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

Habimana, P.

7 REMEDIES TOWARDS A NON-HARMFUL TAX SYSTEM

This chapter compiles the proposals to address the issues raised in the previous chapters. It aims to answer one of the focal research questions about the design of a model for Rwanda, which is free from harmful tax practices. The rationale stems from the previous chapter which focused on the analysis of Rwanda's favorable tax measures. The objective was to identify the harmful tax competition issues that may exist under Rwandan law. This chapter offers solutions to the harmful tax aspects identified in the previous chapters. It does so in recognition of the ultimate research objective of legal scholarship, namely 'what' and 'how' the law should be be.[1] It suggests how the provisions on the identified harmful tax aspects should be formulated to eliminate their harmful aspects. Moreover, based on the principle of tax sovereignty, each country remains free to design its tax system as far as internationally accepted standards are not violated.[2] The same approach forms a cornerstone of this chapter, which considers Rwanda to be entirely free to design its tax system as long as it remains within the parameters of internationally accepted principles.

The proposals made in this chapter are two-fold. Some proposals are unilateral while others are multilateral. While unilateral measures can be taken by Rwanda within the framework of its sovereignty, multilateral measures must be taken at the EAC level. The development of multilateral proposals is based on the international nature of harmful tax competition, the responses to which privilege multilateral actions over unilateral action.[3]

This chapter is divided into four sections. The first section focuses on the proposals aimed at refining the Rwandan tax system of harmful tax practices. The aim of this section is to show how Rwanda can remove harmful tax aspects from its system. The second section develops actions that should be taken at the EAC level to close the gap at the Community level.

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[1] S Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014), p. 32.

[2] OECD (1998), *Harmful Tax Competition: An Emerging Global Issue*, OECD Publishing, p. 15; K van Raad, *Materials on International & EU Tax Law* (13th edn, International Tax Center 2013), p. 1312; M Gaffney, 'Competition: More Harm than Good' (1999) *Int'lT.Rev.* 10(1), p. 47.

[3] R S Avi-Yonah, 'Bridging the North/South Divide: International Redistribution and Tax Competition' (2004) *MichJIntlL* 26, p. 387; N Nikolakakis, *The International Legal Ramifications of the OECD's Harmful Tax Competition Crusade* (LL.M Thesis, McGill Univ. 2006), p. 32; P Lampreave, 'Fiscal Competitiveness versus Harmful Tax Competition in the European Union' (2011) *BFIT* 65(6), p. 6; M Nouwen, 'The Gathering Momentum of International and Supranational Action against Aggressive Tax Planning and Harmful Tax Competition: The State of Play of recent Work of the OECD and European Union' (2013) *Euro.Tax.* 53(10), p. 11; M Nouwen, 'The European Code of Conduct Group Becomes Increasingly Important in the Fight against Tax Avoidance: More Openness and Transparency is Necessary' (2017) *Intertax* 45(2), p. 139.

This mainly concerns the draft Code of Conduct. The third section attempts to demystify the understanding of tax competition in the EAC. The fourth section proposes an EAC model against harmful tax competition before the conclusion comes.

7.1. Refining the Rwandan tax system

The proposals in this section have a unilateral character. This means that their adoption and implementation should be done at the national level and does not require agreement with other states, whether at the regional or international level. Although unilateral measures are the easiest to implement, their effectiveness in combating harmful tax competition is challenged. Nevertheless, their implementation is not meaningless, especially in the context of regional integration. In fact, if one state adopts and implements unilateral measures, this can be a starting point to exert political pressure on other states to do the same. Similarly, the pioneer state can serve as a model for other states in the fight against harmful tax competition.

Granted that, the proposals developed here concern adjustments that should be made to correct the identified harmful tax aspects. Once cleaned up, Rwanda's system will appear pristine not only within the EAC but also in the international tax arena.

7.1.1. Proposals on preferential tax rates

With regard to the 0% and 15% PTRs provided for in the investment law, two aspects have been identified as harmful. One aspect is the time frame during which a qualifying taxpayer can benefit from a PTR. In the absence of transparent legislation providing for this time frame, the administration can take discretionary measures in a non-transparent manner to establish a time frame. To avoid such consequences, it is proposed to add a paragraph at the end of Annex I of the investment law reading as follows:

> The preferential CIT rate of zero percent (0%) provided for in this Annex shall be granted annually upon positive review of the factual fulfillment of the conditions thereto pertaining.

A similar paragraph should be added *mutatis mutandis* at the end of Annex IV of the investment law which provides for the preferential CIT rate of 15%. This addition makes it clear that the preferential CIT rate granted in this measure is not open-ended. This would also limit the discretion of the administration, which can either grant a longer period or terminate the benefit. It would also make the measure more transparent and not harmful in any of its aspects.

Similarly, the PTR of 0% needs to determine, or at least make determinable, the level of employment and training to Rwandans that is 'adequate' enough. Since the number of employees required may depend to a large extent on the company's business activities and the degree to which it uses technology, the proposal is to consider the level of employment adequate, pro rata to the company's overall business and the proportion of the company's business or profits attributable to Rwanda. In this consideration, Annex I (1^0)(b) of the Investment Law should read:

> To provide adequate employment and training to Rwandans pro rata to the company's overall business and the portion of the company's business or profits attributable to Rwanda.

In addition, the pro rata consideration should apply to all categories of employees, i.e senior managers, technical, and support staff. A similar provision should also be added *mutatis mutandis* among the requirements to benefit from a PTR of 15%.

Besides, the preferential CIT rate of 3% on foreign-sourced trading income of a registered investor operating as a global trading or paper trading, pure holding companies, and foreign-sourced royalties of a registered investor operating as an intellectual property company has been criticized as *prima facie* appearing harmful in several aspects including the possibility of attracting paper companies and letter-box companies. Therefore, the recommendation is to make the measure not ring-fenced and emphasize the substantial economic presence requirement. Failure of that, the measure could be abolished. The preferential CIT rates of 25% and 15% given to export investments were also criticized as likely harmful regarding the gateway criterion and ring-fencing criterion 2 alongside the absence of other conditions to measure the satisfaction with other criteria. Thus, it is a recommendation to the legislature to make the measure not ring-fenced and to complete the law and set additional requirements, responding sufficiently to the criteria of transparency, substantial economic presence requirement, and compliance with the OECD rules on profit determination.

7.1.2. Proposals on tax rulings

As mentioned in the previous chapters, the currently available rulings are public. Normally, public rulings raise a few questions regarding their potential harmfulness. Even so, one issue raised is about their methods of publication, which has been shown to be flawed, therefore, in need of improvement. In this context, it is proposed that, in addition to the current publication methods, tax rulings also be published in the official gazette. Therefore, the second paragraph of article 9(1) of the law on tax procedures should be amended to include this element and reads: '*[...] are published in the Official Gazette and through a nationwide media*'. Once worded in this way, the suspicion linking the tax rulings to the harmful tax practices shall notably be brought to an end. Moreover, both rulings should be published, including the private rulings. If need be, the private rulings can be published in an edited format.

Another concern in this respect is the low use of private rulings. Notwithstanding the fact that they are initiated by an individual taxpayer, the benefits associated with this practice are for both sides. Under current Rwandan tax laws, there is no law prohibiting the use of private rulings. Nevertheless, they are less used in practice. In order to ensure transparency, it is recommended that if it happens to issue a private ruling, it must also be published, if need be in an anonymous form. In addition, further practical details should be laid down to determine the procedure for conducting the private rulings. These details should include elements such as the procedure to request a ruling, the timeframe to be issued, the formats to be used, the information required, and other necessary documents.

7.1.3. Proposals on advance pricing agreements

In Rwanda, APAs are primarily concerned with their practical aspect, which is low compared to their theoretical aspect. The rules governing transfer pricing matters under Rwandan law are largely not applied and have remained ineffective since they were first enacted in 2005. The current income tax law provides the principle that prices in controlled transactions between related parties must be at the arm's length.[4] The law is complemented by a ministerial order that sets out the rules for transaction price adjustments.[5] For effective implementation, it is proposed to improve the administrative technical aspects of transfer pricing practices, such as staff training. This is necessary to ensure that the tax administration is equipped with competent staff who have the required level of skills to deal with the transfer pricing technicalities. Otherwise, transfer pricing rules could remain ineffective for another long time.

7.1.4. Disband tax settlement

As for tax settlements, these are suspected of being harmful. Therefore, their abolition is an ideal solution alongside their replacement by an independent board to review appeals of the cases where taxpayers have not been satisfied with administrative appeal decisions. The proposed Board should be fully independent and its members should have expertise in tax matters. It should be under the responsibility of the ministry of finance, whose minister or a

[4] Law No. 016/2018 of 13/04/2018 establishing taxes on income, *O.G.* No. 16 of 16/04/2018, art. 33(1).
[5] 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.

representative should chair it. Other members may include representatives of the RRA, the Institute of Certified Public Accountants of Rwanda, Rwanda Bar Association, academia, and Private Sector Federation. Due to the complexity of tax matters and the paucity of tax specialists in Rwanda, the mandate may be for three years, renewable. However, a member should not serve more than two consecutive terms.

Other practical details, including the conditions for admissibility of appeals, procedures, timeframe, decision-making process, and notification of the decision, should be determined by an Order of the Prime Minister. Taking a dispute to this Board should not be mandatory. The taxpayer should have the choice of bringing the dispute directly before the competent court or taking the matter to the Board before initiating the court' proceedings. However, both avenues should not be exercised simultaneously, and the court option should prevail if they are exercised simultaneously.

It is worth noting that a similar, but not the same, institution used to exist under the name of 'Tax Appeals Commission'. This was established by articles 33 to 37 of Law No. 25/2005 of 04/12/2005 on tax procedures. The practical modalities of this Commission were established by the Prime Minister's Order No. 08/03 of 09/05/2007 on the establishment, composition, and functioning of Tax Appeals Commission. This Commission and its procedures were abolished in 2008 by Law No. 74/2008 of 31/12/2008 modifying and complementing the Law No. 25/2005 of 04/12/2005 on tax procedures.

One reason for the abolition was the EAC Customs Management Act requirement to the Partner States to establish tax appeals tribunals to hear appeals against the Commissioner's decisions.[6] The Commission was, therefore, abolished to leave the room for the then created commercial courts to handle commercial matters including tax disputes. The Commission was also criticized for being dominated by the RRA, which was seen as a fruitless procedure to take the matter before almost similar persons.

To be successful, the proposed Board should differ from the disbanded tax appeals commission, especially in terms of composition and independence. The composition of the tax appeals commission has been dominated by the ministry of finance and the RRA.[7] Indeed, apart

[6] EAC, The East African Community Customs Management Act (2004 as amended to date) art. 231.
[7] Prime Minister's Order No. 08/03 of 09/05/2007 on establishment, composition and functioning of the Tax Appeals Commission, *O.G.* No. Special of 10/05/2007, art. 3.

from the representatives of these institutions, the other three members were also appointed by the ministry of finance,[8] which would not be the case with the proposed board, whose members would be scattered in different institutions whose ordinary functions have a significant relation to tax disputes. The proposed composition of the new board also implies full independence, which is different from the disbanded tax appeals commission.

In addition, the proposed Board would alleviate some issues facing the resolution of tax disputes, such as the low expertise of judges in tax matters. The Board could also speed up the process compared to the current delays in the courts due to backlogs and long procedural rules. This Board would not be dominated by the RRA and would be made up of independent members, as in principle the judges should be. Most importantly, the members of the Board would be people with a high degree of expertise and specialization in tax matters.

Besides the above suggestions to clean up the identified harmful aspects of the favorable tax measures, one recommendation can be made to the general system.

7.1.5. Recommendation to join the Inclusive Framework

It is recommended that Rwanda joins Inclusive Framework. Stemming from the OECD/G20 BEPS Project, the framework was designed as an open opportunity to allow countries, especially developing countries, which did not initially participate in the BEPS Project, to participate on an equal footing in its implementation, provided they show interest and committment. Interest and commitment are expressed through an agreement to implement the four minimum standards.[9] Thus, the commitment thus entails a peer review schedule for implementation with the resulting political peer pressure in the event of a negative review.[10] This means that the commitment is not limited to joining Inclusive Framework but also extends to a preparedness to score positively when reviewed for the implementation of the four minimum standards. These are namely Action 5 on countering harmful tax competition more effectively, Action 6 on preventing tax treaty abuse, Action 13 on country-by-country reporting

[8] Ibid.
[9] M Hearson, 'Developing Countries' Role in International Tax Cooperation' (2017), p. 5 <www.g24.org/wp-content/uploads/2017/07/Developing-Countries-Role-in-International-Tax-Cooperation.pdf> accessed on 31/08/2018; UNECA, 'Base Erosion and Profit Shifting in Africa: Reforms to Facilitate Improved Taxation of Multinational Enterprises' (2018) p. 19; H J Ault, 'Tax Competition and Tax Cooperation: A Survey and Reassessment' in J Monsenego and J Bjuvberg (eds), *International Taxation in a Changing Landscape* (Wolters Kluwer 2019), p. 6.
[10] I J Mosquera Valderrama, 'Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism' (2015) *WTJ* 7(3), p. 5.

of corporate financial information, and Action 14 on resolving disputes between states that give rise to double taxation.

In particular, with regard to Action 5 on curbing harmful tax practices, accession to Inclusive Framework would provide Rwanda with important tools to build a system free harmful tax competition aspects. Rwanda coul also gain practical skills in developing defensive measures that can help protect its tax base against the spillover effects of harmful tax competition. It would also be momentous for Rwanda to join other developing countries in fighting together to protect their interests in international tax law making and governance.

At this time, it is commendable that Rwanda has joined the OECD Development Centre. It is equally commendable that Rwanda has taken steps to join the Global Forum. All these show Rwanda's political will to join other countries in the fight against harmful tax practices, among others. To strengthen this aspiration, joining Inclusive Framework would be an added value. Given the political will already expressed on the matter, it is likely that joining Inclusive Framework would not pose many challenges.

Above are the proposals to build a Rwandan tax system that is free from harmful tax competition. These proposals fall within the realm of unilateral actions. Given the international nature of harmful tax competition, the next section develops the proposals that can be undertaken at the EAC level.

7.2. Closing the EAC shortcomings

As argued in chapter five, the EAC is moving towards a market integration, which may, unprecedentedly, make harmful tax competition unmanageable with the current legal instruments. This situation, therefore, calls for pre-emptive actions to prevent potential harmfulness. Moreover, given the international nature of harmful tax competition, international responses are generally more effective than national responses. The OECD noted that and advised that when dealing with a problem which is essentially global in nature, multirateral measures should be adopted.[11] In addition, the OECD noted the importance of international cooperation to avoid the risks that a country may face if it unilaterally eliminates preferential treatment, as this can lead to business activities moving to other countries that continue to offer

[11] OECD 1998 Report (n 2) p. 37.

preferential treatment.[12] This motivates the consideration of going beyond Rwanda to suggest measures that need to be taken at the EAC level.

The EAC commitment to fighting harmful tax competition has been noted by the Community's Legislative Assembly. In 2012, this Assembly noted an expectation that Partner States would sign a Code of Conduct against harmful tax competition in the future.[13] In this context, this sub-section primarily concerns the draft Code of Conduct.

Indeed, the EAC, with reference to EU best practices, has initiated a process that resulted in a draft Code of Conduct against harmful tax competition. Thinking about and drafting this Code represent a commendable effort that should be quickly taken up by the EAC Partner States. However, it is unfortunate that this Code has remained a draft to date. It has neither been adopted nor officially recognized at any EAC level. As a solution, it is proposed to expedite the procedures to finalize and adopt it as soon as possible. The following paragraphs attempt to suggest some modalities for adoption, some corrections that need to be made before its final adoption, and some enforcement mechanisms that should be considered for the effectiveness of the Code.

7.2.1. Modalities for the adoption of the Code of Conduct

Due to the nature of a Code of Conduct, which is not a legally binding instrument but a political document, it is recommended that the Code of Conduct be adopted by the EAC Council. This should be done on the basis of article 14(1) of the EAC Treaty, which describes the Council as the Community's policy organ. In this regard, the Council has the mandate and power to take policy decisions for the efficient and harmonious functioning and development of the Community, as well as to issue regulations, directives, decisions, recommendations, and opinions.[14]

Given the seriousness of tax competition, it is proposed that the Code of Conduct be adopted as a directive. In other words, to mitigate possible resistance, the Code should specify the objective to be achieved by all EAC Partner States and leave each Partner free to choose the form and method of transposing the directive into its national laws.

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[12] Id., p. 38; B Dickinson and N Nersesyan, OECD Tax and Development: Principles to Enhance the Transparency and Governance of Tax Incentives for Investment in Developing Countries, p. 4 <www.oecd.org/ctp/tax-global/transparency-and-governance-principles.pdf> accessed 23/04/2020.
[13] 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. 12.
[14] Treaty for the Establishment of the East African Community (As amended to date), art. 14(3)(a) & (d) and 16.

The choice about the legal nature of the Code is an important element, as the legal nature of an instrument impacts its effects, forces, implementation mechanisms, and organs. Thus, if the Code of Conduct against harmful tax competition in the EAC is adopted as a directive, it becomes a legally binding instrument and constitutes a hard law. With this nature, failure to comply with it shall call for sanctions along with a possibility of taking the matter to the EACJ for judgment. In contrast, if the Code is adopted as a non-legally binding instrument, it shall be part of soft law, the enforcement of which depends only on political peer pressure from the Partner States. In this case, the EACJ has *prima facie* no jurisdiction to intervene in case of non-compliance.

Thus, comparing the two, it is proposed that the Code be adopted as a Directive, which can easily lead to a robust enforcement mechanism before the EACJ. Non-compliance, which is likely to occur, would also invoke the liability of the defaulting state and expose it to sanctions. This would also close the loophole of low political will in the EAC that may make the Code less effective. Adopting the Code as a directive will also re-emphasize the sovereignty of the EAC Partner States in tax matters. In light of this, Partner States will feel less infringed on their sovereignty, which may increase their support, and thus, increase the Code's political acceptance and influence which are necessary for its success. However, a number of elements still need to be fine-tuned before the Code is adopted.

7.2.2. Salient corrections before adoption

Before it is adopted, some provisions of the draft Code need to be corrected. This applies to article 1(d) and (f), which loosely define harmful tax competition and harmful tax practices as two separate phenomena. Here, it is proposed that harmful tax competition and harmful tax practices should not be separated. Rather the two should be used as synonymous and interchangeable. Similarly, it is proposed to define tax competition as a generally accepted phenomenon, in contrast to harmful tax competition, which is generally not accepted. Besides the need to simplify the definition of tax competition, this can be defined as:

> Provision of special tax measures in the context of a state's sovereign right to establish a fair national tax system that is investment-friendly by lowering the tax burden through minimizing the tax rate and/or tax base.

In contrast, harmful tax competition can be defined as *prima facie* referring to:

> A situation of practices that go beyond building a just national tax system that is designed to attract genuine investment, to set unfair channels that intentionally erode the tax bases

of other jurisdictions, while leaving the national tax base unaffected, and without a proportional corresponding economic activity.

Another salient correction concerns article 3 of the draft Code on standstill and rollback clauses. The second paragraph of this article requires EAC Partner States to roll back, as soon as possible, the legal provisions and practices that constitute harmful tax practices. To ensure the effectiveness of the Code, it is better to propose a timeframe of five years from the date of publication in Community Gazette for Partner States to comply with the rollback clause. Otherwise, the term 'as soon as possible' is ambigous and Partner States may deliberately feign taking a long time to comply with the Code. After the initial five-year period, the Committee of Experts[15] should take over the management of harmful tax competition matters, including a review of national laws and practices relating to harmful tax competition.

The timeframe of five years is reasonable considering that all EAC Partner States are developing countries. In fact, a shorter period than five years would be ideal, considering the negative effects of harmful tax competition. However, as noted by the Council of the EU, a relatively longer period is necessary for developing countries to deal with harmful tax competition. Indeed, the Council noted that:

> Certain developing countries should be given more time to reform their harmful preferential tax regimes covering manufacturing activities and similar non-highly mobile activities considering the heavier economic impact of these reforms on such countries.[16]

Moreover, it is even the COCG's practice to grant an extended deadline when there are genuine institutional or legal impediments to compliance.[17] Thus, to avoid the negative consequences that could occur with a shorter deadline, the five-year period is reasonable for EAC Partner States to roll back harmful tax practices.

In the same vein, the second paragraph of article 7 of the draft Code advises that where a Partner State's regime permits negotiability of tax rates and bases, it should be reviewed. Here,

[15] Draft Code of Conduct against Harmful Tax Competition in the East African Community, art. 20(1).
[16] CEU, The revised EU list of non-cooperative jurisdictions for tax purposes (Council conclusions of 12/03/2019), 7441/19 FISC 169 ECOFIN 297, 12/03/2019, p. 3; CEU, Report on COCG assessment of Costa Rica's manufacturing activities under the Free Zones regime (CR002), 9652/19 ADD 8, FISC 274 ECOFIN 515, 27/05/2019, p. 2.
[17] CEU, Report on COCG assessment of Switzerland's Cantonal administrative company status (auxiliary company) regime (CH001), 13196/19, FISC 390, 16/10/2019, p. 2; CEU, Report on COCG assessment of Switzerland's Cantonal mixed company status regime (CH002), 13202/19, FISC 391, 16/10/2019, p. 2; CEU, Report on COCG assessment of Switzerland's Cantonal holding company status regime (CH003), 13203/19, FISC 392, 16/10/2019, p. 2.

the term ‘advises’ is not as explicit as an obligation to eliminate such practice. For the sake of clarity, it is therefore proposed to replace the term ‘advise’ by a term that implies a direct obligation to eliminate such a practice, such as ‘terminate’, ‘eliminate’, ‘discontinue’, or ‘abolish’. The second paragraph of article 7 should, therefore, read as follows: ‘*Where such a regime may exist, it should be terminated in order to eliminate the harmful tax practices*’.

In order to increase transparency, article 11 of the draft Code on advance tax rulings should add that all advance tax rulings must be published in the Official Gazette to take effect. Publication in the official gazette is seen as a way of informing the public of the existence of such a ruling, which increases transparency as part of the fundamental principles governing the Community,[18] besides being internationally accepted as a tool to curb harmful tax practices.

Moreover, the solution provided for in article 12(4)(a) of the draft Code is disappointing. Under this provision, if it is found that a government is offering state aid or subsidy amounting to harmful tax competition, other Partner States may decide to grant similar aid or subsidy. This should not be a solution and would be seen as legalizing abuses. In fact, once the Code is adopted, any Partner State that may venture to offer aid or subsidies that amount to harmful tax competition will be guilty of malpractice. Therefore, once proven, the solution should not be to do the same, i.e. to misconduct, but rather to stop the activity that constitutes the misconduct. Therefore, it is proposed that this paragraph be deleted before adopting the Code and keep the paragraph that requires the government to review its policy by abolishing or amending it once proven to be harmful.[19]

Still, on the proposals of the changes that must be made before the adoption of the draft Code, article 17(3) contains an idea of considering as exceptions some practices that can normally be considered harmful but be tolerated. These concern the measures used to promote the economic development of particularly disadvantaged regions. It is suggested that disadvantaged sectors be added to this provision. More than that, like for the EU Code of Conduct, it should be made clear in both cases that the support must be proportionate and targeted at its aim.[20] Thus, the first line of article 17(3) would read as follows: ‘*Insofar as the*

[18] EAC Treaty (n 14) art. 6(d).
[19] EAC draft Code of Conduct (n 15) art. 12(4)(b).
[20] CEU, Report on COCG assessment of Vietnam’s Disadvantaged areas regime (VN005), 14114/19 ADD 10 FISC 444 ECOFIN 1005, 25/11/2019, p. 3; K Dirix, ‘Harmful Tax Competition: Six Belgian Tax Incentives under the Microscope’ (2013) *EC T.Rev.* 5, p. 236; M F Nouwen, *Inside the EU Code of Conduct Group: 20 Years of Tackling Harmful Tax Competition* (Ph.D Thesis, UVA 2020), p. 150.

tax measures serve to promote the economic development of particularly disadvantaged regions or particularly disadvantaged economic sectors in a proportionate manner, […]'. The proposals here are: first to add explicitly the terms 'disadvantaged' and 'proportionate' and, second, to include not only disadvantaged regions but also disadvantaged economic sectors.

Still with respect to adjustments, the Code's scope *ratione materiae* in its current draft is too vague. This is set in article 2(1) which states that the Code applies to '*each tax of every description collected by the Revenue Authority of each Partner State*'. Not only vague, but the rationale for applying the Code to any tax is problematic. This is because some tax bases are considerably less mobile and have very little connection to harmful tax practices. This is the case, for example, with tax on immovable properties where the possibility to move from one jurisdiction to another is practically very limited. Thus, given the relevance of business taxation and its potential to fall into the trap of harmful tax competition, as well as the fact that it has so far been the most mobile compared to other taxes such as consumption, labor, and property taxation, the Code's scope of application *ratione materiae* should be limited to business taxation only.

Similarly, the Code should add that it applies to both legislative provisions and administrative practices. This precision will clarify more the scope of the concerned instruments and practices. Thus, article 2(1) of the draft Code should be worded as follows:

> Without prejudice to Partner States' tax sovereignty, this Code of Conduct applies to business harmful tax competition measures embodied in laws, regulations, or administrative practices of a Partner State.

Moreover, in order to avoid any kind of ambiguity, the Code should set out the criteria against which harmful tax practices should be assessed. These criteria should be enumerated in one article, instead of having them scattered in different articles. In the same vein, ring-fencing and the economic substance requirement should be explicitly enumerated among the criteria for determining harmful tax competition. Besides, the above-mentioned corrections cannot be effective without effective enforcement mechanisms, which is the subject of the next sub-section.

7.2.3. Proposals on enforcement mechanisms

Enforcement mechanisms constitute an important aspect regarding the Code of Conduct. Indeed, enforcement mechanisms are important to ensure that the Code serves the rationale of its adoption, as it would be irrelevant to adopt a Code that is not followed. Therefore, the organs responsible for enforcing the Code and the summary of enforcement procedures should be clearly defined.

Concerning the enforcement organs, it is proposed to have enforcement at two levels, namely the Committee of Experts and the EACJ. As for the Committee of Experts, this is proposed in the draft Code. Nevertheless, some relevant elements are missing, such as the composition profile and the complementarity between the Committee and the EACJ.

Regarding the composition profile, the Committee should be a technical committee, acting as an EAC watchdog on issues of harmful tax competition. For this reason, its members should have a high level of expertise in tax competition. Therefore, calling the committee a 'Committee of Experts' would be ideal. Other points proposed in the draft Code are concurred with, in particular the representation of each Partner State. What is needed here is to emphasize the profile of the Committee as a technical and not a political committee. Avoiding the political profile should prevent political bias and considerations that could influence the assessment of the measures' harmfulness. Requiring expertise would also help ensure the most objectively reliable results possible, which would add value to the effectiveness of the Code.

Referring a measure to the Committee should be left as open as possible. This should include the possibility for the Committee itself to decide *proprio motu* on evaluating a measure in any Partner State. Referral should also be open to Partner States, the EAC Council, and any interested physical or moral person. The last opportunity would allow NGOs active in tax competition matters, to access the Committee and the EACJ. However, residence in the EAC should be the prerequisite in order to limit possible interference with the sovereignty of EAC Partner States.

The procedure should be divided into different stages. These include the identification stage, which consists of targeting a particular measure as potentially harmful. This will be done by the Committee, a Partner State, the EAC Council, and any interested physical or legal person residing in the EAC. The identification claim shall be submitted to the Committee of Experts for further consideration. The Committee shall conduct a preliminary procedure to examine the admissibility of the claim and the measure's potential harmfulness. If the outcome is positive, the Committee shall notify the concerned state and invites it to submit its observations. If need be, discussions may also be held between the Committee and the representatives of the concerned state. The Committee shall then decide whether the measure in question is harmful or has harmful aspects and, if so, make recommendations for further action. At this level, a disagreement on the Committee's outcome may be referred to the EACJ for a final binding judgment. Access to the EACJ in this respect should be the same as access to the Committee of Experts.

In light of the above proposals, their adoption and implementation may play a role in managing tax competition in the EAC. Nevertheless, limited understanding of harmful tax competition can be a handicap. To overcome this, a demystification of some features at Community level is needed.

7.3. Demystifying the myth

Currently, there is a myth in the EAC that tax competition is a bad thing. This stems from a low level of awareness of harmful tax competition matters in the EAC. The lack of awareness is most evident in the confusion between tax competition *per se* and harmful tax competition. Moreover, a number of available documents on tax competition in the EAC automatically condemn PTRs as harmful tax competition, which is not really correct.

Even the draft Code of Conduct falls into the same trap. This is evident in some of its articles, such as article 1(d) which defines harmful tax competition as resulting from '*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*'.[21] This definition focuses on the provision of PTRs without referring to other elements of harmful tax competition, such as ring-fencing, lack of transparency, lack of economic substance requirement, and non-compliance with internationally agreed principles on transfer pricing. Equally confusing, article 1(d) and (f) of the draft Code consider harmful tax competition and harmful tax practices as two separate phenomena, which is not really the case.

The same is true for article 13 of the draft Code on effective tax rates. This article lists several mechanisms that can be used to eliminate harmful tax practices in the EAC. Examples include harmonization of VAT, zero-rated regimes, exempted transactions, tax bases, tax incentives, treatment of losses (loss carry forward), excise taxes, and alignment of tax administration procedures.[22] It is obvious that most of the mechanisms proposed in this article

[21] EAC Draft Code of Conduct (n 15) art. 1(d).
[22] Id., art. 13(2) and (3).

have nothing to do with harmful tax competition. To overcome this, there is a need to develop awareness of harmful tax competition among EAC citizens,[23] coupled with the development of expertise on harmful tax competition in the EAC. This can be done through capacity building programs, including but not limited to organizing training, conferences, seminars, and other scholarly activities on tax competition issues. To operationalize all the suggestions mentioned earlier, an overall recommendation is to adopt an EAC model against harmful tax competition.

7.4. Developing an EAC model against harmful tax competition

Without underestimating the relevance of EU and OECD standards in curbing harmful tax competition, chapter four section five of this book identified some drawbacks of their application in developing countries. It therefore becomes necessary to reflect on the possibility of a model that can better serve developing countries. This section confirms the need for a regional standard instead of borrowing from the EU and OECD standards, which may be less applicable and less beneficial. The section also explores the feasibility of developing a regional model with standards of harmful tax competition in the EAC and develops recommendations on which the model can be built to ensure it fits the context and needs of the EAC.

Without undermining the need for regional standards, it is worth noting that the need does not preclude the possible lessons that developing countries can learn from EU and OECD standards. One, chapter six of this book clearly shows how possible EU and OECD standards can be used to assess regimes outside the EU and OECD. However, as mentioned in the conclusion of chapter six, this possibility should be taken with limitations. For instance, if developing countries purely adopt the EU and OECD standards which specifically aim to rule out profit shifting, and other forms of aggressive tax planning, they may risk to unnecessarily lose FDI which is the main concern of developing countries in tax competition. Two, the development and implementation of EU and OECD standards have been positive for their members. Even if difficult to apply them to developing countries, they can learn from the EU and OECD standards and develop their own standards without necessarily starting from scratch. Three, if the EU and OECD standards have achieved positive results for their members, it is an encouragement to developing countries that if they develop their standards, they can also achieve positive results. Four, developing countries can learn from the EU and OECD,

[23] Kambuni, 'AAI & TJN-Africa Tax Competition Study: Key Findings, Highlights of Successes and Challenges, and Recommendations', in M Mukuna, 'Regional Policy Round Table: Harmful Tax Competition in East Africa: A Race to the Bottom' (2011) TJN-Africa & ActionAid, p. 9.

particularly the definitional and interpretive elements of the criteria to determine the harmfulness of a regime, the functioning of the monitoring body, etc.

However, in view of the demerits of EU and OECD standards discussed in the fifth section of chapter four, it would be untenable to think that pure adoption of them by developing countries is feasible. Indeed, apart from the drawbacks, the EU and OECD standards have not been adopted as binding rules, rather as soft rules. Yet, low tax morale and compliance in developing countries may challenge successful implementation of soft rules, such as the EU and OECD standards against harmful tax competition. Thus, the feasibility for developing countries to purely adopt the EU and OECD is limited.

In studying the feasibility of adoption by developing countries of standards developed by the EU and OECD, it may be relevant to ask whether developing countries can benefit from implementing the EU and OECD standards. In the author's view, the answer is negative. This is because, even though the EU and OECD have have made considerable efforts to curb harmful tax competition, which have produced good results in their territories, absolute application of their standards may not benefit developing countries because of the demerits associated thereto. A question that arises from this would be, 'what can be done then?' One possible answer is for developing countries to develop their own standards that fit the context and meet their real needs. Part of implementing this advice is to design developing countries' standards through regional organizations. In this regard, a model against harmful tax competition in the EAC can be an example.

Indeed, the global nature of harmful tax competition compels global cooperation to curb the spread of harmful tax competition. On several occasions, the EAC Partner States have expressed their willingness to combat harmful tax competition.[24] The EAC has even reached the stage of drafting a Code of conduct against harmful tax competition. In view of the discussions in section two of this chapter, the remaining process is to adopt the draft code after correcting the loopholes and errors identified in it.

Since no other regional organization of developing countries has standards against harmful tax competition comparable to those of the EU and OECD, it is likely that the EAC model will be followed by other developing countries. Indeed, being in a similar situation

[24] See for instance 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, pp. 10-11; P Abbott et al., 'East African Taxation Project: Rwanda Country Case Study' (2011) IPAR, p. 14.

(capital-importing) may justify the preference for the EAC model over the EU and OECD models (capital-exporting). However, for this expectation to become realistic, it is necessary to think about recommendations on how to build regional standards that fit the context and needs of the region.

In that regard, the first concern is to determine the context and the needs of the EAC, to which the model should respond. Contextually, the EAC partner states are all developing countries and capital importers. In this regard, the needs of the EAC can be summarized as the need to attract FDI, as one of the ways to promote development and economic growth. However, this should be done without engaging in harmful tax competition. Unlike the EU and OECD where the focus of tax competition is on profit shifting, the EAC concern in tax competition is about the attraction of FDI. In other words, when EAC members engage in strategic uncoordinated FDI attraction, they end up harming each other. Thus, without underestimating a variety of benefits associated with the presence of MNCs, when developing countries compete by lowering the tax burden on MNCs, it becomes harmful as it does not help them to have MNCs that do not pay taxes in host countries. Moreover, some preferential regimes aimed at attracting FDI should be tolerated, even if harmful. These are, for example, the regimes that promote education, health, exports, and other public interest sectors of similar objectives. These sectors are of particular importance to developing countries. In fact, developing countries cannot develop with poor education and health systems as they cannot develop if they import more than they export. There should also be an emphasis on the substantial economic presence requirement concretized by the provision of employment to nationals, plants and building for manufacturing activities, etc. All that being said, an ideal EAC model should encourage FDI attraction while curbing harmful tax competition from the perspective of both developing and developed countries.

Furthermore, even if possible to draw some features of the EU and OECD standards, a well-designed model for developing countries should reflect the particular realities of developing countries. For example, to respond to the challenge of low technical capacity of human resources in developing countries, the model should be easy to understand and implement. The model should also take into account the potential difficulties that EAC Partner States, as developing countries, may face in implementing the standards. The model should also provide for a sufficient period of time to rule out existing harmful measures. The model should also establish strategic mechanisms to ensure a high-level of compliance and provide for compliance monitoring mechanisms.

The model should also address the main concern of developing countries, namely attracting FDI while discouraging profit shifting. In this way, the model should not conflict with either the interests of developing countries or the interests of developed countries. In other words, the ideal model should be able to attract FDI but not at the expense of any other country's tax base. The Model should also adequately protect the base of EAC Partner States by controlling base eroding payments such as excessive interest payments, management fees, royalties and service fees paid from an EAC Partner State to a related party in a no or low tax jurisdiction. Taking all these elements into account, Annex II provides a proposal for an EAC Model Code of Conduct against harmful tax competition.

Conclusion of chapter seven

The content of this chapter followed the trends of chapter six. It would have been futile to point out the problems without proposing the solutions. This was the rationale and focus of this chapter which attempted to suggest measures that should be taken as part of eliminating harmful tax practices from Rwanda's tax system.

Suggestions were made on how to eliminate the identified harmful tax measures or harmful aspects. This means that the measure in question should either be abolished or retained but refined to eliminate the harmful aspect. In other words, for a measure that is completely harmful, the remedy is to eliminate it. This concerned the 3% PTR on foreign-sourced income and pure holdings that should be not ring-fenced and emphasize the substantial economic presence requirement, failing which it should be abolished. The same conclusion holds for the PTRs on export investments that should be not ring-fenced in addition to setting additional requirements regarding transparency, substantial economic presence, and internationally accepted principles on profit determination.

For the measures that are partially harmful, a refinement would be sufficient to save the measure from harmful tax competition. This applies to the 0% and 15% PTRs, tax rulings, and transfer pricing practices. It was also proposed to dissolve the practice of tax settlement and replace it with an independent board of experts. In addition, it was recommended that Rwanda joins the Inclusive Framework. This recommendation is in addition to other steps that Rwanda has taken such as joining the OECD Development Centre and the Global Forum.

In consideration of the international nature of harmful tax competition, Rwanda alone, acting individually, cannot successfully address harmful tax practices in the region. For this reason, to complement the unilateral measures, a number of other measures have been proposed to be implemented at the EAC level. The primary concern was the draft Code of Conduct. It was recommended that the Code be adopted as soon as possible in order to bring discipline to the EAC Partner States with regard to tax competition. Suggestions were also made on the modalities of adoption.

The key element here was the recommendation to the EAC Council to adopt the Code of Conduct as a Directive. Even so, several corrections are necessary before adoption, including the establishment of a timeframe for compliance with the Code's rollback clause, the publication of tax rulings in the official gazette, and the inclusion of disadvantaged economic sectors along with disadvantaged regions as cases of tolerable harmful tax practices. Appropriate definitions of tax competition versus harmful tax competition were also proposed.

Suggestions on enforcement mechanisms were also made. In this context, the establishment of a Committee of Experts to act as a watchdog on harmful tax practices in the EAC was proposed. It was suggested that a measure could be referred to this Committee either by itself *proprio motu*, or by the Council, a Partner State, or any interested physical or legal person residing in the EAC. The procedure to assess a measure was also proposed, the final stage in this procedure being the EACJ judgment on a referral by an interested person in the event of dissatisfaction with the decision of the Committee.

All these proposals, once implemented, would significantly change the situation of tax competition in the EAC. However, the low level of awareness of harmful tax competition in the EAC was mentioned as a handicap. Therefore, one suggestion to overcome this is to increase technical awareness and understanding of tax competition through training, conferences, seminars, and other scholarly activities.

In conclusion, all the suggestions developed here are practically implementable. Therefore, the author recommends that the Rwandan legislature and the EAC take them up. However, this should be done cautiously bearing in mind that tax competition that attracts genuine investment is not problematic while tax competition that unfairly erodes the tax bases of other countries is harmful. Doing so, developing countries should also be mindful of FDI attraction as their main concern. These are the concluding remarks of the current chapter. The general conclusion is presented in the next chapter.