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

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8 CONCLUDING REMARKS

The objective of this study was to examine Rwanda's tax competition practices in the context of other EAC countries to determine whether Rwanda is within the parameters of internationally accepted practices. It identified Rwanda's favorable tax measures and evaluated them from the perspective of EAC law, complemented by EU and OECD criteria. Although not yet adopted, the draft Code of Conduct was extensively reviewed. Two main reasons motivated the use of the EU and OECD criteria. First, the assessment of Rwanda's tax system should ideally be based on the EAC criteria. Unfortunately, the EAC has not yet established criteria to identify harmful tax practices, a phenomenon that is poorly addressed in the Community. Second, the EU and the OECD have so far been praised internationally for their efforts in the fight against harmful tax competition. Moreover, the criteria they have established have not only been exported beyond their own territories, but they have also reached a level of best practice and qualify as international soft law. The standardized criteria developed by these two leading actors in curbing harmful tax competition have been extensively used to answer the four research questions addressed in this book.

By way of review, the first research question related to the current state of affairs regarding favorable tax measures in Rwanda. The second research question analyzed the conventional benchmarks that can be used to identify harmful tax practices in Rwanda. The third research question assessed the current favorable tax measures in Rwanda. The fourth research question explored suggestions that can be developed to protect Rwanda from harmful tax practices.

These research questions were aimed at the primary objective of the study: to examine Rwanda's situation in relation to harmful tax practices in the context of other EAC Partner States. More specifically, the purpose was to determine whether Rwanda's tax competition falls within internationally acceptable parameters. To this end, four specific objectives were elaborated: (a) to explore the current state of Rwandan favorable tax measures; (b) to identify the conventional benchmarks that can be used to identify Rwandan harmful tax practices; (c) to assess the harmfulness of currently available Rwandan favorable tax measures; and (d) to determine the proposals that can be developed to protect Rwanda from harmful tax practices.

The preparation of this book was mainly doctrinal. This involved the consultation, study, and analysis of primary and secondary materials relating to the subject of the book. The primary materials mainly consulted are the 1997 EU Code of Conduct on business taxation, the 1998 OECD Report on harmful tax competition, the OECD Progress reports, the EAC draft Code of Conduct, the COCG assessment reports, the Rwandan income tax law, and the Rwandan investment law. Secondary consulted materials included a wide range of literature on the subject of the book.

This final (eighth) chapter provides a general conclusion and is divided into five sections. The first section provides an overview of the book as a whole, the second section highlights the main findings, while the third section presents the main recommendations. The fourth section highlights the limitations and areas for future research, and the fifth section presents the main contributions of the study.

8.1. Book overview

This book was divided into eight chapters. The first chapter introduced the book. It did so by justifying the main reasons for conducting the research and why it was necessary. This is mainly due to the global nature of tax competition coupled with the paucity of legal research on the situation of Rwanda in particular and the EAC in general as far as harmful tax practices are concerned. After that, the first chapter summarized the context in which the research was conducted. Emphasis was placed not only on the presentation of Rwanda and its legal and taxation system, but also on the reasons for choosing the EAC among other regional integrations to which Rwanda belongs. Similarly, the relevance of the reference to EU law and OECD instruments was explained. This was followed by the problem statement, key research questions, and research objectives. The first chapter also highlighted the research output and scope, the societal and scientific relevance, research methodology, and an overview of the structure of the book.

The second chapter covered a general panorama of tax competition. In this chapter, the conceptual and historical framework of tax competition was discussed. To this end, various definitions were considered and two historical backgrounds of tax competition were discussed, namely the natural background as opposed to the retaliation background. To better understand tax competition, the impact of globalization on tax competition was highlighted. Then, the main principles underlying the field of tax competition, mainly sovereignty, and especially states' fiscal sovereignty, were examined. This was followed by an elaboration on the vicious circle

between tax sovereignty and tax competition. To show the practices of tax competition, the chapter explained that tax competition is not only global in nature, but also a global issue.

Then, the normative perspectives of tax competition were distinguished from the economic perspectives. In this context, two economic schools of thought that underlie economic studies on tax competition were highlighted, namely the race to public poverty school of thought and the taming of the Leviathan school of thought. From a normative perspective, the correlation between tax competition and regional integration was elaborated and the development of international standards on this issue was highlighted. Recognizing the existence of both positive and negative tax competition, the second chapter ends with an attempt to identify the boundary between the two. This was done through three themes: why it is needed, what the boundaries are, and what is the main concern of lawyers in the area of tax competition. Notwithstanding the highlights made in this chapter, the distinction between bad and good tax competition is largely based on the EU and OECD standards. On this point, it is important to emphasize that the EU and OECD standards change their weight from time to time. That makes bad and good tax competition dynamic concepts, whose controversial discussions are not likely to end soon.

Following second chapter, the third chapter consisted of mapping favorable tax measures under Rwandan law. To this end, the first step was to identify the benchmarks that can be used to determine the qualifying criteria. In the absence of criteria set at the EAC level, and with reference to the EU and OECD criteria, two benchmarking guidelines were identified to determine favorable tax measures. These are the derogation from the generally applicable tax rates or tax bases, and the associated effect of lowering the level of taxation. Using these two benchmarks, some legislative tax measures, such as the PTRs, tax holidays, tax exemptions, and profit tax discounts, were identified as favorable tax measures. In addition, three regulatory and administrative practices were identified as favorable tax measures. These are tax rulings, advance pricing agreements, and tax settlement practices.

The fourth chapter focused on the OECD and EU approaches to harmful tax practices. Starting with the OECD, one of its major works in the area of harmful tax competition was highlighted. This was the OECD 1998 Report on harmful tax competition. This Report was summarized before highlighting some praise and criticisms that were made both for and against the Report. While the Report was praised for its contribution to the regulation of harmful tax competition, to the extent of being seen as a rational riposte to the global issue of harmful tax

competition along with achieving the status of international soft law, it was also criticized by some. The criticism related mainly to the infringement of states' tax sovereignty and the question of legitimacy. The OECD was also criticized and seen as an instrument of powerful high-tax states seeking to impose tax structures on low-tax jurisdictions, as a means of creating tax cartels, etc.

The 1998 OECD Report identified two components of harmful tax competition, namely tax havens and HPTRs. Four factors characterize tax havens: no or only nominal taxes; lack of effective EoI; lack of transparency; and no substantial activities. Four key factors also characterize HPTRs: no or low effective tax rates; ring-fencing; lack of transparency; and lack of effective EoI. Seventeen years after this Report, the OECD, in association with the G20, pubished another report on the BEPS, Action 5 of which addresses harmful tax practices. This Action 5 was described as a revamp of the OECD's works on harmful tax practices, thus completing the 1998 Report. In this context, BEPS Action 5 focuses on transparency and EoI.

Not only the OECD, but also the EU played an important role in regulating harmful tax competition. Through the ECOFIN Council, the EU adopted a Code of Conduct on business taxation in December 1997. This Code established five criteria to be used in determining the (un) harmfulness of a tax measure, namely the lower level of taxation; ring-fencing; lack of substantial activity requirement; non-compliance with the OECD Rules on profit determination; and the lack of transparency. Given their respective international influence in regulating harmful tax competition, the OECD factors and the EU Code criteria were compared to identify the similarities and differences between the two. The same chapter discussed the role of these organizations in regulating harmful tax competition. The chapter ended with a discussion on the merits and demerits of the EU and OECD standards from the perspective of developing countries.

The content of chapter five had a similar spirit as chapter four. It was about the EAC approaches to harmful tax competition. The chapter started with some observations on the existence of harmful tax competition in the EAC Partner States before looking at the EAC agenda to tackle harmful tax practices. The EAC agenda in this regard consists mainly of tax harmonization and the draft Code of Conduct. Although not yet adopted as an EAC document in force, its main provisions have been extensively reviewed. These included the provisions to identify the harmful tax competition, provisions on transparency and EoI, and the standstill and rollback clauses, to name a few. This review paved the way for a comparison between the EU

Code of Conduct and the EAC draft Code of Conduct. The fifth chapter ended with a review of the EAC contribution to the regulation of harmful tax competition through the lens of positive and negative perspectives.

Building on the previous chapters, the sixth chapter dissected the Rwandan regime of favorable tax measures. In doing so, the primary objective was to determine which favorable tax measures are harmful and which are not. To this end, the first exercise was to identify the benchmarking criteria to be used. Then, each favorable tax measure was evaluated and in total thirteen measures were assessed. As a result, two measures are *prima facie* harmful,[1] six are not harmful,[2] three are not harmful but contain harmful aspects,[3] while two could not be assessed due to a lack of sufficient information.[4] Following that, the current status of Rwanda's EoI was discussed and Rwanda was commended for its progressive efforts on EoI practices. Chapter six ended with a tour d'horizon of the current discussions about the introduction of the global minimum tax rate, with a focus on GloBE proposals.

To respond to the issues identified in chapter six, particularly in relation to the favorable tax measures evaluated, chapter seven focused on proposing remedies to build a Rwandan tax system free of harmful tax practices. Some of the proposed remedies are to be taken at the Rwandan level, while others are to be taken at the EAC level. Regarding domestic measures, it has been proposed that Rwanda abolishes the preferential CIT rate on foreign-sourced income and pure holdings or makes the measure not ring-fenced besides emphasizing the substantial economic presence requirement; provides additional requirements for the preferential CIT rate to export investments; adopts transparent legislation specifying the time frame for granting PTRs; publishes tax rulings in the official gazette; improves technical understanding of transfer pricing practices; disbands the tax settlement practices and replaces them with the institution of an Independent Board of Experts; and acts on the recommendation to join the Inclusive Framework. At the EAC level, it has been suggested that this Community learn from EU best practices in relation to the Code of Conduct. These proposals include, *inter alia*, fast tracking the adoption of the EAC Code of Conduct as a directive to give it more weight. Several

[1] 3% PTR and PTR to export investment (see 6.2.1).
[2] Five years tax holidays (see 6.2.2); seven years tax holidays (see 6.2.2); exemption to agricultural products (see 6.2.3); capital gains tax exemption (see 6.2.3); exemptions to the Development Bank of Rwanda, Agaciro Development Fund Corporate Trust, and Business Development Fund (see 6.2.3); and profit tax discounts (see 6.2.4).
[3] 0% PTR (see 6.2.1), 15% PTR (see 6.2.1), and Tax rulings (see 6.3.1).
[4] APAs (see 6.3.2) and tax settlements (see 6.3.3).

corrections were also made to the current version of the EAC draft Code of Conduct, as well as some suggestions that will help ensure a high level of states' compliance with the Code, once it is adopted. Chapter seven also made suggestions aimed at demystifying the myth of tax competition in the EAC and ended with reflections on the possibility of developing an EAC Model against harmful tax competition.

Finally, the eighth and current chapter closes the book. It does so through five sections, respectively synthesizing the book; highlighting the key findings; elaborating on recommendations; identifying limitations along with recommended areas for future research; and contributions of the study.

8.2. Recapitulation of key findings

Considering the four research questions that guided this study, the main findings related to each research question are presented below:

With regard to the current situation of favorable tax measures under Rwandan law, this book examined the current situation of favorable tax measures in Rwanda. These were defined as tax measures that derogate from the generally applicable tax system by providing for a lower level of taxation, either through a reduction in tax rates or tax bases. Accordingly, these measures have a significant impact or potential impact on the business location. Such measures are therefore potentially harmful but not yet confirmed harmful, and therefore require evaluation to determine their actual status. In this context, several measures have been determined as favorable tax measures, i.e potentially harmful. These include PTRs, tax holidays, tax exemptions, profit tax discounts, tax rulings, advance pricing agreements, and tax settlements. These measures were then evaluated to determine the extent to which they are harmful or harmless.

Based on the first research question, the second research question focused on the conventional benchmarks to identify Rwandan harmful tax practices. Considering the international nature of tax competition, it also becomes necessary to examine this area in an international context. Thus, the determination of benchmarking criteria is also usually elaborated in an international or regional context. Considering the regional organizations of which Rwanda is a member, the benchmarks established at the EAC level would be ideal to assess the Rwandan situation. However, in the absence of these, this book has largely relied on EU and OECD benchmarks, combined with a close look at the benchmarks from the EAC draft

Code of Conduct. These are a lower level of taxation referred to as the gateway criterion, ring-fencing, lack of economic substance requirement, lack of transparency, and the lack of EoI.

From this perspective, the third research question sought to determine the extent to which the currently available Rwandan favorable tax measures are harmful. In this regard, the potentially harmful favorable tax measures identified in answering the first research question were assessed, one by one, against the benchmarks set in answering the second research question. The results of the assessment showed that some favorable tax measures, although potentially harmful, are not actually harmful. This is the case of tax holidays, tax exemptions, and profit tax discounts. One measure, that is the tax settlement, was identified as harmful, though with some reservations due to the low level of information in the public domain. The preferential CIT rates and tax rulings were evaluated as not harmful in general, but possess one or more harmful aspects. The result of the evaluation also pointed out the difficulties in evaluating the advance pricing agreements due to a lack of sufficient data.

Following that, the fourth research question was about the design of proposals to protect Rwanda from harmful tax practices. In light of the previous findings, several suggestions were made and were clustered into four groups. The first cluster concerns proposals that can be implemented unilaterally at the domestic level. The second cluster is about proposals that can be undertaken at the EAC level. The third is about proposals that seek to demystify the myth of tax competition in the EAC in order to remove the confusion between tax competition *per se* and harmful tax competition. The fourth is about the possibility of developing an EAC model against harmful tax competition. Thus, from the above-mentioned proposals, several recommendations are possible.

8.3. Recommendations

Based on the above key findings and from the book as a whole, several practical and actionable recommendations are made below. Some are addressed to the Government of Rwanda, others to the EAC level.

First, it is recommended that the GoR takes some unilateral actions to limit the identified aspects of harmful tax practices. This include, in particular, proposals to adopt transparent legislation specifying the timeframe for granting a PTR; publish tax rulings, both public and private, in the official gazette; disband the tax settlement practices and replace them with a Board of Independent Experts; abolish the 3% PTR or make the measure not ring-fenced besides

emphasizing its substantial economic presence requirement; and make the PTR for export investments not ring-fenced and set additional requirements sufficiently respond to transparency, substantial economic presence requirement, and internationally accepted principles on profit determination. It is also a recommendation to improve administrative technical matters related to transfer pricing practices. Similarly, Rwanda is recommended to join the Inclusive Framework as one way to improve the regulation and the practices of EoI and transparency, alongside joining hands with other developing countries to fight for the protection of their interests in the context of international tax law making and governance. With particular reference to GloBE, developing countries, including Rwanda, are advised to adopt the GloBE proposal cautiously as it is *prima facie* designed to benefit capital exporting countries but not really capital importing countries. Developing countries should also be aware and mindful that GloBE is not necessarily good for their interests as they remain sovereign to walk out of multilateral measures in favor of unilateral measures in terms of allocation of taxing rights.

Second, the EAC is recommended to finalize and adopt the EAC Code of Conduct against harmful tax competition as soon as possible. To give it more weight, it is suggested that the Code be adopted as a directive. Once adopted, standstill and rollback clauses should be clearly highlighted in the Code as some of the key clauses. Also, some corrections need to be made before the adoption of the Code. It is also important for the Code to have standards for harmful tax competition that reflect the real needs of developing countries, namely attracting investment alongside protecting the tax base against artificial profit shifting. Moreover, collective action should be taken at the EAC level to ensure that the Community Partner States do not engage in harmful tax competition, not only with each other within the Community, but even with other states outside the Community.

Third, the EAC is recommended to learn from the best practices of the EU and the OECD in regulating harmful tax competition. In fact, instead of reinventing the wheel, the EAC is recommended to refer to the EU code of conduct and develop an adapted model, which takes into account the specific context and needs of the region. Such a model should aim to curb harmful tax competition, but without breaching the contextual needs of the EAC to attract FDI. The model should also be easy to understand and implement. It should also give Partner States sufficient time to to roll back existing harmful measures, and provide for strategic compliance and monitoring measures.

Fourth, there is a need to improve the understanding of tax competition in the EAC. In this regard, more research on harmful tax competition in the EAC is needed. Thus, tax law researchers, academics, and practitioners are recommended to vigorously address this area with a special focus on EAC.

8.4. Areas for future research

Without undermining the contribution of this book to the study of tax competition, it is fair to admit that it is not exhaustive. Quite a number of issues related to the topic studied here remain unresolved. This admission arises from the practical impossibility of conducting an exhaustive research. It is also linked to an assertion that predicts the continuity of tax competition challenges in the future, thus requiring different solutions.[5] Therefore, the broad field of tax competition in the EAC certainly deserves further study.

Some areas of unresolved problems require special attention. These include, *inter alia*, the study of the situation of harmful tax practices in each EAC Partner State, a comprehensive comparative study between the approaches of the EAC and the EU in the fight against harmful tax competition, a comprehensive elaboration of what the EAC can learn from the EU in terms of regulating harmful tax competition, the regulation of harmful tax competition in developing countries, the particular needs of capital-importing countries in relation to the regulation of harmful tax competition, the impact of BEPS Action 5 on EAC Partner States, and the approaches that the EAC can take to position itself in the new global tax governance. It would also be interesting to conduct an in-depth study on the relevance of the OECD's GloBE and its impact on developing countries, with a particular focus on the EAC and Rwanda. Thus, research that could focus on one or more of these topics would add important value to the existing body of knowledge on international tax competition.

8.5. Study contributions

This study claims a variety of specific contributions to existing knowledge. Without pretending to be exhaustive, the main contribution claims are as follows:

1. The study was triggered by reports that Rwanda was engaging in harmful tax competition. This is contradicted in this book with scientific facts. To that extent, this

[5] R Azam, 'Ruling the World: Generating International Tax Norms in the Era of Globalization and BEPS' (2017) *SuffolkU.L.Rev.* 50(4), p. 523.

book claims and affirms that Rwanda is sovereignly engaged in tax competition like any other sovereign state, but not wrongly engaged in harmful tax competition.

2. The overall objective was to assess Rwanda's tax practices to determine whether Rwanda is within the parameters of internationally accepted tax competition. The study concluded that there are no pseudo-binding, legal or political standards that directly apply to Rwanda with respect to tax competition. However, an academic and scientific analysis using the international standards on harmful tax competition concluded that some measures under Rwandan law amount in whole or in part to harmful tax practices.

3. With respect to the EAC, the position of this book is that there are as yet no binding EAC benchmarks of harmful tax competition. Thus, without an established binding order, legal or political, defining what is permitted and/or what is not permitted, there is no way to affirm, from a legal perspective, that there is harmful tax competition vis-à-vis EAC law, and any or similar claim would be baseless.

4. This book makes some suggestions to fine-tune the Rwandan system of all aspects of harmful tax practices vis-à-vis the EU and OECD standards. It also recommends the EAC to move forward in regulating harmful tax competition within the Community especially by adopting a Code of conduct that recognizes the need to attract FDI without engaging in harmful tax competition.

5. This book claims to add to the existing body of knowledge on tax competition, in particular by highlighting the dynamics around the distinction between bad and good tax competition and the influential role of the EU and OECD in such dynamic determination.

6. This book claims to have emphasized that a low-tax rate is not problematic in matters of tax competition. Rather, it is ring-fencing that is most problematic. That is to say that offering favorable tax rates or tax bases is generally acceptable as long as residents and non-residents have equal access, i.e., as long as the regime does not erode other states' tax bases without affecting its own tax base.

7. This book is also the first of its kind on harmful tax competition in Rwanda. It not only adds to the existing literature on the subject in general, but also establishes a foundation that can be used for further research on harmful tax competition in the EAC, as well as

for restructuring harmful tax competition policies at both the national and regional levels.

8. This book has shown the possibility and extent of the application of the EU and OECD standards by jurisdictions outside the EU and OECD, particularly developing countries, to build tax systems that are free of harmful tax competition and to fill the gap in developing countries that do not have legal foundations to curb harmful tax competition. However, this book has also shown that the EU and OECD norms are insufficient to root out all harmful tax practices when viewed in the general perspective, both in developed and developing countries.

9. This research study provides a cautionary note to EAC Partner States that they may be listed or de-listed at any time by the OECD or the COCG, along with the political consequences thereto related. It also recommends developing countries to be mindful of the implications of multilateral solutions and the differences in interests between developed countries (capital exporters / residence jurisdictions) and developing countries (capital importers / source jurisdictions).

10. This book represents a viable project that cannot be completed soon given the dynamics of (harmful) tax competition discussions.