# General rules on Transfer Pricing in Rwanda

## A KPMG analysis

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# 1. Preamble

On 14 December 2020, the Minister of Finance and Economic Planning of the Government of Rwanda gazetted the Ministerial Order No 003/20/10/TC of 11/12/2020 which establishes general rules on transfer pricing between related persons involved in controlled transactions (TP Rules).

This analysis highlights the key provisions in the TP Rules which took effect on 14 December 2020.


# 2. General Provisions

## 2.1 Controlled Transactions

A transaction between two parties will be deemed to be controlled when:

- One of the persons involved in the transactions is located in Rwanda and subject to tax in Rwanda while the other is a related person located in or outside Rwanda;
- A non-resident in Rwanda engages directly or indirectly in a transaction with a related person not resident in Rwanda, if the transaction relates to a permanent establishment (PE) in Rwanda of one of the two related persons;
- A person resident in Rwanda engages in a transaction with a person located in a country or a place where the tax administration considers to provide a beneficial tax regime, whether such persons are related or not; and
- A person resides in a country or a place where the tax administration considers to provide a beneficial tax regime, engages in a transaction that relates to a permanent establishment of a non-resident in Rwanda whether such persons are related or not.

### 2.1.1 Beneficial tax regime

A tax legislation of a country or any other tax jurisdiction will be regarded to be beneficial if it is characterised by any of the following:

- Has no income tax or has a maximum income tax rate of twenty percent (20%);
- Grants tax breaks to non-resident individuals or companies;
- Does not require a taxpayer to carry out substantial economic activity within such country or tax jurisdiction;
- Does not tax foreign -sourced income or such income is subject to tax at a maximum rate of twenty percent (20%);
- Does not allow access to information about the corporate structure of legal entities, the ownership of assets, other rights or economic transactions.

### 2.1.2 Related persons

The TP Rules define 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 or not they are communicated to them. The following are considered to be related persons:

- A person who participates directly or indirectly in the management, control or capital of another;
- A third person who participates directly or indirectly in the management, control or capital or both control and capital of another person;
- 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; and
- Persons referred to above who participate directly or indirectly in the management, control or capital of an enterprise.

# 3. Comparability of Transactions

### 3.1 Comparability of transactions

An uncontrolled transaction will be regarded to be comparable to a controlled transaction where no material difference exists between them that could materially affect the factors being examined under the appropriate transfer pricing method.

Where material differences exist, a reasonably accurate comparability adjustment should be made to the relevant factors of the uncontrolled transaction in order to eliminate the effects of such a difference.

### 3.2. Transactions subject to transfer pricing adjustments

- 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; and
- Any other transaction which may affect the profit or loss of the concerned person.

### 3.3. Comparability Factors

The following factors should be considered in determining whether two or more transactions are comparable:

- Characteristics of the property, goods or services transferred or supplied;
- Functions performed by each person involved in the transaction taking into account assets used and risks assumed;
- Contractual terms of the transaction;
- Economic circumstances in which the transaction took place; and
- The business strategies pursued by the related persons in relation to the controlled transaction.

The allocation of risks between related persons must take into account the way the economically significant risks are allocated in contracts between those persons and taking into account:

- The person who assumes the financial risk;
- The person who performs significant risk control and risk mitigation functions; and
- The person who has the financial capacity to assume the risk.

The risk must be allocated to the person who controls the risk and who has the financial capacity to assume the risk.

For tax purposes, the person who contractually assumes risks but does not control the risk nor have the financial capacity to assume the risk, cannot be allocated the profits associated with those risks.

### 3.4 Disregarding a controlled transaction for tax purposes

A transaction between two related parties may be disregarded for tax purposes if the parties do not, at the time of entering into the transaction, determine its arm's length price.

In such a case, the arm's length position would be as if the transaction had not occurred.

## 4. Arm's length principle (ALP), documentation and TP Adjustments

### 4.1 Arm's length prices

The TP Rules require a person who has entered into a controlled transaction to determine the price and margin resulting from the transaction, in a manner that complies with the arm's length principle (ALP).

In determining whether the result of a controlled transaction complies with ALP, the appropriate TP method should take into account the following:

- Strengths and weaknesses of the TP methods;
- Particularity of the TP method taking into consideration the nature of the controlled transaction, through an analysis of the functions undertaken, assets used and risks assumed;
- Availability of reliable information necessary in applying the selected TP methods; and
- Degree of comparability between the controlled and uncontrolled transactions, including the reliability of adjustments that may be required to eliminate differences between them.

### 4.2 Transfer pricing methods

The TP Rules provide for the following five methods of determining arm's length prices - Comparable uncontrolled price method (CUPM), Resale price method (RPM), Cost plus method (CPM), Transactional net margin method (TNMM) and Transactional profit split method (TPSM).

A person may apply a TP method other than these five methods only if the tax administration is satisfied that:

- None of the approved methods may be reasonably applied to determine arm's length conditions for the controlled transaction; and
- 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.

### 4.3 Selection of the tested party

When applying a CPM, RPM or TNMM, it is compulsory to select the tested party to the transaction for which a financial indicator is tested under the most appropriate TP method. The selection of the tested party must be consistent with the functional analysis of the transaction.

The financial information on the tested party is needed, irrespective of whether the tested party is a domestic or foreign entity. In addition, where the tested party is a foreign entity, sufficient information is needed to enable a review by the tax administration of the application of the method to the foreign tested party.

### 4.4 Arm's length range (ALR)

ALR is a range of relevant financial indicator figures produced by the application of the most appropriate TP method to a number of uncontrolled transactions that are all comparable to the controlled transaction under review.

If the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the controlled transactions, and to each other, is uncertain, a statistical approach is used. If such an approach is used, the interquartile range is considered to be an ALR.

A controlled transaction (single of combined) will not be subject to a TP adjustment where the relevant financial indicator derived from the controlled transaction (single or combined) is within the ALR.

Where such a financial indicator falls outside the ALR, the median point will form the basis for a TP adjustment to reflect an arm's length price.

### 4.5 Documentation

A person involved in controlled transactions is required to develop a TP policy, prepare and keep documentation that verifies that its controlled transactions for the relevant tax period are consistent with the ALP. This is in addition to books, other records and information required by Rwandan tax laws.

The TP policy must include at least the following information:

- An overview of the taxpayer's business operations and their organisation;
- A description of the corporate organisational structure to which the taxpayer is a member and the corporate group's operational structure;
- A general description of the multinational enterprise business including:
  - Important drivers of business profit; and
  - A description of the supply chain for the group's five (5) largest products or service offerings by turnover plus any other products or services amounting to more than five percent (5%) of group turnover;
- A detailed description of the business strategy pursued by the taxpayer including an indication whether the taxpayer has been involved in or affected by business restructurings or intangible transfers in the present or immediately preceding year and an explanation of such aspects on transactions that affect the taxpayer;
- A list of the taxpayer's key competitors in Rwanda for each material category of controlled transactions in which the taxpayer is involved;
- A description of the controlled transactions and the context in which such transactions took place including an analysis of the comparability factors;
- Detailed comparability and functional analyses of the related persons in relation to the controlled transaction;

- Explanation of the important assumptions made for the selection of most appropriate transfer pricing method, and, where relevant, the selection of the tested party and the financial indicator;
- A summary of financial information used in applying the transfer pricing method;
- An explanation of the reasons for performing a multi-year analysis, if any;
- A comparability analysis that includes:
  - A description of the process undertaken to identify uncontrolled comparable transactions;
  - An explanation of the basis for the rejection of any potential internal uncontrolled comparable transactions;
  - A description of the uncontrolled comparable transactions;
  - An analysis of comparability of the controlled transactions and the uncontrolled comparable transactions;
  - Detailed information on any comparability adjustments made;
- Details of any industry analysis, economic analysis, budgets or projections relied on;
- A conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure compliance;
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements; and
- A summary of schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

The documentation referred to under paragraph one of section 4.5 above must include at least the following documents:

- Copies of all material intercompany agreements concluded by the taxpayer;
- The country by country report where the ultimate parent of the taxpayer is required to prepare such a report;
- Controlled transactions schedule;
- Any other documentation or information that is necessary for determination of the taxpayer's compliance with the arm's length principle with respect to the controlled transactions.

The country by country report must be filed not later than twelve (12) months after the last day of the reporting fiscal year of the multinational enterprises group.

### 4.6 Time for preparing and submitting TP documentation

Documentation for a relevant tax period must be in place before the deadline of income tax declaration.

The documents related to the global organisational structure of the group of companies to which a Rwandan taxpayer belongs must be submitted to the tax administration with the first income tax declaration.

Such documents must indicate all related persons, their shareholding and their management structure. In case of modification the group organisational structure, the updated version must be submitted to the tax administration.

The controlled transactions schedule must be submitted to the tax administration together with the income tax declaration.

The taxpayer is required to provide the TP documentation within seven (7) days from the date of receipt of a written request by the tax administration

### 4.7. Threshold for TP Documentation

A taxpayer with an annual turnover below FRW 600,000,000, and with controlled transactions with an individual value below FRW 10,000,000 or with an aggregate value below FRW 100,000,000 is not required to prepare TP documentation.

Nonetheless, a taxpayer discharged from the obligation to prepare TP documentation is required to comply with the arm's length principle.

## 4.8 Source of comparable transactions

A taxpayer can use two sources of information on uncontrolled comparable transactions - internal uncontrolled transactions of a taxpayer (if one of the parties to the controlled transaction is also a party to the uncontrolled transaction) and external uncontrolled transactions of a taxpayer where none of the parties is party to the transaction.

Information not available to both the taxpayer and the tax administration cannot be used for comparability analysis by either the taxpayer or the tax administration.

Use of foreign country comparables in TP analysis is allowed where no comparable uncontrolled transaction is available in Rwanda. However, the taxpayer or the tax administration using comparable transactions must analyse the impact of geographic differences and other factors contributing to changes of prices such as:

- Consumer preferences;
- Transport cost;
- Market competition level;
- Differences in accounting standards.

## 4.9 Application of arm's length principle to transactions involving provision of services

A service fee between a taxpayer and a related person is considered consistent with the ALP if:

- The fee is charged for a service that is actually rendered;
- The service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position (benefits test);
- The fee is charged for a service that an independent person in comparable circumstances would wish to pay for such a service if performed by an independent person or would have performed in-house for itself; and
- Its amount corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances.

### 4.9.1 Shareholder costs

The group entity should not be charged for services performed by members of the Group solely because of the shareholder's ownership interest in one or more other group members. The following costs are treated as shareholder costs for which a service charge is inconsistent with the arm's length principle:

- Costs or activities relating to the juridical structure of the parent company of the related person, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company's supervisory board;
- Costs or activities relating to reporting requirements of the parent company of the related person, including the consolidation of reports; and
- Costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the related person and the acquisition benefits or is expected to benefit that first-mentioned person.

The taxpayer is required to identify each specific services and determine whether the charge is consistent with the ALP unless such identification is impossible.

When services are rendered by a taxpayer jointly to various related persons and it is not possible to identify specific services provided to each of them, the total service charge should be allocated among the related persons that benefit or expect to benefit from the services based on reasonable allocation criteria.

## 4.10 Transactions involving intangible property

In establishing the arm's length conditions for controlled transactions involving the exploitation of an intangible asset, a taxpayer must take into account the contractual arrangements and the following factors with regard to the development, enhancement, maintenance, protection and exploitation (DEMPE) of the intangible assets:

- Functions performed by the related person;
- Management and control of those functions;
- Contribution of assets by the related person including financial assets;
- Management and control regarding the contribution of assets including financial assets;
- Risks assumed by the related person;
- Management and control of risks; and
- Financial capacity to assume the risks.

If the contractual arrangements diverge from the above factors, consideration is taken on those factors in determining the arm's length reward from the exploitation of the intangible property.

### 4.10.1 Licensing, sale and transfer of intangible property

When evaluating transaction involving licensing, sale and transfer of intangible property between related parties, a taxpayer must:

a) Take into account both the perspective of the transfer or of the property and the perspective of the transferee, including the pricing at which a comparable independent person would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business; and

b) Consider any of the following special factors relevant when conducting the comparability analysis:

- The expected benefits from the intangible property;
- The commercial alternatives otherwise available to the acquirer or licensee derived from the intangible property;
- Any geographic limitations on the exercise of rights to the intangible property;
- The exclusive or non-exclusive character of the rights transferred; and
- Whether the transferee has the right to participate in further developments of the intangible property by the transferor.

If the intangible assets are hard to value, the tax administration may consider ex-post outcomes as presumptive evidence of the ex-ante pricing arrangements.

## 4.11 Transfer pricing adjustments and corresponding adjustments

A TP adjustment will be made by the tax administration where a taxpayer's transaction fails to comply with the ALP.

If an adjustment is made by the tax administration to the taxable income of a taxpayer in relation to a domestic transaction, the tax administration will make an appropriate adjustment to the taxable income of the other party to the transaction.

Corresponding adjustments for international transactions are made in one of the following conditions:

- An adjustment to the conditions of transactions between a person resident in Rwanda and a related person is made or proposed by a tax administration of a foreign country;
- An adjustment results in the taxation in that other country of an amount of income on which the person resident in Rwanda has already been charged to tax in Rwanda; and
- A country making or proposing the adjustment has a treaty with Rwanda that reflects an intention to provide for the relief of economic double taxation.

When making corresponding adjustments the tax administration in Rwanda shall, while relying on the necessary information, examine the consistency of the adjustment with the ALP and consult as necessary with the Competent Authority of the other country.

## 4.12. Controlled transactions Schedule

A taxpayer must submit a controlled transactions schedule for each year of income detailing each of the following:

- Tax Identification Number
- Taxpayer name
- Tax Period (Fiscal Year)
- Name of related person
- Nature of relationship
- Country of tax residence
- Country of incorporation (where applicable)
- Description of transactions (including transfers if any)
- Aggregate value of transactions from related persons (FRW)
- Aggregate value of transactions to related persons (FRW)
- Transfer pricing adjustment (if any)
- Percentage (%) for which transfer pricing documentation has been prepared
- Transfer pricing method
- Key financial items
- Rwanda Taxpayer (Enter amount in FRW)
- Holding Company (Consolidated) FRW
- Transactions of a capital nature with connected persons, the method used and the value.

# 5. Key Takeaways

Following the enactment of the TP Rules, taxpayers in Rwanda must adopt a new approach to transfer pricing compliance and documentation.

Below is a summary of the key implications of the TP Rules;

- Taxpayers with an annual turnover of more than FRW 600 million and/or substantial controlled transactions (more than FRW 10 million individually or an aggregate value greater than FRW 100 million), shall be required to prepare detailed transfer pricing documentation to evidence the arm's length nature of the controlled transactions;
- Transfer pricing documentation must be in place before filing of the annual tax declaration. On request, this should be submitted to the tax administration within 7 days. As a general rule, the tax administration has the power to audit for a period going back five years, in accordance with the statute of limitations;
- The TP Rules apply to both local and international related party transactions between related persons. Taxpayers that have domestic transactions with related parties operating under preferential tax zones in Rwanda should also ensure compliance with the TP Rules;
- In a bid to counter harmful tax practices and tax base erosion, transactions between independent parties also fall under the ambit of Rwanda transfer pricing law, particularly where these are undertaken with parties based in beneficial tax jurisdictions;
- The median point of a benchmarking study shall be used as the reference point for transfer pricing adjustments, where the pricing of a transaction falls outside the arm's length (interquartile) range;
- The TP Rules introduce the requirement to file a Country-by-Country (CbyC) report not later than 12 months after the last day of the reporting fiscal year, where the ultimate parent of the multinational enterprise is required to prepare such a report;
- Controlled transactions involving a person who does not control the risks or have the financial capacity to assume the risks associated with a transaction, for tax purposes, shall not be allocated the profits associated with those risks; and
- The TP Rules provide specific guidance on intragroup service and intangible transactions, including the analysis of functions relating to the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangibles. As such, taxpayers should ensure that such transactions are appropriately documented in their transfer pricing documentation.

With the TP Rules coming into effect on 14 December 2020, taxpayers should ensure that their controlled transactions and the supporting information thereof, fully satisfy the requirements of the TP Rules.

Further, taxpayers should ensure that they have their transfer pricing documentation in place prior to filing their income tax declaration.

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