WHEN THE TAX ADMINISTRATION FEELS THEBURN OF AGGRESSIVE TAX PLANNING BUT CANNOT CATCH UP TO ITS FIRE

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ABSTRACT

This paper departs from the global existence of aggressive tax planningpractices by multinational companies through which they minimize theirtax bills to the detriment of government fiscal revenues, which in turn failto properly provide adequate public services. While the discussions over the matter have conquered the legal scholarship, the same topic has so far calledlittle attention under Rwandan law. The practice over the same issue also does not stand far from that. In that respect, the key focus of this paper is to analyze the situation of aggressive tax planning in Rwanda, from a regulatoryapproach to a practical approach. Produced mainly using a doctrinal approach, this paper criticizes the inapplicability of domestic taxation approaches whiledealing with the taxation of international transactions.

1. INTRODUCTION

Aggressive tax planning is assumed to have a long existence. However, it is with globalization that its effects became strongly felt by both the taxpayersand the tax administrations. In fact, globalization has largely facilitated free movement of goods, services, labor, and capital. With the free movementof capital, there has been a global division between capital-importing countries and capital-exporting countries mainly due to the divergence of fiscal interests. The same has been exacerbated by the existence of low tax jurisdictions whose fiscal interests are totally opposed to those of high tax jurisdictions. In response to divergence in interests, countries have taken diverging measures as well, each trying to protect its legitimate interests over tax ownership. Whether intentional or not, countries ended up engagingin tax competition, whose consequences are devastating to both parties. The mutual destruction of tax competition is especially felt when it reaches the level of "race to the bottom", along with the creation of tax havens and other harmful tax practices. The overall consequences being governments' inabilities to satisfy the basic needs of citizens and consistent failures to provide adequate public services due to minimized fiscal revenues.

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Conscious of that damaging situation, some international organizations suchas the Organisation for Economic Cooperation and Development (OECD), the World Bank (WB), the International Monetary Fund (IMF), the United Nations (UN), the European Union (EU), the African Tax Administration Forum (ATAF), and more have been and still are engaged in projects aimed at overcoming the challenges associated with aggressive tax planning without breaching other existing rules which primarily regulate international trade and investment.

On a separate but related note, it is conventionally agreeable that the developed world is sensing issues of aggressive tax planning more than the developing world. That is unfortunate because the developing world suffers higher the consequences of aggressive tax planning than the developed world for two reasons. First, aggressive tax planning erodes the tax bases and developing countries are considered to have tax bases that are already narrowed. Second, developing countries need more streams of revenue to cover a myriad of needs, contrary to developed countries where some of these needs are already covered.

This paper is individualized to the particular traits of Rwanda in relationto aggressive tax planning. It departs from some court cases where the Rwandan tax administration had been sensing some of the aggressive tax planning practices, but failed to catch up the exact source of the practice. The reasons behind that failure are outside the scope of this paper, whichis limited to proving the ineffectiveness of applying domestic approaches while dealing with aggressive tax planning under Rwandan law. To arrive at that end, the production of this paper partakes in a critical analysis of the ways issues of aggressive tax planning are tackled in light of the comparative solutions. In consideration of a general saying that 'no shoes fitall', the individualization of this paper to the Rwandan situation justifies itsrelevance and importance to the Rwandan community.

This paper is structured into six sections. After the introduction, the first section contrasts tax planning with aggressive tax planning, while the second section highlights the main methods used in aggressive tax planning. The third and fourth sections describe the practices of aggressive tax planning in Rwanda and the regulatory guards against it, respectively. The fifth section focuses on proving the ineffectiveness of current approaches under use by the Rwandan tax administration and suggests the progressive approaches to move forward. The paper ends with a conclusion made of a summary andkey recommendations.

2. TAX PLANNING VERSUS AGGRESSIVE TAX PLANNING

Tax planning is defined by the International Bureau of Fiscal Documentation(IBFD) and the Organisation for Economic Cooperation and Development (OECD) glossary as "arrangement of a person's business and/or private affairs in order to minimize tax liability".[1] Tax planning is widely regarded as a right for any taxpayer to plan his/her business in a way that better fitshis/her interest provided that it is not in breach of tax laws.

Opposite to tax planning is aggressive tax planning, which is defined as "situations where the taxpayer exploits the disharmony coming from the interaction of two or more tax jurisdictions for the purpose of reducing thetax liability".[2] Applied to multinationals, aggressive tax planning refers to multinationals' practices of profit reallocation for the purpose of minimizing their global tax bill through the exploitation of the differences between countries' tax systems.[3] The European Commission has concretized what aggressive tax planning is and defined it as "exploiting the differences in tax systems by taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability".[4]

Both practices, i.e. tax planning and aggressive tax planning, are widely used, especially by multinational companies (MNCs) and tax administrations are constantly keeping a watchdog eye on their use and abuse. With a particularfocus on aggressive tax planning, MNCs and tax administrations have different views. For instance, some of the MNCs view tax liability limitationsas their right and this view is backed up by the philosophy according to which there is no patriotic duty in paying taxes. The taxpayer's right toplan their taxes in a way that better praise their own interests has been well accepted by courts in the United Kingdom (UK), the United States of America (USA), and India.[5] The prevailing view held by the courts mostly

[1] IBFD, *International Tax Glossary*, 5th ed., 2005, p. 407 and OECD, *Glossary of Tax Terms*, available at http://www.oecd/org/ctp/glossaryoftaxterms.htm, accessed on 25th September 2018.

[2] P Piantavigna, 'Tax Abuse and Aggressive Tax Planning in the BEPS Era: How EU Law and the OECD are Establishing a Unifying Conceptual Framework in International Tax Law, despite Linguistic Discrepancies', *World Tax Journal*, February 2017, p. 54 [Piantavigna].

[3] S Beer, R Mooij and L Liu, *International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots*, IMF Working Paper WP/18/168, 2018, p. 4 [Beer, Mooij and Liu].

[4] The European Commission Recommendation of 6 December 2012 on Aggressive Tax Planning C (2012) 8806 Final, 2 cited in I Burgers & I J Mosquera, 'Corporate Taxation and BEPS: A Fair Slice for Developing Countries?', *Erasmus Law Review*, August 2017, No. 1, p. 29. See also I J Mosquera, 'Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism', *World Tax Journal*, Vol. 7, No. 3, 2015, p. 2.

[5] See *Gregory v. Helvering, 293 U.S. 465 (1935); Inland Revenue Commissioners v. Westminster(Duke), [1936] AC 1 (HL) and India-Vodafone International Holdings B.V v Union of Inida &*

of English law tradition is that "no legal obligation rests upon a taxpayer to pay higher taxes than he is legally bound to pay under the taxing Act".[6] In the same vein, it has been further stated that "a taxpayer is not prevented from entering into a genuine, or *bona fide*, transaction which, when carried out, has the effect of avoiding or reducing liability to tax".[7] This thinking has been popularized by Judge Learned Hand who held in *Gregory v. Helvering* that;

> Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern whichwill best pay the Treasury; there is not even a patriotic duty to increase one's taxes... Over and over again courts have saidthat there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to paymore than the law demands: the taxes are enforced exactions,not voluntary contributions. To demand more in the name ofmorals is mere can't.[8]

That decision of Judge Learned Hand had established his preeminence as a tax judge and it has been remembered as one of the most significant judicial statements on the matter of tax avoidance.[9] A similar position has been heldby the Lord President Clyde in the case *Ayrshire Pullman Motors Services andD M Ritchie v. IRC* which held that;

No man in this country is under the smallest obligation, moral or otherwise, to arrange his legal relations to his business or to his property so as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow –and quite rightly – to take advantage, which is open to it under the

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Anr. [S.L.P. (C) No. 26529 of 2010, dated 20 January 2012] cited in D Tharwah, *A Principled Evaluation of the Effectiveness of Selected Aspects of the OECD's BEPS Proposals to Prevent "Tax Treaty Abuse"*, Master of Commerce in Taxation in the Field of International Tax, Universityof Cape Town, 2015, p. 3 [Tharwah].

[6] UNECA, *Base Erosion and Profit Shifting in Africa: Reforms to Facilitate Improved Taxation of Multinational Enterprises*, Addis Ababa, 2018, p. 7 [UNECA].

[7] A W Oguttu, 'Tax Base Erosion and Profit Shifting in Africa: Africa's Response to the OECD BEPS Action Plan', WP 54, ICTD, June 2016, p. 7 [Oguttu, Africa's Response to the OECD BEPS Action Plan].

[8] See *Gregory v. Helvering, 293 U.S. 465 (1935)* cited in D Tharwah, Supra note 5, p. 3. See also Tax Analysts, As Certain as Death – Quotations about Taxes, 2010 edition, pp. 223- 24, http://www.taxhistory.org/www/freefiles.nsf/Files/Yablon2010_9_Avoidance.pdf/$file/ Yablon2010_9_Avoidance.pdf (accessed 01 June 2017) [Tax Analysts, As Certain as Death].

[9] M A Chirelstein, "Learned Hand's Contribution to the Law of Tax Avoidance", Yale Law School, Faculty Scholarship Series, 1968, p. 441, http://digitalcommons.law.yale.edu/cgi/ viewcontent.cgi?article=5558&context=fss_papers (accessed 02 June 2017).

taxing statutes for the purpose of depleting the taxpayer's pocket. The taxpayer is in the like manner, entitled to be astute to prevent, sofar as he honestly can, the depletion of his means by the Revenue.[10]

The same philosophy has been defended by other lawyers like William H. Rehnquist, who emphasized that "There is nothing wrong with a strategy to avoid the payment of taxes - the Internal Revenue Code doesn't prevent that".[11] The Internal Revenue Service has also accepted the idea that there is no offense in avoiding taxes provided that it is done within legitimate permissible means.[12] Furthermore, it has been held in the case of *Levene v. IRC* that:

It is trite law that His Majesty's subjects are free, if they can, to maketheir own arrangements so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties, and, strictly speaking, no moral censure if, having considered the lines drawn bythe legislature for the imposition of taxes, they make it their businessto walk outside them.[13]

The same has been repeated in the landmark English case of *ICR v. Duke of Westminster*, where Lord Tomlin held that:

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled topay an increased tax.[14]

The above jurisprudence coupled with an absence between crossing the line between tax planning and aggressive tax planning justify the consistent debates between the two. In a similar consequence, some of the multinational companies view aggressive tax planning as constituting their right as long as it is done within permissible extents. However, the governments' views are far from that. Moreover, what is much discussed is not whether tax

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[10] *Ayrshire Pullman Motors Services and D M Ritchie v. IRC*, 14 TC 754 cited in Oguttu, Africa'sResponse to the OECD BEPS Action Plan, Supra note 7, p. 7.

[11] Tax Analysts, As Certain as Death, Supra note 8, p. 224.

[12] *Id.*, p. 225.

[13] Oguttu, Africa's Response to the OECD BEPS Action Plan, Supra note 7, p. 7.

[14] *ICR v. Duke Westminster*, 51 TIR 467, cited in *Ibid*. See also UNECA, Supra note 6, p. 7. Seealso F K Mugendi, An Overview of Tax Planning in Respect of Personal Income Tax in Tanzania, 2015, p. 1, available at https://www.academia.edu/11765366/An_Overview_of_Tax_Planning_in_Respect_of_Personal_Income_Tax_in_Tanzania, accessed on 01st September 2018.

planning is a right for taxpayers or not. Rather, what is often discussed is whether a given particular practice falls within the permissible extents of tax planning or whether it exceeds the permissible extents to fall within thescope of aggressive tax planning. In that consideration, the main discussionsrevolve around the practices of tax planning as opposed to the practices of aggressive tax planning. This justifies the exploration of the latter's channels in the next section.

3. METHODS OF AGGRESSIVE TAX PLANNING

Aggressive tax planning is done through a variety of methods and it would be ludicrous to imagine that all the methods of doing so are exhausted. Considering the technicalities involved in profit shifting as well as the invention of new clandestine methods by the multinationals, it would also be erroneous to assume that all current profit shifting methods are publicly known. This section, therefore, discusses some of the most popularaggressive tax planning methods, namely the transfer pricing method, the treaty shopping method, and the thin capitalization method.

a. Transfer Mispricing

Transfer mispricing departs from the transfer pricing. In most cases, transfer pricing is used referring to transfer mispricing and the two terms are often used interchangeably. In simple terms, transfer mispricing isdefined as "over or under-invoicing of related party transactions in order to avoid government regulations or to exploit cross-border differences in the rates".[15] Thus said, transfer pricing occurs in international transactions involving two or more interrelated companies, and refers to the pricing of intragroup cross-border transactions between related parties and deals onhow to set the prices for controlled transactions.[16] In this consideration, transfer mispricing occurs as a case of concertation of related parties. In fact, contrary to transactions between unrelated or independent parties, where each party wants the best price, transactions between interrelated companies do not necessarily seek the best price, but rather the best overallresult for the group to which they belong, and one of the best ways is to minimize the group payable taxes.[17]

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[15] Lorraine Eden, "Taxes, Transfer Pricing and the Multinational Enterprise", in *The Oxford Handbook of International Business*, ed. Alan M. Rugman (New York: Oxford University Press, 2009), 593 cited in B B Kristiaji, Incentives and Disincentives of Profit Shifting in developing Countries, Master Thesis - International Business Tax Economics, Tilburg University, Tilburg School of Economics and Management, 2015, p. 19 [Kristiaji].

[16] A Waris, "Taxing Intra-Company Transfers: The Law and its Application in Rwanda", *Bulletinfor International Taxation*, 2013, vol. 67, No 12, p. 3 [Waris].

[17] *Ibid.*

Historically, transfer pricing practices have existed for decades, but startedto pose a serious tax issue with the proliferation of MNCs that resulted in expanding their operations' scope for the purpose of shifting profits from one jurisdiction to another.[18] Today, transfer mispricing constitutes a serious issue, considering that 60% of international trade is intragroup[19] (i.e. flowing and taking place within the same multinational group). In this context, it is arguable that at least two-thirds of the world's trade is likely tobe affected by transfer pricing issues.[20]

Awareness of the damaging consequences of transfer pricing to national fiscal revenues pushed governments to develop mechanisms to counteract transfer pricing manipulations. One of the solutions offered to transfer pricing matters is a universally accepted standard method known as the "arm's length" principle. This principle constitutes the basis of transfer pricing rules.[21] According to the arm's length principle, associated companies must, for tax purposes, allocate income according to the same procedures they would use if they were independent third parties, operating under similar circumstances.[22] That is to say that for tax purposes, the prices usedwhen dealing with inter-company transactions must not differ from the prices used when dealing with unrelated parties.[23] In other words, internal prices between related parties should in all cases resemble the prices that would also show with external parties i.e. between independent parties.[24]

Implemented properly, this would mean that the price should be at the fairmarket value and related entities should be dealing as if they were not relatedand should, therefore, be aiming at maximum protection of its interests.

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[18] A P Morris & L Moberg, Cartelizing Taxes: Understanding the OECD's Campaign against "Harmful Tax Competition", University of Alabama, School of Law, Working Paper, 2011, http://ssrn.com/abstract=1950627 (accessed on 14 April 2017), p. 21.

[19] Lamers, Mcharo & Nakajima, Supra note 237, p. 10. See also S Kapoor, *Exposing the myth and plugging the leaks*, in *Impossible Architecture*, Social Watch Report (2006) cited in Waris, Supra note 17, p. 3. See also R C Christensen, *Professional Competition in Global Tax Reform:The Case of BEPS Action 13*, Master's Thesis, Copenhagen Business School, 2015, p. 1.

[20] R C Christensen, *Ibid*.

[21] *Id.*, p. 3.

[22] See art. 33.6º of the Law No. 016/2018 of 13/04/2018 establishing taxes on income, in *O.G.* No. 16 of 16/04/2018 [Income Tax Law]. See also P Valente, Base Erosion, Profit Shifting and Tax Governance: Future Prospects, in S V Thiel (ed.), Confederation Fiscale Europeenne ForumReports on European Taxation: Policies for a sustainable tax future, Tackling base erosion and profit shifting, Recent developments in VAT and the financial transactions tax, Brussels, CFE Forum 2014, p. 9 [Valente].

[23] R J Jr Hines, "How Serious is the Problem of Base Erosion and Profit Shifting?", *Canadian Tax Journal / Revue Fiscale Canadienne* (2014) 62:2, 443-53, p. 449.

[24] Beer, Mooij and Liu, Supra note 3, p. 7.

This consideration ensures and guarantees that "the price applied and the conditions established in transactions entered into between associated entities are identical to the ones provided for transactions carried out between independent third parties".[25] To formalize this, the comparability of transactions in similar conditions and economic circumstances is essential, with a possibility of making adjustments where applicable.[26]

Even though transfer pricing is the main method used for profit shifting, other methods (such as treaty shopping, which we will discuss next) play arole in profit shifting too.

b. Treaty Shopping

Treaty shopping departs from the existence of a tax treaty. A tax treaty, also referred to as a double taxation avoidance agreement (DTAA) or simply a double taxation agreement (DTA), is a bilateral mechanism consisting of an agreement between the two states on strategies to avoid double taxation. In other words, tax treaties refer to tools that sovereign countries use to coordinate the exercise of their respective rights.[27] However, these initiatives occasionally get abused and exploited as opportunities for MNCs to pay littleor no tax at all.

Avoidance of double taxation is instrumental in the foundation and existenceof tax treaties. Double taxation occurs when two or more states want to raisea comparable tax (i.e. the same tax on the same transaction for the same taxpayer and during the same tax period). Double taxation is consequentialin making trade less profitable and therefore discouraging international trade, ultimately causing harm to international economic growth.[28] Double taxation is primarily caused by States' sovereign power to set up tax systemsthat benefit their own interests. Hence, it is the existence of those different tax systems, each set at a national level in consideration of national interest,that creates discretionary effect and risk causing double taxation or doublenon-taxation.

Contrary to double non-taxation, which used to be ignored by countries

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[25] Valente, Supra note 23, p. 9.

[26] Joint Committee on Taxation, *Background, Summary and Implications of the OECD/G20 Base Erosion and Profit Shifting Project*, JCX-139-15, November 2015, p. 24 [Joint Committeeon Taxation].

[27] Piantavigna, supra note 2, p. 58.

[28] J J Fichtner & A N Michel, "The OECD's Conquest of the United States: Understanding the Costs and Consequences of the BEPS Project and Tax Harmonisation", *Mercatus Research,* Mercatus Center at George Mason University, Arlington, VA, March 2016, pp. 22-23 [Fichtner& Michel].

until recently,[29] much of the focus on double taxation has been on how to overcome it, resulting in countries engaging in tax treaties, among other strategies.[30] Today, there exist more than 3,000 tax treaties and most of them, if not all, are based on the OECD Model Tax Treaty (and the UN ModelTax Treaty too)[31] to an extent that some authors term the OECD Model Tax Convention as having gained a universal use in negotiating tax treaties.[32]

The OECD issued its first Model Tax Convention on Income and on Capital in 1958,[33] and has been improving it to an extent that the 2017 version is the tenth update. Since OECD members are developed countries, its Model Tax Treaty has been regarded as designed in favor of capital-exporting countries over capital-importing countries.[34] In contrast, its twin UN ModelTax Convention between developed and developing countries is regarded as designed to protect developing countries and therefore favors capital importing countries over capital exporting countries.[35] However, the UN Model has been criticized for being largely based on the OECD Model with some particularities to developing countries.

Even though designed to curb double taxation, multinationals have in odd moments utilized tax treaties for aggressive tax planning schemes.[36] This resulted in tax treaties departing from the purpose they are meant for,[37]

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[29] H Ault, 'Some Reflections on the OECD and the Sources of International Tax Principles', *Tax Notes International*, June 2013, 1195 cited in M Markham, 'New Developments in Dispute Resolution in International Tax', *Revenue Law Journal*, Vol. 25, Issue 1, Article 4, 2017, p. 2.

[30] According to OECD, it has been focused too much on relief from double taxation in neglect ofthe flip side of taxation in globalised world, namely double non-taxation. For details see OECD,*Addressing Base Erosion and Profit Shifting*, Paris, OECD Publishing, 2013 cited in Kristiaji, supra note 16, p. 9.

[31] Kristiaji, supra note 16, p. 8.

[32] Fichtner & Michel, supra note 29, p. 22.

[33] The Fiscal Committee of the Organization for European Economic Co-operation (OEEC, which became the OECD a few years later) started working on the draft in 1956 and published interim reports in 1958 and 1961 before presenting the final project done and adopted on 30th July 1963 under the title "Draft Double Taxation Convention on Income and Capital". See The 50th Anniversary of the OECD Model Tax Convention, http://www.worldcommercereview.com/publications/article_pdf/59 (accessed 04 June 2017). See also L'Elan, "History of the OECD Model Tax Convention", http://impatriation-au-quotidien.com/en/ressources/history/186.html(accessed 04 June 2017).

[34] A W Oguttu, *Tax Base Erosion and Profit Shifting in Africa: A Critique of some Priority OECD Actions from an Africa Perspective*, WP 64, ICTD, February 2017, p. 14 [Oguttu, A Critique of some Priority OECD Actions from an Africa Perspective].

[35] *Ibid*, p. 14.

[36] Kristiaji, supra note 16, p. 9.

[37] C Makunike, The Nexus between Tax Treaties, Transfer Pricing and BEPS: Lessons for African Tax Policy Makers and Administrators, ATRN working Paper 05, May 2016, p. 3,

either by paying nothing, that is double non-taxation, or by paying very littlein taxes. One of these tax planning schemes is referred to as treaty shopping,or "tax treaty abuse".[38]

Neither the OECD Model Tax Convention nor the UN Model Tax Convention defines treaty shopping. However, a variety of treaty shopping definitions exist. For example, the US Treasury Department's International Tax Counsel David Rosenbloom defined treaty shopping as "the practice of some investorsof borrowing a tax treaty by forming an entity (usually a corporation) in a country having a favorable tax treaty with the country of source".[39] Treaty shopping is also referred to as "a strategy through which a person who is not a resident of a country that is a party to a particular bilateral income tax treaty attempts to obtain benefits of that treaty that are available only for residents of the treaty countries".[40] Treaty shopping also refers to "the use of DTAs by the residents of a non-treaty country in order to obtain treaty benefits that are not supposed to be available to them",[41] and it is done through interposing a conduit or intermediary company in one of thecontracting states to shift profits out of those states.[42] Treaty shopping is alsodefined as "the situation where a person who is not entitled to the benefits of a treaty makes use of an individual or of a legal person in order to obtainthose treaty benefits that are not available directly"[43] or as "arrangements through which a person who is not a resident of a contracting state attemptto obtain benefits that a tax treaty grants to a resident of that state".[44] In summary, treaty shopping exists when residents of a non-treaty country

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http://atrnafrica.org/admin/documents/download/05%20CEPHAS%20MAKUNIKE%20-%20The%20Nexus%20between%20Tax%20Treaties,%20Transfer%20Pricing%20and%20BEPS. pdf (accessed on 30 May 2017).

[38] Even though, a scholar P Piantavigna considers treaty shopping as different from treatabuse. According to this author, 'treaty abuse is different from (and more prevalent than) treatyshopping, which is (almost) abuse per se'. For details see Piantavigna, supra note 2, p. 59.

[39] R S Avi-Yonah, "Rethinking Treaty Shopping: Lessons for the European Union", in C H Panayi, *Tax Treaties: Building Bridges between Law and Economics*, 21-50, Amsterdam: IBFD,2010, p. 21.

[40] Joint Committee on Taxation, supra note 27, p. 21.

[41] S Van Weeghel, *The Improper Use of Tax Treaties with Particular Reference to the Netherlands and The United States*, Kluwer Law International, 1998: 119 cited in Oguttu, A Critique of some Priority OECD Actions from an Africa Perspective, supra note 35, p. 14.

[42] F J Wurm, "Treaty Shopping in the 1992 OECD Model Convention", *Intertax*, 1992: 658 andE Tomsett, *Tax Planning for Multinational Companies,* New York, Woodhead-Faulkner, 1989:149, cited in *Ibid*.

[43] Treaty Shopping in IBFD International Tax Glossary, 6th revised edition, 2009 cited in Piantavigna, supra note 2, p. 53.

[44] Action 6 Final Report OECD, cited in Piantavigna, supra note 2, p. 53.

obtain tax treaty benefits that are not supposed to be available to them.[45]

As an instrument of international tax planning, treaty shopping is often linked to the loss of tax revenues.[46] It also constitutes a violation of the principle of treaty reciprocity and breaches the balance of concessions between contracting states.[47] However, it is not the only method used by multinationals to minimize their overall payable taxes. Company financing methods are also used as part of aggressive tax planning.

c. Thin Capitalization and Debt Shifting

In principle, companies finance capital is constituted through either equityor debt (which is procured through loans). Equity entails dividend paymentsto shareholders while debt entails interest payments. When it comes to taxation, the dividend payments are not deductible expenses while the latter are deductible from taxable income. This treatment is applicable in most jurisdictions worldwide.[48] This differential treatment justifies why sometimes companies prefer financing through debt rather than equity.

It is through that foundation that the phenomenon of thin capitalization occurs. This is another aggressive tax planning technique and refers to a situation where a company is financed through a relatively high level of debtcompared to equity, which results in a high debt-to-equity ratio.[49] Through thin capitalization, MNCs attempt to ensure that their subsidiaries are financed with more debt than equity capital.[50]

However, it is important to note that all debt financing does not constitute aggressive tax planning. The problem mainly occurs with cross-borderexcessive debt within the same multinational group or intragroup debtor intercompany loans.[51] In other words, what is challenged is not debt contracting or financing through loans because most of the businesses often resort to loans for financing. However, if the loans become excessive, they may be damaging to the tax base, especially when the debt is granted among

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[45] UNECA, supra note 6, p. 14.

[46] Oguttu, A Critique of some Priority OECD Actions from an Africa Perspective, supra note 35, p. 26.

[47] *Id.*, p. 25.

[48] Joint Committee on Taxation, supra note 27, p. 16. See also Oguttu, A Critique of somePriority OECD Actions from an Africa Perspective, supra note 35, p. 8.

[49] Kristiaji, supra note 16, p. 2.

[50] G Richardson, D Hanlon and L Nethercott (1998), "Thin Capitalisation: An Anglo-American Comparison", *The International Tax Journal*, 24: 2: 36 cited in Oguttu, A Critique of some Priority OECD Actions from an Africa Perspective, supra note 35, p. 8.

[51] *Id.*, p. 18.

related parties where the interest payer is in high tax jurisdictions and the interest payee is low tax jurisdictions.

The above description of aggressive tax planning channels is not exhaustive. The above description is also broad and general in nature. Its role is mainlyto cement the following sections that focus on the particular situation of Rwanda.

4. AGGRESSIVE TAX PLANNING PRACTICES IN RWANDA

The current effect of globalization has made the world very small in the sense that countries are very close to each other to an extent that what is happening in one country is likely to happen in another or at least have an influence on the other. Consequent to that, Rwanda is not an island and is not immune to what is happening in other countries in terms of aggressivetax planning.

In Rwanda, the practices demonstrate some situations where the tax administration has been uncovering aggressive tax planning practices. Examples of such cases include *MTN Rwanda Ltd. v. RRA* and *Total Rwanda v. RRA*, along with many others. As far as the first case is concerned, MTN Rwanda began its operations in 1998 as a part of MTN Group, a South African based company which was launched in 1994 and currently operating in22 countries throughout Africa, Asia and the Middle East.[52] Although the claims have been strongly contested, this company has faced allegations of shifting large sums of profits out of some of its operating countries like the Ivory Coast, Uganda, South Africa, and Ghana, and transferring them into tax havens.[53]

In 2015, the same company held similar disputes with Rwanda Revenue Authority (RRA) over an amount of approximately 9 billion Rwandan francs (around USD $13.2 million). The RRA was initially poised to lose the case before the two parties agreed to settle out of court for an amount of around 2 billion Rwandan francs (around $2.6 million USD).[54] The main

[52] Information obtained from "http://www.mtn.co.rw/Content/Pages/15/About_MTN_Rwanda", consulted on 16 May 2017. Countries of operations in alphabetical order are as follows: Afghanistan, Benin, Botswana, Cameroon, Côte d'Ivoire, Cyprus, Ghana, Guinea Bissau, Guinea Republic, Iran, Liberia, Nigeria, Republic of Congo (Congo Brazzaville), Rwanda, South Africa, Sudan, South Sudan, Swaziland, Syria, Uganda, Yemen and Zambia.

[53] F Kokutse, "How MTN moved large sums of money out of Ghana, other African Countries intoTax Havens", Ghana Business News (GBN), 9 October 2015, https://www.ghanabusinessnews.com/2015/10/09/how-mtn-moved-large-sums-of-money-out-of-ghana-other-african-countries-into-tax-havens/ (accessed 29 May 2017).

[54] B Namata, "Rwanda Revenue Authority, MTN in Discussion over $13M Tax Dispute", *The East African*, November 14-20, 2015, p. 4.

issue in this dispute was regarding the management fees for the services that MTN Rwanda received from its parent company MTN Group based in South Africa. On this matter, the RRA wanted MTN Rwanda to disclose in its financial statements the exact amount of support it received, as the RRA could not understand how a company could import services for 10 years and continuously import the same services instead of building a strong localpresence.[55] It is worth mentioning that the matter of excessive charges for intragroup management services constitute a major base erosion and profitshifting challenge in Africa.[56]

In the same vein of RRA difficulties to recover taxes, the Rwandan Supreme Court held the case RComA 0027/12/CS opposing RRA to Total Rwanda Sarl / Engen Rwanda Ltd.[57] The summary of facts showed that Total Rwanda Sarlwas a company with two shareholders, namely Total Outre Mer SA with 99%shares, and Didier Harel with 1% shares. Sometime later the shareholder allocation changed and Total Outre Mer SA had 25,749 shares, while MomarNguer retained 1 share. On 30th July 2008 Total Outre Mer SA (France) signedwith Engen International Holdings Ltd (Mauritius), and Engen Petroleum Ltd (South Africa), for a share purchase agreement in Total Rwanda Sarl subject to the fulfilment of some conditions. On 27th October 2008, in a General Assembly meeting, Momar Nguer transferred his one (1) share to Total Outre Mer SA. This resulted in Total Rwanda Sarl becoming a companyowned by a single shareholder in the name of Total Outre Mer SA with 100%shares. In other words, at that date, Total Rwanda Sarl became a subsidiary fully owned 100% by Total Outre Mer SA. In the same General Assembly meeting, it had been decided that the shares in Total Rwanda Sarl from TotalOutre Mer SA would be transferred to Engen International Holdings Ltd. That is to say that the status of Total Rwanda Sarl changed from being a subsidiary fully owned by Total Outre Mer SA, to a subsidiary fully owned by Engen International Holdings Ltd. In a subsequent General Assembly meeting held on 13th February 2009, it had been decided that Engen International Holdings Ltd will stay with 25,749 shares in Total Rwanda Sarl and transfer 1 share to Adama D. Soro. This time, the shareholding in Total Rwanda Sarl changed from a single shareholder to two shareholders.In the same meeting, it had been further resolved to change the name of thecompany from Total Rwanda Sarl to what it is currently known as Engen Rwanda Ltd.

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55 *Ibid*.

56 UNECA, Supra note 6, p. 28.

57 *Rwanda Revenue Authority v. Total Rwanda Sarl / Engen Rwanda Ltd*, RComA 0027/12/CS,13 May 2016.

The RRA charged Total Rwanda Sarl taxes on income and VAT, considering that there was a sale of assets of Total Rwanda Sarl. This consideration had been challenged by Total Rwanda Sarl according to which Total Outre Mer SA simply sold its shares. The Supreme Court ruled that no tax was due since the operations that were conducted were not taxable under Rwandan tax laws. We can assume that the RRA had suspected a case of tax avoidance in the operations surrounding Total Rwanda Sarl but failed to find a real gap from which it could tax it appropriately.

The same issue has been raised by D. Malunda who presents a case study of I&M Bank Ltd. This bank began operations in 1963 as the Commercial Bank of Rwanda. Since 1994, the bank changed ownership several times and the author states that it is not clear whether the Government of Rwanda ever received capital gains tax.[58] Furthermore, this author questions more adding that changing ownership transactions might have cost the government a considerable amount of taxes foregone.[59]

On a separate but related note, Rwanda has once detected the potential implications of aggressive tax planning through treaty shopping. This arose from the double taxation avoidance agreement between Rwanda and Mauritius, a country which is considered as a treaty haven for offshore activities from African countries.[60] The two countries signed this tax treaty in 2001, but Rwanda later complained about disproportional benefits from the treaty, which ultimately ended with the suspension of the treaty in 2013.[61] On this concern, the Commissioner General of the RRA at the time explained that the treaty had been suspended because it has been discovered that it was encouraging treaty shopping and granting more taxation rights to Mauritius.[62] According to him, the way that treaty was devised would encourage people to do business in Rwanda, however, they would register

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[58] D Malunda, *Corporate Tax Incentives and Double Taxation Agreements in Rwanda: Is Rwanda getting a Fair Deal? A Cost Benefit Analysis Report,* Institute of Policy and Research Analysis, Kigali, 2015, p. 40.

[59] *Ibid.*

[60] Oguttu, A Critique of some Priority OECD Actions from an Africa Perspective, Supra note 35, p. 14. For more information on the status of Mauritius in terms of treaties membership, it is worth noting that this country is the first on African continent for having signed many DTAs totaling to 38 among which 13 are with peer African countries plus 36 Investment Promotion Protection Agreements that add value to foreign investors' protection.

[61] African Tax Administration Forum, The Global Tax Agenda and its Implications for Africa: ATAF Consultative Conference on New Rules of the Global Tax Agenda, Johannesburg, South Africa, 18-19 March 2014, ATAF Discussion Paper, p. 6, http://ataftax-dev.co.za/images/atrn_documents/Global%20Tax%20Agenda%20-%20ATAF%20Discussion%20Paper.pdf (accessed on 30 May 2017).

[62] *Id.*, p. 7.

the business in Mauritius. This would allow them to repatriate their income and profits in Mauritius as a low tax jurisdiction without paying taxes in Rwanda, which was considered a high tax jurisdiction.[63] This resulted in the treaty being amended with a provision in which it replaced the zero rate withholding tax on management fees with a 12% withholding tax, and 10% withholding tax on dividends, royalties, and interest.[64]

Still on the matter, a deep analysis of the case RCOM 0710/13/TC/NYGE[65] would have, to a large extent, led to the discovery of an aggressive tax planning practice. In this case, RRA charged MTN Rwanda Ltd an amount of 1,255,442 Frw of VAT on services the company imported from foreign companies like Ernst & Young Kenya, KPMG Kenya, Biodata South Africa,et cetera in a situation where similar services would be provided by the Rwandan companies including the same companies such as Ernst & Young Rwanda, KPMG Rwanda, et cetera. Likewise, MTN Rwanda imported some services from its parent company MTN International in a situation where MTN Rwanda had qualified staff who could provide similar services. The court rejected RRA arguments motivating that RRA failed to produce convincing evidence of the availability of imported services on the Rwandanmarket. RRA appealed this case, but dropped its appeal before it was decided. It has been echoed that the withdrawal was due to a settlement out of court. However, this information and some other details of the case in appeal stay outside the public domain.

From the above examples, it becomes clear and obvious that Rwanda is suffering the consequences associated with aggressive tax planning. The magnitude of such problems is outside the scope of this paper. However, a complete denial of the existence of such problems would be sticking one's head in the sand like in ostrich games. Thus, it matters to explore what Rwanda has done so far to safeguard itself against the abuse of aggressive tax planning.

5. REGULATORY GUARDS AGAINST AGGRESSIVE TAX PLANNING

From a legislative approach, Rwanda has adopted a number of legal provisions that, in one way or another, may counteract aggressive tax planning maneuvers. This is the case of the provisions that deal with transfermispricing and interest limitations.

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[63] *Ibid.*

[64] *Ibid.*

[65] *MTN Rwanda Ltd v. RRA*, RCOM 0710/13/TC/NYGE, 17/12/2013.

a. Transfer Mispricing Regulation

Contrary to most African countries which do not have rules on transfer pricing,[66] the Rwandan legislature discerned the use of transfer pricing to shift profits and step footed in modern countries tax rules by enacting, for the first time, the rules on transfer pricing in 2005.[67] This legislation was repealed in 2018 and the new income tax law deals with the transfer pricingin its article 33 provides that:

Related persons involved in controlled transactions must have documents justifying that their prices are applied according to arm's length principle. Failure to do so, the Tax Administration adjusts transactions prices in accordance with general rules on transfer pricing, issued by an Order of the Minister.[68]

To the best of the author's knowledge, the Ministerial Order setting out the general rules on transfer pricing was not yet issued at the time of writing this paper. As long as this Ministerial Order is not yet adopted, it would be difficult to apply this legal provision due to its incomplete character coupled with a variety of methods that are used to deal with transfer pricing matters.

On the contrary, the repealed law previously authorized the Commissioner General of RRA to make advance arrangements with persons carrying out business to ensure that they are concluding their business in the same way as would be the case between unrelated parties.[69] The implementing Ministerial Order,[70] also repealed along with its source law, used to provide methods that could be used to determine the pricing at arm's length principle, namely the Comparable Uncontrolled Price (CUP) method, the Resale Price Method (RPM), the Cost Plus Method (CPM), and also allowed for any other method that the fiscal administration may deem appropriate.[71]

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[66] Waris, supra note 17, p. 5.

[67] See art. 30 of the Law nº 16/2005 of 18/08/2005 on direct taxes on income, *OG* (nº 1 of 01/01/2006) as modified and completed by the law nº 73/2008 of 31/12/2008, *OG* (nº 19 of 11/05/2009) modified and complemented again by the law nº 24/2010 of 28/05/2010, *OG* (nº special of 28/05/2010) and again by the law nº 28/2012 of 27/07/2012, *OG* (nº 37 of 10/09/2012).

[68] Income Tax Law, art. 33.

[69] Art. 30 para 2 of the law nº 16/2005 of 18/08/2005 on direct taxes on income, *OG* (nº 1 of 01/01/2006) as modified and completed by the law nº 73/2008 of 31/12/2008, *OG* (nº 19 of 11/05/2009) modified and complemented again by the law nº 24/2010 of 28/05/2010, *OG* (nº special of 28/05/2010) and again by the law nº 28/2012 of 27/07/2012, *OG* (nº 37 of 10/09/2012).

[70] That was the Ministerial Order nº 004/07 of 09/05/2007 governing the implementation of thelaw nº 16/2005 of 18/08/2005 on Direct Taxes on Income.

[71] *Id.*, art. 10, 11, 12 and 13.

Furthermore, assessed from a theoretical aspect to a practical aspect, the application of transfer pricing rules in Rwanda is still problematic, even though legislation has been enacted. According to A. Waris, one of the causes of weak applicability of transfer pricing rules in Rwanda is the fact that these rules have been enacted simply to complete Rwandan tax laws and without any notice of misuse of international transfer pricing laws or any discussion on the need of such rules.[72] This position is concurred with, since enacting a law without a proper need to prevent the occurrence of transfer mispricing situations risks negatively impacting its applicability. A lack of sufficient personnel in RRA with enough qualifications and skills to deal with transfer pricing cases has also been identified as a challenge to aneffective application of transfer pricing rules.[73]

All of the above elements, inter alia, justify why the transfer pricing rules havebeen in place since 2005, yet have not been applied until recently. However,this problem is not unique to Rwanda, but rather seems to be a general situation in developing countries. For example, A. Waris reports that so far, only two cases of transfer pricing have reached the courts in Eastern and Central African countries, namely the case of Unilever v. The Commissioner General, KRA 2005 and the case of Kuruturi Limited v. Commissioner of Domestic Taxes, KRA.[74]

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[72] Waris, Supra note 17, p. 6. According to this author, the situation in Rwanda is unusual and different from others because normally most tax legislation become introduced on the discoveryof an issue to be resolved as it has been the case in Kenya in 2006 when similar laws havebeen introduced after losing a transfer pricing case that opposed Unilever Kenya Limited to theCommissioner of Income Tax (see for details KE: HC 17 Sept. 2003, *Unilever Kenya Limited v. Commissioner of Income Tax,* eKLR Income Tax Appeal 753 of 2003 available at www.taxriskmanagement.com/wp-content/uploads/2010/10/Unilever-Kenya-Ltd-v-CoT-Income-Tax-Appeal-753-of-2003.pdf (accessed 27 March 2017).

[73] By 2013, no single tax auditor or any other member of RRA staff had been trained in applicationof transfer pricing rules. See *Ibid*.

[74] A Waris, 'How Kenya has Implemented and Adjusted to the Changes in International TransferPricing Regulations: 1920-2016', ICTD Working Paper 69, October 2017, p. 12 and 17. In Unilever case, the audit team discovered that there was a discrepancy in the prices of goods manufactured by Unilever (Kenya), but sold in Uganda by Unilever (Uganda). Unilever (Kenya)was manufacturing washing powder and toothpaste and transferring them to Unilever (Uganda)for sale in Uganda under a contract of 1995. Unilever (Kenya) also manufactured and sold suchproducts to customers in Kenya, and to other unrelated customers in the export market. The auditteam found that Unilever (Kenya) charged lower prices to Unilever (Uganda) than those chargedboth to customers in Kenya and to unrelated parties in the export market both in Uganda and elsewhere.

b. Regulation of Interest Limitation and Thin Capitalization

Debt shifting has the potential to erode the tax base in developing countries[75] and several countries have set up standard interest limitation rules.[76] Rwanda has adopted the same approach and deals with interest limitationsthrough establishing a threshold of equity to be invested before qualifying for tax incentives. For instance, to benefit from a corporate income tax holiday of up to seven years, an investor is obliged, among other conditions,to invest an equivalent of at least $50,000,000 USD, with at least 30% of thisinvestment being contributed in the form of equity.[77]

The Rwandan legislature has also considered aggressive tax planning through intragroup lending and tightly counter-acted thin capitalization through the tenth point of Article 26 of the income tax legislation, which excludes from deductible expenses the interest arising from loans betweenrelated persons either paid or due on the total loan, which is greater than four times the amount of equity.[78] However, this provision does not apply to commercial banks, financial institutions and insurance companies, which is quite fair considering the nature of their businesses.

Nevertheless, these rules on thin capitalization are not sufficient to counteract thin capitalization, because what is limited here is the quantity of the loan amount vis-à-vis equity amount. However, nothing is limited in relation to intragroup lending, which is a more serious way of aggressive tax planning, since the circulation of loans transpires within the same group of companies with a possibility of lending to relatives on high interests. In the same vein, the consideration of four times is relatively unfairly high andshould have been limited to a lower level, perhaps two times.

Furthermore, one substantial question would be whether the existing rules are effectively enough to safeguard against the practices of aggressive tax planning. In the view of the author, the mere existence of rules is one thing, while the right application of rules is another. The latter remains one of the main preoccupations of this paper and the following section highlights the points that prove the ineffectiveness of the approaches that are currently used.

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[75] Kristiaji, Supra note 16, p. 86.

[76] *Ibid.*

[77] Law nº 06/2015 of 28/03/2015 relating to investment promotion and facilitation, commonly referred to as Investment Law, *OG* (nº special of 27/05/2015), Annex, III.

[78] Income tax law 2018, art. 26.10º.

6. INEFFECTIVENESS OF THE GOVERNMENT TAX AGENCY'S APPROACHES

Detecting and handling aggressive tax planning practices are apparently still constituting challenges to the Rwandan tax agency. Rather, considering the multiplicity and the volume of international transactions, it would not be erroneous to say that a wise taxman should, in this era of globalization, focus on the taxation of multinational taxpayers. This is because the tax revenue from one international transaction, once taxed properly, would possibly equate to or exceed the potential revenues from thousands of smalldomestic taxpayers.

Looking back to the Rwandan tax administration, one of the causes of the difficulties in curbing aggressive tax planning lies in handling international tax matters using domestic approaches. For instance, if we refer back to thecase RCOM 0710/13/TC/NYGE[79], a deep diagnosis would have led, to a large extent, to the discovery of an aggressive tax planning practice. It is in the author's view that even if RRA did not go in deep to provide evidence provingthe availability of imported services on the Rwandan market, one would easily think of the possible strategy by MTN Rwanda to import services from its parent company, MTN International based in South Africa, for the purpose of shifting the profit from the subsidiary to the parent company. This would be possible considering the difference between the corporate income tax rates in Rwanda (30%) and South Africa (28%). Apart from the difference in corporate income tax rates, one would also inquire into the possibility of MTN International getting exemptions from the exported services, which shall increase the company's overall profit. To a large extent,one would also raise doubt over the pricing methods used. Thus, if this case had been deeply diagnosed, a scenario of aggressive tax planning through profit shifting would have been probably discovered.

On the contrary, one of the ways to progress is to strengthen the legislativearsenal along with strengthening the human capacity through buildingexpertise of the tax administration staff and equip them with modernized tools to allow them to deal with the technicalities and complexities of aggressive tax planning practices appropriately.

7. CONCLUSION

This paper discussed the situation of aggressive tax planning practices under Rwandan law. It started with highlights of the general image of aggressive tax planning before focusing on their specific effects in Rwanda. The available legislative provisions on the matters of aggressive tax planning have been highlighted along with some examples of real-world situations that would

[79] *MTN Rwanda Ltd v. RRA*, RCOM 0710/13/TC/NYGE, 17/12/2013.

in one way or another qualify as falling within the scope of aggressive tax planning.

The main purpose was to demonstrate that the Rwandan tax administration has become aware of, or at least sensed some practices that would easily amount to cases of aggressive tax planning. However, due to several different reasons, such cases have been handled like other ordinary domestic cases, which resulted in the minimization of tax administration benefits.

Furthermore, treating such cases like ordinary domestic cases risks to easily lead to the conclusion that aggressive tax planning cases in Rwanda are non-existent. This would be a serious problem since the fact of having no known cases of aggressive tax planning in Rwanda does not necessarily mean that such cases do not exist. It is more likely that they do exist, but since they are not properly identified, documented and handled, the environment makes it seem as if there are none.

Finally, the overall recommendation has been to improve the legal frameworkon aggressive tax planning along with strengthening the capacity of tax administration staff. In addition to that, the tax administration staff should also, be equipped with modernized tools to facilitate them executing their duties properly.

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