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EFFECT OF 2018 INCOME TAX REFORMS ON THE REVENUE COLLECTION PERFORMANCE AT RWANDA REVENUE AUTHORITY

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ABSTRACT

Rwanda Revenue Authority introduced income tax reforms in 2018 mainly to expand the tax base and eliminate the loopholes on the repealed law No 16/2005 of 18/08/2005. The main objective of this study was to establish the effect of 2018 income tax reforms on the revenue collection performance at Rwanda Revenue Authority. A special focus was done on reforms in Corporate Income Tax, Personal Income Tax and Withholding Taxes. To achieve this, the study described the key changes in the 2018 income tax reforms, assessed the determinants of Revenue collection performance at Rwanda Revenue Authority and relating the influence of key changes in the 2018 income tax reform on Revenue collection performance for the post reform period at Rwanda Revenue Authority. Considering various aspects of 2018 income reforms, and using various econometric methods based on ordinary least squares, instrumental variable two-stage least squares, and iteratively reweighted least squares, the study assesses whether reforms are important for increasing revenue. The study adopted descriptive research design and the study population comprised of 90 auditors from Tax audit department at RRA Headquarters. Stratified random sampling technique was used to select the respondents. Data was collected from both primary and secondary data using questionnaires and documentation. Data collected was analyzed using SPSS version 21. Data analysis involved statistical computations for averages, percentages, and correlation and regression analysis. Ordinary least squares (OLS) regression method of analysis was adopted to determine the inferential statistics. The findings showed that there is a strong positive relationship between tax reforms and revenue collection at RRA at a Pearson correlation coefficient r=0.681. Therefore, 2018 income tax reforms greatly affect revenue collection and this call for more effective tax reforms to be put in place in order to improve domestic revenue mobilization. From the regression equation, it was revealed that holding Corporate Income Tax, Personal Income Tax and Withholding Taxes to a constant zero, revenue collection would be at 0.347. A unit increase on Corporate Income Tax would lead to increase in revenue collection performance by a factor of 0.162, a unit increase in Personal Income Tax would lead to increase in revenue collection performance by a factor of 0.194 and unit increase in Withholding Taxes would lead to increase in revenue collection performances by a factor of 0.211. The results showed that 2018 income tax reforms contributed to significantly increased tax revenue performance. The study suggested the following recommendations. RRA should train its employees and taxpayers on the key changes brought by the 2018 income tax reforms especially on the requirements of transfer pricing since most of developing countries are suffering from loss of tax revenue from multinational entities. There should be continuous review and reforms in the Rwandan tax system to reflect the current *realities of the modern economy since results of this study have shown that tax reforms have significant effect on revenue performance. More reforms in all types of taxes are needed to increase the amount of tax collected by RRA and to eliminate any loopholes in the existing tax laws that could lead to tax avoidance and loss of tax revenue. To increase Tax to GDP ratio, RRA should look on different ways to broaden the tax base, employees be regularly trained on modern revenue collection procedures and more qualified staff should be recruited. The study finally suggested further studies to be carried out to determine the impact of transfer pricing regulations on Revenue collection performance from MNEs operating in Rwanda.*

Keywords: *Taxation, Tax Reforms, Revenue Collection performances, Corporate Income Tax, Personal Income Tax and Withholding Taxes*

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INTRODUCTION

Tax reform is a main component of macroeconomic policy. Tax reforms are considered as the most important part of fiscal policy and also in agreement with monetary policy (Holban, 2017). The aim of tax reform is to raise revenue effectively in consistence with each country's uniqueness and administrative capacity (Kariyoto, 2010). International financial institutions pioneered by the International Monetary Fund (IMF) and the World Bank (WB) have advised policymakers in developing countries to undertake a tax reform that would ultimately help reduce the dependence of their tax structure on international trade tax revenue in the medium to the long term (Benedek, *et al.,* 2012).

Mostly, tax reform seeks to improve the efficiency and productivity of taxation (Wagacha, 2009). He said that tax reforms can be split into three as follows: custom reforms, VAT and excise duty reforms, and income tax reforms. Cobham (2012) said that in order to achieve the tax reforms it's of great importance to first strengthen the administrative capacity of the tax institution. The strengthening measures that need to be taken include taxpayers' e-registration, e-tax filing, and introduction of stifle tax penalties, taxpayer education and taxpayer services (Delessa, 2014). Acute fiscal imbalance forced developing nations to undertake a series of tax reforms. In the light of this fact, recent developments in the literature of tax reforms have heightened the need for tax reforms in view of boosting tax revenues for fiscal sustainability.

Improving tax revenue performance has become a priority for many developing countries in recent years due to increased financing needs for service delivery and reduced donor support. Realizing the full potential of domestic resource mobilization in developing countries is central to the financing of the Sustainable Development Goals (Morrissey, 2013a). A study conducted by USAID in 2018 on domestic resource mobilization, case study of Rwanda for the period 1990-2016 found that Rwanda has achieved considerable progress in building its tax system over the past two decades. The country's tax revenues rose from just under 10% of GDP in 2000 to 16% in 2016 due to improvements in tax administration and tax policy (Keen, 2012).

Consequently, tax reforms ought to lead to a growth-oriented tax system that endeavor not only to abate economic distortions but also promote drivers to economic growth such as investment, entrepreneurship and innovation (OECD, 2010a). A comparative analysis of different taxes by OECD established that direct (income) taxes were more harmful to economic growth than indirect (consumption) taxes hence concluded that tax burden would be shifted to indirect taxes from direct taxes by a growth-oriented tax reform. Due to distortionary effect of income taxes, tax reforms tend to be biased towards consumption taxes and more so the value added tax (VAT) which a number of scholars have advocated for its adoption because it is believed to have high revenue potential, to be less distortionary, efficient, cost effective and has a broader base (Moyi & Muriithi, 2003; Bird, 2005and Keen & Lockwood). Therefore, VAT has been adopted in more than 160 countries across the globe, in both developed and developing economies as part of the tax reform process (IBFD, 2014).

Despite these efforts, the tax system still fails to raise adequate revenues (is not buoyant or income-elastic) thereby encouraging domestic borrowing and seeking external finance, which are only temporary measures of deficit financing. Moreover, external funds can no longer be relied on due to donor conditions and the increasing interest to channel funds to Eastern Europe after the cold war (Gelb 1993). Furthermore, potential sources for domestic borrowing are few and external grants reduce autonomy and increase political and economic dependence. The alternatives are therefore to raise money through taxation, curtail desired government expenditures, or continuously revise the tax structure. The system also over-dependents on a small number of sources of tax revenue, namely trade taxes, VAT and income tax (Muriithi and Moyi 2003; Wawire 2006; Karingi *et al.,* 2005; Moyi and Ronge 2006).

Rwanda's efforts to improve revenue generation through tax policy and administrative reforms appear to be largely successful. For the period 1998 to 2017, Rwanda's bottom-line annual tax-to-GDP ratio improved to 16.7% from 10.8%. Schreiber (2018). To further enhance tax collection performance, in 2018, RRA introduced the new income tax law repealing Law no 16/2005 of 18/08/2005. The new income tax law was intended to streamline income taxes by removing ambiguities in the wording of the previous law and widening its scope to improve tax administration and support revenue mobilization.

Majority of theoretical literature agrees that tax reforms contribute significantly to tax collection performance. It is however difficult for RRA to continuously undertake different tax reforms if not enough information is known about its impact on tax collection performance. This study therefore explored the impact of 2018 income tax reform on Revenue collection performance at RRA.

Statement of the problem

Tax plays a key role in the growth of any economy and an improved revenue collection translates to growth of an economy. The expansion of the tax base in Rwanda is increasingly recognized as an important policy goal, as an increase in Revenue collection leads to reduce foreign aid dependence. The evidence base on tax reform is limited, but has been growing significantly recently. The question as to why some tax reforms contribute to improved revenue collection while others do not has raised a lot of concern among economists, governments and tax administrators alike, and would 2018 income tax reforms enhance revenue collection performance at RRA?

Several studies have suggested that appropriate tax policy reforms can improve revenue collection and ensure that the needed resources are collected for the development agenda of the country (Bird, 2015). Tax reform can reduce tax evasion and avoidance, and allow for more efficient and fair tax collection that can finance public goods and services. It can make revenue levels more sustainable and promote future independence from foreign aid and natural resource revenues. It can improve economic growth and address issues of inequality through redistribution and behaviour change (Rao, 2014). However, there other previous studies that found negative of tax reforms. For instance, Tax reforms initiated in India since 1991 caused an immediate loss of revenue as there was a significant decline in tax rates and no commensurate increase in the tax base (Rao, 2000). The tax-to-GDP ratio, which was 16% in 1990-1991, declined sharply to less than 14% in 1993-1994.

Over the last two decades, RRA has made key tax reforms which contributed to its success today. In 2018, RRA introduced the new income tax law repealing Law no 16/2005 of 18/08/2005. The new income tax law was intended to streamline income taxes by removing ambiguities in the wording of the previous law and widening its scope to improve tax administration and support revenue mobilization.

Experience from various countries showed that reforms could have both positive and negative effects on Revenue collection. This depends mainly on the type of reforms implemented, on whether an immediate impact or a long-term analysis is considered. It is against this background that this study investigated the effect of 2018 income tax reforms on Revenue collection performance at RRA.

Research Hypotheses

The study was based on the following hypotheses;

- Reform in Company Income Tax (CIT) has significant effect on Revenue collection performance at Rwanda Revenue Authority.
- Reform in withholding taxes (WHT) has significant effect on Revenue collection performance at Rwanda Revenue Authority.
- Reform in Personal Income Tax (PIT) has significant effect on Revenue collection performance at Rwanda Revenue Authority.

LITERATURE REVIEW

Rational Choice Theory

According to Keynesian economic theory, the aggregate demand is influenced by a host of economic decisions which at times tend to behave erratically. Blinder (2008) observes that public decisions include monetary and fiscal such as spending and tax policies. This theory believes in government's that are aggressive in seeking to stabilize the economy based on value judgment has the capacity to improve the economy. Application of this theory was evident during massive US tax cut of 1981 and 1984 in which real GDP growth was unaffected.

Keynes provided both a specific rationale for government's taking a bigger role in the economy and a more general confidence in the ability of government to intervene and manage effectively. Despite Keynes's fascination with uncertainty and his speculative talents in the marketplace, Keynesians deemed government knowledge to be superior to that of the marketplace.

From this theory, Income tax revenues rise when income increases. When government revenues go up, government spending usually increases. Therefore, it explains what happens when the 2018 income tax reforms were carried out and their impact on revenue collection.

Conceptual Framework

The conceptual framework is the mental picture of the relationship between the independent variables, the dependent variable and the intervening variable. Conceptual framework is a scheme of concept (variables) which the researcher operationalizes in order to achieve the set objectives (Mugenda & Mugenda, 2013). A variable is a measure characteristic that assumes different values among subject (Mugenda & Mugenda, 2013). Independent variables are variables that a researcher manipulates in order to determine its effect of influence on another variable. The conceptual framework for this study is presented in Figure 1, which identifies the variables for the study.

The variables to be studied are Tax reforms as the independent variable, which contains three elements: Reform in Corporate Income Tax (CIT), Reform in Personal Income Tax (PIT), Reform in withholding taxes (WHT) whereas the dependents

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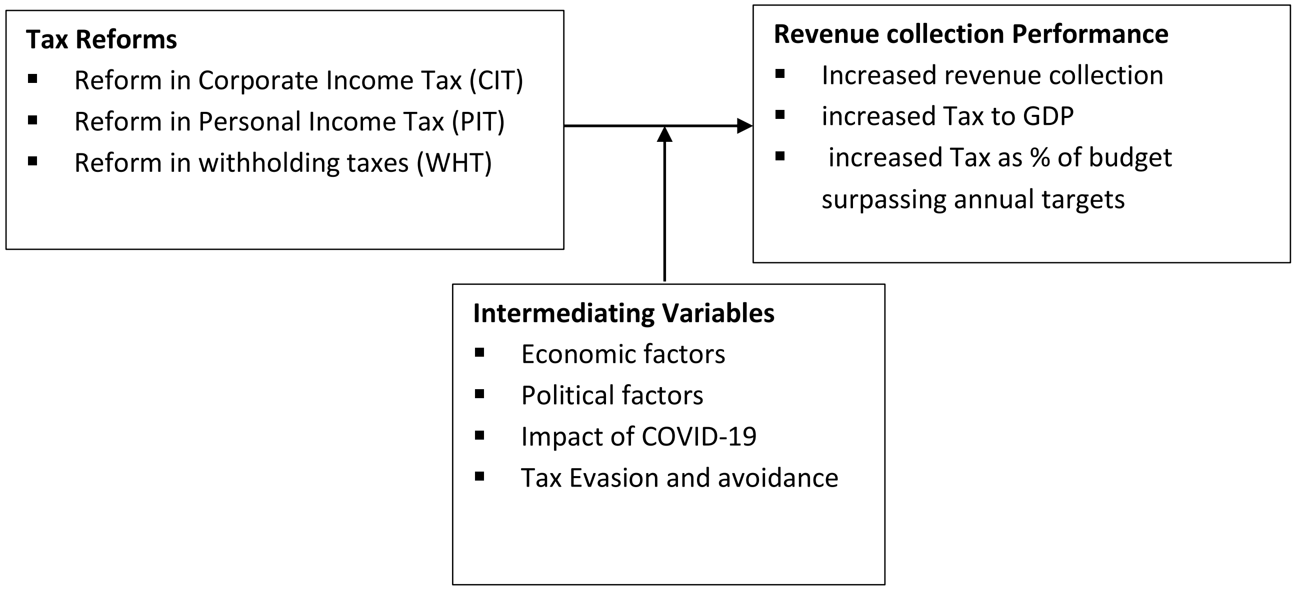
variables are revenue collection performance chosen for the study are: Increased revenue collection, increased tax to GDP ratio, increased tax as % of budget, and surpassing annual targets. Lastly the intermediating variables to be studied are: Economic factors, Political factors, Impact of COVID-19, Tax Evasion and tax avoidance. The relationship is shown in Figure 1.



Independent variable **Intermediating Variables** **Dependent variable**

Figure 1: Conceptual Framework

Source: Author, 2022

METHODOLOGY

The study regards a descriptive case study research design thus; both quantitative and qualitative research design. The study method was employed by the as data collection technique to study into detail every bit of information about tax audit on revenue collection in Rwanda. The population of the study consisted of 90 RRA tax audit staff reported by the Human Resource department (2021). This population consisted of RRA staff involved in day-to-day Tax auditing. These includes; Head of Divisions, Group leaders and Officers involved in the tax audit activities. The study used simple random sampling methods in selecting the respondents in the study. Data was collected from both primary and secondary data using questionnaires and documentation. Data collected was analyzed using SPSS version 21. Data analysis involved statistical computations for averages, percentages, and correlation and regression analysis. Ordinary least squares (OLS) regression method of analysis was adopted to determine the inferential statistics.

RESULTS AND DISCUSSIONS

Key changes in the 2018 income tax reforms at Rwanda Revenue Authority

The first objective was to examine the key changes in the 2018 income tax reforms at Rwanda Revenue Authority. Respondent's views regarding to the key changes in the 2018 income tax reforms at Rwanda Revenue Authority are recorded on Table 1.

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Table 1: Respondents views on 2018 income tax reforms at RRA

Statements	1	2	3	4	5	Mean	Std. Dev
Reforms on Permanent establishment (PE)	0 (0.0%)	2 (2.9%)	3 (8.6%)	28 (40.0%)	34 (48.6%)	4.34	.759
Reforms on Taxable income	0 (0.0%)	0 (0.0%)	9 (12.9%)	37 (52.9%)	24 (34.3%)	4.21	.657
Reforms on tax rate	0 (0.0%)	1 (1.4%)	17 (24.3%)	24 (34.3%)	28 (40.0%)	4.13	.833
Reforms on the taxation of Benefits in kind	0 (0.0%)	0 (0.0%)	10 (14.3%)	33 (47.1%)	27 (38.6%)	4.24	.690
Reforms on the taxation of sitting allowance	0 (0.0%)	0 (0.0%)	(8.6%)	28 (40.0%)	34 (48.6%)	4.26	.674
Reforms on Management, technical and royalty fees	0 (0.0%)	5 (7.1%)	14 (20.0%)	24 (34.3%)	27 (38.6%)	4.04	.939
Reforms on the depreciation of assets	0 (0.0%)	4 (5.7%)	8 (11.4%)	28 (40.0%)	30 (42.9%)	4.20	.861
Reforms on the tax treatment of bad debts	0 (0.0%)	3 (4.3%)	8 (11.4%)	14 (20.0%)	45 (64.3%)	4.44	.862
Reforms on the tax treatment of Loss carried forward	0 (0.0%)	0 (0.0%)	10 (14.3%)	17 (24.3%)	43 (61.4%)	4.47	.737
Reforms on Transfer pricing between related persons	0 (0.0%)	1 (1.4%)	10 (14.3%)	27 (38.6%)	32 (45.7%)	4.29	.764
Reforms on Capital gain tax	0 (0.0%)	1 (1.4%)	11 (15.7%)	18 (25.7%)	40 (57.1%)	4.39	.804
Reforms on Taxation of income from the rent of movable and immovable assets	0 (0.0%)	0 (0.0%)	2 (2.9%)	18 (25.7%)	50 (71.4%)	4.69	.526
Reforms on Withholding taxes	0 (0.0%)	2 (2.9%)	12 (17.1%)	31 (44.3%)	25 (35.7%)	4.13	.797

Source: Primary data, 2022

Table 1 showed that majority of respondents 48.6% of the study participants strongly agreed with the statement that 2018 income tax reforms brought changes on Permanent establishment while 40% strongly agreed with the statement. Majority (52.9%) agreed with the statement that at RRA 2018 income tax reforms influenced reforms on Taxable income while 34.3% only agreed with the statement. The findings also indicated that 40% of the respondents strongly agreed with the statement that 2018 income tax reforms brought changes on tax rate, 34.3% just agreed while 1.4% disagreed with the statement. Majority (47.1%) agreed with the statement that the new income tax law revised tax treatment of Benefits in kind on accommodation and transport, while 38.6% strongly agreed with the statement. Majority (48.6%) of the study participants strongly agreed with the statement that 2018 income tax reforms revised tax treatment of directors' sitting allowance. Most (38.6%) of participants strongly agreed with the statement that on the reforms on the tax treatment of Management, technical and royalty fees paid to non-resident related persons while 34.3% agreed with the statement. Majority (42.9%) of the study participant strongly agreed with the statement on the reforms on the depreciation of assets while 40% just agreed with the statement. The findings also indicated that 64.3% of the respondents strongly agreed with the statement on the reforms undertaken on tax treatment of bad debts, 20% just agreed while 4.3% disagreed with the statement. Furthermore, Table 1 shows that 61.4% of the study participants strongly agreed with the statement on reforms made on tax treatment of Loss carried forward while majority (24.3%) agreed with the statement. Majority (45.7%) strongly agreed with the statement on reforms made on transfer pricing on controlled transactions while 38.6% agreed with the statement. Respondents at a percentage of 57.1% strongly agreed on the new tax treatment of Capital gain tax while 25.7% only agreed with the statement. The findings also indicated that 71.4% of the respondents strongly agreed with the statement on reforms undertaken on taxing of income from the rent of movable and immovable assets, 25.7% just agreed while 2.9% were undecided with the statement. Lastly, Majority (44.3%) agreed with the statement on reforms made on withholding taxes while 35.7% strongly agreed with the statement.

Correlation analysis

Findings on the relationship between the 2018 income tax reforms and revenue collection performance were considered and can be evidenced in the table below.

Table 2: Relationship between tax reforms and revenue collection

		2018 income tax reforms	Revenue Collection
Tax Reforms	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	70	
Revenue Collection	Pearson Correlation	.681**	1
	Sig. (2-tailed)	.000	
	N	70	70

**. Correlation is significant at the 0.01 level (2-tailed).

From Table 2, findings showed that there is a strong positive relationship between 2018 income tax reforms and revenue collection at RRA at a Pearson correlation coefficient r=0.681. Therefore tax reforms greatly affect revenue collection and this call for more effective tax reforms to be put in place in order to improve domestic revenue mobilization.

Regression model

Regression analysis was done to determine the relationship between 2018 income tax reforms on revenue collection performance.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.542[a]	.294	.268	.130

a. Predictors: (Constant), Corporate Income Tax, Personal Income Tax and Withholding Taxes.

Source: Primary data, 2022

Table 3 showed that the coefficient of determination R square is 0.294 and R is 0.542 at 0.05 significant level. The coefficient of determination indicates that 29.4% of the variation in the dependent variable revenue collection performance is explained by the independent variables (Corporate Income Tax, Personal Income Tax and Withholding Taxes). Meaning there are other factors that affect Revenue collection performance apart from 2018 income tax reforms.

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Table 4: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	.575[a]	3	.192	11.388	.000[b]
1	Residual	1.379	51	.017		
	Total	1.953	54			

a. Dependent Variable: Revenue collection
b. Predictors: (Constant), Corporate Income Tax, Personal Income Tax and Withholding Taxes.
Source: Primary data, 2022

Table 4 presents the results of Analysis of Variance (ANOVA) on 2018 income tax reforms on revenue collection. The ANOVA results for regression coefficient indicate that the significance of the P is 0.00 which is less than 0.05. This implies that there is a positive significant relationship between tax reforms on revenue collection and that the model is a good fit for the data. Since the P value is less than 0.05, it means that 2018 income tax reforms are significant factors of Revenue collection performance. Since 2018 income tax reforms are significant determinant of revenue collection performance in Rwanda, the study rejects the null hypothesis which stated that there was no significant influence of 2018 income tax reforms, hence accepting the alternative hypotheses.

Table 5: Coefficient results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.347	.231		1.973	.106
	Corporate Income Tax	.162	.009	.444	1.815	.009
	Personal Income Tax	.194	.017	1.075	3.159	.025
	Withholding Taxes.	.211	.240	.230	.850	.028

Source: Primary data, 2022

From the data in the Table 5, the established regression equation was:

$Y = 0.347 + 0.162\, X_1 + 0.194\, X_2 + 0.211\, X_3$

From the regression equation, it was revealed that holding Corporate Income Tax, Personal Income Tax and Withholding Taxes to a constant zero, revenue collection would be at 0.347. A unit increase on Corporate Income Tax would lead to increase in revenue collection performance by a factor of 0.162, a unit increase in Personal Income Tax would lead to increase in revenue collection performance by a factor of 0.194 and unit increase in Withholding Taxes would lead to increase in revenue collection performances by a factor of 0.211.

Discussion of Results

The study agreed with Malcolm Gillis (1989) who found out that it is quite important for one to devise a model blueprint for tax reforms and quite another to have it ready when the moment is ripe for reform and to apply it successfully.

Moreover, the results agreed with the study conducted by Ndiaye (2019) on effect of Reforms on Tax Revenue Performance in Senegal revealed that tax reforms, institutional reforms, and all reforms combined were important drivers of the increased performance of tax revenue in Senegal during the 1970-2014 period. These findings imply that more tax-related reforms and more institutions-related reforms are crucial for higher tax revenue.

CONCLUSION AND RECOMMENDATIONS

This study investigated the effect of 2018 income tax reforms on revenue collection performance in Rwanda, a country that has experienced improved tax collection for all the tax reforms undertaken since Rwanda passed through several reform periods after the end of the country's 1994 genocide when it had to re-establish its institutions.

2018 income tax reforms have an effect to revenue collection performance as according to the ANOVA analysis and model analysis on the three variables on the 2018 income tax reforms with reference to revenue collection. This clearly indicates that tax reforms increase revenue collection. That in essence means that the more the tax reforms conducted, the more revenue is collected. Thus, it is right to say that reforms are directly related to revenue collection performance. All the tax reforms are important because they add something to revenue and thus should be encouraged as it assists the government in collecting appropriate tax revenue.

From the findings and conclusion, the following recommendations were established:

- The study recommended that the key changes brought by the 2018 income tax reforms be trained to all taxpayers and RRA employees mainly on the requirements of transfer pricing since most of developing countries are suffering from loss of tax revenue from multinational entities. RRA should be therefore understand the number and type of MNEs operating in Rwanda and the types of transfer pricing risks that are likely to arise. Taxpayers who are involved in controlled transactions should be guided on the requirement to have transfer pricing documentation that support the arm's length principle of their transactions with related companies.
- There should be continuous review and reforms in the Rwandan tax system to reflect the current realities of the modern economy since results of this study have shown that tax reforms have significant effect on revenue performance. More reforms are needed to increase the amount of tax collected by RRA and to eliminate all loopholes in the existing tax laws.
- It was noted that Tax to GDP ratio remains very low in Rwanda and in most of developing countries in comparison to OECD countries. It was also noted that Tax to GDP ratio is still below the 18% Sub-Saharan average. Hence, to increase Tax to GDP ratio, RRA should look on different ways to broaden the tax base, employees be regularly trained on modern revenue collection procedures and more qualified staff should be recruited.

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