

# **The Impact of an Effective Tax System On a Developing Economy: A Review of Rwandan and Nigerian Tax Systems**

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*ABSTRACT: Taxation is a crucial factor in the growth of every economy. The tax system is an integral part of the legal framework within which business firms operate. Taxes are used for different purposes, including revenue generation to finance government expenditures, as a regulatory device, as incentives to achieve certain social and economic objectives, and as tools for redistributing income and wealth. Taxes can also be used to influence the choice of inputs by businesses or individuals in order to attain certain policy outcomes. A well-developed tax system is an indispensable tool of sound economic management. It is a vital instrument in the achievement of economic growth and social equity as well as in providing funds for the effective operation of the state. Taxation is a major source of revenue for most governments and forms the backbone of all national economic policies. However, its objectives have been changing over the years, and now it has assumed several dimensions. This article aims to assess the impact of an effective tax system on a developing economy.*

**KEYWORDS:** Capital gains, Fiscal system, Tax efficient,

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## **INTRODUCTION**

### **Definition of the effective tax system**

Tax efficiency refers to legally minimizing an individual or company's tax obligations. A financial choice is tax efficient if it results in lower taxes compared to alternative economic structures with the same goal ("Learn about Tax Efficiency," 2021).

### **The workability of an effective tax system in a developed nation of the UK**

There is no doubt that the UK tax system is a complex system for taxation. It is one of the longest and most comprehensive taxation systems. However, it's pretty easy. Those who live in the UK or work in the UK prefer to pay taxes from the UK.

### **The British tax system**

The central agency for collecting and administering taxes in the UK is HM Revenue and Customs. (HMRC). In 2019/20, more than £633.4 billion was raised for the United Kingdom, and over a year, it

increased by 2.1%. The UK's basic tax system covers property taxes, income tax, capital income tax, VAT, and inheritance taxes in the United Kingdom. This system also includes progressive taxes and means paying higher revenue rates if somebody has higher incomes (The complete UK tax system guide). The tax system in Britain has been expanded across the United Kingdom like Wales, Britain, Scotland, and Northern Ireland. There are few differences due to their unique legal systems (Ortiz-Ospina & Roser, 2021).

The Chancellor emphasized the government's plan in the March 2020 budget to create a tax system suitable for today's challenges and opportunities. With the significant advancements in technology and the increasing demand for global customer service, the UK needs a fully digital tax system that can offer taxpayers a complete range of services. The COVID-19 pandemic has highlighted the need for governments to be more flexible and resilient in their programming, policies, procurement, infrastructure, and operations. Effective fiscal management is crucial, and the HMRC has risen to the challenge by efficiently providing world-class job support systems in record time. However, they faced limitations from a renewable taxation system. The United Kingdom needs to be prepared for the challenges of the 21st century. We need to learn from COVID-19 to efficiently support people, families, businesses, and jobs during future disasters. There is a significant opportunity for fiscal system improvements to increase productivity and innovation. This is especially true for software and tax-related service providers, as well as companies and organizations throughout the country.

#### **A clear vision of being resilient and effective.**

Real-time information is essential for an effective and contemporary tax system, allowing the government to assess changes in the economy for both businesses and individuals. It is also crucial that the tax is paid in time, as companies and private individuals can easily and quickly pay their taxes. The government will assist businesses and individuals during emergencies with a practical and updated tax system, which is essential for our nation's economic and social stability.

The government aims to ensure accurate tax payments for individuals and businesses. The process should be simple for taxpayers to calculate and pay their dues. Thus, Systems designed to assist with tax rights enforcement make it more difficult to bend or break the rules. HMRC will use real-time risk assessment to intervene and prevent income loss earlier, sometimes even before it is reported. In general, the avoidance of paying the taxes they owe will be much more difficult for people. The difference between the tax payable in theory for the HMRC and paid will then be reduced. Currently, the tax gap is £31 billion in income that cannot be used to support vital utilities ("A comprehensive overview of the tax system in the UK," 2021). This vision in the next ten years is important, valuable, and feasible. It consists of three elements:

- Policy means the gradual increase of digital taxation work of HMRC  
When it comes to systems, it's important to determine the appropriate timing and frequency for paying various taxes, as well as the necessary technological infrastructure to support it. As for law and practice, reforms must be made to the fiscal management framework itself ("Budget 2020 - GOV.UK", 2021).

### **The Key Contemporary Taxation System.**

The UK's tax authority is one of the best in the world, but HMRC seeks improvement. With the Making Tax Digital Program, HMRC is introducing a new digital VAT service with the Making Tax Digital Program, aiming to support more companies in benefiting from digital accounts and increasing productivity. The government aims to expand its services to additional taxpayers and agents. These services will operate in closer proximity to real-time in accordance with international best practices. This will ensure taxpayers have an up-to-date understanding of their tax position and eliminate the risk of errors, resulting in accurate payment of taxes.

### **The need for reform**

Although digital tax services have advanced significantly, many of them still need to rely on outdated, manual paper-based processes that no longer suit the needs of the modern era. The outdated paper-based time-lagged system conflicts with the modern world shaped by intelligent devices, streaming services, and social media platforms that influence communication, earning, and payment methods. Changes in asset management and fast-paced global trends have strained the tax system. (Nenbee et al., 2022). The more difficult work patterns and companies become, the more difficult it becomes to correct taxes with the same old methods and approaches. This means that taxpayers, agents, and governmental representatives are time-consuming and expensive and that the HMRC has difficulty collecting the required tax ("Building a trusted, modern tax administration system," 2021).

### **Nigerian Tax System**

Nigeria's tax history dates back even when it wasn't coined Nigeria's name. The tax managers were then traditionally the chief tax officers during this time. The majority of farms and other essential goods at this time. The Federal Government of Nigeria's modern taxation system within the Federal Inland Revenue Board (FBIR), which was created under the Companies Income Tax Act, could have been traced back to 1939. After establishing the first fiscal body, it permanently changed in response to subsequent tax law changes. The Federal Inland Revenue Service (FIRS) The operational branch of the Federal Inland Revenue Board was established, (FIRS) in 1978 under the leadership of Alhaji Shehu Musa (FBIR) ("Tax System in Nigeria: All You Need to Know," 2021).

The three levels of government are vested in the tax administration of Nigeria. The Federal Inland Revenue Service (FIRS) administers federal taxes. The State Governments receive payment from the State Boards of Internal Revenue (SBIRs) in all 36 states of the Federation. Local governments also manage their various councils to collect rates and levies ("Tax System in Nigeria: All You Need to Know," 2021).

In Nigeria, people doing business pay a good number of taxes. The following taxes will be imposed on income, capital gains, and goods/services: income taxes on companies, personal income taxes, VAT, education tax, technology taxes, stamping duties, and withholding tax. Penalties will apply for failure to pay ("Administration Of Taxes In Nigeria - Tax - Nigeria," 2021).

### **What is the reason for paying taxes in Nigeria?**

Some taxes are payable because of tax laws enforced by the government (Ideh et al.,2022). For government services of all sorts, taxpayers' money pays ("Tax System in Nigeria: All You Need to Know," 2021). Taxes, while legal, are also considered a municipal obligation to pay taxes. If you fail to pay, you will be required by the supervising tax mediators (the Federal Inland Revenue Service) to do so, or you will be penalty-free, such as hefty fines and prison terms ("Taxation in Nigeria: A Beginner's Guide To Nigeria's Tax System", 2021).

### **The Rwandan Tax System**

The implementation of policy reforms in developing countries is hindered by several factors, including challenges with resource mobilization, the emphasis on technocratic policy management promoted by donors, and the persistence of state centralism. In Rwanda, tax system reforms are implemented to improve tax compliance and contribute to the national GDP. Due to implementation flaws such as limited technical and financial resources, a narrow technocratic approach, and failure to mobilize political resources, the above objective became less attainable. This research analyzes the implementation process of institutional and policy reforms in Rwanda's tax system through secondary data on tax system administration. This paper deals with formulating the research problem, hypothesis, and methodology for tax system reform. Furthermore, it offers an outline of the tax system reform in Rwanda, a comparative analysis of reform policies implementation in developing nations, and novel experiences in tax system improvement. The formative and normative factors that influenced tax system reform in Rwanda are examined. It evaluates how successfully reforms are implemented, compares them to norms, and provides a summary of the findings. The Rwanda Revenue Authority (RRA) is responsible for tax collection in Rwanda and follows tax laws, Ministerial Orders, and Commissioner General rules for tax administration. Tax compliance is a critical risk for companies. Management, accountants, and tax consultants spend considerable time on it due to frequent changes in laws("Taxation in Rwanda | Haystack Africa," 2021).

In Rwanda, all residents are required to pay income tax while non-residents pay a withholding tax rate of 15% on all income earned in Rwanda, including employment income. A taxpayer who is a resident is liable for income tax from all national and foreign sources per the tax period. A taxpayer not resident in Rwanda shall be responsible for income tax only.

Rwanda operates a taxation system based on both source and residence. In other words, in Rwanda, any income considered by Rwandan authorities is subject to taxation. Furthermore, residents are taxed on their global gains. Such revenues are taxed in a country other than Rwanda. However, a tax credit is permitted, which does not exceed the tax paid for the same gains in Rwanda. Entities that are not residents of Rwanda are subject to taxation on their income from Rwanda through a permanent establishment. The standard CIT rate is 30%. The standard CIT. Micro-enterprises pay, however, flat tax amounts (in the fiscal period, and small enterprises with sales ranging between 12 million RWF and 20 million RWF during the tax period, as well as Micro Enterprises with a turnover of less than 12 million RWF, pay a lump-sum tax at a rate of 3% of sales (Kamasa, 2021).

### **Income generated through taxation in Rwanda and Nigeria between 2017 and 2020**

The countries with the highest economic growth in the region are Nigeria, Rwanda, Tanzania, and Kenya, but they face various downside risks that could undermine their development prospects. Agriculture is vulnerable to natural disasters, relies heavily on commodity exports, and faces rising oil prices, persistent current account deficits, and increased external debt. International trade on the continent is low, averaging around 14.5%, and has remained roughly unchanged for the past five years. However, intra-EAC marketing is the highest among all regional economic communities in Africa, with over 20% of exports, significantly higher than the continental average (Simeon et al., 2021). The Continental Free Trade Area (CFTA) was launched in Kigali in March 2017 and will continue until 2020. The CFTA was motivated by the tripartite free trade area of COMESA, EAC, and the Southern African Development Community, particularly in East and Southern Africa.

In 2020, Nigeria received 5.9% of its general government revenue as a percentage of GDP. While there has been significant fluctuation in recent years, the percentage declined by 5.9% from 2001 to 2020.

### **Government revenue**

Revenue includes taxes, social payments, allowances, and other income. It is the total amount of money that a government receives. This money increases the net value of the government, which is the difference between its assets and obligations (GFSM 2001, paragraph 4.20). Note: Transactions that only modify the balance sheet composition do not affect the net value, such as the sale of non-financial and financial assets or the incurrence of liabilities ("Nigeria General government revenue (% of GDP), 1980-2020 - knoema.com", 2021).

### **DISCUSSION AND CONCLUSION**

Structural changes in the tax system and revenue changes can impact economic activity, but not all tax changes have positive long-term growth impacts. Income tax reductions increasing growth is often considered gospel, but theory, evidence, and simulation studies tell a different and more complex story. Tax cuts can boost economic growth by incentivizing labor, savings, and investment, but they can also lead to income inequality and subsidize existing capital, discouraging new economic activity. Conclusively, tax cuts that are not accompanied by spending cuts usually increase the federal budget deficit. The increase in deficit reduces the domestic economy, American equity, and future revenue. It also raises interest rates, which negatively impacts investment. The uncertain effect of tax cuts on economic growth depends on the structure and nature of the tax break.

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