The Effectiveness of Tax Amnesty Programs in Selected Countries

Tax evasion presents a serious problem for a variety of countries Every year, governments lose large amounts of potential revenue because many citizens, in some manner, avoid paying taxes In Italy, for example, some estimates place tax evasion as high as 20 percent of gross domestic product each year[1] Estimates of the amount of unpaid taxes in the United States range as high as $100 billion yearly[2] The problem of tax evasion is especially serious in less developed countries (LDCs), where large percentages of the population fail to pay taxes fully

To address the problem of tax evasion, many countries have implemented tax amnesty programs over the years In this decade alone, Argentina, Australia, Belgium, Colombia, Ecuador, France, Honduras, India, Ireland, Italy, Panama, the Philippines, and the United States have all implemented some form of tax amnesty[3] In addition, Denmark, Mexico, the Netherlands, Norway, Peru, Sweden, and West Germany have, or have had at one time in the 1980s, standing tax amnesty programs reducing or abolishing penalties for delinquent taxpayers who voluntarily disclose past errors or omissions The specific provisions of the programs have differed greatly, the length of time the amnesties are effective, the types of taxes eligible for the amnesty, and the types of penalties absolved vary across countries Nevertheless, most amnesty programs share a common feature — a grace period during which delinquent taxpayers can correct prior infractions of the tax law without incurring penalties normally associated with tax delinquency

Governments implement tax amnesties to raise revenues from three main sources. The first source is the large amount of revenue in the domestic economy that goes unreported because it is circulating in the underground economy Tax amnesties are designed not only to increase current tax revenue but also to reduce permanently the amount of economic activity occurring in the underground economy, thereby increasing future tax revenues as well The second source of potential revenue is flight capital Governments use amnesties as an inducement for citizens to repatriate sums of money, often very large, that have been illegally transported abroad A substantial amount of potential tax revenue is lost yearly, especially in LDCs, because of flight capital According to one set of estimates, for example, the compounded value of flight capital assets held abroad from 1977 to 1987 amounted to $84 billion for Mexico, $58 billion for Venezuela, $46 billion for Argentina, and $31 billion for Brazil[4] The third and final source of potential revenue is the payment of back

[1]John Wyles, "The Taxing Problem Italy Faces," *Financial Times*, August 7, 1989, p 15

[2]Herman Leonard and Richard Zeckhauser, "Amnesty, Enforcement and Tax Policy," National Bureau of Economic Research, Working Paper Series, no 2096, 1986, p 2

[3]The United States has never had a federal tax amnesty program, but the following states have implemented tax amnesties Alabama, Arizona, California, Colorado, Idaho, Illinois, Kansas, Louisiana, Massachusetts, Minnesota, Missouri, New Mexico, New York, North Dakota, Oklahoma, South Carolina, Texas, and Wisconsin See U S Department of the Treasury, Internal Revenue Service, "Study of Tax Amnesty Programs," August 1987

[4]"LDC Debt Reduction A Critical Appraisal," *World Financial Markets*, Morgan Guaranty Trust Company, December 30, 1988, p 9

taxes by those who inadvertently underpaid taxes but never reported this mistake because of the penalties associated with tax evasion. Tax amnesties encourage full repayment by eliminating or lessening such penalties.

This article examines the benefits and costs of tax amnesty programs. It analyzes programs enacted in six countries in the 1980s, giving particular consideration to those features that appear to have contributed most to program success The analysis suggests that tax amnesties are successful only if they are perceived as onetime opportunities to redress tax violations. In addition, the evidence gathered here shows that the effectiveness of the programs is enhanced if they are accompanied by stricter tax enforcement or changes in tax rates

Benefits

A number of benefits may be derived from tax amnesty programs. The most evident potential benefit is a windfall revenue gain that accrues to the government from the collection of past debts. Some governments have collected substantial sums of back taxes that have helped reduce the treasury's borrowing requirements Programs have also proved successful in collecting money from both the underground domestic economy and capital held abroad.

A further benefit is that amnesty programs can increase the tax base and thereby improve future tax collections. Governments implement the programs hoping both to enlarge the base of registered taxpayers and to increase the amount of reported economic activity. A well-regulated tax amnesty program can ensure that those individuals who utilize the amnesty are not only added to the list of taxpayers but also carefully audited in the future. Amnesties can therefore decrease the need to raise taxes in the future because of the expanded tax base Consequently, regular taxpayers can also benefit from tax amnesties as nonpayers are brought into the fold

An additional advantage of these programs is that they can ease the transition to a new tax enforcement regime. A government that desires to strengthen its tax collection mechanism can couple this enhanced enforcement with a tax amnesty This coupling allows those taxpayers who were unwilling to acknowledge past underpayments to come forward without fear of penalties before the new collection regime is introduced

Costs

The benefits of tax amnesty programs must be weighed against a number of potential costs First, the programs can have undesirable incentive effects if they are implemented frequently. Citizens may come to expect their governments to offer periodic tax amnesties These expectations can decrease the incentive to pay taxes routinely and lead eventually to an increase in the number of tax evaders Moreover, if amnesties make evasion seem forgivable, they may reduce voluntary compliance over the long run, causing serious financial consequences for the governments

Amnesties may also have the effect of penalizing regular taxpayers Some of the amnesties have offered better returns on assets to those who have evaded taxes than to those who have routinely paid Most amnesties, however, seem simply to have rewarded errant taxpayers by absolving them of penalties on unpaid taxes.

A further cost of a tax amnesty is that it can be interpreted as a sign of the government's inability to enforce its tax laws Consequently, an amnesty carries the potential of reducing the credibility of the government instituting the amnesty

By providing a windfall gain in revenue, tax amnesties may also enable governments to ignore structural problems in the economy For example, a government receiving such a windfall may be less inclined to reexamine burdensome regulations and poor economic policies that often are the root causes of the tax evasion Were governments to concentrate on correcting these structural inefficiencies, they would encourage more activity to take place in the legal economy, thereby increasing the overall tax base

Requirements for a successful program

The performance of the programs examined in this study strongly suggests that a tax amnesty can be successful only if it is perceived as a unique event Many countries offering tax amnesties on a repeated basis have met with little or no success after the initial program The reason is fairly simple. If the citizens of a country expect there to be more than one amnesty, they have little or no incentive to report or redress an offense immediately In fact, because they expect a future amnesty, they have an incentive not to pay current taxes. Only if individuals see the amnesty as their single opportunity to redress past offenses is the program likely to be effective. Thus, in deciding whether to participate in the amnesty, these individuals are likely to be guided by the government's announcements about future policy. Repeated tax amnesties not only remove the incentive for reporting overdue taxes, but also in many cases increase the frequency of tax evasion.

Evidence to date also suggests that amnesties, to be successful, require adjustments in other areas of the tax system. Most notably, the effectiveness of an amnesty program is likely to improve markedly if the existing enforcement mechanisms are strengthened

An amnesty alone may not be sufficient to induce delinquent taxpayers to declare heretofore unreported income They may come forward, however, if the amnesty is accompanied by the increased likelihood of detection The public must therefore be convinced that tax evasion successfully practiced before the amnesty will no longer be possible once the amnesty is in place The enhanced enforcement mechanisms may not only increase participation in the amnesty but also reassure regular taxpayers of the government's resolve to apprehend future tax offenders [5]

Because tax evasion is often the result of high tax rates and poor economic policies, amnesties have also proved more successful when they have been part of an overall package of tax changes For example, Colombia reduced its tax rates at the same time as it announced a tax amnesty, while the Philippines increased allowable exemptions In the long run, however, the success of tax amnesties depends importantly upon the government's willingness to undertake structural changes The experience of countries that have implemented tax amnesties to date indicates that an amnesty can lead to revenue gains, but the country must address the more fundamental economic problems of the economy that may have encouraged tax evasion in the first place

Finally, the effectiveness of a tax amnesty program may be influenced by the type of government in power or likely to take power Tax amnesties often fail not on the merits of the program but as a result of political factors For example, citizens may refrain from participating in an amnesty program if they believe that the current government or one likely to be elected will not abide by the amnesty or will adopt economic measures greatly reducing the value of the newly reported income In fact, some amnesty programs have become highly politicized. For example, the socialist parties in France in 1986 and Belgium in 1985 repudiated recently passed tax amnesties in their election platforms because they were convinced that the amnesties would almost solely benefit the wealthy

The following sections examine tax amnesty programs enacted by six countries in the 1980s The discussion underscores the variation in program design and explores the reasons for the programs' differing success rates

Ireland

By most accounts, the Irish government has carried out the most successful tax amnesty program to date. In the January 1988 budget, the Irish government introduced a comprehensive proposal that gave delinquent taxpayers ten months to pay overdue taxes without incurring any interest or penalty charges The government also promised not to prosecute any of these delinquent taxpayers

In addition to granting the amnesty, the government simultaneously implemented a series of supporting measures It increased the number of "tax sheriffs" responsible for enforcing tax collection It began publishing in the national newspapers lists of the names of people who were delinquent in their tax payments At the end of the ten-month amnesty, it introduced a new tax system Further, the government increased interest and penalty payments on delinquent taxes and gave added power to the revenue commissioners The additional powers included the right to seize stock and other assets and to freeze bank accounts belonging to convicted tax evaders

According to the Central Bank of Ireland, the tax amnesty raised approximately $750 million This windfall gain helped reduce the treasury's total borrowing requirement to approximately 3 4 percent of GDP in 1988, compared with 10 percent in 1987 [6] The amount of revenue raised from the amnesty far exceeded expectations when the amnesty was first proposed The government had anticipated raising only about $50 million, the final amount of $750 million clearly represented a success The one remaining question is whether Ireland's tax amnesty will lead to a larger permanent tax base or whether the gains will have been achieved on a onetime basis only

Although the experience of most programs to date suggests that tax amnesties are not likely to widen the tax base, Ireland may prove to be the exception because of its emphasis on greater tax enforcement Still, much of the success of the Irish program appears to be due to the laxity in collecting taxes before the amnesty Substantial sums were available for the amnesty because a large percentage of Irish wage earners had successfully underpaid for many years

More important, Ireland's program probably benefited from the fact that the government had never previously attempted a tax amnesty In implementing the 1988 program, the government emphasized that this amnesty was the first and last opportunity for delinquent taxpayers to be forgiven A large percentage of the $750 million was raised in the last few months of the program because Irish citizens seemed to realize that this was a onetime opportunity

One factor that may undercut the success of Ireland's amnesty in increasing future tax revenues is that the government did not reduce its tax rates or increase exemptions as part of the package The widespread

[5] Peter Stella, "An Economic Analysis of Tax Amnesties," IMF Working Paper, WP/89/42, May 1989, p 13

[6] Central Bank of Ireland, *Quarterly Bulletin*, Winter 1988 p 11

evasion of taxes in Ireland was probably in large part a response to the country's tax rates, which are among the highest in Europe Therefore, while the strengthened enforcement measures should help sustain the widened tax base, the maintenance of high tax rates may well increase the incentive for tax evasion

India

In February 1981, the Indian government introduced a unique form of tax amnesty For a period of about three months, the government sold special bearer bonds that were designed specifically to tap untaxed income Anyone holding black market funds was allowed to use these funds to purchase the bonds with no questions asked about the source of the income The bonds, which mature in 1991, carry only a nominal annual interest rate of 2 percent. But the money invested in the bonds was exempted from the wealth tax imposed on other bank deposits and from an income tax on principal and interest at the time of maturity Some estimates suggest that a tax evader who bought the bonds with black market money would have up to 60 percent more money in ten years than would a citizen who bought the same amount of regularly issued bonds with money held in a savings account[7] The Indian government was reportedly able to attract over $1 billion from the issuance of these bonds[8]

Although the money collected was fairly substantial, the government did not raise as much money from the amnesty as it had anticipated, nor did it succeed in widening the overall tax base The government had hoped to widen the tax base by adding taxpayers to the rolls and carefully auditing in the future those who participated in the program Yet the issuance of the bonds was not accompanied by any strengthening of the tax laws or any structural changes in the tax system Because the enforcement mechanisms remained the same, delinquent taxpayers had no reason to believe that penalties would be more likely in the future

In addition, this amnesty, while different in form, was the fifth in a series of amnesty programs offered by the government over a period of twelve years Many citizens may have assumed that the government would offer other, possibly more attractive, amnesties in the future Consequently, they had little incentive to participate in the 1981 program

The Indian program illustrates the way in which amnesties can penalize regular taxpayers In this case, regular taxpayers were unable to purchase the more lucrative special bearer bonds

[7]"India's Amnesty for Tax Evaders," *New York Times*, February 3, 1981

[8]*Reserve Bank of India Bulletin*, vol 35, no 6 (June 1981), p 462

Argentina

Another type of amnesty program exempts from taxes all previously unreported income that is used for investment purposes. Argentina attempted this form of tax amnesty to stimulate the return of flight capital as part of its 1987 debt-to-equity program The 1987 debt-to-equity program was open to both foreign and local investors It stipulated that, for every dollar of debt converted, the investor had to contribute an additional dollar in fresh funds Together with the matching funds, the converted debt had to be used to purchase new equipment, build new plants, or increase the physical capacity of existing facilities Under the amnesty, the government permitted the return of the matching funds free of any taxes owed It also promised not to investigate the origins of these funds or prosecute delinquent taxpayers[9]

For a number of reasons, the program failed Investors viewed the matching funds requirement as overly stringent The one-to-one rule, even with the lifting of taxes, largely undercut the benefit from participating in the debt-to-equity program In addition, the attraction of not paying taxes on the matching funds was in some ways inconsequential because tax evasion in Argentina is widespread in any case Finally, the potential impact of the program was undermined by the frequency with which the Argentine government had offered tax amnesties In 1988, the government adopted a new debt-to-equity program that partially removed the matching funds requirement and annulled the tax amnesty

The case of Argentina supports the argument that a modest tax amnesty unsupported by structural adjustments is likely to fail Argentina has for years lost large amounts of potential tax revenue to flight capital and the underground economy Although tax amnesties have been introduced under various regimes, there has been little effort to address the sources of the tax evasion problem The underground economy remains large, in part because of the highly regulated nature of the economy, while capital flight has recurred because of uncertainty concerning economic policies Consequently, the tax amnesties in Argentina have failed to produce their intended results

Belgium

In 1984, the Belgian government enacted a tax amnesty whose purpose was to attract flight capital and bring black market funds into the open economy[10] The law exempted from taxes any capital invested by

[9]John Whitelaw, "Argentina Plans Debt Cut, Investment Spur," *The Christian Science Monitor*, September 5, 1986

[10]U S Department of the Treasury, Internal Revenue Service, "Study of Tax Amnesty Programs "

Belgian residents in employment-creating activities before the end of the year It also excused these residents from any obligation to report the origin of the funds One-eleventh, or 9 percent, of the amount in question, however, had to be invested in five-year non-interest-bearing treasury certificates Ultimately, the center-right coalition government, confronted with a number of political problems in 1985, annulled the legislation

Colombia

The Colombian government implemented a successful amnesty program in 1987. The program stipulated that taxpayers who had previously failed to report assets or who had declared nonexistent liabilities would be able to rectify their reports without incurring sanctions or being subject to investigation or reappraisal The law further stated that to be eligible for the amnesty the income declared could not be less than the income declared in the previous year Finally, the amnesty was not made available to anyone already under investigation by the tax authorities[11]

[11]Central Bank of Colombia, *Revista del Banco de la Republica*, vol 59 (December 1986), p 58

Table 1

Effectiveness of Tax Amnesties

Country	Year Program Implemented	Estimated Amount Raised (In Millions of Dollars)	Amount as Percentage of GDP	Amount as Percentage of Central Government Deficit
Argentina	1987	—	—	—
Belgium	1984	—	—	—
Colombia	1987	93	0 3	54
France	1986	1610	0 22	8
India	1981	1000	0 54	10
Ireland	1988	750	2 55	158

At the same time the Colombian government instituted the amnesty, it unified the corporate income tax rate, lowered personal income tax rates, eliminated the double taxation of dividends, and raised income tax withholding rates The government estimates that its tax amnesty yielded about $94 million, or the equivalent of 0 3 percent of GDP in 1987[12]

In Colombia's case, it appears that the tax amnesty in conjunction with these other changes may have improved overall tax collection The expansion of the revenue base that began with the 1987 amnesty continued in 1988 Nevertheless, revenue collections will have to be measured for a few more years to assess fully how these changes have affected the tax base

France

France in 1986 enacted a tax amnesty geared solely toward recouping income illegally transferred abroad Under the amnesty, the government reduced the tax rate on repatriated capital to 10 percent, a rate much lower than that normally imposed on income The government also abolished the wealth tax and allowed the holdings of gold to be anonymous

The government adopted these additional measures to make this amnesty more successful than one adopted in 1982 The 1982 law was also designed to encourage French citizens to repatriate capital illegally held abroad That program failed in part because of the high wealth tax in existence in France at that time

The exact amount of the revenue raised from the 1986 amnesty is unknown, but nonbank private capital inflows grew about 400 percent in 1986 Much of the increase, according to the central bank, was the result of this fiscal amnesty[13] France's experience supports the view that a successful tax amnesty depends impor-

[12]Central Bank of Colombia, *Revista del Banco de la Republica*, vol 60 (December 1987), p xi

[13]"La Balance des Paiements de la France," *Bank of France Annual Report*, 1986, p 88

Table 2

Characteristics of Tax Amnesties

Country	Accompanied by Enhanced Enforcement	Implemented for First Time	Designed to Attract Flight Capital	Geared to Domestic Capital	Accompanied by Tax Rate Adjustments
Argentina	No	No	Yes	No	No
Belgium	No	No	Yes	Yes	No
Colombia	Yes	Yes	No	Yes	Yes
France	No	No	Yes	No	Yes
India	No	No	Yes	Yes	No
Ireland	Yes	Yes	No	Yes	No

tantly upon the government's willingness to adopt simultaneously other structural changes. An amnesty alone was unable to attract the return of flight capital in 1982; the government had to address some of the causes of flight capital before it could achieve its purpose.

Conclusion

Tables 1 and 2 summarize the quantitative and qualitative characteristics of the programs examined in this article. As Table 1 indicates, tax amnesty programs have had varied success Most of the programs have not led to a widening of the overall tax base, and many have failed to produce even very large onetime revenue gains. In the case of programs that combine tax amnesty with rate adjustments and more rigorous enforcement, it is difficult to distinguish revenue gains attributable to tax amnesty from the gains attributable to enhanced tax enforcement or changes in tax laws On the one hand, if enhanced enforcement or other structural changes would have raised the same amount of revenue without the introduction of an amnesty, then the amnesty could have resulted in a loss of money to the state because of the forgone interest or penalty charges. On the other hand, if the amnesty accelerated the repayment of taxes, the state would have gained the advantage of collecting the money sooner, a benefit not available to governments making only structural changes.

Most programs seem to have failed because the countries implementing the amnesties did not possess the means or desire to enforce tax collection after the amnesty. As a result, the programs often led to one-time revenue gains but appear to have had no lasting effects.

For these reasons, it seems likely that developing countries in particular will gain little by implementing a tax amnesty until they improve their overall systems of tax collection. In addition, many developing countries have already enacted several tax amnesties, thereby diminishing their chances of implementing truly successful programs in the immediate future. Nevertheless, a well-designed tax amnesty program, accompanied by structural and tax reforms, has the potential to lead to beneficial results in both developed and developing countries.

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