

# **TAXPAYER PERCEPTIONS ON THE RRA APPEAL SYSTEM**

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TAXES FOR GROWTH AND DEVELOPMENT

## Taxpayer Perceptions on the RRA Appeal system

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### Summary

The key responsibility of RRA is to fairly and efficiently collect tax revenues, non-tax revenues and local government taxes. Conducting audits is one of the tools deployed by RRA in detecting non-compliance. Taxpayers may appeal to RRA against decisions within 30 days following the conclusion of audits and/or receiving any assessment notices of taxes or penalties. In this regard, the study analyses why the number of audit cases that proceed to appeal increase every year. It further asks how taxpayers perceive the appeal system in RRA, how it can affect compliance and provides research evidence and information to substantially improve the operation of appeal system. The study utilized both qualitative and quantitative methods to evaluate the performance of the appeal system by RRA. Findings from qualitative work reveal that the aggregate taxpayer perception of the accuracy of the audit outcome influence the number of cases which proceed to appeal. The quantitative results show that *interests* and *additional penalties* on outstanding taxes increase the chances of a taxpayer to make an appeal whereas *time between audited period and audit start date* decrease the chances of a taxpayer to make an appeal. Moreover, the quantitative results show that tax declared and a result in favour of the taxpayer increase together and it is statistically significant with 95% confidence.

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## Acronyms

CG	Commissioner General
CIT	Corporate Income Tax
EBM	Electronic Billing Machine
FY	Fiscal Year
GoR	Government of Rwanda
HAMD	Head of the Appeals Management Division
L&BSD	Legal and Board Secretariat Department
PAYE	Pay As You Earn
PIT	Personal Income Tax
PSF	Private Sector Federation
RRA	Rwanda Revenue Authority
Rwf	Rwandan Franc
TADAT	Tax Administration Diagnostic Assessment Tool
TIN	Taxpayer Identification Number
VAT	Value added tax
WHT	Withholding Tax

## 1 Introduction

In Rwanda, a significant number of tax cases appealed against audits return an amount that is waived in favour of the taxpayer. This raises a range of questions about the integrity of the appeals process and/or whether the audit function is too harsh in its treatment of taxpayers. This paper intends to explore in details the underlying factors associated with this behaviour.

A country's tax appeals process is an intuitive correlate to the compliance process; it is the tax administration's jury on equity, accounting for and responsible for portraying the integrity and transparency of the institution. If it fails, or performs its job poorly, taxpayers may not respect the institution charged with tax collection. If it is effective and impartial, it serves as a deterrent to taxpayers who try to *cheat* the system.

Several hypotheses have been considered to help understand better the major attributes. Under one hypothesis, it is possible that the appeals system is functioning well, but rather, the audit function is relatively harsh with its treatment of taxpayers. If this hypothesis is true, then the appeals system is correct to waive substantial amounts of audit treatments, and decide in favour of the taxpayers. Alternatively, it may be true that the audit system is functioning well, but that the appeal system is too forgiving of taxpayers. Finally, it may also be possible that both of these cases hold (audit excessively punitive and appeal too forgiving) some merit in the context of Rwanda Revenue Authority, in this instance both the appeal and the audit function requires review and reform.

In order to streamline tax collection and solve tax disputes, Rwanda Revenue Authority (RRA) has implemented a number of reforms geared towards increasing domestic revenue collection. The responsibility of RRA is to fairly and efficiently collect tax revenues, non-tax revenues and local governments' taxes. Improved compliance is the RRA key objectives in order to fulfil its mandate of mobilizing revenues. In order to support its key objectives and detect non-compliance, the RRA relies upon different initiatives including better quality of service delivery, conducting of audits, monitoring devices (like EBM), written guidance and processes, education, and other compliance instruments.

Many countries experience problems with tax disputes where serious backlog of tax cases threatens revenue collection and confidence of taxpayers in the tax system. The note on Tax Law by Victor, Lead & Isabel (2013) emphasizes the avoidance of disputes at the earliest possible stage and resolving as many disputes at the administrative level as possible, consistently with protecting taxpayers' rights.

### 1.1 Objectives

The overall objective is to investigate the source of the increase in number of audit cases that are appealed against. To the best of our knowledge, no study related to taxpayers' perception of appeals and how they affect compliance was conducted in Rwanda. It is against this background that the study seeks to:

- i. Find out how taxpayers perceive the appeal system in RRA and how it can affect compliance.
- ii. Provide research evidence and information to improve the operation of appeal system,

- iii. Evaluate quantitatively the impact of appeals on compliance,
- iv. Understand and provide recommendations on the relationship between audit and appeal process.

The remainder of this paper is structured as follows: Part Two tackles the literature review on the subject; Part Three describes the methodology used, followed by empirical results discussed in Part Four before the concluding remarks in Part Five.

## 2 Literature review

### 2.1 Theoretical framework

There are some terms, which are referred to in the subsequent sections. To ensure that each of these are well understood in the context of this paper, this section will briefly lay them out in advance.

1. **Appeal:** a formal request by a taxpayer asserting their legal right to have a tax decision reviewed by the same institution,
2. **Amicable settlement:** a formal request by a taxpayer asserting their legal right to have an appeal decision reviewed by the same institution,
3. **File a case:** a formal request by a taxpayer asserting their legal right to have appeal decision reviewed by the competent court,
4. **Complaints/protests/grievances:** informal requests by taxpayers to review discussions made by the institution or its personnel.

### 2.2 Conceptual framework

A review of the appeals system will consider literature at the intersection of economics and law. The design of the appeal system must account for the incentives, which it creates, while simultaneously ensuring that it is predicated on a firm legal framework.

Appeals systems act to re-inforce the mechanisms, which they supervise. Feess, & Sarel (2018) review the impact of the existence of an appeals system, and how it impacts the decisions of trials. If the effort exerted by the judge has a bearing on the validity of the decision, they show that the existence of an appeals mechanism can improve the decisions made by judges. As judges suffer reputational losses when decisions are overturned, the appeals system acts to enforce correct decisions.

The same principles can be applied to the tax administration. Generally, appeals processes are made as a result of the outcome of audits. The presence of an internal review system within a tax administration increases the effort of tax auditors, since they are aware that if appeals are overturned, their reputation as a competent auditor may suffer. In tax administration too, it is reasonable to assume that by deploying additional effort to the audit process, correct decisions are made with increased likelihood.

By performing a supervisory role over the adjudicator, the existence of an appeals system directs the outcome towards the social optimum more often. Shavell (2006) assumes that the appeals process has the same utility function as that of a social planner, and so acts to deter adjudicators from making decisions that are in their personal interest.

This finding also holds some relevance to multi-step mechanisms in Tax Administration. Since the court reflects both the letter and the substance of the law, the representation which they put forward is similar to that of a social planner for that country. The adjudicator in this case is the individual in the tax administration who has reviewed the appeal, not the auditor. The adjudicator may hold some personal interest at heart, such as those of the revenue authority. However, the existence of a process where these issues can go to another institution delivers further checks on the decision of the adjudicator.

### *Best practice*

A number of surveys and studies consider what different processes are in place globally. In order to put the practice in Rwanda into context, it is important to consider which other systems are in place. RRA 2019 TADAT report and Reichel, Hammond, Esejo, Magalhaes and Cebreiro (2016) consider certain good practice pillars are generally adhered to:

1. **A legal definition of the appeals process:** the laws governing the tax-review process should be clearly presented and easily understandable to non-specialists.
2. **Harmonize the internal review procedure:** objections can be lodged against various types of tax assessment, but there should be a minimum number of methods to make an objection.
3. **The independence of the review institution:** the independence of the internal review institution increases the credibility of the entire tax system, encourages voluntary compliance with tax laws and results in more satisfactory decisions. However, there is a trade-off between independence and administrative costs. No assessment should be reviewed by the same agent that made the original assessment.
4. **Communicate effectively with the public and with the taxpayers involved in the review process:** well-informed taxpayers are less likely to submit cases that lack merit and more likely to complete the documentation in a manner that is likely to support the functionality of the review process (submit complete documentation through the correct channels).
5. **Resolve disputes as early in the process as possible:** internal review systems and scope for amicable settlements can minimize the time that is spent on review processes. However, it is vital that when more integrated relationships are formed with the revenue authority, that the equity and consistency of the treatment is preserved.
6. **Collect, publish and report performance data:** data should be made available to the public in the interest of transparency, accountability and establishing realistic expectations among taxpayers.

7. **Embrace ICT solutions:** case tracking can enhance transparency.
8. **Improve the quality of Tax documents:** accessible tax forms are crucial to the efficiency of tax administration. Procedural manuals can enhance the flow of information within the tax authority and improve the consistency of the review process.
9. **Establish and use performance indicators:** policymakers can use performance indicators to assess the effectiveness and efficiency of tax institutions and design appropriate reforms. Include i) the number of objections filed and resolved ii) whether the case was settled, fully or partially decided iii) the length of the objection process.

### 2.3 Assessment of the current appeals framework

Using each of the pillars assessed above, we can assess RRA's current performance. This exercise is performed to identify potential areas that are leading to an excessive amount of appeals: firstly, the legal definition of the internal review procedure is well documented in two legal documents. The law on tax procedure N° 026/2019 of 18/09/2019 documents the process for appeals while the Commissioner General's ruling determines the modalities of the amicable tax settlement procedure. The second pillar is also catered for by this legislation; the process is the same for different tax types.

The independence of the reviewer is ultimately preserved by the court system. RRA has the benefit of learning from its internal review process, as it is kept close to the original reviewer. The administrative review mechanisms are not totally independent of the audit process according to RRA 2019 TADAT report. Three performance indicators are used to assess Effective Tax Dispute Resolution:

- Existence of an independent, workable, and graduated dispute resolution process,
- Time taken to resolve disputes,
- Degree to which dispute outcomes are acted upon.

The table below sets out the trade-offs inherent in such a choice:

**Table 1 Indicators to assess Effective Tax Dispute**

	Efficiency	Independence	Transparency	Credibility
Official who issued the original decision	+++++	+	+++	+
Different official, but from the same institution	++++	++	+++	++
Official from a different institution	+++	+++	+++	+++
Head of the institution	+++	++	+++	++
Appointed third party	+++	+++	++++	+++
Panel of officials	++	+++	++++	++++
Independent panel	+	+++++	+++++	+++++

Note: + = weakest, +++++ = strongest

Source: The Administrative Review Process for Tax Disputes: Tax Objections and Appeals in Latin America and the Caribbean

Fourthly, communications are legislated to happen regularly and through formal processes. Article 48 of the law on tax procedure stipulates that *the Commissioner General makes a decision on the appeal in a period not exceeding thirty days from the date of receipt of the appeal & communicates it to the taxpayer in writing.* This also pertains to the fifth pillar, as the period for response is stipulated to be less than 30 days, unless an extension is provided for.

The data collection as recommended by pillar 6 is available, though data entry is currently not in database structures, but rather into Microsoft excel. Facilitation of this sort can simultaneously enhance the performance of the audit process, as considered by pillar 7. Considering the ninth pillar, the requirements for an appeal are detailed in the legislation, but currently no tax form for an appeal is available.

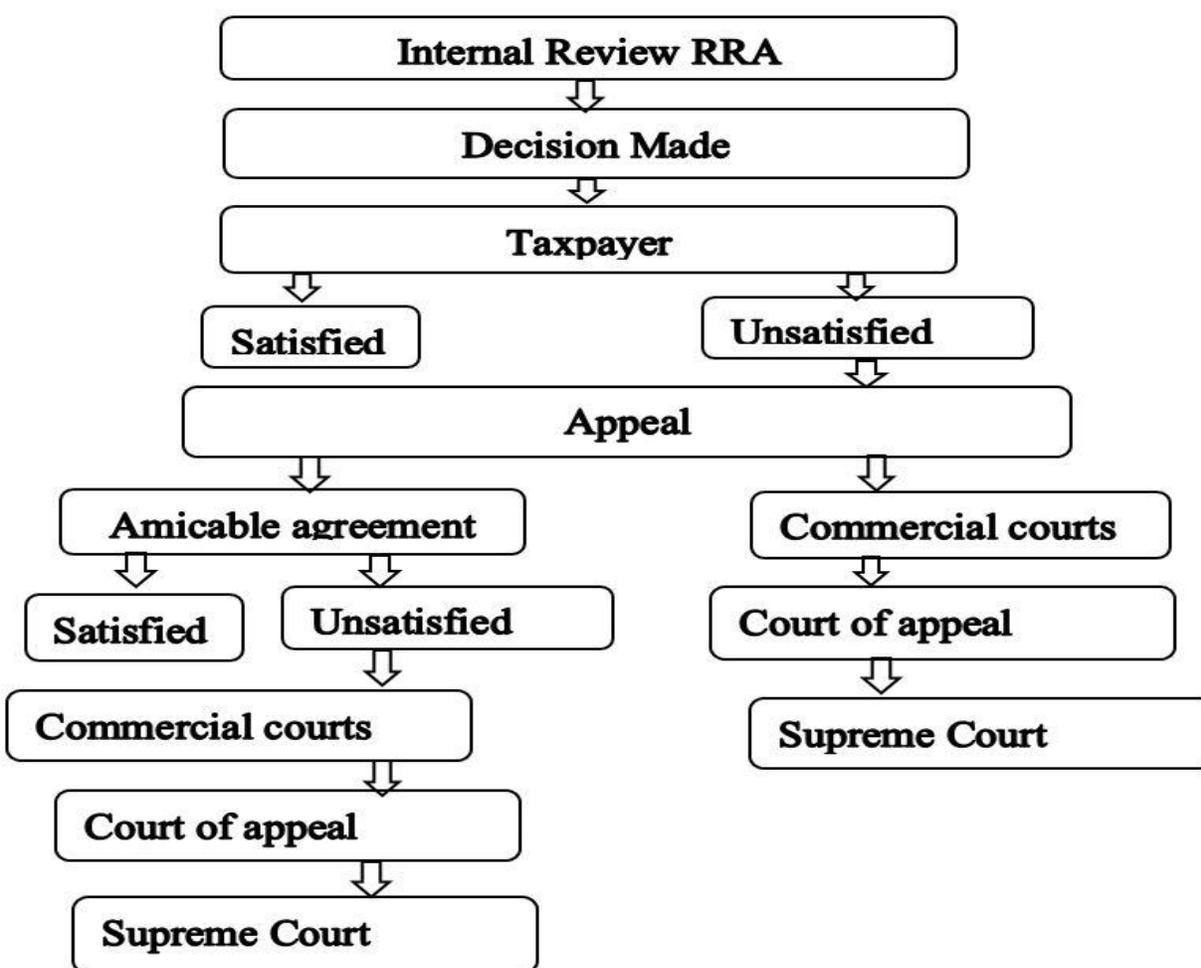
Lastly, the domestic tax department undertakes Key performance indicator management. Appeals outcomes are not routinely supervised.

## 2.4 Description of the current appeal system

Procedurally, unsatisfied taxpayers of the audit results can appeal to Commissioner General who sets up an appeals committee housed in the Legal department (appeal unit), to review the taxpayers’ complaints. In order to appeal, taxpayers must write a letter addressed to the Commissioner General of RRA within 30 days of receiving notice of the decision they wish to appeal, who forwards the same to the Head of the Appeals Management Division (HAMD) a unit

that is situated in the Legal and Board Secretariat Department (L&BSD). The HAMD assigns such cases to appeal officers for review in so doing, they may interview the auditor that finalized the case and/or the taxpayer and preparation of a draft decision. The draft decision is initially presented to the appeals sub-committee (at a pre-appeal meeting) which is chaired by the HAMD. Input of the sub-committee is subsequently incorporated in the final explanatory note that is presented to the appeals committee that is chaired by the CG as provided for in the RRA procedure (RRA Tax Handbook, 2019). If the taxpayer is not satisfied with the decision taken at the appeals level, they may request the CG for an amicable settlement. If an agreement cannot be reached, the taxpayer may take the appeal further to the Commercial Court, the High Court and the Supreme Court in turn.<sup>2</sup>

**Figure 1** The description of the current appeal system.



The Figure 1 shows the current appeal process at RRA. In brief, RRA assesses internally all types of tax to check if taxpayers comply with tax laws. If they find issues, they inform the taxpayer and

<sup>2</sup> [Compilation of Fiscal Laws and Regulations in use in Rwanda Version 2017](#), P 291, Article 32

may conduct an audit. After being enforced or after being audited, unsatisfied taxpayer (with audit result) can appeal to Commissioner General. After reviewing the case, it can be rejected or accepted depending on the convincing facts provided. Then, a taxpayer can proceed either for an amicable agreement within RRA or direct to Commercial courts, court of Appeal and Supreme Court. If amicable agreement is not reached, the taxpayer may file a case to the Commercial Court, the Court of Appeal and the Supreme Court.

### 3 Data

This study uses administrative tax data in the analysis of the appeals process. As well as tax declaration for each of the key tax heads, we matched the audit and appeal dataset from 2014-2019. In addition, appeal data from 2014-2019 and declaration data from three key tax heads: PAYE, VAT and CIT were used for understanding the compliance effects of the appeal process. Nine years of declaration data are considered from 2011 to 2019. The study used administrative audit and appeal dataset for the period of five years (2014-2019).

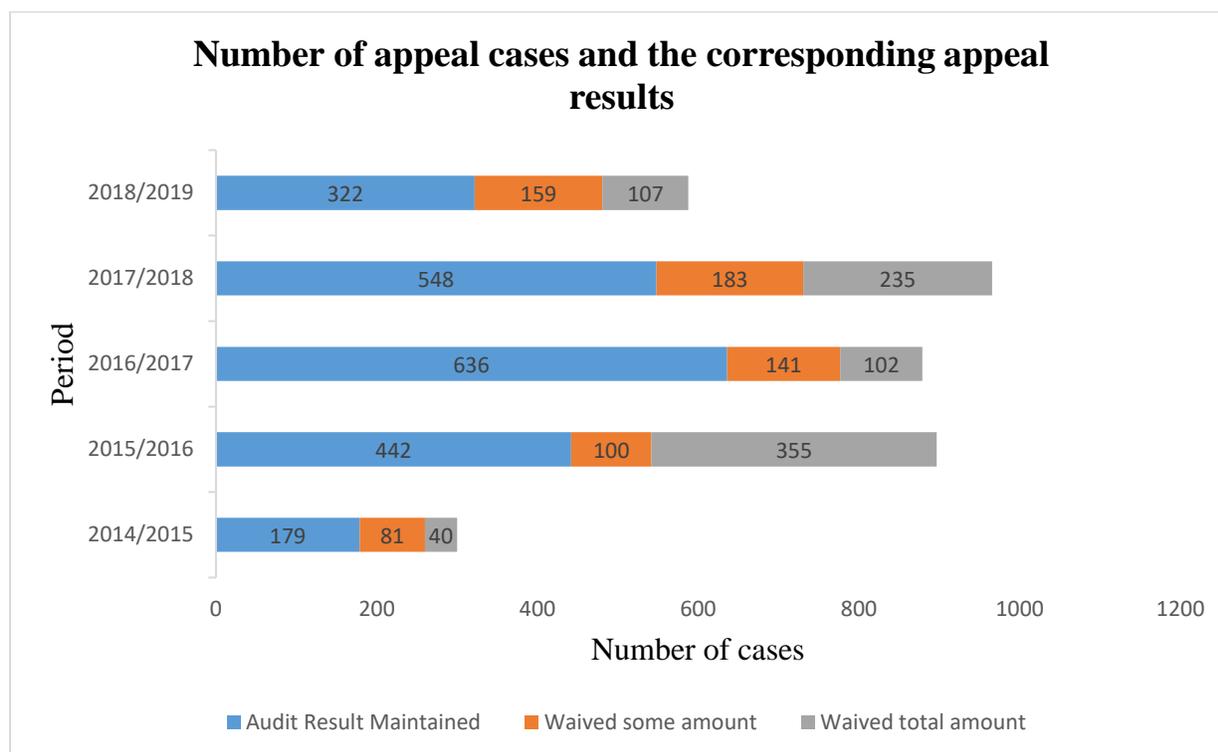
**Table 2 Summary of variables for the used dataset**

<b>Variables for audit dataset</b>	<b>Variables for appeal dataset</b>
Size	Taxpayer's name
TIN	Date of reception of letter of appeal
Taxpayer's name	Date of reply
Auditors	Tax type
Tax type	Decision taken
Audited Period	Tax originally assessed in Rwf
Audit type	Tax waived in Rwf
Audit start date	Tax to be paid in Rwf
Audit end date	
Self-assessment	
Principal	
Fine for understatement	
Late payment fine	
Interests	
Total amount	

Since appeal data does not record the TIN of the taxpayer, the matching of the appeal cases back to the original audit cases was not straightforward. String match algorithms were used to match taxpayer names of those who were audited to those who appealed following the audit and the process was successful at 90%.

The maintenance of an audit cause number, which is unique for each taxpayer, tax type, and audit type and audit instance will be helpful for future studies. This number should be recorded at the appeal stage, such that there is a one-to-one mapping of the appeal case back to the audit case.

**Figure 2 Number of appeal cases and appeal decision**



Source: Author’s computation using administrative data from Legal and Domestic Tax Departments

Figure 2 above shows the number of appeal cases per type of appeal decision over five fiscal years (FY). Total appeal cases recorded a sharp increase between FY 2015/16 and FY 2017/18. The recorded average number of appeal cases over the years is 726 cases. The number of cases on which audit results maintained fluctuated over the years and averaged to 425 cases with the recorded lowest and highest values of 179 and 636 cases respectively for FY 2014/15 and FY 2016/17. On average, the decision to maintain audits results was taken for 59% of total appeal cases. The number of cases on which some amount was waived averaged 133 cases over the years. This implies that the decision to waive some amount was taken for 20% of the total appeal cases. Cases on which total amount was waived fluctuated over the years and averaged 169 cases equivalent to 21% of total cases.

## 4 Methodology

The study utilized both qualitative and quantitative methods to evaluate the performance of the appeal system by RRA. For methodology, we used three steps:

### 4.1 Qualitative Analysis

The study was carried out in Rwanda with a survey of 46 taxpayers who have been in dispute with RRA and 35 individuals and stakeholders that we believe have information about appeal system in RRA to gather their point of view and to validate the administrative data. The sampling strategy was built on a multistage sampling, 4 categories of taxpayers were chosen across the country for the period of five years (2014-2019): Taxpayers who were audited and were satisfied with audit results, those unsatisfied with audit result and appealed against audit decision, Taxpayers who proceeded to amicable settlement and those who filed a case to the court. Twelve Taxpayers were randomly chosen in each of the targeted categories.

The questionnaires were composed of two main sections: respondent general information and questions related to research objectives. The questionnaire used depended on the type of institution queried. The survey questionnaires can be found in the appendix of this paper.

**Table 3 Institutions that participated in the survey**

Institution	Staff	Number of individuals interviewed
RRA	Auditors and Appeal Officers	15
ATAR	Tax Advisors	8
Supreme Court	Judges	2
Court of Appeal	Judges	4
Commercial Court	Judges	3
Commercial High Court	Judges	3

### 4.2 Quantitative Analysis

#### 4.2.1 Why do taxpayers appeal audit results?

The study utilized fixed effect regression models to analyse administrative data on appeal and audit cases respectively from the Legal and Domestic tax departments. Identified variables that might be correlated with the decision to appeal are:

- i) *Principal*

The principal is the discovered tax liability that the taxpayer must pay, in addition to what was indicated on their self-declaration. A priori, we would expect that a taxpayer may be inclined to appeal the result if they are unable to pay the principal. For that reason, we expect that, if significant, the effect of principal on appeal to be positive ( $\beta > 0$ ).

ii) *Understatement penalties*

The understatement penalty is the administrative penalty when an audit or investigation shows that the amount on a tax declaration is less than the tax liability the taxpayer ought to have paid, he/she shall pay the non-paid tax and also be subject to the understatement penalties. In this case, we expect the effect of understatement penalties on appeal to be positive ( $\beta > 0$ ) if significant.

iii) *Late payment penalties*

If the amount of tax shown on a tax declaration or the amount of tax which is the result a declaration not paid on or before the deadline, the taxpayer is subject to a late payment fine. This can also lead to appeal when a taxpayer decides to write a letter of appeal for late payment or request a reversal or correction of a penalty. For example, if the taxpayer was not able to pay due to IT failure by RRA. If significant, we expect the effect of late payment penalties on appeal to be positive ( $\beta > 0$ ).

iv) *Additional penalties*

Any taxpayer who commits other offences provided for by compilation of fiscal laws and regulations in use in Rwanda may be subject to the additional sanctions. If significant, we expect  $\beta > 0$ .

v) *Interests*

Generally, interest is charged on any unpaid tax from the original due date of the return until the date of payment. The RRA will charge interest of 1.5% on a monthly basis on late or unpaid taxes (RRA Tax Handbook, 2019). The period covered always begins with the original due date of the return, and ends with the receipt of payment by the RRA. A taxpayer may be more likely to appeal. We expect the effect of interests on appeal to be positive ( $\beta > 0$ ), if significant.

vi) *Size*

Mainly, taxpayers are grouped into three categories based on the size of their business firms: The thresholds for Small taxpayers carries forward up to FRW 500,000, The thresholds for Medium taxpayers carries forward up to FRW 2,000,000 and The thresholds for Large taxpayers carries forward up to FRW 5,000,000. We think large taxpayers have tax advisors and more knowledge to appeal process which can lead them to appeal compared to small and medium taxpayers.

vii) *Auditors*

A tax auditor is a professional who evaluates financial records to determine whether they comply with the applicable laws. They work to check if companies, individuals, agencies and organizations comply with tax laws. They can help identify fraud and tax errors by conducting random audits for companies, especially those suspected of tax evasion or fraud. If the audit function is not operating effectively, the appeal system will come under pressure due to an excess number of appeals. This analysis will allow us to identify auditors whose audits often lead to appeals. A dummy variable is used to represent auditors.

*viii) Audit type*

An audit is one of the methods RRA uses to ensure that taxpayers are correctly declaring and paying their taxes. Audits involve RRA checking the relevant documents concerning a taxpayer's tax obligations for any tax period(s) within the past five years. If there is evidence of non-compliance, the taxpayer will be issued with an assessment notice. This contains details of the offence(s), and the unpaid tax due, as well as additional penalties or fines that must be paid.

There are four types of audit:

- *Desk audit*
- *Issue audit*
- *Comprehensive audit*
- *Refund audit*

Desk audits are conducted by RRA staff using information that has already been submitted to RRA. Issue audits are usually focused on a single tax type, single aspect or single tax period. Refund audits are a type of issue audit, focused on tax declarations claiming refunds from RRA. Issue audits may be desk-based or involve visits to the taxpayer's business premises. Comprehensive audits are more in-depth and time-intensive. These are usually conducted by RRA staff whilst visiting the taxpayer's business premises and reviewing all relevant documents. This model will assess whether the different types of audit are more likely to lead to appeal. A dummy variable is used for each type of audit.

*ix) Tax type*

RRA has different tax type such as: Personal Income Tax, Corporate Income Tax, Value Added Tax etc. We will investigate if a certain tax type can have a high chance to lead to appeal. For example, the fact that EBM exists for VAT can be a reason that there might be more appeals for VAT. This model will assess which tax types are most likely to lead to appeal.

*x) Interval between when audit take place and audited period*

The interval between when audit take place and audited period is the length between audit start date and the audited period. For instance, audit can start in 2017, but the audited period is 2012. Taxpayers who are audited for old years and they cannot provide all requested documents in the short period given prior to audit can proceed to appeal in order to get additional time provided by

an appeal process. If significant, we expect the effect of interval between when audit take place and audited period on appeal to be positive ( $\beta > 0$ ).

### 4.2.2 Fixed Effects Regression

A fixed effects regression is an estimation technique employed in a panel data setting that allows one to control for time-invariant unobserved individual characteristics that can be correlated with the observed independent variables.

The FE model for audit and appeal data is given by:

$$\begin{aligned}
 Appeal_{it} = & \beta_1 Principal_{it} + \beta_2 Understatement\ penalties_{it} + \beta_3 Late\ payment\ penalties_{it} + \\
 & \beta_4 Additional\ penalties_{it} + \beta_5 Interests_{it} + \beta_6 Time\ audited\ period\ and\ audit\ date_{it} + Size_i + \\
 & Auditors_i + Audit\ type_i + Tax\ type_i + \varepsilon_{it}
 \end{aligned} \tag{1}$$

### 4.2.3 Understanding the compliance impact of the appeal process

In principle, compliance is measured as the difference between the tax declared initially (self-reported by the taxpayer) and the tax liability resulting from the audit and appeal process. We measured compliance through declared tax, the amount which the taxpayer puts forth as having declared after the appeal for this study since the difference was not available to us, unless the taxpayer was audited again. This is in the interest of the revenue authority; whose key mandate is to collect revenue on behalf of the Government of Rwanda (GoR).

We consider a number of key variables from the appeal dataset which allow us to examine the relationship between compliance and appeal:

- **Appeal:** We consider what the impact of appealing an audit verdict is. A priori, we may expect this to have a negative correlation with tax compliance, since it is an indication that the taxpayer was not satisfied with the audit outcome. This would suggest  $\beta < 0$ , where the decision to appeal is coded as 1.
- **Result:** We consider the impact of the appeal result. A positive appeal result may be correlated with positive future compliance, as it may increase voluntary compliance. On the contrary, an appeal result in favour of RRA, may have a negative effect on compliance as the taxpayer may be dissatisfied with the outcome. This would suggest  $\beta > 0$ , where a result in favour of the taxpayer is coded as 1.

In addition, we control for spurious correlation in the regression by accounting for the business turnover, the size of the business, the location of the business and the sector classification, as well as time trends.

This leads us to two specifications:

$$Tax\ due_{it} = \beta_1 Result\ for\ taxpayer_{it} + \beta_2 Amount\ waived_{it} + \beta X_{it} + ISIC_i + Size_i + Tax\ Center_i + \varepsilon_{it} \tag{2}$$

For the set of firms who appealed and:

$$Tax\ due_{it} = \beta_1 Appealed\ audit\ result_{it} + \beta X_{it} + ISIC_i + Size_i + Tax\ Center_i + \varepsilon_{it} \tag{3}$$

Where X is a set of time trends and turnover.

## 5 Results

### 5.1 Qualitative results

#### Tax Advisors

Tax advisors often intervene to advise a taxpayer whether to appeal or to accept an audit decision from the Revenue Authority. Given both their experience and familiarity with the appeals system, this study interviewed eight tax advisors in order to gather their opinion on the integrity and efficacy of the RRA appeals system.

Tax advisors broadly identified three similar issues with appeals system. Firstly, advisors highlighted a number of issues with the audit function which has a subsequent impact on the appeals system. Secondly, the tax advisors highlighted some structural concerns which create perverse incentives within appeals system. Lastly, some recommendations were made to improve the legislation which concerns appeals.

If the audit function is not operating effectively, the appeal system will come under pressure due to an excess number of appeals. Tax advisors believe that due to issues in the underlying audit process, many cases go to appeals which should not have been raised by auditors, at all. The advisors cite a lack of professionalism, insufficient knowledge of the law, a lack of attention to detail, incomplete understanding of the law, unwillingness to cooperate (by both the taxpayer and the auditor) and, in some instances, corruption.

Secondly, numerous tax advisors highlighted the importance of the structure of the appeals system for its integrity. According to them, the structure should be independent from RRA such that the incentive for all involved parties is to accurately report on the compliance level of the taxpayer, and to minimize disruptions to this decision. Some noted that the appeal process ought to be an independent body outside of the RRA. For the advisors, the concern is that in some instances, the legal officer charged with handing the appeal may be pressured to determine the case in favour of his/her employer, the RRA. Further incentive issues arise during the audit process. Advisors felt that in some instances, the auditor's work is seen to be more diligent if penalties and fines are levied, and lacklustre otherwise.

Finally, the legislative framework which underpins the appeals system was brought to the fore. Tax advisors suggested a number of recommendations to address this: a PSF representative ought to be assigned to the decision committee of an appeal case; the examination period of forty five days on average is too long which is inconvenient to the taxpayer and; more time should be granted to the taxpayer to respond to requests for documentation.

#### Tax Auditors

The primary objective of tax auditors is to ensure that, accurate taxes are paid according to the tax laws and procedures and give notice for non-compliance. The aggregate taxpayer perception of the accuracy of the audit outcome determine the number of cases which proceed to appeal. Eight auditors from RRA were interviewed in this study for the purpose of getting their point of view on the performance of appeal system.

RRA auditors mainly identified three issues with appeals system. Auditors highlighted lack of knowledge and legislative familiarity on both sides of the audit process. Firstly, auditors emphasized that taxpayers lack in-depth understanding of the whole tax audit procedure, its importance and their role in the whole process. Secondly, auditors mentioned their own insufficient knowledge of the law and lack of regular training and updates about the new change in law, which can lead them to take incorrect, outdated decisions.

Lastly, they highlighted that time given to appeal officers who handle the appeal is insufficient to handle the number of cases allocated to them. As a consequence, they do not have time to do deep analysis and consider all elements of the audit examination. Auditors recommended RRA to increase the number of legal officers, to improve the communication between auditors and legal officers in order to avoid unnecessary contradiction.

### **RRA Legal Officers**

The role of RRA legal officers is to provide the taxpayers with easily accessible, efficient, fair and independent means of tax arbitration. Appeal system in RRA gives any taxpayer an opportunity to settle disagreements with the RRA on matters arising from audit results. This study interviewed seven legal officers in order to gather their inputs on the integrity and efficacy of the RRA appeals system. Legal officers as the ones taking appeal decisions highlighted three measure points on the appeal system.

Firstly, the legal officers in appeal unit drew attention to the lack of professionalism, insufficient knowledge of the law, a lack of attention to detail, incomplete understanding of the law by auditors, and lack of commitment for auditors (they just push the work to legal officers), in some instances, corruption.

Secondly, appeal officers emphasized on the independence of the appeal system. They recommended that taxpayers should be allowed to attend the appeal committee. This would increase the perception of fairness and trust. Further, thorough communication between the appeal officer and the auditor in advance of the appeal committee would allow the committee to sit without the auditor present, further increasing the credibility and unbiasedness of the decision.

Thirdly, appeal officers recommended RRA to increase the number of appeal officers, to train auditors and appeal officers regularly. This could mitigate the inadvertent waiver of an amount on audit result due to lack of interpretation of laws and procedures by auditors.

### **Taxpayers**

Taxpayers' ability to access an independent and impartial tax dispute resolution process is important. Access to tax justice may improve voluntary tax compliance by boosting tax morale; access to tax justice fulfils the principle of social justice which demands that everyone is treated equally by the law. While effective access to a legal system is important in resolving conflicts of taxpayers with RRA, the appeal system can be ineffective if taxpayers are discouraged from using it for dispute resolution. Thirty-six interviewed taxpayers in the study specified three main points on the appeal system in RRA.

Firstly, taxpayers pointed out that they are audited for old years and they cannot provide all requested documents in the short period of three days for issue audits and seven days for comprehensive audits given prior to audit. Owing to the additional time provided by an appeal process, taxpayers can provide documents in appeal which were not provided during audit.

Secondly, taxpayers also mentioned the lack of motivation, competencies, knowledge, experience and specialization within the industries for some auditors which affect audit quality.

Lastly, taxpayers' recommendations are that RRA needs to strengthen capacity through trainings, legal department to be independent from RRA and auditors to improve on charging fines without applying laws and procedures which lead to the increase of number of cases that proceed to appeal and the waiver of some amounts by appeal officers. Moreover, taxpayers recommended legal department to minimize time taken to reply during appeal process.

## **Judges**

Judges who took part in the study pointed out three main points.

Firstly, lack of responsibility and time to go in depth for cases and insufficient interpretation of law by auditors.

Secondly, judges revealed that tax disputes are resolved slowly 45 days on average, resulting into a large back log of outstanding disputes, very few cases are resolved by the legal department due to the back log of cases appearing at their hands. Moreover, tax disputes are commonly withdrawn by taxpayers due to lengthy legal bureaucracy.

Lastly, wrong interpretation of laws by RRA concerned staff. In addition, taxpayers are facing the challenge of providing a burden of proof in tax appeals cases which is difficult since most taxpayers do not keep proper records for tax assessment and hence fail to prove to auditors and appeal officers. The inability to provide a burden of proof may discourage taxpayers from seeking tax justice and thereby reduce tax morale and hence voluntary tax compliance. Moreover, RRA must approach taxpayers so that taxpayers consider RRA as stakeholder who is helping them to run their businesses rather than enemy. Judges recommendation is that RRA should minimize the number of cases that proceed to appeal and court by improving audit process and amicable settlement.

## **5.2 Quantitative results**

### **5.2.1 Why do taxpayers appeal audit results?**

Table 4 below shows the results of the fixed effects regression of specification (1), correlated with the decision to go to appeal.

**Table 4 FE Regression Results**

	<i>Dependent variable:</i>
	Appeal
Principal	-0.00001 (0.0001)
Understatement Penalties	-0.0001 (0.0001)
Late Payment Penalties	0.0004 (0.0005)
Additional Penalties	0.0004*** (0.0001)
Interests	0.002*** (0.001)
Interval audited Period and audit date	-0.029*** (0.003)
Desk Audit	-0.046 (0.029)
Issue Audit	0.042** (0.021)
Refund Audit	-0.169*** (0.059)
PAYE	-0.020* (0.011)
PIT	-0.062** (0.025)
VAT	-0.008 (0.010)
WHT	-0.058*** (0.012)
Medium Size	0.245*** (0.065)
Small Size	0.219*** (0.067)

Observations	17,774
R <sup>2</sup>	0.334

The model results show that interests and additional penalties are statistically significant on appeal, which is matching with our expectation that an increase for a unit on interests or additional penalties will increase the probability of the decision to appeal. The time between audited period and audit start date has a negative association with appeal, which is contrary from the expected sign. It might be that when a lot of time has passed, taxpayers simply lost the documentation and are in no position to argue their case. The coefficient  $-0.029$  for the interval audited period and audit date reveal that if the interval is increase by one year, it will decrease taxpayers' decision to appeal by 2.9 percentage points.

The results show that the *Medium* and *Small* taxpayer are associated with the increase by 24 and 21 percentage points respectively over the *Large* taxpayer on the decision to appeal. Perhaps, *Large* taxpayers are trying to cheat and when they are audited they do not have to appeal because they are already aware that they are non-compliant. Moreover, the results also show that *the Issue audit* is associated with the increase by 4.2 percentage points on the decision to appeal over the *Comprehensive audit* while the *Refund audit* is associated with the decrease by 16.9 percentage points on the decision to appeal over the *Comprehensive audit*. *PIT*, *PAYE* and *WHT* are associated with decrease in the probability of appeal by 6.2, 2 and 5.8 percentage points respectively over the *CIT*. Some reasons behind: Since *PAYE* is withheld and declared together with the pension contribution is not easy to be undetected & noncompliant for *PAYE* and therefore taxpayers audited on *PAYE* are less likely to have the evidence to appeal the audit results. Similarly to large taxpayers, it may be that *PIT* taxpayers are generally less compliant and when they are audited, they are more likely to accept the detection.

### 5.2.2 Understanding the compliance effects of the appeal process

Table 5 below shows the results from specification (2) and (3). Columns 1 and 2 hold the sample of those who appealed only, and compares whether a positive result is associated with an increase in tax due. Columns 3 and 4 take the sample of those who were audited, and explores whether the decision to go to appeal has an association with tax due.

**Table 5 Regression results**

	<i>Dependent variable:</i>			
	Tax due Result (1)	Result FE (2)	Appeal (3)	Appeal FE (4)
Result for taxpayer	50.210**	52.378**		

	(24.800)	(25.393)		
Amount Waived	0.000	0.00000		
	(0.000)	(0.000)		
Appealed audit result			59.337***	9.500
			(13.557)	(13.463)
Turnover	0.139***	0.133***	0.121***	0.114***
	(0.010)	(0.013)	(0.007)	(0.008)
Tax Period	-0.050***	-2.634	-0.042***	1.365
	(0.009)	(4.321)	(0.007)	(2.280)
Observations	7,334	7,334	16,914	16,914
R <sup>2</sup>	0.683	0.771	0.612	0.738

The results show that there is a positive association between tax declared and a result in favour of the taxpayer (column 1 and 2), which is in line with the expectation that if appeal result is in favour of the taxpayer it will increase the level of compliance. This result is statistically significant with 95% confidence.

However, in the regression in which the decision to appeal is an independent variable (column 3 and 4), the coefficient is positive. The results are not interpreted here because they do not include fixed effects, which seem to account for the relationship spuriously. The positive association between turnover and tax due is intuitive, they increase together.

## 6 Conclusion and recommendations

Overall, the study aimed to:

- i) Find out how taxpayers perceive the appeal system in RRA and how it can affect compliance and provide research evidence and information to substantially improve the operation of appeal system,
- ii) Evaluate quantitatively the impact of appeals on compliance and
- iii) Understand and provide recommendations on the relationship between audit process, appeal process, time to complete a case and number of cases resolved both at appeal and court levels.

The analysis was conducted using secondary administrative data from both from Legal department on appeal cases and Domestic tax department on audit cases. Key informant interviews were carried out to supplement administrative data. The findings have revealed that the variables *interests* and *additional penalties* increase the appeal level, whereas *time between audited period and audit start date* decrease the appeal level. The results also show that taxpayers are likely to appeal more by *Medium* and *Small* size than *Large* one. The *Issue* audit increase the chance of the decision to appeal over the *Comprehensive* audit. The findings show that the tax type *PAYE*, *WHT* and *PIT* decrease the chance of the decision to appeal compared to the *CIT*.

Moreover, the results show that result in favour of the taxpayer and tax declared increase together and it is statistically significant with 95% confidence.

This report strongly recommends the introduction and consistence use of audit number, which is unique for each taxpayer, tax type, and audit type and audit instance. This number should be recorded at the appeal stage, such that there is a one-to-one mapping of the appeal case back to the audit case.

Regarding the integrity and efficacy of the RRA appeals system, the stakeholders have highlighted a number of issues with the audit function which has a subsequent impact on the appeals system. Taxpayers are facing the challenge of providing a burden of proof in tax appeals cases which is difficult since most taxpayers do not keep proper records for tax assessment and hence fail to prove to auditors and appeal officers. The inability to provide a burden of proof may discourage taxpayers from seeking tax justice and thereby reduce tax morale and hence voluntary tax compliance. The feedback also revealed that tax disputes are resolved slowly, resulting into a large back log of outstanding disputes with RRA appeal unit, very few cases are resolved by the appeal unit due to the back log of cases appearing at their hand. For instance, for 2018/2019 an appeal officer handled 9 cases per week on average. As a consequence, tax disputes can be withdrawn by taxpayers due to lengthy legal bureaucracy.

To improve the legislation which concerns appeals at RRA and minimize the number of appeal cases, the following should be addressed:

- Audits time periods matter. In order to undertake an accurate and fair audit, keep the time between the audit and the tax period to a minimum of two years at most. In addition, taxpayers need to be constantly reminded of their obligation of record keeping in line with the legal provisions.
- Domestic Taxes Department should know that the appeals process has no detectable negative effect on revenue collection. In fact, results in favour of the taxpayer is associated with more tax declared in future years. However, delay to resolve appeals negatively affects taxpayers, particularly small and medium ones in terms of expenses since decision making for all tax appeals cases, are decided at RRA headquarter. The decentralisation of decision making for tax appeals cases at district level will reduce those travel.
- Keep records of common mistakes made by both auditors and appeal officers in order to use those records to inform collective actions.
- RRA to strengthen capacity of taxpayers through trainings of the whole tax audit procedure, its importance and their role in the whole process.
- Regular trainings of auditors in order to keep them updated about new or changed laws. This could mitigate the inadvertent waiver of an amount on audit result due to lack of interpretation of laws and procedures by auditors.
- To train appeal officers regularly and increase the number of officers who handle the appeal cases.
- Appeals unit in Legal department to be independent from RRA and to minimize time taken to reply to taxpayers during appeal process. This recommendation was also highlighted in the RRA future operating model report and RRA 2019 TADAT report.

- The examination period is too long which is inconvenient to the taxpayer and; more time should be granted to the taxpayer to respond to requests for documentation.

**Appendix**

**Appendix 1 Questionnaire for taxpayers**

**SECTION A: GENERAL INFORMATION**

**A1. RESPONDENT INFORMATION**

<b>Q1</b>	<b>IDENTIFICATION</b>	
<b>Q1.1</b>	<b>Gender of the respondent</b>	1.Male <input type="checkbox"/> <span style="float: right;">2.Female <input type="checkbox"/></span>
<b>Q1.2</b>	<b>Year of birth</b>	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
<b>Q1.3</b>	<b>Highest level of Education</b>	<input type="checkbox"/> R1: Primary <input type="checkbox"/> R2: Secondary (Ordinary level) <input type="checkbox"/> R3: Secondary (Advanced level) <input type="checkbox"/> R4: TVET or Vocational <input type="checkbox"/> R5: University (Bachelor) <input type="checkbox"/> R6: University (Masters) <input type="checkbox"/> R7: University (PhD) <input type="checkbox"/> R8: None
<b>Q2.4</b>	<b>Telephone number</b>	<input type="text"/>
<b>Q2.5</b>	<b>Location of the business</b>	Province:.....
		District:.....
		Sector:.....
		Cell:.....
		Village:.....
<b>Q2.6</b>	<b>Respondent's Relationship to the taxpayer</b>	<input type="checkbox"/> R1: Owner <input type="checkbox"/> R2: Relative <input type="checkbox"/> R3: Manager <input type="checkbox"/> R4: Accountant <input type="checkbox"/> R5: Other, specify.....

**SECTION B: QUESTIONS RELATED TO RESEARCH OBJECTIVES**

<b>Q3</b>	<b>AUDIT RELATED QUESTIONS</b>	
<b>Q3.1</b>	You have been audited by Rwanda Revenue Authority in the last five fiscal years. In your opinion, why were you audited?	..... ..... .....
<b>Q3.2</b>	What are your thoughts on how you were informed about the audit? Why?	..... ..... .....
<b>Q3.3</b>	After being informed that you will be audited how did you react?	..... ..... .....
<b>Q3.4</b>	What is your opinion on the time given to prepare prior to be audited?	..... ..... .....
<b>Q3.5</b>	Were you able to provide the requested documents, on time, before concluding the case? If not, what was the reason?	..... ..... .....
<b>Q3.6</b>	Is there any supporting document that was rejected by auditor during audit? If this is the case, Please describe your answer?	..... ..... .....
<b>Q3.7</b>	What was your perception about the audit results/findings?	..... .....
<b>Q3.8</b>	In your opinion, what are the major challenges that you faced during audit period?	..... ..... .....
<b>Q3.9</b>	Based on your previous filing and payment behaviour, how did audit change	..... ..... .....

	your tax compliance behaviour?	.....
<b>Q3.10</b>	If you were to recommend, what would be your areas of focus and what would you recommend to improve audit process by RRA?	Area1.....
		Recommendation1.....
		Area2.....
		Recommendation2.....
		Area3.....
		Recommendation3.....
<b>Q4</b>	<b>APPEAL RELATED QUESTIONS</b>	
<b>Q4.1</b>	You have appealed against an audit result in the last five fiscal years. Why did you decide to appeal against audit decision?	..... ..... ..... .....
<b>Q4.2</b>	How did you know that you can appeal against audit decision?	..... .....
<b>Q4.3</b>	In your opinion, what were the reasons that led to the decision made by the auditor?	..... ..... .....
<b>Q4.4</b>	In your opinion, which assurance did you have about appeal decision? Please describe your answer?	..... ..... ..... .....
<b>Q4.5</b>	What were the convincing facts/arguments that pushed you to appeal against audit decision?	..... ..... ..... .....
<b>Q4.6</b>	The facts/arguments provided during appeal were also	..... .....

	provided during audit?If no, why they were not provided?If yes, why were they rejected?	..... ..... .....
<b>Q4.7</b>	In your opinion, was it difficulty for you to meet the legal officer? Please describe your answer?	..... ..... .....
<b>Q4.8</b>	What were your perception about appeal result?	..... .....
<b>Q4.9</b>	In your opinion, what are the challenges in the appeal process?	..... .....
<b>Q4.10</b>	What % of appeal cases do you think return some waived tax to the taxpayer?	..... ..... .....
<b>Q4.11</b>	In Rwanda, a significant number of tax appeal cases to audits return an amount that is waived in favors of the taxpayer. Do you have any reason which might explain why this is the case?	..... ..... ..... ..... ..... .....
<b>Q4.12</b>	In your opinion, what RRA can do to reduce the number of cases that go to appeal?	..... ..... .....
<b>Q4.13</b>	If you were to recommend reforms to improve appeal system in RRA, what would be your areas of focus be and what would you recommend?	Area1..... Recommendation1.....
		Area2..... Recommendation2.....

		Area2.....
		Recommendation2.....

<b>Q4.</b>	<b>POST-APPEAL RELATED QUESTIONS</b>
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<b>Q4.1.</b> You have taken an appeal decision to the court/amicable settlement. What element of the appeal were you unsatisfied with?	..... ..... ..... .....
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<b>Q4.2.</b> How did you know that you can take an appeal decision to the court/amicable settlement?	..... ..... .....
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<b>Q4.3.</b> You choose to take your appeal to either the court or the amicable settlement. Why did you choose the court/amicable settlement?	..... ..... ..... .....
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<b>Q4.4.</b> What percentage of amicable settlements do you think waive some amount of tax for the taxpayer?	..... ..... .....
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<b>Q4.5.</b> XX% of cases which are taken to amicable settlement waive some amount in favour of the taxpayer. Do you have any reason to explain why this might be the case?	..... ..... ..... ..... .....
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<b>Q4.6.</b> If you were to recommend reforms to improve the amicable settlement process in RRA, what would be your areas of focus be and what would you recommend?	Area1.....  Recommendation1.....  Area2.....  Recommendation2.....  Area2.....
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	Recommendation2.....
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**Thank you for your cooperation.**





.....

12. Based on your experience, what is the reform needed to improve the appeal process in Rwanda?

.....

.....

**Thank you for your cooperation.**





.....

24. According to you, what RRA can do to minimize the number of cases that go to appeal?

.....  
.....  
.....

25. Based on your experience, what is the reform needed to improve the appeal process in Rwanda?

.....  
.....  
.....

**Thank you for your cooperation.**

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