ICTD Research in Brief
Issue 55 • July 2020

Active Ghosts: Nil-filing in Rwanda

Summary of ICTD Working paper 106 by Giulia Mascagni, Fabrizio Santoro, Denis Mukama and Naphtal Hakizimana, prepared by Adrienne Lees

Introduction

Poor compliance is one of the key factors behind persistently low tax-to-GDP ratios in developing countries. Two dimensions of non-compliance that have been widely studied are under-reporting and non-filing (i.e. failing to submit a tax declaration altogether). However, there is a third and largely under-researched dimension of non-compliance: nil-filing. It refers to taxpayers who are registered and submit a tax declaration, but report essentially no information to the revenue authority (i.e. they report zero in all fields) and, as a result, generate no tax revenue. This behaviour is widespread in Rwanda: it concerned over half of all corporate income tax (CIT) returns and a quarter of personal income tax (PIT) returns in 2017. Despite being a well-known problem among tax administrators, there is no literature examining the cause of this apparently puzzling behaviour. If these businesses intend to evade taxation, then why register for taxes at all? Alternatively, if these businesses truly do not make any income, why do they continue to exist?

This paper uses a mix of descriptive analysis of administrative data, a randomised control trial (RCT), and qualitative information collected through interviews with tax officials and taxpayers to shed light on the reasons behind this phenomenon. We argue that evasion is not a major part of the explanation for nil-filing. Rather, this behaviour appears to be driven by the interaction between aggressive taxpayer recruitment campaigns by the Rwanda Revenue Authority (RRA) and taxpayers' responses to complexities in the tax system. To the best of our knowledge, this is the first study to document nil-filing behaviour in detail and to test the reasons behind it.

Data and methodology

This study uses two main data sources: administrative data from CIT and PIT returns between 2013 and 2017, allowing the authors to observe actual compliance behaviour at the taxpayer level; and interviews with a random sample of 30 nil-filers and 24 RRA officials. The authors also conducted an RCT aiming to nudge taxpayers with messages specific to nil-filers and test two hypotheses: that nil-filers are evaders; and that nil-filers should in fact deregister but fail to do so. The treatment involved sending three versions of an SMS message from RRA to comparable groups of nil-filers: a reminder, a deterrence message, and a deregistration message. The treatment effects were compared with a control group which received no message.

Anatomy of active ghosts

The analysis of administrative data showed that nil-filing is a common practice: the five-year average rate of nil returns over the total number of returns lodged is 53% and 17% respectively for CIT and PIT. Further, nil-filing is common in the life of a taxpayer, especially for corporations, with 70% of CIT and 18% of PIT taxpayers filing nil at least once in the period examined. Importantly, two thirds of CIT payers who nil-file at least

“If these businesses intend to evade taxation, then why register for taxes at all? Alternatively, if these businesses truly do not make any income, why do they continue to exist?”

once are "perpetual" nil-filers, who nil every time they file during the study period. We also observe a sharp increase in nil-filing around 2014, which corresponds with a drive by the RRA to register new taxpayers, without much consideration for whether businesses had actually begun operations. Considering several relevant taxpayer characteristics, the authors find that the typical nil-filer is a small, relatively young business, based in Kigali, with a consistent habit of filing late. Nil-filing is also more prevalent in the construction and energy and mining sectors.

Key findings

The RCT found that receiving any treatment significantly reduces the probability to file nil by 2.2 percentage points, with the reminder being the most effective nudge. As expected, the deregistration message led to a 1 percentage point increase in deregistrations, implying a doubling relative to the average in the control group. While these treatments were effective in statistical terms, the magnitude of the impact was quite small. Importantly, the great majority of the sample, approximately 85%, did not react to the nudge at all, continuing to nil-file. These results suggest that, while evasion and the need to deregister play a role in the decision to nil-file, they do not represent a conclusive explanation.

The qualitative interviews offered a more comprehensive picture, finding that taxpayers are well-aware of their nil-filing behaviour and persisted with it as a way to cope with confusing administrative practices and rules. The majority of nil-filers interviewed reported that they had registered a business that in fact never operated. This may be related to a rather aggressive taxpayer recruitment strategy recently pursued by RRA. Mass registration campaigns are likely to bring new taxpayers into the tax system before they have begun any income-generating activity. Being registered in such a circumstance is likely to generate significant confusion for new taxpayers, which is aggravated by a lack of guidance from RRA on what new taxpayers should do next. In addition, RRA actively encourages registered taxpayers to file declarations, even if they have nothing to declare. When combined with a reluctance to deregister (due to a mixture of administrative complexities and a fear that deregistration would trigger an audit), this has unintentionally created a large pool of nil-filers.

A further explanatory factor is that taxpayers are generally not well-acquainted with the tax system and their obligations. This confusion is compounded when administrative practices are unclear, and sometimes even inconsistent with the law. As a result, taxpayers adopt nil-filing as a mechanism to be compliant with practical (though not legal) requirements to file, although they cannot afford the compliance cost of filing an accurate declaration, especially since they would pay little to no tax anyway. Anecdotal evidence also suggests that nil-filing is employed as a strategy to avoid late filing and non-filing penalties.

Policy recommendations

The reasons for nil-filing are intricate and there are substantial obstacles to change. However, our analysis allows us to draw four policy recommendations:

- Reduce confusion by enhancing communication with taxpayers at the point of registration, as well as ensuring that only taxpayers who effectively need to register are urged to do so.
- Review the usefulness and necessity of the practical rules of tax administration which are not prescribed in the law.
- Simplify procedures as much as possible throughout tax administration and ensure that simplified procedures are communicated to taxpayers so that they can take them up.
- Target a small portion of nil-filers with checks to close any evasion gap and lend credibility to messages of deterrence.

Further reading

Citation: Mascagni, G; Santoro, F; Mukama, D; Karangwa, J. and Hakizimana, N. (2020) *Active Ghosts: Nil-filing in Rwanda*, ICTD Working Paper 106, Brighton, IDS.

Credits

Giulia Mascagni is a Research Fellow at the Institute of Development Studies (IDS) and Research Director of the International Centre for Tax and Development (ICTD).

Fabrizio Santoro is a Research Officer at the Institute of Development Studies and PhD student in Economics at the University of Sussex.

Denis Mukama is the Head of Research and Policy Analysis at the Rwanda Revenue Authority. John Karangwa is Manager for Research and Policy Analysis at the Rwanda Revenue Authority.

Napthal Hakizimana is Research and Policy Analysis Officer at the Rwanda Revenue Authority.

Adrienne Lees is a Research Officer at the International Centre for Tax and Development.

The ICTD is funded with UK aid from the UK Government and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation.

institute of development studies

ICTD is based at the Institute of Development Studies, Brighton BN1 9RE UK.