

## **INTRODUCTION**

This letter reviews the steps to be implemented in order to improve the fiscal climate in the country. We provide our suggestions for your review regarding the announcement of tax amnesty which describes advantages and disadvantages of the amnesty. Taking into consideration the situation in Georgia, we think that there is no need to implement the tax amnesty and it will not have a positive impact on improvement of business and tax climate. As an alternative, we propose to carry out tax and customs reforms which will make the process of fulfillment of tax liabilities much easier and transparent. The recommendations provided in this document are general and indicate the main directions. We strongly believe that our proposal is vital in the current context and we are looking forward to discussing it in detail with your team.

## **MEASURES AIMED AT TAX AND CUSTOMS LEGISLATURE IMPROVEMENT**

### **1. The single-phase diminishment of the tax rates**

As known, current legislation envisages the diminishment of the income tax by 15 % as well as total abolishment of the income tax on interests and dividends by the year of 2013. This initiative will no doubt facilitate the improvement of the business climate, though 4 years required for this process shall reduce the cumulative effect. We therefore believe that the positive impact that the diminishment of the tax rates may produce shall be better observed if a single-phase diminishment is undertaken within 1 year instead of 4 years.

### **2. Eliminate Ambiguity in Tax Code**

Present Tax Code still contains equivocal and unclear provisions. After the adoption of a new Tax Code, several efforts have been made to clarify vagueness of the legislation. Unfortunately, such efforts often have opposite effects. Consequently, amendments make the wording even more ambiguous.

I think, it will be an important step forward if we make an addition to the Tax Code, which stipulates that, if tax dispute arises due to statutory ambiguity, the dispute shall be resolved in favor of a taxpayer if the latter proves that such ambiguity exists. It should be noted that such practice proved to be very successful in other countries.

### **3. Balance Between Tax Bodies and Taxpayers in their Rights and Responsibilities**

Current legislation doesn't seem to provide sufficient symmetry between tax authorities and taxpayers. In this regard, responsibilities of the parties can be mentioned as a good example. As opposed to taxpayers, tax representatives bear less responsibility for making irrelevant or erroneous decisions. Such decisions can be changed based on taxpayer's claims, however tax authorities are not kept liable for the loss incurred by a taxpayer due to the groundless decisions made.

### **4. Monetary Incentives (Bonuses) to tax inspectors**

The system of bonuses applied to the tax inspectors may serve as a vivid example for existing asymmetry described in this paragraph. According to the current legislation, the volume of bonuses that tax inspector may benefit from is directly dependant on additional funds the tax inspector is able to attract to the state budget. Therefore while undertaking the outdoor or laboratory inspection of the taxpayer, the inspector is literally motivated to have the taxpayer heavily sanctioned. Moreover, as mentioned in the previous paragraph, the tax inspector never bares proportional level of the responsibility if the tax sanctions/penalties are illegally applied against the taxpayer.

We believe that the existing system of bonuses creates serious threats to business society; given the existing unrefined tax and juridical systems open the door to implementing an inadequate control over the business.

### **5. Rigidity of Tax Sanctions**

Substantive amendment made to a new Tax Code was about enhancing administrative part and increasing sanctions. However, as a result of a new tax code and respective amendments, number of taxes as well as the tax rates were dramatically decreased. Therefore, the portion of penalties increased in the total volume of additional assessments made as a result of audit. At present, there are low tax rates, although the amount of penalties to be imposed in case of violations is unproportionally high. Many taxpayers think that severity of sanctions provided by the Tax Code are inconsistent with the liabilities imposed as a result of violations. In other words, tax sanctions are unproportionally high compared to the scope of violation.

Two more aspects should be emphasized with regard to rigidity of sanctions. The first is that tax bodies (government) can create serious problems to the business community and jeopardize their operation capabilities by establishing severe penalties and fines. The result we have is the increased level of control/pressure of the government on businesses.

The second aspect is that stringent sanctions significantly belittle the positive impact made as a result of tax liberalization. It means that a taxpayer does not bear a heavy tax burden until he/she is audited and assessed by the tax inspection.

## **6. Tax Administration**

The more streamlined and liberalized the Tax Code has become, the more inflexible remained its administration. As a result of reforms implemented in tax administration, many experienced tax officers were dismissed. New employees, hired in lieu of old ones arguably are not enough qualified and do not possess knowledge even on simple aspects of tax collection. The situation is compounded by “fear” which persists amongst tax employees. This is the reason why, subordinate employees who are qualified to address and resolve tax disputes sometimes try to delegate responsibility to the higher management if the dispute can be settled in favor of a taxpayer. In result, there is an unreasonable waste of time spent on routine cases.

The other problem which complicates tax administration is the fact that “internal rules and regulations” (secondary legislation) have in fact treated as having a superior power over the law. Although it is explicitly stipulated that the Tax Code has a prevalence over any secondary legislation, tax officers often base their judgment on internal rules and regulations that are frequently inconsistent with the Tax Code. The only mechanism to address unjustified assessments is the tax appeals procedure which generates results only at the final stage of appeals process (Dispute Resolution Council or court). As a result resolving of even simple and straightforward matters requires significant time. For example, there were numerous cases when due to bugs in the software system used at tax authorities taxpayers unlawfully were charged with late payment interest. It took years to taxpayers to abolish such unlawfully accrued interests due to inflexibility of tax administration. During the period of the dispute the taxpayers were subjected to tax collection enforcement measures.

## **7. Bank Guarantee Required for Tax Appeals**

Pursuant to the Tax Code, one of the means to start an appeal process for taxpayer is to submit a bank guarantee to tax authorities. Submitting a bank guarantee is costly and a complicated procedure and represents a serious problem for small and medium businesses. Therefore, majority of taxpayers cannot use the rights provided by the Tax Code to suspend tax liabilities during ongoing appeals’ process.

## **8. Customs Reform Priorities**

**-Simplification of Customs Dispute Processing Procedures** – The rule of law will be better adhered to if the procedures for customs dispute consideration are streamlined. There are instances when burdensome administrative expenses hinder the traders from initiating a dispute. Such cases mostly occur when dispute is being processed but goods cannot be duly released. Under these circumstances, increasing storage costs are incurred by a trader.

**-Amendments to ambiguous Articles of Customs Code with regard to Customs Offences** – Pursuant to the Articles of the Customs Code, (Article 253), customs officers are authorized to penalize the trader for any minor mistake. Also, there are certain articles of the Customs Code related to customs offences, the relevancy of which should be examined and respective amendments made.

**-Introduction of Voluntary Compliance** - Under the rules of voluntary compliance, the trader is required to report and rectify customs violations until Customs or Tax Authorities disclose them. For instance, trader should not be kept liable if he/she considers it necessary to correct the customs declaration after goods are released.

**-Provision of Respective Explanations and Guidance to a Trader on Customs Procedures** - It is important that Customs Authorities furnish the trader with preliminary information on different aspects of Customs Code. There are cases when a trader needs to know Customs' position, therefore customs should provide a trader with interpretations on certain customs procedures. Interpretations released by Customs' higher management should be binding to subordinate customs officers.

**-E-filing** – Introduction of e-filing would obviate the need for a customs broker. Brokerage services will no longer be needed. Also, it will eliminate unnecessary costs and difficulties caused by low knowledge and competence of customs brokers.

## **ICC-Georgia COMMENTS AND SUGGESTIONS ON TAX AMNESTY AND TAX CLIMATE IMPROVEMENT**

As far as tax amnesty has lately acquired topicality, we would like to provide you with our comments and suggestions on the given topic and tax climate improvement prospects.

### **1. TAX AMNESTY ADVANTAGES**

With respect to tax amnesty, the following advantages can be highlighted:

#### **Voluntary Compliance of Delinquent Taxpayers**

Tax amnesty gives an opportunity to certain group of taxpayers to legalize their shadow economy activities and bring them into conformity with the law. This would contribute to reduction of the scope of shadow economy and increase the tax base as well as the number of taxpayers.

#### **Providing Supplementary Information to Tax Authorities on Taxpayers and their Economic Activities**

The tax amnesty is eligible to the taxpayers who will submit an information to tax authorities on undeclared business activities and outstanding tax liabilities for the previous periods. Thus, tax authorities will receive additional information on taxpayers and their taxable bases. Such information will help the government to gain more in-depth insight about the incidence of shadow economy and implement more efficient finance and economic policy.

#### **Reducing Burden of Tax Administration Expenditures**

Following the tax amnesty, tax authorities are not required to take any actions with regard to tax collection or tax audit against the subject liabilities incurred prior to the amnesty announcement.

### **Capital Inflow**

As a result of tax amnesty, foreign or shadow capital may often “flow” from shadow into the legal sector. This results in increase of capital turnover, which is vital for economy of the country.

## **2. TAX AMNESTY DISADVANTAGES**

Tax amnesty also has negative impacts. Some of the negative aspects are specified below:

### **Diminishing Preventive Force of Tax Sanctions, Inducing Tax Evasion**

After the announcement of tax amnesty, some taxpayers may think, that tax evasion does not represent a serious violation. Moreover, tax amnesty may induce noncompliance amongst taxpayers who would hope that future amnesty may clear their outstanding tax liabilities.

### **Compliant and Non-Compliant Taxpayers Equally Treated**

As a result of tax amnesty, non-compliant taxpayers are relieved from certain liabilities which very often puts them on the same level with the compliant taxpayers. Thus, the constitutional right of entrepreneurs to enjoy equal conditions may, to some extent be infringed. For instance, the taxpayer who did not fulfill his/her tax obligations but was forgiven due to tax amnesty has advantage over the taxpayer who is fully compliant. Considering the above-mentioned, issuance of tax amnesty may hinder the creation of sound legal framework imperative for business development and violate equality of competitive conditions.

### **Weakness of Tax Administration**

Tax amnesty may be indicative of tax administration policy weakness. In other words, the government may prefer to “do it by their own will then be dragged into doing it.”

### **Revenue Reduction over the Next Year**

In majority of cases, tax amnesty entails state tax revenue reduction for the next tax periods. As long as another amnesty or “absolution of tax sins” is anticipated, tax revenues, augmented at the first stage of the amnesty program will further decrease, otherwise more rigorous efforts should be exerted to collect taxes.

## **3. FACTORS AFFECTING TAX AMNESTY**

In addition to above-referred advantages and disadvantages of tax amnesty, there are number of factors that need to be taken into consideration when the decisions is undertaken to enforce an amnesty. Some of the effecting factors are as follows:

### **Comprehensive Business Climate Reform**

Mostly, tax amnesty constitutes a set of measures aimed at revitalizing business climate (including tax climate). Under these conditions, tax amnesty may serve as a powerful tool for making changes. Also, amnesty may be used as an effective mechanism to reverse taxpayers' mindset. On the other hand, amnesty enforced without supporting package of changes may have substantially less positive effect than intended or anticipated.

### **Tax Amnesty as an Inducement for State Revenue Growth**

Budget deficit may be one of the factors that trigger off tax amnesty. The reason is that amnesty is often considered as an additional incentive to taxpayers to pay taxes. Considering the above mentioned, we can presume, that tax amnesty is less important for the countries not suffering from budget deficit.

### **Tax Amnesty Period**

Time period is an important factor contributing to effectiveness and relevancy of tax amnesty. As stated above, one of the factors which may affect tax amnesty is when such program is initiated during substantial tax changes. Moreover, the time when significant legal and regulatory changes are being implemented can also be conducive to tax amnesty.

### **Periodical (Repeated) Tax Amnesty Programs**

In large number of cases, amnesties run in cycles- they recur periodically and become a constituent part of economic processes. Observation made on repeated amnesties shows that negative effects, by large, prevail over the positive effects. In other words, the next amnesty would minimize advantages as opposed to disadvantages. Therefore, frequent tax amnesties require thorough analysis in order to identify aggregate outcomes and a series of measures to neutralize adverse consequences.

## **4. TAX AMNESTY ANNOUNCED IN 2004**

Speaking about efficiency and relevancy of tax amnesty, we can refer to the example of Georgia. In 2004, the Parliament of Georgia passed the Law on "Tax Amnesty, Non-declared Tax Obligations and Property Legalization." The law was adopted due to the government restructuring as well as tax amendments and regulatory changes in the commercial law. At the time, when the relevancy of tax amnesty program was discussed, contributing factors such as government reshuffle and draconian regulations existed earlier, were emphasized. It was noted that under the previous tax code it was extremely difficult to precisely determine tax liabilities. This ambiguity was often misused by tax authorities triggering off reasonable protest among taxpayers. As long as the tax code was somehow considered to be "unfair", non-payment of taxes was morally justified. Under the conditions mentioned above, tax amnesty was deemed as the start of a new era, when a taxpayer would be free from pressure or adverse influence from tax representatives.

Dramatic changes in tax authorities and state bodies as well as business climate liberalization generated favorable outcomes. Consequently, the number of taxpayers and volume of tax revenues increased. Although, there is no public information available which would help us to determine to what extent the tax amnesty issued in 2004 contributed to positive bottom line. In other words, we are not

familiar with a comprehensive survey determining whether the rise in revenues was conditioned by tax amnesty, tax liberalization or by other incentives.

Negative consequences following the tax amnesty in 2004 should also be noted. One of the most conspicuous cases was when tax authorities were prohibited to conduct audits with regard to tax liabilities emerged prior to 2004. This had a negative impact on those taxpayers who had initiated a tax dispute or had claimed a refund by the time the amnesty was announced.

On the pretext that tax authorities were not allowed to audit the liabilities of the previous period, tax representatives rejected refund claims thus causing serious hindrance to tax dispute resolution.

Believably, the experience of 2004 should be considered if decision on starting a tax amnesty program is made. Specifically, a new law on amnesty should be explicit (in case if it is adopted), free from ambiguity, clearly delineating roles and responsibilities of parties to the tax system. Furthermore, the rights of compliant taxpayers should be strongly adhered to. All necessary measures should be taken not to aggravate the state of compliant taxpayers after tax amnesty is announced. Although, as stated above, tax amnesty may entail some negative effects (unequal competitive conditions for compliant and non-compliant taxpayers).

## **SUMMARY**

Tax amnesty is characterized by positive as well as negative effects. Prior to amnesty announcement, the government should set clear goals and objectives to be achieved through tax amnesty. Afterwards, it should be assessed how feasible it is to fulfill the set goals via tax amnesty or if there are any other more efficient tools available.

It should be mentioned that eliminating the above referred and other flaws will benefit to the improvement of tax climate more than tax amnesty itself.