



## **Project Proposal for**

**Honduras**

**January 2025**

Component: Revenue

Module: RM II – Revenue Administration



## PROJECT SUMMARY

|                               |                                                                               |                    |
|-------------------------------|-------------------------------------------------------------------------------|--------------------|
| <b>COUNTRY:</b>               | Honduras                                                                      |                    |
| <b>LEAD DEPARTMENT:</b>       | FAD                                                                           |                    |
| <b>REGION:</b>                | WHD                                                                           |                    |
| <b>PLANNED DATES:</b>         | FY25 - FY27                                                                   |                    |
| <b>FUNDING PROGRAM TITLE:</b> | Honduras – GPFP Revenue Module I&II                                           |                    |
| <b>PROJECT MANAGERS:</b>      | Juan Redondo (Revenue Administration)<br>Azael Perez (Revenue Administration) |                    |
| <b>ESTIMATED BUDGET</b>       | \$ 757,050                                                                    |                    |
| <b>PROJECT AMENDMENTS:</b>    | <b>PURPOSE</b>                                                                | <b>SC APPROVAL</b> |
| <b>AMENDMENT 1</b>            | Addition of Revenue Administration module                                     | January 2025       |

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## ACRONYMS

|       |                                                                             |
|-------|-----------------------------------------------------------------------------|
| CD    | Capacity development                                                        |
| CIP   | Compliance improvement plan                                                 |
| CRM   | Compliance risk management                                                  |
| FAD   | IMF's Fiscal Affairs Department                                             |
| LJT   | <i>Ley de Justicia Tributaria</i>                                           |
| IADB  | Inter-american Development Bank                                             |
| PFM   | Public financial management                                                 |
| RMTF  | Revenue Mobilization Thematic Fund                                          |
| SAR   | Honduran tax administration ( <i>Servicio de Administración de Rentas</i> ) |
| STX   | Short-term expert                                                           |
| TADAT | Tax Administration Diagnostic Assessment Tool                               |
| VAT   | Value-added tax                                                             |

## I. PROJECT PURPOSE

### Country request and relevance/importance

**The project supports the authorities' commitment to strengthening revenue administration within the framework of the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) approved by the Executive Board of the IMF.** This is a 30-month project structured around the Revenue Component, Module II and has the following three strategic objectives: (i) to strengthen revenue administration management and governance arrangements; (ii) to strengthen core tax administration functions; and (iii) to improve customs administration functions.

### Description of Modules

**This new 27-month module aims to consolidate the gains achieved through prior tax administration reforms to enhance tax compliance and further revenue mobilization.** The project will build on the recommendations of the previous Revenue Mobilization Thematic Fund (RMTF) initiative (January 2021 - April 2024), continued capacity development (CD) through Fund resources (May 2024 to present), the findings from the HQ scope mission on tax administration (September 2023), and the HQ mission on customs administration (November 2023). This will be complemented by ongoing dialogue and discussions with the authorities.

**Furthermore, at the request of the authorities, the project will support the strengthening of the customs administration as part of efforts to drive further economic growth.** Honduras' foreign trade accounts for more than 85 percent of GDP, and customs revenues represent 38 percent of total revenue collected. This underscores the essential role of customs in supporting revenue collection—combating evasion and facilitating trade—which is crucial for boosting growth given the economy's dependency on trade. Therefore, enhancing revenue mobilization must also include improvements in customs administration. The project will continue implementing ongoing reforms, aligning tax and customs operations with international best practices, with the aim of enhancing compliance levels, improving trade facilitation, and increasing the revenue mobilization necessary for long-term and inclusive growth.

**Under this project the IMF's Fiscal Affairs Department (FAD) will deliver CD to:** (i) strengthen strategic and operational planning; (ii) implement a compliance risk management (CRM) framework; (iii) support human capital risk management; (iv) reinforce core processes of tax administration particularly strengthening value-added tax (VAT) refunds process and improving the management of tax

expenditures through effective control of special regimes or exemption programs; (v) assist in updating the customs legal framework; (vi) support the re-engineering of core customs processes; and (vii) define new IT modules to enhance process management.

The estimated budget for this three-year project \$757,050 and endorsement is requested for the full amount through FY27.

## II. BACKGROUND

### Macro-fiscal situation

**Fiscal management by the Honduran authorities has been prudent.** For 2023, the Honduran non-financial public sector fiscal deficit stood at 1.3 percent of GDP, well within the 2.0 percent target of the ECF/EFF program, approved in September 2023. This year, fiscal performance is also expected to overperform program objectives, supported by solid tax revenues and strengthened public financial management (PFM). That said, the authorities have faced capacity constraints in disbursing social support, given that these programs are newly designed, but are expecting to scale these up going forward. Under the program, the baseline fiscal deficit is expected to converge to the 1 percent of GDP deficit ceiling under the fiscal stability law by 2026.

**The program supports a scaling-up of productivity-enhancing public capital investment while safeguarding debt sustainability.** Honduras' public debt is manageable at 48 percent of GDP at end-2023. An increase in public investment is warranted to reduce poverty, bolster resilience to climate change and increase the economy's growth potential. For this purpose and given that, the program includes some flexibility for additional public investment and therefore a higher fiscal deficit, if external disbursements exceed projections.

**The authorities have been implementing several improvements to PFM since 2022.** These include the unwinding and reintegration into the budget of all trust funds, which created corruption risks; adoption of a medium-term debt strategy and resumption of domestic treasury bond issuance; operationalization of an online platform by the tax agency to enable taxpayers to conduct all tax-related processes online; submission of decrees to congress to strengthen the treasury single account, reduce high exemptions to the income tax and streamline special regimes, and to join the international Convention on Mutual Administrative Assistance in Fiscal Matters.

## Country engagement and alignment to reform priorities

**The revenue components of this project are aligned with the government's priorities.** In September 2023, the Executive Board of the International Monetary Fund (IMF) approved an arrangement under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) for Honduras for the next three years. The program encompasses economic and institutional reforms aimed at supporting macroeconomic stability sustainably while creating fiscal space for much-needed productive investment and social spending. Additionally, the program seeks to foster durable and inclusive growth, enhance climate resilience, and support the authorities' efforts to improve governance and transparency. The authorities have committed to enhancing domestic revenue mobilization.

**The previous RMTF project was adapted to support the priorities articulated by the authorities appointed in early 2022.** The authorities are promoting a significant tax reform bill—*Ley de Justicia Tributaria* (LJT)—which aims to reduce widespread exemptions. The proposed LJT eliminates banking secrecy for tax purposes, establishes global income as the taxable base, and introduces a registry of beneficial ownership, along with the approval of the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The estimated revenue foregone due to generous tax incentives and exemptions is about 7 percent of GDP. At the authorities' request in 2022, the CD activities were targeted to develop a compliance improvement plan (CIP) for managing tax incentive risks and to formulate recommendations for audit programs concerning beneficiaries of tax incentives. Moreover, the authorities planned a structural reform of the SEFIN directorate responsible for managing tax incentives (DGCFA), which performs functions typically undertaken by revenue administrations.

**At the end of 2023, the customs administration launched its modernization plan, highlighting the need to adopt an integrated risk management approach as a critical element to fulfill its core mandates.** This new risk management approach should focus on identifying and analyzing the root causes that lead to the materialization of major customs compliance risks. During the FAD HQ mission in November 2023, several cross-cutting challenges were identified that must be addressed to improve compliance: (i) an outdated customs law, lack of regulations, and a weak sanctioning framework; (ii) the need to redesign several core customs processes; (iii) high rates of physical examinations that exceed operational capacity, generating high costs for traders and opportunities for corruption; (iv) deficiencies in the IT system that do not meet current needs and have exhibit low

interoperability with third parties; and (v) low data usage, lack of data governance, and very limited information sharing with third parties.

**To support this reform process, the customs administration is receiving a \$50 million loan from the Inter-American Development Bank (IADB).** It is noteworthy that FAD and the IMF's Regional Technical Assistance Center for Central America, Panama and the Dominican Republic (CAPTAC-DR) have played a proactive role in defining the components of the customs modernization plan and how to prioritize them, which has been highly appreciated by the authorities and the IADB. The authorities have expressed interest in FAD providing technical support during the implementation of the reforms.

### IMF priority areas / cross-cutting themes

This project will support the core processes required for the IT system in Customs.

## III. PROJECT MODULES - DESCRIPTION

This proposal will provide CD support to Honduras in the area of revenue administration. FAD CD will support improvements within the strategic objectives presented in Table 1.

**Table 1. Summary of Objectives covered by the Proposal**

| Component | Module                         | Objective                                                                                                                                                                                                                               |
|-----------|--------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Revenue   | RM II / Revenue Administration | <ul style="list-style-type: none"> <li>Improved customs administration functions</li> <li>Strengthened core tax administration functions</li> <li>Strengthened revenue administration management and governance arrangements</li> </ul> |

### A. RM II - Revenue Administration

#### Scope

**According to the latest HQ scope mission (September 2023), the SAR continues to face significant challenges in improving tax compliance.** The project will support the tax administration in the following areas: (i) strengthening reform management capacity; (ii) enhancing CRM, including international tax risks and risk incentives, by extending their scope; (iii) building

capacity and structures to address SAR's human capital risks; (iv) improving core tax administration functions, specifically VAT refunds process and the management and control of tax incentives; and (v) supporting the implementation of the proposed LJT, which is currently under debate in the National Assembly, pending approval.

Regarding customs administration, the CD will focus on assisting the authorities in improving customs compliance by: (i) developing a risk-based compliance plan; (ii) updating the customs legal framework; and (iii) redesigning core customs processes and the IT modules that support them.

### Program Objectives

**The project proposal focuses on resource mobilization and strengthening management in tax and customs operations to raise revenue and enhance the management of tax incentives, contributing to long-term and inclusive growth.** This project aims to achieve two main strategic objectives: (i) strengthen revenue administration management and governance arrangements; and (ii) enhance core tax and customs administration functions.

To improve the management and control of tax incentives, the project will support the implementation of the proposed legal tax reforms LJT—which aim to rationalize tax incentives, pending approval. Additionally, the project will modernize and restructure the Directorate of the Ministry of Finance (SEFIN), which is currently responsible for managing tax incentives.

The project will help identify key potential risks, define treatment measures, and improve core processes to prevent the materialization of compliance risks within the tax and customs administrations. Specifically, it aims to develop a CIP that expands the scope of CRM beyond audit case selection, thereby enhancing strategic and operational planning. Furthermore, the project will support the implementation of a legal framework for a register of beneficial ownership, which will enhance the use of information obtained from exchanges with other jurisdictions under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, as included in the LJT, if approved. Additionally, the project will continue efforts to improve the management of human capital risks, addressing identified issues related to capabilities, capacity, and compliance, among others.

Considering the new IT system (SIISAR), which is currently fully operational and allows automating tax administration operations and improves interaction with taxpayers, the project will assist in modernizing the management of VAT refunds, aligning with the new LJT bill.

In terms of customs modernization reforms, the project will provide assistance in drafting a new Customs Law to ensure its alignment with international instruments and best practices. Moreover, the project will offer guidance in defining the functionalities and modules of the new IT system that will support core customs processes and risk management. Additionally, the project will focus on improving the customs clearance process to enhance voluntary compliance through greater automation, strengthened cargo traceability, reduced discretion of customs officials, and improved data collection and analysis for decision-making at strategic, tactical, and operational levels.

Both in-person and online training will be provided to help Honduran tax and customs administrations develop the necessary capacities to advance the reform process and complement the project's objectives.

### **Expected Results (outcomes)**

The project aims to improve tax compliance and raise revenue by consolidating the CRM process, strengthening core functions, enhancing the IT systems in tax and customs administrations, and updating the customs legal framework. Additionally, it seeks to strengthen the management of tax incentives.

The expected results are as follows:

*Consolidation of CRM progress:* The project will build upon the progress made in CRM beyond the current audit case selection operated by MGR-H. It will adopt a broader approach to compliance risks, which includes designing comprehensive compliance improvement programs that differentiate taxpayer segments and address relevant sector- and segment-specific risks (such as international tax risks and tax incentives), while strengthening CRM governance.

*Enhanced management of tax incentives:* The project will continue to implement more effective management strategies for tax incentive risks to prevent abuse and revenue leakages. This will involve establishing institutional arrangements and governance mechanisms to reduce vulnerabilities.

*Improvement of the VAT refund system:* The project will enhance the VAT refund system through documented, risk-based procedures designed to reduce the time taken for refunds. This is particularly relevant in the context of the proposed reform bill LJT, which calls for the establishment of institutional and organizational arrangements to implement rules regarding beneficial ownership and to reinforce the collection of third-party information.

*Human Capital Risk Strategies:* The project will define strategies to address human capital risks, focusing on recruitment, training, and regular performance evaluations to build the capabilities of human resources teams.

Regarding customs administration, practical guidance will be provided to develop a Customs CIP based on an Integrated Risk Management (IRM) approach. The CIP will enable the following actions: (i) segment foreign trade operators by size and risk level; (ii) identify the root causes of risks within core customs processes that may lead to compliance risks; (iii) define and implement treatment measures to mitigate risks in each segment and correct vulnerabilities identified within core processes; (iv) develop key performance indicators to assess the effectiveness of selected treatments and measures in preventing or mitigating risks and improving compliance; and (v) establish clear and effective governance structures.

Additionally, during the development and implementation of the CIP based on IRM, the project will: (i) help define new functionalities for the IT systems that support core processes; (ii) propose a new model to improve cargo traceability and customs clearance, along with the implementation of a pilot program; (iii) establish a national intelligence center to drive compliance and enforcement activities; and (iv) develop a legal framework aligned with best international practices to provide the customs administration with the necessary powers for effective functioning.

## IV. ORGANIZATIONAL ARRANGEMENTS

### A. Country Engagement

**With support from the previous RMTF project and Fund financed CD, the Honduran tax administration (SAR) has demonstrated significant progress.** Since 2016, the SAR has established the foundations of a modern tax administration. The Tax Administration Diagnostics Assessment Tool (TADAT) evaluation (February 2020) provides evidence that tax administration

reforms have positively impacted tax operations, yielding key outcomes. The RMTF project also supported the implementation of a new IT system—SIISAR—under the financial and technical assistance of the IADB and provided guidance to enhance data governance, as well as to define procedures and standard rules for interoperability. The project was adapted to align with the priorities expressed by the authorities appointed in early 2022. CD activities focused on developing a CIP for managing risks associated with tax incentives and formulating recommendations for audit programs targeted at beneficiaries of tax incentives.

**This project will consolidate ongoing progress and support efforts to improve voluntary compliance.** The SAR's strategic plan for 2023-26 aims to: (i) support voluntary compliance; (ii) tackle tax evasion and avoidance; and (iii) rationalize the management and control of tax incentives. The plan also incorporates additional strategic objectives related to gender perspectives, measures of nondiscrimination, and respect for labor rights. According to the latest HQ scope mission and continuous dialogue with the authorities, FAD can assist in addressing the challenges that the Honduran tax administration continues to face.

**The customs administration has a clear roadmap for initiating deep modernization reforms and securing resources for their implementation.** The authorities are highly interested in receiving support from FAD and CAPTAC during this modernization process. Permanent coordination is maintained among FAD/CAPTAC, the authorities, and the IADB to identify opportunities for synergy and optimize resources among all parties. It was agreed that FAD/CAPTAC will focus on providing technical guidance to review and update the customs regulatory framework, improve compliance, define the new customs clearance process, and outline the main components and features of the new risk management IT system.

## B. Delivery Modalities

**CD will comprise of a mix of remote and in-person activities.** Virtual deliveries will be used to provide efficiencies to in-person support, including pre-engagement meetings and post-follow-up meetings. The following CD activities will be delivered as a package:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, ensure short-term expert (STX) work is aligned to plans, coordinate with other CD providers, and adjust reform implementation plans.

- **STX** visits to help implement the recommendations delivered by the HQ missions; a limited number of STXs will be assigned to provide specialized assistance in specific areas of revenue administration and PFM. The project will seek to use Portuguese-speaking experts.
- **Workshops**, during the HQ missions, staff visits, or STX visits, to share experiences, provide stakeholders with a view of progress achieved and challenges faced, and discuss with the managers and staff their views on the reforms and particular technical subjects.

### C. Coordination / Cooperation

| Partner                    | Coordination Type                                                                                                                | Coordination Area                                                                                                                                                                                                                                   | Frequency |
|----------------------------|----------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| CAPTAC-DR                  | Continuous support, backstopping, design and deliver CD, joint CD support, data sharing to strengthen relation with authorities. | Objectives and outcomes covered by the project                                                                                                                                                                                                      | Permanent |
| IADB, CIAT, WB, UNDP, OECD | Exchange information and agree on areas to be covered by each donor                                                              | IT System implementation, analytical tools for CRM, electronic invoicing system, Exchange of Information on international matters, enhance tax fraud investigation, taxation analytical studies. Closed follow-up modernization process in Customs. | Quarterly |

## V. RISK ASSESSMENT AND MITIGATION

| Category/Module                                              | Description                                                                                               | Risk Assessment | Mitigation Measures                                                                                                                                                                                                                                                                                                  |
|--------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|-----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>EXTERNAL CLIMATE/CONDITIONS</b>                           |                                                                                                           |                 |                                                                                                                                                                                                                                                                                                                      |
| <b>RM II - Revenue Administration</b>                        | Risks that external events create a more challenging environment to implement reforms                     | Low             | Ensure sufficient flexibility in program execution and allow for ability to adjust activities in the case of adverse events.                                                                                                                                                                                         |
| <b>POLITICAL SUPPORT</b>                                     |                                                                                                           |                 |                                                                                                                                                                                                                                                                                                                      |
| <b>RM II - Revenue Administration</b>                        | Political instability due presidential elections in November 2025 can slow the implementation of reforms  | Medium          | Honduras has prioritized strengthening tax and customs administration based on its needs assessment. Focus on strategic advice and hands on capacity building to have a more permanent impact.                                                                                                                       |
| <b>MANAGEMENT AND TECHNICAL STAFF SUPPORT AND COMMITMENT</b> |                                                                                                           |                 |                                                                                                                                                                                                                                                                                                                      |
| <b>RM II - Revenue Administration</b>                        | Continuous rotation of managers undermines the absorptive capacity                                        | Medium          | The missions will work with stable staff and officials encouraging authorities to implement administrative reforms that contribute to a more stable staff. Continual/regular high-level engagement and monitoring.                                                                                                   |
| <b>RESOURCE ADEQUACY</b>                                     |                                                                                                           |                 |                                                                                                                                                                                                                                                                                                                      |
| <b>RM II - Revenue Administration</b>                        | Deterioration of fiscal situation may impact availability of resources to finance reforms                 | Low             | Careful alignment of reforms with the main priorities of the government. Reforms at SAR, Customs and MoF are underpinned by comprehensive strategic plans, and the projected results from the respective government's strategic decision to strengthen tax and customs administrations and to reduce non-compliance. |
| <b>OTHER RISKS</b>                                           |                                                                                                           |                 |                                                                                                                                                                                                                                                                                                                      |
| <b>RM II - Revenue Administration</b>                        | Lack of coordination among capacity building partners duplicate efforts and deliver contradictory advice. | Low             | Take an active role in engagement with other donors to ensure support is well coordinated especially with IADB.                                                                                                                                                                                                      |

## VI. CD DELIVERY PLAN

**Table 2. Summary of Indicative CD Delivery**

| CD Modalities<br>(Remote or Field-based CD) | FY25     | FY26     | FY27      | Grand Total |
|---------------------------------------------|----------|----------|-----------|-------------|
| HQ led CD mission                           | -        | 1        | -         | 1           |
| STX visits                                  | 3        | 6        | 10        | 19          |
| Staff visits                                | 1        | -        | 1         | 2           |
| Workshops (inc. during HQ and remote CD)    | 1        | -        | -         | 1           |
| <b>TOTAL</b>                                | <b>5</b> | <b>7</b> | <b>11</b> | <b>23</b>   |

**Table 3. First year workplan**

| Timing                                | CD Modality                  | Proposed Topics of CD           |
|---------------------------------------|------------------------------|---------------------------------|
| <b>RM II - Revenue Administration</b> |                              |                                 |
| Q3/FY25                               | Field-Based work - FB        | Tax: Staff visit                |
| Q3/FY25                               | Field-Based work - FB        | Tax: Workshop on CRM            |
| Q4/FY25                               | Duty station-based Work - DS | Tax: Legislation updated.       |
| Q4/FY25                               | Duty station-based Work - DS | Customs: Legislation updated.   |
| Q4/FY25                               | Duty station-based Work - DS | Customs: IT systems for customs |

## VII. PROGRAM FINANCIALS

| Module                         | FY25             | FY 26            | FY27             | TOTAL (USD)      |
|--------------------------------|------------------|------------------|------------------|------------------|
| <b>Direct Delivery</b>         |                  |                  |                  |                  |
| RM II - Revenue Administration | \$96,686         | \$305,388        | \$305,449        | \$707,524        |
| Trust Fund Management Fee (7%) | \$6,768          | \$21,377         | \$21,381         | \$49,527         |
| <b>TOTAL</b>                   | <b>\$103,454</b> | <b>\$326,765</b> | <b>\$326,831</b> | <b>\$757,050</b> |

## VIII. TARGETED LOGICAL FRAMEWORK

### A. RM II – Revenue Administration

| Objective                                                                                                                     |                                                                                                                                                |
|-------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|
| Strengthened revenue administration management and governance arrangements (SDG 17.1) - RAM                                   |                                                                                                                                                |
| Outcome(s)                                                                                                                    | Indicator(s)                                                                                                                                   |
| Capacity for reform increased due to clear reform strategy and a strategic management framework adopted and institutionalized | Reform management capacity strengthened or in place for reform implementation, including dedicated resources                                   |
| Corporate priorities are better managed through effective risk management                                                     | Improved identification, assessment, ranking and quantification of compliance risks (TADAT POA2-3)                                             |
|                                                                                                                               | Better mitigation of risks through a compliance improvement program TADAT POA2-4)                                                              |
|                                                                                                                               | Better identification, assessment and mitigation of institutional risks (TADAT POA2-6)                                                         |
| Support functions enable more effective delivery of strategy and reforms                                                      | Improved human resources strategies and practices to support the tax administration (TADAT 2019 POA2-7)                                        |
| Tax and/or customs laws are updated, simplified, and better aligned with modern standards and international protocols         | Substantive provisions of the customs laws are better aligned with modern standards and/or protocols, and are widely communicated, and applied |
| Digital technologies are better aligned with strategic objectives                                                             | Capacity to work with data and analytics is strengthened                                                                                       |
|                                                                                                                               | Core systems and process automation are consistent with good practices                                                                         |
| Objective                                                                                                                     |                                                                                                                                                |
| Strengthened core tax administration functions (SDG 17.1) - TAD                                                               |                                                                                                                                                |
| Outcome(s)                                                                                                                    | Indicator(s)                                                                                                                                   |
| A larger proportion of taxpayers meet their payment obligations as required by law                                            | Management of refunds improved (TADAT 2015 POA8-24/TADAT 2019 POA8-28)                                                                         |
| Objective                                                                                                                     |                                                                                                                                                |
| Improved customs administration functions (SDG 17.1) - CAD                                                                    |                                                                                                                                                |
| Outcome(s)                                                                                                                    | Indicator(s)                                                                                                                                   |
| Foreign trade operators better comply with their reporting and payment obligations                                            | Traceability of goods and customs actions in the customs systems strengthened                                                                  |
|                                                                                                                               | Self-assessment used to declare goods at customs and strengthened                                                                              |
|                                                                                                                               | Alignment of customs procedures (including transit) with international standards and regional integration objective improved                   |