

PRIVATIZATION IN THE AREA OF TAX ADMINISTRATION: AN OVERVIEW

Peter D. Byrne

ABSTRACT

A nation's finances depend on tax and customs administration, so such administrations would seem to be inappropriate candidates for privatization. Nevertheless, some countries have experimented with privatization because their tax administrations have become centers of corruption and incompetence. Privatization presents opportunities, but also challenges and dangers.

One challenge is to isolate functions that can be delegated to the private sector. This paper discusses several aspects of tax and customs administration that might be considered for privatization. Some countries' experiences are examined, and suggestions are offered for countries that are considering privatization.

Subcontracting with private entities may be considered as a transition to a more efficient tax authority run by the state. Such a tax authority should utilize several private sector strategies that enhance efficiency.

Peter D. Byrne is Deputy Director of the International Tax Program at Harvard University.

PRIVATIZATION IN THE AREA OF TAX ADMINISTRATION: AN OVERVIEW

Peter D. Byrne

Tax administration has been caught up in the tide of privatization sweeping the world during the last decade. The logic is the same as in other types of privatization: the private sector should be able to carry out certain duties more efficiently than the public sector.¹ However, most candidates for privatization are enterprises that historically have been private. The enterprises may have ended up in government hands through expropriation, or perhaps to save jobs when private owners could no longer operate at a profit. The enterprise may have been created by the state to fill a perceived need (in a "strategic" industry, for example). When the foregoing types of operations are privatized, it is generally understood that private ownership is intrinsically superior and will be permanent.

Few activities, however, seem as inappropriate for private management as tax administration. The profit motive appears out of place for an organization charged with extracting money from the population. So, why is privatization under discussion?

First, privatization in the area of tax administration is a more traditional concept than one might think. The areas of voluntary compliance or employer withholding, for example, are undramatic but clear examples of participation by the private sector in tax administration.²

Second, there is immense dissatisfaction in many countries with the operation of the tax administration. What might be considered inadvisable under normal circumstances becomes reasonable when significant change is urgently needed.

¹ See Butler, Stuart M., "Turning Privatization from a Concept into a Program", *The Privatization Review*, Winter 1987.

² Tax farming provides another example of private participation in tax collection with a long history. See Stella, Peter, "Tax Farming: A Radical Solution for Developing Country Tax Problems?", *IMF Staff Papers*, Vol. 40, No. 1, March 1993.

Third, no one proposes total privatization. The challenge is to isolate parts of tax administration that can be privatized, but allow proper supervision from public entities.

Fourth, it might be useful to look at "privatization" in a broader sense. Even in areas where literal privatization is difficult or impossible, management practices used in the private sector may be implemented by a tax administration.³ Unfortunately, this sort of "public privatization" often is not feasible, which may lead to calls for actual privatization.

In analyzing the efficiency of a reform, especially when the proposed reform is privatization, one must look at "efficiency" from a societal point of view, not just the tax administration's point of view.⁴ For example, a tax administrator might be tempted to hire new auditors as long as they bring in revenue in excess of their salary. This may be sensible from the tax administration's viewpoint; however, it is the duty of the tax administration to consider the expense incurred by the taxpayer. Therefore, when "efficiency" is analyzed, compliance costs must be taken into consideration. In addition, the tax administration must make a serious effort to calculate the real cost to the government of performing a function. An employee's salary is not the only issue; benefits, opportunity costs, office space and equipment, support staff, etc. must also be factored in to provide a realistic comparison. Finally, the tax administration must factor in the cost of monitoring the private contractor.

The Root of the Problem

It is no secret that privatization in tax administration is under discussion because there is a significant problem. The developing country tax administration that operates efficiently is still the exception. Too often the tax administration is overstaffed with incompetent personnel. Low

³ Ramirez Acuna, Luis Fernando, "Privatization of Tax Administration," Improving Tax Administration in Developing Countries Ed. Bird and Casanegra (Madrid, 1992) p. 394. Many items included in this paper are discussed in Mr. Ramirez's article. This paper attempts to complement Mr. Ramirez's excellent article.

⁴ See Sanford, Godwin and Hardwick, Administration and Compliance Cost of Taxation (Fiscal Publications, BATH BA2 SAR 1989) pp. 10-23.

performance standards combine with low salaries to make corruption almost inevitable. The reasons for this dismal situation are varied. In some cases, wage levels are linked to and limited by low civil service pay scales. Unions often impede any attempt to discipline or dismiss employees for incompetence or corruption. In other cases, the tax and customs administrations are used as resources for political patronage. Turnover due to political changes discourages professionalism, especially if political supporters traditionally have sought such positions because of the opportunities for illicit activity.⁵

The general level of incompetence often reflects the government as a whole. In the case of tax and customs, the problem is particularly serious because the opportunities for corruption are so numerous, and because the rest of the government depends on tax and customs revenue for its operations. In addition, ineffective tax and customs administration causes upward pressure on rates to make up for lost revenue. Corruption and inefficiency in the tax and customs administration also can cause the citizens to lose confidence in their government.

Some commentators emphasize modernization and greater professionalism in the tax administration⁶. The general idea is to make the tax administration autonomous, with its own pay scale and standards. This echoes the approach taken by many countries to assure the competence and integrity of the Central Bank.

Peru is a dramatic example of this approach. The Superintendencia Nacional de Administracion Tributaria ("SUNAT") was established in 1988, but real reforms took place in 1991. Between March and September of that year, SUNAT's workforce was reduced from over 3000 to 800⁷. This downscaling was achieved through voluntary resignations (with monetary

⁵ Stories abound of low-level customs and tax positions being sought by a new government's supporters. Opportunities for enrichment are the only explanation.

⁶ See Jenkins, G., "Modernization of Tax Administrations: Revenue Boards as an Instrument for Change," *Bulletin for International Fiscal Documentation*, Vol. 48, No. 2, IBFD Publications BV, Amsterdam, The Netherlands, February 1994.

⁷ See Fuentes Acurio, S. et. al., "Reform of the Tax System and Administration", paper presented at the IDB

incentives) and competency tests. The "new" SUNAT implemented higher standards and salaries competitive with the private sector. SUNAT now is a place where recent university graduates aspire to work. SUNAT obviously has hired many new people to replace those who departed. Notwithstanding their lack of experience, the investment in new personnel appears to be paying off: revenues as a percentage of Gross Domestic Product nearly doubled in the first three years of the new institution.

This is an example of "privatization" in the sense of reforming the tax administration to function more like a private enterprise. Any private enterprise would appreciate the logic of paying higher salaries to enlist more talented professionals when it can be demonstrated that the professionals will bring in money far in excess of the salaries they demand; it is a simple cost/benefit analysis. However, when unions are involved, tax officials earn large sums through corrupt activities, and many taxpayers are happy because they can minimize their tax liability through unofficial payments, the forces of inertia are daunting. Many politicians will balk at the notion of throwing thousands of employees out of work, no matter how incompetent or corrupt.

For better or worse, the Peruvian approach often is not politically feasible. True privatization may offer a reasonable alternative in such cases.

Prospects for Privatization

1. Taxpayer Preparation of Returns (Voluntary Compliance). Some countries still have an official assessment system for income tax where the tax administration calculates each taxpayer's liability. Needless to say, this involves intensive labor.⁸ The extensive contact between tax administrator and taxpayer provides ample opportunities for corruption. As a result, most countries already have a voluntary compliance system. The shift to voluntary compliance means that more resources must be allocated to auditing and taxpayer education. However, most

Seminar, Tax Reform in Latin America and the Caribbean: Achievements and Prospects (July 1993).

⁸ Leon Yudkin, A Legal Structure for Effective Income Tax Administration (Tax Technique Handbook, Harvard Law School, 1971)

tax administrations have found that the cost is more than offset by the resources that are saved by having the taxpayers prepare their own returns.

2. *Withholding/Reporting.* Employer withholding on wages for income or payroll taxes, or withholding on dividends, interest or other payments is another form of privatization. The withholding agent is charged with the responsibility of collecting amounts that correspond to tax liability owed by another person.⁹ The requirement to withhold may be viewed as a simple condition for doing business. However, businesses may be more favorably inclined to cooperate if there is a benefit for them. Normally, the benefit is the right to retain the money for a period before turning it over to the government.

For purposes of both taxpayer preparation of returns and withholding, the compliance cost to the private sector must be considered. Nearly all countries have decided that these mechanisms should be implemented, but this does not relieve the tax administration of its duty to facilitate the process for the taxpayer. Educational programs and taxpayer assistance (discussed below) ought to be provided.

3. *Filing Returns/Payment of Tax at Banks.* The most significant trend in tax privatization is authorizing banks to accept tax payments.¹⁰ There are several compelling reasons for this movement: the mail service is unreliable; tax offices are too busy and inconveniently located; and computerization/electronic transfers make the arrangement feasible. As noted above, the incentive to the bank ordinarily is use of the money for a brief interval, so there is little expense to the government. Banks also may use this service as an opportunity to attract new customers. The tax authority will benefit from the fact that the banks will be less likely to make mistakes than the taxpayers.

⁹ Bolivia imposes additional requirements. Businesses must calculate the amount of tax to be withheld from employee's salaries after the employees submit value added tax receipts for credit.

¹⁰ Ramirez Acuna, note 3 supra.

While this arrangement has been largely successful, there are lessons to be learned from the experience of other countries. For example, payment at the tax office should not be an option in a bank payment system.¹¹ This not only complicates the system unnecessarily, but also distracts the tax office from other tasks.

There is also the temptation to allow payment of tax at any bank branch in the country. Computer experts correctly point out that this is possible from a technical point of view. However, from a practical point of view, much less can go wrong where the taxpayer must choose one bank to be his paying bank. In addition to being simple, this system also introduces a useful psychological element: the paying bank will normally be the taxpayer's principal bank, and the taxpayer will be more careful about paying taxes to remain "respectable" in the bank's view. An efficient system for payment at banks should provide incentives based on number of returns received, so that the banks will not focus only on larger taxpayers. Refunds present another problem area. Banks should only be authorized to issue refunds if substantial safeguards are in place.

4. *Printing, Storage, Etc.* Printing and storage are two examples of duties that may be prime candidates for privatization. In many countries, government operated printers or warehouses may be very inefficient. It may be difficult to subject such operations to a cost-benefit analysis because the true costs are hidden, or because tradition makes it difficult to look at other options. Nevertheless, the experience of several countries demonstrates that great savings might be derived by privatization of these and other similar operations.¹²

When analyzing warehouse cost (or analogous costs), opportunity cost ought to be considered. For example, it may not be accurate to compare private storage with the expense of

¹¹ Mexico is one example in which the tax administration has authorized banks to be the only recipients of tax payments. See Gil Diaz, F., The Subsidiarity Principle Applied to Tax Administration, Conference on Information Technology and Fiscal Compliance, Harvard University, November 5-6, 1992.

¹² The author is advised that Jamaica's tax from printers, now privatized, turn a profit. Prior to privatization, the same basic operation cost the government more and operated at a loss.

a government-owned warehouse if overhead (such as the cost of the warehouse) is not included. A government might consider selling or leasing the warehouse to a private entity- the overall expense may turn out to be far less.

In the area of printing, the entire expense of the printing department must be included, not just the marginal cost of certain projects. When office space and equipment, personnel and overhead are considered, it may be sensible to downscale a printing department and subcontract most projects. An option to consider for certain projects, such as tax forms, is to issue specifications and allow any printer to do the job and sell the item to the public at a fixed price.¹³ The question here is whether the additional compliance cost offsets the savings to the tax administration.

Any other task, from painting to plumbing, could be subjected to the above analysis.

5. Valuation of Assets. Some countries have had success contracting out the valuation of certain items that constitute the tax base. The most often cited example of this is aerial photography for purposes of calculating property tax. Theoretically, this practice facilitates rapid assessment of land size, use and value without problems of access. Care must be taken, however, to ensure that this system does not become an excuse for further delays in collection of property tax. Most delays in collection of property tax arise from a lack of political will, not from inaccurate valuation.

The emergence in several Latin American countries of an alternative minimum tax based on assets may provide another appropriate candidate for private valuation.¹⁴ Needless to say, it is beyond the capacity of most tax administrations to place a value on the assets of each business

¹³ Several Latin American countries have privatized some aspect of printing operations or form distribution. See Ramirez Acuna, note 3 supra, and Gil Diaz, F., note 11, supra.

¹⁴ Byrne, P.D. "The Assets of Tax in Latin America - No Credit Where It Is Due" *Tax Notes International*, August 15, 1994 at p. 533. This point perhaps fits more comfortably in the audit category since value for purposes of this tax ordinarily is based on book value.

in the country. Therefore, the administration must rely on either self-assessment or some other type of private valuation. Appraisal by private professionals may be considered.

6. Computer Systems. The growing importance of computers in tax administration cannot be doubted. By now all national tax administrations surely use computers for some tasks. The question is whether some computer tasks can be more effectively performed if done privately rather than by the tax administration.¹⁵ The logic is that computers are so critical that the most capable computer experts should be utilized, and they are in the private sector. In certain areas such as data entry, a private contractor will have more flexibility to provide the necessary incentives for quick and accurate performance. Moreover, the private sector can adapt to advances in computer technology more rapidly than the public sector, and greater use of private contractors will make the advances available for use more quickly.

To be sure, efficient use of computers should be a focal point for any tax administration. However, privatization must be handled carefully. First, confidential information often will be part of a project, and disclosing this information to a private contractor will be problematic. Second, the vital nature of computers may argue against privatization; rather, efforts should be made to bring very strong computer experts into the tax administration. This is a clear case where not paying adequate salaries will result in disproportionate revenue loss. There may always be good reasons for contracting out some computer work, but having strong computer experts at the tax authority will help to ensure that such contracts are sensible.

7. Education. A significant part of any tax administration's duties should be facilitating compliance. Not only can this enhance revenue, but it also can reduce taxpayer irritation with the tax system. One part of facilitating compliance is streamlining the forms and procedures for filing; another is educating the taxpaying public.¹⁶ Television may be the best means to reach a

¹⁵ Computer functions may be shared between the tax administration and the private sector. For example, the function of data entry may be done by banks and processing by the administration. Countries electing to do this are Colombia, Bolivia and Ecuador. See Ramirez Acuna, note 3, supra.

¹⁶ The National Superintendency of Tax Administration (Superintendencia Nacional de Administracion Tributaria,

broad spectrum for the more basic issues. For more complex issues, seminars might be organized. In either case, private contracting may be the preferred option. For television spots, there may be a competitive bidding procedure, designed to utilize private companies' expertise in television production, but at the same time ensuring the desired content. Seminars may also be arranged on a competitive basis. University professors or tax professionals who have considerable experience may be appropriate for such seminars. In some cases, tax professionals may be willing to perform such duties at no charge as a matter of public service, or for public relations purposes. In most cases, a tax administration representative should participate in order to assure that the seminar explains how to comply with the tax law, not how to avoid it.

For such television spots or seminars, private participation is desirable because private persons have more experience in the area and therefore can do a better job. In addition, such experience should save money, because doing the project in-house would involve considerable start-up costs. Performance should be monitored, and successful participants should be rewarded with further contracts. After a few years, the projects can be evaluated to determine whether the tax administration should develop its own capacity, or should continue to use private contractors.

Another area falling under the general heading of education is taxpayer assistance. Whether by telephone or in person, this involves answering taxpayers' questions. An evaluation should be undertaken to determine whether the tax administration has the resources to perform such duties itself, and at what cost. After such evaluation, it may be decided that a private entity could perform the task more efficiently. When evaluating the cost of subcontracting in this area, the cost to the tax administration of adequate monitoring should be included.

8. Return Certification. Many taxpayers routinely pay private tax experts to prepare their returns. This practice benefits the tax authority because it reduces errors. However, return preparers always want to save their client money. This often results in aggressive tax planning,

SUNAT) of Peru implemented a campaign of public information that sought to make all taxpayers aware of their obligations and the work of SUNAT. See Fuentes Acurio, note 7, supra. Mexico also has undertaken a broad information campaign.

and occasionally in unethical conduct. The question thus becomes whether the positive effects of private tax preparation can be preserved while eliminating the negative.

One option would be to require an accountant's signature on the tax return of any taxpayer with assets or turnover above a threshold amount.¹⁷ Expanded use of tax professionals would reduce errors, and tax preparers may do their job more carefully if they must sign.

Return certification is a more aggressive possibility. The tax administration can establish a registry of authorized tax preparers (perhaps certified public accountants) whose certification will result in a lower level of scrutiny by the tax administration. Unsatisfactory performance (judged by taxpayer errors not detected, or otherwise not representing the government's interests adequately) will result in being deleted from the registry.¹⁸

For this approach to work, the appropriate incentives must be in place for the tax preparer to be willing to do this type of work, for taxpayers to use the procedure voluntarily, and to ensure that the government's interests are protected. This means adequate compensation for the tax preparer. Whether the compensation comes from the taxpayer, government, or both, must be carefully considered. Charging the taxpayer discourages use of the system, and payment by the government exhausts resources (though it must be viewed in light of the resources this procedure saves, and the additional revenue collected). To encourage tax preparers to exercise adequate care, it has been proposed that tax preparer, rather than the taxpayer, be held liable for the amount of understated tax.¹⁹ The harshness of this penalty (in cases other than fraud by the tax preparer, which should be treated as a crime) casts doubt on whether it would be enforced.

¹⁷ See Ramirez Acuna, note 3, supra.

¹⁸ The tax administration may use chartered accountants for this purpose. See Terkper, S., "Improving the Accountancy Content of Tax Reform in Developing Countries", *Bulletin for International Fiscal Documentation*, Vol. 48, No. 1, IBFD Publications BV, Amsterdam, The Netherlands, January 1994.

¹⁹ Ramirez Acuna, note 3 supra, at p. 388.

Tax preparers on the registry must be subject to guidelines so that the tax authority can monitor their performance. In addition to rules regarding fees, there must be records covering (among others) quantity of returns certified, additional revenue collected because of the certification, and taxpayer complaints. Of course, the tax administration should not surrender its ultimate assessment authority, and must carry out performance spot checks.

9. Advance Rulings. In many countries, taxpayers are permitted to submit a proposed transaction to the tax authority for its opinion ("advance ruling") on the tax characterization of the transaction. Normally the taxpayer will pay a fee for the opinion, and the opinion will be binding on the tax authority as long as the transaction is carried out in the manner set forth in the proposal.²⁰ If the taxpayer disagrees with the opinion and wishes to challenge it in court, it may do so. This practice is desirable because it gives taxpayers a vehicle to achieve the predictability so important for investment decisions. It is advantageous for the tax authority because more transactions can be monitored at less cost (because of the fee). A tax authority may not have the resources, however, to manage an advance ruling system efficiently.

This type of advance ruling combines elements of private tax planning and assessment by the tax authority. Because advance rulings already contain elements of private tax planning, they provide a good possibility for privatization. Under ordinary private tax planning by tax professionals, the tax authority must examine the tax treatment closely because the tax professional is paid by the taxpayer to find a favorable solution. Private tax professionals will be more neutral in their analysis if they are paid by the tax authority, their work is subject to review, and future work is conditioned on satisfactory performance.

To implement a privatized advance ruling scheme, it will be necessary to establish a fee schedule for taxpayers, guidelines for format and payment to private contractors, and a review mechanism that protects the tax authority's interest and creates a history of the contractor's work to use in deciding whether to employ such contractor in the future.

²⁰ The Private Letter Ruling system in the United States has a long and useful history.

10. Taxpayer Audit. The audit function goes to the very heart of tax administration, and therefore presents a more controversial proposal for privatization than any of the foregoing. In addition, items such as certification of returns or advance rulings are voluntary on the part of the taxpayer, and rights to confidentiality can be explicitly waived. There is no such voluntary aspect to audit. Nevertheless, unsatisfactory audit capacity in the public sector of so many developing countries has caused serious consideration of this controversial concept. The close contact between auditor and taxpayer, combined with the low wage scale for tax inspectors, provides a perfect environment for corruption.

The serious problem with confidentiality must be overcome before other issues can be addressed. One option would be to solicit a limited waiver from the taxpayer after the taxpayer has been selected for audit. In many countries this mechanism is used with respect to the statute of limitations. A less desirable option is to shield the taxpayer's identity, but this may make most audits ineffectual.

If the confidentiality problem is overcome, other obstacles remain. For example, private auditors will be subject to many of the same pressures that lead to corruption in the public sector. Therefore, tax administration must review the performance of the private auditors with care. Such control may be more effective than efforts to control corruption within the tax administration because there is more distance between the auditor and the reviewer, institutional corruption cannot be protected through unions or civil service rules, and the private auditor may consider his professional reputation more important than government tax agents do.

For the foregoing reasons, private audits may occasionally be sensible. However, it is a less desirable option than ridding the tax administration of the conditions that cause ineffective audit. Resorting to private audits as an interim measure may be necessary to move the tax administration in the direction of reform.

A final issue is how private persons can help the tax administration identify tax cheats for audit. Several countries offer rewards (generally a percentage of the recovery) for information

leading to greater revenue.²¹ This policy not only discourages evasion, but also discourages flaunting of tax evasion. This latter point is important, because nothing embitters honest taxpayers more than the knowledge that others are not supporting their share of the burden.

11. Collections. Many tax administrations suffer from an inability to collect taxes after they have been assessed. At times, collection is frustrated even after the tax authority has prevailed in court. This may be a result of simple inefficiency or corruption in the tax administration, but often is the result of ineffective performance by the legal system, both law enforcement and the courts. For this reason, it would be better to attack the root of the problem, which involves imposing meaningful interest and penalties, empowering the tax administration to do more functions itself (close businesses and seize property) as well as creating a separate, efficient tax court. Where the foregoing options are not politically feasible, unusual measures may be necessary to break the vicious cycle in which taxpayers do not pay what is due, and demoralized tax officials do not pursue collections vigorously because there is little hope of success. Privatization may offer some improvement.²²

One candidate for privatization is the legal work associated with collecting an assessment. Especially where the amount of money is large, it is a sensible investment for the tax authority simply to hire an experienced outside lawyer (the United States hires top quality outside lawyers for certain claims, though not normally in the tax area). Compensation may be performance rated.

A more extreme option is simply to sell to private persons the right to a taxpayer's debt.²³ The government receives all or most of its money immediately, and collecting the tax debt becomes the sole concern of the private contractor. A private party may be able to collect the debt

²¹ In the United States, jilted spouses and lovers are the most willing participants in this program.

²² Some interesting approaches have been proposed. See Hood, C., "Privatizing UK Tax Law Enforcement?", *Public Administration*, Vol. 64, Autumn 1986.

²³ See Hood, C., note 22, *supra*, and Yudkin, note 8, *supra*, at p. 41.

more efficiently because it is not subject to the same limitations as the government. Obviously the private contractor has more incentive to collect quickly than a tax official who will not benefit directly from the collection. For this scheme to function, there must be adequate safeguards.²⁴ First, there must be control to ensure that the private collector does not use illegal means (e.g. threats of physical violence) in his efforts. Second, the sale of the tax debt cannot be an opportunity for the taxpayer to purchase his own debt at a discount.

12. Pre-Shipping Inspection (Customs). One aspect of customs enforcement has been privatized already in many parts of the developing world, and that is pre-shipping inspection ("PSI"). Several large, international companies provide this service, which involves inspection of international cargo for quantity, quality and legality, prior to import. After the cargo is inspected, it may proceed to the border (often in sealed containers). The PSI companies charge the importer a fee for the service, usually based on the value of the shipment.

The PSI concept has several components. First, customs is often the most corrupt government institution. The potential for bribery is immense, because the money involved is considerable (an importer saves both customs duty and value added tax) and the borders are often remote and difficult to control. The PSI company creates a record of the shipment that facilitates control. Second, it is supposed that the PSI companies have computer capacity and technical expertise in valuation that many customs agencies lack. The PSI companies are less subject to corruption because they have their international reputation to protect, and because their fee is based on value, which discourages under-valuing of goods. Third, proper use of the PSI mechanism involves forwarding the import information to the tax authority, which should improve value added tax enforcement.

The PSI system has been deemed a success in many situations. However, the approach is not without flaws, and illustrates some of the problems that can arise in a privatization. Most important, the PSI mechanism is useless if the customs administration does not use the information

²⁴ See Ramirez Acuna, note 3, supra.

and shipments continue to pass customs after a bribe is paid. As in other potential areas for privatization, the contractor's efficient work may be frustrated because of a lack of political will or competence in the government. Another common flaw in PSI is using more than one PSI company. When the PSI companies must compete for business, an importer can play the PSI companies against each other. This drives valuations down and can encourage corruption. This lesson should be applied to other privatization possibilities: private contractors should never be put in the position of competing with each other in such a way that the government's interests are compromised.

13. Customs Warehouses. Privately owned and operated customs warehouses have been instituted in some countries. The customs administration's role is limited to inspection and control. It is possible to arrange the warehouse operations so that the various warehouses compete to offer superior service. The privately operated customs warehouses have been favorably received, and can raise revenue for the government.

14. Internal Audit. One of the most difficult areas of official corruption to eliminate is the corruption of those charged with exposing internal corruption. It never a popular duty and can be dangerous if done well. Therefore, whether in the area of tax or customs, it must be performed by an elite group, and private companies may be the best source of such a group.²⁵ Unlike an internal anti-corruption group, a private organization will have the necessary distance from the people it is controlling. In addition, the private company can simply be dismissed for inadequate performance.

²⁵ Mexico used this approach to help root out corruption in customs. Gil Diaz, Footnote 11, *supra*.

Conclusions

As can be seen from the foregoing, there are a number of areas of tax administration where a government might consider privatization. Some are more practical than others, and some tax administrations may determine, after analyzing privatization possibilities, that no further privatization is warranted. Such an analysis should nevertheless be undertaken.

The most realistic possibilities for privatization at present (other than self-assessment and withholding) are authorizing payment at banks, and hiring outside contractors to do specific tasks, such as printing, or lawyers to prosecute cases. In the area of customs, pre-shipping inspection companies are already widely used and warehouses should be scrutinized for privatization potential. More aggressive efforts to privatize might consider the concept of return certification or contracting out advance rulings. The consideration of these options should include the fact that fewer responsibilities will enable the tax administration to focus its efforts and do a better job in areas remaining under its control.

The areas of private auditing or computerization are initially appealing, but involve several problems, such as confidentiality.

While considering privatization, it should be noted that some tasks are appropriate for the private sector, but that certain fundamental areas of tax administration naturally belong in the public sector. For areas such as audit and certain computer functions, privatization should only be considered as an interim measure to correct serious problems. Eventual overhaul of the tax authority is preferred.

In all situations, the introduction of private-sector concepts of operating should be studied. Dramatic revenue growth has been registered in many developing countries by increasing pay to attract more qualified tax and customs administration employees. Any efficient private company would increase the pay scale where it could be demonstrated that the company would recoup the amount many times over. Merit must be the major factor for advancement, and reasonable

performance must be a prerequisite to keeping one's job. Unfortunately, many tax administrations are paralyzed by tradition, civil service rules or unions. A different danger is presented by too much change in personnel for political patronage purposes. In general, only the top few tax officials should be political appointments. The key is to balance safeguards against political interference in personnel decisions against the ability to dismiss or reassign ineffective personnel. Autonomy of the revenue authority can help achieve these goals.

Finally, some problems cannot be solved through any sort of privatization because the problem is legal or outside the tax administration (in the courts, for example). In such situations, the only recourse is to push for legal reforms, including establishment of a tax court. Other branches of the government may need to be reminded that their revenue depends on such reforms, and that such reforms more than pay for themselves without increasing levels of taxation.

BIBLIOGRAPHY

Butler, Stuart M., "Turning Privatization from a Concept into a Program", *The Privatization Review*, Winter 1987.

Fuentes Acurio, S. et al., "Reform of the Tax System and Administration", Seminar on Tax Reform in Latin America and the Caribbean: Achievements and Prospects, July 1993.

Gil Diaz, F., The Subsidiary Principle Applied to Tax Administration, Conference on Information Technology and Fiscal Compliance, Harvard University, November 5-6, 1992.

Hood, C., "Privatization UK Tax Law Enforcement?", *Public Administration*, Vol. 64, Autumn 1986.

Jenkins, G., "Modernization of Tax Administrations: Revenue Boards as an Instrument for Change", *Bulletin for International Fiscal Documentation*, Vol. 48, No. 2, IBFD Publications BV, Amsterdam, The Netherlands, February 1994.

Ramirez Acuna, L.F., "Privatization of Tax Administration", Tax Administration in the CIAT Countries (Madrid, 1992).

Stella, Peter, "Tax Farming: A Radical Solution for Developing Country Tax Problems?", IMF Staff Papers, Vol. 40, No. 1, March 1993.

Terkper, S., "Improving the Accountancy Content of Tax Reform in Developing Countries", *Bulletin for International Fiscal Documentation*, Vol. 48, No. 1, IBFD Publications BV, Amsterdam, The Netherlands, January 1994.