# Tax Amnesties

## Theory, Trends, and Some Alternatives

Katherine Baer and Eric Le Borgne

International
Monetary
Fund

# Tax Amnesties: Theory, Trends, and Some Alternatives

Katherine Baer and Eric Le Borgne

International Monetary Fund
Washington, DC

Production: IMF Multimedia Services Division
Cover Design: Andrew Sylvester
Typesetting: Alicia Etchebarne-Bourdin
Cover Photo: Frank May/dpa/Corbis

**Cataloging-in-Publication Data**

Baer, Katherine.
Tax amnesties : theory, trends, and some alternatives / Katherine Baer and Eric Le Borgne – Washington, D.C. : International Monetary Fund, 2008.

p. cm.

Includes bibliographical references.
ISBN 978-1-58906-736-3

1. Tax amnesty. 2. Tax collection. 3. Taxpayer compliance. I. Le Borgne, Eric. II. International Monetary Fund.

HJ2319 .B347 2008

Disclaimer: This publication should not be reported as representing the views or policies of the International Monetary Fund. The views expressed in this work are those of the authors and do not necessarily represent those of the IMF, its Executive Board, or its management.

Please send orders to:
International Monetary Fund, Publication Services
700 19th Street, NW, Washington, DC 20431, U.S.A.
Telephone: (202) 623-7430 Telefax: (202) 623-7201
Internet: www.imfbookstore.org

# Contents

## Boxes



## Figures



## Tables

# Abbreviations and Acronyms

| | |
|---|---|
| BIR | Bureau of Internal Revenue (Philippines) |
| CPBO | Congressional Planning and Budget Office (Philippines) |
| DIAN | Dirección General de Impuestos Nacionales (General Directorate of National Taxes, Colombia) |
| FTA | Federation of Tax Administrators |
| FY | Fiscal year |
| GDP | Gross domestic product |
| GF | General fund |
| GNP | Gross national product |
| IR | Irish Revenue |
| IRAS | Inland Revenue Authority of Singapore |
| IRPF | Impuesto sobre la renta de personas físicas (personal income tax, Spain) |
| P | Philippine peso |
| PAES | Parcelamento Especial (Special Installment program, Brazil) |
| TL | Turkish lira |
| VAAP | Voluntary Abatement and Assessment Program (Philippines) |
| VAT | Value-added tax |

*This page intentionally left blank*

# Preface

Tax amnesty programs have a long history and remain as popular as ever, across both countries and states. Policymakers often view such programs as an efficient tool that produces both short- and medium-term benefits. In the short term, amnesties yield additional revenue, although often not as much as expected. This "extra" revenue can be most desirable in times of recession or financial crisis when revenues are under pressure and expenditures are growing quickly. In the medium term, a successful tax amnesty is expected to increase the tax base, and therefore future revenue collection, as tax evaders are brought into the tax net. In other words, the amnesty is expected to improve tax compliance. Some policymakers view tax amnesties as an efficient measure, as they immediately raise the yield of a given tax without changing its structure (its tax rate and base), and also as an equitable one, as the revenue collected from tax evaders reduces the disparity in the effective tax rate of previously evading citizens and tax-law-abiding ones.

International experience, however, shows that the perceived benefits of tax amnesty programs are at best overstated and often unlikely to exceed the programs' costs—of administration and of reduced taxpayer compliance—which are rarely measured. The benchmark that policymakers often use to assess the revenue impact of a tax amnesty is the short-term *gross* revenue gain, and not the *net* revenue gain—not only in the short term, but also over a medium-term horizon. Over the medium term, potentially the largest and most significant cost of a tax amnesty can be a reduction in future tax compliance.

This paper provides an overview of the advantages and disadvantages of tax amnesties as a tool for raising revenue and increasing tax compliance. Drawing on results from the theoretical literature, econometric evidence, and selected country and U.S. state case studies, it concludes that (1) "successful" tax amnesties are the exception rather than the norm as, over time, net revenue collection and compliance are often negatively affected by amnesties; (2) the main problems that tax amnesties set out to address, namely, weak revenue performance and high delinquency and noncompliance rates, are unlikely to be resolved without an improvement in the tax administration's detection and enforcement powers; and (3) the most "successful" amnesty programs have relied on improving the tax administration's enforcement capacity. Finally, given the potential drawbacks of tax amnesties, a few alternative measures are discussed.

The authors gratefully acknowledge the contributions to this paper by several colleagues, including Peter Barrand, John Brondolo, Dale Hart, Allan Jensen, and Geremia Palomba, and the valuable comments provided by Michael Keen, Andrea

Lemgruber, Victoria Perry, and Carlos Silvani. The authors would also like to thank Graciela Kaminsky for the insightful comments she provided on the paper during the IMF Fiscal Affairs Department's 2007 annual Policy Development and Research Seminar. Rebecca Obstler of the External Relations Department coordinated the production of the publication.

CHAPTER

# 1 Introduction

"Our new Constitution is now established, and has an appearance that promises permanency; but in this world *nothing can be said to be certain, except death and taxes*." (emphasis added)

Benjamin Franklin (1817)
(letter to Jean-Baptiste Leroy, 1789)

Notwithstanding Benjamin Franklin's famous statement on the certainty of taxes, tax amnesties—which are an invitation to tax evaders to join the ranks of people who pay the "unavoidable" taxes—have shown an extraordinary resilience over the centuries. The first documented tax amnesty, dating from over two millennia ago, can be found on the Rosetta Stone (200 B.C.) in Egypt (it provided for the release from prison of tax evaders).[1] The popularity of amnesty programs over time and across countries is understandable. Every so often, a "very successful" tax amnesty program occurs and attracts widespread media and policymakers' attention. One such recent example is Italy's Scudo Fiscale (2001), which targeted undeclared offshore capital and enabled the repatriation of some €60 billion. Because of the large sums involved, variants of this amnesty program soon emerged across several European and accession countries. Within the United States, a surge in tax amnesty programs among states occurred in the late 1990s and early 2000s owing to a combination of dwindling fiscal revenue and mandatory balanced budget constraints.

Policymakers often view tax amnesty programs as an efficient policy tool that produces both short- and medium-term benefits. In the short term, amnesties become an additional source of revenue. The gross revenue collected through an amnesty can amount to a few percentage points of the targeted tax collection, and in some cases can be significant. This "extra"

[1]See Adams (1993) for a historical account of taxes and tax amnesties.

revenue can be most desirable in times of recession or financial crisis when revenues are under pressure and expenditures are growing quickly. In the medium term, a successful tax amnesty program is expected to increase the tax base and therefore future revenue collection, as tax evaders are brought into the tax net. In other words, the tax amnesty is expected to improve tax compliance. By immediately raising the yield of a given tax without changing its structure (that is, its tax rate and base), tax amnesty programs are an efficient policy measure, and also an equitable one, because the revenue collected from tax evaders reduces the disparity in the effective tax rate of previously evading citizens and tax-law-abiding ones. This is expected to improve horizontal equity—because, for a given income level, a tax evader is subject to a lower effective tax rate—and, potentially, vertical equity too—in the case where tax-evasion motives and opportunities are an increasing function of income. Finally, some tax amnesty programs are designed with a broader macroeconomic aim in mind, such as repatriating flight capital (for reasons that go beyond immediate revenue and tax compliance motives, such as balance of payments, domestic investment, or financial system considerations).

Experience, however, reveals that the perceived benefits of tax amnesty programs are at best overstated and often unlikely to exceed the programs' costs, which are rarely measured. The benchmark that policymakers often use to assess the revenue impact of a tax amnesty is the short-term *gross* revenue gain, and not the *net* revenue gain, not only in the short term, but also over a medium-term horizon.[2] Against a more comprehensive benchmark, the short-term gross revenue collected, which is often advertised as proof of an amnesty's success, needs to be offset by (1) any eventual reduction in taxpayer compliance (resulting from the loss of credibility of the tax administration and the adverse incentive effects this creates); (2) the direct cost of administering the amnesty (administrative resources, advertising, etc.); and (3) the cost in forgone tax revenue (i.e., the incentive component of a tax amnesty program, such as waived penalties and interest rates, for all tax evaders, even though some of them would have been detected by the tax administration and would have eventually paid these financial penalties).

Over the medium term, potentially the largest and most significant cost of a tax amnesty program can be a reduction in future tax compliance. Several behavioral channels predict such an effect. For example, if citizens expect another tax amnesty program to be offered again, then tax evasion becomes less costly than it was before the launching of the first tax amnesty program; that is, if a "new" tax evader decides that the benefits of tax evasion

[2]Casanegra (2002) argues that even in terms of their short-term revenue objectives, the majority of tax amnesties have failed to fulfill the expectations of increased revenue.

outweigh the costs, a legal escape route is expected. Ironically, expectations of a future tax amnesty, which drive up noncompliance, are likely to become self-fulfilling as policymakers try to reduce noncompliance by introducing a tax amnesty aimed at bringing tax evaders back to the tax net. Having observed a "successful" tax amnesty (that is, one that is perceived as having motivated many previous evaders to come forward), taxpayers can update their prior beliefs regarding the tax administration's capacity to detect evaders. Their conclusion might be that, at the margin, it is optimal to become a tax evader, because the savings from evaded tax payments may outweigh the expected probability of detection and the associated fines. Another "cost" of tax amnesty programs is that they affect the intertemporal dimension of gross revenue collection. On one hand, they may bring forward revenue collected from identified tax evaders (if these are allowed to participate in the tax amnesty program). On the other hand, however, in the immediate post-amnesty year, a decrease in revenue stemming from tax settlements, fines, and penalties is likely.

The ease in quantifying the short-term benefits of tax amnesty programs combined with the difficulty in quantifying their costs, especially in terms of compliance, could partly explain amnesties' popularity. This bias is reinforced by policymakers' well-known high discount rate (because their horizon is often as long as the next election): a tax amnesty program provides short-term benefits (extra revenue without raising taxes) at the expense of a potential future—that is, post-election—drop in tax compliance.

Notwithstanding the (often misguided) appeal of tax amnesties, alternative policies do exist in both the short and medium terms, and have been successfully applied by countries. These alternative strategies tend to target the source of the original problem, namely, weak tax compliance. Weak compliance is often the result of several factors, notably (1) weak administration, (2) a weak legal system (or enforcement of the law), and (3) inadequate tax policy (for example, a tax system that is too complex, regressive taxes, high tax rates). Clearly, addressing some of these areas of relative weakness takes time (and the formulation of medium- to long-term strategies); however, some short-term measures aimed at (1) raising revenue in the short term and (2) improving short-term compliance with a view to improving future revenue can also be implemented. These include payment installment agreements (including in situations of economic crisis), extended payment installment arrangements, and permanent programs to encourage voluntary disclosure of violations. All of these short-term measures follow the general recommendation that *up-front write-offs of tax liabilities, including interest and penalties, should be avoided.*

This paper is structured as follows: Chapter 2 defines "tax amnesty" and provides an overview of the types of tax amnesties that have been introduced. Chapter 3 reviews the economic literature on tax amnesties and summarizes its key results. Chapter 4 describes recent trends and presents recent econometric evidence and various state and country case studies. Chapter 5 highlights alternative policy measures to a tax amnesty. Chapter 6 presents some broad conclusions.