

AMERICAN UNIVERSITY OF ARMENIA

**FISCAL EFFECTS AND POLITICAL PURPOSES OF INTRODUCING LUXURY
EXCISE TAX IN ARMENIA**

**A MASTER'S ESSAY SUBMITTED TO
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LIST OF ABBREVIATIONS

NA- National Assembly

RA-Republic of Armenia

RF-Russian Federation

VAT-Value Added Tax

EU-European Union

TVA- Taxe sur la Valeur Ajoutée

ISF- Impot de Solidarité sur la Fortune

MF-Ministry of Finance

MP-Member of Parliament

Abstract

In Armenia, within the framework of legislative consideration of the 2012 fiscal year State Budget, the Government suggested a number of changes in the Law on Taxes, among them the most controversial being one of the amendments in the Law on Excise tax. According to the amendment, the owners of cars with the assessed value of 25 million AMD and more, or date of production 2 years, and engine volume 4500 cm³ and more should pay 20% of the total estimated value of the cars when imported.

In Armenia this amendment came to be unofficially called “Luxury tax” and stirred up a lot of critique and disputes. Within the framework of current essay analysis of the fiscal effects and political appeals of luxury excises is carried out and estimation of the latest changes and amendments in the Law on Excise Tax of RA is made within the context of these analyses.

The essay considers the international experience of luxury excises in US, UK, France, and Russia. The findings of the essay summarize the taxation of vehicles under the Property tax, the latest amendment with its expected fiscal effects and relevant statistics, the draft bill on luxury tax prepared by former MP Viktor Dallakyan, and the results of interviews with competent persons.

Taking into consideration the analysis of the findings, the essay provides number recommendations aimed at improving the major problems revealed.

Introduction

Luxury taxes are included in the category of selective sales taxes or excise taxes. These taxes are levied on items that are “uniquely or predominantly consumed by the rich” meaning that the act of purchasing the goods is considered to be evidence of extraordinary ability to pay taxes (Lee, Johnson & Joyce 2007). Although luxury excises are argued not to yield significant revenues, they have been and are still practiced in some countries of the world the rationale behind its application differing from country to country.

In Armenia, within the framework of legislative consideration of the 2012 fiscal year State Budget, the Government suggested a number of changes in the Law on Taxes, among them the most controversial being one of the amendments in the Law on Excise tax. As the bill was adopted by the NA, it was set in the 5th article of the amendment on “Law on Excise Tax”, that the owners of cars with the assessed value of 25 million AMD and more, or date of production 2 years, and engine volume 4500 cm³ and more should pay 20% of the total estimated value of the cars. In Armenia this amendment came to be unofficially called “Luxury tax” and stirred up a lot of critique and disputes. Since, the current amendment generates “features” of a luxury tax it is noteworthy to study the rationale behind its introduction and possible fiscal effects.

Thus, the aim of the current research is to analyze the fiscal effects and political appeals of luxury excises and estimate the latest changes and amendments in the Law on Excise Tax of RA within the context of these analyses.

Research Questions

The following research questions will be addressed:

- What are the expected fiscal effects of new tax amendments? Did the government make a substantial policy research and impact analysis before introducing the change in the Law on Excise Tax?
- Can the introduction of Excise Tax on luxurious cars become a ground for broadening its base (for the introduction of a separate luxury tax in Tax Law of the Republic of Armenia)?
- Why was the draft on the Luxury Tax introduced by former MP Viktor Dallakyan rejected by the Government of the Republic of Armenia in 2010?
- Can the timing of the latest amendment be linked with the 2012 elections to the National Assembly of the Republic of Armenia?

Literature Review

Luxury Tax in Theory

Luxury excises are included in the category of selective sales taxes or excise taxes. These taxes are levied on items that are “uniquely or predominantly consumed by the rich” meaning that the act of purchasing the goods is considered to be evidence of extraordinary ability to pay taxes. Such taxes may be levied on different items of luxury, e.g. furs, jewelry, yachts, etc. But the general logic of these taxes rests on the assumption that the purchase of these goods is evidence that the consumer can afford the tax (Lee, Johnson & Joyce 2007).

Luxury taxes can be observed from the perspectives of incidence and ease of administration, fiscal/economic efficiency and political appeal. In general, the use of luxury excises is explained or justified by a variety of rationales.

Giertz states that luxury excises are primarily used as a means of implementing an ability-to-pay approach to taxation. By taxing items consumed disproportionately by higher-income individuals, these taxes achieve an element of progressivity. There are questions, however, concerning horizontal equity because not all people at the same income level have similar expenditure patterns for luxury items (Giertz 2005).

Due brings forward other rationales for luxury excises. He states that from the very beginning of its introduction the luxury excises were imposed to protect major revenue sources as domestic production replaced importation. The underlying motive was to reduce luxury consumption of imported goods for foreign exchange reasons (1994). Thus, this tax served as a form of protectionist policy applied by the government to promote domestic industries, and consequently protect domestic economy.

Luxury excises are sometimes employed because of ease of administration; such taxes are imposed only on selected goods and number of producers is small. However, on the other hand, luxury excises have a major administrative shortcoming referring to what can be considered a luxury good. Luxury excises are often criticized for their arbitrariness. There is the problem of ambiguity here. It might mean that the tax requires such attention to detail that it leads to inconsistency. There are cases when commitment to tax luxuries at a differential rate was really astounding. For example in Britain irons were once taxed as luxuries but ironing boards were not (Berry 1994).

Luxury taxes can also be arbitrary because the category is in itself indeterminate. Luxury items differ from state to state, and there is no single set of criteria upon which the items are selected. According to Due in terms of progressivity, the basic rule is that taxes

should be applied to commodities with high income elasticity of demand; that is, as income rises, consumption rises by a greater percentage. However, in the selection of items, not infrequently, ones are included that are either not consumption goods (e.g., cement), or are widely used in the lower income groups, sugar and kerosene being the prime examples. Furthermore, luxury excise systems are scarcely "systems" at all and do not automatically adjust to changing conditions. New products developed, though similar to ones taxed at the moment, will not be brought within the tax network unless there is deliberate action by the government. As a result, firms may change the nature of taxed items slightly, bringing them out from under the tax, thus evading tax compliance. This is another administrative problem faced by government (1994).

In literature there are both objections and justifications for the practice of luxury excises. The objections to luxury taxes are several. First, they distort producer and consumer choices. As the tax establishes the difference between the resource-cost ratios in production and the price ratios to which consumers respond, there will be unnecessary loss of economic welfare in the economic system. Second, and pragmatically more important, the tax will distribute burdens on the basis of personal preferences for the taxed items. The tax will impose higher effective rates on people within an income class who have high taste for the taxed commodities or services. Third, there are administrative problems with these excises. Because retailers would have difficulty separating the sales of the taxed luxury items from sales, these excises typically apply to the manufacturer or wholesaler level (Mikesell 2003).

However, Forbonnais and Graslin stress the importance of progressive luxury tax. They state that it is necessary to limit the terrible effects of luxury by a progressive tax on consumption goods. This tax would increase the price of luxury goods and bring about a fall in their sales. The latter can be justified by two important principles- first, the stress should be

on the production of items of first necessity and second, the wealth will be distributed equally (Orain 2010).

According to Forbonnais and Graslin what matters is to produce items of first necessity, of which the consumption is vast, and not expensive luxury goods in small quantity. Graslin adds that a good policy spreads the wealth of the nation in a way that is always desirable towards items of necessity; the abundance of these items being general and universal wealth. For both authors, there is a hierarchy of needs, and the only real policy is to diminish the inequalities so as to ensure that the basic needs are satisfied for all members of society (Orain 2010).

From the moral standpoint needs ought to be met before luxuries. This claim can be understood both individually and socially. It may claim that individuals ought to allocate their own resources in such a way that their needs are met before they proceed to indulge themselves in the acquisition of luxuries. Or it might claim that a society (its political leaders) should ensure that the needs of its members are satisfied. No harm ensues if individuals do not enjoy luxuries. It does not of course follow that it is morally legitimate to prevent that enjoyment but it does provide the rationale for levying extra taxes upon them (Berry 1994).

Designing the optimal luxury tax system is difficult. One major problem is that there is no generally accepted method for determining how much of the value of a good is from its status attributes. This makes it difficult to reach agreement on the imposition of a status tax even after the principle is accepted. The second problem is that the extent to which a good is purchased for status reasons varies heavily within each category of goods. Food, shelter, and clothing are necessities of life but some categories of these goods are bought primarily for status. Thus, it is usually difficult to tax a status good without imposing a heavy tax on those who are buying a good for its use value (Miller 1975).

According to Berry (1994) luxury excises are levied for two reasons. The first and most obvious is to raise revenue. The second is to act discriminately as a tool of social policy. Like all taxes they are primarily designed to collect revenue for government expenditure. Accordingly luxuries may be argued to be a more appropriate object of taxation than necessities. In addition, a tax on necessities means that the poor would be contributing disproportionately than the rich, because the percentage of their total expenditure devoted to necessities is high.

Luxury taxes as well as raising revenue are also used as an instrument of social policy. They enable governments to discriminate between activities. But why to discriminate? This is an important question since it would be administratively easier and cheaper to collect it if the rate of the tax was uniform and applied to all goods. Indeed, there must be other factors involved. While they can be criticized for lack of “neutrality” and distorting consumer choices, they are mostly favored for their impact on choice (Berry 1994).

From the economic point of view, luxury taxes cannot be considered significant fiscal tools. Economists generally have condemned such taxes as imposing an "excess burden" in comparison with more broadly based general sales or income taxes. Also, it is alleged that any desired income redistribution could be obtained with more efficiency (and perhaps greater equity) through a progressive income tax (Miller 1975). Revenue growth for most luxury excises is low, largely because their specific nature does not allow capture of price effects; tax base for luxury taxes is too specific and narrow. They do yield some revenue, although at considerable collection cost. Mikesell argues that luxury excises, in fact, are not strong elements of a revenue system; they are mostly exploited for political purposes (2003).

However, as there is no specific literature found to discuss the political appeal of luxury excises, we will try to review it from the standpoint of tax manipulation for political purposes in general.

Overall, tax manipulations for political purposes are primarily shaped by the timing of such decisions and the preferences of electorate. The literature on “political business cycle” or “political budget cycle” casts light on the temporal aspect of using tax policies for political purposes. The argument here is that the action of governments in taxing and spending will constitute a major portion of their attempts to be reelected. The governments’ actions may not be the same throughout their term of office, but rather will be time to coincide with the electoral cycle (Peters 1991). Not to say that after a while the tax may be repealed as it happened with yacht luxury tax in US.

A question often raised about election-year expansions as a signal of competence (or some other desirable characteristics of a politician) is why the signal should be sent just before an election, rather than earlier in the politician’s term. Works of Drazen (2007) and Mikesell (1978) contribute to the understanding of this factor. Accordingly if a government believes it must take changes in tax policy unfavorable for the electorate, it will tend to do so early in its term of office so that any negative repercussion of the change will have been forgotten by the time of the next election. Likewise, the governments will attempt to increase public expenditure, or will undertake changes that will favor majority of the population, late in their terms of office so that the citizens would more likely remember the good deeds of the government and return them to office (Drazen 2007).

Furthermore, just before elections, governments are most probable to target a specific type of taxes to decrease or increase in order to improve their reelection chances. In developing countries, the median voter is more likely to own less capital than the mean capital endowment and will therefore prefer taxes affecting the richer layer of population. An incumbent government will project expansionary fiscal policy, meanwhile implementing a tax policy preferred by the median voter in election years. Consequently, the rich become more vulnerable to political manipulations (Ehrhart 2010).

Brender and Drazen (2003) follow and even expand the previous argument, mentioning that it is not macroeconomic expansion that politicians are after, but influence on specific constituencies. There is a “revealed preference” argument. If politicians choose expansionary policies before elections, it is likely that they “get” something out of it, namely, they increase their chances for reelection. Manipulations may occur at a level other than the aggregate, for example, transfers to one group offset by a reduction in transfers to other groups of voters or in changes in the composition of spending towards spending valued by “impressionable” voters.

According to Brender and Drazen this would be consistent with voters being fiscal conservatives who dislike the need to finance higher aggregate spending, rather than disliking electoral economics per se. It would also be consistent with it being harder to detect fiscal manipulation that doesn't affect the overall size of the budget, particularly, in “new democracies”. It is not that new democracies are characterized by unsophisticated or naïve voting population, but that in countries with less of an electoral history, and less exposure to pre-electoral fiscal manipulations, a political cycle is more likely to occur. The results of their study suggest that learning about pre-electoral fiscal manipulations is a local learning process that is probably not easily transferable across countries (2003).

The consequences of such manipulations of taxes for election purposes might be severely damaging to the economy especially given the fact that an eroded tax base one year cannot be easily recovered and may take many years after the election to reach again the level of tax revenues prevalent before elections (Erhart 2010). Policies that shift the timing of economic activity so that the economy expands before an election are considered harmful to the economy over time in terms of “unsmoothing” consumption, inducing investment cycles, etc. Clearly, if voters are rational they would not support such policies, so that pre-electoral manipulation would be punished rather than rewarded (Brender and Allan Drazen 2003).

International Experience of Luxury Tax

The Application of Luxury Tax in the US

The history of luxury excises in the US like all excise taxes is dated back to the American Revolution at the end of the 18th century. The colonies incurred large war debts in the six years of winning independence from the British Empire. In order to raise revenue to cover those debts, Alexander Hamilton (the Secretary of treasury appointed by George Washington) supported the adoption of internal excise taxes. In 1790 he proposed that an excise tax on whiskey to be enacted. Whiskey was a convenient commodity to be singled out for the new excise tax, as the consumption of it was considered a luxury. The first luxury tax in the form of excise tax on whiskey was approved on March 3, 1791. However, the farmers in Pennsylvania rebelled; in their view whiskey was not a luxurious item rather it was the basic medium of exchange in a largely barter economy. Nevertheless, the government managed to impose the tax successfully (Shughar 1997).

The tax on whiskey opened the door for additional excise taxes on “luxury” items. A similar tax was imposed on carriages in 1794. These carriages were taxed according to the number of wheels they had, a rough proxy of how much their owners had spent on them (Frank 1999). The 1794 excise tax system was later expanded to include duties on the sale of certain liquors, the manufacture of snuff, the refining of sugar, and the purchase of salt. Not all those taxed items could have been justified on the ground of being luxury; they were mostly targeted for the purpose of raising revenue (Shughar 1997).

Despite the prevalence of all kinds of hostilities, the revenue generated from the imposition of luxury tax was considered to be of immense importance by the American Government, since there was no other significant source of revenue, not even income tax which was introduced only during Civil War. Hence, there was no plan on the part of the Government either to limit or annul the tax, though discontentment had already started

spreading among the common masses. Since the revenue earned from the imposition of Luxury Tax was rather high, “ordinary” goods were also tagged as luxury ones (Luxury tax in The USA 2010). This was perhaps the reason why Luxury Tax was unpopular among the common masses. Using abolition of Luxury Tax as one of his campaign promises Thomas Jefferson eliminated the latter except for the tax on salt.

As the consequent decades illustrated with the exception of the period following the Great Depression, luxury excises were predominantly enacted in wartime to fund the military expenses and were mostly customarily repealed in peace time.

When in 1812 the US again found itself in war with Britain, the Congress approved new luxury taxes on carriages, distilled spirits and sugar. It was presented to the public as war taxes and was supposed to be annulled in a year when the war was over. The same problems were faced by the government when the Civil War in 1862 broke out in US. President Lincoln signed the Internal Revenue Act of July 1, 1862, according to the latter the items that were previously taxed as luxuries were enacted, meanwhile the list expanded to include railroads, steamships, and ferryboats (Shughar 1997). Thus, the modern type of luxury tax, in the form of excise taxes, began in the U.S. in the Civil War; a heavy, comprehensive system of excise taxes on "non-essentials" being adopted in 1862, the rates being increased again in 1864. These excise taxes supplied over half the Civil War tax receipts; the income tax playing a minor role. In addition, the War Revenue Act laid new taxes on a wide range of "non-essential" commodities, many of which were promptly dubbed "nuisance" taxes. Some, like the tax on soda fountain drinks, were not only costly to collect but were frequently evaded. The objectionable "nuisance taxes" (on soda fountain drinks, transportation tickets, etc.) were repealed only when the Revenue Act of 1921 was adopted (Blakey 1922).

The country again found itself in financial crisis during WWI and WWII, as in previous wars the imposition of luxury excises was justified primarily for the purpose of revenue

collection. In addition, for the first time excise taxes were justified for their effect on “discouraging the purchase of certain items.” The intent was to put additional burden on luxury goods, such as furs, toilet preparations, jewelry, and luggage. Based on these considerations “war” taxes began to reincorporate elements of “sin” into the federal revenue system (Shughar 1997).

The Revenue act of 1921 becoming a law on November 23, 1921 repealed some luxury taxes. The latter defined as “an act to reduce and equalize taxation, to provide revenue and for other purposes,” amended the Revenue Act of 1918, and went into effect on January 1. The new act was the result of a rather long and spirited contest between those who desired to reduce the rates of the Revenue act of 1918 upon large incomes, profits and wealth and those who opposed such reductions or who, at least, opposed the shifting of greater burdens upon the masses through sales and other taxes (Blakey 1922). Under this act the manufacturer, producer and importer still paid a sales tax to the Government on certain articles but the consumer had nothing to do with this matter. It was settled between the dealer and the manufacturer (Exit Luxury Taxes 1922).

The new law took the tax off of some sporting goods, chewing gum, cosmetics, proprietary medicines and some other goods; reduced the tax on candy from 5 to 3 cents per pound and in general cut the tax from 10 percent to 5 percent on the excess price of expensive carpets, clothing, lighting fixtures, etc., besides eliminating some articles and changing the basis for others (Blakey 1922). Suits and, hats, shoes, and furs were no longer rated as luxuries and were not taxable. Sporting goods and hunting paraphernalia were also exempted (Exit Luxury Taxes 1922). Only the most remunerative taxes, were retained, namely, those on automobiles, motorcycles, tires, and accessories. However, many inconsistencies appeared with this law, for example, candy was taxed and chewing gum was exempted, or cameras were taxed and billiard balls were exempted (Blakey 1922). According to a manager of a

chain of drug-stores, “During the war no one objected to this tax. The people paid it willingly. But today we are met with constant complaints at the continued taxation. The war is over, they argue, and taxation should be at an end. Tooth paste, which is a necessity, was classed as a luxury under the revenue act of 1918, and for three years the consumer has paid a luxury tax on it” (Exit Luxury Taxes 1922).

Prior to Great depression (1929-41), and for most of the time afterward, luxury excises were primarily enacted during war time. During Great Depression the economy became devastated and tax receipts consequently went down (Shughar 1997). The impact of the 1929-35 depression was such that new luxury taxation became inevitable, not only through Federal excise taxes but through state sales taxes. The Revenue Bill of 1932 taxed admissions and laid manufacturers' excise taxes on cosmetics, furs, jewelry, sporting goods, cameras, yachts, motor boats, fire arms, radios, phonographs, automobiles, mechanical refrigerators, chewing gum and candy, beverages, malt, oil, gasoline, telephone and telegraph messages, matches, pipe lines, safety deposit boxes. Earlier luxury taxes included tobacco, liquor, club-dues, playing cards, sale of produce, oleomargarine, stock transfers, etc. Long distance calls were also added to the list. Important exemptions were made—garden and farm products, food items, newspapers, periodicals.

The US government's recent foray into luxury taxation was launched in 1991 by the levy of a 10 percent tax on all expenditures for autos, boats, aircraft, furs, and jewelry above the following threshold; autos -- USD30, 000, boats -- USD100, 000, aircraft -- USD250, 000, and furs and jewelry -- USD10, 000. (Frank 1999) The luxury tax on the above mentioned items was pushed through by congressional Democrats as part of the autumn, 1990, budget accord between Congress and the White House and accepted reluctantly by Bush as a necessary price for the pact (Bush Will Try to Kill Luxury Tax on Yachts 1992). At that time, the bill was idealistic and simple to understand — only the rich can afford luxury items, and a

tax on the rich fulfills social justice. The main aim of the tax, nevertheless, was balancing the Federal budget. So far, deficit spending has been a way of life for the federal government for most years since World War II. A whole generation of elected federal officials had come and gone without ever balancing the budget. The last time that federal budget expenditures were brought into balance with revenues was in 1969, and prior to that the last time was in 1960 (Shannahan 1991).

Although the bill violated Bush’s election promise “not to raise taxes” during his term as president, he did not receive much opposition in proposing the luxury tax. However, in August 1993, two years after its introduction, the U.S. Congress decided to end the “luxury tax” because the tax revenues were disappointing and the livelihoods of common folks who made a living by selling “luxury items” were negatively impacted.

Although Democrats had intended the soak-the-rich levy as an "equity" measure, affected businesses claimed that it stunted sales of yachts, cars, private airplanes and other luxury goods, sparking plant shutdowns and layoffs (Bush Will Try to Kill Luxury Tax on Yachts 1992). The tax was originally projected to provide revenues of USD9 billion over the next five years raising USD31 million revenue a year. If we calculate the percentage of expected USD9 billion revenue from luxury tax for five years with the total five-year federal budget of US, it comprises 0.16% of the latter.

Table 1. Federal Budget Receipts and Outlays

Fiscal Year	Total Budget			G.D.P.	% of G.D.P.			Luxury tax as a % of total budget receipts
	Receipts	Outlays	Surplus or Deficit		Receipts	Outlays	Surplus or Deficit	
	<i>in billions of dollars</i>							
1990	1,032.0	1,253.0	-221.0	5,734.5	18.0	21.9	-3.9	0.003
1991	1,055.0	1,324.2	-269.2	5,930.5	17.8	22.3	-4.5	0.0029
1992	1,091.2	1,381.5	-290.3	6,242.0	17.5	22.1	-4.7	0.0028
1993	1,154.3	1,409.4	-255.1	6,587.3	17.5	21.4	-3.9	0.0026
1994	1,258.6	1,461.8	-203.2	6,976.6	18.0	21.0	-2.9	0.0024

Source: <http://www.presidency.ucsb.edu/data/budget.php>

However, in reality it became obvious that the original projections were, at best, unrealistic. In addition, on a larger scale, the imposition of the excise tax has been reported in the press as aggravating the plight of the luxury industries already hard hit by current economic conditions (Peters 1999-2012). Legislators levied the tax on only five industries, allegedly to make the tax easier administer. It was decided, for example, that electronics should be dropped as a category since there are too many different types of dealers and equipment. However, as it soon became evident, the Government did not manage with the targeted industries either (Elda 1991).

Within eight months after the change in the law took effect, Viking Yachts, the largest US yacht manufacturer, laid off 1,140 of its 1,400 employees and closed one of its two manufacturing plants. Before it was all over, Viking Yachts was down to 68 employees. In the first year, one-third of U.S. yacht-building companies stopped production, and according to a report by the congressional Joint Economic Committee, the industry lost 7,600 jobs. When it was over, 25,000 workers had lost their jobs building yachts, and 75,000 more jobs were lost in companies that supplied yacht parts and material. The U.S., which had been a net exporter of yachts, became a net importer as U.S. companies closed. Jobs shifted to companies in Europe and the Bahamas. The U.S. Treasury collected zero revenue from the sales driven overseas (Williams 2011).

Back then, Congress stated that the luxury tax on boats, aircraft and jewelry would raise USD31 million in revenues a year. Instead, the tax destroyed 330 jobs in jewelry manufacturing and 1,470 in the aircraft industry, in addition to the thousands destroyed in the yacht industry. Those job losses cost the government a total of USD24.2 million in unemployment benefits and lost income tax revenues. The net effect of the luxury tax was a loss of \$7.6 million in fiscal 1991, which meant Congress' projection was off by USD38.6 million (Smail 2011).

Congress repealed the luxury tax in 1993 after realizing it was a job killer and raised little net revenue. The initiators of the Revenue Act 1990 simply assumed that the rich would act the same after the imposition of the luxury tax as they did before and that the only difference would be more money in the government's coffers. According to economists like most politicians then and now, they had “a zero-elasticity vision of the world”, a fancy way of saying they believed that people do not respond to price changes (Williams 2011).

In addition it was enacted in haste and unlike most tax legislation which is the subject of extensive comment and review, accountants, attorneys and the public had little input into the 1990 act, which was drafted and presented almost exclusively behind closed doors. Aside from the fact that the tax probably unjustly placed its burden on only five industries, many argued that it was an administrative and compliance nightmare that actually used more resources than it could provide. In 1993 under the Revenue Reconciliation Act Congress eliminated the luxury tax on everything but cars (Elda 1991).

Recently President Barack Obama called for a luxury tax on corporate jets as a means to generate revenue to fight federal deficits. Critiques are very skeptical about this announcement, and urge to review the events that followed the inaction of Omnibus Budget Reconciliation Act of 1990. In addition, although the last luxury tax was repealed by Congress in 2002 and was not renewed by Congress after it expired due to its unpopularity with consumers and car manufacturers alike, the state government of Connecticut is already considering implementing a new luxury fee on high-end vehicles. History has shown that these fees add up to hurt small businesses and ultimately reduce the very tax revenue they are meant to build (Smail 2011).

Today the Connecticut general assembly has drafted a bill that would establish a three percent luxury tax on the value of car and truck purchases over USD50, 000. Dealers in that state already contributed almost USD400 million in sales tax revenue in 2009. If the Luxury

Tax is passed, they anticipate sales will go down, reducing that number significantly. In addition, they say their business will take a hit and they will be forced to lay off workers. Other states are watching what happens in Connecticut (ibid).

The Application of Luxury Tax in UK

The imposition of taxes on articles which are deemed to be luxuries in UK sprang from one of two motives, or, sometimes from a combination of both. Firstly, the tax was intended to restrict the expenditure of money in certain directions. Here it formed a part of sumptuary legislation designed to repress the ostentation and extravagance of private persons. In England from the 14th to the 16th centuries there is a long history of sumptuary legislation, never properly enforced, directed chiefly against the wearing of rich clothes of foreign materials, the purchase of which tended to create an adverse balance of trade and thus ran counter to one of the cardinal principles of mercantilist policy (Encyclopedia Britannica 1992). However, most English laws of this nature were repealed in 1603. Economic writers in the 17th century considered that the consumption of luxuries was good for trade, and the growth of the finer types of manufacture of silk and woolen goods inside England removed the opinion that such products could only be procured from abroad. In the 18th century laws were passed against the wearing of French lawns and laces, partly to protect English manufactures and partly as a weapon of offence against the French (ibid).

Secondly, luxury taxes were imposed for revenue purposes as a method of taxation of the rich. As such luxury tax has its origins in the Civil War being levied specifically to pay for the expenses of the war. It covered many different items, but its scope was reduced ten years later to cover just chocolate, coffee, tea, beer, cider and spirits (Platt 2007). Initially to pay for the army commanded by Oliver Cromwell, the Parliament in 1643 imposed excise

taxes on essential commodities (wheat, meat, etc.). The taxes imposed by the Parliament extracted a lot of funds especially from the poor. The excise taxes were so regressive increasing the taxes on poor so much that the Smithfield riots began in 1647. The latter started as the new taxes lowered the rural laborers ability to buy wheat. Despite the riots, after 1688 it was progressively widened to include other essentials such as salt, leather, beer, candles and soap (Platt 2007).

Decades later in the 18th Century England was no exception to the need to raise revenue. Mercantilism was the English policy and a military presence was required to support the English role in overseas colonies and possessions even more than before. Expansion of world interests requires two things: a strong military and funds to support military activities.

Considering tea a tropical luxury, the English government saw revenue-raising opportunities in tea to fund a military buildup that supported expansion of the British Empire. By the 18th Century, tea was a hugely popular drink in Britain and the Government had to legitimize the tax and did so by treating tea initially as a "luxury" that could support high duties in the eyes of the public. Later, however, tea was correctly classified as a "necessity" that would only support lower levels of taxation (Stout 2007). In addition duties on "luxury" items, such as wine, silks, gold and silver thread, silver plate, horses, coaches and hats were aimed at wealthier consumers. Parliament raised or lowered duties, as well as adding new items or dropping others, depending on the needs of the time. In practice, however, consumers were largely unaware of these impositions as it was the traders who actually paid (UK Parliament 2012).

In the late 18th and early part of the 19th centuries duties were levied in England on a number of articles. Hair-powder, silver plate, clocks, watches, horses, carriages, men-servants, dogs, armorial-bearings, playing cards -- all these have, for longer or shorter periods, contributed their quota to the revenue and, in the case of the last five objects

mentioned. It is obvious from the above list that this form of taxation, as a source of revenue, suffers from the defect of being very unproductive. The rate of taxation was generally low, because otherwise the great elasticity of demand, which is a characteristic of most real luxuries, would result in the tax stifling consumption altogether. Relatively to its yield it is also costly to collect and irritating to the taxpayer (Encyclopedia Britannica 1992).

During WWI in order to raise revenue increases in excise duties were targeted on those British staples of alcohol, tobacco and tea and supplemented most notably by the so-called “McKenna Duties”, introduced in 1915 by Reginald McKenna (Chancellor of the Exchequer), which included a one-third ad valorem duty on luxuries such as motor cars and musical instruments. He introduced a 33 $\frac{1}{3}$ % levy on luxury imports in order to fund the war effort. This excluded commercial vehicles, which were needed for the war. The tax, known as the "McKenna Duties", was intended to be temporary but lasted for 41 years until it was finally axed in 1956. It was briefly waived between August 1924 and June 1925, and then extended on 1 May 1926 to cover commercial vehicles (Broadberry & Howlett 2003).

In 1918 the Select Committee appointed by the House of Commons to consider the luxury tax issued a report giving details of the proposals. A long schedule covered a vast number of commodities, many of which were proposed to be subjected to tax, irrespective of value. For example, precious stones, metals, silks, furs, perfume, works of art, and things needed for sport and amusement. A second schedule covers meals und board and lodging. Another list of taxes included men's boot, women's shoes, women's costumes, tobacco, horses, and furniture suites. The committee recommended exemptions in favor of articles purchased by museums, libraries, and art galleries. When the luxury tax was first proposed it was contended that the duty should be levied on the amount by which the price of any article exceeds the luxury limit, and not on the whole cost, as was originally proposed (British Luxury Tax 1918).

Decades later the UK introduced VAT in 1979 to replace luxury tax levied at different rates depending on the item's perceived “luxury”. The starting rate was 12.5 per cent (charged on “luxury” items) and a reduced rate of 8 per cent was charged on many other goods and services including essentials purchased in a pharmacy or grocery store. During the early 90s, the tax was increased to 17.5 per cent by conservative government to pay for a reduction in the community charge (poll tax) and later on it began to be charged on domestic heating and fuels, a further 8 per cent on already expensive items (Adam & Browne 2011). This was unpopular, but the Chancellor found it necessary because other benefits had been offered to taxpayers in the form of direct taxation cuts. Perhaps the most significant was the extension of VAT to cover domestic fuel and power from April 1994, then at a reduced rate of 8%. The original intention was to increase this to the full rate (then 17.5%) a year later, but this second stage of reform was abandoned in the face of fierce political opposition, and in fact the reduced rate was cut from 8% to 5% in 1997, fulfilling a pre-election promise by the Labor Party. Then again there was an increase from 17.5% to 20% in January 2011 as part of the coalition government’s deficit reduction package (ibid).

“Recently the British government has raised taxes on prestigious real estate”, announced the head of the Treasury, George Osborne presenting to the parliament the draft state budget for the next fiscal year. When buying a house with a price higher than 2 million pounds now the buyer will need to pay the treasury not 5% but 7% of its value. These measures are all intended to cover the costs to tax cuts for the middle class and poor. The minister said that this budget will be the first since the global economic crisis, which includes a reduction in taxes (UK Raises Luxury Home Tax 2012).

In considering the proper position of luxury taxes in the general tax system of a country like Great Britain, it may be pointed out that an income tax can only make very partial allowances for variations in necessary expenditure, and there is therefore a strong case for

supplementing the progressive rates of direct taxation with rather high taxes on the kind of luxuries which can only be bought by those whose incomes are much in excess of all normal and necessary requirements (Encyclopedia Britannica 1992).

The Application of Luxury Tax in France

Advocates of “luxury taxes” were unknown before the war in France. In 1895 in France Louis Courtray published “Les impôts sur le luxe” a slender volume on the subject, in which he favored the extended imposition of taxes upon luxury. According to him “the devouring needs of war finance, and the contrast between the hardships of life at the front and the unaccustomed luxury which war wages and war profits have made possible for many civilians, have combined to give the taxation of luxury an important place in the Budget of France” (Lennard 1918). Thus, income tax that was introduced in France during WWI, together with luxury tax became the most important source of revenue to fund the war.

The law on luxury tax adopted in France on December 31, 1917, introduced a tax of 10 percent on *depenses de luxe or luxury spending*. The latter included three classes of payments -- those for articles which are classed as luxuries in any case, those for articles which come within the class of luxuries only when their prices exceed certain specified figures, and those for food, drink, or lodging at an *établissement de luxe* (establishment of luxury) (Horn 2003). In regard to the second of these classes it should be noticed that the tax was charged upon the whole price of the article and not merely upon the excess of its price over the non-luxury limit. The French Luxury Tax came into force on April 1, 1918. It has been estimated that in a year the French luxury tax will produce a billion of francs (Lennard 1918).

According to the law, jewelry, motor-cars (for passengers), motor-boats, and antiques, billiard tables and their accessories, perfumes, hunting garnets, liveries, and liqueurs were classed as luxuries, whatever their price. Furs were only subject to the luxury tax if their price exceeded 100 francs, or 50 francs in the case of "pelletteries." Horses, ponies, donkeys, and mules for pleasure purposes were essential luxuries in France. According to the French scheme an upright piano or a harmonium was a luxury when its price exceeded 1,200 francs and other musical instruments (including phonographs, gramophones, etc.) were luxuries if more than 150 francs was paid for their purchase (ibid). Cigars, cigarettes, and tobacco were absent from the law on luxury tax, undoubtedly because of the Government monopoly over the latter's production. Books other than limited fine editions were not subject to tax in France (Horn 2003).

The tax had not even been in operation sufficiently long for its results to manifest, there began a storm of hostile criticism. There came to be a lot of opposition from the trades affected by it, as well as the general public didn't accept it quite favorably. The practice of luxury tax was particularly opposed to because of its application on articles which were not luxurious by themselves, but necessities. Nevertheless in Government's opinion, if the tax was confined on the articles deemed as absolute luxuries it would yield very little revenue (Luxury Tax in France 1918).

A number of Chambers of Commerce passed resolutions against the tax, or urged its modification, since according to them the luxury tax hit industries which were of great importance to the industrial prosperity of France. A very serious opposition came to the Chamber from the Socialist party in France. The latter argued that people should be taxed on what they receive, and not based on what they spend (ibid).

In addition, before the end of May attempts to evade the tax had already attracted the attention of the Government; the yield of the new taxation being disappointing. In June the

revenue obtained by the tax on payments (which appeared to include the 10 percent tax on luxuries) was 11,876,500 francs as compared with an estimate of 25 million francs for that month. In July the yield was 10,306,500 francs as compared with an estimate of over 32 million francs (Lennard 1918).

However, the Government had no intention to abolish the law. There were three grounds on which the taxation of luxury was defended. Firstly, it was argued to be a means to the discouragement of luxury, and that either because certain luxuries are held to be harmful in themselves or because "luxurious enjoyments absorb productive resources which might be more usefully employed in satisfying the more urgent wants of persons other than those deterred from luxurious gratification by the tax" (ibid). Secondly, luxury tax was practiced as an instrument for securing revenue from those whose expenditure upon commodities for which their need is small indicates that they have money to spend. From this point of view a tax upon luxury may be regarded as a supplement to the income tax, intended automatically to level up its inequalities. Thirdly, luxury tax performed an inverted protectionist function, for it was not payable on any article sold for exportation but mainly for imported goods (Luxury Tax in France 1918).

On March 31 1919, the Senate in France indorsed the Government's demand for the retention of the luxury tax by eliminating from the budget bill an article inserted by the Chamber of deputies abolishing it. There were violent protests in the chamber between the deputies on the one hand advocating the suppression of luxury tax arguing as it was not wanted by merchants and workmen, and the Government, on the other hand, favoring it for additional revenues aimed at funding the war (Luxury Tax for France 1919).

In 1923, however, the tax on luxuries in France was revised. The amount of tax remained unaltered at 10 percent, but the list of articles liable to the payment of the luxury tax was altered. There were two tables, one giving a list of articles which themselves were

considered to be luxuries, the other giving a list of articles which were luxuries if they exceeded certain set prices. If people had antiquities they had to pay 10 percent of their cost to the Government when purchasing them (French Luxury Tax 1923). A billiard table was a luxury, and so were modern and ancient tapestries of wool or silk, carpets of silk, Eastern carpets, and bed hangings. Certain articles of clothing were luxuries; particularly liveries and uniforms of domestic service in private establishments. Upright pianos were not luxuries, but all other pianos, gramophones, phonographs, organs, and their accessories were. Jewelry and goldsmith ware, as well as works of art, were deemed luxuries. But there is a curious exemption; paintings, water colors, and sculpture, appeared to be exempt from tax, if they were sold direct by the author otherwise than by commercial means. A bath, if it was of anything other than common metal, paid 10 percent, tax, and so did harness for saddle horses, new motor cars, mechanically propelled canoes, pleasure boats, and yachts. Chocolate and chocolate confectioneries were a luxury if they exceed 1/4 per lb. Indeed confectionery in any form exceeding that price was taxed accordingly. Many articles of furniture, lighting apparatus, clothing, watches, clocks, articles for games, china ware, and glassware, were all regarded as luxuries if they exceed certain prices (French Luxury Tax 1923).

Starting from April 10, 1954 France fell under the EU VAT system, after Maurice Lauré, Joint Director of the French Tax Authority, the Direction générale des impôts, first introduced VAT in France. In France the VAT is known as Taxe sur la valeur ajoutée (TVA) (Jarry & Bremer 2012). The EU Commission's first proposal for a harmonized structure and level of rates was made in 1970. However, the EU member states at that time still generally applied three or more rates; France, for example, had a reduced rate, an intermediate rate, a standard rate and a luxury rate. The Commission proposed that by 1975 there should be only two: a reduced rate and a standard rate between. (Directorate General for Research 1995) But luxury VAT was terminated only in 1994, by the Commission's decision. E.g. in 1987 France

still had luxury VAT rate at 33% together with standard VAT rates 18-27%. On July 17 1987, the French VAT rate on car sales went down from the luxury VAT rate of 33.33% to the standard VAT rate of 18.6% to meet the criteria put by the Commission (Carbonnier 2011). And by 1994, luxury VAT was abolished, standard VAT remaining at 18% rate. Nowadays, there are different kinds of VAT rates currently applicable in France but for general sales and supply of goods and services the standard rate is 19.6%, there is also a reduced rate of 5.5% and up to 33% for luxury goods. The articles that were previously deemed to be taxed as luxuries, like jewelry, jewels, furs, alcoholic beverages, antiques, cigars, cigarettes, tobacco, and works of art are now taxed by standard VAT rate of 19.6% (Jarry & Bremer 2012).

Nowadays, there is no so called luxury tax on vehicles in France and luxury taxes are rarely mentioned any longer, at least in connection with vehicles. It is now referred to as environmental tax (Linnakangas 2009). Accordingly French drivers who favor large, gas-guzzling cars pay up to EUR3,500 under a radical green road tax scheme unveiled by the Environment Ministry in 2004 as part of the environment bill aimed at cutting air, water and soil pollution over the next five years. The scheme rewards drivers who opt for smaller, cleaner vehicles with payouts of up to EUR700. Thus, drivers who opt for a large luxury saloon with a powerful engine emitting more than 180g of CO₂, or for an outsized, diesel-driven will face a surcharge ranging from EUR1, 500 to EUR3, 500. According to the ministry, the income from the 350,000 big-engine cars sold annually will be used directly to pay the rebates on more environment-friendly models (Jarry & Bremer 2012).

Referring to the taxation of luxurious assets, there exists wealth tax in France known as ISF (Impot de Solidarité sur la Fortune). Residents are liable to wealth tax on their net worldwide assets, including all properties, subject to the provisions of tax treaties (Linnakangas 2009).

- Taxable assets include: real estate, cars, other vehicles, debts due to the taxpayer, furniture (except antiques), horses, jewelry, shares, bonds and the redemption value of any life assurance
- Exempt assets include: those necessary to a business conducted by its owner or their spouse; pictures, tapestries, statues, sculptures, lithographs, antiques over 100 years old; funds in a pension fund constituted in respect of an employment or business (subject to certain conditions)

The French Parliament adopted a major reform of wealth taxation on 6 July 2011 (Finance Act for 2011). This reform constitutes an important change of taxation of private assets. The wealth tax threshold has been increased from EUR800, 000 to EUR1, 300,000 Euros. The actual progressive rates from 0.55% to 1.8% have been decreased to a new rate of 0.25% (Cohen 2011).

As of 2012, if the household of total net wealth is below EUR1.3 million, no wealth tax is due and no return is required.

- Where wealth is between EUR1.3 and EUR3 million, the total net wealth (including the first EUR1.3 million) is taxable at a flat rate of 0.25 percent.
- Where wealth exceeds EUR3 million, the total net wealth (including the first EUR3 million) is taxed at a flat rate of 0.5 percent. (ibid)

Recently a group of 19 left-wing deputies from all around France have drafted a bill aiming at the imposition of a 33.3% sales tax on what is called “luxury cars”. For the purpose of the bill, a luxury car is defined as any new car that has a power output of 180 horsepower or more. A car’s retail price and its size are not taken into account. The bill is an attempt to put much-needed money back in the state’s coffers, though the deputies did not say how much the country would earn if the bill is passed. “In the current economic situation that France is in, it seems necessary to raise taxes on luxury cars in order to help reduce the

country's budget deficit," explained the deputies in a statement. "The main appeal of luxury cars is their power, so it is fitting to tax buyers based on that" (Glon 2012).

Members of the auto industry have loudly spoken out against the bill. Most argue that the deputies' definition of a luxury car is skewed, and that 180 horsepower is too low. According to the bill's guidelines, a Volkswagen Polo GTI falls in the "luxury car" category. Critics also argue that similar measures taken in the 1960s and 1970s ended up killing French luxury cars, and that the effects of those decisions are still felt today by automakers. A decision on the matter will be taken in the summer of 2012 (ibid).

In addition, newly-elect French president François Hollande during his electoral campaign had mentioned that the idea of a higher value-added tax rate on luxury goods made sense, though it is not in his manifesto. That could help balance his plan to cancel an upcoming rise in the main VAT rate to 21.2 percent from 19.6 percent from October, a measure Sarkozy has enacted to enable cuts in social charges for companies (Henley 2004).

The Application of Luxury Tax in Russia

The possibility of taxing people who can afford luxuries more heavily has been under consideration in Russia for the last few years. The feasibility of implementing a luxury tax has been a subject of political and economic discussion, as a measure aimed at addressing the wide income inequalities seen in the country. In 2007 a draft law (Draft Law No. 442151-4 "Regarding Amendments to Parts One and Two of the Tax Code of the Russian Federation" (in terms of establishment of the Luxury Tax)) regarding taxation of luxury property was put forward. However, in 2010 it was rejected by the State Duma in the first reading (Russian Tax Brief 2012). A proposed amendment to the country's tax code, introduced by the

opposition “A Fair Russia party”, stipulated that taxes would be increased on the purchase of real estate worth over RUB15 million (USD500,000), cars costing more than RUB2 million (USD67,000), as well as planes, helicopters and yachts. A State Duma committee recommended rejecting the bill as property tax was already imposed during the purchase of such items under the current Russian legislation. Consequently, the bill would have resulted in double taxation and encourage tax evasion (Tchesnokova 2010).

In 2011 discussions as to the need for such a tax were revived. As a result in February 2012 a new draft law (Draft Law No. 28997-6 "Regarding Amendments to Budget Code of the Russian Federation, amendments to Article 13 of the Tax Code of the Russian Federation and amendments to Part Two of the Tax Code of the Russian Federation") was submitted to the State Duma for consideration (Russian Tax Brief 2012).

The debates over the introduction of luxury tax in Russia started with the then Prime Minister, now president-elect Vladimir Putin’s proposal to raise taxes for people who own luxury apartments, valuable land, planes, yachts and luxury cars from 2013. Vladimir Putin for the first time initiated the introduction of a luxury tax during his annual televised Q&A session in the middle of December. (ITAR-TASS 2012) Whether or not “luxury tax” should be introduced was one of the most hotly debated topics in Russian society during the presidential preelectoral campaigns and even afterwards (Korotun 2012).

Many proponents of such taxes claim that a levy on assets purchased or held by the richest people in the country would address the fact that Russia has a 13 percent flat tax rate on personal incomes, and does not have a progressive tax system for individuals. (Russia Delays Luxury Tax 2012) In this respect, the most important aspect of introducing such tax is social justice rather than an increase in the budget revenue; an introduction of a tax for those leading a life of luxury would constitute a step towards achieving social justice (ibid).

However, the Russian Finance Ministry headed by Alexei Kudrin has always been skeptical about the idea as it is unclear what property should be considered luxurious. The Ministry also states that the collection of the tax would be too expensive and require many amendments to Russian legislation as there is no definition for “luxury” in the Russian legislation and naturally there may many different views as to what should be considered a luxury (ibid). However, there is a broad consensus that a mansion or a private aircraft is a luxury.

According to critics the initiation of a luxury tax by the Russian Government comes as a part of a “tax maneuver”; it basically aims at making Russia more investor attractive by increasing taxes on consumption and lower fees for labor and capital (Cars, boats and homes to get Russian luxury tax 2012). Some experts calculated that no more than RUB200-300 billion / USD6, 390-9, 590 a year would be collected from those rich taking into account the fact that their real luxury is registered abroad. So the tax service will have to spend significant amount of its budget funds to collect these billions. Thus, a fiscal profit will be insignificant (ITAR-TASS 2012).

“These taxes can be easily evaded,” said Arkady Bryzgalin, director-general of the group of companies Taxes and Financial Law. “You can re-register a house to a legal entity that is taxed by a simplified system and that’s all you need. Another variant is to register a house in a state of constant construction. When the construction is underway and a house is not commissioned – no tax can be exempted.” Civil servants evidently play safe not to put ordinary people, who inherited a flat on Arbat in central Moscow from a grandmother, on the list of “luxurious citizens” accidentally. (ibid)

In addition, the presidential candidates nominated by the “A Fair Russia” party and the Communist Party Sergei Mironov and Gennady Zyuganov respectively, included this

initiative in their manifestos. Another candidate, billionaire Mikhail Prokhorov, also supported the introduction of this tax (Korotun 2012).

However, it was a group of lawmakers from the party “A Fair Russia” that introduced a relevant bill in the State Duma (Bill No. 28997-6), which proposed introducing such a tax starting from 2013. According to the preamble to the bill, the authors see it as a tool for redistributing wealth urgently needed because of the high level of social inequality and poverty in Russia. Meanwhile, the Russian government was drafting an alternative luxury tax bill, which took a different stand on the issue than the proposed bill of “A Fair Russia”. The latter made it unlikely that the bill would successfully make it through the Duma to become law (A Fair Tax in Fair Russia 2012).

The draft by “A Fair Russia” was introduced to the State Duma on June 13. While explaining necessity of introducing such a document Sergey Mironov remarked that present situation was unfair since 13 percent income tax rate is to be paid both by poor people and by oligarchs. “Nevertheless, since our idea about introducing of progressive scale of income tax is being refused categorically by the government we came from another side and now are initiating the introduction of luxury tax as we want to recover social justice that is an absolute norm for majority of the countries”, Chairman of Fair Russia emphasizes. “I would like to state under all the responsibility that the law will not have retroactive affect which means that all the real estate, cars and so on, all articles of luxury that were acquired at moment of bill coming into effect, if so, are not a basis for such taxing”, specified the leader of party (“A Fair Russia” will seek after luxury tax introduction 2007).

According to the draft law on luxury tax introduced to the Parliament by “A Fair Russia” the affected taxpayers would be organizations, sole proprietors and individuals that own luxury items. Items subject to luxury tax would include immovable property with a value above RUB30million/ USD960.000 and vehicles with a value above RUB3million/

USD96.000, namely; residential buildings, or parts of a residential building; apartments, or parts of an apartment; summer houses and other residential properties; residential properties still under construction, together with the land plots, after a three-year construction period ends; automobiles; marine and river vessels, and aircraft: airplanes, helicopters, ships, yachts, sailboats, and cutters (A Fair Tax in Fair Russia 2012).

The tax base would be the market value of such assets. The following annual tax rates are proposed:

For immovable property:

- With a value between RUB30m–50m – 0,3%
- With a value between RUB50m–100m – 0,6%
- With a value between RUB100m–150m – 1%
- With a value above RUB150m – 5%

For vehicles:

- With a value between RUB3m–5m – 1%
- With a value between RUB5m–20m – 3%
- With a value between RUB20m–60m – 5%
- With a value above RUB60m – 7% (Korotun 2012).

If enacted the bill will bring to the following consequences:

- The tax would cover only so-called “expensive” assets and properties. So, for example, if an individual owns three apartments, each worth RUB10 million, these properties would not come under the luxury tax.
- Real estate located abroad, as well as modes of transport acquired and registered abroad, owned by Russian citizens would not be subject to the tax (A Fair Tax in Fair Russia 2012).

However, the Russian government failed to support introduction of luxury tax. As comment it was noted in the Conclusion that such tax contradicts with the Constitution as it can lead to double taxation of citizens' property (There Will Be No Luxury tax in Russia 2012). Also the government rebuked the formulation concerning cost of luxury goods. In the bill it is specified that the real estate in cost belongs to luxury from RUB30 million, but is thus unclear, whether it is possible to carry to it the real estate costing exactly RUB30 million. In the bill it is specified that only those vehicles which are bought in Russia can be carried to luxury. The government specifies that it contradicts the existing Tax code, "fixing inadmissibility of establishment of the differentiated rates of taxes depending on a place of an origin of the capital". Nevertheless, the Fair Russia lawmakers forged the draft to the State Duma, the negative conclusion of government notwithstanding. However, the reading in the State Duma on the draft has not taken place yet (There Will Be No Luxury tax in Russia 2012).

On the other hand the government considers as a solution not introduction of a separate tax on luxury, but changes of the Tax code in articles concerning real estate and vehicles. "The Russian Government refused to introduce a separate tax on luxury", said Sergei Shatalov, deputy head of the Finance Ministry. The new suggestions from the Finance Ministry regarding the taxes on real estate and excessive consumption appeared in the draft of the basic directions of fiscal policies in 2013-2015. According to Shatalov, wealthy individuals will pay additional funds in the budget through the increased tax rate on the vehicles whose performance exceeds 410 h/p (No luxury tax planned for Russian moneybags 2012). He has even named the brands which will fall under the new rule: Maybach, Bentley, Lamborghini, Ferrari, Maserati, Porsche, Aston Martin, Rolls-Royce, Chevrolet Corvette and 6-liter Mercedes and 7-Series BMW. This is about 20,000 cars, mainly in Moscow and Moscow region. The engine capacity has been picked to 'almost completely eliminate the

increased taxation of cars manufactured in Russia'. The tax will be introduced in 2013 (Korotun 2012).

The law will also introduce higher tax on expensive property: real estate worth up to RUB100 million (USD3 million) will be taxed at the rate of 0.05%, between RUB100 and 300 million (USD10 million) - 0.1%, and over RUB300 million- 0.3%. For expensive real estate, the taxation system is expected to be progressive from 2014 (No luxury tax planned for Russian moneybags 2012).

Summary and Analysis of International Experience

In order to have a broader picture of the application of luxury tax in the above mentioned countries and rationale behind its practice, it is worth summing up the major points. The US and the UK have a number of similarities in this sense and the mercantilist policy can be the best explanation for the practice of luxury tax, at least in the initial stage. Let alone the fact that luxury excises were initiated in both countries in wartimes to fund military actions; later they were again applied to raise additional revenue either to fill the deficit and acquire balanced budget, or rehabilitate the state economy after the 2008 crisis.

The experience of France can be viewed from a different perspective, at least for the last decades. Initially luxury excises were applied for revenue purposes to fund the war expenses, however, later, with the consolidation of social democratic values in the country the latter was primarily practiced for the major purpose of administering social justice and leveling up inequalities within the population.

The case of Russia which in Brender and Drazen's terms can be referred to as a "new democracy", the initiation of luxury tax (which still exists in the form of a draft bill) has become a tool in the politician's hands for tax manipulations. If we follow the timing of the

bill being highlighted, 2007 and 2011-coinciding with the end of president's term and upcoming presidential elections, a conclusion can be drawn for the latter to be more of a populist means for the incumbents.

Thus, the initiation and application of the luxury tax, as the experience of the mentioned countries illustrates, differs depending on the country's peculiarities and political regime, particularly.

Methodology

Methodology included analysis of primary and secondary data, in-depth interviews with government officials and independent experts. In the framework of primary data analysis corresponding laws of the Republic of Armenia were reviewed and analyzed. For the Purpose of answering the research questions and acquiring a deeper overview of the recent changes in Law on Excise tax, in-depth interviews with the representatives of relevant state agencies, institutions and experts were collected (see the list of interviewees in Appendix A). In order to have multi-sided perspectives over the issue, the selection of the interviewees was based on purposive sampling method. A questionnaire was formulated composed of 7 open-ended questions (see the questionnaire in Appendix B). Each interview lasted from 25-30 minutes. The responses were later translated and inputted for the purpose of analysis. In addition to primary data, analysis of secondary data was undertaken, namely books, scholarly articles, statistics and newspapers were reviewed.

Findings

The Taxation of Vehicles in RA

In the RA the following indirect taxes are applied: Value added tax and Excise taxes. There is no separate “luxury tax” in the Tax Legislation of RA; however, the recent changes in “Law on Excise taxes” which increased the tax rates on luxurious cars are often informally referred to as “luxury tax”. In Armenia vehicles had always been taxed under the Law on Property Tax (2002). This law defines the tax rates for immovable (land and real estate) and movable (vehicles and boats) property. It is worth mentioning that property tax is a direct tax fully assigned to local government budget since 2002, while excise tax is an indirect tax paid to the state budget. According to article 7 of the mentioned law, the following tax rates had been applied for vehicles so far;

1. Property tax for motor vehicles was calculated at the following annual rates:

1) motor cars with up to 10 passenger seats, if tax base was:

- from 1 to 120 horsepower - 200 drams per horsepower;

- from 121 to 250 horsepower - 300 drams per horsepower and additional 1,000 drams for each horsepower above 150 horsepower;

- 251 horsepower and more - 500 drams per horsepower and additional 1,000 drams for each horsepower above 150 horsepower.

2) motor cars and trucks with 10 and more passenger seats, if tax base was:

- From 1 to 200 horsepower - 100 drams per horsepower;

- 201 and more horsepower - 200 drams per horsepower.

4. The property tax on motor vehicles used up to three years is calculated at 100%. The amount of property tax on motor vehicles used for more than three years is reduced for each year following the third year by 10% but no more than 50% of tax amount. The time in use is calculated from the date when that motor vehicle was produced (National Assembly of the Republic of Armenia 2002).

This taxation schedule clearly shows that the tax is progressive, particularly if we compare it with the previous Law on Property Tax adopted in 1997 where additional 1,000 drams for each horsepower above 150 horsepower was not applied, added later during 2002 amendments in Law on Property Tax (National Assembly of the Republic of Armenia 1997). In fact, the law of 2002 already contains elements of heavier taxation on items of luxury. Passenger cars with horsepower above 250 apparently are of a higher value and can be considered items of luxury. For example an owner of a BMW 7 series car 760Li (year of production 2009) with engine power 537 horsepower, which is classified as a super luxury car by U.S. News Rankings and Reviews will be paying property tax equal to $537 \times 500 = 268,500$ plus $(537 - 150) \times 1000 = 387,000$, total AMD655,500 annually, equivalent to USD 1,672. Compared with a relatively cheaper car like KIA cee'd 1.6 CRDi with 90 horsepower engine (year of production 2009), which falls into a category of small family car, the owner would annually pay $90 \times 200 = \text{AMD}18,000$ equivalent to USD46, the progressivity of property tax on vehicles used before 2012 becomes more evident.

“Luxury Tax” in RA and the Recent Amendment in the Law on Excise Tax

Within the framework of legislative consideration of the 2012 fiscal year State budget, the NA of RA on December 6, 2011 promulgated the bill on “Amendments and Additions in the Law on Excise Tax”, which is now informally referred to as “Luxury tax”. It was the Government’s intent to introduce the so-called “Luxury tax” which at this stage is supposed to be levied only on luxurious cars. So far there was no intention to levy luxury taxes on other items, although many insist on its necessity (Torposhyan 2011).

In his speech on budget for the new fiscal year in NA, the Premier Tigran Sargsyan suggested to turn to the 3% deficit, “which means we should spend as much as we can

collect.” Consequently, it became urgent to collect more revenue within the country. The premier stated that it was necessary to increase taxes where there was a possibility of collecting more revenue. For this purpose the idea of introducing luxury tax emerged, although it was never mentioned who stood behind the idea. According to the Government’s decision the taxes were to be increased on cars with market value exceeding the amount of AMD25 million (Araratyan 2011).

The bill was prepared by the Ministry of Finance of RA. In the substantiation part of the draft it was mentioned that the amendment aimed at broadening the tax base for excise tax in RA and provide the state budget with additional revenues. As remark it was stated that “luxurious items (particularly luxurious vehicles) had never been taxed under the Law on excise tax in RA, the latter being one of the basic functions of excise tax” (National Assembly of the Republic of Armenia 2011).

As the bill was adopted by the NA, it was set in the 5th article of the amendment on “Law on Excise Taxes”, that the owners of cars with the market value of 25 million AMD (USD62, 000) and more, or production year of 2 years, 4500 cm³ and larger engine volume should pay 20% of the total assessed value of the cars. The law came into force on January 1 2012, and apparently the cars bought before this date are not subject to taxation under this law (National Assembly of the Republic of Armenia 2000).

The Government of RA came up with the idea to introduce the tax, as it became clear there would be problems with raising the revenue for the budget of the new fiscal year. Thus, the introduction of luxury tax in RA is mostly justified for its fiscal purposes with AMD1 billion revenue provision (Torposhyan 2011).

However, the Government also stressed another cause for the application of this tax. Accordingly it is set to solve more issues than just the expected fiscal effect. Luxury tax is an instrument in the Government’s hands attempting to ameliorate the extreme income

polarization within the society; the latter being a very sensitive issue in Armenia, especially in regions. According to Social Snapshot and poverty in Armenia, 2011, Poverty Incidence by Regions and in Yerevan, 2010 is as follows:

Table 2. Poverty Incidence by Regions and in Yerevan, 2010

Region	Tavush	Syunik	Yerevan	Aragatsotn	Armavir	Vayots Dzor	Ararat	Gegharkunik	Lori	Kotaik	Shirak
Poverty incidence by %	26.1	26.8	27.1	28.9	33.0	37.1	42.4	43.6	45.9	46.8	48.3

Source: <http://www.armstat.am/en/?nid=82&id=1301>

During the period of 2008-2009, income inequality slightly increased. Inequality indicators measured by the Gini coefficient indicate that polarization of population in Armenia is deeper in terms of income distribution than that in terms of consumption distribution. Consumption inequality measured by the Gini coefficient increased from 0.242 in 2008 to 0.265 in 2010. Income inequality, in turn, increased from 0.339 in 2008 to 0.362 in 2010 (Social Snapshot and poverty in Armenia, 2011).

The main cause for poverty, as one can see from the table above is certainly the unequal distribution of wealth and resources. The level of income in many families is lower than the required minimum consumption basket, meanwhile most of the wealth being in the hands of the wealthier section of the society (Torposhyan 2011).

In addition the Government set another goal in the agenda, to decrease the level of poverty with the help of luxury tax; poverty becoming a deeper problem after the Global economic crisis in 2008. It follows that the rich should be more severely taxed and provide the state budget with higher revenues, which was an idea expressed by the head of the committee on economic issues in NA, Vardan Ayvazyan (Vardan Ayvazyan, The Rich Should be More Heavily taxed 2011). According to him this is a way to guarantee social justice. Nevertheless, according to another official, namely MP Armen Mkhitarian, it would have been better to incorporate luxury tax in property tax by raising the rate (Torposhyan 2011). Particularly if we take into consideration that such an attempt was already made when

the tax rates on passenger cars were increased in 2002 Law on Property tax, as it was discussed at the beginning of the chapter, by making the tax rates more progressive.

Another remark worth mentioning is the Government's omission to state at which sector of economy or for what particular social needs the additional revenues collected from the excise tax on cars will be earmarked. This is an important point considering the fact that we have such practice of earmarking budget revenues, e.g. 10% of revenues generated each year from the excise tax on petrol and diesel fuel is earmarked on the reconstruction of roads and highways in the country.¹

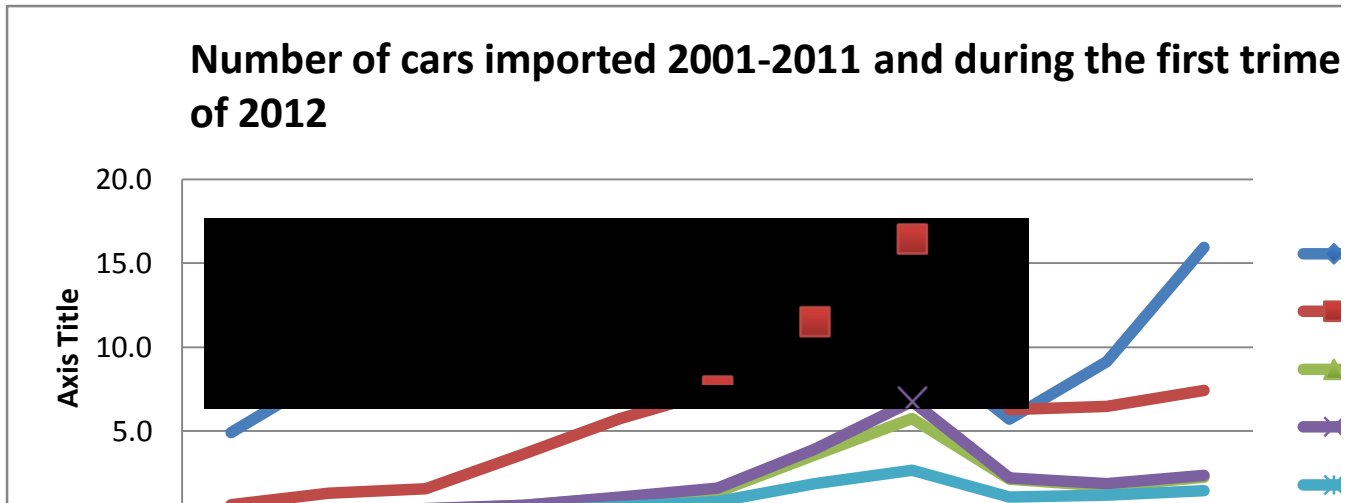
According to the statistics published by the Armenian Customs Service before the global economic crisis (2007-2008), 1800-2600 cars were imported to Armenia annually with market value exceeding USD30, 000 (equivalent to AMD12 million). After the crisis 2009-2010, the amount of imported cars with the same value decreased to 1000-1100, while in 2011, 1400 cars were imported. During the first quarter of 2012, 560 cars with market value exceeding USD30, 000 were imported, only 6 of them taxed by 20%, i.e. exceeding AMD25 million.

Table 3. Number of cars imported 2001-2011 and during the first trimester of 2012.

Year Market Value (USD)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
up to 5000	4,894	8,374	13,851	10,302	11,511	15,029	13,830	10,314	5,680	9,125	15,953	3,787
5-10.000	682	1,285	1,545	3,601	5,742	7,407	11,512	16,428	6,255	6,464	7,430	1,591
10-15.000	96	187	313	566	1,001	1,347	3,556	5,746	2,120	1,704	2,230	437
15-30.000	106	118	379	547	1,048	1,568	3,913	6,773	2,198	1,837	2,343	476
more than 30.000	39	31	113	216	499	806	1,861	2,665	1,043	1,167	1,432	567

Source: <http://customs.am/Content.aspx?itn=csCIForeignTradeByTransportTypes>

¹ See article 18, provision 3 and 4 of the Law of the Republic of Armenia on the Budgetary System of the Republic of Armenia.



As the chart shows, the number of imported cars was steadily increasing from 2001 until 2007-2008, when the world economic crisis started. In 2009 the consequences of the crisis became obvious, as a decline in the number of cars of all price brackets was denoted. The decline was particularly moderate for the cars with assessed value of USD30, 000 (equivalent to AMD12 million) and above, in all other price ranges the fall was rather sharp. Thus, it can be assumed that the crisis has hit the purchase made by the wealthy less as compared with others.

Nevertheless, according to statistics, less than 10% of imported cars during previous years cost AMD25 million or more. By summing up the number of overall imported cars throughout the recent 10 years, it was assumed that less than 1000 cars with the value of AMD25 million were imported to Armenia and most of them older than 2 years. Nevertheless, it was estimated that 100-150 cars will be taxed in total, which will provide the budget with additional USD2-3 million revenue or as mentioned by Premier Tigran Sargsyan approximately AMD1 billion (news.am 2011). It must be noted that the luxury car will be taxed upon importation; the tax will be levied only once and not on an annual basis as property tax does.

The budget for the 2012 fiscal year committed the government to conduct an expansionary fiscal policy and spend a total of AMD1.04 trillion (USD2.74 billion), an increase of about 5 percent from 2011 year's budget. Its revenues are projected to reach AMD911.6 billion, and the deficit consequently will be AMD132.5billion. (2012 State Budget of RA) The State Revenue Committee has to collect AMD101 billion in additional taxes, duties, and social security payments in 2012 to pay for the expenditures in the budget, AMD1 billion being collected from excise taxes on cars, comprising 0.109% of 2012 total budget expected revenues and 3% of customs duties of imported cars of 2011 (AMD29, 388 billion in total).

The revenues collected from excise taxes in the Republic of Armenia for the last decade according to statistics provided by Tax Service of Armenia have comprised 10-15 percent of total tax receipts for the state budget (Tax Service of Armenia 2011). Last year the total receipts from excise taxes derived AMD23, 152 billion, and if we make a simple calculation it generates that the expected revenue from excise taxes on luxury vehicles for 2012 which is AMD 1 billion comprises 4.3% percent of the last years' total receipts. Let alone the fact that the Government projects a raise in revenues from excise taxes derived from other taxable articles, it becomes clear that the portion of tax receipts from luxurious cars may even be less.

Viktor Dallakyan's Draft Bill on "Luxury Tax"

In 2010 an attempt was made in National Assembly to adopt a "law on luxury". This law was aimed at taxing the sumptuous lifestyle of rich people. The initiator of the law, MP Viktor Dallakyan said the law would serve for the social purposes as it is intended to tax expensive items and re-direct these resources to social programs (Avagyan 2010).

The draft bill on “Luxury Tax” (ä-847-16.03.2010-îÐ-010/0) proposed by MP Viktor Dallakyan was sent for review to the Government of RA on March 16 2010. The bill was aimed at setting the tax rates for luxurious items and regulating its payment. In article 2 the authors (Yervand Dallakyan and Armenuhi Saghatelyan) listed the items that were subject to taxation (land parcels, apartments, mansions, vehicles, helicopters, planes, motor cycles, yachts, cash, bonds), article 3 identified the taxpayers, article 7 stated that people in ownership of a property with a total cost of USD500,000 were subject to tax. Article 8 summed up how the revenues raised from luxury tax should be spent, namely these resources should be directed on social programs. According to the authors the bill should have been enacted as of January 1 2011, and covered the luxurious items purchased after September 21 1991. According to the authors the bill was developed based on the deep analysis of Armenian reality and the international experience. And the primary goal was to achieve social justice in Armenia (Dallakyan V., & Y., Saghatelyan 2010).

On April 1 2010, the Government’s conclusion over the draft bill was presented in the session of the NA. A number of comments were made. 1. It was mentioned that the main goal of the luxury tax was to raise more revenue from the wealthier population, but in Armenia progressive taxation was already practiced which laid heavier taxes on those getting higher income or owning more property. So the Government found it more preferable to review the property and income tax rates instead of introducing a new tax in the tax legislation. 2. According to the Government’s assessment, the introduction of the luxury tax would result in double taxation, in some cases even in triple taxation of the object. 3. No criteria were named in the draft according to which land, property and other items were estimated as luxurious. 4. According to the Government’s conclusion the tax rates were rather high, which provoke tax evasion by all possible means. In addition, the tax base for immovable property and land parcels was so broad that an estimated 60% of the population would fall under the tax

schedule. 5. The works of art were also subject to taxation, which was unacceptable as it might have been a family heritage or a donation (Government of the Republic of Armenia 2010).

It was summed up by the argument that no CIS country applied luxury tax, the latter being primarily practiced in developed countries, namely Nordic countries, UK, Australia, and Germany. Thus, the Government of RA opposed the adoption of the bill on “Luxury tax” in the form presented by Mr. Dallakyan (ibid).

Notwithstanding the Government’s decision Mr. Dallakyan introduced the draft to the NA of RA. So far the bill was put on the NA agenda and no reading was held on the draft; the latter being continuously postponed. Last time it was postponed for 90 days during the spring session.

Results of Interviews

For the Purpose of answering the research questions and acquiring a deeper overview of the recent changes in Law on Excise tax, in-depth interviews were conducted with the representatives of relevant institutions and state agencies: Mr.Vaghtang Mirumyan, Ministry of Finance, head of State Revenue Policy and Administrative Methodology Department, Mr.Movses Airstakesyan, Member of the Armenian National Congress, member of the “Power of people” social-political initiative, economist, Mr. Armen Martirosyan, MP, Member of “Heritage” faction, member of Standing Committee on Economic Affairs, and Mr. Ashot Khurshudyan, International Center for Human Development, head of Training Unit, independent expert.

The first question asked was whether the government had carried out a sufficient policy analysis over the issue before introducing the changes in the law. Nevertheless, the opinions

expressed over the issue were rather controversial; the answers were either that the Government had carried out substantial policy analysis by taking into consideration the international experience and the general rates of excise tax in RA, or that there was even no satisfactory criterion upon which the decision to tax luxurious cars more severely was made. The latter being a manipulation from the Government's side to show off to the population how they dispense justice by more severely taxing the rich.

The next issue was contingent from the previous question, asking for the criteria upon which the value of AMD 25 million and more was set for automobiles to be taxed as luxuries. The responses to the question were not univocal either. According to the representative of MF, an analysis and estimation of the number of cars imported during previous years was done, upon which the value was set. The two respondents with the oppositional stand and the expert from ICHD stated that there was either no satisfactory criterion or that the threshold for cars to be taxed under law on excise tax starting from AMD 25 million was too high, as it might have been lower for a country like Armenia with low per capita income.

Referring to the Government's decision to primarily tax luxurious cars and exclude other articles of luxury, the opinions were rather interesting. The state official's stance over the issue was that the taxation of luxury items was projected to be introduced gradually, and the start was done from the cars as they are more vivid signs of the owner's wealth and to ensure the collection of revenue, without endangering the revenue collection which might have happened if other articles were also included in the law.

Interestingly enough the other three interviewees were univocal with the representative of MF on cars' being the most vivid sign of luxury, one of them, the deputy from "Heritage" faction, adding that "by including more items of luxury into the law the state officials would have made the taxation severe first of all for themselves", so they couldn't endanger their fortunes.

Regarding to the possibility of shifting the consumers' preferences by more severely taxing luxurious cars, the respondents were unanimous arguing that in the short-run it might impact the amount of imported cars, however in the long-run the "the enthusiasts for luxury cars will once again shift back to their preferences". In addition, it was stated, that those who have sufficient means to buy such expensive cars will afford paying additional 20% of the car's assessed value.

The next question referred to the possibility of including more articles in the law, and the possibility of introducing a separate "Luxury tax" in Tax Legislation of RA. None of the respondents made positive predictions on the possibility of introducing a separate tax. The representatives of the two oppositional parties stated that it is not probable since the latter will primarily hit the politician's fortune. The representative of MF mentioned quite an interesting point that "the society is more prone to accept an increase in rates of already existing taxes than an introduction of a completely new tax", adding that the tax rates are already progressive in RA and still will be worked on. The independent expert from ICHD mentioned that even, if it ever happens that a luxury tax is introduced, the rich will always find loopholes or any other possible means for tax evasion.

Referring to the Government's rejection of the "luxury tax" draft made by the former MP Viktor Dallakyan in 2010, the state official mentioned that the idea was rather good; nevertheless, it had many inconsistencies with the existing tax legislation. The representatives of "Armenian National Congress" and "Heritage" parties interviewed both stated that the timing of introducing the bill was not appropriate for the Government to show off as if "fighting for social justice by taxing the richer layer of the population". In addition, it was argued that if the Government collaborated with the authors the tax might have turned to be a good one and worked well. The expert from ICHD argued for the draft bill being inappropriate both in terms of its inconsistencies with the existing laws on taxes, and the lack

of study carried out by the authors. To his mind it was a populist strategy from the deputy's part.

Ultimately, the respondents were asked to make an estimation of the Government's intention to introduce the changes in law on Excise tax both from fiscal and political perspectives. The representative of MF contended on the Government's sole intention was to raise additional revenue for the budget for 2012 fiscal year. Meanwhile, the other respondents were more critical in their evaluation of the issue. They argued for the fiscal effect of the law being very low because of possible tax evasion and the taxation threshold for the cars being too high leading to few cars to be taxed. It was mentioned that it might have been more efficient if the price schedule for cars was lower, or if the Government made a decision to reduce the shadow economy and to collect the taxes more properly as a means of raising additional revenue for the budget. Consequently the Government had no intention to allocate the resources at the expense of the wealthier population.

From a political perspective it was univocally stated by the respondents (except for the state official) that it was a "well-minded and semi-imitating step", a sign of populism in pre-electoral period to enhance the authorities' reputation in the eyes' of the population.

Analysis

In the executive preparation phase of the state budget for the fiscal year 2012 the Government set a goal of collecting extra AMD101 billion from additional taxes, duties, and social security payments. In general, the revenue collected from the luxurious cars subject to excise tax will have insignificant fiscal effect, if we assume that for the last decade, the receipts from excise taxes had provided 10-15% of total annual tax receipts, while the expected revenue from vehicles is equal to 0.109% of total 2012 budget revenues, 4.3% of

total excise tax receipts from excise taxes for 2011 fiscal year, which according to the Government's forecast will go up for 2012 fiscal year and 3% of customs duties of imported cars of 2011.

In addition, taking into account the statistics provided by Armenian Customs Service, the number of cars above the set value of AMD25 million during the first quarter of 2012 was only 6 as compared with the 17 cars with the same value imported in the first quarter of 2011. The decline in the figures of imported cars may be explained by the fact that there is sufficient amount of luxury cars already inside Armenia, which were imported in previous years. Inasmuch as the importation of the luxury cars incurs extra 20%, it has become more profitable to purchase such a car in Armenia instead of importing it. As a consequence the demand for the luxurious cars already imported will rise (if it has not yet) along with the price.

Thus, it can hardly be assumed that the expectation of having 100-150 cars imported during the 2012 fiscal year is highly probable. Moreover, it was not clarified in the draft by the Ministry of Finance of RA what criteria were used to set the threshold for cars to be taxed under excise tax. Taking into consideration the international experience and the socio-economic situation in Armenia, the threshold might have been lower in Armenia, thus leading to the inclusion of more cars under the tax and providing more revenue from a broader tax base. Thus, the answer to the research question 1 is dubious; on the one hand either no sufficient analysis was made or the analysis was not deep enough, in both cases however, the Government's intention apparently not being revenue collection; the excise tax on luxurious cars comprising 0.109% of total state budget receipts will yield negligible fiscal effect.

So far there was no intent articulated by the Government to levy the so-called "luxury tax" on other items, although many experts and politicians insist on its necessity. In addition, the possibility of introducing a separate "luxury tax" is not probable since according to the

Government’s statement the taxes in Armenia are already progressive and in the nearest future the Government intends to make them even more progressive. In fact, the first step was already undertaken in 2011, when along with the changes in the law on excise tax the Government raised from 20 to 25 percent the rate of personal income tax for people earning AMD2 million (USD5, 260) or more monthly. If previously the income tax rates were as follows:

Table 4. Income tax rates in 1997

Amount of Monthly	Taxable Income Tax Amount
Up to 80,000 drams	10 percent of taxable income
Over 80,000 drams	8,000 drams plus 20 percent of the amount exceeding 80,000 drams

(National Assembly of the Republic of Armenia, 1997)

After the amendment the rates were revised:

Table 5. Income tax rates in 2012

Amount of Monthly	Taxable Income Tax Amount
Up to 80,000 drams	10 percent of taxable income
80,000-2 million drams	8,000 drams plus 20 percent of the amount exceeding 80,000 drams
Over 2 million drams	392,000 drams plus 25 percent of the amount exceeding 2 million drams

(National Assembly of the Republic of Armenia, 2011)

Let alone the fact that the wealthy have sufficient instruments to lobby appropriate bills in NA or vice versa to block others, which interfere with their interests, luxury tax being undesirable burden for the latter. In any case, the answer to research question 2 is negative, the tax base for excise tax will not be broadened and no “luxury tax” will be introduced, at least in the nearest future it is not included in the Government’s agenda.

Referring to former MP Viktor Dallakyan’s draft bill on “luxury tax” and research question 3, it can be stated that both the composition of the draft and the timing to introduce the bill were not appropriate. The draft had many inconsistencies with the existing tax legislation and the criteria for the inclusion of articles under the luxury tax were inconsistent. Although the authors’ intent was to primarily tax the rich and put them under a heavier tax

burden, the tax if adopted would have impacted the middle and low classes as well. The tax bases particularly for immovable property and land parcels were too broad, the reason of ownership of luxury items due to heritage was not taken into consideration, and some articles might have been taxed twice, in some instances even thrice.

In addition it might have been more successful or at least given bigger significance both in the NA and in the Government (considering that state official interviewed estimated the idea being rather good) if promulgated before the parliamentary elections, taking into consideration the evidence derived from the literature on “political budget cycle”. Accordingly, “the governments undertake changes that will favor majority of the population, late in their terms of office so that the citizens would more likely remember the good deeds of the government and return them to office” (Drazen 2007). Thus, it can be assumed that draft was not properly designed; had many inconsistencies with the existing tax laws and the timing was not appropriate either.

While responding to research question 4, the answer will be based on the analysis of the previous research questions and on the literature review, as there is no relevant data or responses for the latter. Thus, the Government’s extemporaneous decision to conduct expansionary fiscal policy and tax cars with the assessed value of 25 million AMD and more, or date of production 2 years, and engine volume 4500 cm³ and more with 20% excise tax right before the parliamentary elections fits the literature on “political budget cycle”. Particularly, the latter corresponds to the point articulated by Drazen (2007) and Mikesell (1978), “the governments will attempt to increase public expenditure, or will undertake changes that will favor majority of the population, late in their terms of office so that the citizens would more likely remember the good deeds of the government and return them to office”.

In addition, the insufficient level of policy analysis carried out, the possibility of raising revenue through other means, e.g. by making the property tax on cars more progressive or as mentioned by one of the interviewees “through the reduction of the shadow economy and proper collection of the existing taxes”. Moreover, generally the low fiscal effect of “luxury taxes” implemented in different countries, particularly when the tax incidence is rather small, we can assume that it is highly probable that the timing of recent changes in law on excise tax is directly connected with the parliamentary elections. It can be concluded that although some negligible fiscal effect is expected from the excise tax on luxurious cars, it is not the primary reason for its introduction, but the political appeal being the major intent.

As a concluding remark, it can be argued that, the Government of RA, or political parties and incumbents in many instances follow the same path as the Government of Russian Federation, both are manipulating with the electorate before the electoral cycle occurs either by initiating drafts on luxury tax or making partial amendments in law on taxes imitating a luxury tax

Conclusion and Recommendations

As the analysis carried out in the essay illustrates the practice of the luxury excises is justified for a number of purposes; to raise additional revenue, to administer ability-to-pay approach and dispense social justice, to make a political appeal, to carry out protectionist and sumptuary policies, etc. The rationale behind the application of this tax is largely conditioned by the political regime and policy the country pursues. The US and the UK have a number of similarities and the mercantilist policy can be the best explanation for the practice of luxury tax in the initial stage, decades later used to raise additional revenue either to acquire balanced budget or rehabilitate the state economy after the crisis. The experience of France

can be viewed from a different perspective, luxury tax predominantly practiced for the purpose of administering social justice and leveling up inequalities. The case of Russia is completely different, as luxury tax has become a tool in the incumbents' hands for tax manipulations, mostly exploited for populism before the elections.

In regard to Armenia, it can be assumed that the Armenian Government in many respects either imitates or unintentionally follows the path taken by the Russian Federal Government. At least, there can be drawn a parallel between the actions of the two; the disputes over the introduction of luxury tax started before the parliamentary and presidential elections, respectively in Armenia and Russia. However, after the elections the Government of RF didn't support the introduction of luxury tax in Russia making promises of increasing the tax rates both on immovable and movable property instead. In Armenia the Government differed in its initiation of an amendment in Law on excise tax on vehicles, which according to the latter's statement wouldn't be continuous; but the rates of property tax were warranted to be revised.

Recommendations:

- The Government of Armenia should carry out a more thorough policy and impact analysis before the initiation of an amendment in any tax legislation. Particularly safeguards must be undertaken in order to decrease the possibility of tax evasion; to guarantee the expected revenue collection.
- If the Government decides to broaden the tax base for excise tax, it should clearly define the criteria upon which the taxable objects were selected and define how the revenues will be allocated, in other words apply earmarking of collected taxes for specific social programs.

- Even while making populist plans and tax maneuvers to gain voters' support, the Government should consider properly how realistic is the revenue collection by the projected means. Increasing the external debt when the revenue collection fails is not a sustainable solution.
- If the Government intends to raise revenue meanwhile leveling up inequalities, it will be more pragmatic to implement the latter by increasing direct taxes, specifically income taxes. This suggestion derives from the level of poverty in Armenia, which is deemed to be quite high, and by increasing consumption taxes, low-income groups will also fall under the tax burden. Thus, the most optimal option is to raise income taxes.

Limitations and Further Research

There are a number of limitations to accomplish the current research. The main limitation of the research was the lack of reliable and relevant data on the topic. The legal amendment is quite recent and the results will be finalized only by the end of the 2012 fiscal year. Thus, by then no final conclusions can be made over the issue, particularly over the fiscal part of the amendment.

In addition, the highlighted statistics on the number of imported cars given in the essay are generated from the first quarter of Armenian Customs Service data which are not final either, and the figures of cars imported may unexpectedly go up meeting up with the figures forecasted by the Government.

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Appendix A: List of People Interviewed

Vaghtang Mirumyan, RA Ministry of Finance, head of State Revenue Policy and Administrative Methodology Department.

Movses Airstakesyan, Member of the Armenian National Congress, member of the “Power of people” social-political initiative, economist.

Armen Martirosyan, Member of “Heritage” faction, member of Standing Committee on Economic Affairs, deputy.

Ashot Khurshudyan, International Center for Human Development, head of Training Unit, independent expert.

A e d B: Q e a e A e a

1. Մինչ այս հարկատեսակի դրույքաչափի փոփոխությունը որքանո՞վ է ՀՀ կառավարությունը ուսումնասիրել հարցը:
ա/ Ինչ՞ չափանիշների հիման վրա է որոշվել ավելի բարձր դրույքաչափով հարկել 25 մլն դրամ և ավել մաքսային արժեք ունեցող ավտոմեքենաներ: (Ինչ՞ չափանիշների հիման վրա է գնահատվել է շքեղությունը Հայաստանում):
բ/ Ինչու՞ է որոշում կայացվել առաջնահերթ հարկել միայն մարդատար ավտոմեքենաները և ինչու՞ այլ թանկարժեք օբյեկտներ չեն ներառվել օրենքի մեջ:
գ/ Արդյո՞ք հաշվի է առնվել, որ մարդատար ավտոմեքենաների ավելի խիստ հարկումը կարող է ազդել գնորդների նախասիրությունների վրա և հետևաբար հանգեցնել եկամուտների սպասվածից ավելի քիչ հավաքագրմանը:
2. Ինչ՞ կարծիքի եք՝ մոտ ապագայում արդյո՞ք այլ օբյեկտներ նույնպես ենթակա կդառնան մման հարկման և ինչ հավանականություն կա, որ ՀՀ հարկերի մասին օրենքում կավելացվի շքեղության հարկ հասկացությունը:
3. ՀՀ- -ին ԱԺ
պատգամավոր Վ. Դ-ալլաքյանի կողմից, այնուամենայնիվ այն չընդունվեց:
Ինչ՞ կարծիքի եք, որոնք էին օրինագծի նույնիսկ ԱԺ նստաշրջանի օրակարգ չընդգրկվելու հիմնական պատճառները:
4. Ինչ՞ կարծիքի եք, ինչ ֆինանսանսատնտեսական և քաղաքական խնդիրներ է փորձում կառավարությունը լուծել տվյալ օրենքի փոփոխության միջոցով: