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EFFECT OF TAX EVASION ON VAT COLLECTION IN RWANDA (2011-2017)

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ABSTRACT

Tax payment is a civic duty and an imposed contribution by the government to contribute to her principal source of revenue to provide public goods and services to its citizenry. It is a compulsory unrequited payment to the Government. Tax evasion prevalence is vast and greatly impairs taxation's macro- economic objectives thus creating a gulf between actual and potential government tax revenue raising many issues which need urgent attention and solutions. However much the government endeavors to exercise its sovereign right to collect taxes, nobody likes paying taxes although there is great appreciation that taxes need to be paid and this drives some people into tax evasion making the government constantly fail to raise targeted tax revenue. This study sought to establish how tax evasion affects Value Added Tax collection in Rwanda. The study employed a survey research design which involved collection of information from a sample of individuals through response to questions. The study targeted 50 tax evaders investigated by Rwanda Revenue Authority. The study relied on secondary data informed by Rwanda Revenue Authority investigated cases, related materials published by government authorities, work of other researchers and authors in the form of journals, books, bulletins and newspapers articles as well as sources from the internet. The researcher used quantitative methods to quantify the problem by way of generating numerical data. A regression analysis was used to identify the effect of tax evasion on tax revenue. There were strong positive and significant effects of tax compliance based on wrong doing on VAT collection ($β = .444$; $t = 1.815$; $p < 0.05$) and registered of relevant taxes ($β = 1.075$; $t = 1.815$; $p < 0.05$). There were positive effects of registered of relevant taxes on VAT collection ($β = .230$; t =. 850; $p > 0.05$). However, there was weak but significant effects of detection and penalties on VAT collection ($β = 1.231$; $t = 3.616$; $p < 0.05$.). Findings from the analysis using statistics techniques revealed that tax evasion and avoidance had adversely affected economic growth and development in Rwanda, and also, that lack of good governance and unpatriotic act of tax payer, was the basis for which tax evasion and tax avoidance activities was perpetrated. The study therefore recommended that the government should embrace, promote and encourage voluntary compliance of tax liability by the tax payers.

Keywords: *Value Added Tax Collection, Tax Evasion, Rwanda Revenue Authority*

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INTRODUCTION

Governments, all over the world, in order to deliver public services and maintain public security and orderly, need financial resources (Mbera, 2017). Value Added Tax (VAT), is one of domestic revenues and most countries constitutes the major source of revenues as it accounts for between 30% and 35% of all tax revenue collections. The Value Added Tax (VAT) was introduced by a French economist in 1954 (Keen *et al.,* 2001). Maurice Lauré, joint director of the French tax authority, was first to introduce VAT with effect from April 10, 1954, for large businesses, and extended over time to all business sectors. In France, it is the most important source of state finance, accounting for approximately 45 percent of state revenues. West Germany adopted VAT in 1968 and subsequently most other Western European countries also implemented some form of VAT. Many countries in Africa, Asia, and South America have also followed suit, but the United States as a whole has not.

The study conducted by OECD, ATAF and AUC (2017), stated that in Africa most countries had higher tax to GDP ratios in 2015 compared to 2000 where the predominant drivers of the growth in tax-to-GDP ratios on average were increases in revenues from VAT and taxes on incomes and profits (2.2 and 2.3 percentage points, respectively). In East African countries, there is a mismatch between VAT rate and ultimate revenue generated for VAT. Uganda, Rwanda and Tanzania, VAT rates are higher (18%) compared to Kenya of 16% (Robert S., Justine *et al* 2017). However, related to VAT as a percentage of total revenue, VAT contributes significantly to total revenue, as indicated by the graph below.

VAT contribution to total Revenue

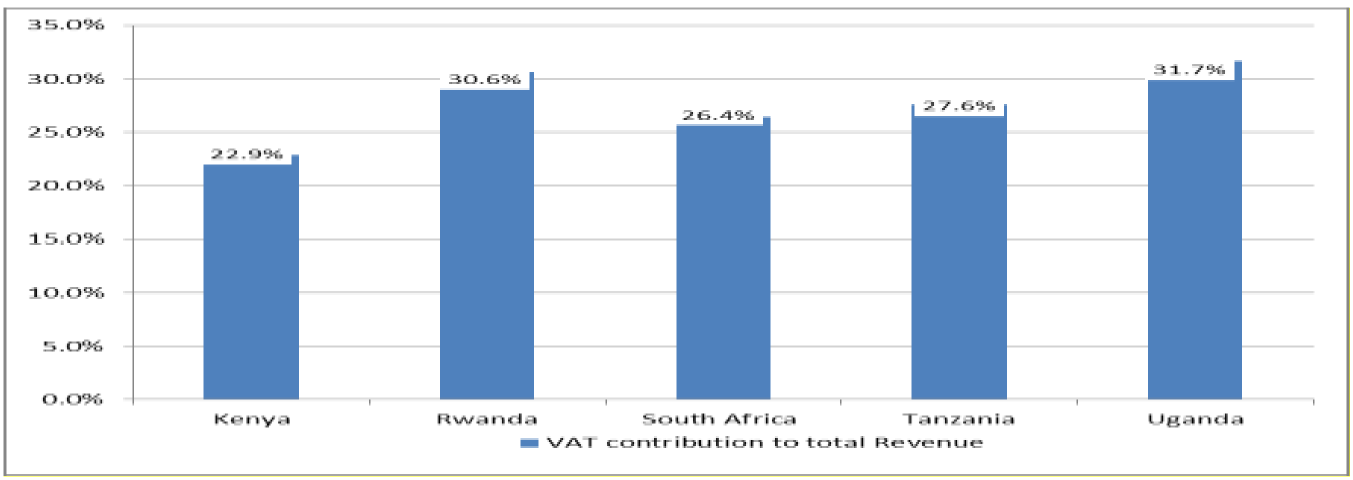

Figure 1: Tax to GDP Ratio: Comparative Study-2013

In Rwanda, Value Added Tax (VAT) was introduced and came into effect on 20 January 2001 to replace turnover tax (Pwc, 2017). Rwanda's VAT legislation is contained in the VAT law (Law No. 37/2012 of 09/11/2012). Law No. 37/2012 of 09/11/2012 is a new law which came into effect on 5 February 2013 and repealed the old VAT law (Law No. 06/2001 of 20/01/2001). This Law establishes the value added tax on supplies of goods and services in Rwanda and on imported goods and services.

Value added tax (VAT) is computed by applying zero percent (0%) on taxable goods or services that are zero-rated; and Standard rate of eighteen percent (18%) for other goods and services. Rwandan compilation of fiscal laws, (2017). VAT is declared and paid within fifteen (15) days after the end of the period of the value added tax. The value added tax payable by

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an importer is due and payable when imported goods reach the country. However, VAT compliance improvement plan and other types of taxes as well are opposed by different factors such as, tax avoidance, low tax compliance and tax evasion which is the main key within this study. Tax evasion is an illegal activity, where registered individuals or businesses intentionally omit, conceal or misrepresent information in order to reduce their tax liabilities (HMRC, 2018).

Tax evasion is accomplished by planned act of omission or commission which in them constitutes immoral acts under the tax laws (Kamau J., 2013). These may include: understating income; documenting fictitious transactions; overstating expenses; etc.

As pointed out by Adebisi & Gbegi (2013), since tax is a principal source of government revenue, if persons are able to escape by illegal means the tax to which they should logically be subject under the general scope of the tax, are lost to a large extent. However, the researcher will examine the effect of tax evasion on Value Added Tax (VAT) collection in Rwanda.

Problem Statement

Reducing tax evasion is a key priority for many governments, particularly in developing countries (Paul C., Dina P., et al, 2014). Tax evasion cheats the public of revenue that is to be used for public expenditures, and puts compliant taxpayers that obey the law at a disadvantage (OECD, 2017).

In Rwanda, tax evasion is explained by different economic and non-economic factors contributes to lowering the ratio of tax revenues to GDP (15% for 2014/2015), which is less than a half of the ratio computed for major industrialized countries members of OECD (Harelimana, 2017).

Furthermore, the research revealed that a number of VAT registered taxpayers report sales through EBM, but under declare VAT. On the other hand, taxpayers underreport sales which in turn lead to false VAT refund claim. For example, RRA identified cases of companies that issued fictitious EBM (VAT) invoices. The audit of these companies revealed falsely claimed input VAT amounting to Frw 3,406,359,890 that had been utilized to suppress VAT amounts included in the VAT declarations.This has denied Government cash flows required to implement priority Government programs (Auditor General report, 2017).

Hence, it seems that since VAT were introduced in Rwanda this issue of tax evasion is still persistent, one may ask if it doesn't matter when taxpayers continue to hide taxes that should have contributed to finance government expenditures. Therefore, this made it interesting and pushed the researcher to investigate the effect of tax evasion on VAT collection in Rwanda while looking on their relationship.

Objective of the Study

The objective of this study was to determine the effects of tax evasion on Value Added Tax collection in Rwanda.

LITERATURE REVIEW

Theory of Tax Avoidance

The General Theory of Tax Avoidance was propounded by (Stiglitz 1986). In his theory, he stated that in a perfect capital market, the principles of tax avoidance are so powerful that they can enable the astute taxpayer to eliminate all taxation on capital income, and possibly all taxation on wage income as well. He noted in particular that much of the general equilibrium gained from tax avoidance arises from differences in tax rates, both across individuals and across classes of income rather than from postponement. Stiglitz (1986) stated that the tax laws constantly change the opportunities for tax avoidance but underneath, there remain three basic principles of tax avoidance within an income tax which are postponement of taxes, tax arbitrage across individuals facing different tax brackets and tax arbitrage across income streams facing different tax treatment. The first principle which is postponement of taxes explains that the present discount value of a postponed tax is much less than that of a tax currently paid, while the second principle involving transactions among different individuals within a family would in the long run reduce the aggregate tax liability as a result of the same individuals facing different marginal tax rates at different times. The third principle states that long-term capital gains are taxed at lower rates than other forms of income from capital. This provision is inducement to convert the returns on capital (or on labour) into long term capital gains. He also added that special treatment is given to the return on capital in the form of housing and pension. Many tax avoidance devices involve a combination of these three.

Critical review

Globally, the trend has been moving from direct taxation to indirect taxation. Apparently, indirect taxes are becoming more important as the burden of direct taxation fall. It is important to note that countries all over the world have reformed or are attempting to reform their tax system. This is after realizing that taxation is a sensitive instrument and if properly used, it can give handsome dividend. If resorted to indiscrimination, it can damage the very foundation of progress. According to Chad and Wolf (1973), a number of countries have made efforts to deal with weak tax administration as well as reduced tax evasion and avoidance. Chad and Wolf (1973), indicate that as in other economic policies where reforms have been successful, a number of common elements have been present and these include: a well thought program of action support for major policy makers and systematic implementation and monitoring aimed at broader and simpler tax basis on which lower rates are imposed. Procedural demands that complicated administration is minimized (Chad & Wolf, 1973).

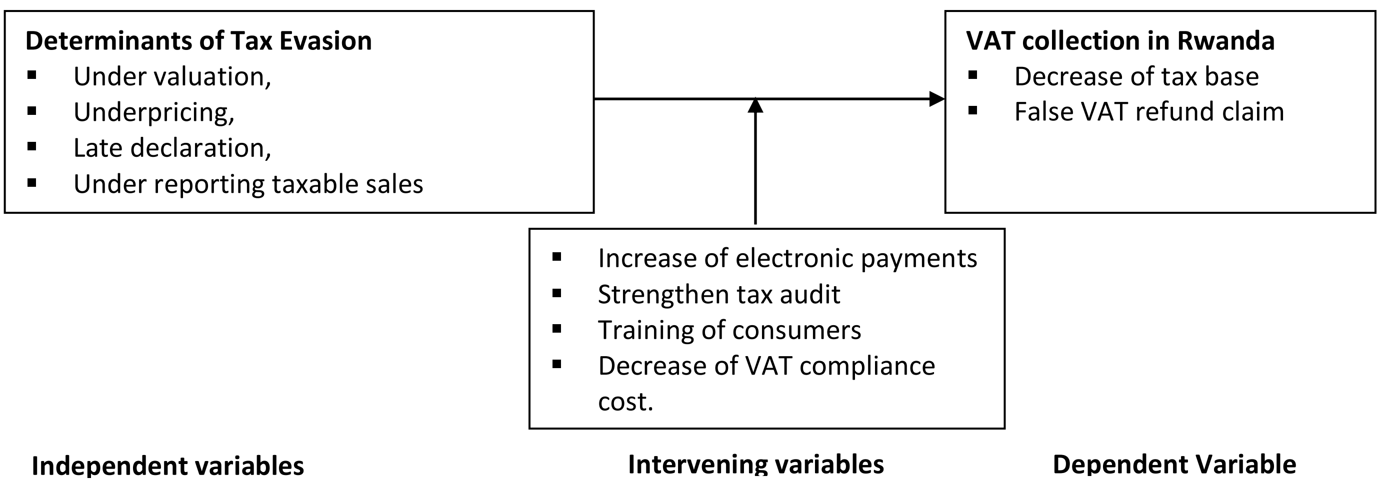

Figure 2: Conceptual Framework

METHODOLOGY

The setting of the present study was Rwanda Revenue Authority Kicukiro Block. Kicukiro Block was deliberately selected from other tax region in Rwanda. This study adopted a quantitative approach of both descriptive and correlation designs. The designs suit this study since they enabled the researcher to determine the effects of tax evasion on Value Added Tax collection in Rwanda. Quantitative data was captured through the use of a questionnaire. The qualitative approaches were used to provide descriptive forms which involved conducting interviews, observation and questionnaires with open-ended questions. The choice for qualitative approach was based on the fact that, interviews, observation and open-ended questionnaires enabled the researcher to gather detailed information on effect of tax evasion on VAT collection performance. The study also employed quantitative method which involved constructing questionnaires with closed-ended questions. The choice for quantitative approach was based on the fact that, the researcher was able to gather broad and quantifiable data on effect of tax evasion on revenue collection performance. Further, the findings of this study were represented by descriptive forms and statistical presentation. The target population was 2706 taxpayers registered on VAT tax under the domestic taxes department, 6 RRA staff at the Domestic Tax Department (DTD). Hence the total target population was 2712 respondents. A sample size of 352 respondents was determined using Slovin's formula (1967)

Table 1: Sample Size

Category	Number	%	Sample size(n)
Small Taxpayers	2020	74.5	260
Medium Taxpayers	686	25.3	88
RRA officers Kicukiro block	6	0.2	1
Total	**2712**	**100**	**349**

Stratified Sampling was used to group the respondents and formations into strata. Stratification was used because the population was structured into various non-homogenous units, hence the need for sample diversity. Structured questionnaires were used as the tool to collect data in order to determine the effects of tax evasion on Value Added Tax collection in Rwanda. The study employed a multiple model to represent the relationship between variables. From the selected model of regression analysis, the study suggested the following representation: $Y=a+b^{I}x^{I}+b^{2}x^{2}+b^{3}x^{3}$ whereby Y is the independent variable and x^{I}, x^{2} and x^{3} are independent variables. In this tax evasion trends, impact of tax evasion on revenue collection and strategies employed by RRA in curbing tax evasion are independent variables (x^{I}, x^{2}, and x^{3}); while collection performance was the dependent variables (Y). Whereby data computed by using statistical package for social science (SPSS), the final results summarized and presented on the tables.

RESULTS AND FINDINGS

The study requested the respondents to indicate the various determinants of tax evasion in Rwanda. In order to measure tax compliance, respondents were asked directly if they have failed to pay taxes or fees that they owed to the government during the last few years. Since respondents were likely to answer untruthfully when asked questions about sensitive issues such as their own tax payment, tax compliance questions were asked indirectly. Following the works of Reinikka and Svensson (2006) on their work on corruption, the present study used an indirectly phrased question to capture tax compliance in order to avoid direct implication of "wrong doing" by the respondent. Thus, they were asked if they thought it is wrong and punishable not to pay taxes, 0 otherwise. The results are shown in Table 2.

Table 2: Tax compliant or not

		Code	Frequency	Percent
Valid	Tax compliant	1.00	142	59.2
	Not tax compliant	0.00	98	40.8
	Total		**240**	**100.0**

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Table 2 showed the results when the respondents were asked if it was wrong and punishable not to pay taxes. Majority 59.2% said that it was wrong and punishable while 40.8% said no. This implied that most owners of SMEs were tax compliant but those who were not tax compliant also formed a considerable number.

Detection and penalties are related to economic deterrence theory such that if detection is likely and penalties are severe, few people will evade taxes. The respondents were asked based on their experience, how easy or difficult it was to avoid paying taxes that they owe to the government. Results were shown in Table 3.

Table 3: Ease of avoiding paying taxes due to the government

		Frequency	Percent
Valid	Very easy	30	12.5
	Easy	178	74.2
	Difficult	24	10.0
	Very Difficult	6	2.5
	Missing	2	0.8
	Total	**240**	**100.0**

As shown in Table 3, majority of the respondents 74.2% said that it was easy to avoid paying taxes owed to the government followed by those who responded by stating that it was very easy at 12.5% then difficult at 10%. Those who said it was very difficult were 2.5%. On the overall, the results reveal that it is easy to evade tax payment to the government.

In addition, the researcher wanted to know the measures to be used to curb tax noncompliance

Table 4: Measures to be used to curb tax non-compliance

	Measures	1	2	3	4	5
Valid	Tax penalty and fines	4.2%	42.5%	9.2%	36.7%	7.5%
	Tax audit	2.5%	17.5%	55.0%	17.5%	7.5%
	Enforcement	5.8%	28.3%	11.7%	45.8%	8.3%

Table 4 showed the proposed measures to be used to curb tax non-compliance and majority of the respondents out of the 240 who responded were of the opinion that or agreed and strongly agreed that enforcement be used at 45.8% and 8.3% respectively fooled by tax penalty and fines at a total of 44.2% in agreement. Tax audits could be used albeit to a low extent with 17.5% and 7.5% agree and strongly agree.

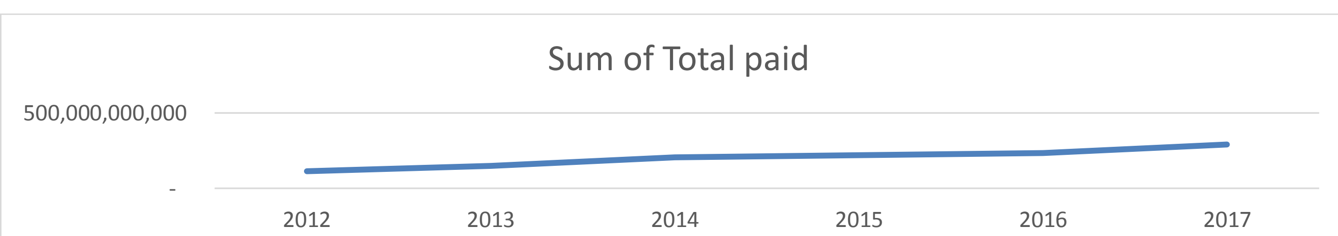

Figure 3: Trends of VAT in rwf

The study obtained data for Value Added Tax (VAT)) in rwf for the period between 2012 and 2017. The trends in the data obtained were shown in figure 1, indicating that VAT has upward movement over the period under study. There was no much variations in the values of Log (VAT) over the years, this was shown by the difference in their respective minimum and maximum values. The skewness of Log (VAT) showed negative this indicated that the left tail was particularly extreme, while Log (GDP) is positively skewed showing that the right tails are extreme. Also, the kurtosis shows that both Log (VAT) and GDP are platykurtic indicating that they have thin tails than normal distribution. Furthermore, the probability of the Jarque Berra statistics shows that both series are normally distributed.

Model Summary

In order to test the research hypotheses, a standard multiple regression analysis was conducted using revenue collection performance the dependent variable, and the three independent variables.

Tables 5, 6 and 7 present the regression results. From the model summary the adjusted R^2 was 0.757 indicating that a combination of tax compliance based on wrong doing, registered of relevant taxes and detection and penalties explained 75.7% of the variation in the Value Added Tax collection in Rwanda.

Table 5: Model's Goodness of Fit Statistics

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.887[a]	.764	.757	.2104

a. Predictors: (Constant), tax compliance based on wrong doing, registered of relevant taxes and detection and penalties

Analysis of Variance

Analysis of Variance (ANOVA), as the name implies, is a statistical technique that is intended to analyze variability in data in order to infer the inequality among population means. ANOVA technique extends what an independent-samples t test can do to multiple means. The null hypothesis examined by the independent samples t test is that two population means are equal. If more than two means are compared, repeated use of the independent-samples t test was led to a higher Type I error rate (the experiment-wise α level) than the α level set for each t test

Table 6: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	120.450	5	120.450	35.037	.000[b]
1	Residual	32.659	32	.573		
	Total	153.109	37			

a. Dependent Variable: VAT collection

b. Predictors: (Constant), tax compliance based on wrong doing, registered of relevant taxes and detection and penalties

From the ANOVA Table 6, it was clear that the overall standard multiple regression model (the model involving constant (tax compliance based on wrong doing, registered of relevant taxes and detection and penalties) is significant in predicting

VAT collection performance in Rwanda. The regression model achieved a degree of fit as reflected by an R^2 of 0.757 ($F = 35.037$; $P = 0.00 < 0.05$). Hence rejecting the null hypothesis and accepting the alternative hypothesis.

Regression Coefficients

Table 7: Coefficient results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.250	.231		1.973	.000
	tax compliance based on wrong doing	.221	.009	.444	1.815	.000
	registered of relevant taxes	.106	.050	1.231	3.616	.002
	detection and penalties	.185	.017	1.075	1.815	.000

The multiple regression equation was that:

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \mu$ and the multiple regression equation became:

$Y = 0.25 + 0.221X_1 + .106X_2 + .185X_3$.

As depicted in Table 7, $p < 0.05$). There were strong positive and significant effects of tax compliance based on wrong doing on VAT collection ($\beta = .444$; $t = 1.815$; $p < 0.05$). and registered of relevant taxes ($\beta = 1.075$; $t = 1.815$; $p < 0.05$). There were positive effects of registered of relevant taxes on VAT collection ($\beta = .230$; $t =. 850$; $p > 0.05$). However, there was weak but significant effects of detection and penalties on VAT collection ($\beta = 1.231$; $t = 3.616$; $p < 0.05$.)

CONCLUSION AND RECOMMENDATIONS

Tax evasion is a very serious social menace that is causing a major setback on Rwanda economic development. From all indications it was now clear that if government engaged in overhauling the tax administrative machineries, the problems of tax evasion and avoidance will be reduced to the barest minimum. It is also important for the government to put in place stiff penalty for corrupt tax officials and made frantic efforts aimed at putting in place adequate enforcement for defaulters. Such penalties and enforcement will help generate more revenue to the coffers of the government. It is hoped that if the measures prescribed in this study are implemented, it will go some way in reducing the problem of tax evasion and avoidance to reasonable dimensions.

Based on the findings of this study, the researcher came up with various recommendations to encourage tax compliance among SMEs. These included; there was need to continuously train technical staff to keep abreast with the tax law and any other changes therein. This way, the officers will impart proper and correct advice to taxpayers during the time of audits and customer care lessons should form an integral part of this training. Recruitment of new taxpayers by the authority should be intensified and enhanced since this will broaden the tax base and reduce pressure on the complying taxpayers. This is a key pointer to the need for improved tax information and simple tax filing procedures as a way of increasing tax compliance. In relation to tax rates and penalty rates, consider lowering the tax rates to enhance collections. This was in line with optimal tax theory where lower tax rates make it less attractive to evade taxes as opposed to high rates. The study findings reveal that high penalty rates will increase compliance but only marginally and these penalty rates should be kept at an optimum level not to discourage taxpayers. Also consider uniform penalty rates for all tax heads.

Furthermore, the tax returns ought to be simplified and accompanying notes reconstructed into plain language that can be understood by all taxpayers and should also be clear and brief but complete in detail to enable the taxpayers file the returns on time.

Suggestions for further research

The study provided some directions for further research. For an improved understanding of tax compliance attitude and behavior in Rwanda, there was need for a more thorough examination of the concept of fairness in fiscal exchange, i.e., the contractual relationship between taxpayers and the government. In this context it is also relevant to analyze if and when user charges are to be preferred instead of general taxes to finance public services. Critical factors in this respect were tax payer's perceptions about the role of the state, how the tax law is administrated, perceptions about enforcement, government trustworthiness; value derived from taxes may have on tax compliance. Furthermore, there was need for research focusing on fairness in tax collection and comparative treatments of taxpayers. For example, under what conditions could compliance be established in Rwanda without an extensive and costly enforcement apparatus? This question is important because it is likely that governments, seeking power on the basis of popular consent, face restrictions in their use of coercion in tax collection.

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