Harmful tax competition in the East African community: the case of Rwanda with reference to EU and OECD approaches

Habimana, P.

3 OVERVIEW OF FAVORABLE TAX MEASURES UNDER RWANDAN LAW

This chapter is based on an assumption that countries are inherently engaged in constant competitions, including competition to attract investment. To attract investment, countries use a variety of methods to create an investment-friendly environment. Some methods are tax-related, others are not. The use of tax measures leads to the game of tax competition, which happens when countries offer favorable tax measures for two purposes. One purpose is to attract investors from other jurisdictions to flow into their jurisdiction. The other purpose is to keep domestic investors from leaving the jurisdiction. As previously mentioned, a tax measure may result not only from laws, but also from regulations and administrative practices. Thus, the tax measures discussed herein include statutes, administrative regulations and practices.

This chapter focuses on Rwandan law. As stated above, tax competition is based on the use of favorable tax measures. Even so, not all favorable tax measures are harmful. This is the premise of the current chapter, which identifies the favorable tax measures that exist under Rwandan law. The focus is on two fundamental laws that greatly impact business taxation in Rwanda: the income tax law of 2018[1] and the law on investment promotion and facilitation of 2021.[2]

The objective of this chapter is not to classify all favorable tax measures as harmful. Equally, it does not determine whether a particular favorable tax measure is harmful. That determination is made in chapter six. This justifies the use of the term 'favorable tax measure' as a neutral term, to avoid any bias concerning the harmfulness *vel non* of the tax measure.

That being the case, this chapter begins with benchmarking exercise, i.e. providing the criteria that determine whether a measure is a favorable tax measure. It then presents a brief historical development of Rwanda's tax competitiveness. Then, it analyzes Rwanda's favorable tax measures in the income tax law of 2018 and the investment law of 2021. Following that, it discusses favorable tax measures that are in regulatory and administrative practices.

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[1] Law No. 016/2018 of 13/04/2018 establishing taxes on income, *O.G.* No. 16 of 16/04/2018.
[2] Law No. 006/2021 of 05/02/2021 on investment promotion and facilitation, *O.G.* No. 04 *bis* of 08/02/2021.

3.1. Benchmark of favorable tax measures

This section establishes the criteria that determine whether a particular tax measure is favorable or not. The concern of this section is to answer the question ‘why can a particular tax measure, among others, be considered as favorable?’. The relevance of this question is based on the consequential effects of a favorable tax measure. Indeed, a favorable tax measure is potentially harmful. A tax measure is potentially harmful if it appears to meet the criteria of harmful tax practices, but it has not yet been determined to be actually harmful. At this level, the measure in question is only suspected, i.e. considered potentially harmful, but not yet confirmed as to whether or not it is actually harmful.

In this consideration, the research herein is based on two premises. The first is the premise that (harmful) tax competition is a global phenomenon. Thus, it is probable that Rwanda, like many other countries in the world, may be engaged in (harmful) tax competition. The first section of the first chapter introduced this premise and the fourth subsection of the second section of chapter two discusses it in detail. The second premise is based on NGOs’ reports that Rwanda is highly engaged in (harmful) tax competition. This premise was also introduced in the first section of the first chapter.

Under these two premises, some tax measures under Rwandan law intuitively appear as favorable tax measures. This couples with the fact that favorable tax measures are impulsively characterized by differential and preferential treatment of certain taxpayers. In other words, some taxpayers are treated differently and preferentially. Therefore, differential and preferential treatments are the benchmarks or determinants of whether a particular tax measure is favorable. Thus, a tax measure that exhibits the two benchmarks is suspected of constituting harmful tax competition. These two benchmarks are respectively described below.

3.1.1. Differential treatment

A tax measure is favorable if it provides differential treatment, i.e. treats taxpayers differently. Differential treatment requires that the tax administration departs from the generally applicable tax standard of taxing all equally, to give special treatment to a particular taxpayer or class of taxpayers. Thus, for a tax measure to be considered favorable, reference must be made to the standard tax rate or standard tax base. In this respect, a favorable tax measure occurs when there is a reduction in the effective tax rate or a narrowing of the tax base.

Thus, in order to assess whether a particular tax measure is favorable, two steps are necessary. The first step is to determine the generally applicable tax rate or tax base. The second step is to determine if there is a deviation from the generally applicable tax rate or tax base for a particular taxpayer or class of taxpayers. Under this view, reductions in general tax rates or tax bases, even if they look advantageous, are not favorable tax measures. This further implies that a situation of favorable tax measures occurs when among taxpayers whose tax rate or tax base should actually be the same, differences are found based on preferential treatment of some of them, as described below.

3.1.2. Preferential treatment

The second benchmark of favorable tax measures is preferential treatment. This arises as a consequence of differential treatment. Preferential treatment consists of lowering tax rates or narrowing tax bases, thereby mitigating or minimizing the tax liability of a particular taxpayer. In this context, preferential treatment favors one or more taxpayers. In both cases, the beneficiaries may be determined, or determinable, by using a set of criteria.

Thus, the preferential treatment results from the government's deviation from the general tax system. In other words, the differential treatment coupled with the preferential treatment result in the difference between the amount of tax paid and the tax that would have been paid had the favorable measure not existed. It is this reduction in the tax payable that encourages business activity to gravitate to a particular country. In this context, the favorable tax measures create a comparative tax advantage, the purpose of which is to attract investors from other jurisdictions to the offering jurisdiction.

From the above, the two benchmarks are closely intertwined. Moreover, they are cumulative. Therefore, favorable tax measures herein discussed include any legislation, regulation, or administrative practice with the above characteristics, namely differentially and preferably treating the benefiting taxpayer compared to the generally applied system. Such measures are discussed in detail in the third and fourth sections. Before doing so, the section below provides a brief historical evolution of Rwanda's tax competitiveness.

3.2. Historical development of Rwanda's tax competitiveness

Since the 1980s, Rwanda has been improving its tax system to create a more business-friendly tax climate. This improvement can be seen through the changes that have occurred in the legal and institutional framework.

Beginning with the institutional framework, in 1998 the Government of Rwanda created the Rwanda Investment Promotion Agency (RIPA), with a mandate to act as a one-stop center to promote local and foreign private investment.[3] The law creating RIPA contained tax advantages such as exemption or payment of single flat fee import duties, investment allowances, and deductions.[4] In 2000, the mandate of RIPA was expanded to include export promotion and its name was changed to Rwanda Investment and Export Promotion Agency (RIEPA). This was replaced in 2008 by Rwanda Development Board (RDB).[5]

Regarding the legal framework, over the last thirty years, Rwanda enacted several laws aimed at promoting investments through tax-friendly measures. Apart from a few legal provisions providing for tax exemptions in previous income tax laws, the history of business-friendly tax measures in Rwanda started with the enactment of law No. 21/87 of 05/08/1987 establishing an investment code. Next came law No. 43/90 of 01/10/1990 on the promotion of exports and the law No. 05/2011 of 21/03/2011 on special economic zones.

In 2005, two major laws with investment-related provisions were enacted. One was law No. 26/2005 of 17/12/2005 relating to investment and export promotion and facilitation. This law contained some advantages and incentives for investors, such as imports exempted from customs duties, investment allowances, deductions, discounts, and tax holidays.[6] The other was law No. 16/2005 of 18/08/2005 on direct taxes on income, which contained several favorable tax measures. The 2005 investment law was replaced in 2015, and again in 2021, while the 2005 income tax law was replaced in 2018.

In view of the above, tax-friendly measures in Rwanda are currently spread across several laws: the income tax law, the law on investment promotion and facilitation, the laws on special economic zones, etc. While the latter law falls outside the scope of this book,[7] a detailed examination of the favorable tax measures in the first two laws is carried out below.

[3] Law No. 14/98 of 18/12/1998 establishing the Rwanda Investment Promotion Agency.
[4] Id., art 29 and 30.
[5] Organic Law No. 53/2008 of 02/09/2008 establishing Rwanda Development Board (RDB) and determining its responsibilities, organization and functioning, *O.G.* No. Special of 05/09/2008.
[6] Law No. 26/2005 of 17/12/2005 relating to investment and export promotion and facilitation, art. 18 and Annex.
[7] Special economic zones are considered *prima facie* not harmful tax competition. See M F Nouwen, *Inside the EU Code of Conduct Group: 20 Years of Tackling Harmful Tax Competition* (Ph.D Thesis, UVA 2020), p. 276.

3.3. Legislative favorable tax measures

This section is limited to the current income tax law and the investment law. The current Rwandan income tax law dates from 2018 and applies to four types of income-related taxes, namely PIT, CIT, WHT, and capital gains tax.[8] It offers a number of favorable tax measures such as tax holidays, tax discounts, and tax exemptions. Taking the income tax law as a baseline, the 2021 law on investment promotion and facilitation also provides favorable tax measures, which are intended to benefit registered investors, i.e. those investors holding investment certificates.[9] Registered investors are distinguished from ordinary investors, which are any natural or legal persons who invest in Rwanda.[10]

Both laws taken together provide to investors several favorable tax measures. Such measures include, but are not limited to, preferential CIT rates, tax holidays, tax exemptions, and profit tax discounts. The two laws also provide for other favorable tax measures but whose impact is minimal in the context of this study. Such are, for instance, the exemption from paying property tax for five years for specialized innovation park and specialized industrial park developers,[11] incentives for startups,[12] incentives for the mining sector,[13] preferential tax incentives for film industry,[14] preferential tax incentives for philanthropic investors,[15] etc. The following sub-sections describe the most favorable tax measures.

3.3.1. Preferential tax rates

Under Rwandan law, several preferential CIT rates exist. These include a PTR of zero percent (0%), a PTR of three percent (3%), a PTR of fifteen percent (15%), reduced PTRs to export investments, and preferential WHT rates of 0%, 5%, and 10%. The following paragraphs discuss those PTRs, starting with the PTR of 0%.

In terms of Annex I of the investment law, a PTR of 0% is given to an international company that has its headquarters or a regional office in Rwanda upon fulfilling the following requirements:

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[8] Income Tax Law (n 2) art. 2.
[9] Investment Law (n 2) art. 2(41^{0}).
[10] Id., art. 2(29^{0}).
[11] Id., Annex XIII.
[12] Id., Annex XIV.
[13] Id., Annex XVI.
[14] Id., Annex XVII.
[15] Id., Annex III.

(a) investing in Rwanda at least ten million USD, (b) providing employment and training to Rwandans, (c) conducting international financial transactions equivalent to at least five million USD a year for commercial operations through a licensed commercial bank in Rwanda, (d) being well established in the sector within which it operates (e) spending the equivalent of at least two million USD per year in Rwanda, (f) setting up actual and effective administration and coordination of operations in Rwanda and performing at least 3 of the preferred services.[16]

The same law enumerates the preferred services as including the procurement of raw materials, components or finished products; strategic planning and business development; marketing and sales promotion planning; information and data management services; treasury management services; research and development work; training and personnel management; and other shared services.[17]

From the statutory language, one could easily think that the PTR of 0% only applies to foreigners. However, the term 'international company' is assimilated to an international commercial entity in the law, which includes any business company that owns or controls production or service facilities beyond its home country,[18] regardless of whether it originates abroad or in Rwanda. In other words, the company may be a Rwandan resident or not; what matters is whether it conducts business operations internationally. Thus, only locally operating companies are excluded to benefit from the PTR of 0%.

In addition, the law is unclear as to whether the above-mentioned conditions are cumulative or whether the fulfillment of one is enough to qualify the international company as a beneficiary of the PTR of 0%. Arguably, the absence of the word 'or' would lead to a conclusion that they are cumulative. However, given the diversity of the requirements, it makes sense to conclude that they are not cumulative.

The second favorable tax rate is that of 3%. Upon fulfilling the requirements set forth by the law, a PTR of 3% is available to five categories of investment: a registered investor licensed to operate as a pure holding company, a special purpose vehicle registered for investment purpose, a registered investor licensed as a collective investment scheme, foreign-sourced trading income of a registered investor operating as global trading or paper trading, and

[16] Id., Annex I.
[17] Ibid.
[18] Id., art. 2 (27^0)

foreign-sourced royalties of a registered investor operating as an intellectual property company.[19]

The third favorable tax rate is that of 15% which is given to a registered investor, who:[20] (a) undertakes an energy-related activity like energy generation, transmission and distribution from peat, solar, geothermal, hydro, biomass, methane and wind but excludes an investor with an engineering procurement contract executed on behalf of the GoR; (b) invests in the transport of goods and related activities whose business is operating a fleet of at least five trucks registered in the investor's name, each with a capacity of at least 20 tons; (c) invests in mass transportation of passengers with a fleet of at least 10 buses, each with a capacity of at least 25 seats; (d) invests in manufacturing in the sectors of textiles and apparels, electronics, IT equipment, large scale agriculture, processing of wood, glass and ceramics, mining and agriculture equipment; (e) invests in ICT involving service, manufacturing or assembly but excluding ICT retail, wholesale trade as well as ICT repair industries and telecommunications; (f) establishes an innovation research and development facility and ICT innovation sector; (g) operates as fund management entity, collective investment scheme, wealth management services, financial advisory, family office services, fund administrator, financial technology, captive insurance scheme, private bank, mortgage finance, finance lease, asset-backed securities, reinsurance, trust and corporate service; (h) invests in the construction of affordable houses; (i) invests in electric mobility; (j) invests in adventure tourism and agriculture tourism; (k) invests in any other priority economic sector as may be determined by an Order of the minister of finance.

Unlike the 0% PTR that requires the investor to operate internationally, the 15% PTR does not impose this requirement. More than that, in contrast to several conditions for an investor to benefit PTRs of 0% and 3%, for the PTR of 15%, the law only enumerates the areas of investment without imposing any further condition.

The above-described 0%, 3%, and 15% PTRs are favorable tax measures in the sense that they deviate from the generally applicable standard tax rate of 30% and provide a major reduction in taxes for qualifying companies. Thus, they satisfy the differential treatment benchmark. The effect of the 0% PTR is to allow a company to operate tax-free, i.e. a reduction

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[19] Id., Annex II.
[20] Id., Annex IV.

of 100%, while the effect of the 3% and 15% PTRs is a substantial reduction of the tax payable by 90% and 50% respectively.

The law on investment also gives a preferential CIT rate to export investments.[21] Two PTRs are possible: 25% for a registered investor who exports between 30% and 50% of the total turnover, and 15% for a registered investor who exports at least 50% of the total turnover. The law limits PTRs for export investments to a maximum of five years and does not apply to the exportation of unprocessed minerals, tea, and coffee without value addition.[22] The PTRs to export investments are favorable tax measures because of their deviation from the generally applicable tax rates. Thus, they meet the differential and preferential treatment benchmarks.

The investment law also provides for preferential WHT tax rates of 0%, 5%, and 10%. A preferential WHT rate of 0% applies to dividends, interests, and royalties paid to an investor who benefits from a preferential CIT rate of 3% and 15%.[23] A preferential WHT rate of 5% applies to dividends and interest income paid to an investor with a company listed on Rwanda Stock Exchange.[24] A preferential WHT rate of 10% applies to specialized innovation parks and specialized industrial park developers on foreign loans interest, dividends, royalties, and management and technical service fees.[25] These preferential WHT are favorable and deviate the generally applicable rates. They, therefore, pass the diferential and preferential treatment benchmarks.

Thus, the tax rates discussed above are both preferential and differential. They also meet the two benchmarks and qualify as favorable tax measures, and are, therefore, potentially harmful. In addition to PTRs, other favorable tax measures are available under Rwandan law, such as tax holidays.

[21] Id., Annex V.
[22] Id., Annex V(2) and (3).
[23] Id., Annex X.
[24] Id., Annex XI.
[25] Id., Annex XII.

3.3.2. Tax holidays

From a general perspective, tax holidays have been in use a long time ago, basically to entice FDI.[26] In Rwanda, tax holidays appear in the income tax law and the investment law, as discussed below.

3.3.2.1. Tax holidays in the Rwandan income tax law

Under Rwandan income tax law, tax holidays are provided for in article 47. This article states that companies and cooperatives licensed to carry out micro-finance activities benefit from a tax holiday of five years from their approval date. During this period, their CIT rate is 0%. At the end of the initial five-year period, the law offers the possibility of another five-year renewal upon fulfilling the conditions set out by an Order of the minister of finance. At the time of writing this book, that ministerial order was still in a draft form.

Under article 47 of the income tax law, a tax holiday is automatically granted once the activities of company or cooperative are approved to be of a micro-finance nature. Under Rwandan law, micro-finance service providers typically serve a clientele that is not usually served by banks and ordinary financial institutions.[27]

In consideration of the benchmarks set at the beginning of this chapter, tax holidays offered to micro-finance institutions are favorable tax measures in the sense that they offer differential treatment to a particular class of taxpayers through diverging from the generally applicable tax rate. The beneficiaries would otherwise pay the standard CIT of 30%. However, they benefit from the deviation and spend five years, or even ten, paying the CIT at 0%, i.e enjoying a preferential tax benefit of 100%. The difference in applicable tax rates is significant, and the tax holiday reduces or eliminates the tax payable for the entire tax holiday period. Therefore, the fulfillment of both benchmarks makes the tax holidays under the income tax law qualify as favorable tax measures, and therefore potentially harmful.

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[26] J M Mintz, 'Corporate tax holidays and investment' (1990) *The World Bank Economic Review* 4(1), p. 81; M R Fahmi, *Analyzing the Relationship between Tax Holiday and Foreign Direct Investment in Indonesia* (Msc. Thesis, Ritsumeikanasia Pacific Univ. 2012), p. 46; T Kinda, 'The Quest for Non-Resource-Based FDI: Do Taxes Matter?' (2014) IMF WP/14/15, p. 3 <https://www.imf.org/external/pubs/ft/wp/2014/wp1415.pdf> accessed 20/09/2019.

[27] Law No. 40/2008 of 26/08/2008 establishing the organization of Microfinance activities, *O.G.* No. 13 of 30/03/2009, art. 2(11^{0}).

3.3.2.2. Tax holidays in the Rwandan investment law

The Rwandan investment law also provides for tax holidays. This law offers tax holidays of up to seven years maximum to an investor who fully invests an equivalent of at least 50 million USD and contributes at least 30% of that investment as equity in the priority sectors, excluding private equity and venture capital.[28] Here, three cumulative conditions are required, namely, the amount invested, the percentage of equity, and the sector of investment. The concerned priority sectors of investment are:

> Energy projects producing at least 25 megawatts excluding an investor with an engineering procurement contract executed on behalf of the GoR and fuel produced energy; manufacturing; tourism; health; ICT involving manufacturing, assembly and service but excluding communication, ICT retail and wholesale trade as well as ICT repair and telecommunications companies; export-related investment projects; other priority economic sector as may be determined by an Order of the Minister of finance.[29]

Apart from the tax holidays of seven years, the law on investment promotion and facilitation has the same generosity as the income tax law which offers tax holidays of up to five years renewable to micro-finance institutions.[30] In addition, a tax holiday of up to five years is available to specialized innovation parks and specialized industrial park developers.[31]

The tax holidays offered by the investment law fulfill the two benchmarks to be identified as favorable tax measures. In each case, the beneficiary pays CIT at a rate of 0%, which obviously deviates from the generally applicable tax rate of 30%, i.e. constituting a differential treatment. In turn, because the tax holidays lower by 100% the applicable tax, they completely eliminate the CIT during the period of the tax holiday, which is very favorable for benefiting companies. Therefore, the benefiting taxpayer is preferentially treated. Thus, the tax holidays offered by the investment law are potentially harmful. Besides tax holidays, tax exemptions also appear favorable as discussed below.

3.3.3. Tax exemptions

The Rwandan income tax law exempts three types of income from tax. First, income from agricultural or livestock activities is exempt up to an annual turnover of twelve million Rwandan

[28] Investment Law (n 2) Annex VIII.
[29] Ibid.
[30] Id., Annex IX(2).
[31] Id., Annex IX.

francs.[32] If the annual turnover is higher than that, the exemption is limited to the first twelve million Rwandan francs. The second tax exemption applies to capital gains from the transfer of shares on the capital market as well as units of collective investment schemes.[33] Third, the Development Bank of Rwanda, the Agaciro Development Fund Corporate Trust, and the Business Development Fund Limited are exempt from the payment of the CIT.[34] For these three entities, the tax exemption is for an unlimited period of time and without any threshold or other limitation.

To benefit from a tax exemption, the taxpayer must fall within the scope of one of the three categories mentioned above. If applicable, the tax exemption results in imposing CIT at a rate of 0%, which differs from the standard CIT payable. The effect is a 100% minimization of the tax that would otherwise be owed. Tax exemptions, therefore, constitute obvious preferential treatment. Because they meet the two benchmarks, tax exemptions are favorable tax measures and look potentially harmful.

Elaborating further on the legislative favorable tax measures, another measure that falls within this category is the profit tax discount, as discussed in the next paragraphs.

3.3.4. Profit tax discount

In Rwanda, profit tax discounts are provided for in article 49(2) of the income tax law. In terms of this article, companies that are newly listed on the capital market enjoy a tax discount for the mere fact of selling on the capital market. This benefit is granted for five years.[35] There are three discount levels depending on the number of company shares sold to the public: a 10% discount if the company sells at least 40% of its shares to the public, a 5% discount if the company sells at least 30% of its shares to the public, and a 2% discount if the company sells at least 20% of its shares to the public.[36] Compared to the standard CIT rate of 30%,[37] a newly listed company in the capital market pays the CIT at the discounted rates of 20%, 25%, or 28%, if the shares it sold to the public are respectively 40%, 30%, and 20%. This is, therefore, an evident deviation from the generally applied tax rates and benefits to the taxpayer. In other

[32] Income Tax Law (n 2) art. 21.
[33] Id., art. 39.
[34] Id., art. 46.
[35] Id., art. 49(2).
[36] Ibid.
[37] Id., para. 1.

words, the benefiting taxpayer is differently and preferentially treated. Thus, this measure is favorable and appears potentially harmful.

Beyond the legislative favorable tax measures, it is also important to consider administrative practices that amount to favorable tax measures. Such practices include tax rulings, advance pricing agreements, and tax settlements as detailed in the next section.

3.4. Favorable tax measures through administrative practices

From a general perspective, besides laws that provide for favorable tax measures, the government or tax administration may also use their regulatory and administrative practices to create favorable tax measures. Such administrative practices include tax rulings, tax agreements, and tax settlements. Through these, the tax administration deliberately customizes a legal provision and tailors it to a particular taxpayer(s) in order to place that taxpayer in a privileged situation. The result becomes a provision of differential and preferential treatment that deviates from generally applicable norms. The Rwandan situation with respect to the three is detailed below.

3.4.1. Tax rulings

From a general perspective, a tax ruling refers to an administrative advice, information, statement, or agreement that a tax administration provides to (or between) a taxpayer about the tax consequences of a particular future transaction and upon which the taxpayer is entitled to rely.[38] The purpose of tax rulings is to provide the taxpayer with certainty as to how the tax administration shall apply a particular tax provision to a particular transaction, and they can be public or private.[39]

In their original nature, tax rulings are not meant to favor specific taxpayers. However, they are sometimes used to serve as a channel through which a taxpayer can benefit from lower tax rates compared to standard rates, thus, becoming a tool of tax competition.[40] Examples include, but are not limited to, failure to clearly specify or make public the conditions associated

[38] C Biz, 'Countering Tax Avoidance at the EU Level after 'Luxleaks' A History of Tax Rulings, Transparency and BEPS: Base Erosion Profit Shifting or Bending European Prospective Solutions? (2015) *DPTI* XII(4), p. 1038; OECD, *Glossary of Tax Terms* <www.oecd.org/ctp/glossaryoftaxterms.htm> accessed 07/02/2019.

[39] L V Faulhaber, 'The Trouble with Tax Competition: From Practice to Theory' (2018) *Tax L.Rev.* 71(311), p. 333; F Cachia, 'Analyzing the European Commission's Final Decisions on Apple, Starbucks, Amazon and Fiat Finance & Trade' (2017) *EC T.Rev.* 1, p. 23.

[40] Faulhaber, Ibid.

with the awarding of tax rulings, or the conditions for their amendment or repeal.[41] Using tax rulings for tax competition happens mainly in cases of private rulings that are not published.[42]

Under Rwandan law, the RRA frequently uses public tax rulings. In contrast, private rulings are infrequent. This situation is similar to most developing countries where the practice of private rulings is very low.[43] This low use of private rulings in developing countries is generally due to a variety of reasons, including mistrust between tax administrations and taxpayers.[44] Insufficient technical capacity to manage the private rulings is also another reason.

With particular regard to Rwanda's public rulings, since the adoption of the current income tax law in 2018, the RRA CG has issued a number of public rulings. Examples include, but are not limited to, the CG's public ruling issued on 29/08/2018 on article 60(3) of the income tax law; the CG's public ruling of 12/02/2019 on article 15(7^0) of the income tax law, and the CG's public ruling of 29/08/2018 on article 26(9^0) of the income tax law.

As stated earlier, the purpose of a tax ruling is to clarify a statutory tax provision. The power to issue tax rulings is vested with the tax administration, which then becomes able to provide an official interpretation of the statute and guides the taxpayer(s) as to how the tax administration will apply a particular tax law. Even so, sometimes that may be departed from and that power becomes customized for a ruling to create a favorable tax measure, deliberately done by the tax administration.

This research has not uncovered any tax ruling in Rwanda that qualifies as a favorable tax measure. Even so, it is worth mentioning article 9(1) of the tax procedures law[45] which gives the CG the authority to issue public and private rulings. This provision requires the RRA to publish public tax rulings 'through a nationwide media'. This raises three questions. First, why did the legislature only require publication of public rulings and not private rulings? Second, the phrase 'nationwide media' is not definite and can open the door to subjective interpretation. Third, the method of publication prescribed by the legislature is not calculated to reach the taxpayers because one media is practically insufficient to reach the public. Rather, the rulings should be published in the official gazette to formalize the information to the public. Moreover,

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[41] Biz (n 38) p. 1040.
[42] Faulhaber (n 39) p. 333.
[43] I J Mosquera Valderrama, 'Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative' (2018) *BFIT* 72(3), p. 6.
[44] Ibid.
[45] Law No. 026/2019 of 18/09/2019 on tax procedures, *O.G.* No. special of 10/10/2019.

to provide the broadest notice to the public, the RRA should simultaneously publish the rulings in different nationwide media alongside private mails of taxpayers. Article 9(2) of the law on tax procedures also authorizes the RRA CG to make rules for issuing advance tax rulings. It is unfortunate that at the time of writing this book such rules were still waited for.

3.4.2. Tax agreements

Tax agreements here refer to advance pricing agreements (APA). An APA is an advance agreement between the tax administration and a taxpayer who transacts with a related person. Through an APA, the tax administration and the taxpayer agree on the transfer pricing method for upcoming sales, normally over a fixed period of time.[46] APAs are useful in resolving an actual or potential dispute about the transfer price between related parties, and have the potential to reduce future costs of litigation, thus benefiting both the taxpayer and the tax administration.[47] The mutual benefit, among other reasons, justify their frequent use, in developed countries. In contrast, in most developing countries, African countries included, the use of APAs is not yet widespread.[48] Some reasons may include limited regulation of transfer pricing coupled with the technicalities that are associated with transfer pricing matters.

Focusing particularly on Rwanda, in contrast to other African countries that do not have transfer pricing laws,[49] the Rwandan legislature thought of transfer pricing for the first time in 2005. Currently, transfer pricing is governed by article 33 of the income tax law, which requires that transfer pricing of transactions between related persons conform to the arm's length principle. Consequently, the taxpayer must be able to show through documentation to the tax administration that the price between related parties is the same as the price would be between unrelated parties. Failing to do so, the law empowers the tax administration to adjust the transaction prices. The modalities and details of transfer prices adjustments are governed by a ministerial order.[50]

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[46] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD Publishing, p. 23; B J Arnold, *International Tax Primer* (3rd edn, Kluwer Law International 2016), p. 209; Biz (n 38) p. 1041; Mosquera Valderrama, Output Legitimacy (n 43) p. 5.

[47] C P Kumar, 'Advance Pricing Arrangement, Transfer Pricing and MNCs: The Implications for Foreign Investment in India' (2007) p. 2 (https://ssrn.com/abstract=1773176, accessed 24/08/2018); B J Arnold and M J McIntyre, *International Tax Primer* (2nd edn, Wolters Kluwer 2002), p. 58.

[48] Mosquera Valderrama, Output Legitimacy (n 43) p. 6.

[49] A Waris, 'Taxing Intra-Company Transfers: The Law and its Application in Rwanda' (2013) *BFIT* 67(12), p. 5.

[50] Ministerial Order No. 003/20/10/TC of 11/12/2020 establishing general rules on transfer pricing, *O.G.* No. 40 of 14/12/2020.

Despite the existence of legal provisions on transfer pricing, the application of transfer pricing rules in Rwanda remains problematic. One cause is the fact that the law was enacted merely to complete the Rwandan tax laws rather than because of any misuse of international transfer pricing or recognition of a need for such rules.[51] This situation appears unusual and different from other countries where tax legislation is usually enacted to address a discovered problem.[52]

Although, from a general perspective, APAs can be used to attract internationally mobile capital by favoring a taxpayer or class of taxpayers, therefore becoming a part of harmful tax competition. This happens when the transfer price is not determined at arm's length. In such cases, the tax administration purposely gives a taxpayer or class of taxpayers a differential and preferential treatment in determining transfer prices. Although possible, this research has not uncovered any APA nor an APA-related case in Rwanda, which resulted into an absence of an APA that offers differential and/or preferential treatment.

3.4.3. Tax settlements

Tax settlements are another part of a tax system that can result in differential and preferential treatment of some taxpayers. Ordinarily, tax settlements occur when the tax administration and the taxpayer agree to settle a dispute out of court. Under Rwandan law, tax settlements are specifically provided for by article 52 of the law on tax procedures. According to this article, if a taxpayer is dissatisfied with the decision from the CG during an administrative appeal, the taxpayer may request to settle the matter amicably.[53] Article 3(7) of the amicable settlement rules[54] limits the taxpayer to only one request for amicable settlement. According to article 53 of the law on tax procedures, if the parties cannot resolve the dispute amicably, the taxpayer may file a case in court no later than thirty days from the date on which the parties failed to reach an amicable solution. The amicable settlement is an option for the taxpayer who, immediate to an administrative appeal, can opt to refer the case to the competent court. Referring the matter to the court remains possible if at the end of the amicable settlement no

[51] Waris (n 49) p. 6.
[52] Ibid.
[53] Tax Procedures Law (n 45) art. 52.
[54] Commissioner General Rules No. 001/2014 of 01/11/2014 determining the modalities of amicable settlement of tax issues, *O.G.* No. 45 of 10/11/2014.

agreement is reached.[55] Similarly, amicable settlement remains an option after the case is in court but before the court delivers the judgment.[56]

The law remains silent about the CG's ability to accept or refuse an amicable settlement once requested by the taxpayer. Part of the answer, the rules on amicable settlement declare *de facto* inadmissible a request on a case that the CG earlier rejected its appeal 'for reasons provided by the law'.[57] Indeed, if the Commissioner's reasons to reject the taxpayer's appeal were based on a sound interpretation of the law, there would be no reason for the CG to settle the case. However, the rules remain silent on other grounds that can motivate the inadmissibility of the request. Thus, the use of the term 'request' may be viewed as entitling the CG with the right to accept or to refuse the settlement request depending on the circumstances, which may include the best interest of the Revenue Authority.

From a practical perspective, numerous tax disputes are settled amicably.[58] An example of this is the case of MTN Rwanda Ltd v. RRA. This case started when RRA charged MTN Rwanda Ltd VAT on imported services from foreign companies. Dissatisfied with the RRA's decision, MTN Rwanda Ltd filed the case in court. On 05/12/2013, the Court ruled in favor of MTN Rwanda Ltd.[59] The RRA appealed the decision, but later withdrew its appeal for reasons not known to the public, other than the apparent fact that the parties settled amicably.

The details of that settlement are not in public domain and limited information is known to the public. Nevertheless, it is worth noting a few elements in relation to the settlement practices using that example. The first is how the RRA determines the settlement amount in a particular case. This determination is critical because, to a certain extent, a settlement could be viewed as relieving a taxpayer from paying a portion of the tax. If viewed in that way, it would risk looking like a case of favorable tax measure, thus, potentially harmful. Second, one can question the RRA's rationale during the amicable settlement process. Ordinarily, all tax disputes begin with an administrative appeal before they reach a court. During the administrative appeal, the RRA has the opportunity to accept a certain amount of tax, but does not. Why then accept that amount at some point later? As in the above case, it is very likely that MTN Rwanda Ltd,

[55] Tax Procedures Law (n 45) art. 53.
[56] Amicable settlement rules (n 54) art. 3(4) and art. 5(2).
[57] Id., art. 3(6).
[58] For instance, in the 2018/19 fiscal year, the RRA received 93 requests for amicable settlement, which was a decrease of 41.9% from the 160 requests it received in 2017/18 fiscal year. See RRA, 'Annual Activity Report 2018/19' (Oct. 2019) p. 43 <https://rra.gov.rw/fileadmin/user_upload/rra_annual_activity_report_2018-19.pdf> accessed 11/02/2020.
[59] MTN Rwanda Ltd v. RRA, RCOM 0710/13/TC/NYGE, Nyarugenge Commercial Court, 05/12/2013.

having won the case at the first level, accepted to settle out of court because the settlement outcome was in its favor compared to the first court's outcome. All those questions raise suspicions on the objectivity and/or subjectivity of amicable settlements. In summary, a tax settlement can be a favorable tax measure, especially if it is deliberately done to reduce the tax that would otherwise be owed.

Conclusion of chapter three

The aim of this chapter was to provide a non-exhaustive summary of the favorable tax measures available under Rwandan law. The starting point was the question of the benchmarks that can determine whether a tax measure is favorable. Two indicators were identified. One is the differential treatment from the general tax system with the application of tax rates and/or tax bases that deviate from what generally applies. The second is whether the effect of that difference is a preferential treatment resulting from a lower level of taxation, i.e., the minimization of the tax payable that benefits the taxpayer.

Focusing on Rwanda's current tax system, this chapter examined the available favorable tax measures in the income tax law and the law on investment promotion and facilitation. From those two laws, four measures were identified: PTRs, tax holidays, tax exemptions, and profit tax discounts. In addition, regulatory and administrative practices also provide favorable tax measures. Three such measures were identified: tax rulings, tax agreements, and tax settlements.

One reason to summarize favorable tax measures under Rwandan law is their innate proximity to harmful tax practices. This chapter has not distinguished whether the identified favorable tax measures are actually harmful or not. This task is saved for chapter six, which focuses on testing each of the identified measures to conclude whether or not they are actually harmful. At this point, the exercise was a mere identification of such measures.

Because of the established relationship between favorable tax measures and harmful tax competition, coupled with the latter's global nature, it is necessary to examine a variety of initiatives undertaken by other countries. Reference to the EU and OECD initiatives is helpful in the study of harmful tax competition. Indeed, some of the Rwandan measures that have been filtered out as potentially harmful are similar to some measures that have been assessed by the EU and/or the OECD. Therefore, the next chapter discusses the approaches of these two organizations to harmful tax practices.