

An International Overview of Tax Amnesty: The Experiences of Different Countries Are Lessons To All?

Robert J. Misesy and Ricardo A. Cadenas
U. S. A.

Introduction

This paper attempts to compare the tax amnesty programs of various taxing jurisdictions within the United States with the experiences of selected American and European countries. The authors take an eclectic approach toward analyzing some of the similarities and differences between cross border occurrences of tax amnesty programs.

The analysis also includes discussion of varied recent tax amnesty programs within Latin American countries (for example Argentina, Colombia and Mexico) which are designed to encourage the return of flight capital.¹ In decades past, such (for the most part untaxed) funds, have drained the region of a much needed source of capital, and its owners have sought safer havens to achieve higher returns. Additionally, an analysis is provided of the well-chronicled attempts of the many states of the United States that have instituted tax amnesty programs. The states' experiences, both positive and negative, may be instructive to other countries wishing to develop similar approaches in their tax amnesty programs.

This essay will focus on tax amnesties in both a domestic and international context. Section II reviews the historical and political background behind amnesty programs. Section III reviews the United States experience with amnesty programs in the individual states. Section IV examines the Latin American experience with amnesty programs for the wealth tax.

Historical and Political Background

A British news reporter² travelling in Europe during 1989 writes of his experience dining at an expensive and exclusive restaurant in Italy, when at the end of the meal he is presented with a large bill for the meal, written upon the torn out page of a child's exercise book.

The British reporter - not wishing to be accused of complicity in the restaurant establishment's tax evasion efforts - asked to be presented with a proper bill and receipt, and his request was honored.

Part of the reporter's concern, is that Italy, in an effort to combat rampant lack of tax compliance has passed a law which punishes customers present in the vicinity of a service establishment, if such customer does not possess a valid receipt for the goods or services obtained. Such potential sanctions against taxpayers³ illustrate the great length that countries will go to deter evasion, often with limited results.

The tax evasion problem in Italy, as in some other countries perhaps, reflects a culture which still tends to regard the state as an occupying power, and its defrauding almost a social duty.

Estimates of delinquent taxes during 1988-1989 were in the neighborhood of two hundred billion United States dollars while at the same time the government faced a deficit of over one hundred billion United States dollars. If administrators efficiently addressed the problem, they could virtually eliminate the deficit.⁴

¹ The term flight capital generally refers to funds which have been withdrawn from a jurisdiction in contravention of the currency restriction laws of the jurisdiction.

² *The Financial Times*, article entitled "The Taxing Problems Italy Faces" by John Wyles, August 7, 1989.

³ Although tax amnesty programs are designed for non-taxpayers, the authors will use the phrases taxpayer or taxpayers to refer to all individuals who had a legal obligation to pay tax.

⁴ *Id.*

Italian tax administrators, as in the past⁵ looked to an amnesty as a possible solution. During this period the Italian Treasury was undergoing austerity measures which indicated that a possible combining of an amnesty program with other revenue raising measures, including an increase in the VAT taxes (sales tax) applicable to numerous domestic items. This combination, extremely angered trade unions who saw it as an increase in tax for the general population, while at the same time, rewarding tax evaders upon forgiveness of part of their debt to the state.

In Italy, as in other countries, amnesty proposals may be a controversial and political issue, particularly with members of trade unions. Their members are generally salaried employees who view it as unfair that their counterparts in the underground economy (generally self-employed proprietors and professionals) receive a reduction of penalties or tax, while often no relief is given to persons who have previously complied with their obligation⁶.

Worldwide, politicians, government officials and tax administrators considering a tax amnesty are often caught between opposing forces. On the one hand, there is the pressure of budgetary shortfalls, or deficits. On the other, there is sometimes the strong popular belief that individuals are overtaxed, and that revenue raising programs are not being prudently administered by government officials. Although a proposal of a tax amnesty may temporarily alleviate a governments need for revenues, such a proposal risks alienating some of its residents and citizens who may feel that their past compliance in not fairly recognized or rewarded.

The Unites States Experience

To date, the Internal Revenue Service has never sponsored a federal tax amnesty within the United States.⁷ However, in 1982, Arizona became the first

state to develop a tax amnesty and thirty-eight states have followed.

The objectives of an amnesty program are twofold: (1) improve future compliance by placing additional taxpayers on the tax rolls and (2) an immediate increase of revenue. Consequently, an amnesty provides a state with an opportunity to clean the slate with respect to some of its delinquent taxpayers, and at the same time it produces much needed revenue. Although these two objectives do not necessarily compete, the need for either is tied to the current economic status of the jurisdiction. For example, when the economy is weak, the jurisdiction's revenue will decrease and consequently need a windfall. However, the major problem with a revenue objective is the propensity towards an amnesty period every time a recession occurs, which would undermine compliance. As for the second objective, adding taxpayers to the rolls will not have an immediate effect, but may provide a future revenue windfall. Therefore, considering the cyclical nature of economic conditions, the objective of adding taxpayers to the rolls should be important during economic prosperity.

A major concern of the taxing authority when instituting an amnesty program is honest taxpayers losing respect for the integrity of the tax system. The integrity focuses on the image, effectiveness, efficiency, and credibility of the system. This provides a question of delicate balancing for the taxing authority. On the one hand, the taxing authority wants to make the amnesty attractive enough so that enough non-compliant taxpayers will submit to the program. On the other hand, the taxing authority does not want to make the amnesty program so attractive that honest taxpayers will lose faith in the authority's tax system and become non-compliant themselves.

Because each of the United States has its own taxing jurisdiction, we are afforded an excellent opportunity to qualitatively examine the attempts of

⁵ Italy attempted a tax amnesty in 1982. The amnesty applied to exonerate ("condono") a delinquent taxpayer from individual, corporate, property and transfer taxes, and included varied and complex conditions to determine one's liability--i.e. a taxpayer would qualify upon agreement to a percentage increase above what in fact was reported. It was optimistically predicted that this tax amnesty program would yield over \$4 billion by the end of 1982, but in fact, it yielded less than \$1 million. The "complexity" of the amnesty program, has at least in part been blamed for the poor results. (Source: Wall Street Journal article dated December 23, 1982, page 13 by David Fleming, entitled: "Italy's Plan to 'Pardon' its Tax Evaders Falters Due to Its Complexity and Confusion.")

⁶ See: Financial Times, August 11, 1989 article regarding Italian trade union strikes protesting proposed tax amnesty

⁷ Although the Internal Revenue Service has never sponsored a tax amnesty program, it does have an ongoing program for offers in compromise. I.R.C. section 7122. We can consider the offer in compromise program a form of tax amnesty. Suppose, for example, that a taxpayer fails to report his income in year 1. In year 2, the Service issues him a notice of deficiency for which he fails to timely file a petition in Tax Court. Therefore, the tax is assessed. Section 7122 allows a taxpayer without financial resources to make a compromise offer, which are usually significantly less than the amount of the tax, based as to doubt of collectability.

different states to institute a tax amnesty program. Our findings indicate that the successful states employed a carrot and a stick approach: an amnesty program coupled with increased enforcement.

However, a taxing authority merely opening its doors and saying its going to offer amnesty while increasing enforcement is not enough; the authority must properly implement these plans. We have determined the following elements as necessary to implement amnesty and enforcement:

The Amnesty Program a.k.a. "the carrot"

We found seven criteria which a country must properly deal with in order to form a successful amnesty program.

- Types of taxes

The most successful amnesty programs were available for all the taxes the authority imposed.⁸ This approach works because it is truly egalitarian, increasing confidence in the tax system by applying to all economic classes of taxpayers,⁹ as opposed to regressively oriented sales taxes or progressively oriented transfer taxes. Therefore, we recommend that countries contemplating an amnesty program apply their amnesty to all taxes, including the wealth tax.

- The nature of the amnesty

The nature of the amnesty ranged from waiving all penalties¹⁰ - civil and criminal - and interest to merely waiving criminal penalties.¹¹ None of the states waived any portion of the tax itself, except to the extent that the state could not determine interest. Although all of the successful programs waived both civil and criminal penalties, waiving interest did not affect the success or failure of the amnesty.¹² Because interest waivers are

irrelevant, in accordance with the objective of raising revenue, we recommend waiving both civil and criminal penalties, but not interest.

- The eligibility of taxpayers

The eligibility schemes engaged by the states varied. Some programs only invited non-filers,¹³ while others included known tax delinquents.¹⁴ Moreover, some conditioned eligibility on the stage of the dispute: precluding those taxpayers under civil audit or criminal investigation or even those who are in litigation.¹⁵ The results due to eligibility were mixed, foreclosing any practical generalizations. However, from a theoretical approach, we recommend disqualifying from amnesty those who are under civil audit, criminal investigation, or whose dispute is in litigation. Because of the objective of increasing the tax rolls, we believe that including taxpayers who are already known to the taxing authority is unnecessary. We further believe that allowing these taxpayers to get another chance will undermine the integrity of the system and decrease future compliance of currently honest taxpayers. Concurrently, we would include everyone else - including non-filers and delinquents - because these are the people from whom the authority wants to increase revenue and update the tax rolls.

On an international basis, we would recommend eligibility for all taxpayers regardless of residence or citizenship. Doing so would help satisfy the objective of raising revenue while avoiding an override of the non-discrimination article¹⁶ of any tax treaty. While a treaty override does not itself limit the effectiveness of the amnesty, it could result in a loss of trust by treaty partners. While representing a careful balancing of interests, tax treaties confer benefits to citizens and residents of all signatory nations. A discriminatory amnesty program would override tax treaties and tilt the balancing of interests.

⁸ See, for example, Colorado, Louisiana, Massachusetts, Missouri, North Dakota, and Wisconsin.

⁹ See, for example, Oklahoma, whose amnesty applied only to income and sales taxes.

¹⁰ See, for example, New York and Wisconsin.

¹¹ See, for example, Arizona.

¹² Compare, for example, Colorado and Illinois, who achieved success without waiving all interest, with New York and Wisconsin, who also achieved success while waiving all interest.

¹³ See, for example, Kansas.

¹⁴ See, for example, Massachusetts.

¹⁵ See, for example, New York and Wisconsin.

¹⁶ Article 24 of the O.E.C.D. Model Tax Convention states that "(n)ationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall, notwithstanding the provisions of Article 1 (Personal Scope), also apply to persons who are not residents of one or both of the Contracting States.

- Budget and staff

In general, the states that increased funding for the amnesty programs were the most successful.¹⁷ However, an increased budget for staff¹⁸ and publicity should not cause a problem assuming that the amnesty will achieve the objective of a revenue windfall. In fact, instead of specifying part of a taxing authority's current allocation for the programs, the state could authorize the authority to use an amount from the expected revenue windfall to pay for the increased budget.

- Publicity

As expected, the greater the publicity, the greater the chances of achieving the two objectives.¹⁹ One successful approach was to send letters to known delinquent taxpayers about both the amnesty and any future increased enforcement.²⁰ The authority can derive publicity through the use of both press releases and advertising on television and radio. Considering that the electronic media are governmentally owned and operated in many countries, advertising of both the amnesty and increased enforcement programs might be the most cost-effective publicity method.

- The duration of the amnesty

The length of the amnesty programs also varied. Although the duration ranged from one month²¹ to six months,²² the typical duration was from eight to ten weeks.²³ We endorse the efforts of those states who chose an eight to ten week period. Although the amnesty with a six month period was successful, we view a longer duration as diluting the affect of any increased advertising while providing time for an evasion minded taxpayer to arrange his affairs so that he may enjoy amnesty with a less burdensome payment. The amnesty program which lasted only one month was disastrous as few taxpayers had time to enter the program.

- The time of payment

We recommend that all taxpayers pay their tax in full by the end of the amnesty period.²⁴ Although this will prevent some willing and eligible taxpayers from entering the program, it will ensure the integrity of the tax system. Allowing participating taxpayers to pay their obligation through some type of installment plan extending beyond the end of the amnesty program does not guarantee payment. Considering that the participants are generally not honorable taxpayers, a closing agreement would probably be meaningless, leading to a loss of integrity, and possible compliance, in the system by honest taxpayers.

The Increased Enforcement Program, a.k.a. "the stick"

Along with the carrot of the amnesty program comes the stick of the increased enforcement program. The increased enforcement program should earn compliance from the non-compliant and increase the integrity in the system that is needed to avoid honest taxpayers becoming non-compliant. We recommend that the enforcement program be composed of two elements: tougher penalties and additional resources.

- Tougher penalties

If the particular country does not impose criminal sanctions for abusive taxpayers, such as evaders, we recommend that it impose some to deter potential criminal tax behavior.²⁵ Nevertheless, because most countries already impose criminal tax penalties for tax evasion and failure to file, we recommend that the countries increase the severity of the punishment. The country could also increase civil penalties for actions such as fraud, negligence, and delinquency. By increasing the punishment and advertising the increase,

¹⁷ See, for example, California and Massachusetts.

¹⁸ See, for example, Oklahoma.

¹⁹ Compare, for example, the success of Illinois, which advertised extensively, with the failure of Idaho, which did not advertise.

²⁰ See, for example, Massachusetts and South Carolina.

²¹ See, for example, Texas.

²² See, for example, Oklahoma.

²³ See, for example, Alabama.

²⁴ See, for example, Minnesota.

²⁵ See, for example, Alabama, Colorado, Illinois, Massachusetts, and New York

the country will try to deter future non-compliant behavior while restoring any integrity in the system that the amnesty may have lost.

- Additional resources

At the same time, the increased penalties will be meaningless without additional resources to enforce the penalties. Collection is derived through the aggressive use of existing tax collection tools such as liens, levies, and seizures²⁶ and the resources to effectuate those tools.

Additional resources require developing new systems, including, *inter alia*, computer networks,²⁷ to catch evaders. Finally, to restore any integrity in the tax system that the amnesty lost, increased enforcement also requires increased staffing²⁸ for both the examination and collection functions of the taxing authority.

Although all of these resources will cost money, we presume that the revenue windfall from the amnesty will provide the sufficient funding to pay for the additional resources. Therefore, even with the costs of increased enforcement, the amnesty program will still provide revenue to the authority's coffers.

Latin America Wealth Tax Amnesty Programs

Although the causes and remedies associated with tax amnesties in the United States and Latin American countries share some basic similarities, the reasons for use of amnesty as an administrative tool, the underlying policies, procedural approaches, and the financial consequences thereof are widely different. For example, legislation directed at sanctioning the repatriation of flight capital has various aims, including: 1) subjecting the taxpayer and the repatriated funds to immediate and future taxation, since they would henceforward be

within the system, 2) requiring a financial investment within the jurisdiction,²⁹ and 3) providing safeguards so that such programs do not benefit money launderers or drug traffickers.³⁰

Because of the non-existence of a significant flight capital concern within the United States, the latter two factors are unlikely to play a role in tax amnesty in a state taxing authority in the United States (or a federal amnesty, if one is over considered). Due to the magnitude of the problems approached, the efforts of some Latin American amnesties must necessarily be much broader in scope than their United States counterparts. In casting such a large net, such broader programs may risk numerous additional economic and legal problems, not usually encountered in programs which have a merely domestic scope.

These programs go beyond revenue raising, since a major portion of the funds do not go to the government, but rather are maintained in private investments. Tax administrators must therefore be concerned not only with future compliance, but they must also verify and monitor the repatriated capital to assure it has no association with illicit dealings.

International Tax Amnesty Concerns

An amnesty program that has the effect of forgiving potential criminal prosecution, interest, civil penalties, and even a portion of income (or other) taxes owed within a given state or country may, at first glance, appear not to have an impact on international trade. However, if for example, such amnesty is limited to citizens or residents of a given state or country, the question arises as to whether there may improper, (and perhaps illegal) discrimination against nonresidents transacting business in such jurisdiction, who have been excluded from the benefits of the amnesty. Such discrimination may have both tax,³¹ and non tax

²⁶ See, for example, Massachusetts.

²⁷ See, for example, California.

²⁸ Compare, for example, California and Colorado, who had successful amnesty programs while promising increased enforcement staffing, with the failures of Kansas and New Mexico, who did not increase enforcement staffing...

²⁹ Some countries, such as Argentina have a dual rate regime for overseas capital merely "declared" but not repatriated (2% to 4% of gross amount declared) and a lower rate (1% to 3%) for repatriated capital. Source: *The Financial Times Limited "World Tax Report" June 1991.*

³⁰ *The Financial Times Limited "World Tax Report" June 1991 article regarding Argentina's amnesty states: "The origin of the money - usually the product of tax evasion - does not have to be declared, but officials promised to prevent abuse of the scheme by launderers of drug trade money." See also: Report and analysis concerning Colombia tax reform entitled "La Reforma Tributaria, 1982-1983" by Lic. Fernando Rojas Hurtado (Documentos ANIF, Bogota 1983), at p. 38.*

³¹ Please refer to the previous discussion regarding the eligibility of taxpayers for an amnesty program.

consequences.³² Also, the country promoting the tax amnesty, in receiving information a particular taxpayer who is participating in the amnesty, may in turn be obligated to provide taxpayer information to another jurisdiction with which it has an exchange of information obligation.

- International Trade Effects

A tax amnesty, may result in the forgiveness of tax, penalties, or interest and may have the effect of improperly subsidizing commercial activity. A common complaint domestically, is that a tax amnesty favors persons in the underground, or cash economy, and is therefore prejudicial towards wage earners, who have little choice in initial tax compliance because of withholding laws. If, for example it is determined that a significant number of persons benefitted by an amnesty are exporters, could the amnesty be at variance with multilateral agreements such as GATT?³³ An illustration involving United States law is instructive on this point.

In order to promote exports, the Revenue Act of 1971 introduced the concept of Domestic International Sales corporations (hereinafter referred to as a DISC) to the Internal Revenue Code.³⁴ In simple terms, the tax benefit associated with a DISC was the deferral of a portion of tax associated with export earnings until the dissolution, or other termination of the corporate export enterprise. As its name implies, DISC benefits were limited to domestic (i.e. United States) corporations, in the business of exporting.

DISC provisions were a source of great debate between the United States and other signatories of GATT, particularly within the European Community, which argued that the DISC scheme of tax deferral were an impermissible subsidy under DISC. In 1976, a GATT panel determined that the DISC, as well as certain export tax practices of Belgium, France and the Netherlands, had some characteristic of an illegal export subsidy. In the case of the DISC, the GATT panel focused upon the DISC provision's failure to

charge interest upon deferred taxes as the offensive subsidy.³⁵

Arguably, a tax amnesty has characteristics that are similar to the DISC provisions, i.e., it condones deferral of taxes by forgiving penalties and potential prosecution.

Additionally, it sometimes forgives interest due upon delinquent taxes.

A tax amnesty that is across the board, and nondiscriminatory should generally not be susceptible to criticism on the grounds that it is an unfair subsidy in the international trade context. One may argue that any benefit to export oriented enterprises is merely coincidental, and not the principal effect or purpose of the tax amnesty program legislation.

In taking such a position, it may be necessary to do more than merely substantiate that the design of the amnesty program is not intended to benefit the export sector. It may also be necessary to show that it does not produce a substantial benefit to the export sector, that is not otherwise available to all other taxpayers. It is conceivable that some countries may find that the way to promote exports is by selective enforcement, i.e., not pursuing noncompliance of export oriented enterprises, or promoting amnesty which will have the export sector as its principal (unnamed) beneficiary. A later forgiveness of tax, interest or penalties by means of an amnesty is tantamount to not having imposed such economic burdens in the first place.

Hence an argument may exist that a tax amnesty program could, under certain circumstances, constitute an impermissible subsidy under GATT terminology.

Some may suggest that the characterization of a tax amnesty as a vehicle for improving a country's international competitiveness in trade is farfetched. This is not the case. Recent tax amnesty programs in various Latin American countries have had the effect of greatly improving said countries' balance of payments and trade deficits. For example during 1989, in Mexico an tax amnesty directed at the wealth tax (amnistfa patrimonial) has been criticized as being no more than a ploy, or a "fig leaf" covering an amnesty for the return

³² Such action by the country promoting the amnesty may be arguably in violation of "non-discrimination provisions" of its Trade, Navigation and Commerce treaties with other countries, and the scope of the amnesty may therefore be required to be extended to nonresidents covered by such treaties.

³³ General Agreement on Tariffs and Trade.

³⁴ For a detailed discussion of the DISC legislation, see: Cohen, "A Decade of DISC, Genesis and Analysis", 2 *Virginia Tax Review* 7 (1982).

³⁵ See: Congressional Committee report concerning Internal Revenue Code N^o 921-927, P.L. 98-369 801(a), at p. 634.

³⁶ Article in *The Economist* magazine, August 12, 1989, entitled "Mexico's Virtue Goes Half Rewarded."

of flight capital.³⁶ During a period of six weeks, the amnesty motivated more than 1.5 billion United States dollars of "footloose capital" to be repatriated, increasing Mexico's foreign currency reserves to a point (almost nine billion United States dollars) so that it would have no problem in meeting its next quarterly interest payment on its foreign debt.

The experience of Colombia is perhaps even more telling. A wealth tax amnesty produced such a flood of repatriated dollars that it caused the local currency to have to be revaluated as against the dollar (i.e., an upward valuation). The situation caused concern in Colombia's export sector (particularly coffee growers) whose goods became more expensive, and therefore less competitive internationally because of the government's fiscal actions.³⁷

Conclusion

Due to compliance problems, we believe that an amnesty program combined with an increased enforcement program will prove to be successful. The amnesty program should include all taxes, affect both civil and criminal penalties, include all taxpayers except those who are involved in a tax dispute, increase budget and staff, be well publicized, last eight to ten weeks, and require full payment before the end of the period.

Nevertheless, when analyzing Latin American wealth tax amnesty programs, we can make some preliminary conclusions from amnesties that sanction the return of flight capital.

These include:

- The effects go far beyond purely domestic oriented amnesties which do not have such a

direct and measurable effect upon international commerce.

- The wealth tax type amnesty - is arguably much broader in scope than a purely income tax amnesty. In order to comply with a wealth tax amnesty, a taxpayer may invite more scrutiny of the source of assets reported (e.g. to assure no relation to the illicit drug trade). Also there may be the requirement of disclosure and valuation of all of one's property on an annual basis. This situation is roughly comparable to the annual preparation of an estate tax return (Form 706) under United States tax law, an exceptional, and revealing one-time occurrence for a United States individual taxpayer.
- There are many other economic factors, such as interest rates, and returns on international investments which motivate a person to comply with a wealth tax-type amnesty,³⁸ and such factors may not play a role in purely income tax amnesties. Moreover, once capital is repatriated, tax administrators may have to monitor the repatriated investments to assure that they do not again disappear.³⁹

The authors believe that a properly run amnesty program can promote a change in tax attitude and behavior. Compliance has increased in the short term for those taxing authorities who have instituted a tax amnesty program. Unfortunately, a long term study is not available because the amnesties for which there are statistics are relatively new.

However, we believe that the carrot and the stick will result in long term compliance. Although cultural differences may produce a difference, the amnesties we examined provide lessons to all.

³⁷ See: Article in the *Financial Times*, July 2, 1991, entitled "Flood of Dollars Puts Colombia on the Defensive".

³⁸ See footnotes 36 and 37.

³⁹ *Id.*