

Washington State's Tax Amnesty Program and the Possibility of Its Introduction in Japan

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The most difficult task in tax collection is to catch undetected non taxpayers and those unable or unwilling to pay tax. Once non taxpayers are detected, it is possible to identify where they live and the amount in arrears. However, as long as such people remain undetected, it is not possible to identify where they are hiding or the amount they are liable for. In order to find that out, the National Tax Agency and local governments carry out criminal investigations or searches, which are costly. Costs can be reduced by incentivizing non taxpayers and people unable or unwilling to pay tax to pay tax voluntarily, which is the most cost-effective method.

In a CIGS Column in February 2011, we discussed how U.S. states have irregularly implemented tax collection campaigns called "tax amnesty," which have produced good results. A tax amnesty is a system whereby non taxpayers and people unable or unwilling to pay tax pay the taxes in arrears within a specified period (ordinarily two to three months) and the state's tax agency gives a tax break to absolve them from all or part of the penalty, fine and delinquency charge for those unpaid taxes. Since U.S. citizens do not know when a tax amnesty program will start, they cannot evade taxes in anticipation of the program.

A tax amnesty is considered to be effective not only for securing tax revenues, but also for uncovering undetected non taxpayers. This report gives an overview of a tax amnesty program implemented by Washington State targeting businesses, and discusses the possibility of introducing tax amnesty in Japan.

1. Status of tax amnesty by U.S. state governments

In the United States, 114 tax amnesty programs had been implemented by 49 states as of September 2011, since Arizona State first implemented the program in November 1982. Louisiana State and New York State have offered the program five times. In 2010, 10 tax amnesty programs were conducted within the country, possibly due to the effect of the global recession. The top five programs generating the highest amounts of revenue to date are as follows: (1) New York State's 2002 amnesty program generating \$582.7 million; (2) Illinois State's 2003 amnesty program generating \$532

million; (3) New York State's 1985 amnesty program generating \$401.3 million; (4) New York State's 2005 amnesty program generating \$349 million; and (5) Washington State's 2011 amnesty program generating \$345.82 million, which is described in this report.

2. Tax amnesty by Washington State

Washington State ran a tax amnesty program for the first time from February 1 through April 30, 2011. The program had been discussed for a few years, but was not implemented immediately. Since a drop in tax revenues was predicted, the state finally decided to run the program in 2011.

Washington State, which has no income tax, specified the retail sales tax as well as the business and occupation tax for businesses—the state's principal tax sources—as the taxes subject to the amnesty program. At the end of December 2010, the Washington State Legislature passed the amnesty bill unanimously. The state prepared for the program during the seven weeks and four days before the program launch. The state set up a portal site (PayMyTax.org), developed application programs for the system, decided on the workflow of administrative processes, and advertised the program through the media. It defined eligible participants to be registered businesses, unregistered businesses, and defunct businesses. The primary aim of tax amnesty is to allow such unregistered businesses and defunct businesses to pay taxes voluntarily. The state sent a program notice to 5,000 businesses (of which 95% participated) and 10,974 taxpayers applied, of which 5,420 were granted amnesty. The program generated \$345.82 million, waiving \$91 million in penalties and interest. Further, \$29.9 million was collected from businesses that registered and paid taxes for the first time, and they are now on the state tax rolls. The state had originally hoped to collect \$28.3 million, but ended up acquiring 12 times that amount of revenue. The cost was originally estimated at \$233,200, but ended up being \$381,200 (personnel costs: \$69,200; media campaign costs: \$80,000). The cost-effectiveness ratio was 907 (Table 1). By industry, the largest amount was collected from the information industry (about \$160 million), followed by the wholesale industry (about \$45 million), and the retail and finance/insurance industries (each about \$30 million). The construction industry accounted for the largest count of taxpayers at 900 businesses, followed by the retail industry (about 700 businesses), and the prof/tech services industry (about 500 businesses). The information industry accounted for a small count of taxpayers (about 120 businesses) but a large amount collected per taxpayer, while the construction industry accounted for a large count of taxpayers but a small amount collected per taxpayer.

Table 1 Tax Amnesty by Washington State (units: \$, count)

	Amount of revenue/cost	Taxpayer count	Amount of revenue per taxpayer
Total revenue	345.82 million	5,420	63,804
In-state	93.44 million	3,636	25,698
Out-of-State	252.38 million	5,422	46,547
Newly registered Business	29.9 million		
Initially estimated revenue	28.3 million	(Outcome: 12 times the estimated revenue)	
Total cost	381,000		
Personnel cost (including overtime costs)	206,200		
Media campaign cost	80,000		
Others	94,800		
Initially estimated cost	233,200		
Cost-effectiveness ratio (revenue/cost)	907		

Source: Calculated based on data from Washington State Department of Revenue (2011).

3. Why tax amnesty?

As shown above, tax amnesty is an effective tool. Tax amnesty can roughly be divided into amnesty for domestic accounts (collecting taxes on undeclared assets in domestic accounts) and amnesty for foreign accounts (returning funds that have moved overseas to the home country; collecting taxes on off-shore financial transactions in tax havens, etc.). Of these, we propose to first introduce the tax amnesties for domestic accounts in Japan.

Three major problems can be recognized. Firstly, while most taxpayers that are properly paying taxes (average tax collection rate is 95% for prefectural taxes and 92% for municipal taxes) do so voluntarily or automatically (through a withholding tax system or through account transfers), a substantial amount of money is spent on efforts to levy taxes against non taxpayers. For a long time, we have had doubts as to whether this situation is truly fair; it seems unfair for the people, at the national level and at the local level of the prefecture or municipality, to continue to bear such costs while a heated debate is going on over a consumption tax increase in order to alleviate financial problems.

The second problem is that there is a limit to the feasibility of finding non taxpayers, unless the non taxpayers voluntary pay. As far as our research shows, tax amnesty is extremely cost-effective. It is considered to be an important role of government employees (and national and local government heads and assemblies) to establish efficient tax collection means.

As such, when considering the introduction of tax amnesty, there must be discussions on fairness and efficiency. Washington State was also very concerned about the possible impact of the amnesty program on non-participant taxpayers that are properly paying their taxes. What should be considered fair is an extremely difficult question. Japan has never had a tax amnesty program, so the first step will be to enact a law that serves as the basis for tax amnesty. It has taken us nearly ten years to research the tax amnesty issue. Learning about its existence in 2002, we began to research the subject by consulting state governments questions via email that same year, but published on this subject for the first time in 2011. During the intervening period, we thought about whether Japan should introduce tax amnesty, and came to the conclusion that the country should seriously consider introducing such a system amid the current lingering financial distress. The issue of fairness is deep-rooted. Recently, some local governments have addressed the problem of an increasing number of abandoned houses in their districts by offering subsidies to dispose of such houses, in order to prevent a fire hazard and to maintain security. This is an example an investment based on positive cost-benefit. National and local governments should also explore various possibilities for effective tax collection by discussing the matter together with residents at the national and local levels. In the discussions, they should examine what kind of collection methods should be used in order to secure financial resources effectively, whether those methods lead to providing better services for national and local residents, and whether it is fairer to spend money on finding non taxpayers or more efficient and fairer to spend the same money on encouraging them to voluntarily pay taxes by waiving penalty charges, among other measures.

Thirdly, the present collection operations should be compared with similar operations in private companies. In the private sector, banks, credit card companies, and servicers engage in collection of loans and credit card debt. These private companies are quick to identify bad debts, write them off, and keep their balance sheets light. These measures are extremely important for reducing costs and risks and for continuing business. A comparison of the collection operations of private companies with those of the public sector shows that the public sector is slow to introduce pro-active thinking. With the recent situation of the E.U. in mind, it is clearly necessary for the national and local governments to streamline their balance sheets soon, and it would seem prudent to offer tax amnesty before writing off delinquent debts.

Lastly, the introduction of a tax amnesty program seems to be effective for national consumption tax and various local taxes. It should also be emphasized that tax amnesty is a short-term measure, and not a permanent solution.

[References]

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