

**International Studies Program
Working Paper 06-12
January 2006**

**The Reform of the
Tax Administration in Spain**

Jorge Onrubia



**International Studies Program
Working Paper 06-12**

**The Reform of the Tax Administration
in Spain**

Jorge Onrubia

January 2006

International Studies Program
Andrew Young School of Policy Studies
Georgia State University
Atlanta, Georgia 30303
United States of America

Phone: (404) 651-1144
Fax: (404) 651-4449
Email: ispaysps@gsu.edu
Internet: <http://isp-aysps.gsu.edu>

Copyright 2006, the Andrew Young School of Policy Studies, Georgia State University. No part of the material protected by this copyright notice may be reproduced or utilized in any form or by any means without prior written permission from the copyright owner.

International Studies Program Andrew Young School of Policy Studies

The Andrew Young School of Policy Studies was established at Georgia State University with the objective of promoting excellence in the design, implementation, and evaluation of public policy. In addition to two academic departments (economics and public administration), the Andrew Young School houses seven leading research centers and policy programs, including the International Studies Program.

The mission of the International Studies Program is to provide academic and professional training, applied research, and technical assistance in support of sound public policy and sustainable economic growth in developing and transitional economies.

The International Studies Program at the Andrew Young School of Policy Studies is recognized worldwide for its efforts in support of economic and public policy reforms through technical assistance and training around the world. This reputation has been built serving a diverse client base, including the World Bank, the U.S. Agency for International Development (USAID), the United Nations Development Programme (UNDP), finance ministries, government organizations, legislative bodies and private sector institutions.

The success of the International Studies Program reflects the breadth and depth of the in-house technical expertise that the International Studies Program can draw upon. The Andrew Young School's faculty are leading experts in economics and public policy and have authored books, published in major academic and technical journals, and have extensive experience in designing and implementing technical assistance and training programs. Andrew Young School faculty have been active in policy reform in over 40 countries around the world. Our technical assistance strategy is not to merely provide technical prescriptions for policy reform, but to engage in a collaborative effort with the host government and donor agency to identify and analyze the issues at hand, arrive at policy solutions and implement reforms.

The International Studies Program specializes in four broad policy areas:

- Fiscal policy, including tax reforms, public expenditure reviews, tax administration reform
- Fiscal decentralization, including fiscal decentralization reforms, design of intergovernmental transfer systems, urban government finance
- Budgeting and fiscal management, including local government budgeting, performance-based budgeting, capital budgeting, multi-year budgeting
- Economic analysis and revenue forecasting, including micro-simulation, time series forecasting,

For more information about our technical assistance activities and training programs, please visit our website at <http://isp-aysps.gsu.edu> or contact us by email at ispaysps@gsu.edu.

The Reform of the Tax Administration in Spain

Jorge Onrubia
Universidad Complutense de Madrid

Introduction

It is hard not to agree with Aaron and Slemrod (2004) when they state that tax administration is the dullest of topics and government function that arouses powerful emotions. A probable explanation for this lies in the wisdom in the following anonymous quote: “It would be nice if we could all pay our taxes with a smile, but normally cash is required. Throughout tax history, in any country, that is how it is and that is all there is to it.”

However, we can not ignore the influence over tax compliance that the tax system in every country may have. The tax system and the tax administration charged with enforcing it ought to be consistent. It is not possible for a rudimentary tax administration to manage complex taxes like some currently applied in developed countries. Efficiency

in tax administration is not only a matter of administrative costs but also of compliance costs. Modern tax systems which involve complex taxes require high levels of human and capital resources, including information technology, to make them reasonably easy to comply with by taxpayers. The bottom line is clearly expressed in a well-known maxim attributed to an Italian economist and prominent statesman Luigi Einaudi: “Any tax system ends up being largely worth what the tax administration in charge of its management is worth.”

In the case of Spain, Einaudi’s maxim tends to reflect reality quite perfectly. Like in many other countries, the history of Spanish tax reforms can not be understood without bearing in mind the evolution of the Spanish tax administration through the corresponding time periods. This interdependence in Spain must also be seen through the lenses of the evolving political framework. As we will see in the second section of this chapter, the almost four decades that General Franco’s dictatorship lasted, prevented the Spanish tax system from moving in parallel with developments in tax policy and administration in OECD countries. So, Spain kept, until late seventies, an obsolete tax system, more typical of the beginning of the twentieth century, in which schedular taxes, together with a cumulative multistage general tax on sales, were the main tax figures.

In correspondence with this tax system scenario, at the beginning of the political transition’s tax reform in 1977, Spain had a very centralized tax administration with only a few General Directorates, which were incorporated within the formal organizational structure of the Ministry of Finance with fairly limited autonomy. Besides the central tax administration at the center, town councils had their own tax administrations, although

these were rather small services for collecting from and inspecting local business and administering real property taxes and several minor local charges.

The adoption of a modern tax system included a progressive personal income tax and a corporate income tax, and later on the European harmonised Valued Added Tax. This became the backbone of the central government tax revenues and forced the ineluctable transformation of the Spanish Tax Administration. These initial stages in the modernization of the tax administration culminated, in 1991, into an entirely new organizational arrangement, the State Tax Agency. Since then the great challenges of the State Tax Agency have been the fight against tax evasion, the reduction of both tax administration and tax compliance costs, and the widespread implementation of an effective assistance-to-taxpayers' service. These challenges have largely provided the guidelines for the Agency's human resources policy as well as its technological investment policy. However, this evolution did not involve only the expected management issues, typical of the tax administration in other developed countries. An unknown (to Spain) new element arose in the middle of this process of tax administration reform: the deep political decentralization process at the regional level. Decentralization meant a complete change in the assignment of tax powers and, in consequence, forced a redefinition of the global objectives that ought to guide tax administration policy and reform.

This chapter deals with the evolution of tax administration in Spain from the initial stages of the democratic process, way back in the second half of the seventies, up to the present time. Given the relevance of the classical interrelation between the tax reform processes and tax administration reforms, we review the main events and milestones in

the last three decades. We analyse the influence that institutional, economic, and political factors have had on both the architecture of the tax administration and its organizational behaviour. Nevertheless, based on what we have just said, the performance of the Spanish tax administration cannot be satisfactorily assessed without explicit reference to the deep decentralization experienced by the Spanish tax system from the early eighties, and especially since 1994. That is why a considerable part of the chapter is devoted to analyze the role played by the successive reforms of the Autonomous Communities' financing system, and the decisions of the regional governments themselves, in shaping Spain's tax administration.

This chapter is organised as follows. In section 2, we review the main features of the Spanish tax system prior to the first tax reform under democracy in 1977, as well as the situation of the Spanish tax administration in that period. This retrospective look is essential for understanding aright how the challenges faced in the building of a modern tax administration system. Section 3 is devoted to considering the demands imposed on the Spanish tax administration by the new taxes implemented through the 1977–1978 tax reform. In section 4, we review the limitations in the organization of the tax administration revealed at the end of the eighties; our focus is on identifying the factors that drove the central government to turn the State tax administration into a semi-autonomous State Tax Agency in 1991. The creation and development of the State Tax Agency, which lasted until 1996, is considered in section 5. Section 6 is devoted to analyzing how tax-sharing arrangements and the devolution of taxing powers to the Autonomous Communities influenced the organizational model of the State Tax Agency starting with 1997. Section 7 examines the effects of the tax reform of 1998 and the

consolidation of a new administration paradigm focused on taxpayer services. Section 8 tries to ascertain to what extent the State Tax Agency is an autonomous institution in relation to political power, assessing its successes and failures up to now. Section 9 concludes.

Spanish Tax Administration before the Democratic Tax Reform of 1977.

An adequate understanding of the last three decades of tax administration reforms in Spain requires knowing the realities of the Spanish tax system in the years prior to the transition to a democratic state after General Franco's death. The essential economic reforms, including the opening-up of the economy to international trade, taken in the Stabilization Plan of 1959 as a result of the agreement reached between the International Monetary Fund and the Spanish Government, brought about the beginning of a long period of significant economic growth (so-called "the sixties' Spanish economic development").

However, the dictatorial regime preserved an economic model of state intervention characterized by a low level of budgetary activity, with total expenditures barely reaching 25 percent of GDP in 1975. Moreover, from a qualitative point of view, the composition of budgetary expenditures and programs differed considerably from the ones in more developed European countries, which were immersed at the time in the full building of the Welfare State. Public expenditures in health, education, and social security benefits, including unemployment benefits, were very limited in Spain in comparison to its northern European neighbours. A similar profile existed for public investment. Public revenues, mainly taxes, did not compare well with European standards. Tax burdens in

Spain were substantially lower than the average for the developed European countries and the composition of taxes was also quite different. Among the most important taxes were Social Contributions (around 10 percent of GDP) together with indirect taxes (about 7 percent of GDP). Direct taxation contributed to tax revenues was only 6 percent of GDP. Furthermore, most direct taxes (4.5 percent of GDP) were schedular taxes with proportional tax rates, which taxed separately different income sources such as income from labour and returns to financial investments.

Nevertheless, the presence of the public sector in the Spanish economy was very considerable through huge numbers of public enterprises which practically all sectors of the economy, and an extensive regulatory framework of the business sector. During this period, intensive public intervention policies were adopted with little regard for efficiency considerations, and in a large number of cases they were instruments for job creation, mechanisms to transfer income, or simply restrictions to market competition.

The tax system was not only obsolete and short of fundraising power, but it also lacked any ability to redistribute income and wealth. Most taxes in force in that period had proportional statutory rates. After accounting for the high tax evasion levels, mainly among high income citizens, it is quite likely that the tax system was *de facto* regressive.

A far from complete list of deficiencies of the tax system back then would include:

- A much lower tax burden than the average in OECD countries (24 percent against 40 percent in 1977).
- A tax yield insufficient even to finance the reduced public expenditure (around 25 percent of GDP).

- A schedular income tax structure including a payroll tax, an industrial and commercial profit tax, both with proportional rates, and an obsolete presumptive tax that was applied separately to each professional group. Taxation of capital income included proportional taxes on interests and dividends. The payment of these direct taxes was made by tax receipts emitted by the tax administration using information from taxpayers' censuses.
- Although there was a so-called "general personal income tax", this tax was only applied to a very limited percentage of the population (1 percent). The levels of tax avoidance and evasion corresponding to this tax were very high.
- There was a general Corporate Income Tax, with a statutory rate of 32 percent, but its taxable income was beset by exemptions and others discriminatory tax treatments targeted at sheltering important sectors of the economy such as utilities and building enterprises. The deep economic crisis of the seventies and the existing generalized tax avoidance and evasion cut the yield of this tax to a bare 1 percent of GDP.
- The main piece of indirect taxation was a cumulative multistage general tax on sales (*Impuesto General sobre el Tráfico de Empresas, IGTE*). There also were several excise taxes on production, distribution and consumption of alcoholic drinks, tobacco, petrol, and other specific goods. In addition, a luxury tax was imposed on some goods and services.

In regard to the tax system as a whole, it is by no means surprising to find that the tax administration in charge of its implementation was quite modest in terms of size and

means. The main features of that Spanish tax administration previous to the democracy tax reform of 1977 were:

- The organizational structure was overly simple, integrated by two General Directorates of the Ministry of Finance. One, the *Dirección General de Inspección* (General Directorate of Tax Audit) was dedicated to the management and enforcement of the general internal taxes. The second one, the *Dirección General de Aduanas e Impuestos Especiales* (General Directorate for Customs and Excise Taxes) was in charge of especial domestic levies and taxes on foreign trade.
- The territorial organization across the country was very centralized. There was only one tax office, the *Delegación de Hacienda*, in each one of the fifty provinces that integrated Spain, and located in the provincial capital (recall that it was not until the early 1980s that Spain introduced the current regional level of government, the Autonomous Communities).¹
- The number of employees to the service of the tax administration was quite reduced. Approximately, in 1977 there were 9,000 public employees (in comparison to 30,000 in 2003.) This fact is quite significant for the effectiveness of the tax administration at the time given that the general approach was a labour-intensive tax administration system. There were several classes of public employees according to specialization:
- Information technology was practically not available until the second-half of the 1980s. The first stage of the general computerization of the tax management culminated in the year 1986, at the same time that the Value Added Tax was introduced in the Spanish tax system.

- The number of taxpayers in the tax net was proportionally small. The 400,000 taxpayers in the tax books in 1977 have been multiplied by almost 40 (more than 15.5 million taxpayers) in 2003.
- With the exception of the tax payments collected using withholding and through repercussion-in-price mechanisms, the tax collection was in the hands of private agents devoid of administrative status, especially in the case of collection of overdue tax liabilities.

In conclusion, Spain had a small-sized tax administration only appropriate for the obsolete tax system that it had to manage. In addition, the training of tax officials not in many cases suitable owed, among other things, to the absence of a tax-culture similar to that existing in other European countries at the time. In this regard, we should point out that until the 1980s there did not exist a law regulating the holding of multiple private and public posts applicable to the public employees in the tax administration service and elsewhere in the Spanish public sector.

Building a New Tax Administration for a Modern Tax System (1978–1987).

The world economic crisis that burst after the first oil shock in 1973 caught Spain in the middle of the transition process towards a democratic regime. The structural problems the Spanish economy had accumulated over the previous stage deepened the effects of the oil crisis. The political situation after the first democratic general elections held in June 1977 did not facilitate the adoption of many necessary and urgent measures to confront the economic crisis.

In the context of the public finance, several structural and relating-to-the-moment factors seriously affected Spanish fiscal sustainability. The clearest sign of the lack of sustainability was the increasing public deficit (Fuentes-Quintana, 2004:175). The meagre provision of public services and public utilities and the practical absence of a system of social protection --comparable to what other European countries had developed-- pushed public expenditure up exceedingly. The obsolete existing tax system was incapable of bringing in sufficient revenues to a budget which was under severe pressure from demands for social expenditures that had surfaced after many years of an autocratic political regime. Besides the thin revenue-collecting potential aggravated by the 1970s economic recession, the existing taxes were extensively evaded.

The high levels of evasion had several roots. Firstly, a poor tax culture did not encourage tax compliance. Secondly, the important limitations of the tax system with regard to distributive justice, both in terms of horizontal and vertical equity, discouraged tax compliance, especially among the middle-class, who felt that they may be the only ones paying taxes. Lastly, as we have seen, there were important problems of organisation, resources and adequate legal framework, all of which affected the effectiveness of the tax administration.

The alarming situation of the Spanish economy in the summer of 1977 prompted the then appointed President of Government Adolfo Suarez to commission a program for putting the economy back on a sound footing, which was given the title of *Programa de Saneamiento y Reforma Económica*. This economic program was to become the basis for the Moncloa's Pacts of October of 1977, agreed to after obtaining a broad political consensus with all the political parties with representation in the Parliament. The

peremptory need for dealing with the reform of the tax system played a start–part in the design of these historical political agreements, which among other things established that the tax reform should be initiated before the end of 1977. This reform was to include the following taxes: a) a personal income tax (*Impuesto sobre la Renta de las Personas Físicas*, hereafter *IRPF*), with a comprehensive tax base and a progressive tax schedule, that should replace the old schedular income taxes that had prevailed until then; b) a permanent (non transitory) personal net wealth tax, properly harmonized with the IRPF to avoid its confiscatory character, applicable on real wealth bases and with a progressive tax schedule; c) a corporate income tax, without the discriminatory exemptions for special economic sectors that had been so frequent in the previous tax on corporate income; d) In relation to indirect taxation, an appeal to the inescapable need to align the Spanish tax system with the taxes applied by the member countries of the European Economic Community. This effectively meant the introduction of the Value Added Tax (here after VAT) as main figure of the general taxation on consumption. However, in this case no time limits were set, in part to avoid possible negative effects on the price level, which at the time was still out of control.

In spite of the political conflict inherent in any tax reform, in so far as it produces alterations *in the status quo* among interest groups, the Spanish tax reform coming out of the Moncloa's Pacts had an extensive political acceptance, at least in the first years after its implementation. In the early seventies, still in the last years of the dictatorship, the *Instituto de Estudios Fiscales* (Spanish Institute for Fiscal Studies), the think tank attached to the Ministry of Finance, directed by the famous Professor Fuentes–Quintana, had prepared several reports that included concrete proposals for the reform of the

Spanish tax system. Although these proposals were initially sterile due to the absence of political will on the part of the governments of General Franco, with the arrival of democracy, the rigorous studies allowed a considerable acceleration for the parliamentary approval of the tax laws.

It is now common knowledge in the literature on tax reform that any substantial modification of the tax system should take into account the possibilities and limitations of the tax administration in charge of managing and enforcing the new taxes (Bird, 1990, Musgrave, 1970, Slemrod, 1992). But in the case of Spain the tax reform initiated in 1977 played a deeper role than the usual tax reform. In many ways it was conceived like an indispensable social commitment to guarantee the process of political transition towards democracy (Lasheras, 1990). Through the reform, the political class intended to send an unmistakable message to society about the irrevocable will to establish an internationally comparable democratic regime in Spain. Therefore, although there was immediate recognition of the need to reform the tax administration, this task was considered secondary and something to take on after the respective tax acts came into effect. Therefore, the reforms in tax policy jumped ahead of the existing capabilities in tax administration, but with a clear sequence established for the administrative reforms that were to follow².

The tax reform initiated in 1977 was phased-in over the next eight years, starting with the first measures in early 1978 and concluding with the last measures in 1985. The tax reform of the new democracy opted for implementing a modern tax system, conforming to the systems in the most developed countries. The aims pursued by the reform of 1977 can be summarized as follows:

- The new tax system should provide enough public revenues for financing the “new public sector.” The old taxes proved unable to finance the limited public expenditure in the early seventies. In this respect, the foreseeable Spain's integration into the European Economic Community suggested an important increase in public expenditure for the “construction” of the welfare state (increased public health, education, housing, public pensions, and other public subsidies and grants, such as unemployment benefits). In addition, the need to provide public infrastructures comparable with the EEC standards also was expected to significantly contribute to the expansion of the budget. From a social point of view, it must not be overlooked that after four decades under a dictatorial regime, the new democratic regime was expected to stimulate people’s demand for public services and social benefits.
- The reduction of inequality in the distribution of income was another main objective of the tax reform. The old pieces of the Spanish direct taxation had not contributed to any noticeable degree of progressivity, since these taxes had proportional tax rates and tax evasion was unusually high among the top income groups. For improving income redistribution, it was necessary to introduce a substantial progressive tax, such as the personal income tax (*IRPF*). This tax was devised in accordance with the dominant trends in the OECD countries at that time: a comprehensive taxable income base that added almost all income sources, a progressive tax schedule with more than thirty tax brackets, numerous tax credits and allowances (for dependents, age, financial investments in public debt and stocks issued, home buying and so on).

- The IRPF, introduced in 1979, involved a withholding tax system applied to labour and financial investment incomes. For labour income, the withholding was calculated monthly as a percentage of gross wages from an annual wage scale that was adjusted based on the number of children and marital status. Whenever a taxpayer received interests or dividends, a fixed percentage of that income was withheld at source. However, capital gains and rents from property were not subject to withholding. For the self-employed a withholding fixed percentage was deducted on their professional revenues when these were paid by individual entrepreneurs, other professionals, corporations or other institutions. On the other hand if the income came from final consumers the withholding did not apply.
- In accordance with the first Law passed by Parliament initiating the tax reform –Law 50/1977 de *Medidas Urgentes de Reforma Fiscal* (Law of Urgent Measures on Tax Reform)– a personal net wealth tax was introduced in 1978 into the Spanish tax system for the first time in the history of the country. Really, this new tax did not aim at either increasing tax revenue collections or achieving important redistributive effects. The main justification for this tax was to have information and control of all sources of income. At the time, there was a widely held belief that without this information on taxpayers’ financial and real-estate assets, it would become practically impossible to apply the new personal income tax uniformly. Being conscious of the huge tax evasion there was in the pre-democratic Spain, the reformer Government coupled the introduction of the wealth tax with a tax amnesty. Under this amnesty, all taxable incomes derived from any asset, or any rights or liabilities, filed in the personal net wealth tax return were exempt up to 31

December 1978. This measure aimed to motivate taxpayers to reveal hidden income sources. This was essential for a successful implementation of the new IRPF. Obviously, from that time on, if tax inspectors found out about any other undeclared source of income, it was to be regularized with the appropriate tax liability and penalties and interest on taxes not paid³.

The approval of the personal net wealth tax was complicated and had to be negotiated within the Moncloa's Pacts signed in October 1977. In fact, when the Government proposed its inclusion, it led to significant social controversy, with an important protest movement coming from the right political parties and economic powers. The passing of this tax law in Parliament required the inclusion of the adjective "temporary" in the name used for the tax: *Impuesto Extraordinario sobre el Patrimonio Neto* (Temporary Personal Net Wealth tax).⁴

Although the new personal and corporation income taxes came into force in 1979, the tax administration essentially remained the same until 1984. As pointed out above, all along, the discussion of the new tax system considered the reform of the tax administration as indispensable. However, the implementation of this plan was tackled in a gradual manner, or a reform that could not be hurried. Up to a point there was a general understanding that the approval of the new legal procedures itself would modernize the tax administration, but the actual changes in tax administration would come later on. Thus, we are indeed faced with a permanent feature of the successive Spanish tax administration reforms: The dissociation between the design of the organisational architecture and the administrative procedures that should govern the application of the different taxes. In fact, this strategy has not been exclusive to the tax administration, but

rather it has been present in all the processes of reform of the Spanish public administration.⁵

In order to understand the intricacy of these tax changes, it is necessary to take into account some features of the Spanish tax administration in those days, which determined a particular model of tax relations both from the taxpayer point of view and the Spanish Tax Administration. In this respect, it is worth mentioning two:

- a) Firstly, the changes in the legal tax procedures were rather limited, concerning only those matters directly related to the new taxes. On this point, it must be highlighted that the new taxes, introduced in the 1977 Reform, had to be paid by means of a self-assessment principle. This contrasts with the previous schedular taxes which were levied through receipts prepared by the tax administration or using a simple at-source mechanism and in the absence of annual tax returns. The adoption of self-assessment brought about a complete revolution for the Spanish tax administration. At the time, the tax administration was faced with the need to process several millions of tax return (8 million for 1979, the first year of the new IRPF, against the 1.5 million the year before, under the previous personal income tax).

We must also take into account that the *Ley General Tributaria* (Spanish General Tax Law) in charge of governing all tax procedures (procedures on tax management, tax inspection, tax collection, taxpayer's complaint, and tax refunding) dates back to 1963. As an example, this law did not regulate explicitly the self-assessment procedure until 1991 even though it had become absolutely dominant since 1979 in the application of the tax laws. Actually, it was not until the more recent General Tax Law of 2003 that the principle of self-assessment became worthy of the legislators' appropriate attention.

b) Secondly, the organizational structure of the central tax administration remained almost unchanged after the 1979 reform, with its two General Directorates, one for Tax Inspection, and the other one for Customs and Excise Taxes. The innovation was the *Dirección General de Tributos* (General Directorate for Taxes) with competence for designing tax regulations and establishing the criteria for their enforcement. These three General Directorates were accountable to the *Subsecretario* (Deputy Minister of Finance) and predominantly carried out a political role. But, it should also be noted that during this period, the Data Processing Centre started to receive attention within the organization. This Centre would play a crucial role over the following years in the computerization of the tax administration.

The first assessment of the application of the new taxes was done in 1983 when the Socialist party formed a new government after its electoral win in October 1982. The results obtained from the evaluation revealed a general popularity of the new taxes, but also the figures provided by the Ministry of Finance showed the existence of a substantial level of tax evasion. The average taxable income for businessmen and the self-employed were quite lower than the mean of income declared by employees subject to withholding. Moreover, the worsening of the economic crisis, consequent to the second oil shock, contributed significantly to the slowdown in tax collections. The government could not remain indifferent to this situation. The fight against tax evasion began to grow in importance on the government's agenda. These circumstances led to the inevitable re-organization of the tax administration, including the need to substantially increase the

human resources and capital investment needed for developing powerful information systems.

Let us now focus on another important aspect of the tax administration in the early democratic period. This was the commitment to the modernization of tax management in the broadest sense. The first step for achieving this objective was to design and implement a new tax management procedure. This was just called the *Nuevo Procedimiento de Gestión Tributaria*, commonly known inside the Tax Administration as NPGT. Two determining and related factors influenced this decision. On the one hand, the increased use of self-assessment for collecting the main levies of the new tax system. On the other hand, the above mentioned spectacular increase in the number of taxpayers.

The new taxes required not only to file one tax return form a year, but also a large number of quarterly tax returns for prepayment of income taxes, withholding tax payments, and any other periodic tax payments, such as the VAT payments. In the words of the OECD (2004), the use of self-assessment principles represent an abandonment of traditional administrative procedures on efficiency and effectiveness grounds, in favour of a more targeted verification approach to verify the information contained in millions of tax returns.

Since the taxpayers became responsible for calculating the tax liability, it was necessary to redefine the administrative control for all tax returns filled out by any natural person or legal entity. This new view of tax management brought about a new and urgent need on the side of the taxpayers. The tax administration had to provide them with the necessary information in order for them to comply with their tax obligations appropriately. This new role forced the tax administration to allocate a considerable sum

of budget resources for creating tax information services and assistance to taxpayers in each tax office.

A key element for the development of the New Tax Management Procedure was the establishment of a unique and permanent taxpayer's personal identification code (so called, Tax Identification Number, *NIF*). From the moment *NIF* was introduced, it became compulsory to use it in all economic transactions with tax implications.

The computerised matching of all taxpayer's returns became a main requirement for proper enforcement of the tax laws. This was going to be the main organisational challenge to deal with in the implementation of the new income taxes and, especially the Value Added Tax, following Spain's integration into the EEC as member State in 1986.

The computerisation process of the Spanish State Tax Administration tackled two main targets in its initial phase. The first one was to take a reliable census of taxpayers. This taxpayer roll had to provide on time accurate information about all the tax liabilities and any other official requirement derived from the management of the state tax system. The delimitation of this set of tax liabilities for each taxpayer or their substitute was made by means of the definition of a tax vector which incorporated all the data with regard to these obligations as a whole. The second target corresponded with the computer processing of all tasks related to recording and supervision of millions of tax returns, monthly, quarterly or yearly, received in each local tax office as a result of the general application of the tax self-assessment mechanism.

The huge volume of interrelations among the annual tax returns and tax payments on account carried out by businessmen, the self-employed, and the withholding by employers, required an efficient computerized system by the Data Processing Centre.

Furthermore, most of the annual IRPF returns call for a refund for taxes overpaid, which should be done within the established time of about seven months from the time of tax filing.⁶

The computerisation process was carried out in an all-round way, including both the head offices and the over two hundred branch offices of the State Tax Administration in Spanish territory, except the Autonomous Communities of Basque Country and Navarre that enjoy a particular tax regime, the so called *Foral* regime, which includes their own tax administration for all taxes collected in their territories⁷. All the computer systems were managed by a central unit - the Data Processing Centre (*CPD*). In addition, local computer units (*ULIs*), provincial units (*UPIs*), and regional computer units (*URIs*) were created, following the territorial organization of the State Tax Administration. Its implementation involved a lot of budget resources, as well as a great deal of effort to train a large number of computer experts.

In the initial years, the non-existence of civil servant corps specialized in computing was a serious handicap. Nevertheless, this scarcity was alleviated in part by recruiting non-civil-servant public employees from the private sector, and also thanks to the meritorious effort of many public officials voluntarily involved in the modernization of the tax administration. All things considered, it can be said that the data processing effort allowed management, with reasonable effectiveness, to process the enormous number of tax returns and tax requests caused by the taxpayers' voluntary compliance. However, the important volume of information accumulated in the system was, for a time, underused in the fight against tax evasion.

With regard to tax audit, its performance was an exclusive task for the tax inspectors who had to be officials belonging to the special corps of State Tax Inspectors. Starting 1980, the administration created a new corps, the State Tax Sub-Inspectors, which, in a few years, was to become the bulk group of tax specialists.

From mid eighties, the central tax administration began to coordinate the tax inspection actions through the so-called “audit plans”, whose main objective was to select efficiently the taxpayers to be audited during the year. The administrative reorganization of the State Tax Inspection established three different levels to carry out the task of inspecting - one on a nationwide basis, through the National Inspection Office (head unit in charge of inspecting big business); a second one at the regional, and a third at the provincial level.

In addition, the central administration created two specific tax inspection units, one of them devoted to fight organized tax evasion, the *Unidad de Vigilancia y Represión del Fraude Fiscal*, and the other with exclusive competence in international tax matters. Broadly speaking, it can be said that the territorial decentralization of the tax inspection was less profound than in tax management units. The provincial level of inspection was especially strengthened under economies scale arguments (not completely confirmed.) Staff of the new Local Tax Administrations was fundamentally filled by officials of intermediate level (sub-inspectors) which took charge of auditing small businessmen and the self-employed. The main change in the upper organizational structure was to establish a new superior level of decision-making, the *Secretario General de Hacienda* (Secretary General of Finance), who was subordinate to the *Subsecretario de Hacienda*. From that

moment, all the General Directorates related to taxes had to report to the Secretary General of Finance.

In addition, the central administration created two new General Directorates for improving the implementation of the new taxes - The *Dirección General de Recaudación* (General Directorate for Tax Collections), and the *Dirección General de Gestión Tributaria* (General Directorate for Tax Management). The first Directorate would take charge of controlling the tax payments collected in a voluntary way, mostly through financial institutions, as well responsibility for unpaid tax liabilities. Until this time, this task had been assigned to private tax collectors. The second directorate would be in charge of organizing relations with taxpayers deriving from the usual management of taxes, as well as providing taxpayers information and assistance for preparing their tax returns. From an administrative point of view, the General Directorate of Tax Management had to keep the taxpayers' census up-to-date and recording and verifying all the tax self-assessments received. This General Directorate was also in charge of designing all the tax forms to be used by the taxpayers.

In short, the Spanish Tax Administration's new structure consisted of one directorship - the Secretary General of Finance -, who directed and coordinated the four operative General Directorates namely, General Directorate of Tax Inspection, General Directorate for Customs and Excise Taxes, General Directorate for Tax Collection, and the General Directorate of Tax Management. The Data Processing Centre, also hierarchically directly under the Secretary General of Finance, remained the main body responsible for tax data processing. All these General Directorates grew significantly in the size in terms of their human resources.

As mentioned above, the territorial deconcentration was the most important change in the organizational reform of the tax administration. In accordance with the new Spanish territorial political–organization, seventeen *Delegaciones Especiales del Ministerio de Hacienda* (Regional Offices of the State Tax Administration) were created, one in each Autonomous Community. From that time, the old *Delegaciones Provinciales de Hacienda* (Provincial Offices of the State Tax Administration) went on to be answerable to these Regional Offices.⁸ Nevertheless, the more important fact was the creation of the new Local Tax Offices, simply so–called *Administraciones de Hacienda*. This represented the establishment, across the country, of more than 200 Local Tax Offices, which sought to forge a closer relationship with the taxpayers. These Local Tax Offices were distributed across the cities and main towns of Spain, as well as in the districts of the big cities.⁹ The implementation of the new territorial organization was put into effect in two years.

The new figure of the Regional Office of the State Tax Administration meant a *de facto* deepening in the decentralization of the different aspects of tax management and it was quite crucial for the operational effectiveness of Local Tax Offices. In the new territorial model, the Principal Tax Administrator in each Autonomous Community took on the task of organizing all the available resources necessary for meeting management, inspection, and collection objectives allotted by the respective central General Directorate. This allowed the reorganization of the tax administration resources, bringing them closer to the special feature of each territory. Nevertheless, there still was inflexibility in human resources management caused by the standardized tradition of the

Spanish Public Administration system. This affected such main features as training, personnel careers, or wage policy.

Between 1982 and 1987, the territorial reform of the State Tax Administration led to an increase in human resources, practically by a factor of two (from 11,600 to 22,500 employees). At this stage, two new corps of tax government officials were created. The first was the *Cuerpo Especial de Gestión de la Hacienda Pública* (Tax Managers Special Corps) that would later become the biggest, and carried out tax management, inspection and collection activities. The second, the Tax Agents corps, was charged with getting information *in situ* about taxpayers' economic activities and their assets. In the early years of the introduction of the VAT, the function of Tax Agents was crucial, feeding back information on a serious black economy outcrop. Moreover, in 1984, different higher corps of tax government officials (tax inspectors, comptrollers, and others public expenditure officials) who work for the different Departments in the Ministry of Finance and for the *Dirección General de Presupuestos* (General Directorate of Budgets) were fused, creating a single higher corps of Inspectors of State Finances. However, officials from the previous Tax Inspectors Corps held nearly all the positions in the Tax Inspection units, thus restricting the entrance to members of other corps.

The Limits of the Former Organisation and the Drive Towards an Autonomous Tax Administration Agency (1988–1991).

As we reviewed in the previous section, the Spanish Tax Administration reforms, established between 1984 and 1987, represented an important transformation in the centralised model that prevailed until then. There is no doubt this change was fundamentally induced by the replacement of the old product–tax system for a modern

tax system, which included income taxes as a basic mainstay. In this respect, it can be said that the two principal elements that characterised the first phase of the reform were, on the one hand, the adaptation to the critical need to maintain relations with taxpayers, and on the other hand, the close-to-taxpayer policy promoted through territorial reorganization.

However, in the late eighties, almost ten years after the new income taxes came into effect in 1979 and after four years of the VAT introduction, everyday reality still showed important weaknesses in the operation of the Spanish Tax Administration. Once the initial effort for computerisation was practically finished and reached an acceptable level of tax system management, some important limitations started to emerge, especially in two areas. On the one hand, the fight against tax evasion did not seem to be effective enough. The Spanish society suspected the existence of high levels of tax evasion, something that already had begun to be corroborated in several studies. For example, the *Comisión para el Estudio y Prevención el Fraude Fiscal* (Commission for the Study and Prevention of the Tax Evasion), instituted by the Spanish Parliament for evaluating the IRPF compliance, quantified the taxable income concealment for the year 1987 at 43.5 percent of all incomes earned and subject to this tax. Moreover, this Commission admitted that barely 60 percent of the people legally required to submit an IRPF return actually did.

The evolution of IRPF compliance assessed by this Commission during the period 1979–1987 is showed in Table 1. From these data, it can be inferred that although taxpayers and taxable incomes showed a significant increase, it is safe to say that compliance was only acceptable in the slightest among employees (about 70 percent of

real taxable incomes). But for all income sources, the concealment of taxable income was very worrying (about 45 percent of real taxable incomes).

The appraisal of these results aimed in two directions. The first was the important weight that the black market economy had in those years. This was in part the result of the rapid and intense increase of tax burdens from 1979, although their levels still were below the average of OECD countries, but nevertheless a new experience to Spaniards. The second was the limitations in human and capital resources that made it practically impossible to improve tax compliance beyond the withholding of employees' incomes. The Spanish society perceived clearly that most of the tax revenues were obtained from wage earners whereas the incomes from financial assets and especially those earned by businessmen and the self-employed enjoyed a much greater laxity of tax compliance. This situation contributed little to improving taxpayers' predisposition to comply with their tax obligations. In addition, the high level of complexity of the Spanish tax regulations made it easier to exploit loopholes for legal tax avoidance.

The fragmentation of the tax management system as a result of the reassignment at the regional level of all wealth taxation (specifically, the Inheritance and Gift Tax, the Net Wealth Tax, and the Net Wealth Transactions Tax) to the Autonomous Communities in the early 1980s brought about an important pitfall for the effectiveness of tax audit activities. The lack of tax information exchanges between the Social Security Administration and the State Tax Administration also hindered the fight against tax evasion and the black market economy.

Table 1. Spanish Personal Income Tax Compliance (1979–1986) (As a percentage of magnitudes recorded in all IRPF tax returns on equivalent Spanish macroeconomic data)

Year:	1979	1980	1981	1982	1983	1984	1985	1986
% of Potential Tax Returns	52.20	56.90	56.17	56.10	59.37	58.71	60.95	64.09
% of True Taxable Income	42.90	47.84	48.92	49.57	50.83	50.52	51.95	55.08
% of True Labor Taxable Income	54.00	62.07	63.42	64.76	66.63	66.66	68.88	71.28
% of True Non-Labor Taxable Income	22.34	24.34	24.56	25.20	23.41	24.60	26.15	30.36

Source: Report of Spanish Tax Evasion Commission (1990).

Table 2. Estimates of Spain's Underground Economy (1973–1996) (As a percentage of GDP in the National Accounts)

Year	% of GDP	Year	% of GDP
1973	12.3	1985	15.7
1974	12.6	1986	15.5
1975	14.4	1987	15.7
1976	15.3	1988	15.7
1977	16.5	1989	15.9
1978	17.6	1990	16.2
1979	18.5	1991	16.7
1980	17.9	1992	18.0
1981	17.9	1993	18.4
1982	17.1	1994	17.8
1983	17.1	1995	16.4
1984	16.2	1996	16.3

Source: Mauleón and Sardá (1997).

From a macroeconomic perspective, and using the currency demand approach, Mauleón and Escobedo (1991, 1997) estimated the size of Spain's underground economy from 1973 up to 1996 (See Table 2). The tax implications of these figures are not simple

to assess but reveal the significance of the phenomenon, in harmony with the results reached by the Commission for the Study and Prevention of the Tax Evasion.

Recently, Esteller (2005) analysed the determining factors of the IRPF compliance and its level during the period 1993 to 2000, using stochastic frontiers methodology. The paper finds that the average compliance was around 80%, although with important differences among provinces¹⁰. As regards the main relevant factors which explain this tax compliance level, the author points out: a) the different productive structure in each province, which influences the AEAT's control plan; b) "electoral competence", "political cycle", and "budgetary policy"; and c) Autonomous Community's level of sharing in the IRPF.

From the point of view of the State Tax Administration's internal organization both coordination among units and the starting incentives to foment team work were weakening. This was largely due to the greater mobility experienced by the Spanish Public Administration after the *Ley de Medidas de Reforma de la Función Pública* (Law of Reform of the Civil Service) introduced in 1984 caused a rapid rate of turnover in staff positions.¹¹ Moreover, two factors influenced the lack of personnel stability over the late eighties. On the one hand, wage policy was too standardised in relation to the rest of the public administration departments which explains the large drain of highly qualified tax specialists to the private sector in those years. On the other hand, there was a lack of a design of careers with the tax administration in the proper sense of the word, which led to constant turnover amongst heterogeneous positions¹².

In this setting, the professional association of State Tax Inspectors (a true corporate-spirit union) lobbied for initiating a very important organizational reform of

the State tax administration. They specifically demanded the creation of a self-governing public body, which should assume all the functions involved in implementation of the State tax system. Other forces were present to give this idea greater credence and strength.

The Establishment of the State Tax Agency and its Performance until 1996.

The strong economic growth of the Spanish economy in the second half of the 1980s after Spain's admission to EEC in 1986 brought to the surface many tensions in the tax system., In particular the above mentioned perception by taxpayers of the rapid increase in individual tax burdens, and their unfair distribution among taxpayers, in particular the high level of tax compliance among wage earners vis-à-vis the rest. In parallel, the end of the 1980s also saw important operational problems emerging in the State Tax administration, many of which had been accumulating after the 1977–1978 tax reform came into effect.

In addition, the late 1980s brought about a complete revolution for personal income taxes as a result of the Constitutional Court ruling, according to which compulsory joint returns for couples applied since 1979 was unconstitutional for horizontal equity reasons (the over-taxation of married taxpayers) and individual privacy. From that time, according to the Court's ruling, it was an inalienable right to be able to file individual IRPF returns for any married or single person. That irrevocable judicial decision, together with the obstinate refusal to include non-discriminatory joint-taxation mechanisms (e.g. the income splitting or the familial quotient applied for many years in most developed

countries), significantly swelled the number of IRPF returns filed with State tax administration starting 1988¹³.

Nevertheless, the single most important fact that triggered off the creation of an autonomous body responsible for the management of the State tax system was the pressure from the tax inspectors union. The response to these demands was the modification of the legal status of the units that made up the State tax administration before then. From a legal point of view, the new organization was going to adopt a legal status that should introduce so much flexibility for managing budgetary and human resources.

The creation process of the *Agencia Estatal de Administración Tributaria* (hereafter, *AEAT* or simply State Tax Agency) formally started in the year 1991. The initial phase can be described as hasty and, in a way, disorderly. It is startling that, in spite of the importance of this organisational reform, the new State Tax Agency did not deserve a specific foundation Act since its legal incorporation was laid out in an Article of the Law 31/1990 of *Presupuestos Generales del Estado para 1991* (State General Budgets for the year 1991). Subsequently, both Law 18/1981 that reformed the *IRPF* after the Constitutional Court's ruling of 1989 and Law 31/1991 of State General Budgets for 1992 also incorporated some regulations. This legal regulatory dispersion revealed the short planning for such a significant organizational change.

From January 1992, The Spanish State Tax Agency has been responsible for implementing and enforcing the tax and customs systems. As we have seen above, the *AEAT* was established by the State General Budgets Law of 1991, even though the new organisation did not start its operations until 1992. We can say that at first the tax

administration was mainly reformed in response to demands for higher wages for the executive tax personnel. In the Spanish general public administration, payments of all public employees were legally limited by general criteria compulsorily applicable to all employees, such as the civil servant's qualification group and the office position held. Let's also remember that in the second half of 1980s, as a result of the spectacular economic growth and of Spain's incorporation into the EEC, there was an important increase in private demand for skilled tax and finance experts with the consequent effect on the wages offered in the private sector.

From a legal point of view, an easy solution was to modify the organisation's legal status from the traditional departmental hierarchical structure toward other alternative legal-organisational framework which allowed it to manage its budget with more flexibility. The chosen legal organizational form was a public entity with full legal capacity within the ambit of both public and private law¹⁴

At the beginning, there were reasons to suggest that the organizational change was essentially more formal than it was real, in so far as the Ministry of Finance's priority was to achieve the maximum possible flexibility. In reality, different General Directorates, directly under the General Secretary of Finance, joined to form the new state institution with a specific legal status and with more flexibility in regulating the management of the system. A case could be made that more autonomy granted by the tax administration reform was initially more a response to the need for greater budget flexibility than a planned search for improving organisational efficiency. The fact is that during the early nineties, the organisation charts of the different new *AEAT* Departments remained hardly without changes in relation to the former General Directorates.

Nevertheless, we should not forget that during the late 1980s, tax administration had been reorganised from the territorial perspective. In this regard, over two hundred local tax administration offices, created between 1984 and 1987, brought tax administration closer to citizens. Moreover, another element to take into account is that until 1994, none of the three main taxes (*IRPF*, Corporation Income Tax, and VAT) had been transferred or shared out with the Autonomous Communities.

Although we have emphasized the fact that it was the need to increase wages for tax experts that triggered the creation of the new Agency, there is consensus about the role played by the absence of an own human resources policy. Before the creation of the Agency, competence in this matter was fragmented among several General Directorates, some of them belonging to the Ministry of Finance, and others to the Ministry for Public Administration, and there was no professional career for tax specialists. From 1984, the Law for the Reform of the Spanish Civil Service authorized any civil servant to hold any position left vacant in any Department or Ministry, practically without restrictions for higher corps of tax inspectors and customs officers. This fact prompted an important rate of turnover of personnel, and today, twenty years after this issue is still not resolved.

The law creating the *AEAT* established it as an administrative organisation responsible for the management of the State tax and customs systems, even though it would act on behalf of the State. In addition, the *AEAT* would also be in charge of collecting financial resources for other Public Administrations, domestic public institutions or for the European Communities, whose management could be entrusted by means of law or agreement.

According to the State Tax Agency's own regulation, the Agency should carry out all those management, inspection and collection activities which are necessary for an efficient and universal implementation of the State taxes. Although in a vague way, it also established the minimization of tax compliance costs. Since Public Finance theory traditionally separates administrative costs and strictly compliance costs, it is reasonable to suppose that the legislator referred to all those costs which the tax administration incurs to collect tax liabilities, including hidden taxation costs incurred by taxpayers such as direct monetary costs, time consuming costs and psychological costs¹⁵.

From an organizational perspective, the *AEAT* was the result of joining, into a superstructure, the old General Directorates belonging to the General Secretary of Finance until 1991. In terms of designation, the General Directorates went on to be called Departments, even though their chief executives maintained the rank of General Director. However, this takeover process also involved staffing dimensional changes, since both the new Departments and the General Manager Office assumed quite a lot of areas of competence which, before then, were under the General Secretary of Finance and of the *Secretario de Estado de Hacienda* (State Secretary of Finance).

The legal status allowed the State Tax Agency to set up some internal financial and budgetary control units inside the *AEAT* organization chart. This task was allotted to the new Internal Auditing Service and the *Oficina Delegada de la Intervención General de la Administración del Estado* (State General Comptroller Office) which is traditionally the agency in charge of financial control in the Spanish State Public Sector. The Internal Auditing Service took over the duties of the *Inspección de Servicios del Ministerio de Hacienda* (Ministry of Finance's General Inspectorate of Services) inside the *AEAT*. In

addition to the public employees control, the *AEAT*'s Inspectorate of Services took on management audit tasks including the procedural analysis, all this with the aim of detecting organisational dysfunction and inefficient performance, as well as suggesting measures for improving tax management. The success within this initiative can be judged as rather modest, considering the typical general limitations of the Spanish Public Administration in this matter.

In addition, the *AEAT* was provided with its own Legal Service department which took on the responsibility for the legal representation of the State Tax Administration in all courts of justice lawsuits brought up by taxpayers. This configuration allowed the State's legal defence team to concentrate its efforts on tax matters and to specialize. Until that point, State lawyers were always dispersed among the different legal services required by the entire public administration. It appears that this reorganization of the State tax administration's legal services achieved greater administrative coordination.

As regards to human resources management, these competences were assumed almost completely by the Human Resources and Economic Administration Department. The *AEAT* took over all responsibilities in both staff design and staffing decisions. Thereafter, the setting of wage scales and the qualifications for each post also became a competence of the *AEAT*. All these human resources management responsibilities were very important in a labour-intensive organisation. As previously mentioned, this area of competence constituted the biggest strength of the new organizational model.

All the employees of the State Tax Agency are subjected to the general regulations of the Spanish Civil Service. From the outset, selection of officials was based on traditional competitive examinations as in the rest of Public Administration Departments,

except for accessory or non permanent positions, for which private contracts for services are accepted. At the beginning, all those public bodies whose officials worked at the Tax Administration were redeployed to the new *AEAT*.

Recruitment of new employees continued to abide by the general rules of the Civil Service, in particular with an examination as a precondition. Nevertheless, the State Tax Agency has full capacity to announce separate entrance examinations for its own. With regard to career development inside the *AEAT*, the patterns are similar to those in the rest of the Spanish Public Administration, where job seniority remains the main criterion for promotion. The only exception is for executive positions, which generally are filled according to political–confidence criteria. The existence of, considerably, above average wages in the *AEAT* relative to the rest of the public sector was effective in significantly reducing the high mobility of labour, which is still a common phenomenon in the whole of the Spanish Public Administration.

The new legal–status of the *AEAT* put the procurement of supplies and investment in capital assets within the ambit of the Private Law which meant an important change with regard to the previous situation when the procurement was ruled by the *Ley de Contratos del Estado* (State Public Contracts Law). This new legal framework tried to make all contracting procedures more flexible so as to ease acquisitions and increase their efficiency.

For safeguarding the rule of Law and to coordinate the large number of state–funded purchases, all the powers were centralized in the *AEAT*'s Sub–Directorate of Economic Administration, specifically in the Under–Department of Purchasing and Contracting. For achieving greater efficiency, simplified general procedures as well as purchase

approval protocols were established. Similarly, the *AEAT* established periodical calls for supply tenders.

Since its creation, the *AEAT* was provided with its own budgetary financing system. According to the statute, the main financial sources of the State Tax Agency are transfers from the State General Budgets and the tax collections – shared yearly at a fixed percentage of all State taxes collected as a result of its actions¹⁶. Therefore, its funding has two basic components. One is of a budgetary nature (fixed); and other is variable, according to annual collections.

In addition, the *AEAT* can also get revenues from local and regional Public Administrations as a result of entering into agreements in regard to the collection of revenues assigned to those administrations. The returns on *AEAT* real estate are considered minor revenues in the statute. As for borrowing powers, this is only allowed for the case of improbable liquidity gap.

On the side of expenditure budget, the State Tax Agency also enjoys a very different system vis-à-vis the majority of the Spanish Public Administration units. Every year, The *AEAT* draws up its preliminary budget plan which is then submitted to the Government for approval and finally sent to the Spanish Parliament. The expenses contained in this budget are limited in its overall amount, while the internal budget appropriation for different headings is only an estimate. Along with the autonomy as regards human resources management and contracting, this power to redeploy the expenses into the annual budget has contributed quite significantly to a flexible management approach in the State Tax Agency.

The Role of the State Tax Agency after the Autonomous Communities began Sharing the Main State Taxes (since 1997).

When the State Tax Agency came into operation in 1992, none of the three large taxes (*IRPF*, Corporation Tax, and VAT) was shared with the Autonomous Communities. In the early 1980s, regional governments had been assigned a series of minor State levies (among others, the Personal Net Wealth Tax, the Inheritance and Gift Tax, the Tax on Property Transactions, and some betting and gambling duties) with limited revenue potential but with greater importance for the control of income sources. From that date on, the majority of the Autonomous Communities created their own tax administrations, which were initially staffed with personnel from the State tax administration.

The initial *AEAT*'s regulation allowed for the possibility of having the State Tax Agency manage those reassigned taxes transferred to the Autonomous Communities, whenever the proper agreement had been reached with the respective regional government. This was mostly seen as a transitory situation as the Autonomous Communities developed their own tax offices. In view of the perspectives of a deep decentralization, instruments of coordination and cooperation regional and local levels were considered (though not specified) in the interest of efficient management of the Spanish tax system in its entirety.¹⁷

However, the tax decentralisation process soon began to surpass this overall view of the tax system. All the Autonomous Communities created their own tax administration departments which were put in charge of managing both the newly transferred State taxes and their own taxes, although the taxes included "own taxes" were very few. We must note that the administration and enforcement of all shared State taxes (the *IRPF*

since 1997, and subsequently the VAT and some excises since 2002) remains the exclusive jurisdiction of the AEAT.

The most recent reform of the Autonomous Communities financing system, in force since 2002, modified some aspects of the regulation of the management of the shared State taxes¹⁸. This reform also redefined the form in which the regional governments (except for the Basque Country and Navarre, which have their own full tax administration) participate in the AEAT's board of directors. On paper, it should be a change of a big magnitude, since the new model of Autonomous Communities' financing granted them a large share of revenues in the *IRPF*, VAT, and State excise taxes.

Specifically, from 2002, the Autonomous Communities share in the following State taxes, (although as we see later, to different extents) : a) the *IRPF*; b) the Personal Net Wealth Tax; c) the Inheritance and Gift Tax; d) the Tax on Property Transactions; e) the Betting and Gambling Duties; f) the Value Added Tax; g) the Beer Excise Tax; h) the Wine and other Fermented-Drinks Excise Tax; i) the Excise Tax on Intermediate Products; j) the Excise Tax on Alcohol and Related Drinks; k) Excise Tax on Hydrocarbons; l) Excise Tax on Tobacco; m) the Excise Tax on Electricity Consumption; n) the Vehicles Registration Tax; and o) the Petrol Retail Sales Tax. The Financing Law 21/2001 provides for the possible elimination or reform, by the Central Government, of any one of these State taxes, with the simultaneous abolition or modification for its shared component by the regional governments. The tax sharing is on the principle of "derivation basis: that is, the Autonomous Community is entitled to the agreed percentage on the tax liabilities collected in its territory. For the territorial delimitation of

taxable events, tax connection points have been established to avoid having several regional governments claiming the same tax bases.

Law 21/2001 provides for two types of transferred taxes with different implications as regards to their management. For the first kind, the transfer only implies to a percentage of the tax liabilities collected from that tax in the respective territory by the *AEAT*, which is in charge of carrying out all activities of management, inspection and collection of these taxes. This alternative, generally known as revenue sharing in the literature and called “partial transfer of taxes or shared taxes” in Law 21/2001, applies to the IRPF (33 percent of total tax liabilities collected in the Autonomous territory), VAT (35 percent of VAT revenues linked to the personal consumption expenditure in the autonomous territory), and some Excise Taxes at a sharing rate of 40 percent of their respective revenues, except for the Tax on Electricity Consumption, which is shared at 100 percent.

The second model of transferred taxes involves the transfer of 100 percent of the tax bases and consequently of all its tax liabilities. These taxes are called, in the strict sense of the term, “transferred taxes”, and currently include taxes originally transferred in the early eighties such as the Personal Net Wealth Tax, the Inheritance and Gift Tax, the Tax on Property Transactions, the Betting and Gaming Duties, besides the Vehicles Registration Tax, transferred in 2001. The last reform has created an optional tax, the Petrol Retail Sales Tax, whose yield is goes to the Autonomous Community that decides to apply it.¹⁹ For all taxes included in this second group, the Financing Law 21/2001 provides that each Autonomous Community, on behalf of Central Government, has to be in charge of carrying out all those activities necessary to manage, collect and inspect the

taxes transferred. The management of these transferred taxes should be audited yearly by the *Inspección General de Servicios* (General Inspection of Services), General Directorate (in Ministry of Finance), which must prepare a management audit report including efficiency and effectiveness aspects of their administration. Insofar as the Spanish Autonomous Communities enjoy a high level of self-government, these audits are rather a formal requirement with hardly any implications for improving the regional tax administrations.

As we have seen, the Autonomous Communities' Financing model in force since the year 2002 extended considerably the sharing of State taxes, especially for the *IRPF* (shared since 1997), and the VAT (first shared in 2002). Moreover, this new model significantly extended the Autonomous Communities' tax regulation powers or competences with regard to some of the transferred State taxes - powers that, for the first time, appeared in the regional financing model for the period 1997–2001. Currently, regional governments can modify some specific elements of the tax structure. In this regard, the Autonomous Governments' competence for modifying the *IRPF*'s marginal tax rates (although on condition that the tax schedule will be progressive and will have the same brackets as the State tax schedule) and the ability to introduce new personal tax credits stand out. However, the competence to modify the tax schedule has not been used by any of the fifteen regional governments involved, whereas the passing of the new tax credits by the regional parliaments has been quite prolific even though their cost in budgetary terms have been rather modest. Since the *IRPF*' management is performed by the *AEAT* free of charge, the Autonomous Communities which decide to introduce these

own tax credits are responsible for establishing all the requirements and the documentation necessary to be able to verify them successfully.

With respect to the Personal Net Wealth Tax, parliaments of the Autonomous Communities can legislate on the personal minimum allowance, the marginal tax rates included in the tax schedule as well as on tax credits, but on condition that any change has to be compatible with the original State regulation for this tax. The special relation between the IRPF and the Personal Net Wealth Tax for audit and control purposes has led to multiple statements and calls for cooperation between the State Tax Agency and the regional tax administrations. Fulfilling these demands would require setting up bilateral agreements between the State Tax Agency and each regional tax administration. However, until now this coordination has only been achieved in some administrative matters, such as filing seasons and form design. Although the regional tax administrations are responsible for inspecting the taxable events of Personal Net Wealth Tax, the *AEAT* still maintains full competence for inspecting those taxpayers who are being audited with regards to the *IRPF*²⁰.

The institutional collaboration between the *AEAT* and the regional tax administrations for exchange of information concerning the administration and enforcement of the Personal Net Wealth Tax is laid down in the law. Nevertheless, the experience so far shows that the joint planning of tax audit activities can be much more effective than the written law.

For the case of the Inheritance and Gift Tax, the Autonomous Communities have discretion to change allowances and exemptions, the tax rate schedule and tax surcharges, as well as the tax credits. Because in the case of this tax it is the Civil Law Code that

defines the taxable events, its administration is more complicated than for other taxes. As such, the implementation of the self–assessment by the regional tax administrations is conditional on availability of assistance units that should give advice to taxpayers for filling their tax returns. Really, in any case, it is not a real self–assessment system, in so far as all taxable events are checked at least in their main elements and data declared in the tax returns.

With regard to the Tax on Property Transactions, the regional governments can modify the tax rates of this tax, and also introducing new tax credits or change existing ones. For the Vehicles Registration Tax, the regulation competence of regional governments only affects the tax rate–fixing. For the Betting and Gambling Duties, this legislative competence is wider, including the regulation of permissions, auditing, and other administrative requirements to be fulfilled by the taxpayers (the organizers). In any case, it should be emphasized that the fact that regional regulation competence powers are not exercised does not mean taxpayers are truly exempt; central government regulation cannot be repealed by the regions. The only exception is for the new Petrol Retail Sales Tax because in this case the central government regulation provided for the possibility of zero tax rates for all taxable categories, which is tantamount to its optional application.

For this group of “fully–transferred” taxes, there is also full devolution of tax administration competences., including all the necessary actions to effectively enforce these taxes. In addition to tax management and collections, this also entails taking on the audit function which includes the qualification of tax offences and the imposition of tax penalties, as well as the ruling on appeals lodged against these tax actions. Nevertheless,

all these devolved tax activities are under the General Tax Law which regulates all the tax procedures. Moreover, with regard to audit, the Autonomous Communities have to prepare their action plans jointly with the *AEAT*. Each year, they are also obliged to report to the Ministry of Finance and to the Spanish Congress and Senate. In addition, there is a reciprocal obligation to exchange information between the *AEAT* and each regional tax administration, even though its performance is not operative.

In view of the high degree of decentralization of the Spanish Tax system, the coordination, both vertical (between the *AEAT* and each regional tax administration) and horizontal (between regional administrations), represents an aspiration which can never be given up if the main aim of the central and regional governments is to fight tax evasion and increase voluntary tax compliance. However, this aim is unlikely to be achieved without a minimum level of efficient coordination among all tax administrations in charge of managing the tax system as a whole. Up to now there is no record of major advances in cooperation between the two levels of tax administration; at the least the experience in previous years, does not suggest any significant improvement of the situation.

The last revision of the Autonomous Communities' financing system in 2001 listed a series of basic principles which should be fulfilled to realize this necessary wide institutional coordination. The Financing Law 21/2001 lays down the following coordination requirements: a) need to realize mutual exchange of information, without exclusion, and at the instance of any tax administration; b) need to prepare coordinated plans of tax audit for all the transferred taxes, paying particular attention to those taxpayers who change their fiscal residence; and c) need to reach agreements of

cooperation and mutual tax assistance targeted at improving application of some transferred taxes. Moreover, the 2001 Financing Law provides for the possibility of reaching collaboration agreements by which the Autonomous governments may contribute financial and human resources to the State management of the *IRPF*, Personal Net Wealth Tax, VAT, and the Vehicles Registration Tax. However, all the indications are that it will be difficult to advance institutional coordination this way. The 2001 Financing Law also indicates that the Autonomous Communities can take their taxpayers to Court over offences regarding the fully transferred taxes. However, in these cases a mutual information procedure must be followed.

The substantial increase in revenue sharing by regional governments in some of the main State taxes solely managed by the State Tax Agency has brought to the surface increasing demands by the Autonomous Communities to be able to get more involved in the *AEAT*'s management board. In 1994, after the newly agreed first tax-sharing of 15 percent of the *IRPF* territorial collection, the regional government of Catalonia made a proposal to create a sole tax administration for each Autonomous Community which should have full powers to manage all taxes levied in its territory.²¹ After the general election on March 1996, the new Popular Party government needed the support from the *Convergencia i Unió* Party in Parliament, which had been governing in Catalonia since the advent of democracy in 1979. This influenced the appointment of some top executives close to this Catalonian Party to the *AEAT* board of directors. These appointments happened at the same time with an extensive reform of its organization chart whose foremost element was the creation of a new *Departamento de Organización, Planificación y Relaciones Institucionales* (Department of Organization, Planning and

Institutional Relations), which was put in charge of relations with the regional tax administrations. But with time it became evident that during the 1997–2001 this greater regional involvement experience was not as effective as had been expected, rather it was inoperative.

After a complicated bilateral negotiation process, the passing of the Autonomous Communities Financing Law meant for the first time, regional representation on the *AEAT*'s board of directors. Firstly, Law 21/2001 created the *Consejo Superior de Dirección* (Higher Board of Directors) in which six Autonomous Communities representatives are full members, and one of them holds the position of second Deputy–President. The State Secretary of Finance (second in command at Ministry of Finance) is the *ex officio* the President of the Higher Board of Directors, with other members including the General Director of the *AEAT* (who holds the post of First Deputy–President) and other top executives of the *AEAT*'s staff (the heads of Department). The six Autonomous Communities representatives are yearly designated by the *Consejo de Política Fiscal y Financiera* (Council of Fiscal and Financial Policies), which is the highest body for tax and fiscal affairs in the relations between Central Government and Regional Governments.

The powers conferred on the Higher Board of Directors are the following: a) informing the Annual Objectives Plan before its endorsement; this Plan includes the *AEAT* Regional General Plan resulting from the aggregation of the individual Plans for every Autonomous Community, as well as the guidelines for the *AEAT* Tax Audit Plan; b) assessing annually the results of the Annual Objectives Plan for the previous year, in addition to its periodic follow-up; c) suggesting the strategic action outlines for the Joint

Commission on Tax Management Coordination and for the Tax Management Territorial Steering Committees; d) advising the President of the *AEAT* as regards the coordination and cooperation among the Ministry of Finance bodies and the tax administrations of the regional and local governments, as well as for the management of the State tax system in a broad sense.

In this new organizational framework, the bodies in charge of the intergovernmental tax relations are the Joint Commission on Tax Management Coordination and the Tax Management Territorial Steering Committees. The first takes decisions as voted on by its members' body, where the Central Government has as many votes as the regional governments. However, the approval of guidelines and plans of action related to the management and regulation of the fully transferred and shared taxes have to be supported by a majority vote of the interested Autonomous Communities. The Joint Commission on Tax Management Coordination is presided over by the State Secretary of Finance in his/her capacity as President of the State Tax Agency, and it is made up of the General Director of the *AEAT* who acts as Deputy-President of the Joint Commission, seven *AEAT* representatives, one representative of the Ministry of Finance's General Inspection of Services, two other representatives of the State Secretary of Finance, and one representative for every Autonomous Community.²² For carrying out their different duties, the Joint Commission can work in plenary sessions, at least once every six months, or in permanent or temporal working groups, which always have to be composed in a "peer manner" (equal number of votes for the State and the Autonomous Communities). The plenary sessions can be unilaterally convened by the President or when at least three Autonomous Communities ask for it. As a means of permanent

communication between all tax administrations, the Financing Law of 2001 has created a Permanent Technical Secretary within the Joint Commission whose top official must belong to the *AEAT*.

Amongst the functions allotted to the Joint Commission on Tax Management Coordination, Law 21/2001 lists the following: a) conducting studies to improve tax design and management of transferred State taxes; b) the assessment of all legal reforms which aim to modify the regulation of transferred or shared taxes; c) drawing up the political general guidelines of tax management for shared taxes managed by the *AEAT*; d) establishing the action criteria as regards tax management coordination and exchange of information between the Autonomous Communities and the *AEAT*; e) coordinating the tax assessment criteria; f) preparing the reports asked for by the Council of Fiscal and Financial Policies, the Ministry of Finance, or the regional finance authorities; g) evaluating the transferred taxes management outcomes, as well as the performance of the Tax Management Territorial Steering Committees; h) informing the Arbitration Committee for Tax Conflict Resolution on cases related to transferred State taxes; i) taking part in the design of inspection plans for shared taxes managed by the *AEAT* and in the establishment of guidelines to carry out coordinated actions; j) assessing the *AEAT*'s General Direction annual report on the shared taxes managed by the State Tax Agency; k) proposing the implementation of the specific systems for telematic exchange of information between the *AEAT* and the regional tax administrations; l) promoting tax management activities by means of coordination between two or more tax administrations.

The Tax Management Territorial Steering Committees were created within the organization chart of the *AEAT* Provincial Offices, with their main task being to undertake many of the functions entrusted to the Joint Commission. To this end, its norm of creation takes into account the following activities: a) adopting arrangements and agreements as regard exchange of information between State tax agency and the regional tax administrations; b) carrying out coordination and collaboration tasks of tax management; c) the design and the planning of the coordinated actions included in the inspection plans; d) deciding on entrusting tax management proposals; e) running the *AEAT*'s management for the shared taxes, in accordance with de Joint Commission guidelines; f) assessing the outcomes from the *AEAT* management for the shared taxes; g) evaluating and suggesting measures for improving the management of the shared taxes; h) carrying out specific inspection plans with regard to the shared taxes managed by the *AEAT*.

There are fifteen Territorial Steering Committees, one in every Autonomous Community subject to the common regime. Each one of them is made of seven members: four representatives of the *AEAT* including the Special Delegate in the respective Autonomous Community, and three representatives of the corresponding regional tax administration. At least each Committee must hold a quarterly meeting and at the request of either of the two parties. In these meetings, the decisions must be taken by majority although for some matters related to the *AEAT*'s management of the shared State taxes the decisions must be reached by mutual agreement. Amongst others, this consensus is required for the following issues: a) the supply of information for its incorporation into the annual Inspection Plan; b) the incorporation, by one regional tax administration, of

own specific inspection programs into the National Inspection Plan; c) the territorial adaptation of the advertising campaign on information and assistance to taxpayers, as well as to agree on tax application criteria in each territory.

In view of this prolific regulation on tax administration coordination and cooperation, we can say that the strong fragmentation experienced by both the tax system and tax administration in its entirety has been identified as a crucial problem. The process of deep political decentralisation that took place in Spain in the last two decades encouraged the creation of regional tax administrations, which saw the light of day at the same time the State tax administration began its modernization process. The instability of the regional financing system has confronted regional tax administrations with continued challenges. Moreover, the complex political circumstances of these devolution processes have not facilitated the organizational redesign of the Spanish tax administration, in accordance with the need for correcting the vertical and horizontal externalities that are inherent to a fragmented tax system like this²³.

The AEAT Reports for the years 2002 and 2003 (AEAT, 2002 and 2003) include an inventory of the actions taken by these Territorial Steering Committees since their creation by Law 21/2001. Although the information provided by the reports is strictly descriptive, the volume of actions registered seems to show a considerable activity which can be appreciated positively, at least in terms of communication among tax administrations. Nevertheless, in this regard, we should point out that this is the view publicised by the State Tax Agency, in other words, by the Central Government, which should be qualified in so far as the majority of these actions are carried out by the *AEAT*

for managing, inspecting, and collecting transferred taxes with the greatest revenue-raising power.

Only a short time elapsed since the current Financing Law 21/2001 incorporated these new organisational instruments of Autonomous Communities' involvement in the *AEAT* board of strategic and operative management. This does not allow an adequate assessment of their performance. However, as has been said above, we are not optimistic about this organizational structure, at least in the short run, in relation to the efficiency improvement of the tax administration as a whole. Conspicuous is the absence of the necessary incentive mechanisms to promote the coordination actions laid out in the legal framework. This fact is particularly worrying in regard to the bilateral exchange of information. As the Economics of organisation suggests, the role of incentives is essential to achieve an efficient coordination between independent organisations, since without them, fulfilling any agreement or commitment of collaboration will be a simple goodwill gesture, although possibly worthwhile for the political strategy of the central government.

The Tax Reform of 1998 and the Consolidation of a New “Close-to-the Taxpayer” Model

The creation of the *AEAT* implied a clear redefinition of the Spanish Government's priorities in relation to the State tax system management. Although it is true that the usual tax evasion-fighting campaigns made a deep impression among the citizens, the main commitment in the long term continued to be improving the assistance and advice to taxpayers with the aim of reducing both administrative and compliance costs. Within this ambit, it can be said that the achievements have been meritorious, even though it is

certain that they should also be valued jointly with the tax reforms of these years, which contributed considerably to simplifying the Spanish tax system.

In 1992, an ambitious computerization plan for the Information and Assistance-to-Taxpayers Services was set in motion, creating units for assistance in filing the *IRPF*, firstly in the most important provincial *AEAT* offices, and not long afterwards in the rest of provincial and local tax offices. Likewise, this process led to the creation of Taxpayer's Offices in the provincial *AEAT* central offices whose function was to give assistance and all-round advice to citizens in all their relations with the State Tax Agency (filing of tax returns, tax certificates, tax refund requests, appeals to the State tax administration, etc.). As Díaz-Yubero (1993) indicates, these Taxpayer's Offices also represented an important information source for the heads of *AEAT*'s Departments insofar as they could detect all those points of inefficiency and underperformance in the application of the tax procedures.

An electronic documentary database (so-called *INFORMA*) was also created for access to frequently asked questions (FAQ) in relation to the main State taxes (*IRPF*, Corporation Income Tax and Value Added Tax), whose contents have been constantly updated by the central services. *INFORMA* provides tax information based on internal rulings (*AEAT* and the *Dirección General de Tributos* --General Directorate of Taxes), as well as on administrative rulings on tax appeals and court rulings. The users of this electronic database were mainly taxpayers, but also tax officers used it. Later, the evolution of the system and its online access through the Web have become a useful help-to-taxpayer instrument, and especially essential for *IRPF* taxpayers.

From the beginning, the State Tax Agency promoted the creation of software for doing-it-yourself tax returns. The program for filling the *IRPF* tax returns (so-called *PADRE* program) has been very widely used for many years. The program for filing the Corporation Tax has been also widely used, although this was introduced not long ago. The successful implementation of the user-friendly software has made it possible to generalize its utilization with some very important positive effects on tax administration and compliance costs. On the one hand, all these programs set up filters and controls that permit detection of the frequently inadvertent or intentional errors which is a common occurrence in a self-assessed tax system. In the *PADRE* case, the design of program allows the use of information provided by the taxpayers themselves (date of birth, marital status, family kinship, age of relatives, transaction dates, etc.) to check up on limits or amount of exemptions, deductions, tax credits, or the tax schedule applicable.

To some extent, there is a broad consensus that the greatest achievement of the *AEAT* since its creation may have been the implementation of an effective assistance-to-taxpayer model which has been implemented in a gradual way. Nevertheless, we need to be aware that there is an important interrelation between this success and the simplification and the quality improvements introduced in the regulation of both taxes and tax procedures by the successive reforms implemented in recent years. In this respect, we must bear in mind what the *IRPF* reform of 1998, in force from January 1999, involved. The *IRPF* Law 40/1998 shaped a new model of personal income tax aimed at increasing the elasticity of revenue collections and making it compatible with a significant tax cut aimed at reducing individual tax burdens²⁴ Setting aside its political opportunism, there was general agreement on the fact that the *IRPF* reform of

1998 was certainly unavoidable, since we are indeed faced with a tax which revealed clear symptoms of too much and too frequent change (González-Páramo, 1997).

But over and above that, the Government opted for the simplification of the *IRPF*, both on its tax structure and relating to its legal regulation. Although the Spanish *IRPF* came into effect way back in 1979, the legal framework for its enforcement had become more and more complex, which increased both taxpayers' compliance costs and tax avoidance opportunities. Undoubtedly, the huge number of tax matters in litigation, both in the administrative and judicial ambit, originated in the "too ambiguous" regulations. In order to achieve these simplification objectives, the alternative offered by the Government was to combine both the regulatory and the public finance-designing measures of reform. Thus, the new *IRPF* embodied important changes of structure which broke with previous patterns, such as: a) the consideration of the personal and family circumstances of the taxpayer through a set of tax allowances, the so-called "personal and family minimum", which replace the previous family tax credits; b) the reduction of the number of brackets in the tax schedule, including the abolition of the first zero-rate bracket; c) the disappearance of the special schedule for joint taxation, returning to a system of a single schedule for both individuals and joint declarations; d) a general reduction of marginal tax rates; and e) capital gains obtained for a time period longer than a year (it was two years up to the year 2000) to be taxed with a proportional tax rate of 18 percent (currently fixed at 15 percent), equal to the lowest marginal tax rate of the progressive schedule.

But, in spite of the initial intentions, the simplification of the legal regulation has been almost imperceptible. The legal process of drafting the bill ruined this aim, which

incorporated the traditional casuistry of the previous tax coding again. The regulation on capital incomes or on tax gains in the current *IRPF* Law or the vast case law established by the General Directorate of Taxes are two good examples of this failure.

As for the *AEAT*, it attempted new plans in the field of the information technology, whose main objectives were: a) providing the possibility of filling the tax returns online through Internet; b) providing taxpayers with all tax information gathered by the *AEAT* every year (such as their annual income, withholdings and other deductions for tax purposes) which is necessary to process *IRPF* annual returns; c) making *IRPF* return drafts and to send them to taxpayers, who can sign and file the drafts if they agree. Those challenges could be taken on, thanks to the tax structure simplification introduced by the new *IRPF* Law since it allowed a reduction in the amount of information needed, and consequently the number of operations to conduct.

From tax compliance point of view, to providing taxpayers with all tax information in the possession of the *AEAT* can be risky. Taxpayers can be tempted to not include those incomes misreported by withholders which are unknown to the tax administration. This problem will only be diminished if taxpayers are also included in the audit tax plans with a positive probability of being audited. Although it involves an increase in administrative costs in the short-term, it will be an efficient solution in the long-term.

Moreover, the *IRPF* reform brought with it a redefinition of the labour income tax withholding system. In the current system, each employer, whether he is a natural person or legal entity, must calculate the average tax rate for each employed worker at the start of the year. The calculation should consider his/her expected gross salary throughout the year, the *IRPF*-deductible social security payments, as well as those personal and family

circumstances considered in the tax allowances. Thus, the withholding rate is applied to all incomes paid by this employer during the year, and will have to be modified if the labour conditions (salary, contract of employment extension or cancellation) or the family circumstances (number of children, marital status) change.

This new withholding tax method for labour incomes has greatly reduced *AEAT* tax refunds since the difference between the definitive tax liabilities in the annual *IRPF* returns and the withheld tax amount has been reduced considerably.²⁵ In addition to this simplification of the withholding tax system, the filling–tax threshold was significantly increased. So, all taxpayers who earn labour incomes below 21,000 euros are not bound to submit an *IRPF* annual return²⁶. The result was a significant reduction in the number of tax returns filed yearly. For those numerous cases in which a tax rebate is due, the *AEAT* implemented a new system of quick–tax rebate. The system involves an application form to be submitted two months before the *IRPF* annual filling period, beginning the first day of May. For reducing the number of tax refunds, where appropriate, husband and wife can opt to offset between them their positive and negative tax–return balances for three years.

The Spanish Ministry of Finance announced in June 2003 that 1.7 million tax returns attributed to the *IRPF* tax campaign of 2003 had been transmitted to the tax administration through the Internet. This number represented an increase of 50 percent relative to the previous year.²⁷

The effects of this *IRPF* reform on tax compliance relative to the previous design have been investigated in Delgado, Salinas and Sanz (2001). Their conclusions show a favourable assessment, although in a modest way. The reform implied a 28 percent

decrease in the indirect burden on the *IRPF* taxpayers²⁸. With regard to monetary costs incurred by taxpayers in order to comply with their tax obligations, costs dropped from 1.8 percent of the tax bill in 1998 to 1.3 percent in 1999. The average time devoted by taxpayers to completing their tax returns has decreased by 1 hour and 25 minutes²⁹. In addition, those tax compliance costs of a psychological nature would seem to have been also reduced as the result of a lower degree of uncertainty in relation to the enforcement of the new *IRPF* Law. Most assuredly, the general availability of the *PADRE* assistance-to-taxpayers program has influenced this change in the perception of taxpayers.

In this respect, we can say that one of the most important advances in the Spanish tax administration in the last decade is the advent of free software to assist individual and professional taxpayers in computing their tax returns and other tax documents. It is reasonable to assume that this innovation has meant important decreases in compliance costs, fundamentally due to the positive reduction of the taxpayers' material errors in the returns and the less time taken to fill out tax forms. However, this may have had a negative influence on the desirable reduction of tax complexity. As Goolsbee (2004) argues, tax software had obviated the desirability of tax simplification, with negative consequences for a group of tax population - those who do not use tax software. In actual fact, if we observe the tax regulations for the new *IRPF* related to the taxable income from financial assets or from capital gains, we would be hard pressed to admit that there has been any simplification at all. Furthermore, the large number of cases in tax dispute sours, in certain respects, the positive results obtained with regard to the tax administration costs.

In addition to the abovementioned changes introduced by the *IRPF* reform of 1999, the growing sensitivity to the need to improve taxpayers' legal security led to Law 1/1998 on *Derechos y Garantías del Contribuyente* (Taxpayer's Rights and Guarantees Law). This Law stated the citizen's rights which must be respected in all their relations with the tax administration. To protect these rights, Law 1/1998 created the *Defensor del Contribuyente* (Taxpayer's Counsel), charged with protecting the rights of citizens. The role of the Taxpayer's Counsel is independent of the administrative and judicial legal system and can lodge an appeal against any level of tax administration.

Really an Autonomous Tax Agency? Successes and Failures of this Organization Model

All the reviewed organizational changes related to Autonomous Communities' involvement in the *AEAT* board have been introduced at a political decision level, although the chairman maintains his pre-eminent position on the strategic direction of the State tax agency (see figure 1).

In fact, the organisational architecture of the *AEAT* has remained practically unchanged. From an operational point of view, the State tax agency is divided into central and territorial services, both directed by its general manager (the *Director General* of the *AEAT*) The *AEAT* central services are organised into functional and support areas – tax management, tax inspection, collection, customs and excises, organisation and planning and institutional relations, information technology, and human resources and economic administration. The territorial services follow the same scheme by areas, but on a territory-by-territory basis (see Figure 2). Currently, there are 17 Regional State Tax

Offices (one in each Autonomous Community) and 56 Provincial State Offices, containing 240 Local State Tax Offices, 37 of which are Customs Offices.

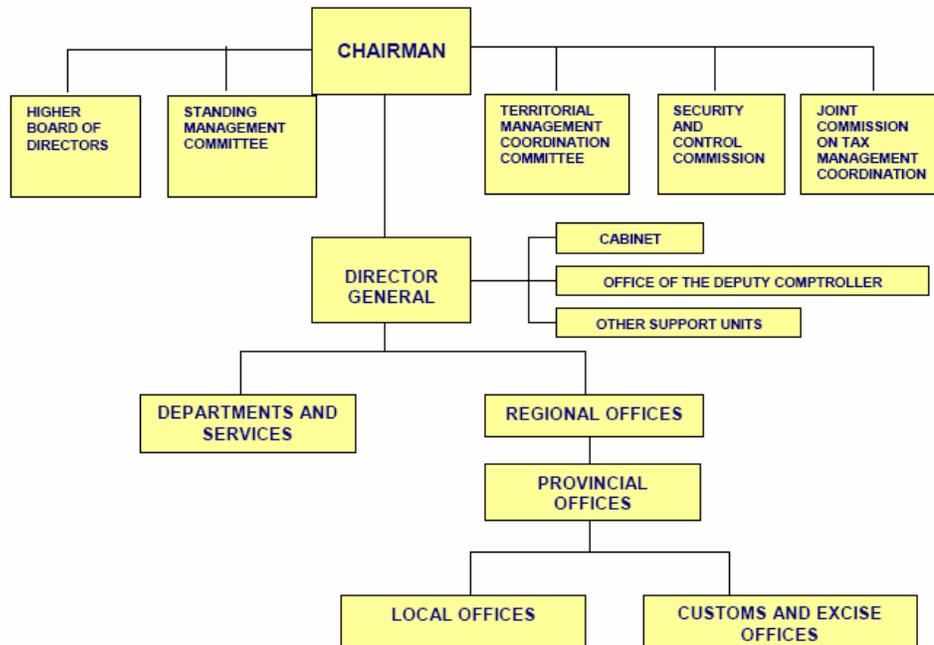


Figure 1.

Source: AEAT (2003).

From the viewpoint of organisation theory, the type of relations between the chairman of the *AEAT* and its general manager does not allow us to identify the *AEAT* organizational model with the notion of agency usually considered in the literature on public administration in Anglo–Saxon and Nordic countries.³⁰ Since its creation in 1991, the appointments of all *AEAT* general managers show a total political dependence on the State Secretary of Finance, and therefore, on the Minister of Finance. Perhaps, what is surprising is that this dependence figures explicitly in the legal organization chart where it states that the State Secretary of Finance will be the *AEAT* chairman. Regarding the appointment of their consecutive general managers, every one of them belonged to the

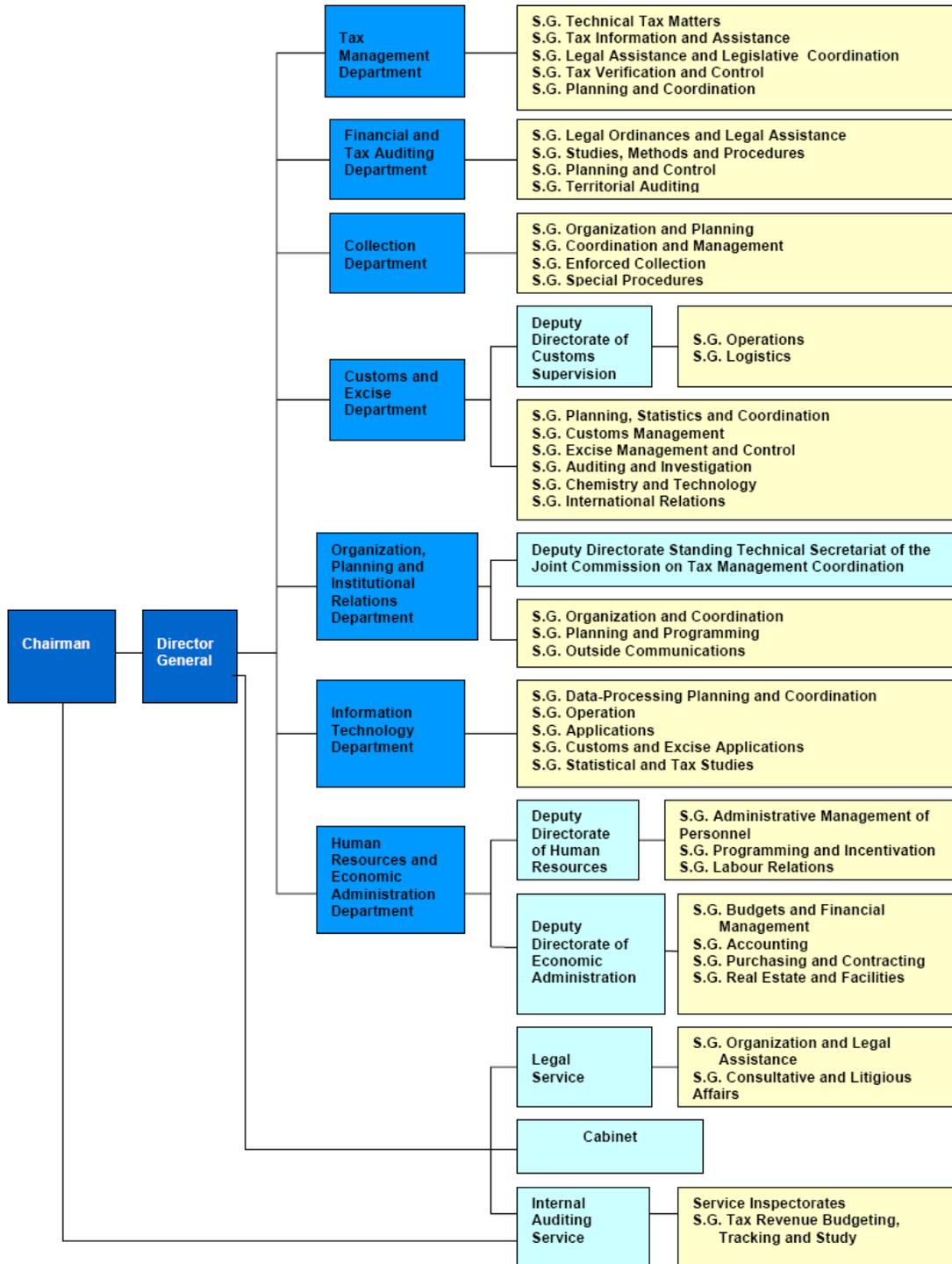


Figure 2.

Source: AEAT (2003).

body of tax inspectors, the most influential civil servant group of the finance administration and, probably, of the whole Spanish public administration. It should be pointed out, however, that in spite of this professionalisation of all its members, the aforesaid dependency on political decisions, together with the lack of competition for the post cause frequent labour disputes and corporative tensions between the board of managers and the inspectors and sub-inspectors who make up its technical staff. This pattern also holds for the regional tax administrations, although within their ambit, the use of the term “agency” has not been that common. Precisely, it is now, with new devolution demands from some historical regions, such as Catalonia or Andalusia, that there is talk about “regional tax agencies”, but only with a political motive.

Perhaps, the best way to characterize the *AEAT* is as a semiautonomous model of agency rather than an agency model in the original Anglo-Saxon sense of the term. As we have seen above, the organizational autonomy resides in its wide competences on budgeting, human resources management, and contracting, compared with the regime for most other public agencies. The mentioned dependence on political power has influenced the *AEAT* performance all along, especially concerning decisions on its priorities, such as the fight against tax evasion. In this respect, internal controversy between the board of managers and the technical staff has common.

Conclusions and Final Remarks.

In this chapter, we have reviewed the evolution experienced by the Spanish tax administration from the outset of the democratic transition, way back in 1977, to the present day. Since I think that a long paper should not be overburdened with a very long

conclusion, my objective here is simply to emphasize the most relevant points to understand the current situation of tax administration in Spain, and above all, to present the challenges over the next years. In a simple way, the current situation of the Spanish tax administration is characterized by the following facts:

- The assistance to taxpayers in the broad sense can be considered the main success achieved by the tax administration, both at State and at regional levels of government. The extensive availability of specific software to fill out tax returns and the implementation of e-Tax services has contributed to a significant reduction in tax compliance costs incurred by the taxpayers.
- The excessive casuistry of the Spanish tax laws, together with the broad interpretative ability showed by the administrative tax bodies and by the courts, explains the high levels of litigation existing in Spain. There is consensus that, in relation to the administration costs, the system has not made as much progress as we would have liked, being largely due to this tax litigation. As it may be presumed, the uncertainty costs related to this situation are considerable.
- Although there is no solvent analysis on the productive efficiency of the tax administration, State or regional, there is a general perception that potential improvements in the human resources productivity are clearly possible. The frequent labour troubles and the corporative tensions between the board of managers and the inspectors and sub-inspectors can help to explain this situation. The use of inadequate schemes of personal incentives, not very compatible with the institutional objectives, and the great mobility of labour also seem to be determining factors of this organisational inefficiency.

- The high level of tax evasion which is very concentrated among the self-employed, freelancers, and small businessmen, as well as in the VAT implementation, is encouraged by the fragmented management of the main State taxes. The relationships between the State Tax Agency and the regional tax administrations in regard to coordination, collaboration, and exchange of information are clearly deficient. The usual political attitudes tending towards maximizing territorial tax collections, without taking into account the obvious vertical and horizontal externalities, explain the unsatisfactory situation currently present in Spain. The tax proposals in the last regional elections proposed to reduce or even to abolish some taxes such as the Inheritance and Gift Tax or the Personal Net Wealth Tax. Such proposals do not provide good prospects for improved control of income sources, essential for an efficient application of income taxes.

The current tax decentralization challenges that Spain faces make it necessary to adopt some reforms as soon as possible. In my opinion, main steps should be taken towards three specific objectives:

- The first one is of an organisational nature: the separation between political and technical responsibilities inside the State Tax Agency. As we have said, this requirement is essential for the incentive schemes to operate correctly. This political independence requires a complex institutional arrangement, where the political parties must renounce the use of the tax administration policy as an instrument to win votes. In this respect, experiences of the Anglo-Saxon and Nordic countries could be very appealing.

- The second one is to achieve an effective integration of regional political decision powers in the AEAT board of directors. If we agree that there are mutual externalities from central and regional tax administration activities, it is essential to take advantage of collaboration between both levels of government, especially in coordination and exchange of information issues. It is also an organisational question which should not be confused with a simple organization chart change. It must not be forgotten that behind this efficiency problem, there is an incentive issue. Organizational design should provide an institutional incentive scheme capable to motivate national and regional decision-makers to reveal all their relevant information about tax evasion, inspection and other control plans.
- The third one is essentially a proposal of juridical technique. As we have seen, the Spanish tax codes raise number of conflicting interpretations. This very negative fact stems from excessively ambiguous tax laws. On numerous occasions, this ambiguity in the law application is a consequence of schemes which distinguish particular cases, circumstances and conditions that are hard to prove. This has led to high administration and compliance costs, as well as to economic uncertainty which encourages tax avoidance. Therefore, future tax reforms should include legal simplification as one of its main aims.

Notes

1. In addition to the offices in the provincial capitals, five other important non-provincial-capital cities had their own tax office.
2. See Sevilla (1979) for a discussion of the original temporary plans for implementing each tax and the subsequent changes.
3. See López-Laborda and Rodrigo (2003) for an extensive discussion of the tax amnesties in Spain. For a specifically review and analysis of the implications of the introduction of the *Impuesto Extraordinario sobre el Patrimonio Neto's* in 1978, see de Pablos (1990).
4. The Spanish temporary personal net wealth tax was applied from 1978 to 1991. The tax reform of 1991 changed its name, deleting the adjective "temporary", but defining it in similar terms as previously was the case. However, with the passing of time, in effect this tax became a "temporary" tax. Ever since its introduction, succeeding Governments and their tax administrations carried out a highly debatable management of this tax. The eventual transfer of the management and collection in

favour of Autonomous Communities in 1980 in the Financing of Autonomous Communities Law (hereafter, LOFCA) was the decisive factor for the Central Government tax administration neglect in improving the management of the personal net wealth tax. We should also note this tax never was included in the tax administration computerization plans started in the intervening years.

5. See Alba (1997).
6. In those years nearly all the tax returns were filed in hardcopy, without electronic process capacity. The first electronic tax returns would not arrive until the early nineties. As we shall see later, universal use of electronic tax returns has allowed to reduce this period about 1 month.
7. Regarding the current Basque and Navarre Foral Regimes' features see López-Laborda and Monasterio's chapter in this book. See also Garcia-Milà and McGuire (2005) for an interesting review about the role of the Foral Regimes in the development of Spanish fiscal decentralization system. About the distinctive features of the Basque Tax Administration (which contains the three provincial Foral Tax Administration of Alava, Guipuzcoa, Vizcaya) see Organo de Coordinación Tributaria de Euskadi (2003).
8. In the new territorial division of the country, the regional governments (or Comunidades Autonomas) typically have within its boundaries several provinces; however, in some cases there is only a province with the Comunidad Autónoma.
9. Again, the exceptions were the Basque Country and Navarre, which as mentioned above have their own tax administrations.
10. This result is similar to the one obtained by Alañón and Gómez-Antonio (2004) using other alternative methodology.
11. As a general rule, the Law 30/1984 of Reform of the Civil Service laid down that any civil servant can be promoted to any position with the only restriction of belonging to some civil servants' corps with degree required for each Civil Service access examination. In the Spanish Public Administration there are five groups in accordance with the education level required: A, university honours degree; B, university general degree (three years); C: secondary education; D: primary education; and E) elementary education.
12. It must be taken into account that Law 30/1984 allowed any civil servant to change his position without hardly restrictions every two years, including changes between different Departments. The great regard of civil servants belonging to Ministerio de Hacienda's Corps generated that these specialists were in great demand in Public Sector, with great expectations to improve their wages.
13. 1989 was the first tax year in which this Constitutional Court's sentence carried out.
14. This was according to the general regulation established in article 6.5 of the *Ley General Presupuestaria* (General Budgetary Law) of 1977.
15. See Sandford, Godwin and Hardwick (1989) for a discussion on the nature of these costs.
16. This percentage was fixed in 16%. Tax liabilities from self-assessments are not included in its calculation.
17. The creation norm made also reference to the tax administration of the European Union's member states, as well as other countries.
18. Law 21/2001 stated mainly changes in reporting procedures between regional tax administrations and AEAT.
19. The inclusion of this new tribute in the Spanish tax system has been explained as a supplementary source of revenues to balance the Public Health budgets in those Autonomous Communities which pleaded lack of resources after taking on the health competences in the year 2002.
20. In this case, the regional tax administration preserve the jurisdiction for ruling the administrative appeals lodged against the AEAT's inspection proceedings.
21. See Costas-Terrones (1994) about this proposal of tax administration decentralization and other alternatives.
22. This includes only the "common regime" regions, leaving out the "special regime" regions of the Basque Country and Navarre.
23. See, for example, López-Laborda, Martínez-Vázquez and Onrubia (2004) who analyse the optimal level of decentralization of tax administration. The focus of this paper is on how well the externalities produced by multiple level of tax administration can be internalized by different models of organization of the tax administration (fully centralized, fully decentralized and territorially coordinated).
24. Initially, this tax cut was estimated by the Ministry of Finance at 11% of the *IRPF* revenues in 1998, whereas Castañer, Onrubia and Paredes (2004) assessed it at 14.7%. Both estimations were done using a no-behaviour microsimulation model which does not incorporate changes in taxpayer population and in the sources of income composition either. After its application in the year 1999, the Ministry of Finance quantified with the real data this tax cut, which was fixed, isolating any behaviour effect, at 14.3% (Instituto de Estudios Fiscales, 2001). Considering the behaviour effects, except population changes and sources of income composition, but including the interactions with indirect taxes and social contributions, González-Páramo and Sanz (2004) have assessed the tax cut between 10.2% per year and 12.6% per year
25. Let's remember that the method applied from 1979 until 1998 fixed the withholding tax rate using a schedule which combines gross salary bracket, marital status, and number of children. Therefore, it is obvious that this system only offered a rough estimate of the final amount of tax to levy.
26. As additional requirement, it was necessary that all labour income was been obtained from a sole employer, since the tax withholding rate is calculated for every employer and, obviously, the *IRPF* is a progressive tax.
27. The AEAT's excellence in e-Tax services was acknowledged at the recent European e-Government Conference held in Como. Spanish Tax Administration received the Europe e-Government Award 2003 for their e-tax services.
28. In this paper, aggregation of direct monetary costs and economic assessment of time employed provides the estimate of the indirect tax burden. This notion does not include the psychological cost.
29. The average time per taxfiler was 3 hours and 37 minutes in 1998, as against 2 hours and 12 minutes in 1999.
30. On the public agency model features see, among others, Flynn and Strehl (1996) and Horn (1995). It is also interesting the political science view in Miller (2000).

References

- Aaron, H. J. and J. Slemrod (2004), 'Introduction', in H. J. Aaron and J. Slemrod (eds), *The Crisis in Tax Administration*, Washington DC: Brookings Institution Press.
- AEAT (2002), 'AEAT Annual Report 2002', <http://www.aeat.es/agencia/memorias/02/ingles/home.html>
- AEAT (2003), 'AEAT Annual Report 2003', <http://www.aeat.es/agencia/memorias/03/ingles/home.html>
- Alañón, A. and M. Gómez-de-Antonio (2004), 'Evaluación y análisis espacial del grado de incumplimiento fiscal para las provincias españolas (1980–2000)', *Hacienda Pública Española/Revista de Economía Pública*, 171, 9–32.
- Alba, C. (1997), 'Modernising Spanish Public Administration : Old Inertias and New Challenges', in W. J. Kickert (ed), *Public Management and Administrative Reform in Western Europe*, Cheltenham-Northampton: Edward Elgar, pp. 177–198.
- Bird, R. M. (1990), 'Expenditures, Administration and Tax Reform in Developing Countries', *International Bureau of Fiscal Documentation Bulletin*, 44(6), 263–267.
- Castañer, J. M., J. Onrubia y R. Paredes (2004), 'Evaluating social welfare and redistributive effects of Spanish personal income tax reform', *Applied Economics*, 36, 1561–1568.
- Comisión para el Estudio y Prevención del Fraude Fiscal (1990), *Informe sobre el Fraude Fiscal en el IRPF*, Madrid: Instituto de Estudios Fiscales.
- Costas-Terrones, J. C. (1994), 'Consideraciones en torno a una Agencia Tributaria única', *Hacienda Pública Española*, 129, 63–71.
- De Juan, A., M. A. Lasheras and R. Mayo (1994), 'Voluntary Tax Compliant Behavior of Spanish Income Tax Payers', *Public Finance/Finances Publiques*, 49, 90–105.
- De Pablos, L. (1990), *Una Valoración del Impuesto sobre el Patrimonio Neto*, Madrid: Instituto de Estudios Fiscales.
- Delgado, M. L., J. Salinas and J. F. Sanz (2001), 'Indirect Tax Burden of the Personal Income Tax: Evidence from the Recent Tax Reform in Spain', *Australian Tax Forum*, 16, 463–482.
- Díaz-Yubero, F. (1993), 'Balance del primer año de gestión de la Agencia Tributaria', *Cuadernos de Actualidad. Hacienda Pública Española*, 3, 81–92.
- Esteller, A. (2005), 'Incumplimiento fiscal en el IRPF (1993–2000): Un análisis de sus factores determinantes', *Documento de Trabajo*, 227/2005, Fundación de las Cajas de Ahorro.
- Flynn, N. and F. Strehl (ed) (1996), *Public Sector Management in Europe*, Hertfordshire, UK: Prentice Hall.
- Fuentes-Quintana, E. (2004), 'Los Pactos de la Moncloa y la Constitución de 1978', en E. Fuentes-Quintana (dir.), *Economía y Economistas Españoles*, 8, 163–238.
- García-Milà, T. and T.J. McGuire (2005), 'Fiscal Decentralization in Spain: An Asymmetric Transition to Democracy', in R. M. Bird and R. D. Ebel (eds), *Subsidiarity and Solidarity: The Role of Intergovernmental Fiscal Relations in Maintaining an Effective State in Diverse Countries*, Cheltenham, UK: Edward Elgar, forthcoming
- González-Páramo, J. M. (1997), 'El IRPF en la encrucijada: Entre la convergencia europea y la cesión a las Comunidades Autónomas', 38, 78–97.
- González-Páramo, J. M. and J. F. Sanz (2004), *Evaluando reformas fiscales mediante el coste marginal de los fondos públicos: criterios analíticos y aplicaciones a España y otros países de la OCDE*, Bilbao: Fundación BBVA.
- Horn, M. J. (1995), *The political economy of public administration: Institutional choice in the public sector*, New York: Cambridge University Press.
- Instituto de Estudios Fiscales (2001), *Evaluación de los efectos de la reforma del IRPF en la Ley 40/1998*, Madrid: Instituto de Estudios Fiscales.
- Laheras, M. A. (1990), 'Percepción Social y Política Fiscal en España. Historia de un compromiso', en *Sistema Fiscal y Administración Tributaria. Análisis de dos realidades España y Argentina*. Madrid: Instituto de Estudios Fiscales.
- López-Laborda, J., Martínez-Vázquez, J. and J. Onrubia (2004), 'Crossing the Optimal Level of Decentralization in Tax Administration', *mimeo*.

- López-Laborda, J. and F. Rodrigo (2003), 'Tax Amnesties and Income Tax Compliance: The Case of Spain', *Fiscal Studies*, 24 (1), 73–96.
- Martínez-Vázquez, J. and A. Timofeev (2005), 'Choosing between Centralized and Decentralized Models of Tax Administration', Working Paper 05–02, International Studies Program, Andrew Young School of Policy Studies, Georgia State University, Atlanta.
- Mauleón, I. and J. Sardá (1977), 'Estimación cuantitativa de la economía sumergida en España', *Ekonomiaz*, 39, 124–135
- Miller, G. J. (2000), '“Above politics”: Credible commitment and efficiency in the design of public agencies', *Journal of Public Administration Research and Theory*, 10 (2), 298–328.
- Musgrave, R. A. (1969), *Fiscal Systems*, New Haven: Yale University Press.
- Órgano de Coordinación Tributaria de Euskadi (2003), *Informe Anual Integrado de la Hacienda Vasca*, Vitoria-Gasteiz: Departamento de Hacienda y Administración Pública, Gobierno Vasco.
- Sandford, C.T., Godwin, M.R. and Hardwick, P.J.W. (1989), *Administrative and Compliance Costs of Taxation*, Bath: Fiscal Publications.
- Sevilla, J. V. (1979), 'Estructura de las Reformas Tributarias Contemporáneas', *Hacienda Pública Española*, 56, 31–49.
- Slemrod, J. B. (ed) (1992), *Why People Pay Tax: Tax Compliance and Enforcement*, Ann Arbor: University of Michigan Press.