

Revenue Administration: Functionally Organized Tax Administration

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TECHNICAL NOTES AND MANUALS

Revenue Administration: Functionally Organized Tax Administration

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This technical note addresses the following questions:

1. Why is the choice of an organizational model so important?
2. What is a function-based organization?
3. What are the key components of a function-based organization?
4. What are the main advantages of a function-based organization?
5. How does the function-based organization work?
6. How is management direction given in the function-based organization?

The organization structure of the tax administration is a key component of an effective reform and modernization program. Of the many possible options, the function-based organization is viewed as best suited to support a reform and modernization program. This note describes the model and its components and discusses the management challenges in dealing with this kind of structure.

I. Why Is The Choice of an Organizational Model So Important?

In recent years, organization structures have become increasingly important in both the private and public sectors. Concerns have been raised related to accountability, responsibility and transparency within organizations—for example, what are their legal authorities and powers, what oversight mechanisms exist, what kind of flexibilities are available to address modern management problems. Governments are seeking ways to improve operational results while increasing transparency and accountability within their departments and agencies. The organization structure of the tax administration is a key component in these efforts.

The organization structure of tax organizations has evolved considerably over time. From organization structures based on type of tax, to those based on function (the subject of this note) to those based on the type of taxpayer (small, medium or large), economies of dif-

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ferent sizes and at different stages of development have attempted different kinds of organizational reform. Many tax administration organizations are actually a combination of these structural categories.

An effective organization is the basic platform from which all other procedural reforms are launched and maintained. Without the right organization structure in place, revenue administrations cannot operate effectively and their revenue collection efforts will be sub-optimal. Where function-based organizations have not been implemented, the extensive procedural and operational reforms needed to support modernization would likely be ineffective.

II. What Is a Function-Based Organization?

A function-based organization is one structured on the basis of the type of work performed, rather than the type of business or product or the type of customer. This model is based on the theory that in grouping together similar activities that require similar skills or specialties, real gains are achieved through an increased depth of knowledge in core areas of business expertise.

The function-based organization is usually anchored by **a strong headquarters organization** that sets policy and program direction and guidance. The main responsibilities of headquarters are:

- Preparing an annual national work plan specifying expected work volumes, service and enforcement initiatives, and staffing levels and expenditure budget requirements. The national plan would contain quantity, quality, and timeliness performance measures.
- Regular monitoring and reporting on national performance against the national work plan, explaining variances, and recommending corrective action.
- Designing and maintaining standardized processes and policies, producing related documentation (manuals, circulars, etc.), and assuming “ownership” for the business processes and IT requirements related to those processes.
- Providing advice and guidance to field operational units as required.

The function-based organization includes a **distinct organization for field operations and delivery** and this organization may be managed by a single individual who reports directly to the head of the organization.¹ Under the overall direction and guidance of headquarters, the field organization is directly responsible for program delivery.

¹Depending on the size of the organization and the geography of the jurisdiction, the heads of individual field units may all report to the head of the tax administration, or may report through a senior manager at head office or through district or regional managers who in turn report to head office.

There may be merit in housing headquarters staff separately from operational activities to avoid a blurring of roles or a tendency to revert to operational activities which often arises when a tax administration first attempts to institute an effective headquarters. In small administrations this may however not be practical, necessitating concerted effort to keep the two responsibilities and activities distinct.

Some of the characteristics of matrix management are wholly or partially present in the function-based organization. Matrix organizations are generally characterized by: (1) horizontal and vertical structures that exist simultaneously; (2) matrix managers that do not have complete control over subordinates; and (3) employees within the matrix have two bosses and must maintain effective relationships with both.

Headquarters managers have a vertical reporting relationship through the hierarchy to the head of the organization but will also have functional responsibility for the delivery of their specialization in the field. In this way, a headquarters manager will have direct oversight—of the units reporting directly to him vertically as well as functional oversight for the plans, objectives and results of the field operations for his or her particular specialty. Equally, a field manager will have a direct reporting relationship in the vertical hierarchy in the field but will also take functional direction from the group of headquarters managers across the range of specialties that are delivered in the field.

III. What Are The Key Components Of A Function-Based Organization In Tax Administration?

Many countries have adapted the principles of a function-based organization to the core business of tax administration. In essence, a function-based tax administration organizes its work in logical groupings of core functions that encompass all taxes for which the administration is responsible. This approach allows for the standardization of common work (versus different approaches that could be taken for each different tax in a tax-type organization) and simplifies the relationship between the tax administration and the taxpayer i.e. there is one point of contact for service, one point of contact for payment etc.

Several common tax administration activities emerge in a function-based model:

- **taxpayer services and education**—strategies, materials and channels for delivery of education and services targeted at specific taxpayer segments;
- **returns processing and payment**—timely processing of all tax payments and returns, electronic commerce, and all related accounting systems;
- **audit and investigations**—national audit strategy, procedures for all types of audit, including single issues audits, audit standards, coverage rates, etc.;
- **collections enforcement**—collection procedures and legal issues; and

- **tax operations policy**—appeals, rulings and operational policy for all tax types, legislative review, international activities and double taxation agreements; and other residual issues.

Each of these functions should have a clear organizational locus at headquarters.² As indicated above, headquarters is responsible for planning at the national level, for design and maintenance of standardized processes and policies, for monitoring and reporting on national performance and for advising and guiding field operations.

As also noted above, headquarters would develop and design programs and procedures for their respective area of competence, ensure consistent implementation and application of the programs and procedures throughout the network of field offices, assign resources and performance targets to field offices and monitor their performance.

Put simply, headquarters is responsible for both design and monitoring of programs and procedures. In many cases, both design and monitoring occur in the same headquarters unit, as specialist experts are considered well placed to know the demands of their particular function, to be able to assess how well programs are working and to make needed adjustments as soon as possible. In some administrations, however, the design and monitoring functions have been split, based on the idea that this can provide better objectivity and a neutral assessment of how well programs and procedures actually work.

Monitoring, in this sense, refers to ongoing operational monitoring, not to more formal assurance activities such as internal audit and program evaluation. Most organizations have in place these forms of assurance (e.g. internal audit) in order that senior management has proper oversight of whether programs, policies and procedures are delivering what was expected and whether the programs, policies and procedures are in fact the right ones for the organization.

It is clear though that for medium and small organizations, splitting the design and monitoring functions would be difficult given the limited staff complement of these organizations and a desire to not overload the organization structure with a multiplicity of divisions and units.

There are also a number of support functions present in the headquarters organization that provide service to the entire tax administration. These include:

- **human resources**—to manage the human resources function for the entire administration, including staffing and recruitment, compensation, employee relations (all set within the broader government context managing the employment relationship)
- **finance and budgeting**—managing and overseeing the budget allocated to the tax administration and its further allocation to headquarters and field units

²In a larger administration, each function would be headed by a senior manager. In some smaller administrations, several functions may be managed by a single HQ manager, given the challenges of scale.

- **corporate planning**—preparing a regularly updated strategic plan and overseeing the development of operational and work plans by individual units
- **information technology**—managing the tax administration’s IT platform (including both its hardware and software)
- **internal audit and internal investigations**—reporting directly to the head of the administration, undertaking internal audits and internal investigations of staff as needed.

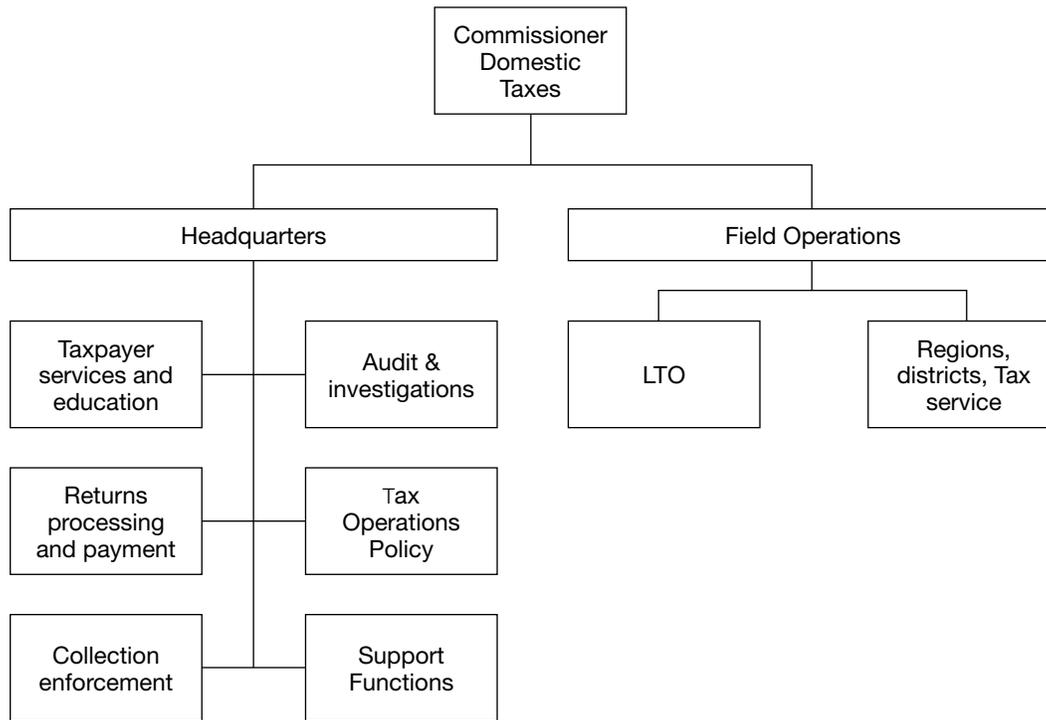
Depending on the size of the organization, these HQ support functions are sometimes grouped together into one cluster that reports to the head of the tax administration. HQ support functions provide functional direction to field units in the same manner as described for tax administration functions.

As described in the previous section of this note, the field organization mirrors that of headquarters but is focused primarily on operational and program delivery. The nature and size of the field organization will be influenced by many factors, including geography and the scope of taxes or fees administered (which drives the need for accessibility e.g. drivers licenses and vehicle registration). Some tax administrations have opted to organize their field structure by specific segments or components of the taxpayer population i.e. large, medium or small. Offices structured in this manner could provide a complete range of tax administration functions but would focus particularly on the needs and compliance challenges of the taxpayer segment in question. Alternatively, some functions could be shared across segments for economies of scale (e.g. returns and payments processing), or could be regionalized or concentrated in a few locations where there is sufficient critical mass.

The shape and structure of tax administration field organizations have changed in recent years. Government pressure for greater efficiency has in some cases forced a review of the field office network and resulted in a smaller number of larger offices. Equally, the increasing presence and power of information technology as a tax administration tool has changed the nature of service delivery (with more tax administrations relying less on physical presence and more on the Internet and telephone). However, it remains the case for many countries—and especially for developing economies—that decisions on the field organization are driven by the need for a physical presence across the country.

A typical organization chart for a function-based tax administration organization is shown at Figure 1.

Figure 1. Typical tax administration function-based organization



IV. What Are The Main Advantages Of A Function-Based Organization?

There are several advantages to a function-based organization when compared to a tax-type organization.

Greater uniformity and specialization across the organization. All core tax administration functions are grouped together, overseen by one senior official, with processes designed and delivered in the same way—regardless of where the taxpayer lives in the country. The organization can capitalize on this structure by building on the core knowledge and expertise it has grouped together in the various disciplines. For example, locating audit staff within the same headquarters unit results in synergies that would not otherwise be possible. One set of direction is given to the field offices for service, processing, payment and audit and their work is monitored accordingly.

Improved compliance results. The tax administration benefits from a complete view of taxpayer behaviour across all tax types. The administration is able to identify trends in non-compliance and act more quickly to address these trends. Individual taxpayer behaviour is also more easily observable.

Simpler processes for the taxpayer and the administration. Common processes for core functions (rather than variations on these processes depending on the type of tax) result in easier and simpler interactions for the taxpayer. With only one access point for registration and service (although perhaps multiple channels), one point for payment and another in the event that the taxpayer is audited, the taxpayer is not forced to repeat these interactions across each tax type. This results in simpler tax administration processes.

Centers of excellence. One of the strengths of the function-based tax administration is the ability to develop specialties within the administration. For example, all work related to registration is located in one place within the organization so tax officials can study, research, develop and perfect new techniques and approaches to ensuring that the taxpayer register is as complete and accurate as possible. This same approach holds true for other specializations within the tax administration.

Better resource management. Resource management improves for several reasons. Overall administration costs should be reduced as duplicated processes are eliminated. For example, the function-based organization only requires one IT system and support team, not multiples for each type of tax. Productivity should be enhanced, meaning that the administration can do more with the same amount of resources. The tax administration will also be better positioned to determine resource allocation, with headquarters assessing the needs of field operations and making informed investment decisions. The function-based organization also makes it easier to respond to seasonal peaks in one area (e.g. returns processing) when other parts of the organization may not be subject to a similar workload.

A tool for integrity. The function-based tax administration shares responsibility for all tax types across functional lines. As no one unit or division is entirely responsible for one tax, the opportunity for collusion amongst officers is reduced.

V. How Does The Function-Based Organization Work?

The function-based organization can be complex. As the organization chart at Figure 1 shows, all unit heads could report directly to the commissioner or director general of the tax administration or through a senior manager to maintain workable management spans of control.

The organization structure is based on two important principles: (1) that it is necessary to have policy direction and oversight located at headquarters and separate from actual field operations and (2) that policy direction should be organized by functional specialty i.e. service and registration, processing and payment, collections enforcement, audit, and tax operations policy.

The function-based organization does require a headquarters staff of sufficient size to monitor the overall health of the tax administration system, formulate national strategies to achieve improvements in overall performance, design reform initiatives and arrange for their imple-

mentation, and then to evaluate the results of such reforms. At the same time, headquarters is also responsible for monitoring operational performance to detect negative trends that may require a timely and cross-country response.

While the head (or heads) of field operations report to the commissioner, they receive direction from each expert headquarters unit, depending on their area of specialization. Field offices are usually structured in a manner that mirrors the functions established at headquarters. In this way, services are properly set up for taxpayers, staff efficiency can be maximized, and the locus of functional direction will be clear. Depending on the size of the organization, some tax administrations opt to have all field offices report directly to the commissioner (for larger administrations) while others choose to have subordinate field managers report to one person who in turn reports to the commissioner. A large tax administration might also choose to organize its field offices into a smaller number of regions and these regions in turn would report directly to the commissioner. As noted earlier, some administrations have created large taxpayer offices (LTOs) and even medium taxpayer offices (MTOs) as key components of their field network.

Recent work by the OECD shows that larger economies, such as Australia, Canada, Ireland, New Zealand and the United States tend to have a greater number of staff assigned to headquarters.³ Table 1 shows percentages as reported to the OECD for 2008. It is difficult to make meaningful comparisons between countries as there are differences in what countries consider to be headquarters functions (note the range between Netherlands at .05 percent and Iceland and Switzerland at 100 percent).

Table 1. Selected OECD countries—percent of total staff at headquarters

Country	Percent	Country	Percent
Australia	15	Luxembourg	15
Belgium	3	Mexico	25
Canada	21	Netherlands	0.05
Czech Rep.	1	New Zealand	23
Denmark	1	Norway	4
Finland	7	Poland	4
Germany	1	Portugal	12
Greece	5	Slovak Rep.	9
Hungary	8	Spain	12
Iceland	100	Sweden	3
Ireland	18	Switzerland	100
Italy	4	Turkey	3
Japan	1	United Kingdom	9
Korea	4	USA	20

Source: OECD Report

³OECD: Tax Administration in OECD and selected non-OECD countries. Comparative Information Series (2008).

Little formal information is available on the actual break-down of staff across the core headquarters functions of taxpayer service and registration, returns processing and payment, audit, collections enforcement and tax operations policy. In recent years, IMF advice has developed international best practice along these lines:

Table 2. Division of staff across headquarters functions

Headquarters function	%
Taxpayer service and registration	15–20
Processing and payment	10–15
Audit	25–30
Collections enforcement	15–20
Large taxpayers	8–10
Support services	10–15

Source: Various IMF technical assistance reports

An example related to audit may serve to illustrate how the function-based organization works in practical application.

The headquarters audit unit determines the overall audit strategy and plan for the year, sets audit coverage rates and expected results, allocates resources to field units for audits, and provides support and guidance to field units for more complex cases. Headquarters also develops and manages the delivery of audit training. The field unit carries out audits according to the plan set by headquarters, uses the resources assigned, follows appropriate guidance and direction and manages the overall workload and performance of its auditors. The field unit informs headquarters of challenges in achieving the expected plan and results, of trends in non-compliance as they emerge and seeks discussion with headquarters on the resolution of more complex cases. Box 1 describes the case of Canada.

Box 1. Canada: A function-based tax administration

On November 1, 1999, the Canada Customs and Revenue Agency (CCRA) was created as an agency of government (assuming the functions of the former Department of National Revenue). It is responsible for the administration of tax programs as well as the delivery of social and economic benefits. It also administers certain provincial and territorial tax programs. In addition, the CRA has the authority to enter in to new agreements with the provinces, territories and other government bodies to administer non-harmonized taxes and other services at their request and on a cost recovery basis.

The CRA is lead by a Commissioner and employs close to 40,000 people. It has a function-based organization structure with a headquarters that includes branches for:

- Taxpayer service and debt management
- Compliance
- Assessment and benefit services
- Legislative Policy and Regulatory Affairs
- Assessment and collections
- Appeals

These branches set national programs, develop operational policy and procedures and monitor performance against targets that they set. They play a role in resource allocation to a network of field offices that includes five regional offices and a number of subordinate tax offices.

The CRA is also supported by a number of corporate branches that provide essential support and these include internal audit and evaluation, finance and administration, human resources, information technology, legal services, public affairs and corporate strategies and business development.

VI. How Is Management Direction Given in the Function-Based Organization?

In the case of the function-based organization, management direction means guidance or direction that cuts across normal, vertical lines of authority in an organization. It refers to direction or guidance provided by headquarters to field offices as well as guidance provided by one branch of the organization to another.

Management direction includes matters of both policy and procedures. It usually takes the form of formal directives, operating memoranda, instructions or written guidance. It can also consist of informal guidance by telephone, e-mail or in person. In the context of tax administration, direction often takes the form of a headquarters unit setting and communicating policies to field offices who in turn deliver the corresponding programs and services. The notion

of management direction in this model is closely tied to accountability – if a field office takes direction from headquarters that office is clearly accountable to headquarters for what it does.

There are many management challenges that prevail in a function-based tax administration. The success of this model depends heavily on the skill of senior management and their ability to work in the sort of matrix management model described earlier in this note. Dual accountability and reporting relationships characterize the function-based administration—no matter what the size of administration that chooses this course of action.

In a function-based organization in tax administration, there is a need for clarity, standards, authority and a compliance mechanism to ensure success:

- **Clarity**—those with mandated functional responsibility must review the legal framework and government policies that control governance. An accountability structure would then be created that matches the responsibility.
- **Standards**—well-enunciated policies, processes and expectations are the keys to success. Standards must be communicated to responsible staff and this should include proactive education and training programs.
- **Authority**—Clear accountability is central to success. Horizontal accountabilities must be clearly understood and communicated.
- **Compliance**—the headquarters office that sets the standards should be responsible for measurement and compliance tools.

Functional direction is a feature of most modern public sector organizations but problems in functional direction generally stem from confusion about roles and responsibilities combined with inadequate communication between managers and a lack of attention by senior management.

Practical experience shows that for functional direction to work well three basic requirements must be met:

1. ***The roles and responsibilities of both the operational and headquarters functional management must be clearly defined***—this means setting out clear accountabilities so that staff knows to whom they are accountable for each aspect of their work. It also means making careful distinctions between formal functional direction and the softer functional advice or guidance.
2. ***Good communication must be maintained between headquarters and operational managers at all levels.*** Functional direction puts a premium on the need to work together on specific issues. Field managers must know what direction or advice their staff are receiving from headquarters while headquarters managers must get feedback from field offices if they are to ensure that their policies fit the operational reality.

3. *Senior management must hold both the line and headquarters managers accountable for their respective responsibilities*—with responsibility divided horizontally and vertically.

IV. Key Points For Tax Administration Design

- A function-based organization for tax administration is the most effective organization to launch successful reforms and to support a modernization program.
- A function-based organization is based on fundamental principles of matrix management. Managers have dual accountabilities to both vertically (the traditional reporting relationship) and horizontally (from headquarters to the field office and back).
- The function-based organization offers the best possibility of developing specialities within the tax administration i.e. registration and services, returns and payment processing, audit etc and allows for the development of centres of excellence.
- Managing within a function-based organization can be complex, depending on the size and overall geographic spread of the organization. It requires a high degree of management vigilance and some countries may want to consider implementation in phases to ensure success.

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