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Rwanda | General Rules on Transfer Pricing 2020

Brief context and purpose of the transfer pricing guidelines

The Rwanda government published a ministerial Order number 003/20/10/TC of 11/12/2020 establishing the general rules on transfer pricing (TP) between related parties involved in controlled transactions (related party transactions). The rules came into effect on 14 December 2020. This tax alert summarises the key components of the rules that companies should consider in respect to related party transactions.

The rules provide guidance on the scope of transfer pricing, documentation required and the determination of arm's length prices for intercompany transactions. The rules also empower the Rwanda Revenue Authority (RRA) to adjust profits earned between related parties in a situation where the trading arrangements between the related parties are considered not to adhere to the arm's length principle.

Under Article 27 of the general rules, it is stated that all prior provisions contrary to the order are repealed.

Scope of transfer pricing

The transactions subject to transfer pricing rules include:

- ✓ Transactions between resident entities or a Rwandan Permanent Establishment ("PE") and a non- resident related entity; and
- ✓ Transactions between resident entities or Rwandan PEs and non- resident persons in a country where the tax administration considers to provide a beneficial tax regime, whether such persons are related or not.

A beneficial tax regime is generally defined to include countries:

- ✓ whose income tax rate is 20% or less;
- ✓ that grant tax breaks to non-resident individuals or companies;
- ✓ do not require a taxpayer to carry out substantial economic activity within this country or tax jurisdiction;
- ✓ do not tax foreign-sourced income or to tax it at a maximum rate of twenty percent (20%); or
- ✓ do not have transparency/ allow access to information about the corporate structure of legal entities, the ownership of assets, other rights or economic transactions.

In our view, the scope of transactions goes beyond the international guidelines and imposes TP compliance requirements on entities transacting with independent non-resident entities if the said non- resident entity is in a beneficial tax regime or where the economic substance cannot be demonstrated.

The rule is aimed at addressing the tax authority concerns that taxpayers fail to disclose their relationship with offshore entities.

Transactions covered

According to the rules, the following transactions are subject to adjustment of prices:

- ✓ Sale, purchase or transfer of goods for free and or lease of tangible assets;
- ✓ Sale, purchase, or transfer of goods for free, giving or receiving the right to use intangible assets;
- ✓ Provision of services;
- ✓ Lending or borrowing of money; and
- ✓ Any other transaction that affects the profit or loss of the concerned person.

Definition of related persons

A person is deemed to be a related party if the person 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 or not communicated to them. In particular, the following persons are considered as related persons:

a) an individual and his or her spouse and their direct lineal ascendants or direct lineal descendants and their relatives in collateral lineage to at least third degree;

b) a person who participates directly or indirectly in the management, control or capital of another;

c) third person who participates directly or indirectly in the management, control or capital or both control the capital of another person;

d) persons referred to under sub-items a), b) and c) who participate directly or indirectly in the management, control or capital of an enterprise.

Transfer pricing methods

In line with the OECD Guidelines, the rules have adopted the application of the 'most appropriate TP method', having regard to:

- Strengths and weaknesses of the TP methods;
- Particularity of the TP method taking into consideration the nature of the controlled transaction;
- Availability of reliable information; and
- Degree of comparability.

The rules specify the following transfer pricing methods of determining arm's length prices:

- **Comparable uncontrolled price method** (CUP) which consists of comparing the price charged on a good or service in a related party transaction to the price charged on a similar good or service in a comparable unrelated party transaction.
- **Resale price method** – This is the price at which a product that has been bought from a related party is resold to an independent person. After adjusting for the costs associated with the purchase of the product, the remaining amount after deducting the gross margin is considered the arm's length price.
- **Cost Plus method** – This method begins with the costs incurred by the supplier of property, goods or services in a related party transaction and an appropriate cost plus mark up is added to the costs incurred to make an appropriate profit, considering the functions performed and market conditions.
- **Transactional net margin method** – This compares the net profit margin relative to an appropriate base such as costs, sales or assets that a person achieves in a related party transaction with the net profit margin achieved in a comparable unrelated party transaction.
- **Transactional profit split method** – It consists of splitting the profit between related persons on an economically valid basis, comparing the division of profit and loss that a person achieves in a related party transaction with the division of profit and loss between independent persons.

Use of alternative method

The rules prescribe that a person may apply any other TP method only if the tax authority is satisfied that;

- none of the approved methods may be reasonably applied to determine arm's length conditions for the controlled transaction;
- such other method yields a result consistent with that which would be achieved by independent persons engaging in uncontrolled comparable transactions under comparable circumstances of controlled transactions.

Selection of tested party

A tested party is defined as an enterprise to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found. Where the tested party is a foreign entity, the rules require that sufficient information shall be availed to the tax authority to enable a review of the application of the method to the foreign tested party.

In our view, this rule grants powers to the tax authority to request for information on foreign entities where they are selected as the tested entity. This is in line with recent international developments that have seen increased transparency on the operations of multinationals.

In our view, a challenge may arise where the information requested by the tax authority is excessive or not available. In some instances, it is difficult for resident entities to obtain the information from the non-resident related parties. This may result into testing of the local entity even where the said entity is the more complex entity in the transaction.

Arm's length range

The rules provide for a statistical approach where the interquartile range is considered as the arm's length range which is in line with the OECD Guidelines.

A controlled transaction will not be subject to an adjustment where the relevant financial indicator being tested under the appropriate transfer pricing method is within the arm's length range. Where the results of the tested transaction fall outside the arm' length range, the taxable profit/ TP adjustment will be computed using the median of the arm's length range.

Transfer pricing documentation

A person involved in controlled transactions is required to develop a transfer pricing policy, to prepare and keep the documentation that verifies that the conditions of its controlled transactions for the relevant tax period are consistent with the arm's length principle.

The TP documentation for a relevant tax period must be in place before the deadline of income tax declaration. There is no requirement to file the transfer pricing documentation at the point of filing the tax declaration. The rules provide that a controlled transactions schedule must be submitted to the tax administration together with the income tax declaration. Notably, the taxpayer will be required to provide the documentation within seven (7) days from the date of receipt of the written request.

Exemption from TP documentation requirements

A taxpayer with an annual turnover below six hundred million Rwandan francs (FRW 600,000,000) (Appr USD 600,000) is not required to prepare the documentation. Besides the turnover test, taxpayers are expected to meet either of the following two conditions to be discharged from the obligation to prepare a TP policy and to keep TP documentation;

- The value of the related party transactions should be below ten million Rwandan francs (FRW 10,000,000~USD10,000); or
- The aggregate value of related party transactions should be below one hundred million Rwandan francs (FRW 100,000,000~USD100,000).

A taxpayer discharged from the obligation to prepare documentation must comply with the arm's length principle.

Country by Country Reports (CbcR)

For the taxpayers who are part of a multinational group, there is a requirement to file documents relating to the global organisational structure of the group of companies indicating all related persons, their shareholding and their management structure . This must be submitted to the tax administration with the first income tax declaration.

In addition, a country by country report (CbCR) must be filed not later than twelve (12) months after the last day of the reporting fiscal year of the multinational enterprises group. CbCR reports include information about the jurisdictional allocation of profits, revenues, employees and assets.

This is in line with the BEPS action plans aimed at increasing transparency on operations of Multi-National Enterprises (MNEs) and information sharing between tax authorities as well as possible coordination of audits between revenue authorities.

TP considerations for services

In line with the OECD Guidelines, the Rwandan TP rules consider the following factors when assessing whether a service fee between related parties is consistent with the arm's length principle:

- The service to which the fee relates must actually be rendered;
- The service should provide, or when rendered is expected to provide the recipient with economic or commercial value to enhance its commercial position;
- The amount paid corresponds to what would be agreed between independent persons in comparable circumstances; and
- The fee charged is comparable to what an independent person would wish to pay for a similar service performed by an independent person.

The TP rules are however silent on the restriction of service fees paid to related parties to 2% of the turnover. Article 26 of Law No 016/2018 of 13/4/2018 establishing taxes on income, issued by the RRA provides that management, technical services and royalty fees paid to a non-resident person exceeding two percent (2%) of the turnover are not deductible expenses from taxable income.

Intra-group services are an important feature of most multinationals. Our view is that proper guidance should be provided on the deductibility of service fees that meet the arm's length principle set out in the TP rules.

TP considerations for intangible property

The rules provide that the determination of arm's length conditions for related party transactions involving the exploitation of an intangible asset should consider the development, enhancement, maintenance, protection and exploitation of the intangible asset. This approach is in line with the BEPS actions on intangible assets and involves identifying entities in the group assuming key risks and allocating the returns based on functions performed.

Corresponding adjustments

In order to eliminate double taxation, the rules provide for corresponding adjustments under the following circumstances:

- Where a TP adjustment has been made to the taxable income of a taxpayer in a domestic controlled transaction, an appropriate adjustment to the taxable income of the other party shall be made.
- A transfer pricing adjustment has been made in another country with which Rwanda has a Double Tax Treaty (that reflects an intention to provide for the relief of economic double taxation) with regard to transactions which affect the taxpayer; and the adjustment results in taxation in another country of profits already charged to tax in Rwanda. In this case the affected taxpayer must apply to the Tax Authority which will consider the application in consultation with the competent authority of the other country and make an appropriate adjustment if satisfied that the adjustment is consistent with the arm's length principle.

  This is a positive measure given Rwanda has double tax treaties with countries such as South Africa, UAE, Belgium, Mauritius and Turkey.

Conclusion

With the introduction of the TP rules, it is expected that the RRA will intensify transfer pricing audits. MNEs with a presence in Rwanda should take necessary measures to ensure compliance by putting in place appropriate transfer pricing documentation before the due date of tax declaration.

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