to make its actions profitable and will maintain long-term quality standards.

6. Costs of the segmented focus

i) Costs for the Taxpayer

- **Execution of Works:** Increase in the degree of temporary taxpayer dissatisfaction with the execution of civil Works; because the Taxpayer had to be served elsewhere or in facilities under repair.
- **New Service Organization:** Greater degree of dissatisfaction, because if the process examiner was known, the same would go to him and was served directly, regardless of what segment had to see the case.

ii) Costs for the Tax Administration

- **Infrastructure Adaptation:** High cost to enable and readapt physical spaces. In some cases and because the staff continues executing its duties the lease of temporary spaces is required.
- **Temporary Adjustment of the Examination:** The effective control carried out (amount of taxpayers examined) during the implementation of the project, undergoes significant reductions, which in some cases reach approximately 50%. The use of this release of resources was destined to additional training

work for the new tasks, change management workshops and Project dissemination.

- Socialization and Internal Dissemination: Creation of new work teams at the central level that visit and are in permanent contact with all Regional Offices in the country, during the whole project development cycle. This is for the assessment of regional tasks and needs to face the change, adaptation of local administrative procedures, internal coordination schemes, etc.
- Training of Officers: 50% increase in normal openings for training of officers assigned to control as well as to attention and Assistance, due to the specialization of duties and updating of knowledge.
- Change Management: Contracting of HR experts to accompany the change in all its stages.
- Dissemination to Taxpayer: Lecture cycles are added for Business Associations with a high dissemination cost and entering into agreements with Professional Associations.
- Work environment: Destine efforts to maintaining the work environment, due to the characteristics pertaining to a change process.

7. Results after one year

One year after implementing the segmentation project, the following progress may be highlighted:

- The average amount of times people have to come to SII offices to complete a procedure goes down from 1,8 to 1,2 times.
- 5% increase in the amount of procedures or self-attentions made by the Taxpayer through the Internet platform.
- In average, there is a 40% drop in the amount of Taxpayers that must pass to a verification process, focusing the attention in this second stage on more substantial problems, where this is no longer an additional step in the procedure.
- An additional 50% in collections for the Persons and Micro and Small Enterprises segment due to communication of differences in the VAT Operation process.
- 16% increase in coverage on established businesses, through examination presence actions in the field, which increases the feeling of control.

- 37% increase in the amount of taxpayers under Mass Examination and 42% increase in effectiveness measured according to performance.

8. Conclusions

- The Taxpayers Segmentation project, as other change processes, brings along big disturbances internally and externally; that is why it is indispensable that consideration be given at all times to all those involved as a critical success factor.
- Differentiating between Taxpayers allows providing a better Service quality (Attention, assistance and examination); because the same problem has a different impact depending on the taxpayer type, with differentiated solutions and performance indicators (collections, total sum, etc.).
- Focus efforts by Taxpayer type, allows knowing more about the Taxpayer's business and grants greater legal certainty to the Audits that are executed.
- Although the Taxpayer Segmentation project provides important results in the short term; nothing guarantees that these will be repeated in the following cycle; and, therefore, the focus should be a continuously changing process (like the real world is), but one the organization is prepared to face.