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

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5 EAC's APPROACH TO HARMFUL TAX PRACTICES

In terms of article 79 of the Treaty establishing the EAC, the Partner States have undertaken to harmonize and rationalize investment incentives in order to promote the Community as a single investment area, while avoiding double taxation.[1] Article 83 of the Treaty requires the Partner States' commitment to adjust their fiscal policies for the purpose of removing tax distortions.[2] These Treaty provisions show the extent to which the EAC Partner States are willing to advance with tax integration as part of full regional integration. Tax integration constitutes a significant step in addressing harmful tax practices at the regional level. In this sense, the adoption of Community rules on tax competition is key to building a Community free of harmful tax competition.

This chapter provides a general picture of the current situation of the EAC with respect to harmful tax competition. It does so by considering both theoretical and practical aspects. In this context, a general picture of the EAC's engagement in this process is first given by highlighting some indicators of the EAC Partner States' engagement in harmful tax competition. This is followed by a look at the EAC tax competition agenda, including an overview of the EAC tax harmonization approach with a focus on the draft Code of Conduct against harmful tax competition. Thereafter follows a brief comparison between the EAC and EU approaches to harmful tax competition. The chapter concludes with a reflection on the general contribution of the EAC to the regulation of harmful tax practices.

5.1. State of play of tax competition in the EAC

It is generally accepted that (harmful) tax competition is a global phenomenon. This implies its existence in all parts of the world, including the East Africa. Its existence in the EAC has been noted in several reports that show how the EAC Partner States are racing to the bottom.[3] These reports are mainly from the international organizations and NGOs.[4] To give examples, the 2006

[1] Treaty for the Establishment of the East African Community (As amended on 14/12/2006 and 20/08/2007), art. 80(1)(f) and (h).
[2] Id., art. 83(2)(c) and (e).
[3] J B Kiprotich, *Income Tax in the East African Community: A Case for Harmonization and Consolidation of Policy and Law with a Focus on Corporate Income Taxation* (Ph.D Thesis, UoN 2016), p. 170; P O Ochieng, *Assessing the Relevance of Tax Incentives on Investments in Kenya's Export Processing Zones: In Support of Equitable Sharing of Tax Burdens*, (LL.M Thesis, UoN 2016), pp. 70-71.
[4] IMF, 'Kenya, Uganda and United Republic of Tanzania: Selected Issues' (2008) IMF Country Report No. 08/353, p. 6 and 8 <www.imf.org/external/pubs/ft/scr/2008/cr08353.pdf> accessed 14/05/2019; TJN & ActionAid, 'Tax

IMF report noted the prevailing attitude of the EAC Partner States to expand tax competition through investment tax incentives.[5] In line with the IMF, Tax Justice Network Africa (TJNA) in collaboration with ActionAid International published a report in 2012 mentioning that Partner States were engaging in harmful race to the bottom.[6] In 2011, IPAR published a report noting unfair tax competition among EAC states.[7] All these reports describe (harmful) tax competition as one of the serious problems in the EAC as a regional community.

Other features of harmful tax competition also exist in the Partner States. Examples include the existence of zero or low effective tax rates, artificial definition of the tax base, lack of transparency, lack of EoI, secrecy provisions, and non-adherence to the internationally accepted principles on transfer pricing.[8] The desire to eliminate harmful tax competition and bring about fair tax competition as expressed in the draft Code of Conduct[9] also evidences acknowledgement of harmful tax competition in the EAC.

Introspectively, the EAC itself classifies harmful tax competition as one of the priority issues of the Community. In this context, the Community's legislative assembly warned against the increasing offer of tax incentives by Partner States, each vying to attract as many foreign investors as possible.[10] The same report also confirms the EAC Council's awareness of the problem of harmful tax competition.[11] In a 2009 meeting, the EAC Sectoral Council on Trade, Industry, Finance, and Investment noted the need to remain internationally competitive at the same time recognizing that tax competition can lead to harmful tax practices and unfair competition among members.[12]

The existence of harmful tax competition in the EAC is caused by several factors. One is the unwillingness of Partner States to relinquish their fiscal sovereignty.[13] This is evident

Incentives for Investors: Investment for Growth or Harmful Taxes?' (2011) Policy Brief on Impact of Tax Incentives in Rwanda, p. 1; P Abbott et al., 'East African Taxation Project: Rwanda Country Case Study' (2011) IPAR, p. 12.

[5] IMF, Id., p. 8.

[6] TJN & ActionAid, Tax Competition in EAC (n 4), p. iv and 4.

[7] Abbott et al., East African Taxation Project (n 4) p. 12.

[8] Kiprotich (n 3) p. 170.

[9] B C Kagyenda, 'Development of an EAC Model Agreement for the Avoidance of Double Taxation and an EAC Code of Conduct against Harmful Tax Competition', Final Report, EAC Secretariat – GIZ EAC Tax Harmonization Project, Arusha, Preamble.

[10] EAC, 2nd Meeting of the 1st Session of the 3rd East African Legislative Assembly, Oral Answers to Priority Questions, Question: EALA/PQ/OA/3/06/2012, Nairobi, 13/09/2012, p. 10.

[11] Id., p. 11.

[12] Abbott et al., East African Taxation Project (n 4) p. 14.

[13] Kiprotich (n 3) p. 170.

from many Community initiatives that are launched, but remain ineffective for a long time without any official or valid justification. This is the case, for example, of the EAC Code of Conduct on harmful tax competition, whose proposal was tabled in 2011 but has not been adopted to date. Other reasons include the lack of adequate human resources capable of dealing with harmful tax competition issues, and a low level of information and knowledge about the impact of harmful tax competition.[14] Besides, an economic imbalance between Partner States also adds a reluctance in the fight against harmful tax competition in the Community. Indeed, the divergence of economic situations affects the divergence of economic interests, with subsequent diversity on harmful tax competition considerations.

More than that, there is a persistent trend within the EAC of not distinguishing tax competition from harmful tax competition. This is the case with the aforementioned reports that automatically portray the use of tax incentives for tax competition as harmful tax competition.[15] A common element in these reports is the calculation of the tax revenues foregone due to tax incentives,[16] from which harmfulness is inferred. That is why one of their recommendations has been the removal of all tax incentives to FDI through a coordinated approach engaging all EAC Partner States.[17] This approach is critical because it undermines the need for Partner States to remain internationally competitive. That approach also completely ignores the need for good tax competition, which is beneficial to both the country and the general taxpayer.

In spite of the noted alleged harmful tax practices, the Community goals are different to that. In general, the EAC aims to have a community free of harmful tax competition. In this regard, the EAC approaches on the matter are summarized in the Community's tax harmonization approach and the draft Code of Conduct.

5.2. The EAC tax competition agenda

In matters of harmful tax competition in the EAC, two agendas are currently available. One is the tax harmonization approach and the second is the commissioned study that resulted in a

[14] Id., p. 172.
[15] IMF (n 4) p. 6 and 8; TJN & ActionAid, Tax Competition in EAC (n 4) p. 1; Abbott et al., East African Taxation Project (n 4) p. 12.
[16] Abbott et al., East African Taxation Project, Id., p. 28; TJN & ActionAid, Tax Competition in EAC, Id., p. 10; Ochieng (n 3) pp. 70-71.
[17] TJN & ActionAid, Tax Competition in EAC, Id., p. 18.

proposal for a Code of Conduct against harmful tax competition in the EAC. The two are discussed in detail in the next paragraphs.

5.2.1. The EAC tax harmonization approach

One part of regional integration is economic integration, and this cannot be achieved without tax integration.[18] Thus said, regional integration depends on tax integration as a regional integration remains unattainable until fiscal integration is achieved.[19] Tax integration is also widely associated with the restriction of tax competition, besides the fact that it is considered as its minimizing force. Indeed, if each state runs its own national tax incentives, harmful tax competition becomes more fueled.[20] In this regard, tax harmonization is relatively seen as a rational approach to overcome that.[21]

Following the above, on different occasions, tax harmonization in the EAC has been considered as a strategy to eliminate harmful tax competition within the Community. This reflects the general trend in the EAC and can basically be traced in the Community's governing legal instruments. The first EAC legal instrument with provisions against tax competition is the EAC Treaty. This contains several provisions aimed at harmonizing tax systems in the Community. In particular, in article 75 of the Treaty, the Partner States have agreed not to impose new duties and taxes or increase existing ones on products traded within the EAC. Under the same provision, the Partner States have also agreed to refrain from enacting legislation or applying administrative measures that could directly or indirectly discriminate against the same or like products of other Partner States.[22] This is a standstill clause, which provides a good starting point for the harmonization of tax practices in the Community.

Similarly, article 79 of the Treaty provides for the Partner States' commitment to ensure the development of the industrial sector. To this end, the Partner States committed to harmonize and rationalize investment incentives within the Community, including those relating to the taxation of industries, in particular those using local materials and labor, with a view of

[18] A T Marinho & C N Mutava, 'Tax Integration within the East African Community: A Partial Model for Regional Integration in Africa',p. 2<https://pdfs.semanticscholar.org/3cd7/ce5b507d7a04acd640dfb37401d6aebc33f6.pdf> accessed 27/03/2020.
[19] Ibid.
[20] H G Petersen (ed), 'Tax Systems and Tax Harmonization in the East African Community' (2010) Report for the GTZ and the General Secretariat of the EAC, p. 91.
[21] Ibid.
[22] EAC Treaty (n 1) art. 75(4) and (6).

promoting the Community as a single investment area.[23] Similarly, article 85 of the Treaty expresses the Partner States' commitment to harmonize the taxation of capital market transactions.[24]

In a like manner, article 82 of the Treaty underlines the Partner States' commitment to cooperate in monetary and fiscal matters. To this end, they undertake to remove obstacles to the free movement of goods, services, and capital within the Community.[25] Article 83 of the EAC Treaty also provides for harmonization of monetary and fiscal policies. Under this provision, the EAC Partner States undertake to adjust their fiscal policies […] in order to ensure monetary stability and the achievement of sustainable economic growth.[26] Furthermore, the EAC Partner States undertake to harmonize their tax policies with a view of removing tax distortions in order to bring about a more efficient allocation of resources within the Community.[27]

To harmonize tax policies, coupled with the implementation of article 75 of the Treaty on the creation of the EAC Customs Union, the Partner States adopted the East African Community Customs Management Act in 2004, and it was last amended on 8 December 2008. This Customs Union is regulated by a Protocol, the roots of which are enshrined in article 75 of the Treaty. To a large extent, the Customs Union contributes to pulling the EAC Partner States closer and reduces the divergence between them.

From the above, it is evident that the EAC focuses largely on tax harmonization to build a community free from harmful tax competition. More so, the EAC associates tax harmonization with harmful tax competition, in one way or another. For example, the EAC Legislative Assembly mentions the discussions on the Code of Conduct against harmful tax competition among the processes undertaken towards tax harmonization.[28] Tax harmonization has also been described as capable of addressing many fiscal issues in the Community, including the possibility of eliminating harmful tax competition.[29] This has been especially true of the harmonization of CIT and more specifically the tax incentives thereto pertaining.[30] In this context, it has been suggested, *inter alia*, that minimum tax rates should be set in order to avoid

[23] Id., art. 80(1)(f).
[24] Id., art. 85(1)(c).
[25] Id., art. 82(1)(c).
[26] Id., art. 83(2)(c).
[27] Id., art. 83(2)(e).
[28] EALA (n 10) p. 12.
[29] Kiprotich (n 3) pp. 23-24 and 26.
[30] Id., p. 87.

harmful tax competition.[31] However, this approach would not be effective due to economic differences between the EAC Partner States and would rather have detrimental effects.

Moreover, most of the proposed approaches show further the state of confusion between tax competition and harmful tax competition in the EAC. This contention is based on the fact that minimum tax rates alone are not sufficient to address harmful tax competition. The introduction of minimum tax rates may also lead to misunderstandings between Partner States, which have different economic levels and comparative competitive advantage factors. Not only this, but also the general international competitiveness of the EAC Partner States could be seriously jeopardized. Therefore, a more holistic approach needs to be taken.

Moreover, tax harmonization may relatively be the most far reaching step in the general fight against harmful tax competition. However, without undermining its role, it is not sufficient in itself, given its main concern, which is the approximation of comparable tax bases and rates. In this context, comparable does not mean equal, but rather, sufficiently in line each to an extent of not causing large distortions. This is therefore not sufficient, which justifies the necessity of other measures.

In this sense, the EAC commissioned a study which, as a result, proposed a Code of Conduct against harmful tax competition in the Community. This study represents another aspect of the EAC agenda in the fight against harmful tax competition and reflects the EAC view in terms of inhibiting harmful tax practices.

5.2.2. Draft Code of Conduct against harmful tax competition

The EAC, with the support of the German Agency for International Cooperation (GIZ), commissioned a study on harmful tax competition in the Community. This study ended in 2011 with a proposal for a draft Code of Conduct against harmful tax competition in the EAC. Even before that time, in 2006, the IMF report had proposed the introduction of a Code of Conduct in the EAC to establish a transparent rule-based system of investment incentives.[32] The current draft Code has been appreciated and commented as an important initiative.[33] While this is correct and worthy of approval, the fact that this draft has not been adopted after ten years, as of 2021, sends the message that the issue of harmful tax competition is not really taken

[31] Id., p. 105.
[32] IMF (n 4) p. 4, 6, and 17.
[33] Kiprotich (n 3) p. 171.

seriously. Therefore, this draft remains a proposal until now and is not legally binding, nor has it any political influence.

Following on, the question is how long it will remain in the drawer? This is a serious matter, because a draft which is not adopted remains ineffective. More than that, the EAC's failure to adopt the proposal shows the low priority that the Partner States attach to the issue of harmful tax practices. In the same vein, it may show the political will of the Partner States to continue to engage in tax competition. Thus, a step towards eliminating harmful tax practices would therefore be the adoption of the EAC Code of Conduct against harmful tax competition as a robust legal instrument. Although still a draft, some key features of the Code are worth highlighting.

5.2.2.1. Key features of the draft Code

In the preamble, the draft Code acknowledges the positive effects of fair tax competition, and thus, supports the international competitiveness of the EAC Partner States. Conversely, it condemns harmful tax competition and advocates its elimination in favor of fair tax competition. The preamble to the Code also sets out its nature as a political commitment that does not affect the rights and obligations of Partner States as set out in the Treaty. However, this nature is vexed by the same draft *in fine,* which establishes the Code as an agreement to be signed by the representatives of the Partner States. The reference to an 'agreement' between the Partner States, makes it look somewhat different and signals that it is a binding convention. The Code's objective is explicitly stated: the elimination of harmful tax practices in the Community. The Code is expected to come into force once published in the EAC Gazette.

The draft Code is commendable as it defines harmful tax competition, as well as harmful tax effects and harmful tax practices. Article one of the draft Code defines harmful tax competition as:

> The competition created within an economic block as a result of preferential tax regimes that offer tax advantages to particular entities at the detriment of other entities operating within the same country or other countries thereby putting the other entities in a less competitive position.[34]

Apparently, this article defines tax competition not between states, but between companies. This is induced from what is mentioned as effect of harmful tax competition. According to that

[34] Draft Code of Conduct against Harmful Tax Competition in the East African Community, art. 1(d).

definition, the effect of harmful tax competition is to place favored businesses in a privileged position while placing other businesses in a less competitive position. The definition clarifies that the entities may be located in the same country or in different countries, which clearly indicates that the competition in question is between business entities and not between countries. Thus, the definition in the draft EAC Code seems to define something else, much closer to state aid or subsidies, but not harmful tax competition.

The definition of harmful tax effect in the draft Code is also problematic. The draft Code defines harmful tax effect as the '*negative spill over to other countries that arise from the harmful preferential tax regimes.*'[35] This definition confuses HPTRs with harmful tax practices. A benchmark here is the OECD structure of harmful tax practices, which consists of tax havens and HPTRs. The consideration of the draft Code's definition would mean that tax havens do not generate harmful tax effects. This would mean that only HPTRs produce harmful tax effects, which is incorrect. Indeed, tax havens actually produce the most harmful effects.

Article 1(f) of the draft Code defines harmful tax practices as:

> Tax measures by tax havens and/or preferential tax regimes that affect the location of financial and other services activities, erode the tax base of other countries, distort trade and investment patterns and undermine the fairness, neutrality and the broad social acceptance of systems.

Although not as highly critical as previous definitions, the draft Code's definition of harmful tax practices is specific in many respects, but also open to criticism. On the positive side, it includes some elements of harmful tax practices, such as tax havens. It also includes the generally recognized consequences of harmful tax practices, such as tax base erosion, trade distortion, and unfairness. The draft Code also explicitly requires that harmful tax practices 'affect the location of financial and other services activities'.[36] On the negative side, however, the definition is not specific that the preferential tax regimes must be harmful. This means that the qualifying word 'harmful' should have been added to the phrase 'preferential tax regime' to fall within the scope of harmful tax practices.

Moreover, the definition of harmful tax practices does not encompass all elements of harmful tax practices. To be more specific, it does not mention some key elements that characterize harmful tax practices, such as ring-fencing, lack of transparency, lack of EoI, and

[35] Id., art. 1(e).
[36] Id., art. 1(f).

lack of substantial activity requirement. Yet, these three elements are fundamental in determining harmful tax practices. In addition, contrary to the OECD, which uses harmful tax competition interchangeably with harmful tax practices, the draft Code distinguishes the two terms and defines each as a separate concept.

Beyond the definitions, the scope of the draft Code is also problematic. According to the draft Code, it is intended to apply to 'each tax of every description' collected by the tax administration of each Partner State.[37] This description is too broad, as some taxes are not related to harmful tax practices. These are, for example, the tax on land and other immovable properties, the tax on consumption, and the tax on labor. Some other taxes are also meaningless to lower the tax burden, due to their *de minimis* impact. This is the case, for example, with the trading license tax, which, in Rwanda, ranges between 4,000 Frw (less than 4 USD) and 250,000 Frw (approximately 250 USD) per year.[38] This is a very small amount to have a significant effect in terms of business location or tax base erosion. The overly broad scope of the draft Code, if adopted the way it is, risks to negatively impact its effectiveness.

Interestingly, the draft Code provides for standstill and rollback clauses. The standstill clause appears in the first paragraph of article 3 while the rollback clause appears in the second paragraph of the same article. Another interesting element of the draft Code is the provision on transparency and EoI. With respect to transparency, it clearly states that administrative practices that are not transparent, or are inconsistent with, or negate or nullify statutory laws, should be considered as harmful.[39] Regarding EoI, the draft Code requires Partner States to comply with article 27 of the EAC DTA.[40] Referring to the EAC DTA is reasoned as it avoids the overlap of legal texts, which in turn limits the risk of contradictions.

Partner States are also required under the draft Code to review bank secrecy laws in accordance with internationally accepted principles, with reference to the OECD and UN.[41] Failure to do so constitutes harmful tax practice.[42] Government permissions to negotiate tax rates or bases are also deemed harmful.[43] Partner States are also urged to agree on uniform

[37] Id., art. 2(1).
[38] Law No. 75/2018 of 07/09/2018 determining the sources of revenue and property of decentralized entities, *O.G.* No. 44 of 29/10/2018, Annex.
[39] EAC draft Code of Conduct (n 34) art. 4(1).
[40] Id., art. 5(2).
[41] Id., art. 6.
[42] Ibid.
[43] Id., art. 7(1).

transfer pricing rules and incorporate them into domestic tax laws along with using the EAC Model Convention when entering into a tax treaty with a third country.[44] In addition, the draft Code recognizes two types of tax rulings, namely private tax rulings and general tax rulings.

Besides, the draft Code contains a provision on state aid and subsidies.[45] This provision is out of place because the matters relating to state aid and subsidies are governed by other EAC instruments, such as the Protocol on Common Market, the Competition Act, Customs Union Protocol, and Customs Union Regulations.[46] This is another consequence of the aforementioned incorrect definition of harmful tax competition, combined with the persistent confusion between tax competition *per se* and harmful tax competition, as well as the confusion between competition between companies and competition between states. In this sense, article 13 of the draft Code enumerates several models and harmonizations that must be undertaken to ensure effective tax rates. These include VAT, income tax, and excise taxes. That long list is a consequence of the broad scope of the draft Code, which goes beyond the area of harmful tax competition to include other aspects that are normally not substantially related to harmful tax competition.

In addition, the draft Code provides for a broad geographical extension so that the Code can reach third countries as far as possible.[47] It also provides for the procedure to assess the harmfulness through reviews, and the establishment of a committee by the Council to assess harmful tax measures.[48] The draft Code also contains some provisions on transparency and EoI as explained below.

5.2.2.2. Provisions on transparency and exchange of information

In the proposed EAC Code of Conduct, transparency is enshrined in article four. This article states that administrative practices that are not transparent, or that are inconsistent with or negate

[44] Id., art. 8 and 11.
[45] Id., art. 12.
[46] EAC, Protocol on the Establishment of the East African Community Common Market, art. 34(1) and (2) [EAC CMP]; EAC, the East African Community Competition Act, 2006, sec. 14, 15, 16, 17, 22, 24, 37, 42(1), 44, and 46; EAC, the Protocol on the establishment of the East African Community Customs Union 2004, art. 1; EAC, the East African Community Customs Union (Subsidies and countervailing measures) Regulations, 2006, Regulation 7(1).
[47] EAC Draft Code of Conduct (n 34) art. 15.
[48] Id., art. 17 and 20.

or nullify statutory laws, are harmful.[49] The same provision requires transparency in all tax administration procedures, which must be clear to all stakeholders.[50]

Transparency is also set as a standard of EoI.[51] In addition, the draft Code advocates the publication of all tax rulings, i.e. private tax rulings and general tax rulings, as part of their transparent administration.[52] To this end, article 10(9) of the draft Code describes a lengthy procedure that includes submission modalities such as the use of the prescribed form, the submission timeframe, the pre-screening process to verify compliance with the checklist, the substantive review process, meetings with the ruling specialists, notification of the decision, and the issuance and publication of the ruling.[53]

Like the EU Code of Conduct, the draft Code requires the Partner States to inform each other of existing and proposed tax measures that may fall within the scope of the Code.[54] This requirement is intended to ensure transparency and openness between the Partner States.

In addition to transparency, the draft Code also requires EoI. On this account, article 5 of the draft Code requires Partner States' commitment to exchange information where it is foreseeably relevant to the administration and enforcement of national tax laws.[55] In this regard, the draft Code requires Partner States to comply with article 27 of the EAC DTA on EoI.

The EAC DTA was signed on 30 November 2010 as an agreement between the EAC Partner States to avoid double taxation and prevent fiscal evasion with respect to taxes on income. Article 30(1) of the EAC DTA states that it shall enter into force on the date of the last notification of the ratification process in accordance with the respective domestic procedures of the members. So far, only three states, namely Kenya, Rwanda, and Uganda, have ratified it.

Although not yet in force, pending all Partner States' ratifications, article 27 of the EAC DTA provides for the EoI between the Partner States. Further to that, article 5(10) of the draft Code requires Partner States to review their laws and ensure they are consistent with the internationally accepted principles on the EoI.

[49] Id., art. 4(2).
[50] Id., art. 4(1).
[51] Id., art. 5(1).
[52] Id., art. 10(6).
[53] Id., art. 10(9).
[54] Id., art. 16.
[55] Id., art. 10(1).

Besides the above key features, the draft Code contains some elements that are very similar to the EU Code of Conduct. For this reason, a brief comparison between the two might be interesting.

5.3. Comparison between EAC and EU Codes of conduct

To tackle harmful tax practices, the EU adopted a package including a Code of Conduct on business taxation. With a similar objective, the EAC started a process that led to a draft Code of Conduct against harmful tax competition. The two Codes are similar in some respects, but also different in others. This section compares the two Codes of Conduct against harmful tax practices by highlighting the similarities and differences.

5.3.1. Similarities between the two codes

On various occasions, scholars have encouraged the EAC to learn and borrow from the success stories of the EU, as the EU is seen as a model for the development of EAC regional integration.[56] In this regard, the draft EAC Code of Conduct against harmful tax competition is modeled on the EU Code of Conduct. Thus, the EAC draft Code is similar to the EU Code of Conduct in several respects.

As to the similarities, both organizations use the terms 'Code of Conduct'. Notwithstanding the fact that the EAC draft Code, *in fine*, sets itself as an agreement, both Codes explicitly declare themselves as non-legally binding instruments. Both also share the same genesis, which is the existence of intra-community harmful tax competition through which member states compete and, thereby harm each other. The objective of the two organizations is also the same: tackling harmful tax practices. The two codes also acknowledge the benefit of good tax competition as opposed to harmful tax competition. They also have some common clauses, such as the standstill and rollback clauses. The content of the two clauses is *verbatim* identical in both Codes. Both codes also provide for a review process and geographic extension beyond their respective members. In addition, both emphasize the importance of transparency and EoI.

[56] Marinho and Mutava (n 18) p. 11; A Titus, 'Fiscal Federalism and the EAC: The Way Forward' (2014) *ILJTBE* 1(1), p. 1; E Ugirashebuja, J E Ruhangisa, T Ottervanger and A Cuyvers (eds), *East African Community Law: Institutional, Substantive and Comparative EU Aspects* (Brill Nijhoff 2017), p. ix; J Otieno-Odek, 'Law of Regional Integration: A Case Study of the East African Community', in J Döveling, H I Majamba, R F Oppong and U Wanitzek (ed), *Harmonization of Laws in the East African Community: The State of Affairs with Comparative Insights from the European Union and other Regional Economic Communities* (LawAfrica Publishing 2018), p. 41.

Regarding transparency and EoI, the EU Code of Conduct identifies transparency as a key element in determining whether a regime is actually harmful. In this respect, the EU Code interprets a lack of transparency broadly to include legal provisions that are relaxed at an administrative level in a non-transparent manner.[57] The EU Code also compels the Member States to inform each other of existing and proposed measures that may fall within the scope of harmful tax practices.[58] This shows the extent to which the two elements are crucial in relation to harmful tax practices under the EU Code of Conduct. Similarly, the draft EAC Code details transparency and EoI as important elements in the fight against harmful tax practices. However, despite the many similarities, the two Codes also have some differences.

5.3.2. Differences between the two codes

First and foremost, the EU Code has already been adopted, has been in use, and is producing beneficial effects, whereas the EAC Code remains a draft without any impact. Closely related to this, is that the EU Code of Conduct is widely accepted in the EU and largely supported by political peer pressure. It is unlikely to expect that the EAC draft Code, even if eventually adopted, will receive comparable acceptance and political support. This fear is justified by the consistently low level of political will that characterizes the EAC Partner States in some of the community initiatives.

Indeed, political will is key to the success of regional integration, while its absence is fatal.[59] It is therefore absurd that in the EAC, decision making almost fully lies with the governments of the Partner States instead of the EAC.[60] This results in a weak Community that appears strong only on paper through Acts that are in force in theory, but have no practical enforcement.[61] Despite many contributing factors, an important one is the fact that the Partner States are not yet acquainted with surrendering their sovereignty to the Community. Indeed, the EAC Partner States are bound by their individual nationalism and are more attached to their respective national concerns.

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[57] EU Code of Conduct 1997: Conclusions of the ECOFIN Council meeting of 1/12/1997 concerning taxation policy DOC 98/C2/01, *OJEC* (6.1.98) C 2/3.
[58] Id., C2/4.
[59] Otieno-Odek (n 56) p. 30.
[60] W Masinde and C O Omolo, 'The Road to East African Integration', in E Ugirashebuja, J E Ruhangisa, T Ottervanger and A Cuyvers (eds), *East African Community Law: Institutional, Substantive and Comparative EU Aspects* (Brill Nijhoff 2017), p. 20.
[61] Id., p. 18.

Back to the differences, some elements of the EAC draft Code are explicitly different from the EU Code of Conduct. For example, the two have different scopes of application. The EU Code applies to business taxation, while the EAC draft Code applies to each tax of every description collected by the Revenue Authority of a Partner State. This means that the scope of the draft EAC Code is much broader than the scope of the EU Code. Similarly, the draft EAC Code goes beyond the area of harmful tax competition to cover other areas, such as state aid and subsidies, which is not the case with the EU Code. The draft EAC Code is also much more detailed compared to the EU Code. Lastly, the EAC draft Code ends up presenting itself as an agreement to be signed by the representatives of the EAC Partner States, which is not the case with the EU Code which was issued as a Council Resolution.

Nevertheless, the initiative that led to the drafting of the Code of Conduct in the EAC is, more or less, commendable. The next section discusses the possible contribution of the EAC in the fight against harmful tax competition.

5.4. EAC's contribution to the regulation of harmful tax practices

The EAC's contribution to regulating harmful tax practices is relatively limited and controversial. As developed below, the regulation of harmful tax practices in the EAC is almost non-existent if viewed *stricto sensu*. The few elements that do exist can be viewed in the context of tax harmonization and other provisions aimed at developing a common market.

Under EAC law, the Common Market is enshrined in article 2(2) of the EAC Treaty, which provides for the establishment of the Customs Union and the Common Market as transitional stages and integral parts of full integration.[62] To firm up these provisions, article 76 of the Treaty provides for a Protocol establishing the Common Market and sets out its details. This Protocol was signed on 20 November 2009 and came into force on 1 July 2010 after ratification by all EAC Partner States.

The Protocol provides for five freedoms in relation to the Common Market, namely freedom of goods, persons, labor, services, and capital.[63] In addition, the Protocol provides for two rights, namely the right of establishment and the right of residence.[64] Article 32 of the

[62] EAC Treaty (n 1) art. 5(2).
[63] EAC CMP (n 46) art. 2(4).
[64] Ibid.

Protocol focuses on the progressive harmonization of tax policies and laws in order to eliminate tax distortions and facilitate the free movement of goods, services, and capital.

With regard to tax harmonization in the EAC, it is evident that the Treaty and Common Market Protocol converge. Nevertheless, the implementation of the Protocol and other Community instruments is questionable. This raises controversies about the role of the EAC in tackling harmful tax competition, which can be viewed optimistically and pessimistically as discussed below.

5.4.1. Optimistic view

Despite the above criticisms, the EAC has so far made some positive progress in regulating harmful tax competition. First, the explicit provisions of the EAC Treaty on tax harmonization are useful tools to relatively counteract harmful tax practices. Indeed, in the view of approximation of laws, if the EAC achieves tax harmonization, there would be a reduction in tax law differences, which would reduce differences in the definition of tax bases, tax rates, tax deductions, etc. Even so, approximation does not mean equality and tax differences would not be completely eliminated, which creates the necessity for other instruments to curb harmful tax competition.

Another step taken by the EAC on harmful tax practices is the draft Code of Conduct. Although not yet adopted, this draft has some notable merits. For example, the draft Code contains standstill and rollback clauses. It also provides for review processes to eliminate harmful tax practices in EAC Partner States. The draft Code also emphasizes that lack of transparency and EoI constitute harmful tax practices. Not only these examples, but also the existence of the draft Code is a major step forward in recognizing the harmful effects of harmful tax competition and the need for the Community to address it.

However, without underestimating the efforts mentioned above, the EAC still has much work to do on harmful tax practices. For example, tax systems in the EAC Partner States are domestically confined, with very few regionally coordinated efforts. This leads to disparate tax systems, where each Partner State uses its unilateral tax sovereignty to attract investment in complete disregard of the others. It is against this background that a harmonization process such as the common market may fuel tax competition instead of reducing it. This leads to a pessimistic view, which is described below.

5.4.2. Pessimistic view

The EAC is struggling to achieve a common market. To this end, the Treaty, complemented by the Common Market Protocol, provides some guiding principles. The realization of the Common Market, coupled with the fully operational Customs Union, grants each Partner State's access to the entire EAC market. Without a coordinated approach of favorable tax measures, EAC Partner States might be tempted to increase their favorable tax measures to attract foreign investors.[65] Left unchecked, a Partner State could engage in harmful tax practices that will end up harming all Partner States.[66]

Thus, the Common Market may run the risk of negatively encouraging tax competition in the sense that some companies may take advantage of the Common Market to plan their tax schemes. For example, with the right of establishment, an undertaking can choose to establish itself in a country that offers the most favorable tax measures, as the undertaking will access other Partner States' markets without jurisdictional barriers.

In the same vein, the fact that tax bases are defined differently by each Partner State also fuels tax competition. With the removal of market barriers, as advocated by the Common Market establishment, an undertaking is able to access the entire EAC market. Therefore, the business location becomes determined by the level of tax payable in terms of tax bases and tax rates.[67] Of course, other factors play a role, but tax factors play the most significant role.

Conclusion of chapter five

Starting with the recognition of regional initiatives against harmful tax competition, this chapter focused on the EAC. The chapter summarized the approaches that are in use by the EAC to tackle harmful tax competition. The aim was to describe the regulatory aspects as well as the practical ones.

As indicated in several reports by international organizations and NGOs, the existence of harmful tax competition among EAC Partner States is axiomatic. To a large extent, each EAC Partner State is trying its best to attract more foreign investors to its own territory, in total disregard of the harm this may cause to other Community members. In this struggle to attract investment, Community laws are ignored.

[65] IMF (n 4) p. 5.
[66] Ibid.
[67] Marinho and Mutava (n 18) p. 11.

Nevertheless, based on the Community's objectives, the EAC has sought to create a legal environment whose effective application can partially curb harmful tax competition. At the forefront is the EAC Treaty, which contains several provisions aimed at the harmonization of laws, including tax laws. The Treaty is supplemented by other legally binding instruments such as the EAC Customs Management Act, the EAC Competition Act, the EAC Competition Regulations, and the EAC Common Market Protocol. In addition, a Code of Conduct against harmful tax competition in the EAC has been drafted but is not yet in force.

With regard to the Code of Conduct, it is praiseworthy that the EAC emulated the EU and started the process that led to a draft Code of Conduct. However, it is unfortunate that, unlike the EU, low political will in the EAC has impeded the adoption of the draft Code. Moreover, the draft Code appears to be overly ambitious, attempting to regulate more than is actually necessary. More on this contention, alongside corrective proposals, are discussed in chapter seven, specifically in the second sub-section of section two.

In summary, EAC programs against harmful tax practices exist in theory but not in practice. This is evidenced by several elements. One is the fact that the EAC Partner States have so far retained their full sovereignty. Consequently, each EAC Partner State has its own laws, with no coordination, and each runs its own preferential tax regimes. Second is the fact that the draft Code has remained in draft form for a very long time, and has still not been adopted, which reflects the Partner States' very low political will to curb harmful tax competition in the Community.

Nevertheless, harmful tax competition is a global problem that needs to be studied beyond a limited jurisdiction to include references from other jurisdictions. This is the approach taken in the next chapter, which assesses Rwanda's regime of favorable tax measures. The main reference is, of course, to the EAC law. However, reference is also made to other significant works, particularly to fill the gaps identified in the EAC law.