Tax Alert

Transfer Pricing (TP) Guidelines in Rwanda

DNR PARTNERS CPA LTD

KN 84st, Kigali City
2nd Floor, Athene building
P. O. Box 5247 Kigali, Rwanda
+250 788 386 134
info@dnrpartners.com
www.dnrpartners.com

Our social media

On 14/12/2020 The Minister of Finance and Economic Planning of Government of Rwanda has announced in official gazette, the Ministerial order № 003/20/10/TC of 11/12/2020 which establish the general rules on transfer pricing between related parsons involved in controlled transactions.

This summary highlights the key provisions in the transfer pricing rules between related persons involved in controlled transactions which took effect on 14/12/2020.

1. General provisions

1.1. Controlled transactions

Two parties entered into controlled transactions in the following circumstances:

- 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;
- When a non-resident in Rwanda engages directly or indirectly in a transaction with a related person not resident in Rwanda if the transaction is in relation to a permanent establishment in Rwanda of one of the two related persons;
- When a person resident in Rwanda engages in a transaction with a person located in a country or a place where the tax administration considers providing a beneficial tax regime, whether such persons are related or not; and
- When a person resides in a country or a place where the tax administration considers providing a beneficial tax regime, engages in a transaction that relates to a permanent establishment of a nonresident in Rwanda whether such persons are related or not.

1.2. Related person

According to the Tax Pricing guideline rules, the related party are defined 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 or not communicated to them.

The following persons are considered as related persons:

i. 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;

ii. A person who participates directly or indirectly in the management, control or capital of another

iii. A third person who participates directly or indirectly in the management, control or capital or both control and capital of another person;

iv. Persons referred to above who participate directly or indirectly in the management, control or capital of an enterprise;

1.3. Beneficial tax regime

Tax legislation of a country or any other tax jurisdiction characterized by any of the following:

i. Does not tax income or to tax it at a maximum rate of twenty percent (20%);

ii. Grant tax breaks to non-resident individuals or companies;

iii. Does not require a taxpayer to carry out substantial economic activity within this country or tax jurisdiction;

iv. Does not tax foreign-sourced income or to tax it at a maximum rate of twenty percent (20%);

v. Does not allow access to information about the corporate structure of legal entities, the ownership of assets, other rights or economic transactions.

2. Comparability of Transactions

2.1. Comparable transaction

An uncontrolled transaction is comparable to a controlled transaction when there is no difference between them that could materially affect the factors being examined under the appropriate transfer pricing method.

In case such difference exists, a reasonably accurate comparability adjustment is made to the relevant factors of the uncontrolled transaction in order to eliminate the effects of such a difference

2.2. Transactions subject to 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.

2.3. Comparability factors

In determining whether two or more transactions are comparable to the extent that they are economically relevant to the facts and circumstances of the transaction, the following factors are to be considered:

- 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;
- The business strategies pursued by the related persons in relation to the controlled transaction.

For purposes of determining whether two transactions are comparable, 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;
- The person who has the financial capacity to assume the risk

If a person who contractually assumes the risk does not control the risk or does not have 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 cannot be allocated the profits associated with those risks.

2.4. Disregarding a controlled transaction for tax purposes

If the arrangements made in relation to a transaction between related persons differ from those arrangements between independent persons behaving in a commercially rational manner in comparable circumstances, such transaction as structured by the taxpayer may be disregarded for tax purposes. In such a case, the arm's length position would be as if the transaction had not occurred.

3. Compliance with arm's length principle, documentation and necessary adjustments of TP Policy

3.1. Arm's length prices (ALP)

If a person enters into a controlled transaction, s/he must determine the price and margin resulting from the transaction, in a manner that complies with the arm's length principle.

In determining whether the result of a controlled transaction complies with the arm's length principle, the appropriate transfer pricing method takes into account the following:

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

3.2. Methods of determining arm's length prices

The TP guideline provide five methods to be used in determining the arm's length price as below:

a. Comparable uncontrolled price method
b. Resale price method
c. Cost plus method
d. Transactional net margin method
e. Transactional profit split method

A person may apply any other transfer pricing method other than above 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;
- 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

3.3. 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 transfer pricing method. The selection of the tested party must be consistent with the functional analysis of the transaction.

Financial information on the tested party is needed, irrespective of whether the tested party is a domestic or foreign entity. However, if the most appropriate method is a CPM, RPM or TNMM and the tested party is the foreign entity, sufficient information is needed to be able to reliably apply the selected method to the foreign tested party and to enable a review by the tax administration of the application of such method.

3.4. Arm's length range (ALR)

An ALR is a range of relevant financial indicator figures produced by the application of the most appropriate transfer pricing method to a number of uncontrolled transactions that are all comparable, and equally comparable to the controlled transaction.

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 arm's length range.

A controlled transaction or a set of controlled transactions that are combined are not subject to an adjustment where the relevant financial indicator derived from the controlled transaction or set of controlled transactions and being tested under the appropriate transfer pricing method is within the arm's length range.

Where such financial indicator falls outside the arm's length range, the taxable profit is computed on the basis that the relevant financial indicator is the median of the arm's length range.

3.5. 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 policy must include at least the following information:

- An overview of the taxpayer's business operations and their organization;
- A description of the corporate organizational structure to which the taxpayer is a member and the corporate group's operational structure;
- A general description of multinational enterprise business including:
    - Important drivers of business profit;
    - 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;
- 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;
- List of the taxpayer's key competitors in Rwanda for each material category of controlled transactions in which the taxpayer is involved;
- Detailed comparability and functional analysis 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 description of the controlled transactions and the context in which such transactions took place including an analysis of the comparability factors;
- 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;

- A summary of schedules of relevant financial data for comparable used in the analysis and the sources from which that data was obtained.

The documentation 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 with the model form annexed to this Order;
- 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 required in item must be filed not later than twelve (12) months after the last day of the reporting fiscal year of the multinational enterprises group.

3.6. Time for preparing and submitting TP documentations

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

- The 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.

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

- In case of modification on documentation, the updated version must be submitted to the tax administration.

- The taxpayer is required to provide TP documentation referred to in this Order within seven (7) days from the date of receipt of the written request.

3.7. Taxpayer discharged from the obligation to prepare TP documentation

A taxpayer with an annual turnover below six hundred million Rwandan francs (FRW 600,000,000) is not required to prepare the TP documentation.

To be discharged from the obligation to prepare documentation, a taxpayer referred to above must have made controlled transactions with the value below ten million Rwandan francs (FRW 10,000,000) or with an aggregate value below one hundred million Rwandan francs (FRW 100,000,000).

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

3.8. 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;

- External uncontrolled transactions of a taxpayer, which are uncontrolled transactions to which none of the parties to the controlled transaction is a party.

Information concerning a comparable external uncontrolled transaction is not relied upon by the tax administration for the purposes of making an adjustment of prices if the information is not available to the taxpayer.

The taxpayer does not rely upon information concerning a comparable uncontrolled transaction for the purposes of demonstrating the compliance of a transaction with arm's length principle if the information on the transaction is not available to the tax administration.

Where no comparable uncontrolled transaction is available in Rwanda, the taxpayer or the tax administration may use foreign country comparable transactions in taxpayer's transfer pricing analysis and determination of reliable comparable from a foreign country is made on a case by-case basis.

The taxpayer or the tax administration using comparable transactions must analyses the impact of geographic differences and other factors contribute to changes of prices such as:

- Consumer preferences;

- Transport cost;

- Market competition level;

- Differences in accounting standards.

3.9. Consistency of services between related persons with the arm's length principle

A service fee between a taxpayer and a related person is considered consistent with the arm's length principle 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;
- 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;
- Its amount corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances.

3.9.1 Shareholder costs

A service fee paid to a person is inconsistent with the arm's length principle if it is paid by a related person solely because of the shareholder's ownership interest in one or more other group members.

The following costs are treated as shareholders cost for which services charge is inconsistency 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;
- 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.

If it is possible to identify specific services provided by a taxpayer to a related person, the determination whether the service charge is consistent with the arm's length principle for each specific service is needed.

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

3.10. Transactions involving intangible property

The determination of arm's length conditions for controlled transactions involving the exploitation of an intangible asset must take into account the contractual arrangements and the following factors with regard to the development, enhancement, maintenance, protection and exploitation 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 referred to in item 5 of this Paragraph;
- Financial capacity to assume the risks.

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

3.10.1. Licenses, sales or other transfers of intangible property

In determination of arm's length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between related persons, a taxpayer must:

- Takes into account both the perspective of the transfer or of the property and the perspective of the transferee, including in particular, 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.

When conducting comparability analysis, the following special factors should be considered:

- 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;
- 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.

3.11. Necessary transfer pricing adjustments

If a 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.

3.11.1. Corresponding adjustments for domestic transactions

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

3.11.2. Corresponding adjustments for international transactions

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;
- 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.

The tax administration, upon request by a person resident in Rwanda, shall examines the consistency of that adjustment with the arm's length principle consulting as necessary with the competent authority of the other country.

If the adjustment proposed or made by the other country is consistent with the arm's length principle, the tax administration makes a corresponding adjustment to the amount of the tax charged in Rwanda on the profits of the taxpayer in order to eliminate the economic double taxation.

3.12. Schedule of controlled transactions

The following information shall be provided when taxpayer submit the controlled transactions for each tax period

- Tax identification Number
- Taxpayer name
- Tax Period
- Name of related person
- Nature of relationship
- Country of tax residence
- Country of incorporation
- Description of transactions
- Aggregate value of transactions from related persons (FRW)
- Aggregate value of transactions to related persons (FRW)
- Transfer pricing adjustment used
- 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 capital nature with connected persons
- Transfer pricing method for transactions of capital nature with connected persons
- Value of disposals transactions
- Mode of payment for transactions

Get in touch with us

Emmanuel Twizeyumukiza
Tax Manager
DNR Partners CPA Ltd
Email: mukizae86@gmail.com
Kigali, Rwanda.

Dieudonne NGIRIMANA
Managing Partner
DNR Partners CPA Ltd
Email: ngilidius@gmail.com
Kigali, Rwanda.

Find us

KN 84st, Kigali City
2nd Floor, Athene building
P. O. Box 5247 Kigali, Rwanda
Office : +250 788 386 134
info@dnrpartners.com
www.dnrpartners.com

Our social media

Disclaimer

This Tax Alert does not contain professional advice, opinion or comment of DNR Partners CPA Ltd, However, it is intended to provide accurate and timely informational summary of the law. There can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in examination of the particular situation in the future . No one should act on such information without consulting a professional advice regarding a particular situation and DNR Partners CPA Ltd shall not be liable for any loss as a result of wrong interpretation of this tax alert.