

Police Enforcement of Tax Arrears Collection: Political Opportunism or the Last Resort for Transition States?¹

By
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Introduction

The countries of Central and Eastern Europe (CEECs) and the Russian Federation have all embarked, with varying degrees of success, upon significant economic changes from centrally-planned, partly 'closed' economies, to more open free-market economies. Consequently, free-market systems for raising revenues for public sector activities have had to be developed and implemented. Under these systems, as former Russian Federation Prime Minister Kirenko said, '...if the State does not learn to collect taxes, it will cease to exist' (Treisman, 1998, p. 56). For many of these countries the scale of the problem is quite significant, as noted by the Council of Europe in 2001, '...*tax evasion*, pursued on a large scale and linked to economic crime, continues to hamper the economic resources of many countries in Europe' (Council of Europe, 2001, para. 4 [ix]). Two important contributing factors are institutional inefficiency in the state tax services (ILO, 1995) and the unintended criminal opportunities resulting from privatisation. Referring to the problem of economic crime, a Council of Europe Committee (1998) stated that, 'The most common predicate criminal offences arise out of the process of privatisation ... e.g. offences of unlawful business, tax evasion...'

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This paper will, first, outline some of the problems facing the Russian Federation and the CEECs and compare the late 1990s to the current situation. Second, I will examine the public sector institutional responses to direct and indirect tax evasion by reference to the enforcement methods employed in some CEEC states and the Russian Federation. Although, for simplicity, the title refers to police, the institutional spectrum actually covers police, as normally understood, customs services and tax administration and investigation services. Transition countries are under international public scrutiny in this area as a consequence of opening up their economies to foreign investment and business. At the international level, loans from the IMF may be linked to improving revenue collection, as was the case for the Russian Federation in 1998. Because the CEECs are candidates for accession to the European Union (EU), since 1997 their taxation and economic crime problems have been subject to annual scrutiny reports issued by the European Commission as part of the accession evaluation process. A serious level of EU concern about taxation problems and economic crime could be a barrier to entry. Third, I will consider some contemporary policy issues in the light of the results being achieved by different types of revenue enforcement systems.

The evidence suggests that revenue collection based upon the development of well embedded civil society norms can be quite effectively carried out by civil (non-police) tax administration bodies even in countries where economic and political transition are not yet fully complete. The CEECs are helped, in this respect, by the accession partnership with the EU and its Member States. By contrast the Russian Federation's development of quite a large tax police reflects the very different political and economic circumstances in that country and, perhaps, the absence of the sort of clear and externally monitored national goal provided by the prospect of EU membership.

Examples of Problems with Taxation Systems

Before looking at examples, certain structural problems need to be identified. First, personal tax liability is a new experience for all the populations of the former Soviet Bloc, and brings with it fears of new forms of state surveillance and control. Second, the actual process of developing new tax legislation, procedures and tax personnel skills is complex and demanding.

The development of staff skills can have perverse results. Skilled public sector personnel can often be poached away to the private sector by higher salaries. This problem has been noted in the European Commission's 1998 Report on Slovakia (EC, 1998, p. 42). Some of these problems require long term solutions, as in the case of the 25 year consultancies provided in the OECD's Special Russian Programme (Hochmann & Meir, 1997, p. 343). Third, indirect taxation can be seen as simply an inconvenience and a barrier to economic gain for both suppliers and consumers. There is evidence of this in respect of tax evasion on alcohol, tobacco products and luxury consumer goods. In the Russian Federation, tax evasion on the resale of high value imported goods by individuals is known as 'shuttle trading' and is done to avoid a 30% tax (Kuznetsvo and Anantsasyov). Fourth, the most significant area of tax evasion, other than the black economy, is within the corporate sector and often involves privatised former state-owned enterprises. In some cases, the problems are actually caused by the public sector being unable to pay for goods and services because of a lack of revenue. This situation, if uncorrected, leads either to a perpetuation of non-payment of tax or its avoidance by barter arrangements.

Using, mainly, the European Commission's Accession Country Reports and Opinions, the range of national problems in the CEECs can be illustrated. For this purpose, the 1996-1998 period will be compared with 2000-2001. In general these reports found that revenue collection was a common problem, irrespective of the transition status of countries. Romania is an example of the more challenged economies. In 1996, the Romanian intelligence service was reporting that tax evasion was a major threat and was equal to 70% of the state budget. However, even Poland, representing one of the more advanced transition economies, had tax receipts equalling only 36% of total expected revenue in 1998 (EC Commission, 1999, p.20). Slovenia, regarded as one of the most promising transition economies, was seen, in 1998, as experiencing '...disappointing tax revenues...' (EC Commission, 1999 p. 20).

The EU has seen itself as entering into a structured dialogue with the Accession States for the purposes of helping them to carry out the necessary economic, institutional and legislative changes for the adoption of the *acquis*. Within the accession process, the CEECs are required to have a clear *acquis* adoption strategy which has to be set out in a national plan that is

updated annually. These national plans then form one of the bases in the European Commission's annual audit. As the possible entry date of 2004 approaches, the EU's accession progress scrutiny focuses not just on adoption of *acquis* but also on implementation. From the Commission's 2001 Reports, it is evident that, benefiting from clear goals and from PHARE , bilateral aid and regional aid programmes, the transition states are achieving acceptable standards of taxation systems and revenue collection. Negotiations on Accession Chapter 10 (Taxation) have been opened for all 12 Accession States and provisionally completed, already, for the Czech Republic and Hungary. Whilst the Commission Reports for the Accession States continue to identify problem areas, by contrast to the 1990s these now seem to be administrative and legislative problems that can be easily remedied. For example, in Bulgaria, one of the Accession States with particularly problematic economic and political circumstances, it is evident that quite major reforms have been realised. The Commission notes (EC Commission, Bulgaria Report, 2001, p.57) that the Law on Tax Procedures of 2000 has '...significantly increased the enforcement powers of the tax administration and has a positive impact on collection figures.' The only Accession State whose achievements are still causing concern is Romania, where it is noted that '...limited results have been achieved in modernising the tax administration.' (EC Commission, Romania Report, 2001, p. 61).

In the Russian Federation, in the mid-1990s, Treisman found that '...fifty enterprises owed about half the debt to the Federal budget... [and]... Among these, the fuel and energy complex accounted for 73% of the debt (Treisman, 1998, p.262). Overall, it is generally estimated that, by 1998, the Russian Federation was only able to collect about 60% of the total tax due. The ways in which customer-supplier problems undermine tax collection is well illustrated by the case of the Balekovo Nuclear Power Plant, whose General-Director, Pavel Ipatov, stated that 'Formally, the claims that the State Tax Service have filed against us are legitimate' (Bellona Report, 2001). However, the problem actually related to non-paying customers: although the Balekovo Plant owed 125 million roubles in tax, its customers owed it 310 million roubles. In total, it has been estimated that the Russian nuclear industry is owed about \$US3 billion plus by its customers. Another major Russian problem is the connivance at tax avoidance between the privatised former state enterprises, like Gazprom and Lukoil, and

their political supporters and beneficiaries. One of President Putin's main current policy aims is to try to wrest control of the economy from these oligarchs (Online Asia Times, 2000). However, the President seems to be having significant problems in achieving this goal. This year, he '...publicly rebuked Russia's most senior law enforcement officers...saying that they were losing the war against crime and threatening the country's future...he was forced to admit that organised crime still controlled much of the economy' (The Times, 12 February 2002). Even where the economy may be functioning in a near-normal fashion, for example with Gazprom voluntarily paying its tax obligations in 1999, there remains a general revenue collection problem, which Goorha (2001 p.402) has pointed out as existing when: 'Payments of tax obligations and wages have...been routinely done using barter...Perhaps more interesting is the overall demonetisation of the economy.' In such a situation, individual economic survival tactics, political corruption and criminal practices reflect a weak civil society base and may impede the effectiveness of even seemingly powerful, police based revenue collection enforcement systems.

Institutional Responses

Whilst to American and British eyes the existence of an armed and, when necessary, uniformed tax police, such as that found in Russia, would be seen as repressive law enforcement, there does exist a similar long-established continental European service, the Italian Guardia di Finanza, alongside the more typical civil service bodies like the UK's Inland Revenue. The Italian, Dutch (FIOD) and British examples will be described for comparison with the systems being developed in the CEECs and Russia.

The Italian Guardia di Finanza had a strength of 60,735 in 1994. It has wide functions including land, sea and air frontier control. For tax policing purposes, the Guardia di Finanza has a Central Unit of Tax Policing with 13 regional, 81 provincial and 2 sub-provincial units. Its tax police functions are also regarded as high status activities in terms of tackling '...the more important aspects of the investigative and repressive function' (Secretariat General of Interpol, Lyon, France, Nov. 1998).

The FIOD was established in 1945 within the Dutch Tax and Customs Department. Its remit, powers and structure are very similar to those of the Russian Tax Police. The FIOD is tasked ‘...to investigate and combat fiscal fraud, customs fraud and certain forms of organised crime and to collect and analyse information.’ The Investigations Division of the FIOD has powers of search and seizure of evidence, arrest and detention of suspects. It also handles co-operation with other law enforcement agencies in the Netherlands and mutual legal assistance requests from other countries. It is organised on similar lines to the Russian Tax Police, with a central headquarters and regional offices. There are a number of examples of armed, uniformed customs services, such as the French Douane, as well as the armed US Bureau of Alcohol, Tobacco and Firearms. Nonetheless, for common law tradition states, the idea of a Tax Police can appear very alien. In Britain, a unarmed civilian body, the Inland Revenue, has the sole responsibility of administration, investigation and prosecution in all areas of personal and business taxation, except for excise duties and VAT, which come under HM Customs & Excise, a partly uniformed service. The British police would rarely become engaged in these areas unless some other types of offences were involved, such as fraud and money-laundering.

Within the CEECs, the dominant mode of revenue collection and enforcement is through a combination of customs services and civil service (i.e. non-police) tax administrations working to European Union and Schengen requirements and standards. These public sector agencies usually come under the overall direction of the finance ministries as, for example, is the case in Bulgaria, Czech Republic and Slovakia. This model, therefore, is closer, in EU Member State terms, to the UK model than it is to the Italian model. However, two of the Accession States have a mixed model, which includes a police agency, as well as a civil service tax administration. Whilst Latvia’s main agency is the State Revenue Service, it also has a 125-strong Financial Police Service tasked with disclosing and preventing fraud in the area of state revenues. Lithuania, similarly, has both a State Tax Inspectorate under the Finance Ministry and a Tax Police Department under the Ministry of the Interior. A common and related accession requirement, which all the Accession States must endeavour to comply with, is the development and implementation of an anti-corruption programme. In the revenue collection field, official corruption has often been mentioned as a problem, particularly affecting customs services.

What is common in both the current Russian Federation law enforcement and economic regulatory system and its Western European and CEEC counterparts is that economic crime control, broadly defined, inherently involves inter-agency cooperation between both police and non-police bodies. What is far less common is for tax collection enforcement to be carried out by armed, partly uniformed, specialist police, as in the Russian case (Eee the incident reports in *The European*, 9-15 Feb., 1998 and *Reuters*, 30 Sept. 1998).

The Federal Tax Police Service of the Russian Federation (FSNP) free market tax administration was established in May 1992, initially as the Main Administration of Tax Investigations. This was a normal bureaucratic development within a free market tax administration system, that everywhere includes an investigative branch with enforcement powers. However, the realities of law enforcement in a transition state may make the process of investigation very risky. The new tax investigators were soon facing physical injury in their work. Because of assaults on the tax investigators, the Supreme Soviet granted, in September 1992, permission to bear arms and use force. However, arming the investigators was not a sufficient enhancement of their capabilities. The investigation service was separated from the Tax Service and established as a specialised police service by the law of 15 July 1993 ('On the Federal Agencies of Tax Police'). The creation of a police force specifically for tax crime was a response to the large scale of the problem, the risks of law enforcement, and the involvement of criminals in free market activities. The Tax Police is thus a distinct organisation headed by its own State Committee of the Russian Federation.

By its establishment the Tax Police became (Almazov, 1995) '...a law enforcement body and an inherent part of the economic security system of the Russian Federation.' It is a national police agency deployed in the republics of the Russian Federation, in autonomous regions and in local offices such as the district tax police offices in Moscow and St. Petersburg. It has four basic tasks:

- to detect and avert tax crimes and related legal infringements and put a stop to those already in existence;
- to provide protection for the officials of the State Tax Inspectorate in the execution of their duties;

- to detect, avert and put a stop to existing corruption in all agencies dealing with taxation affairs;
- to investigate crimes and infringements, which fall under the relevant articles of the Criminal Code.

The amplification of these tasks reveals two points of particular interest. First, the Tax Police must work with other policing agencies as necessary. They are required to: 'render assistance to tax authorities, agencies of the Office of the Public Prosecutor, the State Security Service (FSB), the Ministry of Internal Affairs (MVD) and to other state agencies detecting, averting and putting a stop to crimes and offences in the field of tax legislation. (In cases of tax crime, the Tax Police has priority over the other agencies)' (Gregory & Brooke, 2000, p 436).

Second, the Tax Police must provide a policy advisory service for the government. Here the requirement is to collect and analyse information on observance of tax legislation, forecasts trends in development of tax evasion methods by corporate bodies and by individuals and to inform the government about significant methods of income concealment for tax evasion purposes.

The powers of the Tax Police are broadly commensurate with their duties and, unlike normal Western-type police, they also have their own enforcement powers as well as recourse to criminal court processes. Using a British analogy, the powers of the Tax Police are an amalgam of those available to the UK police, HM Customs & Excise and the Inland Revenue. At its foundation in 1992, as the Main Administration for Tax Investigations, the service had a staff of 17,000 organised into 88 territorial administrations and divisions. As the Federal Tax Police Service, its strength in September 1999 was 53,300. Having the status of a State Committee of the Russian Federation brings two advantages. Firstly, it confers autonomy on the service, with accountability being to the Russian Federation Government as a unit, and not through subordination to a particular ministry. Secondly, its establishment by its own law means that the Tax Police cannot be abolished by the whim of a presidential decree. Its status can only be altered by a subsequent law. The service describes itself (1997 Report) as '...an agency of federal executive power exercising leadership over a single system of federal agencies.' A resource problem, relating to the federal structure of the service and the limited availability of

central government funds, was highlighted by the previous Head of the Service, Almazov, who commented, in an interview, that often office premises, transport and equipment depended upon arrangements with local officials and noted: 'What can a local chief [of Tax Police] do if all he receives from the centre is money for salaries. He naturally approaches the Governor, who helps out, which can lead to a degree of dependence' (Almazov, 1999). Although the status of the Tax Police may not be alterable by presidential action, this does not prevent presidential action directed against individual members of staff. .

Unlike many of the EU Accession States, which carried out programmes to cleanse law enforcement bodies of personnel believed to have been involved with repressive activities under the communist regimes, the Russian Federation carried out no such programmes. Therefore the Tax Police has drawn a significant fraction of its personnel from former members of the KGB, GRU (military intelligence) and MVD (ordinary police). It has been argued that the high educational levels of the ex-KGB officers make them well suited to the complexities of tax policing (Gregory & Brooke, 2000, p.445). However, given President Putin's KGB background and the political opportunities that arise from powers to closely scrutinise individual and corporate affairs, there are obvious concerns that the Tax Police could be used to pursue political agendas in the guise of tax enforcement. Ledeneva (2001, p. 14), referring to some major cases, calls this practice '...selective [and used]...almost exclusively when they involve known opponents of the Kremlin.'

This point can be illustrated by the following examples. In 1998, the St. Petersburg Tax Police launched an 'unexpected audit' of the offices of a Human Rights Centre and an Environmental Rights Centre (Bellona Report, 2001). In 2000, armed Tax Police were reported as raiding the Jesuit-run Inigo Centre in Novosibirsk, seizing videocassettes, a computer and video recorder. The report noted that the Tax Police did not explain the reasons for the raid (Russia Reform Monitor, 2000). Particularly worrying have been the periodic raids by Tax Police on Media-MOST. They seem to target the free media. For example, there were raids on Media-MOST in the 1994-96 period at the time of its reporting of the Chechen war. It was also raided again in 2000, at a time when one of its programmes was a satire on the State Security Service. The Chairman of Media-MOST, Vladimir Gasinsky, claimed that the raids

were 'a factor of political pressure' (abcNews, 2000). However, it is also a fact that the organisation owed \$US300million in unpaid debts (RFE/RL, 2000).

Police Enforcement: political opportunism or last resort in revenue collection ?

The transition states face very significant problems in developing and operating, under the rule of law, free market taxation systems. The CEECs, which benefit from the partnership relationships with the EU in the accession process, appear to be relatively successful in tackling the problems by methods that conform to the EU's *acquis* requirements. They seem to be overcoming what Pirittilä (1999) has called '...certain special features of transition economies...[which]...include the legacy of socialism resulting in a state willing to exercise discretionary power but possibly lacking credibility and public support, the 'disorganisation' phenomenon that hampers efficient tax administration and the relationship of restructuring, speed of reform and the tax system.'

One way in which the growth of positive public support can be demonstrated is in the development in some Accession States of taxpayer associations, which have existed in the West since the 1900s. These associations have as their mission '...to increase the rule of law, entrepreneurship and economic growth' (Hansson & Tarras Wahlberg, 2001). Evidence of government-public dialogue can be found in some of the EU Commission's Accession Reports. For example, in the 2001 Report on Bulgaria it is noted (p.56) that 'An advisory board to the General Tax Director representing different taxpayers groups has been established, which provides advice on taxpayers issues.' Such dialogues can be reinforced by external aid packages, as in the case of the \$US 5.5million World Bank loan to Latvia in 1999. This was to help the Latvian government develop a sustainable revenue system, based on voluntary compliance, lower compliance cost and reduced corruption and tax evasion. In the case of Estonia, Hansson & Wahlberg record that the taxpayers' association was able to work with the Ministry of Finance to obtain fifty changes to tax laws and thus produce more taxpayer friendly laws. By contrast, reports from Russia show not only limited successes in improving revenue collection, despite the existence of a specific tax compliance enforcement police and the involvement of the main successor to the KGB, the State Security Bureau, in the control of tax

evasion. For example, the Samara Oblast Tax Police recorded, in 2000, that: “The total of detectable offences was much bigger than in that of 1999; the criminal schemes of tax evasion tended to be more intricate and the scale of tax evasion kept being large in 2000” (Samara Oblast, 2000).

In conclusion, two points can be made. First, the highly structured accession requirements and the continuity of EU accession assistance, plus less severe political and economic transition problems, have clearly helped the CEECs avoid recourse to the more draconian forms of tax law enforcement. Secondly, even where a more visibly coercive form of tax law enforcement is utilised, the deep rooted nature of the problems in a country like the Russian Federation limit its achievements and provide little protection against abuse of power.

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