4 February 2021

# Global Tax Alert

News from Transfer Pricing

# Rwanda issues general rules on transfer pricing

## EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, pesrsonalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

## Executive summary

A Ministerial Order establishing general rules on transfer pricing was gazetted by the Rwandan Government on 14 December 2020. The general rules are consistent with the Organisation for Economic Co-operation and Development Guidelines (OECD Guidelines).

This Ministerial Order is based on the provisions of Article 33 of the Income Tax Laws of Rwanda which provide that related persons involved in controlled transactions must maintain documents to support that their prices are applied according to arm's-length principle. Failure to maintain such documents will result in pricing adjustments.

## Detailed discussion

### Scope of the transfer pricing rules

The transfer pricing (TP) rules apply to controlled transactions between a resident person with its related parties, both in and outside Rwanda, or a permanent establishment of a foreign entity in Rwanda engaging directly or indirectly in a controlled transaction with a related person not resident in Rwanda.

Building a better working world

It also applies to deemed controlled transactions, which are transactions with a person located in a country or a place that the Tax Administration considers to be providing a beneficial tax regime, irrespective of whether such persons are related persons.

A beneficial tax regime has been defined as tax legislation of a country or any other tax jurisdiction characterized by any of the following:

- The country or tax jurisdiction does not tax income or taxes it at a maximum rate of 20%
- The country or tax jurisdiction grants tax breaks to nonresident individuals or companies
- The country or tax jurisdiction does not require a taxpayer to carry out substantial economic activity within the country or tax jurisdiction
- The country or tax jurisdiction does not tax foreign-sourced income or taxes it at a maximum rate of 20%
- The country or tax jurisdiction does not allow access to information about the corporate structure of legal entities, the ownership of assets, other rights or economic transactions

## Definition of a related person

The order broadly defines a related person as any person who acts or is likely to act in accordance with the directives, opinion or intentions of another person whether such directives, opinion or intentions are communicated to them.

In particular, spouses with their direct lineal ascendants or descendants and their collateral lineage relatives to at least third degree are considered as related persons. Also, a person or a third person who participates directly or indirectly in the management, control or capital of another person are also considered related persons.

It is notable that the order does not define in specific terms what constitutes management, nor does it quantify what control (percentage) in another person refers to.

## Transactions covered

The Ministerial Order deems the following transactions as being subject to an adjustment of prices:

- Sale, purchase or transfer of goods for free
- Sale, purchase, transfer of goods for free or lease of tangible assets
- Sale, purchase, transfer for free, giving or receiving the right to use intangible assets
- Provision of services
- Lending or borrowing of money
- Any other transaction which may affect the profit or loss of the concerned person

## Substance over form in allocation of risks and profits

The order also introduces the concept of *substance over form* in establishing comparability and allocating profits associated to risks. It provides that allocation of the economically significant risks between the related persons must be considered. Specifically, the risk must be allocated to a person who controls the risk and who has the financial capacity to assume the risk. This is regardless of whether the person contractually assumes the risk.

Consequently, the person who only assumes risks contractually cannot be allocated the profits associated with those risks. The person should be able to control as well as have the financial capacity to assume the risks.

## Disregarding a controlled transaction for tax purposes

Arrangements in transactions between related persons will be disregarded if they differ from the arrangements that would have occurred between independent persons behaving in a commercially rational manner in comparable circumstances. In such a case, the arm's-length position would be as if the transaction had not occurred.

## Determining the arm's-length price

The order provides for the application of the most appropriate TP method out the five potential methods, which are:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Transactional net margin method
- Transactional profit split method

Further, the order allows for the use of an alternative method, where none of the first five methods may be reasonably applied to determine the arm's-length conditions for the controlled transaction. The alternative method must also yield a result consistent with that which would be achieved by independent persons engaging in uncontrolled comparable transactions under comparable circumstances of the controlled transactions.

The interquartile range, determined through a statistical approach, is considered as an arm's-length range where a number of financial indicators are determined through a comparability analysis. The financial indicators identified by the order include mark-up on costs, gross margin or net profit. Where the financial indicator in a controlled transaction falls outside the arm's-length range, the median of the arm's-length range is considered.

## Selection of the tested party

A tested party is required where either the cost plus, resale price or transactional net margin method is selected as the most appropriate method. The tested party can be local or foreign. In the case of a foreign-tested party, sufficient information is needed for the selected method to be reliably applied and reviewed by the tax administration.

## Documentation and information

A person involved in a controlled transaction is required to develop a TP policy, and to prepare and maintain the documentation that verifies that the conditions of its controlled transactions for the relevant tax period are consistent with the arm's-length principle. Although the order does not provide a specific format of the policy and documentation, it provides for the specific information (aligned to the OECD Guidelines) to be included in the documentation.

## Time period for preparing the documentation and filing

The TP documentation should be maintained in one of the official languages of the Republic of Rwanda including Kinyarwanda, English and French. The TP documentation should be in place before the deadline of income tax declaration for the tax period.

It is to be submitted upon request by the tax administration within seven days from the date of receipt of the written request. However, a schedule of the controlled transactions must be submitted in a prescribed form to the tax administration together with the income tax declaration. The corporate annual income tax declaration is due by the end of the third month following the financial year end.

Documents related to the global organizational structure of the group of companies to which a Rwandan taxpayer belongs, indicating all related persons, their shareholding and their management structure, must be submitted to the tax administration with the first income tax declaration and updated as and when there are changes to the structure.

## Submission of Country-by-Country (CbC) report

As part of the TP documentation process, the person involved in a controlled transaction is required to file the CbC report where the ultimate parent of the taxpayer is required to prepare such a report. The CbC report must be filed no later than 12 months after the last day of the reporting fiscal year of the multinational enterprises' group.

The order defines a CbC report as a report by a company to governments, of tax figures and other financial data on a country-by-country basis.

## Taxpayers discharged from the obligation to prepare documentation

Taxpayers whose annual turnover is below FRW600 million are not required to prepare TP documentation where the individual value of their controlled transactions is below FRW10 million or the aggregate value of controlled transactions is below FRW100 million. However, such taxpayers must comply with the arm's-length principle.

## Sources of information on uncontrolled comparable transactions

Sources of information on uncontrolled comparable transactions include:

- Internal uncontrolled transactions of a taxpayer, if one of the parties to the controlled transaction is also a party to the uncontrolled transaction
- External uncontrolled transactions of a taxpayer, which are uncontrolled transactions to which none of the parties to the controlled transaction is a party

Information on the transaction that is not available to both the taxpayer and the tax administration will not be relied upon by either party for the purposes of making an adjustment of prices or demonstrating the compliance of a transaction with the arm's-length principle.

Where no comparable uncontrolled transaction is available in Rwanda, the taxpayer or the tax administration may use foreign country comparable transactions during a taxpayer's TP analysis.

## Intra-group services

Consistent with the OECD Guidelines, the Order provides that services between related persons are considered as consistent with the arm's-length principle where the following conditions are met: (1) the service was actually rendered; (2) the service provided or is expected to provide the recipient with an economic or commercial benefit to enhance the recipient's commercial position; (3) an independent person in similar circumstances would be willing to pay to a third party for such service or would have the service performed in-house; and (4) the amount is equal to what would have been agreed on by independent persons.

For centralized intra-group services, the order provides for use of reasonable allocation criteria for the costs involved in providing the services.

## Transactions involving intangible property

The determination of arm's-length conditions for controlled transactions involving the exploitation of an intangible asset must consider the contractual arrangements and the factors relating to the development, enhancement, maintenance, protection and exploitation of the intangible assets.

The factors, among others, include the functions performed and management and control of the functions; assets contribution and management and control of the assets; risks assumed and management and control of the risks; and financial capacity to assume the risks.

Where it is hard to value the intangible assets, the tax administration may consider ex-post outcomes as presumptive evidence of *ex-ante* pricing arrangements.

## Necessary adjustments of prices in the case of non-compliance with the arm's-length principle

In the event the taxpayer fails to comply with the arm's-length principle and the non-compliance has the effect of reducing or deferring the taxpayer's tax liability for the tax year, the taxable income must be computed as if the conditions of transaction were consistent with the arm's-length principle.

## Next steps

All concerned taxpayers should put in place measures to comply with these TP regulations granted that the TP compliance requirements should be adhered to by 31 March 2021.

It is important to note that the Rwanda Revenue Authority is focused on enforcing the implementation of these rules which will likely trigger an increase in TP audits.

For additional information with respect to this Alert, please contact the following:


### Ernst & Young (Kenya), Nairobi

- Francis Kamau francis.kamau@ke.ey.com
- Nelson Ngaira nelson.ngaira.@ke.ey.com
- Simon Njoroge simon.njoroge.@ke.ey.com

### Ernst & Young Rwanda Limited, Kigali

- Michael Ichura michael.m.ichura@rw.ey.com

### Ernst & Young Société d'Avocats, Pan African Tax – Transfer Pricing Desk, Paris

- Bruno Messerschmitt bruno.messerschmitt@ey-avocats.com
- Alexis Popov alexis.popov@ey-avocats.com

### Ernst & Young LLP (United Kingdom), Pan African Tax Desk, London

- Kwasi Owiredu kwasi.owiredu@uk.ey.com
- Byron Thomas bthomas4@uk.ey.com

### Ernst & Young LLP (United States), Pan African Tax Desk, New York

- Brigitte Keirby-Smith brigitte.f.keirby-smith1@ey.com
- Dele Olagun-Samuel dele.olaogun@ey.com

EYG no. 000791-21Gbl

1508-1600216 NY
ED None