CASE STUDY 9 – RWANDA

The Rwandan Revenue Authority Project

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Context and particularities

A DfID and FIAS study is improving understanding of the impact of tax policy, and in particular its administration in southern Africa. "Tax administration *is* tax policy"[1]: The study aims to understand not just tax policy but also how its administration impacts on the business climate

Governments and the international community have begun to understand that tax is a key political basis for relations between the state and society. Taxation, aid and democracy are closely related in poor aid-dependent African countries. The way domestic revenue is raised significantly influences both economic growth and democratic consolidation.

Bargaining over tax and developing a 'fiscal contract' between citizen and state is central to building relations of accountability based on mutual rights and obligations, rather than on patronage. Taxpayers' mobilisation around common interests has potentially positive outcomes for governance.

Objectives

The DfID/FIAS study has applied these approaches in Rwanda, where revenue collection capability has been transformed in the last few years. The Rwanda Revenue Authority (RRA) was established in 1997 as a semi-autonomous executive agency. It employs around 650 staff, 90% of whom are under the age of 45, and has twelve departments.

The success of the RRA has been built through establishing its strong legitimacy, underlined by its slogan of 'Taxes for Growth and Development'. Overcoming the legacy of civil war has been the key challenge, requiring the state to create security while seeking long-term stability through economic growth and effective administration, including of resource mobilization.

From the outset the RRA has been able to count on the personal support of the President, who has gone on to play a major part in the campaign to change public attitudes towards paying taxes and related challenges such as corruption. The president has underlined the importance of the RRA as enabling the country to finance poverty reduction expenditure, and to reduce its dependence on outside assistance.

The president has also publicly stressed the importance of creating an enabling environment for investment, which has stimulated the RRA in making considerable effort at outreach to the private sector. In addition, the principle of the 'fiscal contract' has been well understood by Rwanda's political leadership, so the RRA has been seen to be "contributing to developing a culture of

[1] M. C. de Jantscher: Administrating the VAT: in : Value Added Taxation in Developing Countries: World Bank 1990, p.179.

participation and citizenship as part of a wider process of establishing the norms and practices of democratic governance, and of bringing government closer to the people".[2]

With substantial financial and technical support from DfID, and driven by high-level political commitment to change on the part of Rwanda's leadership, the RRA has helped raise revenue collection from 9.5% of GDP to over 13% of GDP.

Structure and participation

The RRA was established with an understanding of the wide significance of taxation. The Board of the RRA includes not just the MINECOFIN but also the Ministry of Commerce, including the Investment Authority, charged with managing the relationship between the collection of revenues and creating an enabling environment for private sector investment and development.

The Rwandan Private Sector Federation has been actively involved in and consulted on the RRA's functions and reforms. Understanding Rwanda's tax policy and its administration requires analysis of the tax/incentive system political dynamics that link taxation, powerful vested interests, business development and economic growth.[3] Particularly in a low-income country like Rwanda where the overwhelming proportion of the tax base comes from a small number of companies, large domestic and foreign companies may have strong incentives to organize and use their economic importance to secure their interests.

In Rwanda, this is difficult to assess, partly thanks to the largely even-handed nature of the way that tax reforms have been formulated by the Ministry of Finance and RRA, and the transparency of the process.

There have been noticeable differences in yields of different taxes, reflecting partly the reform process and partly political choices: International trade taxes rose from RWF 14bn to 27bn, VAT increased in the same period from RWF 24bn to RWF 47bn, and direct taxes from RWF 24bn to 39bn, of which the property tax however rose only slightly from RWF 0.6bn to 0.85bn. This, and the weakness of the devolved rental income tax now collected by sub-national government, may be the result of politically influential vested interests in avoiding effective property taxation, but more likely the need first to clarify contested land-holding arising from Rwanda's complex history, and planned land reform.

"Investments and private sector development are no longer issues we take for granted. We recognize them as the real engines of growth and we are pursuing their realization with determination and focus. That is why we have put in place the necessary legislative and institutional mechanisms to promote investments into our economy."[4]

The government has put considerable emphasis on growth. Rwanda has a small open economy, with a sizeable informal sector and is significantly non-monetized. Rwanda's economic structure is overwhelmingly agricultural. The scarcity of land requires policies that would reduce, over the coming years, the number of people depending on agricultural activities. There is no apparent sign

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[2] Developing Capacity for Tax Administration: The Rwanda Revenue Authority". Tony Land, ECDPM Discussion Paper no 57D, November 2004: p.3

[3] e.g. S. Haber (ed): Political Institutions and Economic Growth in Latin America: Stanford 2000; Christian Michelson Foundation research on tax systems in Namibia, Tanzania and Uganda – e.g. Chekwoti, Caiphas 2002. "Tax compliance analyses: households and firms in Uganda."; D. Mushi 2002. "Tax compliance in Tanzania: Why do firms evade tax?"; L.Rakner & S. Gloppen 2003. "Taxation and accountability in sub-Saharan Africa"; A. Sindzingre 2002. "Political economy of taxation and international financial institutions in sub-Saharan Africa: reforms as problems and solutions.": Paper presented at the *Annual Conference*, Windhoek (4-5 April 2002).

[4] The President of Rwanda at the second Rwanda Investment Conference held at Intercontinental Hotel-Kigali on 13th May, 2004

of an ‘urban bias’ in Rwanda, with agriculture benefiting from general tax exemptions, reflecting the political sensitivity of the sector and the difficulty of outreach to farmers.

RRA and the private sector

The RRA approach to business has been a significant improvement on its predecessor, which was noted for closing down businesses that ran in to trouble paying taxes.[5]

There are fewer than 3,000 registered companies paying national taxes in Rwanda: 280 ‘large taxpayers’; around 1,500 VAT registered companies; and around 1,000 companies with turnover less than 20m RWF which pay the 4% turnover tax. Customs and Excise Department and the Large Taxpayers Department [LTD] both contribute 43% to total government revenues, with 10% coming from the IRD and 4% from other sources such as the Magerwa levy.

As a result, the top 13 companies are estimated to pay some 80% of all taxes collected in Rwanda, and the top 280 covered by the LTD pay around 90%. With a very large non-monetized economy and a substantial informal sector, the fiscal contract between state and citizen, and between the private sector and the state, is limited.

The FIAS/DfID study indicated a good working relationship with the RRA, with some complaints in detail about the taxation process. Many changes have been or are in the process of being made, to improve tax administration, and ease the compliance burden. These include establishing in 2004 an LTD for the top 280 companies and the IRD for other taxpayers. This was also linked to a greater emphasis on self assessment supported by a comprehensive audit and penalties regime. At present the RRA is setting up an Operational Policy Department to formalize its processes, while introducing an integrated computer system in tax and customs with a longer term aim of facilitating e-filing for large taxpayers.

Many of the complaints heard from the private sector represent apparent glitches in the process of implementing reform, rather than substantial systemic problems. The RRA has only recently introduced its new rolling cycle of audits in the LTD aiming to cover all taxpayers at least every 3 years, and many of the uncertainties in the interpretation of the new laws seems to be due to lack of established precedent and to the failure of the private sector to make the most of the resources available to clarify uncertainties through the legal and taxpayers services department.

Processes and milestones / Outreach strategies

The government has recently approved the formalization of RRA budget, to be financed by a 2.6% retention of revenue collected. This puts the RRA finances on a secure footing, enabling it to plan with confidence and to create confidence among its suppliers and employees. The new SIGTAS computer system has been rolled out now in both the LTD and the IRD, where the VAT register was updated in March 2005.

The RRA’s Audit Manual spells out clear audit processes. Audit teams for example must keep detailed audit notes, recording points found during audit that require clarification. The Heads of Audit in the LTD and IRD run case-study training sessions for staff every week to help auditors to raise potential issues and share experience. Many issues inevitably take several years to clarify. The process of introducing VAT has thrown up unforeseen problems which will need clarification or amendments to the law, ministerial orders or CG Rulings (e.g. the reverse VAT charge).

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[5] Developing Capacity for Tax Administration: The Rwanda Revenue Authority”. Tony Land, ECDPM Discussion Paper no 57D, November 2004: p.7.

The move to the functional structure of the RRA has allowed all taxes to be audited at the same time, making for a much more efficient and effective process.

The RRA recognizes that the appeals process may need strengthening – at present the first appeal is to the same staff that made the initial decision, then the Commissioner and then to the RRA Appeals Committee, which again consists entirely of RRA staff. The private sector complain that while this lengthy process is being pursued, fines and interest costs build up. The RRA however point out the at the LTSD is always available to advise, that VAT-registered taxpayers have to visit the RRA monthly to file VAT returns and so can consult the LTD then, and that taxpayers are free to rectify tax returns before any audit happens simply by filing an amended tax return.

RRA outreach has included for example a personal visit by the RRA's LTD staff to the 280 large taxpayers to explain the new procedures involved in the SIGTAS computerization system.

The RRA is regarded as effective and disciplined. In 2005, Transparency International for the first time included Rwanda in its Corruption Perceptions Index. Rwanda appears at number 83 out of 158, a better rating than all other countries in the Great Lakes region and East Africa. Corruption at the RRA, while not unknown, does not appear to be a major problem.[6] The relative success of the RRA in preventing or curbing corruption appears to be due to a number of critical factors: comparatively good pay, strong internal controls, and clear political support for the RRA's management and purpose.

The RRA has made impressive efforts at outreach and has been effective in creating a good working relationship with the private sector. Tax advisory councils established around the country feature broad civil society participation.

It appears that RRA staff do not face distortionary internal incentives that might undermine business and growth. In the absence of incentives for overly focusing on large taxpayers to secure big wins for revenue targets, RRA staff are not apparently assessed against revenue targets, with large taxpayers already handled by a dedicated department.

DFID and other donors have played a significant part in assisting the RRA with tax reforms, but there is no evidence that aid flows have created perverse incentives.

The RRA has a Taxpayers' Charter of Rights that was revised in March 2005 and accessible through the RRA website, and the LTD had established customer service standards. The RRA recognizes businesses as key stakeholders, with the LTD generally regarded as effective and efficient in meeting the needs of the main contributors to the Rwandan government resources. RRA incentives therefore do not seem to clash with the interests of businesses.

There is no significant evidence of business tax compliance being exchanged for greater voice and representation in economic and sector policies. The private sector was widely consulted in recent reforms aimed at creating simpler, more predictable tax legislation and supporting ministerial orders and Commissioner-General Rulings.

Monitoring mechanisms

The DfID project monitors progress.

[6] http://www.u4.no/themes/pfm/Revenueissue/revenue3.cfm

Challenges

The Rwanda Private Sector Federation, and its organisation for small business, were both consulted on tax reforms, although many private sector people interviewed during the mission expressed doubt as to the effectiveness of these organisations in influencing the government or in communicating with their members.

There is no attention paid to small businesses, which account for over 80 percent of employment. It is not clear whether large businesses already have the political influence they need through other channels; there is little available political economy research about whether different types of businesses – exporters, importers, large, small, rural, urban, domestic and foreign – engage with clientelistic political systems and influence central government. But the evidence from the RRA is that the public sector carries much more weight in Kigali than private sector concerns and interests.

There remains significant doubt about the real effectiveness of the Private Sector Federation in representing the interests of its all members to government, or in facilitating training of members on tax issues. Few members, for example, seemed aware of the VAT option and its merits. As a result, it seems that the Rwandan Private Sector Federation is inadequately staffed and funded to effectively engage with the MINECOFIN and RRA on tax policy and how tax administration effects business development and pro-poor growth concerns. Inevitably, small and informal sectors are presumably even less influential.

The RRA has been successful in that it has established a good relationship with the main taxpayers. But at the same time, the RRA has not been responsive to the specific needs of small tax payers; this is especially true in terms of outreach and education.

The RRA is currently reviewing internal performance measures. Current performance is not evaluated by incentivizing revenue collected, and the RRA is alert to the perverse incentives that this might create. But more modern performance evaluation measures are needed, and DfID is supporting reforms in this area in the Human Resources Management and Administration Department (HRMAD).

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He joined RRA in August 1994 as a Deputy Customs Collector after completing his studies at Makerere University in Kampala. He has conducted research on the performance of the Uganda Investment Authority and completed a case study on the knowledge, attitudes and practices of family planning in rural areas which was presented to the Uganda Family Planning Association in 1993.

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Richard Stern is regional program coordinator for Central and Southern Africa for the Foreign Investment Advisory Service (FIAS). At FIAS, he has worked extensively in Sub-Saharan Africa as well as in Eastern Europe and Central America, leading studies of barriers to investment. Mr. Stern has concentrated work on tax policy and administration issues, especially in Africa, focusing on the effects of taxation on small and medium enterprises and the informal sector. Before joining FIAS in 2003, Mr. Stern was an economist at the International Monetary Fund for nine years, working mainly on former Soviet countries (Latvia, Estonia, Kazakhstan), Central African countries (Gabon and Congo), and post-conflict countries (Rwanda, Congo, and Bosnia and Herzegovina).