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Integrating a Unified Revenue  
Administration for Tax and Social  
Contribution Collections:  
Experiences of Central and Eastern  
European Countries

*Peter Barrand, Stanford Ross,  
and Graham Harrison*

## IMF Working Paper

Fiscal Affairs Department

### **Integrating a Unified Revenue Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries**

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Authorized for distribution by Jean-Paul Bodin

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#### Abstract

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During the 1990s, a failure to collect social contributions in Central and Eastern European countries deprived pension schemes of resources needed to meet their obligations. Based on these countries' experience, this paper examines the trend to increase coordination of tax and contribution collections. It sets out the rationale for establishing a unified agency as the best long-term strategy, and discusses policy and administrative issues in implementing this approach. The appendix presents three case studies for Albania, Bulgaria, and Romania, which are establishing a unified revenue administration. Another case study is presented for Sweden, which successfully integrated tax and social contributions collections in the 1980s.

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**ABBREVIATIONS**

CEE	Central and Eastern Europe
EU	European Union
FAD	Fiscal Affairs Department
GDP	Gross Domestic Product
GDT	General Directorate of Taxation
HII	Health Insurance Institute
ILO	International Labor Organization
IMF	International Monetary Fund
IOTA	Intra-European Organization of Tax Administrations
ISSA	International Social Security Association
LTO	Large Taxpayer Office
LTU	Large Taxpayer Unit
MOU	Memorandum of Understanding
NAFA	National Agency for Fiscal Administration
NHF	National Health Fund
NHIA	National Health Insurance Agency
NHIF	National Health Insurance Fund
NPF	National Pension Fund
NRA	National Revenue Agency
NSI	National Statistical Institute
NSIB	National Social Insurance Board
NSSI	National Social Security Institute
NTB	National Tax Board
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
SC	Social Contribution
SIAP	Social Insurance Administration Project
SII	Social Insurance Institute
SIN	Social Insurance Number
SUNAT	Tax Administration of Peru
TIN	Tax Identification Number
UIF	Unemployment Insurance Fund
URA	Unified Revenue Collection Authority
VAT	Value Added Tax
WB	World Bank

## I. INTRODUCTION

There is increasing awareness that the financial sustainability of pension and other social funds depends on achieving more effective collection of contributions. Many transition countries are struggling to find an effective collection strategy suited to the diversity of pension schemes in use or being implemented.

A failure during the 1990s to collect the full amount of contributions required by law in several Central and Eastern European (CEE) countries has either deprived pension schemes of the resources needed to meet pension obligations, or produced a drain on general revenues that could have been used for other important government purposes. Too little was done during that decade to address these problems, and the issue is now becoming central to many national pension debates. Significant risks exist for countries with insufficient levels of contribution collection compliance, some of which are scheduled to enter the European Union (EU). Opinion in these countries is divided over the merits of collection of contributions directly by pension institutions or fund managers versus collection by a unified revenue administration. Both approaches have been implemented in EU countries. Thus, while France and Germany have a tradition of parallel collection systems, Sweden has a unified revenue administration, which has also been seen as a more effective approach by other advanced revenue administrations in the OECD, including Canada and the United States.

There is increasing discussion of this topic. In April 2003, to strengthen the coordination of their technical assistance to CEE countries, the IMF and World Bank organized a workshop in Washington to discuss the merits of existing approaches to modernizing collection and the challenges of implementing more integrated approaches. This working paper is an outgrowth of the discussion papers prepared for that workshop.<sup>2</sup>

Section II places the role of collections within the context of the overall administrative structures of pension institutions and revenue administrations. It explains the significant trend for countries to increase coordination of tax and social contributions collection, and charts international practice. Increasingly, scrutiny has focused on the relative merits of three broad approaches to collection: (1) full-service pension institutions that handle all major functions, including collection; (2) arrangements involving closer coordination between tax administrations and pension institutions, including systematic sharing of data and joint audit operations; and (3) unifying collection responsibility in a single revenue administration.

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<sup>2</sup> A draft of this paper was also discussed in November 2003, during a conference sponsored by the International Labor Organization (ILO) and the Slovenian Ministry of Labor, Family, and Social Affairs. The conference brought together social agencies, employers, and unions from CEE countries to focus on measures needed to improve contribution collection for pension schemes, whether public or private. In June 2004, the International Social Security Association (ISSA) met in Poland to discuss changes in the structure of social security administration, with concern for the efficient collection of contributions.

Sections III and IV set out the rationale for unification as the best long-term strategy for maximizing collections, and discuss key policy, administrative, and implementation issues, as well as the risks to be managed in implementing this approach. Section V concludes.

The appendix presents three case studies that discuss the recent experiences of Albania, Bulgaria, and Romania, which are in the process of unifying revenue collection within a modernized revenue administration. A fourth case study shows the successful integration of social contributions and tax collections in Sweden.

This paper is not a comprehensive survey of practices in every country. Rather, the intention is to highlight the trend toward integration of tax administration and social contribution collection within a unified revenue administration in the transition economies of CEE, and the analysis driving this trend. It should be a contribution to the widening discussion of how to improve social contribution collection systems and make pensions and other social schemes more sustainable in the years ahead.

## **II. CURRENT PRACTICE AND CRITICAL ISSUES**

This section provides a brief description of the current international practice with respect to administrative arrangements for the collection of social contributions. It places this description within the context of the overall administrative structures of pension institutions and of revenue collection agencies. Its goal is to identify critical issues and to establish why a government-wide approach is necessary to successful reforms. While much of the following discussion deals with the integration of pension contributions collection, in many countries health insurance contributions can be as important as pension contributions. The reasons supporting integration of pension contributions are equally applicable to the collection of health and other social contributions.

### **A. Basic Features of Pension Systems**

There are several core requirements for a viable pension system, including: (1) reliable collection of revenues; (2) correct calculation and prompt payment of benefits; (3) secure financial management and productive investment of assets; (4) maintenance of accurate data on contributors and beneficiaries; and (5) production of financial statements and reports that are supported with effective governance, transparency, and accountability systems.

There are two basic administrative models for public pension institutions: (1) a full-service social insurance institution model where all the major functions, including collection of revenues and payment of benefits, are managed by the pension institution,<sup>3</sup> and (2) a benefit

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<sup>3</sup> These institutions exist in many countries including Brazil, France, Germany, Japan, Mexico, and Thailand.

payment model that relies on the tax administration for collection, and focuses the role of the social institutions on the payment of benefits.<sup>4</sup>

There are, however, many variations on these basic models. For example, in the United States, while the Social Security Administration is a benefit payment agency, cash management and the investment of its assets are handled by the treasury. In other countries, such as Sweden, the benefit payment agency handles cash management and investment of pension assets. Increasingly, countries are adopting funded, individual account approaches for pensions, which utilize fund managers to collect contributions. These fund managers can be private sector organizations regulated by the government, or public sector organizations. There are variations in practice reflecting historical and cultural factors, as well as legal and political constraints particular to a country. Table 1 lists selected countries by the type of administrative collection arrangements predominantly used for public pension schemes.

Table 1. Selected Economies by Main Type of Collection Agency

Tax Collection Agencies	Social Security Organizations	Fund Managers
Albania	Austria	Chile
Argentina	Belgium	El Salvador
Australia	Brazil	Hong Kong SAR
Bulgaria	Czech Republic	Malaysia
Canada	China, People's Republic of	Peru
Croatia	France	Singapore
Estonia	Germany	
Finland	Greece	
Hungary	Indonesia	
Iceland	Japan	
Ireland	Mexico	
Latvia	Philippines	
Montenegro	Poland	
New Zealand	Portugal	
Netherlands/	Korea, Republic of	
Norway	Slovak Republic	
Romania	Switzerland	
Russia	Thailand	
Serbia	Uruguay	
Slovenia		
Sweden		
United Kingdom		
United States		

Thus, while no two countries have identical pension institutions, whatever institutional model is used, it is important that the core functions be carried out efficiently and effectively. Table 2 shows the core functions of a public pension system, the administrative systems that

<sup>4</sup> Examples of this model are found in Australia, Canada, New Zealand, Sweden, the United Kingdom, and the United States.

are needed to carry out those functions, and the broad performance criteria that are commonly used to evaluate those structures.

Table 2. Functions, Systems, and Performance Criteria for Public Pension Systems

Function	Systems	Criteria for Evaluation
1. Revenue base	Contribution collection system	Actual compared with potential collections, level of arrears.
2. Benefit payments	Benefit payment system	Error rates based on ratio of correct payments to those legally required
3. Financial management and investments	Actuarial office for projection of revenues and expenditures and financial office to control investments	Accuracy of projections in relationship to actual results; performance of investments
4. Maintenance of data	Data and information systems; computer systems and telecommunication networks	Record accuracy; usefulness of data bases; timeliness of reports
5. Reporting and accountability	Program management office that uses data and information to analyze results and issue reports	Usefulness of reports; transparency of activities

### **B. Pension System Administration Costs**

In mature, well-run social security systems, administrative costs of pension programs are often less than one percent of contribution collections (or benefits payments, depending upon which ratio is most appropriate). Even with more difficult to administer programs like disability pensions, administrative costs are often less than five percent.

A higher cost structure may be experienced in the early years of a new pension system, or when reforming an existing system to meet current needs. However, many long-established systems, especially in developing and transition countries, also display high-administrative costs with low levels of efficiency. The administrative costs of funded, individual account schemes are often relatively high in relation to the contributions collected or assets managed. In general, social insurance schemes are less costly to administer than individual account schemes. An unacceptably high-administrative cost of collection reduces the capacity to pay adequate benefits and represents a serious threat to the sustainability of pension systems.

### **C. Collection Reliability and Pension System Sustainability**

In many respects, the critical issue for a pension system is to have reliable revenue collection that establishes a strong financial base for the system. Reliable revenue flows are the key to a viable system, whether collected by the social insurance institution or the tax collection agency. Contributory pension systems cannot pay benefits unless the required contributions are made. Further, the level of assets to produce investment returns depends on the actual



collections that are made. While all of this may seem fundamental, in many countries weak collection mechanisms are evident.

One of the key aspects of any pension system is its effective coverage, that is, the proportion of people who are brought into the system as contributors and who will ultimately receive a pension as a beneficiary. Where collection systems are weak, effective coverage is weak. Indeed, if systems are not carefully managed, individuals can enter without having made the required contributions and that makes a system even weaker. If effective coverage is inadequate, government subsidization generally becomes important and, while subsidies for some social pensions may be in order, major government subsidization of a contributory scheme often undermines its basic rationale.

Another issue that is tied to collection is the adequacy of benefits. Unless contributions are reliably collected at an adequate level, benefits cannot be adequate. Moreover, benefits need to be calibrated to collections in a contributory system. If the level of collections is low, benefits need to be kept low. In this regard, it is important for policymakers to avoid over-promising the benefits that will be forthcoming based on dubious assumptions about revenues. Prescribed benefits may not be attained or may become impossible to pay when actual collections lag those erroneously forecast.

Adequacy of collection is also an issue in some advanced economies of the OECD. For example, adequacy of collection has long been a major issue in Italy, which has only recently been addressed. Even where the issue is not as apparent, as in France, it is a critical factor in shaping the design of the system. Thus, there are separate systems for various categories of workers on the premise that solidarity and compliance will be enhanced by this approach. In sum, collection issues are critical everywhere, even though the most dramatic problems are manifested in developing and transition countries.

#### **D. Historical Development of Collection Models**

The collection function can be organized in two fundamental ways. One is to run parallel collection systems, as in the case of France and Germany. The other is to run integrated collection systems, as is the case in Sweden and the United States. Historically, in Western Europe, parallel systems developed, but in other places, integrated collection systems have always prevailed, as in Australia and the United States. In these countries, social insurance institutions developed later and could effectively use established tax collection systems, again a reflection of historical circumstance. In some countries, parallel systems have converted to an integrated collection system to achieve greater efficiency, for example, in Ireland, Italy, Sweden, and the United Kingdom. Recently, some transition countries, including Estonia, Hungary, Latvia, and Slovenia, have taken steps to move from parallel systems to integrated systems. In contrast, there appear to be no cases of a well-run integrated collection system converting to a dual collection system.

The box below provides a regional classification of selected countries by the predominant type of collection agency for social contributions. It should be recognized, however, that

most countries manifest a combination of collection mechanisms and in a sense are mixed systems. For example, while the United States has the largest integrated collection system in the world, it also has the largest private pension and individual account systems, with contributions being paid directly to fund managers in the latter systems. In addition, the U.S. state and local governments are collectors for social schemes, such as unemployment insurance and workers compensation. Issues of fiscal federalism often influence collection systems to produce complex arrangements.

**Box. Regional Classification of Selected Economies by Predominant Type of Collection Agency for Social Contributions**

***Asia/Pacific***

- ✓ Tax Collection Agencies—Australia, New Zealand
- ✓ Social Security Institutions—Japan, Republic of Korea, Philippines, Thailand, People’s Republic of China
- ✓ Fund Managers—Hong Kong SAR, Malaysia, Singapore

***Americas***

- ✓ Tax Collection Agencies—Canada, United States, Argentina
- ✓ Social Security Institutions—Brazil, Mexico, Uruguay
- ✓ Fund Managers—Chile, El Salvador, Peru<sup>5</sup>

***Western Europe***

- ✓ Tax Collection Agencies—United Kingdom, Norway, Sweden, Italy, Ireland
- ✓ Social Security Institutions—Belgium, France, Germany

***Central and Eastern Europe and former Soviet Union***

- ✓ Tax Collection Agencies—Estonia, Latvia, Croatia, Hungary, Bulgaria, Romania, Albania, Russia, Montenegro, Slovak Republic, Slovenia
- ✓ Social Security Institutions—Poland, Czech Republic, Georgia, Lithuania, and most former Soviet Union Republics

An alternative model applied in countries that rely on funded, individual account approaches as their predominant system for pension provision. In these countries, the fund manager collects the contributions directly or through an agent. In Asia, for example, Hong Kong SAR, Malaysia, and Singapore have provident funds that collect contributions, manage investments and pay benefits. Because they are public sector institutions, provident funds may be viewed as a type of social insurance institution operating a parallel collection system. However, because of the funded, individual account nature of the scheme, they differ from a traditional Western Europe type of social insurance institution and have much in common with private sector systems based on fund management.

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<sup>5</sup> Health care and public pension contributions collection has been integrated into the tax agency, the SUNAT.

In Latin America, there is a new generation of defined contribution plans that have developed out of failed defined benefit schemes that dated back to the 1920s. Commencing with Chile in the 1980s, such models, in which private sector fund managers collect contributions, have been adopted in other countries including Peru<sup>6</sup> and El Salvador. Argentina, which initially adopted such a plan, subsequently integrated collections in the tax administration.

Australia adopted a mandatory occupational scheme to supplement its basic means-tested pension scheme funded by general revenue collections. Managers directly collect the contributions to these new defined contribution schemes, which over time are expected to become the primary pension institutions for the country.

In Western Europe, many countries have, in recent years, added complementary plans based on funded defined benefit approaches, to their traditional schemes. These have often been part of a reform agenda to compensate for retrenchments in public defined benefit schemes that faced financial shortfalls because of changing demographics.

In the United States, there are large voluntary, funded defined contribution plans and individual account systems, in which funds are contributed directly to private fund managers by employers, employees, and the self-employed.

In Central and Eastern Europe and in the former Soviet Union, there has been an extraordinary amount of change in the past decade. There has been an integration of collection activities in Croatia, Estonia, Hungary, Latvia, Russia, Serbia, and Slovenia. There are reforms in progress for integration in Albania, Bulgaria, Romania, and Montenegro. In addition, there has been adoption of funded defined contribution schemes in a number of countries, including Poland, Hungary, and Bulgaria, in which funds are collected in a variety of arrangements.

Latvia has adopted plans to unify collection, has reversed those decisions, and most recently, has reinstated and implemented that approach. It is still, however, in the early years since integration. Estonia and Slovenia, which are relatively small and homogenous countries with a large measure of stability, have successfully implemented integration.

Croatia is moving toward implementing an integrated collection system. It modernized and adopted a central financial agency that was a holdover institution from its period as a republic of the former Yugoslavia. In contrast, Macedonia has not yet been able to undertake reforms that would address weaknesses in contribution collection.

Hungary has integrated most aspects of collection of contributions for the basic pension and health care systems, but has chosen to have separate collection for the newly introduced funded tier, and presents a more mixed experience essentially reflecting continuing

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<sup>6</sup> In the last five years, Peru has managed to integrate successfully the collection of its public pension system and its health care insurance scheme with the tax administration agency, the SUNAT.

difficulties in modernizing collection administration. While good progress has been made, there remain major deficiencies in compliance, record-keeping, and coordination. Georgia, which had adopted an integrated system, has now reversed that decision and reverted to a parallel system. Lithuania has indicated that it intends to integrate but has not yet been able to implement that decision. Poland has considered integration at great length but has postponed any efforts to move forward.

Russia had a parallel system with weak collection performance in both the pension fund and the tax administration. Although there has now been integration, the transmission of necessary information from the tax administration to the pension fund has been inadequate. Thus, one of the main requirements for successful implementation is still incomplete. Other countries, including the Czech Republic, and most of the former Soviet Union Republics (e.g., Armenia and Kazakhstan), are satisfied to retain parallel systems. Uzbekistan is an exception, having now implemented an integrated collection system.

Table 3 summarizes the current Central and Eastern European country experience with integrated collection. Reforms in process range from planning and proposals, to enacted legislation in various stages of implementation. Classification is sometimes difficult and changes are taking place continuously. However, there is a clear trend evident over the last decade toward integration in the region. Although success in implementing integration has been mixed, and it is not clear how far and fast it will go, countries in the region appear to be increasingly taking steps to better coordinate or merge parallel collection systems in an attempt to improve their collection performance.

Table 3. Selected Eastern European Country Experience with Integrated Collection

Integration Essentially Implemented	Integration in Process	Integration Stalled	No Integration in Process
Estonia	Albania	Georgia	Czech Republic
Latvia	Bulgaria	Lithuania	Macedonia
Croatia	Montenegro		Most former Soviet Union Republics (e.g., Armenia; Kazakhstan)
Hungary	Romania		Poland
Russia			Slovak Republic
Slovenia			
Uzbekistan			
Serbia			

### E. Information Needs of Social Systems

Pension institutions inevitably require individual account records. Whether defined benefit or defined contribution, funded or unfunded, public or private, most pension designs require keeping track of lifetime earnings and/or contributions by individuals in order to prepare accurate benefit calculations. Indexing of wage records and indexing once initial benefits

have been set are important functions of most pension systems. Eligibility must be established, and initial benefit calculations must be made. Old age pension records must be kept up to date for address and status changes. All of these activities can be efficiently and effectively automated using modern information technology.

Disability pensions present greater challenges for data collection and management. Medical data very often is difficult to reduce to electronic form. In addition, beneficiaries' conditions change and there is more frequent need for re-evaluation and post-entitlement actions. It can be more complex to develop information technology systems needed for disability determinations than old age and survivor pensions. Health insurance institutions often require information on family composition, and incomes, together with changes on a monthly basis, adding significant complexity to the information collection task.

In time, information technology will make all data collection and record-keeping easier. A major issue is, however, to ensure that pension design does not make data collection and record-keeping overly difficult. Too often, legislators, as part of a political process, produce unduly complex and convoluted pension systems. This, in turn, makes systems and processes more complex. A tradeoff is required between the information needs generated by policy designers, and the requirement for ease of administration.

#### **F. Accountability and Transparency Issues**

Pension institutions should regularly provide various kinds of reports to both contributors and beneficiaries, as well as the public, to show that they are properly performing their functions. Externally audited formal annual reports to contributors and the wider public are increasingly produced by pension institutions. In addition, a strong management information system generates information to identify issues that need special attention and provide the accounting and other data that are necessary for policy development.

Accountability demands strong governance systems. Governance of pension institutions should always be based on having adequate checks and balances. Thus, there should be strong oversight of an agency's collection, payment and investment functions. The governance mechanisms provide a structure for the entire system.

In private systems where there are fiduciary duties and regulatory regimes, these functions are usually formalized. However, it is equally important that public institutions have such control mechanisms, even if they are organized somewhat differently. Particularly if a public institution is autonomous or semi-autonomous within the government, having adequate governance mechanisms is a critical issue.

Accountability is also closely related to maintaining political and public support for a pension system. The system needs to conduct its business openly and in public with full explanations for its performance. In public systems, resources are usually provided by a legislature, and the legislature must have good information if it is to provide resources adequate to ensure successful performance. Similarly, the public must have confidence that

the institution is functioning in accordance with the laws and their understanding of its purposes. Thus, any corruption, or creation of special privileges in the system often undermines the pension scheme and the administering pension institution. Accountability and transparency are keys to the success over the long term of pension institutions.

### **III. RATIONALE FOR UNIFICATION OF COLLECTION OF TAX AND SOCIAL CONTRIBUTIONS**

#### **A. Introduction**

In principle, it is logical as part of any whole of government strategic reform to consolidate the collection of key government revenues in one highly professional revenue administration. The previous section described an emerging trend for countries to increase coordination of tax and social contribution collection. This has often involved the cross checking of data obtained by the agencies operating independently of one another. This has sometimes extended to joint reporting and sometimes joint audits.

Such joint operations and information exchanges as an interim stage have yielded valuable results. However, there is strength to the argument that this is not a substitute for a longer-term goal of unifying collection responsibility in one strong and effective revenue collection agency. In line with this, a number of countries undertaking revenue administration reforms are also transferring responsibility for social insurance collections to the tax administration. This is particularly the case in Central and Eastern Europe.

The overriding objective of the unification of tax and social contributions collection is to achieve the best possible revenue collection performance. This funding is critical for the long-term sustainability of social insurance schemes. The major benefits arising from integrating social contribution collection with the tax administration can be summarized in terms of: (1) synergies that exist between organizations and their core functions; and (2) administrative and compliance cost reductions that are possible. This section discusses the issues that arise in integrating the collection of tax and social contributions.

#### **B. The Reasons for Full Integration**

##### **Commonality of core processes**

The argument for unifying the collection of tax and social contribution collections stems from the commonality of the core processes involved in collection of tax and social contributions including the need to: (1) identify and register contributors and taxpayers using a unique registration number; (2) have systems to collect information in the form of returns from employers and the self-employed, usually based on similar definitions of income; (3) for employers, withhold tax and contributions from the income of their employees and pay this to the agencies (usually through the banking system); (4) have effective collection systems to follow up those employers who do not file, or do not account for payments; and (5) verify the accuracy of the information shown on returns using modern risk-based audit methods.

It is recognized that revenue agencies and social security organizations have different requirements regarding data needs, record retention, and other related aspects of core processes. Also, there are generally differences in taxpayers covered, taxable income bases, and related items that must be taken into account. While such differences add complexity to implementation of integration projects, they are manageable issues that do not obviate the fact that the core processes are common in both systems even as details may differ.

### **Efficient use of resources**

Countries that have moved to integrate social contribution collection activities into their revenue administrations have often found that the marginal costs of expanding systems used for tax administration to include social security contributions are relatively minor. This is a particularly important factor to consider for those countries that lack the resources to implement two very similar sets of reforms in different agencies. For example, some countries have integrated the collection of payments as diverse as accident compensation insurance contributions, health care contributions, child support contributions, and student loans repayments into the tax administration. While the features of each are very different, the countries in question have seen the value of using the tax administrations core collection capacity to lower collection costs and improve collection rates.

From a collection administration viewpoint, social insurance contributions (particularly those based on income) have many of the features of a “tax type”—albeit one tied to a particular purpose. Special arrangements relating to separate accounting apply to these contributions, and information transfers must be made to another agency, but the principles of collection are strongly aligned to those used for core taxes—particularly employee withholding taxes.

Countries planning to modernize their collection capacity need to align reform efforts being undertaken in both the tax administration and social collection agencies. Central to this is the strategic choice whether to: (1) maintain tax and social contribution collection agencies as separate entities (but with mechanisms established to share information); or (2) seek to consolidate the agencies into one unified collection agency. In making the decision to integrate, governments need to consider the capacity of social contributions agencies to achieve as high a level of collection effectiveness as a tax administration structured with this as its sole focus, and, the importance of efficiently using scarce government resources by avoiding the costly duplication of IT system developments and infrastructure.

### **Perceptions on the nature of social contribution collection**

It is worth noting that the OECD treats social contributions as in the nature of “taxes” and includes them in its compilation of tax burden statistics. Some developed countries, of course, simply pay benefits out of consolidated tax revenues.

Public perceptions of tax and social contributions may differ, but if the social contribution is compulsory general attitudes to payment and non-compliance are likely to be similar. That said, it is recognized that attitudes to compliance may vary between tax and social

contributions, and between social contributions of different types. For example, attitudes to compliance, and therefore collection rates, arguably may be better for unemployment insurance contributions than for pension contributions—reflecting that contributors believe that benefits of making unemployment contributions are likely to flow in the shorter term—compared with the greater uncertainty of benefits associated with contributions toward longer-term pension schemes.

In this example, it is possible that age of the contributors is likely to be a significant factor, with compliance rates for pension schemes being lower for younger age-groups than for contributors in the age groups closer to retirement. Compliance improvement strategies of modern revenue administrations are designed to recognize and implement programs to deal with these complex compliance risks associated with the various revenues they collect.

### **Core competencies of tax and social organizations**

Over time, tax administrations build core competencies in relation to collection functions. There are countries where tax administrations have improved collection levels in relation to social contribution payments, or been able to do this more efficiently, when they have been transferred from social insurance agencies. Tax administrations, where the sole focus is on revenue collection, develop compliance-based organizational cultures and strongly aligned processes suited to the assessment and collection of monies.

Similarly, social insurance agencies typically build a strong focus on establishing individual entitlements to benefits and efficiently paying them out to recipients. They develop organizational cultures and processes aligned to this role and it is logical to conclude that incorporating the somewhat counter-intuitive responsibility for collections compromises both the collection efficiency and the provision of benefits. Social insurance agencies may have limited success in proceeding beyond a certain level of collection performance.

### **Lowering government administration costs**

Placing responsibility for collections with the tax administration eliminates duplication of core functions that would otherwise occur in the areas of processing, enforced collection of returns and payments, and audit of employers. This can contribute to significantly reducing government administration costs, with:

- ✓ Fewer staff and economies of scale in human resource management and training, fewer numbers of managers, and common processes for filing and payment, enforcement, and data entry data and verification.
- ✓ Lower infrastructure costs in office accommodation, telecommunications networks, and related functions.
- ✓ Elimination of duplicated IT development costs and less risk in system development and maintenance.



There is often an opportunity during the modernization program of the tax administration to incorporate improved processes and new IT systems for the collection of social contributions. These systems can be designed with the inter-agency transfer of information in mind. It might be argued that significant costs can be incurred under a unified system with transferring information between agencies and managing other linkages. On the other hand, if parallel collection systems are to work effectively, significant coordination will be required including data matching across registration and income bases. While no empirical evidence exists to measure the relative information transfer costs, it can be argued that coordination costs in a parallel system would be at least as high as in a unified system.

### **Lowering taxpayer and contributor compliance costs**

Placing responsibility for collections with the tax administration also significantly reduces compliance costs for employers, with less paperwork as a result of common forms and record-keeping systems, and a common audit program covering VAT, income and payroll taxes, and social contributions. The increasing use of internet based electronic filing and payment systems within the tax administration also lowers taxpayer and contributor compliance costs. This simplification can also help improve the accuracy of the calculations made by employers, and therefore compliance levels.

### **C. Improved Inter-Governmental Coordination**

There are strong potential benefits arising from integration. These typically involve a requirement for a much higher level of inter-agency cooperation and consultation, particularly over harmonization of policy or procedures, in particular in the following areas: (1) the definition of income, including the treatment of difficult areas such as income “in-kind;” (2) the definition of employee/self-employed; and (3) filing intervals, payment dates, and penalties for non-compliance. These considerations impose some constraints over design features, but are often beneficial in that they are driven by a need to maintain acceptable compliance costs for employers and administration costs for the government. They can also contribute to the long-term sustainability of social insurance schemes by ensuring realistic policy and administration choices.

## **IV. KEY IMPLEMENTATION ISSUES AND RISKS TO BE ADDRESSED**

### **A. Implementation Issues—Establishing the Appropriate Environment**

#### **Timing of introduction**

A careful assessment needs to be made of the readiness of the tax administration to take on the new responsibility for collection of social contributions. The tax administration must currently have the capacity to take on this new role, or, the transfer should be incorporated into a modernization program being undertaken by the tax administration. A tax administration that is not well structured, has existing tax collection fragmented across different agencies, is not organized with effective processes for collection and audit, has

poorly trained staff, and has ineffective management, will not be in a position to achieve the significant potential benefits of improved collection levels—and any transfer in these circumstances may in fact damage collections in the short term. In these cases, integration should be undertaken in conjunction with a modernization of the tax administration's structure and core collection processes.

Thus Bulgaria, Albania, and Romania have developed ambitious plans to integrate tax and social contribution collection functions. Latvia has also made considerable progress in this regard, with a successful transfer of social insurance collections to the general revenue authorities. This transfer was preceded by extensive analytical work, and was linked to a social insurance administrative reform that was backed by extensive donor financing for the necessary technical assistance, equipment, and training.

In Albania, a project is in its early stages to transfer social contribution collection functions from the Social Insurance Institute to the General Tax Directorate. The IMF and the World Bank are supporting a phased implementation, starting with the largest contributors that have been transferred to the tax administration's large taxpayer unit (LTU).

In Bulgaria, significant work is underway to create a new National Revenue Agency (NRA) to absorb the operations of the existing tax administration agency and incorporate the collections of social insurance and health contributions.

In Romania, responsibility for the collection of social contributions was transferred to a newly established national agency for fiscal administration (NAFA) in January 2004. Plans are now underway for the detailed integration of tax and social contributions collection processes in the context of a modernization program for the NAFA.

### **Government and senior management commitment**

Central to the consolidation of collections within one agency is clear government leadership at the highest levels, and widespread support for the proposal and recognition of the benefits. It is important that the project to implement the proposal is properly resourced and actively monitored. The relevant agencies must be encouraged to work together constructively on implementation issues.

### **Implementation timetables**

Decisions are required on the pace of implementation. An important question is whether the transfer is to be phased—such as first integrating various social contribution funds and then conducting a significant size pilot for the transfer of collections, e.g., in the LTU—or whether the transfer is to be made in one step—possibly as part of the introduction of a tax administration reform program. The case studies in the appendix show that both approaches can be successful if properly managed. Albania has chosen a phased approach by piloting the transfer starting with the LTU, while Bulgaria is proceeding with plans for a full transfer when the new NRA is fully established.

Project implementation timetables must balance the need to ensure a smooth implementation with the need to avoid unduly prolonged timeframes and a loss of momentum—and delays in achieving the improved collection outcomes being sought. Ensuring continuation of existing revenue streams during the implementation process is critical.

### **Preliminary steps**

The first step in resolving the issues in integrating social contributions collections with tax administration is developing an understanding by the government, at the ministerial level across the agencies involved, of the need for a permanent, well-designed solution, and that it will likely require amendments to legislation and the administrative responsibilities of all the agencies involved. The objectives of the integration should be agreed, including that the scope of the issues should encompass not only collections, but also the collection of the related reporting information that is required both to validate payments and to determine eligibility and administer benefits.

Under ministerial direction, a cross-agency task force should be established, and the most senior executives from the agencies should be made accountable for guiding the work and ensuring that sound reform outcomes are achieved. Ministerial oversight is needed to ensure that the solution is forward-looking, provides for substantial harmonization of the bases, provides for the eventual payment of collections into a single treasury account, and is capable of facilitating the eventual transfer of collections for non-employer contributors.

With ministerial direction and senior executive leadership and collaboration in place, a working group of officials can be established from the agencies involved, with expertise in the social programs, tax, collections, information reporting, all the relevant legislation, treasury, banking, and information technology. There should also be a person seconded to the working group from the business community with a good understanding of the business processes used by employers.

### **Approach to the work**

The working group should be required to approach the work without preconceived views of the outcome based on current operational practices within each of the agencies. The objective is to bring multi-agency, and multi-disciplinary expertise together in the development of the best overall solution for government and employers. Initial steps should include ensuring an understanding of the objectives as set out above, and establishing a set of design principles, using those described above as a starting point. The design principles should be approved at the ministerial level before work begins.

Designing business processes that cross the boundaries of multiple agencies is best done by focusing on the process needed to accomplish the tasks, and the information that needs to flow along the process lines to support the activity, rather than focusing at the outset on which agencies should perform which task. In assigning tasks to agencies, the core competencies and main interests of the agencies should be kept in mind: the main

responsibility of the revenue administration is the proper collection and verification of state revenues; the main responsibilities of the social funds are the delivery of social programs.

### **Project schedule**

Designing the new approach, including high-level business processes, information flows, changes to the mandates and authorities of the agencies, and making major decisions, such as the reporting cycle for information about employees, is likely to take up to 12 months, with the working group members working full time. This would not include the drafting of legislative amendments, and a legislative process, which is likely take at least a further six months. Implementation would likely take six to nine months after legislation is passed. This suggests that effective implementation of a satisfactorily integration effort is likely to take a minimum of two years, even when properly supported. Beyond this, there is likely to be a period of systems development to integrate tax and social contribution collection.

### **Transitional measures**

If the ultimate, permanent, solution involves single reporting, from substantially harmonized bases, to a single treasury report, with all funds sharing a single information source for eligibility information, implementation is likely to take several years and occur in phases. The government may consider some of the possible transition measures, such as in Table 4.

Table 4. Transitional Collections Measures Possible Before Integration of Systems

Area of Activity	Goal	Approach
Collections management	Integrated management of results, tracking of results against plan, tracking results of performance improvement approaches.	Combine the existing performance tracking reports of both tax and social contributions into a single report.
Missed filers/payers, late filers/payers	An integrated follow-up with taxpayer for both tax and social contributions.	Feed existing late-filer/missed payment reports from both tax and social contributions systems into an <i>ad hoc</i> computer-based system, by identification number, and distribute the resulting integrated cases to collections officers.
Arrears	Integrated reporting on arrears.	Manually or with a computer combine existing tax and social contributions arrears report into one.
	Integrated handling of arrears.	Using the same technique as for non-filers, combine the existing reports and distribute integrated case loads to officers.
Audit	Single audits for both tax and social contributions.	Tax withholdings and social contributions are easily audited together since both center on payroll operations at the employer. A single audit team, equipped with information reports from both tax and social contributions, conducts the audit.
Filing of information returns, particularly of tax withholdings with a joint return form	An integrated return.	Once the return is designed, clients may use it prior to the computer systems being integrated, by having a temporary front-end system split the information return into its present two separate streams for tax and social contributions purposes.

### B. Policy and Legislation Issues—Harmonization

Ideally, before steps are taken to integrate the collection functions of tax and social contributions, there needs to be harmonization in a number of core areas: (1) the structure of the social contribution and tax rates; (2) definition of the payment/income base; (3) coverage and definitions of the types of payers—employees/self-employed, and treatment of special categories, such as the agricultural sector; (4) calculation and payment regulations; and (5) appeals and judicial processes.

Inevitably, in addressing these harmonization issues, difficult policy trade-offs will be faced, for example to reflect different industry factors. For these, a balance needs to be found that will permit unique factors to be reflected while, at the same time, minimizing unnecessary divergence that adds to costs of administration and compliance.

### **Tax and social contribution rates**

Work is needed to ensure that tax and social contribution rate scales are structured on a coherent policy framework. Consideration needs to be given to the combined effective marginal tax rates at various levels of income.

### **Definition of income**

A common definition of income for tax and social contribution assessment purposes is highly desirable. This simplifies the assessment process, reduces administrative and compliance costs, and facilitates enforcement. For example, in the case of the self-employed, it is sometimes the case that different deductions are allowed in coming to the assessable amount. Another example relates to the treatment of different kinds of income not paid in cash.

### **Coverage and definition of payers**

In some countries coverage of the tax base and social contribution bases differs. For example, in a number of countries some forms of income derivation are exempt from the tax net— agricultural income is one. However, this same income might be subject to social contribution payments. It is desirable to harmonize the coverage as far as possible. In addition, the categorization of employees might be different for each of the bases. It is highly desirable that common definitions of employees and self-employed are used.

### **Definition of payments for social contributions**

The definition of when a contribution is considered “paid” for the purposes of determining entitlement for benefits is critical. In some social funds, the fund has an obligation under the law to determine that contributions by employees have been paid as a prerequisite to providing the related benefit. If the definition of “paid” is that the fund has verified that the amount due was withheld from the employee’s pay and remitted to the treasury, then this requires the fund to carry out reconciliations of payments with information reported by the employer. If, on the other hand, the definition of “paid” is that the employer has withheld the amount due from the employee, the responsibilities of the social fund change dramatically.

In this scenario, the employer acts as a “trust agent” in holding the contribution, which is really the employee’s money, until remitted to the treasury on the employee’s behalf. The employee is deemed to have fulfilled his obligation, and whether or not the amount has actually been remitted to the treasury becomes an issue of collection of a debt from a trustee, not a pre-requisite for entitlement to benefits. The task of reconciliation of an employer’s aggregate payment to individual employee accounts would be eliminated, and eligibility would be determined merely from what was reported in the information return to the fund (subject of course to audit), and not from the amounts collected. This type of arrangement

will require a significant realignment of the responsibilities and authorities of the social funds, which will likely involve a restructuring of the applicable legislation.<sup>8</sup>

### **Appeals and judicial proceedings**

The assessment/appeals process should be the same as that applying across the tax administration. This is because the assessment basis will usually be the standard income or payroll figure used for tax purposes. Any appeal in relation to a tax assessment would automatically be reflected in the assessment of the social insurance contribution, and vice versa. This, of course, assumes that the objective of harmonization of the tax and social contribution bases has been achieved. Judicial rulings need to take a common approach.

### **Legislation**

Appropriate legislation must be passed to authorize the tax agency to collect information and payments, take enforcement action, impose non-filing and late payment penalties, and exchange information with the social security agency. The legislation in these matters must, in all respects, be consistent with the legislation governing the collection of tax payments.

There also needs to be legislative rules governing collection priority, for example in bankruptcy situations where there are personal income tax withholding debts, unpaid social contributions, and other unpaid taxes. In many countries, social contributions are treated as being in the nature of trust monies held by the employer on behalf of the employee. For this reason, they are given a higher priority when it comes to distributions in bankruptcy or liquidation proceedings. Similarly, penalties on employers for default in accounting for social contributions withheld are often stronger (and may include prison terms) for social contributions than for general taxes.

In existing parallel social contribution systems each fund's legislative framework includes all the authorities needed to operate—including collection powers. In each case, the enabling legislation creates an organization responsible for their administration. Accordingly, each fund was given all the legislative authorities it needed, including the legal responsibility, to assess, collect, audit, and administer benefits. For each fund, the only way in which their mandate was shared with another government agency concerns the use of the treasury—in all other respects each fund was fully self-sufficient.

Consequently, different approaches to such tasks as information reporting can be imbedded in various pieces of legislation. For example, for salary taxes, employers may remit payments throughout the year, but only file an information return that reconciles total withholdings to

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<sup>8</sup> In Canada, for example, where social benefits programs were designed from the outset to have collections and information reporting through the revenue administration, the social legislation itself is divided into two parts—one administered by the revenue administration, and the other one by the agency responsible for the social program.

individual employee accounts at year-end. If a person ceases to be an employee during the year, a return for just that employee is filed at that time. For unemployment and pensions, each month, an information return may be filed indicating all employees on the payroll and their status. For health, the legislation may provide for information to be filed initially when a person becomes an employee, and be updated every month to show departing or arriving employees, or changes to information concerning other family members. Integrating the reporting of information will require that one of these systems be selected and used for all social programs and tax.

Privacy legislation in some countries restricts the sharing of information across government agencies. Tax administrations often have specific secrecy provisions preventing the release of confidential taxpayer information. This legislation needs amendment to permit information sharing where necessary for the administration of collection of tax and social contributions.

### **C. Administrative Issues—Key Design Features**

Careful attention should be given to the administrative design of a system of integrated collection of tax and social contributions to ensure that the potential benefits are realized. In particular, key decisions are needed in the following areas: (1) the scope of the collection activity to be transferred; (2) the importance of using a common unique identifier across all of the agencies; (3) the degree of integration of processes; and (4) the accounting and reporting arrangements that need to be put in place.

#### **Broad design strategy**

Countries where the social programs were not designed in contemplation of integrated collection through a revenue administration, and who are now seeking the benefits that come from integration, can benefit from study of the collection framework in those countries in which such programs were designed from the outset to be collected through the tax system. In many of these countries, the design has the following features:

- The tax administration is more properly a “revenue administration,” building core competencies in collecting most government revenues, including social programs.
- Social agencies administer social programs and have responsibilities such as program design, setting contribution rules and rates based on appropriate actuarial principles, maintaining information on plan participants, determining eligibility, and managing the delivery of benefits.
- Employers and non-employer contributors remit single payments for all their obligations, including tax withholdings and social programs, to the revenue administration. In some countries, employers only provide a breakdown of the payment among tax and the various social programs annually, in other cases, with every payment.



- Employers file an information declaration, usually annually, that provides full detail on allocating all the amounts paid to taxes and social programs, with detail for each employee. Generally, this information declaration is sent to the revenue administration, which reconcile it with payments and then provide the employee information to the appropriate social agencies.
- New or departing employees, or changes in dependents are handled in a variety of ways. In some countries, where benefits are universal, these are not reported until year end. In other countries, changes are reported as they occur through the revenue administration, and in other cases, they are not reported to the revenue administration until year end, but are reported immediately to the social agency if they affect eligibility.
- To reduce employer compliance costs, every attempt is made to reduce the number of separate reports that employers make that are based on their payroll information.

Whatever arrangement is chosen, the mandates of the various agencies and their authorities to act on behalf of each other and share information must be specified in legislation. It is likely that, in formulating long-term solutions in most integration efforts, these factors will be paramount.

### **Scope of the transfer**

An issue to consider is the scope of the collection responsibility to be transferred—in particular the collection of voluntary contributions. It is logical that any transfer should avoid splitting the collection responsibility for contributions to obviate the need to set up parallel systems for particular collection categories. Thus, responsibility for all collection activity should be transferred to one agency.

### **Common numbering system**

It is important to adopt a common numbering system to facilitate the transfer of information. Typically, this should be based on a taxpayer identification number (TIN), incorporating a security check digit. Both employers and contributors would be issued with a TIN which would then be used on all documentation provided by individuals and employers involved. In countries where employees are not currently required to be registered for tax, because their final income tax liability is determined through the withholding tax system, it is necessary to allocate TINs so that social security contributions can be tracked.

If the social insurance number (SIN) meets the criteria of the TIN, it would be reasonable for the tax administration to use the pre-existing SIN as the basis of the TIN for the employees brought into the tax system for the first time.

### **Integration of collection system into core processes of the unified collection agency**

The collection of the social contributions should be integrated into the core processes of a tax system built on self-assessment principles (filing of returns, returns and payments processing, enforced collection, and post assessment audit). The normal tax and employer returns are used as the basis for the information for assessment and payment collection—amended to incorporate new information fields needed for social contribution payments. Systems must be designed to capture specific information relating to contributors and transfer this to the social insurance agency in a form compatible with its IT systems.

The integration should be as “seamless” as possible. There should be a common basis of determining liabilities, common payment and reporting dates and forms, common sanctions for noncompliance, as well as common internal procedures. This is especially the case in relation to enforcement programs, where integrated payroll audits are used to ensure compliance with all withholding obligations for both tax and social contributions.

There would not be a separate management structure within the tax administration responsible solely for the social contribution collection. Rather accountability would be an integral part of the role of the functional departmental managers in the tax administration. These would cover taxpayer and contributor services and education, filing procedures, processing of returns, collections enforcement, audit and appeals.

The set of operational and legislative issues discussed in the preceding sections reveal that the resolution of the issues will be both structural and procedural. The analysis of the situation must begin with fundamentals, and not with the view that a few administrative adjustments will result in a system that will serve well in the future.

In some of the most successful reforms, the participants develop a set of objectives for what they are seeking to accomplish, and then a set of principles to guide the actual design of the new arrangement. In the case of integrating the collection of social contributions with tax, the objectives are to achieve the potential benefits, which include:

- ✓ Improved collections performance by better managing all aspects of collections across tax and the three social funds at once.
- ✓ Better compliance by an integrated approach to audit and enforcement.
- ✓ Lower burden of compliance on taxpayers by reducing the number of reports and payments they must make, and the number of government agencies they must deal with.
- ✓ Reduced total cost to the government of collections across the different programs.
- ✓ Reduced costs in the social houses by integration of payment and eligibility information based on information collected once and shared for the purposes of all funds.

With these objectives in mind, it is possible to set out some design principles that should be respected to ensure the goals are achieved. Some of these are discussed below.

***Eliminate duplication of activity, and align activity to agencies with the related competency.*** Each necessary activity should be done once. The total set of tasks required should be distributed across the agencies involved according to their core competencies.

***Legislative authorities should exist for agencies to perform work on behalf of each other, and to exchange information with each other.*** Agencies must rely on the services and information they provide to each other with the same authority as if they had performed the activity themselves. This would mean, for example, that when the single agency reconciling payment and reporting information completes this process, the other agencies would be required to accept, for their administrative purposes, the information provided.

***Only necessary information should be collected.*** The amount of information collected from employers should be the minimum necessary to verify collections, determine eligibility and manage benefits. In the case of the social houses, there should be a careful re-confirmation that their legislative authorities to collect information are in fact appropriate to what they need to administer their programs.

***A single return period and filing method for all information reporting by employers about employees should be chosen.*** Various methods, including annual, monthly with complete reporting, and monthly with only change reporting, should be replaced with a single reporting mechanism, which, when the bases are ultimately harmonized, can be consolidated into a single report. It would seem reasonable that the annual reporting method with monthly change information only should be selected since its impact on both business and government is less. This will require changes to some social fund legislation, or at least the interpretation of the legislation, since, for example, the pensions fund may be required to calculate, monthly, the pension entitlement based on data including the current contribution, even though they only issue certificates showing pension entitlements annually.

***Reconciliation should be designed to be as simple as possible, and done once on behalf of all agencies.*** In this regard, payment and information reporting should remain together and be reported to the same authority until they are reconciled against each other, once and only once. This means that at the initial point of reconciliation, it must meet the objectives of all agencies that have an interest in the information.

***Ease of administration by the government as whole and the burden on taxpayers must be key considerations in the selection of a solution.*** When legislation is enacted that does not lend itself to efficient administration, it becomes difficult for government agencies, particularly with modest levels of staff, to administer properly. Further, the burden on businesses increases. These two effects together lead to poor, inefficient administration and non-compliance. Ease of administration should be a design criterion for any new approach.

***Any tight linkage between an individual's contributions and benefits entitlement is a design choice that might be re-considered.*** It appears that, for some social benefit programs, an individual's participation in the social program is not sufficient grounds for determining entitlements, and that the exact amounts the individual has contributed are considered. This is

a design choice in creating social programs, and constitutes a “tight linkage” between individual contributions and benefits. If a decision were made to loosen the linkage somewhat, where possible, the requirement for positive confirmation of a particular employee’s contributions in determining eligibility for benefits might be reduced, with corresponding administrative efficiencies.

### **Managing the information needs of the various agencies**

Social funds often consider they lack important information that, to varying degrees, they consider the revenue administration’s responsibility to address. The information used by the social funds usually falls into two broad categories: that related to payment information, and that related to the details of contributors (employees) who are participants in the various funds and may be entitled to receive benefits. These concerns are commonly as follows:

- ✓ Health and pension funds often have requirements under the law to identify expenditures made by employers, who in some cases deliver benefits such as income supplements for children and medical leave that they offset against current contributions owing, and to record these by type of benefit paid.<sup>9</sup> The information provided by revenue administration to the funds may not include this information and new systems and processes are needed to provide it if this approach is to be retained.
- ✓ Some funds report a lack of information concerning the flow of revenues to their fund, and claim to have no information on the levels of collection for their fund. Other funds are provided with this information on a daily basis directly from the treasury.
- ✓ For some social programs, it is a legal requirement that benefits are to be paid only if contributions have been paid. The information provided by the revenue administration to each fund may indicate the total withholdings made by an employer, but this is not considered sufficient for the fund to determine if the withheld contribution for a particular employee has been paid by the employer on behalf of the employee. Generally, any separate return sent to the social fund directly by the employer contains the details by employee, but the aggregate information from the revenue administration does not constitute sufficient evidence that a particular employee’s contribution has been remitted.
- ✓ Some funds have responsibilities for accounting for individual contributions, since these determine entitlements. However, accounting laws may require the funds to have their own auditable basis for the payment, which creates difficulties for the funds as the payment is recorded by revenue administration.
- ✓ In some health funds, their own administrative processes may rely on detailed data from the employer about each employee and related dependents, to determine entitlements, as

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<sup>9</sup> Social agencies in some countries are moving away from this off-set approach in favor of paying the benefit themselves, to decrease audit work and revenue risk.

well as to verify that correct amounts have been remitted. In the case of at least one country health fund, the details of family members takes on a particular importance since it affects the remuneration of family doctors, which is determined, in part, by the population of patients that they serve.

Separating payments from information reporting creates some significant difficulties for the funds. Where social contributions are collected directly by a social fund, information from the employer is important for two reasons: (1) to permit verification that the amount of contributions is correct; and (2) to provide the information about contributors necessary to determine entitlements and administer benefits. With the transfer of collections to the revenue administration, the first requirement should be eliminated once all the issues are addressed and properly reflected in amended legislation, with appropriate systems and processes in the revenue administration. The second, issue, however, remains important for the proper administration of each fund's program. A transfer that does not address both payment and information needs of the funds in an integrated way could be described as a "collections-centric" view of the problem, in that it realigns collections with revenue administration, but leaves the reporting and information issues unresolved. Further, since the revenue administration in this case has the payment information but not the corresponding information return, they do not have all the information necessary for audit and arrears collection.

The best approach is to keep information reporting and payment processing together. If these remain separate, reconciliation becomes a major task across two agencies. If the revenue administration reconciles the information return with the payment, then the revenue administration can supply the social funds with the information they need for the management of benefits. This is likely to require legislative adjustments—to give the revenue administration authority to collect the information, to distribute it to the social funds, and for the social funds to accept and use that information as if they had collected it themselves.

### **Accounting and reporting for collections**

There should be effective and reliable accounting systems for social contribution collections. In many countries there is a reluctance to go down the integration path because there is a fear that the social contributions paid will be "swallowed up" in normal tax revenue and the taxpayer loses some/all of their entitlement. It should be automatic that a separate account be credited with the social contributions immediately after payments are received.

There is also greater transparency for taxpayers if their employers are obliged to report to them regularly how much has been remitted on their behalf to the tax authority as a social contribution. The use of internet based technologies to give individuals access to relevant information is an important step to take in improving accountability and transparency.

## **D. Critical Success Factors**

### **Effective implementation requires a government-wide approach**

Often the difficulties of integration do not constitute simple problems that can be worked out administratively by officials. The problems are severe, and unless resolved will prevent the attainment of the projected benefits of transferring social contributions collections to the revenue administration. If not properly and urgently addressed, it may force one or more agencies to operate administratively outside the provisions of their legislation to perform the tasks necessary for proper administration of benefits and appropriate reconciliation of amounts tendered to the treasury.

The issues are therefore broader than the responsibility of any one ministry, and resolution will involve the assignment of responsibilities and authorities across ministries. It is likely that a task force of legislative and administrative experts will be needed from the revenue administration, the social funds and perhaps the ministry of finance, and careful attention will be needed to ensuring the appropriate ministerial guidance and oversight for the work, leading ultimately to legislative proposals that will affect multiple ministries.

To resolve the issues, the matter must be viewed as an issue for the government as a whole and not from the perspective or interest of just one of the agencies. The heads of the social funds and top management of the revenue administration must meet together on the issues regularly, as active senior collaboration is vital. Whatever work is done to resolve these issues will require guidance and oversight from a steering committee consisting of the top management of the social funds, revenue administration, and the ministry of finance, who, in addition to providing guidance, must be accountable for the overall integrity and workability of the solution finally chosen.

### **Roles and relationships**

A clear delineation of roles in relation to policy setting and systems design is critical. First, the social insurance agency has exclusive responsibility for policy and associated systems in relation to all matters not interacting with the collection of contributions. This includes responsibility for integrating the data from tax administration reports into the contributors' database of lifetime records that is used to determine pensions. It is also responsible, usually in conjunction with the ministry of finance, for determining the rates of contribution (as part of the government budget setting process). Second, the tax administration must have exclusive responsibility for collection and audit verification processes according to law.

A process of consultation must be instituted to discuss and agree to changes proposed by either agency where these are likely to affect the operations of the other. In practice, a memorandum of understanding (MOU) is developed between the agencies to outline a process for these consultations to take place (see below).

### **Performance standards**

It is important that strong performance standards are set for the tax agency in relation to collection performance. In general these standards will relate to timeliness of processing, debt and non-filing actions, audits, and the timing and speed of transfer of information and payments. Where appropriate these must be consistent with the standards applicable to core tax administration processes with which they are integrated. These would be negotiated annually, and performance against these standards reported regularly throughout the year, by the tax administration to the social insurance agency and the government.

### **Funding**

The tax administration should be properly funded for the volume of work associated with the new collection responsibility. As part of an annual budgeting cycle the tax administration should be expected to “contract” for a given level of activity and this should be costed and funded. An approach used in some countries is for the tax administration to recover the direct costs of collection from the social insurance agency, based on accurate management accounting approaches. This would enable the social insurance agency to show the actual cost of administration of the scheme in its annual reports.

The tax administration should report on its performance in delivery against this output specification at the end of the year—and be accountable for how it has used that funding. This is a general principle that is good practice across all areas of the tax administration.

### **Project management**

Strong project management and appropriate resources are vital if the transfer of social contribution collection to the tax administration is to be successful. Important features to be addressed include the creation of an effective steering committee with a clearly defined role accountable for (1) approving the project plan; (2) ensuring resources—both people and funding—are made available to the project team. It is critical that high-quality staff from all agencies involved are seconded to work as part of the project team; (3) monitoring delivery against key project milestones; (4) ensuring that project risks to the project’s success are identified and appropriate risk mitigation strategies are developed and implemented.

A dedicated project team should also be established, headed by a highly competent project manager with clearly defined responsibilities related to (1) preparing a comprehensive plan for the approval of the project steering committee; (2) conducting and coordinating all the activities associated with the execution of the project; (3) reporting to the project steering committee at regular intervals on progress against the plan milestones and significant issues.

### **Management of change**

The significant change management issues that inevitably arise with a project of this size need to be managed, in particular: (1) impacts of the changes on the operational policies and

procedures of both agencies; (2) impacts on the staff of both agencies, including communication and consultation needs, work analysis and job design, and training needs; (3) staff selection for new roles and the transfer of staff from the social contribution collection agency to the tax administration; (4) training impacts; and (5) impacts on taxpayers and employers and contributors, including a communication campaign about the changes and information related to changes in obligations being imposed.

It is particularly important to ensure that that strong staff selection processes are followed, sufficient high quality staff are transferred, and that plans are implemented to assimilate them into the culture of the tax administration. It is essential that staff are properly trained in new processes—particularly in the information technology impacts that are often the major issue to be addressed in projects of this kind. Finally, close coordination is needed throughout the development stage, and careful attention needs to be paid to interagency role design.

### **Inter-agency management relationships**

Strong protocols are needed to protect sensitive information exchanges, but at the same time facilitate the transfer of appropriate information. Memoranda of understanding and service level agreements and reporting systems need to be maintained and actively monitored to ensure successful operation. Often senior management liaison meetings and relationship managers are employed as management tools to ensure early identification of problems and facilitate their resolution.

Ongoing information technology plans need to take into account the needs of both the tax administration and the current and future needs of the social contributions collection agency. Protocols and consultations are needed over any future system changes, processes and design changes. This must flow both ways. Tax administration cannot change systems that compromise the social insurance agencies objectives, and the social insurance agency cannot make changes without considering inter-agency administration questions. This involves some tradeoffs, but also has some advantages.

### **Dealing with existing arrears**

A case-by-case decision needs to be made about how to deal with existing arrears. In some countries existing arrears remain with the social contributions collection agency for collection. A temporary “collections task force” is retained to deal with the outstanding arrears. The rationale for this is to allow the tax agency to make “a fresh start” for the future collections. In other countries existing arrears are transferred to the tax administration but ring-fenced with a temporary special task-force set up to determine collectible from uncollectible arrears and act to collect them. Uncollectible debts are identified and written off. In the meantime the new arrears are collected according to new procedures by the enforced collections department of the tax agency. Finally, in some countries, arrears are transferred and simply added to the existing stock of arrears for enforced collection.



While each alternative is viable, on balance it is likely the best outcomes will be achieved from the second and third approaches. This is because it is cleaner to avoid two agencies chasing debt and competing with each other: one for old debt, the other for fresher debt. It is highly desirable if uncollectible debt is written off by the contribution agency before the residual debt is transferred to the tax authority for collection.

In any event, the practice in some countries when after a certain period (usually between two and six months) arrears are transferred to an independent collections agency should be avoided. Best practice suggests that accountability for the collections process should be the continuing responsibility of the revenue administration through all stages of the process.

## **V. CONCLUSION—INTEGRATION EXPERIENCE IN CENTRAL AND EASTERN EUROPE**

Section II described the recent experiences of transition countries in developing and implementing plans to integrate all or some aspects of the collection of social contributions and taxes. Many of these countries are in the early stages of their initiatives, and it is too early to assess the results. Some preliminary observations are possible, however, including useful lessons regarding the issues to be dealt with in developing plans for integration.

In Central and Eastern Europe, it is often the case that both the social security institution and the tax collection agency need significant modernization. Moreover, there are differences in the circumstances of each country as illustrated in the case studies presented in the appendix.

In Albania, modernization of the tax agency has preceded that of the social insurance agency, and was sufficiently advanced that the integration may help the social insurance agency to move forward with a modernization plan of its own. An interesting feature of the Albanian experience is that while an employer-based withholding system for personal income taxes was present, the integration of collection of social contributions into this system has led to steps to improve this withholding system.

In Bulgaria, the social security institution was largely modernized, and a plan was developed to establish a new revenue administration that could both modernize tax collection as well as integrate the collection of social contributions.

In Romania, modernization of the social security institution and the revenue administration are both at preliminary stages. A national agency for fiscal administration (NAFA) was established in January 2004, and responsibility for social contribution collection was transferred to this agency. The challenge is now to integrate the core collection processes for tax and social contributions collections as part of a planned modernization effort.

The key lessons that can be drawn from these cases and broader experience within the CEE countries relate to the importance of:

- ✓ Taking a cross government view of administration reform, and carefully integrating and sequencing the reforms in the tax administration and the social agencies, taking into account the status of modernization of both.

- ✓ Ensuring political commitment to the reform effort, and the involvement of social partners in promoting public understanding of the need for, and support of, the reforms.
- ✓ Properly sequencing the reforms, including taking measures to harmonize policy and administration aspects as part of the implementation process.
- ✓ Ensuring strong attention is given to the information needs of the various agencies when integrated systems and procedures are being designed.
- ✓ Ensuring adequate implementation and project management capacity within the agencies involved, and availability of internal and external funding and external technical assistance to support the reforms.
- ✓ Encouraging strong interagency coordination.
- ✓ Implementing risk management techniques to protect revenue during the changes.

There are many important factors that determine the degree of success of plans for integrated collection, including: (1) the status of modernization of the tax administration; (2) the status of modernization of the social security agency; (3) public perceptions and the level of taxpayer/contributor compliance; (4) the extent of harmonization of policy and legislation; (5) the effectiveness of administrative design and implementation; (6) project planning and management, including political and institutional commitment; and (7) the strength of interagency coordination after the integration.

In an ideal world, integration of collection activities will work best where both the social insurance agency and the tax administration are both modern and effective so that the task of integration can be focused on the integration and improvement of collection functions. This was the case in Sweden and the project to integrate collection was particularly effective.

Even in the developed country world, however, often one or more agencies require modernization. For example, integration efforts in the United Kingdom, Ireland, and Italy faced a variety of challenges from both the social security institutions and revenue agencies. The integration projects in these countries were combined with wider modernization programs and the integration efforts were ultimately successful.

In Central and Eastern Europe, it is more often the case that both the social security institution and the revenue collection agency need significant modernization. Integration of collection activities in such circumstances is far more challenging. On balance, however, it is reasonable to conclude that there will be better results and more efficient uses of resources by pressing ahead with integration as part of a broad-ranging modernization program across the government sector, rather than waiting for separate modernization programs to be completed in each of the individual institutions prior to considering an integration program.

## CASE STUDY: ALBANIA

Until the early 1990s, social protection and universal healthcare was the responsibility of the state. The position changed with the transition to a market economy, and funding for these programs now relies heavily on mandatory contributions from employers, employees, and self-employed. Until recently, responsibility for collection rested with the Social Insurance Institute (SII)—an independent public institution established to administer various social benefit programs, particularly pensions.<sup>10</sup> In December 2002, the government decided to transfer the collection function from the SII to the General Directorate of Taxation (GDT).

### Background

Under the social insurance and healthcare schemes, employers are required to withhold social contributions from the gross wages of their employees, and pay the amounts monthly (via the banking system) to the relevant funds. The contribution rate for social insurance is 42.5 percent—comprising a 32.5 percent employer contribution, and 10 percent from the employee. For healthcare, employees and employers make a joint contribution of 4 percent. The contribution rates, in aggregate, are amongst the highest in Europe (see Table 5 below).

Separate arrangements, including different contribution rates, apply to the self-employed, and certain other individuals (e.g., farmers).<sup>11</sup> Self-employed individuals are required to make quarterly contributions through the banking system. Farmers are also required to make quarterly contributions, but most do not. In reality, the rural pension scheme is a separate program that is heavily subsidized by government—it is essentially a social assistance program rather than a contributory social insurance scheme. Voluntary schemes are also in operation (e.g., for immigrants), but participation is minimal.

The importance of the pension system—and the mandatory contributions on which it relies—is expected to grow, as the number of beneficiaries is forecast to increase from current levels of around 15 percent to one-quarter of the population by year 2050.

### Rationale for integration

Integration of social contribution and tax collections has been driven by a need to improve collection performance, which, at current levels, threatens the sustainability of Albania's social protection schemes. Despite mandatory contribution requirements, participation in the schemes is low. Contributions in 2001 accounted for 3.8 percent of GDP, being considerably less than contribution levels in other transition economies in Europe with similar schemes (see Table 5). Recent estimates indicate that less than 40 percent of the workforce makes

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<sup>10</sup> While administration of the health insurance scheme is the responsibility of the Health Insurance Institute (HII), authority was given to the SII to collect contributions.

<sup>11</sup> Amendments to the law in 1994 required farmers, for the first time, to contribute to the pension system—albeit at a heavily subsidized rate.

contributions, with 4 in every ten contributors coming from the public sector. Evasion of contributions is pervasive in the private sector, both through failure to register as well as non-compliance among registered entities.<sup>12</sup>

Table 5. Social Contribution Collections: Comparison Among Eastern European Countries (2001)

	Percent of GDP	Standard Contribution Rate
Albania	3.8	45.9
Bulgaria	7.8	38.7
Croatia	12.9	37.2
Czech Republic	14.8	47.5
Estonia	12.1	33.0
Hungary	12.9	35.0
Latvia	10.5	35.0
Lithuania	6.8	35.0
Macedonia	10.7	30.1
Romania	12.4	52.5
Slovakia	11.9	50.8
Slovenia	15.5	38.0

Source: IMF.

The government's decision to transfer the social contribution collection function from the SII to the GDT was based on an assessment of the relative collection and enforcement capacities of the two agencies. This assessment is summarized in Table 6.

### Implementation process

To manage the risks, the government decided to transfer the collection function from the SII in stages, starting with collections from large enterprises and then proceeding to other sectors. Amending legislation was scheduled for Quarter 3, 2003, and a broad implementation timetable was approved (see Table 7). Overall accountability was assigned to the deputy minister of finance, and an interdepartmental working group was created under her direction.

<sup>12</sup> It is estimated that less than 50 percent of private urban companies are known to the SII, of which around 80 percent make contributions.

Table 6. Albania: Comparison of Collection and Enforcement Capacities of the SII and the GDT

SII	GDT
Organizational culture and core functions are not geared to collection—the SII sees itself essentially as a benefits payment organization.	Organizational focus is on revenue collection.
Weak enforcement powers.	Full range of collection enforcement powers provided for under the law.
Seventy staff allocated to collection enforcement activities, representing 7 percent of the SII's workforce.	Over 500 staff allocated to audit and debt collection functions, representing almost 40 percent of the GDT's workforce—further capacity is planned through modernization initiatives.
Limited computerization—the SII's business operations are mainly paper based, and there are no firm plans to modernize.	Core revenue collection functions are computerized, albeit at a rudimentary level in some areas—redevelopment is underway as part of a comprehensive modernization program.
Weak central management of the collection function.	Headquarters capacity has been strengthened under the modernization program.
Limited training in collection enforcement procedures.	Core training programs are in place.

Table 7. Albania: Revised Timetable for Transfer of Contribution Collections to the GDT

	Sector	Implementation Date
1	Large taxpayers	November 1, 2003
2	Medium size businesses (i.e., taxpayers registered for VAT)	May 1, 2004
3	Government budget institutions	August 1, 2004
4	Small businesses	January 1, 2005
5	Remaining groups—mostly the rural sector	July 1, 2005

Source: Planning paper prepared by the authorities with the support of consultants in early 2003.

The authorities prepared a high-level project plan,<sup>13</sup> covering the following areas:

- ✓ Legislative changes.
- ✓ Computer system development.
- ✓ Design of work processes, procedures, and jobs.
- ✓ Taxpayer publicity and education.
- ✓ Workload estimation and staffing.

<sup>13</sup> The preparation was supported by a UK-DFID-funded project.

- ✓ Data exchange between the GDT and SII.
- ✓ Design of new forms.
- ✓ Staff training.

At the time of preparation of this case study, implementation of stage 1 (i.e., installation of the new arrangements in the GDT's large taxpayer unit<sup>14</sup> in Tirana) had successfully been completed. The lessons learned from stage 1 will be important for stage 2, which will involve 10,000 registered medium size businesses located throughout the country.

Stage 3 will be straightforward, as obligations of government budget institutions are paid by way of entries within the government's financial system. Stage 4, involving 40,000 small business taxpayers, will be the greatest challenge, but with the experience gained in earlier stages is expected to be manageable. Stage 5 covering the rural areas is being reconsidered.

### **Critical issues and lessons learned**

***Project management.*** Projects of this kind are complex because of the number, range of tasks involved, and the effort required to coordinate activities and decision-making across agencies. For this reason, the authorities incorporated the project into the GDT's modernization project, under the supervision of the project manager. This was very effective in moving the project forward. But it also had a potential downside. Because the project was mainly driven from the GDT, the SII was concerned that social contribution collection issues would not receive the same attention as tax administration issues.

***Oversight by deputy minister and interdepartmental committee.*** Placing overall responsibility for the project with the deputy minister, and establishing an interdepartmental working group, was a positive step. The working group's meetings served as an effective forum for discussion of problems and communication on the project implementation strategy.

***Memorandum of understanding.*** To ensure effective coordination and cooperation between the GDT and the SII, the implementation plans proposed that a memorandum of understanding (MOU) be signed by the heads of the GDT and the SII, as well as relevant ministers.

***Legal framework.*** Changes to the social insurance, health insurance, and tax procedure acts were required to give the GDT authority to collect contributions. Other legislative changes were sought to: (1) harmonize the taxable bases for the contributions and personal income tax (PIT)—to allow PIT and social contributions to be collected from employers using a single declaration form; and (2) expand the taxable base to include in-kind benefits. Parliament rejected both of these amendments. These changes to the law will need to be revisited at a

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<sup>14</sup> The LTU administers the largest 450 taxpayers—its revenue collection capabilities are more developed than those in the GDT are generally.

later stage because, without them, the GDT will face difficulties in designing efficient collection processes and will be faced with administering an eroding tax base.

*Expertise in withholding systems.* The integration of social contribution and PIT collections should provide an opportunity to improve collection performance and employers' compliance with payment of withholding obligations. Audits of large businesses have until now concentrated on profits tax and VAT, with limited attention given to PIT compliance. Implementation of the new arrangements have brought fresh focus to strengthening expertise in withholding systems generally—including developing research and analytical capabilities.

### **Conclusion**

The project to integrate collections is in the early stages, and it will be some time before implementation is complete. While the benefits of integration may not be immediately apparent, there are signs the GDT is being stimulated to pay closer attention to the collection of personal income tax, and that the SII is beginning to see an opportunity to reorient itself as a benefit payment agency. Significant work remains, and improvements in revenue administration alone will not address all the social protection issues. A range of policy matters need revisiting, including the high contribution rates, and the situation in rural areas.

## CASE STUDY: BULGARIA

Integration of social contribution collection processes with tax administration is an important element of Bulgaria's structural reform program, the pace of which is accelerating as the country prepares for EU accession (anticipated in 2007). This has placed key public institutions, like the revenue collection and social security agencies, in the reform spotlight. In this regard, the national social security institute (NSSI) has undergone continuous change since it was established in 1995. Reform of tax administration, while initially slower to happen, is now the subject of a major modernization program.

### **Background**

Social insurance in Bulgaria consists of publicly managed social security and mandatory private pension schemes. Every public and private sector employee and self-employed person born after December 31, 1959 must become a member of a universal pension scheme managed by a pension insurance company.<sup>15</sup> Healthcare coverage is also mandatory.

Employers are required to withhold compulsory social contributions from the gross wages of their employees, and pay the amounts monthly via the banking system to the authorities. Separate arrangements apply to the self-employed and agricultural workers, including different contribution rates and bases used in calculating contributions. Self-employed persons are required to make quarterly contributions through the banking system.

Currently, the NSSI has responsibility for collecting social contributions, including transferring collections to private pension funds and the national health fund (NHF). The NSSI will relinquish this role in 2005 when the collection function is absorbed into the operations of a newly created national revenue collection authority (NRA).

### **Rationale for integration**

Integration of tax and social contribution collections in Bulgaria is happening as part of a broader package of reforms that began with the social insurance administration project (SIAP) in the mid-1990s.<sup>16</sup> A 1996 appraisal of the SIAP indicated that the single most important action that the government could take to improve social contribution collections, which were unacceptably low, was to upgrade the level of coordination between the general taxation department (GTD) and the NSSI.

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<sup>15</sup> The universal pension schemes are defined contribution schemes and contributions accumulate in individual accounts. Persons are free to choose any universal fund for membership. The regulatory framework for the schemes is set out in a mandatory social insurance code legislated in 1999.

<sup>16</sup> The SIAP was a 5-year multi-million project supported by the World Bank to modernize social security administration, including IT systems. It was launched in 1996, coinciding with the creation of the NSSI.



In October 1999, the Bulgarian government decided to create an entirely new unified revenue collection agency. While the decision was initially prompted by concerns about poor collection performance in relation to mandatory social contributions, it was also motivated by mounting evidence that the tax administration, generally, needed a major overhaul.<sup>17</sup> Against this background, it was concluded that a unified revenue agency would provide an opportunity to: (1) establish a single-point of accountability for tax and social contribution collection performance; (2) better coordinate collection and enforcement efforts, by replacing the current fragmented collection functions with a single dedicated and properly equipped collection authority; (3) introduce streamlined registration, filing, and payment procedures for employers and self-employed; (4) eliminate duplicated functions and rationalize administrative support structures of the GTD and the NSSI; and (5) sharpen the focus on risks to revenue, particularly in the emerging private sector.

### **Implementation process**

In June 2000, the council of ministers approved a concept paper that included a restatement of the government's objectives, and a description of key features of the proposed unified revenue collection system and agency, including:

- ✓ Harmonization—as far as practicable—of the tax and social contribution legislation.
- ✓ Development of integrated business processes and information technology (IT) systems for collecting taxes and social contributions.
- ✓ Adoption of a single national identification number (Bulstat number) to facilitate information exchange with other government agencies.
- ✓ Use of banks as primary collection agents.
- ✓ Implementation of modern audit techniques based on risk management principles.
- ✓ Implementation of integrated taxpayer and contributor assistance programs.
- ✓ Establishment of a modern function-based organization structure.
- ✓ Development of strong human resource management practices.

This concept paper provided a framework for subsequent design of the NRA, noting that the reform process would involve implementation in manageable stages over several years. It proposed a two-phase approach. The enabling phase entailed the GTD and the NSSI engaging in joint activities, such as working toward harmonizing the income bases of social insurance contributions and personal income tax (PIT), developing a single statutory definition of labor income, and conducting joint audits of taxes and compulsory contributions withheld at source. The subsequent implementation phase entailed a comprehensive modernization program that would create the entirely new unified institution.

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<sup>17</sup> An assessment by the Intra-European Organization of Tax Administrations (IOTA) pointed to a need to upgrade the tax administration to meet EU standards. A similar conclusion had been reached by a joint IMF/World Bank mission.

In November 2002, legislation was enacted to establish the NRA as a formal legal entity reporting to the minister of finance. The legislation gave the new agency responsibility for collecting domestic taxes and social contributions, and implementing the revenue administration reform program. In June of the following year, a loan was secured from the World Bank to provide funding to design and implement the NRA.

### **Critical issues and lessons learned**

Despite slow progress initially, there are many positive features to the revenue administration reform effort underway in Bulgaria, including strong government support for the project, secure project funding, and a comprehensive reform package directed at building an effective integrated revenue administration.

In bringing the project to its current state of development—the project is roughly at the mid-way point—however, the authorities have faced several significant issues, and learned a number of important lessons. Some key areas are discussed below.

***Political support and commitment of resources.*** During the twelve months following the council of ministers' approval of the NRA concept, the project languished owing to insufficient commitment of resources. This changed, however, after the appointment of a new minister of finance in mid-2001, who took a strong interest in the project. Key decisions and actions followed, two of which were instrumental in moving the project forward (i.e. passage of the NRA Act, and securing project funding via the World Bank loan).

***Legal framework.*** In giving the newly created NRA responsibility for all components of the project, the NRA Act helped remove difficulties in coordinating GTD and NSSI modernization efforts.<sup>18</sup> To protect the interests of the NSSI and the NHF, the law provided for a NRA advisory board that included the heads of these agencies.

As the project progressed, it became clear that significant changes to substantive tax and social security laws were needed to align legal definitions, calculation bases, taxpayer/contributor obligations and rights, and penalty regimes. An overhaul of enforcement powers and other administrative provisions was also necessary. The ensuing legislative program proved to be far bigger and more complex than anticipated, and thereby demanded greater efforts, most particularly in its coordination across agencies and ministries.

***Project management and implementation schedule.*** Since the NRA project's inception, it has gone through various iterations of project management. A small project team was formed in March 2000, comprising representatives of the GTD, the NSSI, and the NHIF (on a part-time basis). The activities of the team were managed as a joint agency effort, and a unified revenue agency commission—formed by decree of the council of ministers, and chaired by

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<sup>18</sup> Under the former project structure, GTD and NSSI project staff had continued to report to their respective agencies.

the deputy minister of finance—was given responsibility for coordinating activities across relevant ministries and agencies,<sup>19</sup> and making decisions of a policy and strategic nature.

A GTD deputy director was subsequently appointed as the NRA project leader, but remained part of the GTD executive. An IT directors' board with GTD and NSSI representation was also established. Given that the project was in its early stages (focusing on the NRA conceptual design, legislation, and high-level development plans), and that the project team was still small, the approach to project management was flexible.

With passage of the NRA Act in November 2002, and securing of World Bank support in mid-2003, the project took on new proportions. The NRA Act gave the new agency authority to implement the revenue administration reform program, and the NRA board became the chief body responsible for overseeing the reform program. The scope of the project expanded, the implementation team grew to over 90 staff, and a vastly more complex range of activities and issues emerged. With this new phase of the project, a more formalized approach to project governance was called for, including a need by the authorities to hire-in specialist project management expertise. Because earlier implementation plans and timetables were too ambitious, it has been necessary for the authorities to consider an incremental approach to implementation—including gradual integration of social benefits collection into the processes, systems, and organization of the NRA.

***Integrated work processes.*** An important element of the NRA project has been the development of work processes and interactions with taxpayers, contributors, banks and other agencies, based on the following design principles:

- ✓ A single national database comprising taxpayer and contributor information, with a single, accurate, and reliable identifier (the Bulstat number).
- ✓ A simple registration system requiring only one visit to the agency.
- ✓ A single account for each taxpayer and contributor.
- ✓ As far as possible, integrated work processes and systems for taxes and contributions, including registration, processing, collection, taxpayer service, audit, and appeals.
- ✓ Maximum use of banks for the collection of tax and contributions, and continued use of collection points, such as post offices.
- ✓ Simplified forms and declarations, including electronic filing.
- ✓ Joint audit activities for tax and contributions.
- ✓ Speedy cash and information flows between the NRA and related funds.
- ✓ On-line access by the NSSI to information and data for the purposes of administering the social benefits system.

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<sup>19</sup> Including ministries of finance, labor and social policy, and health, and the GTD, the NSSI, the NHIF, and the NSI.

## **Conclusion**

Bulgaria has taken significant steps in establishing a strong foundation for reform, including development of the NRA concept, passing the NRA Act, establishing an implementation team, and securing adequate project funding. However, the bulk of the project development task, including careful transition of the existing GTD and NSSI collection operations into the NRA, lies ahead. Continued political support and careful project management will be critical to delivering the project benefits, which, in the longer term, stand to be substantial.

## CASE STUDY: ROMANIA

During Romania's transition decade (1989-2000), there was a dramatic decline in the number of contributors and large increases in the number of beneficiaries of social insurance schemes. A significant contraction of the labor force, an increase in self employment, growth in the informal sector, and an increase in unemployment all were factors resulting in an inefficient and under-funded social security system. However, by the year 2000 all major social insurance programs had undergone significant reform. From late 2003, significant developments have also taken place in revenue administration in Romania. A single national agency for fiscal administration (NAFA) is now established to manage all revenue administration, including responsibility for the collection of social contributions payments for employers, which were transferred to the new agency on January 1, 2004.

### Background

Romania has three main social insurance funds: the National Health Insurance Fund (NHIF), the National Pension Fund (NPF), and the Unemployment Insurance Fund (UIF).<sup>20</sup> Contributions to these funds represent a major part of government revenue.

The pension fund was revised in 2000, changing the pension structure to base the calculation of benefits on the contributors' lifetime employment history, and to expand its scope to include self-employed, farmers, and the unemployed. Pension coverage is mandatory for employees and for other specified classes of self-employed persons, and is voluntary for others. Farmers are excluded. Unemployment insurance coverage is mandatory for employees and voluntary for others. Health coverage is mandatory for all. The contribution base differs depending on the type of contributor (employee, employer, self-employed, farmer, unemployed) and on the type of insurance (pension, unemployment, health).

Contribution rates for Romania are high within the region, despite significant reductions in 2003 designed to improve compliance, provide more equity in the system, and promote economic growth.

Compliance in social contribution collections significantly deteriorated in the mid-1990s as many businesses, including state-owned enterprises, ceased to pay their contribution liabilities due to financial difficulties. Outstanding arrears debt in the social funds is high, with the largest corporations (mostly state-owned) accounting for the bulk of it. There is also significant non-compliance in the area of registration. For example, with pension reform

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<sup>20</sup> The health fund was established in 1997 and is administered by the National Health Insurance Agency (NHIA), an independent agency within the ministry of health. The pension fund is administered by the National Agency for Pensions and Other Social Insurance Rights (or the Pension Agency), which is part of the ministry of labor, social solidarity and family. The unemployment insurance fund, founded originally in 1991, was re-structured by new legislation in 1999. It is administered by the National Agency for Employment, also an executive agency part of the ministry of labor, social solidarity, and family.

there were 1.6 million civil contracts that should have been registered under the new law; however, just 100,000 were actually registered.

### **Rationale for integration**

In 2003, the government decided to integrate social contribution collection and tax administration for two main reasons: (1) improving administrative efficiency and provide better services by centralizing and rationalizing the fragmented collection services and enforcement activities undertaken in separate agencies within a unified revenue administration; and (2) improving tax and social contribution collection compliance.

Integration is expected to improve the level of collections and general compliance levels, provide for a more consistent treatment of taxpayers, reduce costs to government through the achievement of economies of scale, and reduce administrative burden on taxpayers. In aggregate, these represent significant potential benefits.

### **Implementation process**

In 2002, it was decided that collections of health, unemployment insurance, and pension contributions should be integrated with the collection of withholding taxes from wages. As an interim step, it was concluded that the best approach involved integrating all the social contributions within a separate collections agency, pending later integration of social contributions and tax in a unified revenue administration. However, the government decided in early 2003 to transfer social contributions collection directly to the new NAFA to be established from January 2004.

The NAFA now exists as legal entity, and operates largely autonomously from the MOPF under the management of a president, who is also a secretary of state. Government orders necessary to accomplish the transfer of the collections of social contributions from the social funds to the revenue administration have been issued, and the initial transfer, for employers only, became effective on January 1, 2004. New legislation was adopted to implement the integration of the collection of social contributions with tax administration. The legislation provides that:

- ✓ The collection functions to be transferred include payment, audit, controls, appeals, and enforced collection of arrears.
- ✓ The transferred functions will be those related to *employers* only.
- ✓ Audit and appeals will be carried out according to the rules and authorities of the tax administration (but based on the requirements of the enabling social legislation).
- ✓ All legal rights of transferred employees will be retained.
- ✓ Responsibilities for collection of social contributions for *non-employers* can be transferred at a date to be determined by the government.

*Employers* make payments to the tax administration, but retain the obligation to advise each social house monthly of the names of each employee covered, the amount remitted, the period of coverage, etc.

The reform agenda continues under the direction of a single executive reporting to the NAFA president. In mid-2003, a government ordinance provided for the transfer of the collections of social contributions to the revenue administration. As a result, staff were transferred from the social houses, initially for audit and collection enforcement in October 2003, and in December 2003 and January 2004 for remaining activities. Amendments in the relevant pieces of legislation aligned administrative features, including payment dates and provisions for interest and penalties, to facilitate management of social contributions collection together with tax obligations. Payment forms and processes were re-designed to provide a single payment declaration, but with multiple payment orders, and employers were advised of the changes in payment provisions. A one-time self-declaration of arrears for all social programs was required from employers, with this due February 15, 2004. Reporting of information remained unchanged with employers continuing to provide information on their individual employees and contributions for each, directly to the social houses.

The full set of benefits potentially arising from integration will be achieved when current plans for comprehensive reform are implemented to fully integrate not only the payments, but also the information reporting for social contributions with that of tax, ultimately allowing the social houses to fully dismantle their infrastructures for the processing of payments, collection of reporting information, and related activities for audit, verification, and reconciliation.

### **Critical issues and lessons learned**

***Project scope.*** The work completed so far is primarily a transfer of activities from the social houses to the tax administration, rather than a redesign and integration of collections and information reporting of social contributions with salary tax remittances. To realize the full extent of the benefits, actions so far will be part of a larger sequenced revenue administration modernization project that would include:

- ✓ Integration of payments and collections processes for the employer contributions, combining liabilities for salary taxes, pension, unemployment, and health into a single declaration and payment system. This will be a comprehensive undertaking that will include: (1) a review of existing operations and business processes in all collection functions, including those of the tax administration; (2) better definition of business requirements (including the specialized information requirements of the social houses); (3) elimination of unnecessary or duplicative functions; (4) a re-engineering of the fundamental business processes; and (5) integration of the IT platform for these operations. It is also recognized that harmonization of the tax base for social security contributions must be pursued.
- ✓ Integration of taxpayer and contributor services, collection enforcement, and audit.

- ✓ Finalization of the transfer of the collections, audit, and appeals functions for social contributions by non-employer contributors to the tax administration. This will allow the three social houses to dismantle their collections infrastructures completely and should result in further cost savings.

Further study will be required to determine which of the above steps would be possible under the present legislation, and which would be possible and practical without harmonization of the bases and related definitions for the social contributions with those of salary taxes.

***The NAFA experienced significant problems in reconciling the data provided by the social houses with their own, and with the self-declarations of arrears made by employers.*** These problems are generally consistent with those that arise when data about the same entities, but maintained by separate organizations, are combined. The NAFA has been required to apply significant manual effort to resolve discrepancies in the data. There were important differences between the amounts reported as arrears by the social houses and the amounts self-declared by many employers, with the latter being generally higher. The process of reconciling the self-declarations against the data and the paper files provided by the social funds is likely to last for many months, and consume considerable resources. Reconciliation is further complicated because there is generally no alignment of the dates of the prior audits undertaken by each of the social houses and the NAFA. In planning the initial transfer of information related to the self-employed, greater inter-agency coordination is planned.

***For large taxpayers with branch offices, the benefits of integration are reduced by the requirement to file payroll taxes at the local level.*** Present laws require that, where there are five or more employees at a branch office location, payroll taxes must be remitted at the local level.<sup>21</sup> Collection of payroll taxes using the same approach as social contributions would reduce the burden on those businesses with branch offices, as well as reduce the number of individual payment transactions that must be processed by the NAFA.

***The social funds consider they lack important information, which, they consider NAFA's responsibility to address.*** Attempts are being made to address these concerns.

***It is apparent that the number of employees transferred from the social funds to the new NAFA with the collections-related work is inadequate.*** This may compromise the ability of the NAFA to deal with the workloads that have been transferred, and to obtain the social fund skills and knowledge that are required to manage its new responsibilities.

***Each social program was designed separately, and includes all the authorities needed—including collection powers. The measures to set up the transfer of social contributions were incomplete.*** A Government Ordinance set up the transfer. It was accompanied by complementary ministerial orders in the other organizations that dealt with authorities for collections, aligned payment dates, provided transitional measures and the mechanics of the

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<sup>21</sup> Revenues from wage taxes are a major source of local level government funding.



transfer of work. This total set of activities, however, has not dealt with critical issues that remain unresolved, and which are giving rise to the implementation issues. The government ordinance was drafted on the assumption that the base legislation for the funds would be amended to resolve the issues of overlapping authorities; however, this has not occurred.

***The definition of when a contribution is considered “paid” for the purposes of determining entitlement for benefits is critical.*** Officials reported that in several of the social funds, the fund has an obligation under the law to determine that contributions by employees have been paid as a prerequisite to providing the related benefit. If the definition of “paid” is that the fund has verified that the amount due was in fact withheld from the employee’s pay and duly remitted to the treasury, then this requires the fund to carry out reconciliations of payments with information reported by the employer.

***Different approaches to information reporting are imbedded in legislation.*** For salary taxes, employers remit payments throughout the year, but only file an information return that reconciles total withholdings to individual employee accounts at year-end. If a person ceases to be an employee during the year, a return for just that employee is filed at that time. For Unemployment and Pensions, each month, an information return is filed indicating all employees on the payroll and their status. For Health, the legislation provides for information to be filed initially when person becomes an employee, and be updated every month to show departing or arriving employees, or changes to information concerning other family members. As noted earlier, the NHIF’s administrative practice is to require the provision of full information every month. Integrating the reporting of information will require that one of these systems be selected and used for all three social programs and tax.

***Full alignment of the bases for the programs remains a future objective.*** It is generally accepted that substantial alignment of the bases should remain an objective for the longer term, as it would enable easier calculation of contributions for employers, and simpler administration by a single collections authority.

## **Conclusion**

The first steps in integrating the social contribution collections with tax administration have now been taken in Romania. Some benefits should be evident quickly, such as improvements in audit activity and enforced collection. However, rationalization of legislation, and a full re-design of the collections business process still needs to be done before major benefits, including improvements in efficiency and effectiveness, and service to contributors and taxpayers, can be achieved. The work to be done is broader than the responsibility of any one ministry, and resolution will involve the assignment of responsibilities and authorities across ministries, with strong government level oversight.

### CASE STUDY: SWEDEN<sup>22</sup>

Sweden is an example of a modern effective fully integrated system for the collection of tax and social contributions. The main part of the Swedish social security system, excluding unemployment insurance, is administered by the National Social Insurance Board (NSIB), and on the regional and local levels by social insurance offices. The National Tax Board (NTB) at the central level, and the tax authorities and local tax offices at the regional and local levels, are responsible for population registration and since the mid 1980s for the administration of collections, and enforcement activities.

The process of change, as part of a decentralization strategy and drive for administrative efficiency, began in the mid-1970s, with the transfer of the computer system for the administration of collections to the NTB and the local tax administration offices. In the mid-1980s the tax administration was assigned responsibility for the entire contributions collection system. Over time, there has been a trend to simplify procedures to make the system easier to administer and to make it more secure and improve control. This has included a number of policy harmonization measures, such as unifying the wage base for various schemes, and removal of complex calculations for determining contributions (such as those taking into account deductions based on the number of employees and the maximum wage base for high-income employees). Against this, there has been pressure at times to introduce special arrangements and incentives that would tend to make administration more complex. The overall result, however, has been a more smoother, and more efficient and effective contributions collections system.

A common personal identity number is used, and information on changes in individual circumstances is exchanged with the NSIB regularly. Collection of social contributions from employers is undertaken monthly using a single page tax return form. Registered employers are sent these forms monthly. Submission of the return form and payment is made by the 10<sup>th</sup> of the following month. Payment is through the banking system and payment information is provided by the banking sector to the NTB electronically. Return forms are processed and filed. Annual checks are made from the employees' returns against the employers' submitted data. The tax administration undertakes more in-depth audits on annual returns if warranted.

Sweden generally has a high level of payment compliance. This is generally thought to be a result of good compliance culture supported by a history of a strong enforcement function administered by the tax administration. Arrears are promptly followed up with reminder letters and increasingly stronger enforcement actions to recover debt. Active employer audit is in place to verify that calculations are correct. An effective system of fines and penalties is in place to sanction those in default.

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<sup>22</sup> See *The Swedish contributions collection system*, Goran Smedmark and Yvonne Svenstrom, International Social Security Association, Interactions of Social Security and Tax Systems" (Geneva 1997).

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