RWANDAN TAX EXPENDITURE: Setting up a benchmark

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By Israel BIKORIMANA & NIYIGENA Lucie
Economist,
Ministry of Finance and Economic Planning,
Rwanda Revenue Authority

Structure of the presentation

Introduction Purpose, *Responsible institutions, Frequency, coordination and Dissemination*

Establishing Benchmark on VAT, Income tax and customs

Results since FY 2017/18 to FY2020/21

I. Introduction: Purpose of report

Accountability

- Illustrate revenue foregone from different provisions to senior officials
- Bring tax expenditure to the attention of Parliament

Use of information

- Accessible to all stakeholders
- Reference point
- Identify areas for increasing transparency

I. Introduction:
Responsible Institution

TE can be carried out by a range of institutions: ministries of finance, revenue authorities, financial institutions, credit rating agencies, researchers and others;

In the case of Rwanda, MINECOFIN is the custodian of TE estimation and dissemination, with inputs from RRA through division of Labor.

Other institutions may be requested to support the estimation exercises as relevant

I. Introduction:

Frequency, coordination and dissemination

- Normally TE done every year with one year lag
- It is an annex of the Budget framework paper

- Data come from RRA and NISR
- Responsibilities for estimation split between MINECOFIN and RRA

- Report drafted by MINECOFIN and published on MINECOFIN website

II. Establishing a Benchmark

VAT

- The Value Added Tax has an international benchmark which makes it simple to compute in theory.
- However, Value-added tax terminology can be confusing, so it's important to understand the three states of the tax: taxable, zero-rated, and exempt supplies

In Rwanda’s VAT model, benchmark is defined as:

- **Unit of taxation**: The VAT is intended to be borne by final consumers—typically households—by collecting VAT on all goods or services supplied to them.
- **Tax base:** The benchmark VAT base is consumption broadly defined and comprises all goods and services consumed in Rwanda. As such, the tax applies on a "destination basis" and that it applies to goods imported into Rwanda, but not to goods exported from Rwanda. The zero-rating of exports is a fundamental characteristic of a value-added tax, it is thus part of the benchmark not a deviation.
- **Tax period**: The benchmark tax period is the calendar monthly or quarter.
- **Tax rate:** The benchmark rate is a single rate applying to all goods and services consumed in Rwanda: this standard rate is currently 18%.

Based on SUT data we estimate benchmark by calculating;

1. **Benchmark exempt for Industry Share**: the ratio of exempt supply for each commodity by an industry to total supply by that industry multiplied by the share of that commodity that is not exported (export gross down).
2. **Benchmark exempt effective rate**: the effective tax rate that applies to the intermediate use matrix because of exempt supplies.
3. **Benchmark revenues on inputs into exempt:** the tax revenue from denied ITCs(inputs tax credits) as a result of the production of exempt commodities. The revenue is associated with the commodities that are inputs into the production of the exempts commodities.
4. **Benchmark tax revenue embedded in exempts:** the tax revenue from denied ITCs as a result of the production of exempt commodities. The revenue is associated with the commodity that are exempt (and not their inputs).

II. Establishing Benchmark

Income Tax

- There is, however, no consensus definition of a benchmark income tax system.
- The benchmark business and personal tax system for Rwanda reflects debate over the core structural characteristics of Rwanda's tax system, including: progressive taxation of labor income; flat rate taxation of investment income; a presumptive tax regime for micro and small businesses; and the importance of Pay As You Earn (PAYE) as a final tax on employment income.

In Rwanda's Income model, benchmark is defined as

- The total income tax expenditure is calculated as the increase in CIT payable by removing all the relevant provisions simultaneously in a "revenue gain method".
- The benchmark unit of taxation for the corporate income tax is the single company, cooperative society, public business, partnership or other entity established to realize profits from business activities within a calendar year.
- However, the Minister may allow a qualifying taxpayer to apply any other twelve-month period as a tax period.
- The statutory general rate of 30% is applied to worldwide income of Rwanda businesses minus expenses incurred to earn that income. Beyond this general concept, the benchmark includes the following specific rules:

II. Establishing Benchmark

Income Tax

In Rwanda's Income model, benchmark is defined as follows:

- In the case of a capital asset that contributes to earning business income beyond the year in which the asset is purchased, the benchmark accounts for the cost being allocated over the useful life of the asset (i.e., the period during which the capital asset contributes to earnings).
- The cost of a capital asset "economic depreciation" is thus deducted over the period during which the capital asset contributes to the earning of business income.
- Losses can be deducted against income, but the excess of losses over income in a given taxation period is not refundable.
- Measures that provide relief from double taxation are considered part of the benchmark income tax system.
- The simplified presumptive tax regime for small businesses is also considered part of our benchmark.

II. Establishing Benchmark

Customs

- The customs taxes considered are: Import Duty, Excise on Imports, Withholding Tax of 5% (WHT 5%), Infrastructure development levy (IDL) and the African Union Levy (AUL)

In Rwanda’s customs model, benchmark is defined as

- The benchmark tax base includes all imports into Rwanda (excluding government imports as for VAT)
- **For import duties**, the benchmark rates for: raw materials is 0%; intermediate inputs is 10%; and finished goods is 25%(Some products are classified by EAC as Sensitive Items and have a benchmark rate which varies from this)
- Because free trade with regional partners is a structural component of customs in Rwanda, the benchmark customs rates are usually duty-free importation from members of either the East African Community (EAC) or the Common Market for Eastern Southern Africa (COMESA).
- This means that such duty-free importation is not considered as tax expenditure

II. Establishing Benchmark

customs model, benchmarking… cn’t

For excise on imports, list of products covered are mainly:

- motor vehicle with respect to their engine capacity: (5% for these below 1500cc, 10% between 1500cc and 2500cc while above 2500cc excised at 15%)
- lubricant,
- Cigarettes,
- beer,
- liquor,
- soft drinks,
- water and milk powder, with all of those products attracting different rates.
- The benchmark tax base and rate are those specified in “Law N°37/2015 of 30/06/2015” as amended to date. Any exemption is considered a tax exemption

II. Establishing Benchmark

customs model, benchmarking… cn’t

WHT 5%:

- It’s a Customs tax that is deductible from an importer’s income tax Declaration
- However, this is not deductible for those who cannot or do not file an income tax declaration
- Exemption of WHT 5% at importation for a non-registered person’ is therefore considered to be tax expenditure.
- **Regarding the Infrastructure development levy (IDL) and the African Union Levy (AUL), an ad-valorem rates of 1.5% and 0.2% on the CIF value of imports are charged on all products**. Any exemption is considered a tax exemption

II. Establishing Benchmark

How these decision are reached, How feedback loops allowed some provisions to be estimated more precisely

- These decision reached from the best practice (TA from IMF) and the discussion with stakeholders.
- Feedback from the meetings/high levels of government help in improvement where some provisions estimated more precisely

Future improvement

- More accurate method for estimating TE from loss carry forward and accelerated deprecation,
- Getting domestic excise data for exempted products

III. Main results

Tax type	Tax expenditure (Rwf bn)				Tax expenditure as % of potential tax revenue				TE as % of total TE
	2017/18	2018/19	2019/20	2020/21	2017/18	2018/19	2019/20	2020/21	
VAT	117.9	133.4	141.0	172.6	26.0%	26.0%	23.5%	28.0%	46.3%
Income tax*	22.9	33.4	41.3	54.9	8.9%	10.9%	12.1%	13.6%	14.7%
Import duties**	49.0	79.5	110.2	145.0	39.8%	33.3%	39.6%	41.6%	38.9%
Total	**194.3**	**258.8**	**304.2**	**372.5**	**14.3%**	**16.5%**	**17.9%**	**19.3%**	**100%**

- Acceleration in TE growth
- Increased sharply as a share of potential tax revenue
- VAT remains the largest component
- Import duties TE is growing most

Thank You