

Position Paper

On the Legislative Initiative Regarding the Tax and Capital Amnesty

“All citizens of the Republic of Moldova are equal before the law and public authorities, regardless of the race, nationality, ethnic origin, language, religion, sex, opinion, political affiliation, property or social origin.”

Constitution of the Republic of Moldova, Article 16(2).

What Happened?

On December 16, 2016, the Parliament approved in first reading the Draft Law no. 452 on capital liberalization and fiscal stimulus¹ and the Draft Law no. 451 on amendments and additions to certain legislative acts². The Parliament registered both bills on December 1, 2016, and passed them in the first reading in an unprecedented rush on December 16, in breach of all rules of transparency in decision-making and legislative drafting.

The Law on capital liberalization and fiscal stimulus essentially consists of two basic components. The first one refers to capital liberalization: any individual (Moldovan citizen or his/her legal representative, such as parent, adoptive parent, guardian or trustee) may declare assets (e.g. cash, real estate, stockholdings, securities or road vehicles) that hitherto were registered in the name of other persons (relatives, intermediaries, etc.) or were not registered at all, or may reevaluate the assets whose declared value was understated, benefitting of guaranteed legal protection (the state will neither be able to verify the origin of these assets nor apply penalties to public officials for the illegal acquisition or failure to declare these properties) for a fee in the amount of 2% of the assets. The second component refers to tax stimulus: the annulment of all tax penalties for individuals and legal entities in exchange for payment of debt. **Basically, the bill provides for an amnesty of capital and a quasi-amnesty of tax liability (which covers only tax penalties, but not the principal debt).**

Draft Law no. 451 amends and complements other laws with a view to implementing the Law on capital liberalization and fiscal stimulus. In particular, this bill prohibits the National Integrity Authority to verify the liberalized assets and tax authorities to audit the calculation and payment of taxes and other charges applicable during the tax amnesty period. Below we will refer mainly to Draft Law no. 452 (on capital liberalization and fiscal stimulus) since Draft Law no. 451 is associated with it.

Basic Premise

Main reservations about the tax and capital amnesty

Any form of tax and capital amnesty is by definition controversial because it conflicts with the core principles of fairness and competition. In the Republic of Moldova this effect is even stronger, considering the high level of corruption – the 2015 Corruption Perceptions Index ranked Moldova 103 out of 167 countries³ and, according to the Global Competitiveness Report for 2016-2017, corruption is the worst obstacle for business⁴. In this context, the proposed capital amnesty means nothing less than the legalization of previous acts of corruption and the retention of corrupt officials in office, which is at odds with the goals of the fight against corruption (especially the grand corruption). The

¹ <http://parlament.md/ProcesulLegislativ/Proiectedeactelegislative/tabid/61/LegislativId/3503/language/ro-RO/Default.aspx>

² <http://parlament.md/ProcesulLegislativ/Proiectedeactelegislative/tabid/61/LegislativId/3502/language/ro-RO/Default.aspx>

³ 2015 Corruption Perceptions Index, Transparency International, <http://www.transparency.org/cpi2015> (for a detailed analysis in Romanian, see <http://anticoruptie.md/ro/stiri/raport-indicele-perceptiei-coruptiei-in-lume-in-moldova-mai-mult-ca-niciodata-a-devenit-vizibila-legatura-dintre-coruptie-si-capturarea-institutiilor-statului>)

⁴ <http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=MDA>

legalization of previous acts of corruption and the perpetuation of corruption are determined particularly by the fact that relevant agencies will not be able to verify the origin of the declared assets, which compromises the entire reform of the integrity verification and assurance system. Additionally, considering the frauds committed in the banking system in 2014 (known as “the billion theft”) and the ineffectiveness of the investigations to restore the embezzled funds and to hold liable the culprits, there is a justified suspicion that capital liberalization will be used by individuals who benefited from those frauds.

Defiance of the rules of transparency in decision-making and legislative drafting

Draft Laws no. 451 and no. 452 are promoted in an unprecedented rush, in breach of the rules of transparency in decision-making and legislative drafting.

According to para. 4.3.1 of the Concept paper on the cooperation between the Parliament and civil society, approved by Parliament Decision No. 373 of December 29, 2005, civil society organizations can file comments to bills within 15 working days from the date of their publication on the Parliament’s Website or from the date of an explicit request by the Parliament. According to para. 4.3.5 (a) of the Concept paper, civil society organizations must be notified about unscheduled meetings at least 10 days in advance.

Draft Laws no. 451 and no. 452 were filed on December 1, 2016, without being sent to the interested parties. Moreover, there was only one two-hour public debate on December 14, 2016, just one day before the hearing of the bill in the Parliament. Civil society representatives were invited to the December 14 debate only one day in advance, at approximately 13:00 hours of December 13, 2016. In such conditions, these debates cannot be qualified as public consultation debates because they were organized in flagrant breach of para. 4.3.1 of the Concept paper on the cooperation between the Parliament and civil society, Article 21 of the Law on legislative acts, and Article 49¹ of the Regulations of the Parliament (the Organization of Public Consultation Procedures by the Standing Committee Informed of the Matter). According to Article 58 of the Regulations of the Parliament, bills and legislative proposals submitted by Members of Parliament must receive Government’s opinion, which, according to Article 131 of the Constitution, is mandatory for bills and legislative proposals or amendments that entail an increase or decrease of budget revenues or loans and an increase or decrease of budget spending. During the first reading of Draft Laws no. 451 and no. 452, the Parliament’s website did not provide information on the Government’s opinion on these draft laws. From the debates in the plenary session of December 16, 2016, it appears that the Government’s opinions have not been presented to the Members of Parliament. Even on December 18, they still were not published on the Parliament’s website. These circumstances suggest that the Parliament passed Draft Laws no. 451 and no. 452 in first reading without Government’s opinion.

According to Article 57 of the Regulations of the Parliament, at the meeting of the Standing Bureau for scheduling the bill for hearing, the standing committee informed of the matter presents the list of persons or organizations that have reviewed the bill, the economic-financial substantiation of the bill, the opinion of the standing committee(s) on the bill, and the results of public consultations on the bill. However, this information was not ready or at least was not published before the first reading of Draft Laws 451 and 452.

According to Article 22 of Law No. 780 on legislative acts, the anti-corruption expert review is mandatory for all bills. However, it was not presented at the so-called debate of December 14, nor in the first reading of Draft Laws no. 451 and no. 452.

In conclusion, the Government, development partners, and representatives of civil society and private sector did not have enough time to get thoroughly familiar with Draft Laws no. 451 and no. 452 and to propose qualitative evidence-based recommendations.

The bills are not accompanied with an analysis highlighting the extent, causes and effects of the problem, alternative solutions to it and their impact. Therefore, it is not clear what effects of the proposed amnesty the authors of the bills expect. Considering the rush with which the bills are promoted and their quality (see the next section), it seems that the proposed amnesty has hidden purposes and is not anchored in a broader policy to formalize the economy.

What are the main risks?

1. The risk of worsening tax evasion

According to specialized literature,⁵ the negative effects of tax and capital amnesties prevail over the positive ones, which are rather exceptions anyway. Tax and capital amnesties usually worsen tax and legal compliance (the degree to which tax and legal liabilities are discharged). This is because amnesties create undesirable motivations among the population/businesses by the mere fact that they favor those who do not observe the law to the detriment of those who do. This act of open injustice provided by law fosters the inclination for tax evasion, which is already rather strong⁶. The cause of this lies in the erosion of fundamental factors discouraging tax evasion.

Normally, the inclination for tax evasion is low when the costs and probability of exposure are high, and the benefits are small.

Tax evasion decreases when:

$$\uparrow \text{Evasion costs} / \downarrow \text{Evasion benefits} * \uparrow \text{Probability of exposure}$$

- The *evasion costs* refer to the size of penalties for tax evasion and the damage to reputation in the event of public exposure of the perpetrator.
- The *evasion benefits* refer to the size of taxes and other charges that the perpetrator does not pay.
- The *probability of exposure* refers to the ability of state authorities to identify cases of tax evasion and to successfully complete investigations and punish the perpetrators.

Following an amnesty:

$$\downarrow \text{Evasion costs} / \uparrow \text{Evasion benefits} * \downarrow \text{Probability of exposure}$$

- *Evasion costs* **decrease** because the state forgives tax penalties and, in case of capital amnesties, allows individuals who bypassed the law to legalize their assets with impunity.
- *Evasion benefits* **increase**, especially in capital amnesties, because the 2% liberalization fee proposed by Draft Law no. 452 is extremely small in comparison with the size of the income tax or capital gain tax.
- The *probability of exposure* **decreases** because the beneficiaries of a capital amnesty can escape prosecution and liability (Article 10 of Draft Law no. 452 and Draft Law no. 451).

⁵ K. Baer, E.L. Borgne, Tax Amnesties: Theory, Trends, and Some Alternatives, IMF, 2008

⁶ Tax Discrepancy—An Invisible Reality, Expert-Grup, 2014

Another extremely important issue is that most tax amnesties create expectations regarding possible future amnesties and thus encourage tax evasion. This risk is particularly high considering that the Republic of Moldova has gone through an amnesty in 2007. In time, expectations (possibly connected with electoral cycles) of new amnesties may rise in one form or another. As a result, in anticipation of the amnesty, businesses stop paying taxes and individuals do not declare their capital as required by law. For example, in 2016, tax arrears achieved record highs despite the economic recovery⁷, whereas in 2015, which was a year of economic recession, they decreased. Therefore, there are reasons to infer that at least some businesses knew about a forthcoming amnesty and took advantage of this information to the detriment of their competitors who paid taxes on time.

The IMF warned about the risks associated with the erosion of tax compliance, respectively, the increase of tax evasion⁸, mentioning that tax amnesties, especially in the countries where such practice is repeated periodically (Argentina, Philippines, Turkey), undermine the effectiveness of tax administration and long-term tax revenues. Therefore, one can anticipate the future accumulation of new historical debts that will wait for another amnesty.

2. The risk of increased corruption and money laundering

Allowing anyone to legalize their assets without an investigation of their origin clearly favors individuals who obtained those assets through corruption, money laundering or other illicit activities. Despite the repeated claims of the authors of the bill that the capital amnesty will not favor these categories, the bill does not provide for a mechanism that would ensure this. Thus, some civil servants who acquired a house, bank deposit or other assets by means of corruption will be able to declare this property and will benefit of the capital amnesty without any legal consequence, because the bill prohibits the investigation of the origin of these assets and expressly excludes the punishment of civil servants and dignitaries who have not previously declared or have inadequately declared their property. This situation is at odds with the recent efforts to combat corruption in the public sector.

Moreover, capital amnesty without the possibility of investigation creates major risks of corruption perpetuation or increase in the future. Public officials will be able to declare their assets held in cash, while the money received later on thorough bribes will be considered cash declared as a result of the capital amnesty, even though the money declared through capital amnesty in reality may have been spent in the meantime (currently, there is no thorough mechanism for monitoring spending). Thus, the comparison base is artificially increased and, in case of future crimes, such officials may declare assets, making reference to the asset base legalized as part of the capital amnesty.

Moreover, the initiative of capital liberalization contradicts the “Integrity Package” voted by the Parliament in the summer of 2016, which was part of the Priority Reform Action Roadmap established by the Republic of Moldova and the European Union. The “Integrity Package” establishes a thorough mechanism for declaring and verifying assets and interests of civil servants. The liberalization of capital prohibits the investigation of the origin of civil servants’ properties and their punishment for the previous failure to declare these properties. This initiative nullifies the “Integrity Package” and discourages the officials who have honestly declared their properties.

In addition to the risks of corrupting civil servants, the proposed bills create major risks of increasing money laundering. The same prohibition against verifying the origin of the declared assets may be misused to legalize capital, including foreign capital, by involving Moldovan citizens as

⁷ On October 13, Mold-street.com published the article “[A New Tax Amnesty in The Works? In Three Months Tax Arrears Increased 75%](#)”, which referred to the increase of arrears to the national public budget to record 1.8 billion leis as of the August 31, 2016.

⁸ K. Baer, E.L. Borgne, Tax Amnesties: Theory, Trends, and Some Alternatives, IMF, 2008

intermediaries. For example, a person X in country A transfers a sum of money to a Moldovan citizen Y, who uses this money to purchase various assets that will be subsequently legalized through the capital amnesty. After the payment of the 2% fee, the assets are reverted to person X in country A.

This risk is particularly evident and imminent in light of the “billion theft” that happened in the Republic of Moldova in 2014. According to the Draft Laws no. 451 and no. 452, any individual may liberalize their capital and the origin of the declared assets will not be investigated. Given the ineffectiveness of the investigation of the culprits and, especially, the final beneficiaries of the bank frauds of 2014, these bills open a wide door for the legalization of the capital acquired by the final beneficiaries of those frauds and there is no mechanism that would prevent this.

3. The reputational risk for the banking sector

The banking system already has a dented reputation, both locally and internationally, after the bank frauds and cases of large-scale money laundering that captured the headlines of international media outlets. And even though in 2016 the Government launched a comprehensive reform of the banking system, which already started to restore the reputation of this sector, and the National Bank took firm actions to strengthen the prudential and regulatory framework, which fueled positive expectations for the future, this process risks to be compromised by the bill on the tax and capital amnesty. This is because the capital amnesty will be applied through the banking sector. Moreover, the NBM was assigned to develop “regulations for the implementation of the law in the part that refers to the financial institutions’ activities related to the liberalization of capital, including the instructions concerning the procedures for preventing and combating money laundering” (Article 5(3) of the Draft Law no. 452). It is not clear how the NBM will implement these rules, given the money laundering risks outlined above, which result from the safeguards laid down in Article 10 of the same bill that prohibit the investigation of the origin of the declared assets. Additionally, according to Article 5(3) of the Draft Law no. 452, financial institutions are responsible for the enforcement of the rules developed by the NBM in this regard, as part of the liberalization of capital. Furthermore, it is not clear how banks will implement the basic provisions regarding the prevention of money laundering, set up as part of MONEYVAL and FATF (Financial Action Task Force) procedures in terms of the verification of the origin of assets owned by politically exposed persons. The Republic of Moldova is part of the FATF platform and has a series of commitments in preventing money laundering, and a possible violation of the principles of this organization will entail major risks for the connection of the Moldovan banking system to the international payment system.

4. The risk of worsening relations with development partners

Just as with the banking system, the reputation of the entire country has been significantly affected over the past years in light of the bank frauds, money laundering and the inefficiency of the fight against corruption. The positive evolutions that began in the relations with the development partners at the beginning of 2016, driven by “political stabilization” and, especially, by the resumption of the reforms, some of which pretty bold (e.g. the pension reform or the public administration reform), risk being compromised by the approval of the bill on the tax and capital amnesty. This is because, considering the risks mentioned above, the approval of this bill will undermine the rule of law and the efforts to ensure integrity in the public sector and to reform the banking system, which are essential conditions for budget support from key development partners. Undermining these principles creates risks for further budget support resumed after significant efforts made by the Executive so far.

Moreover, the tax and capital amnesty conflicts with the spirit of the Memorandum signed with the IMF. It is worth mentioning that, at the international level, the IMF is usually very skeptical about any form of amnesty. According to a research carried out by the IMF⁹, in most cases, the costs of a tax amnesty prevail over its benefits because it undermines tax compliance and the long-term efficiency of tax administration. Moreover, the IMF expressed a negative opinion about the 2007 tax amnesty.¹⁰ Thus, according to the 2007 country report, “The sweeping tax amnesty is risky as it could undermine future tax discipline,” “capital amnesty could also present risks to the AML regime,” and “tax/capital amnesty (...) threatens to put program objectives at risk, particularly in 2008.” Therefore, it will be no wonder if in its next program review, which will take place in February 2017, the IMF expresses a similar opinion about the proposed amnesty. Considering that the Republic of Moldova already has a negative experience with the IMF, where it missed the last funding tranche from the previous program, one cannot rule out similar risks in the current Memorandum.

Conclusions and Recommendations

The adoption of the Draft Law no. 452 on capital liberalization and fiscal stimulus, which basically provides for a quasi-amnesty of tax liability and a capital amnesty, and of the Draft Law no. 451 linked to the Draft Law no. 452), poses imminent risks for the Republic of Moldova, whose materialization will undermine the long-term development of the country. These risks refer to compromising of the rule of law and the fight against corruption, the increase of opportunities for corruption in the public sector, the legalization of money laundering and tax evasion, the increased erosion of the reputation of the banking sector, and the chill in the ties with development partners. The main source of these risks lies in the liberalization of capital without the possibility for the State to verify the origin of declared assets and in the inclusion of public officials among the subjects of the capital liberalization. In a rule of law state, corruption cannot be legalized.

Moreover, the first reading of the Draft Laws no. 452 and no. 451 was carried out in breach of the main rules of transparency in decision-making and legislative drafting. The bills were not accompanied by an impact assessment, including the analysis of the impact of the 2007 amnesty, were not subject to public consultations, did not receive the Government’s opinions prior to the advancement, and were not accompanied by anti-corruption expert review. The Parliament registered both bills on December 1, 2016, and passed them in the first reading already on December 16, 2016. Such a rush is unprecedented. Considering the complexity and the risks posed by the bills, such a hasty promotion in defiance of the rules of legislative drafting and public consultation of the bills raises big questions about the true purpose of the authors, including its connection to the ways of legalizing the assets obtained from the bank frauds of 2014 and to the intention of nullifying the potential positive impact of the “Integrity Package” adopted in the summer of 2016 on corruption in the public sector. In addition, the hasty promotion of the bills in the context of the massive increase of tax arrears in 2016 raises a justified suspicion that the tax amnesty is hastily promoted for those legal entities who knew/were informed about a possible tax amnesty beforehand.

In this context, we request the authors of the Draft Laws no. 451 and no. 452 to withdraw them, despite their adoption in the first reading.

If the authors of the Draft Law no. 452 truly wish to improve the investment climate, to increase investment flows toward entrepreneurial activity, and to reduce the shadow economy, as they claim in

⁹ K. Baer, E.L. Borgne, Tax Amnesties: Theory, Trends, and Some Alternatives, FMI, 2008

¹⁰ IMF Country Report No. 07/275

the explanatory note, they must come with thoroughly thought bills consulted with all interested parties and with sufficient mechanisms for excluding the risks of increasing corruption, money laundering, and tax evasion.

Therefore, **we request the Parliament to organize extensive and transparent consultations with civil society, development partners, private sector and other relevant actors with a view to a thorough review of these bills so as to completely exclude the risks identified in this paper and other risks that other actors may identify.** We would like to reiterate the importance of involving civil society in decision-making and the obligations assumed by Parliament to observe the rules of transparency in decision-making. The Parliament has already infringed the rules of transparency in decision-making when it passed in the first reading the Draft Laws no. 451 and no. 452. Advancing them in the second reading without public consultations required by the law will demonstrate that the Parliament itself and every Member of Parliament who will vote for the bills in the second reading do not observe the law. This will further undermine the public trust in the Parliament and the legitimacy of its current composition, and will be a clear indicator of the absence of a genuine rule of law in the Republic of Moldova.

We also **request the initiation of a comprehensive reform that would considerably diminish the shadow economy. This must be the purpose of policy makers and the tax and capital amnesty should not be an end in itself (as it is currently perceived). The reform should provide for much more fundamental and effective actions than the proposed amnesty, such as:**

- The development of the electronic payment system and the discouragement of the utilization of hard cash;
- A further improvement of the tax administration and the drafting of a new Tax Code that would be consistent with best international practices;
- The increase of the size of fines; the strengthening of the authorities' capacity to identify cases of tax evasion and informal employment or remuneration; and a potential extension of penalties for informal employment to workers;
- The revision of tax rates with a view to a possible adjustment to boost tax compliance and to reduce the benefits of tax evasion;
- The increase of public awareness and information about the risks of tax evasion and informal employment;
- The increase of the efficiency, sustainability and transparency of the retirement system;
- The increase of transparency in the issuance of authorization documents for companies, and the reduction of the discretionary powers of civil servants in this respect;
- The reform of government control mechanisms by reducing their numbers and increasing their efficiency and targeting;
- Other relevant actions consistent with best international practices in this field.

Signatories (the list is being updated):

1. Expert-Grup Independent Think-Tank
2. Legal Resources Centre from Moldova (LRCM)
3. Association for Efficient and Responsible Governance (AGER)
4. Transparency International - Moldova
5. Association for Participatory Democracy (ADEPT)

6. Institute for European Policies and Reforms (IPRE)
7. Centre for Analysis and Prevention of Corruption (CAPC)
8. Veaceslav NEGRUȚĂ
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