

## **TAX AMNESTY IN TRANSITION ECONOMY: LONG-TERM TRUST OR SHORT-TERM REVENUES?**

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### **Abstract**

*The article covers the rationale, organisation and characteristics of tax amnesties conducted in Georgia, Kazakhstan, Kyrgyzstan, Latvia, and Russia, as well as the potential advantages and disadvantages of tax amnesties and an analysis on the results of tax amnesties implemented in transition economies. In the Russian tax amnesty the long term negative impact on tax revenue is minimal. Tax amnesties carried out in Kazakhstan and Russia were more successful, from the standpoint of funds received and implemented by the tax authorities.*

**Keywords:** *Tax amnesty; Georgia; Kazakhstan; Kyrgyzstan; Latvia; Russia; Transition economy; Emerging market.*

**JEL Codes:** *H20, H26*

### **Introduction**

The Russian Federation carried out two tax amnesties – in 1993 and 2007. However, some experts (Torgler, Schaltegger, 2005) also consider the restructuring of overdue taxes and fees in the late 1990s as a form of tax amnesty. Thus, the simplified declaration of individual incomes in 2007 became the third tax amnesty in Russia. It took the form of a simplified procedure for declaring individual incomes that were not taxed until 2006.

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Progressive reform of the tax administration contributed to the announcement of tax amnesty. This factor expresses the desire to improve simplicity and transparency of tax procedures. It is consistent with providing individuals the opportunity to declare untaxed incomes.

However, the State of public finances has been relatively healthy. This circumstance, *inter alia*, served as a significant prerequisite for the possible imposition of sanctions against those individuals 'not interested' in tax amnesty. This is consistent with the statements of the federal Government.

Thus, the general background for the tax amnesty looked quite favorable. In Kazakhstan, there were two tax amnesties conducted in 2001 and 2006/2007. In Georgia, a tax amnesty was conducted in 2004, in Latvia – in 2012, in Kyrgyzstan – in 2013.

### **Conceptual Framework**

Tax amnesty can be defined as a programme that allows a reduction of taxpayers' declared or undeclared tax liabilities, in comparison with tax obligations established by law (Le Borgne, 2006).

Several elements of a tax amnesty should be identified: its purpose, the type of taxes to be collected, the real world effects of a tax amnesty, who can participate in the programme, incentives for participating in a tax amnesty, and its duration.

During the course of other such amnesties, individuals and organisations were allowed to repay arrears on any tax liabilities. In recent years, some countries announced a tax amnesty in order to return capital that taxpayers illegally transferred overseas. This is one of the key reasons, for the introduction of the simplified procedures for the declaration of income of individuals in the Russian Federation in 2007. A tax amnesty of this type, usually reduces tax obligations (or exempts from taxes) of previously undisclosed income.

During the tax amnesty, the amount of unpaid taxes, penalties and sanctions to be forgiven by the tax authorities should be determined.

In the Russian Federation, with the introduction of the simplified procedure for declaring income for individuals in 2007, in the event the individual paid the declaration payment, individuals acknowledged their obligation to pay tax on the personal income; filing a tax return on personal income tax; payment of the unified social tax.

In other cases, a tax amnesty allowed debtors to pay their debts in instalments. In this way, tax authorities could decide whether to include the interest for the taxpayer's obligations in instalments.

Duration of a tax amnesty may consist of a one-time period with a predetermined period, usually from two months to one year. When making such announcements it was generally emphasized that debtors had only one single opportunity to declare all unpaid taxes in a timely manner. Nevertheless, in some countries, it has become common practice to declare multiple tax amnesties. Some countries implement permanent tax amnesties, which allow taxpayers to pay their taxes at any time.

Tax amnesties are used, as a rule, for immediate, short-term increases in tax revenues. As a result of certain tax amnesties, substantial increases in revenues are realised.

The long-term impact of amnesty on tax revenues can be negative. This adverse effect can occur for several reasons (Alm and Rath, 1998; Malik and Schwab,1991; Stella,1991):

- 1) Honest taxpayers may consider tax amnesty as an injustice and may reduce their compliance with paying their tax obligations.
- 2) Some individuals may pay taxes, predominately, for fear of being punished. If amnesty reduces the penalty as a motivating factor after its implemented, tax compliance worsens.

- 3) Taxpayers may decide to wait until another tax amnesty is announced in future, and decide to pay less in taxes with the expectation that in the future their tax evasion will be forgiven.

## **Results and discussion**

### **Implementation of tax amnesties**

*Georgia.* In Georgia tax amnesty was conducted in 2004. For the legalization of income the required amount of payment was 1% of the declared value of the property or income. Individuals who were facing criminal charges, or were in the process of having their property confiscated were not affected.

*Kazakhstan.* Tax amnesty implemented in Kazakhstan (2001) was extended to individuals and companies. Legalized funds were exempt from taxes and fines. During the amnesty period, business cheques were banned. Another tax amnesty – amnesty of capital and assets carried out in Kazakhstan from July 2006 to August 2007.

*Kyrgyzstan.* Tax amnesty in Kyrgyzstan was conducted in 2013 during the procedure of income legalization – from 1 July to 31 December 2013. It was required to pay a fixed declaration payment of 1 percent on the declared income (45 million Kyrgyz soms and above).

*Latvia.* In Latvia, the tax amnesty was held in 2012, it envisaged zero returns for residents, who at the end of 2011 owed taxes on any assets held abroad or in Latvia cost more than 14,000 Euro, as well as amnesty for income from which taxes had not been paid.

*Russia.* The Simplified procedure for the declaring of individual income (SPDII) in 2007 assumed payment from individuals without filing tax returns and documents on the types and sources of income received. The Declaration payment was considered as the amount of money paid by individuals in accordance with SPDII (Act 269-FZ, 2006; On obligatory pension insurance, 2001; Ministry of Finance, 2007; Ernst

and Young (2007). The main purpose of the tax amnesty for the Government was the strengthening of trust between the State and the taxpayers (Trust in the State (2007). The Simplified procedure for declaring income of individuals in the Russian Federation was regarded by authorities as a one-time measure (New times (2007).

The SPDII's aim was to enable individuals to fulfil the obligation to pay tax on income received before 2006 and who were subject to taxation.

The SPDII was aimed at raising budget revenues. This procedure allowed individuals to legalise previously received incomes which had not been taxed in accordance with tax laws.

The federal Government did not expect a substantial increase in revenues from the SPDII. The government's scheduled revenues during the implementation of SPDII (2007) was 222,970 thousand roubles (USD 9,050,000).

The SPDII was a fairly transparent form of a tax amnesty. Technically, legislators even moved away from using the term "tax amnesty" so as not to confuse people who had to pay the declaration payment.'

The proper title of Act No. 269-FZ, and within the text of the document, in the opinion of the legislator, was used a more neutral term "a simplified procedure for declaring income." The term emerged during the hearing of the Bill in the Parliament, and its use was justified by the desire to move away from the slightest mention of possible fault of taxpayers and, thus, minimise the risks of the number of those paying the declaration payment. An important argument to this is, that prior to 2006, the behaviour of taxpayers in their (non)payment of tax obligations could have had a significant impact on the complexity of legislation, which would have caused high taxes and any implementation of tax reform (Zolotov and Kogan, 2007).

The Simplified procedure for declaring the income of individuals did not apply to incomes of individuals, in accordance with the tax legislation of the Russian Federation, who had previously paid taxes, or the state social insurance contribution to the extra budgetary funds.

The SPDII did not apply to persons in respect of who had entered into legal force a conviction for an offense for evasion of taxes and fees (Penal code, 1996), if the conviction for the offense had not been removed, cancelled or repaid. The general characteristics of payers and the elements of the declaration payment are given in Table 1.

**Table 1. Contributors and elements of the declaration payment**

Elements of declaration payment	Characteristics and elements of the declaration payment
Payers	Individuals
Object of Taxation	Personal income
Payment Base	The sum of incomes of individuals, in accordance with the tax legislation of the Russian Federation who had not paid appropriate taxes and fees.
Pay period	March 2007 – December 2007.
Rate of payment	13 percent
Calculation of payment	Declaration payment was calculated based on an individual's income, which in accordance with the tax legislation of the Russian Federation, who had not paid the appropriate sum of taxes, plus the rate of the declaration payment
Payment procedures and deadlines	Declaration payment was to be paid during the period of 1 March 2007 until 1 January 2008 through a credit institution with authorisation from the Central Bank of the Russian Federation to engage in the transaction of financial assets of private individuals for depositing, opening, and maintaining bank accounts, in the form of hard cash and cashless debits, on account of the territorial bodies of the federal Treasury.
Reporting	None (submission of any form of reporting was not required)

The Declaration payment (DP) was calculated based on an individual's income, which in accordance with the tax legislation, had not previously taxed, at the rate of 13%:

$$DP = D_{NU} \times 13\%$$

DP – Declaration payment;  $I_{NP}$  – Income from which taxes were not paid until 2006; 13% – the rate of the declaration payment.

The Declaration payment applied at the rate of 13% regardless of the types of income and the corresponding tax rates applicable at the time of tax evasion. Declaration payment refers to non-tax income revenues (Budget code, 1998).

Individuals who had paid the declaration payment were considered to have fulfilled their obligations under payment of personal income tax (Tax code, 2000); filing of individual income tax return.

Moreover, taxpayers who received income from business or private practice, who made the declaration payment were also considered to have fulfilled their obligations under: payment of the unified social tax, social insurance contributions; submission of tax return under the uniform social tax on their income.

The declaration payment rates of the mentioned tax amnesties varied from 0 to 15% (Table 2).

**Table 2. The rate of declaration payments during tax amnesties**

Country	Declaration payment, %
Georgia	1
Kazakhstan (2001)	0
Kazakhstan (2006-2007)	10
Kyrgyzstan	0/1*
Latvia	15
Russia	13

\* Up to KGS 45 million declared income and assets – 0%, more than KGS 45 million – 1% of the KGS 45 million.

### Declaration payment revenues

*Georgia.* During the tax amnesty, eight people declared income of USD 35,000 (Table 3).

**Table 3. Tax amnesty revenues collected**

Country	Revenues, USD thousands*
Georgia	35
Kazakhstan (2001)	480,000
Kazakhstan (2006-2007)	670,000
Kyrgyzstan	na
Latvia	738
Russia	148,456

\*. At the official exchange rate of the national currency on the last day of the tax amnesty.

*Kazakhstan.* As a result of the tax amnesty in 2001, funds received were amounted to USD 480 million. The revenues collected during the amnesty of capital and property in 2007 were amounted to USD 670 million.

*Kyrgyzstan.* The total revenues of tax amnesty have not been released.

*Latvia.* As a result of the tax amnesty 84 people declared income of 2,767 thousand Latvian lats, and the amount of tax paid (15%) was 415 thousand Latvian lats (USD 737,900).

*Russia.* For the whole period in which the simplified procedures for declaring the income of individuals was carried out (March-December 2007) total income tax payment in the Russian Federation amounted to 3,657,751 thousand roubles (USD 148.5 million). Considering declaration payment rate, the total amount of declared income on which charges were paid on declaration payments amounted to 28,136,547 thousand roubles (USD 1,142 million). In comparison to the personal income tax, which was collected during that same period (March-

December 2007), the Declaration payment was at 0.33% of this value (Table 4).

**Table 4. The ratio of Declaration payment base in the Russian Federation**

Tax base of personal income tax		Tax base of declaration payment		Declaration payment base / personal income tax base,%
In thousands of roubles	thousand USD	thousand roubles	thousand USD	
8,649,965,545	351,072,319	28,136,547	1,141,966	0.33

The above amount (3,657,751 thousand roubles) (USD 148.5 million) was generated primarily by two federal districts – the Central and Far Eastern districts. Their contribution to total revenue was 80% (64 and 16% respectively) (Table 5).

**Table 5. Structure of declaration payment by Russian Federal districts**

Federal districts	Declaration payment		
	thousand(s) of roubles	USD million	%
Central Federal District	2,339,424	94.9	64
Including Moscow	2,125,206	86.3	58
North-western Federal District	230,427	9.4	6
including St. Petersburg	199,143	8.1	5
Southern Federal District	117,226	4.8	3
Privolzhsky Federal District	166,204	6.7	5
Ural Federal District	119,247	4.8	3
Siberian Federal District	87,521	3.6	2
Far Eastern Federal District	597,702	24.3	16
Total	3,657,751	148.5	100

The Russian practice of tax amnesty has not moved away from the well-established traditions around the world: the bulk of declared payments during the tax amnesty amounts were received in the last month (84%). An increase of the declaration payment revenues (up to

3%) occurred in the first month after the announcement of a tax amnesty and during summer holidays (*Table 6*).

**Table 6. Time series of declaration payment in the Russian Federation**

Period	Paid Declaration payment		The structure of the payment, %
	thousand(s) of roubles	USD million	
March	48,500	2.0	1
April	101,587	4.1	3
May	46,177	1.9	1
June	78,313	3.2	2
July	102,559	4.2	3
August	41,431	1.7	1
September	37,174	1.5	1
October	53,468	2.2	1
November	90,433	3.7	2
December	3,058,110	124.1	84
Total	3,657,751	148.5	100

## Discussion

Revenues collected via the declaration payments, were generated primarily by two federal districts – the Central and the Far Eastern. Their contribution to the total amount collected was 80%. The bulk of the tax amnesty of declared amounts were received in the last month.

The tax procedure of the declaration campaign was marked by relatively high level of privacy in reporting income, a lack of requirement to provide any tax documents, as well as relatively low rate of the declaration payment. The lack of an elaborate scheme within the simplified declaration tax mechanism should be attributed to individual entrepreneurs who were not covered under the declaration campaign.

The relatively low level of information provided and outreach campaign to support the simplified income Declaration. In this regard, the potential of a tax amnesty seems underutilised, even taking into

account the administrative costs. On the other hand, this fact is a positive one. One of the adverse effect tax amnesties is a possible reduction in tax compliance. As a result, in the Russian version of the tax amnesty, there is a lack of awareness of taxpayers; therefore, the long term negative impact on tax revenue is minimal.

### **Conclusion**

Tax amnesties usually have little effect on government budgets, collecting relatively small revenues. Total revenues collected during the Russian tax amnesty amounted to a relatively small amount of revenues as compared to the current individual income tax revenues (0.3%).

Tax amnesties carried out in Kazakhstan and Russia were more successful than in other countries discussed, from the perspective of funds collected and realised by the tax authorities.

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