Rwanda Tax Expenditure Report

What is tax expenditure?

- **The tax revenue that is foregone through provisions in the law** such as VAT exemptions and zero-ratings, income tax holidays and preferential rates. We explain each of these in more detail later in the report.
- **A form of government spending**, since it is essentially tax revenue that is being spent for the benefit of specific sectors or consumer groups. It is typically subject to less scrutiny and fewer approval requirements than expenditure out of the national budget.

Tax expenditure (TE) is concentrated in VAT, import duty and CIT. Of these, VAT is the most significant. The majority of overall tax expenditure relates to the activities of large producers.

Table 1: Overview of total tax expenditure by tax type in 2017/18

Tax type	Tax expenditure (Rwf bn)	Current tax revenue (Rwf bn)	Potential tax revenue (Rwf bn)	Tax expenditure as % of potential tax revenue	TE by tax type as % of total TE
VAT **(exc. govt)***	117.9	335.4	453.3	26.0%	60.7%
Income Tax**	22.9	235.9	258.8	8.9%	11.8%
Import duty***	53.5	80.9	134.4	39.8%	27.5%
Total	**194.3**	**1,163.8**	**1,358.1**	**14.3%**	**100%**

** we exclude VAT TE on government purchases and outputs because it is tax revenue spent to provide public services. Including govt, VAT TE is Rwf 282.6bn. For consistency, we also exclude VAT revenue from govt.*

*** excludes some tax expenditures that are not currently measurable.*

**** we measure TE compared to a baseline of EAC / COMESA tariffs, and we have included excise duty TE based on the same Customs laws.*

!

Table 1 shows the potential additional revenue that would be generated by eliminating tax expenditure for each tax type. It will be at least as important to consider the context and rationale for each tax expenditure rather than just the estimates in isolation.

Estimating these requires different assumptions depending on the granularity of the data available. The VAT calculations use 2014 data and sector-specific growth rates to estimate 2017/18 levels. They also exclude the 46% of production by the informal sector – we assume there are no changes to what proportion of the economy is informal.

Rationale for tax expenditure

The reasons for Rwanda's tax expenditure can be broadly summarised into five groups:

- Improving affordability of sensitive products (such as healthcare, education and agriculture);
- Internationally recognised administrative difficulties about how to apply taxes (such as defining the value added in financial services or gambling);
- Regional integration and harmonisation (such as EAC-wide import duty exemptions);
- Targeting development and competitiveness of priority sectors (such as transport); and
- Attracting investment to Rwanda which generates other economic benefits (such as job creation, economic growth, knowledge sharing and local production).

Tax expenditure decisions should be considered as trade-offs between the benefits and their costs, and any policy evaluations should consider the magnitude of the benefits too. Estimating this is a separate question beyond the scope of this report.

We see that VAT provisions form the majority of measured tax expenditure. Most of these have the main aim of improving affordability and/or promoting priority sectors. A relatively smaller proportion is because of attracting investment through CIT incentives for investors.

Value Added Tax (VAT)

Table 2 shows that most non-government VAT tax expenditure is concentrated in a few sectors:

Table 2: Sectors targeted most through current VAT tax expenditure (exc. government)

Sector	Tax expenditure (Rwf bn) on outputs produced by…	As % of total VAT tax expenditure
Financial services	17.517	14.9%
Machinery and equipment (except transport)	16.416	13.9%
Dairy products, fruit juices, preserved vegetables, oils and fats	14.405	12.2%
Refined petroleum products	13.947	11.8%
Education	10.503	8.9%
Transport services	9.953	8.4%
Chemicals and chemical products	5.713	4.8%
Human health activities*	5.244	4.4%
Transport equipment	4.701	4.0%
Agriculture	4.452	3.8%
Other sectors	15.027	12.7%
Total	**117.878**	**100.0%**

** This includes medical consultation and treatment; short- or long-term hospital activities; and health activities not performed by hospitals, medical doctors or dentists. It is separate from the manufacture and sale of pharmaceutical products.*

The tax expenditure in VAT law comes through two types of provisions:

- **Zero-ratings.** These mean that firms do not charge output VAT but can still reclaim input VAT. While exports are zero-rated, this is not considered tax expenditure because it is a necessary feature of Rwanda's VAT system – the products are taxed in the country they are consumed in, not where they are produced.
- **Exemptions.** These mean that firms do not charge output VAT and cannot reclaim input VAT. As a result, removing an exemption has a positive and a negative impact on tax revenue. The positive impact is through the output VAT they would charge, and the negative impact is through the input VAT that they can now reclaim.

The relevant VAT law is "Law № 02/2015 Of 25/02/2015 Modifying and Complementing Law N° 37/2012 of 09/11/2012 Establishing the Value Added Tax". It references schedules which provide detailed lists of specific products that are exempted or zero-rated, available on the RRA's website.

We highlight the following VAT tax expenditure provisions from this law:

Table 3: VAT tax expenditure by provision (exc. government)

#	Provision	TE estimate (Rwf bn, 2017/18)	Rationale
1	**VAT exemption for agricultural products, inputs and milk**	30.76	Increase affordability of products from a sensitive sector. Since most of agricultural produce is informal, the tax expenditure is driven by milk production and agricultural inputs.
2	**VAT exemption for financial services**	16.45	Intended to increase affordability of a sensitive product. Exemptions are applied by many countries because of difficulties in applying VAT to this sector.
3	**VAT exemption for Information, Communications and Technology Equipment**	16.06	Encourage use of modern ICT equipment and technologies.
4	**VAT exemption for specified energy equipment and fuels**	13.59	Harmonise with EAC VAT policies; increase affordability of a sensitive product; target development of electricity generation.
5	**VAT exemption for educational materials, services and equipment**	9.44	Increasing affordability of a sensitive product. Excludes TE on public sector education.
6	**VAT exemption for transportation services**	8.54	Targeting development of a priority sector and increasing affordability of these services. Majority of the impact of this is through international passenger transport.
7	**VAT exemption for supplies for health-related purposes**	6.60	Increasing affordability of a sensitive product. Excludes TE on public healthcare provision.
8	**Zero-rating for goods and services intended for people of a "Special Category"**	2.90	Facilitates the supply of public goods and services by organizations working in partnership with the Government for the benefit of Rwanda. Excludes TE on government-led projects.
9	**VAT exemption for mobile telephones and SIM cards**	2.14	Improve affordability of modern communication technologies, and support the movement towards a cashless economy.
10	**VAT exemption for raw materials and capital equipment supplied to the manufacturing and processing sector**	2.17	Targeting development of a priority sector; address administrative challenges in refunding input VAT; improve cash flow position for the sector. Impact is spread across a few production sectors such as paper products, chemicals and machinery.
11	**Zero-rating of package tours**	1.93	Improve the competitiveness of Rwanda as a destination for foreign tourists.
12	**Zero-rating of international transportation services for goods**	1.19	Target a priority sector, improve the regional competitiveness by harmonising with EAC treatment, and address administrative challenges in refunding input VAT for their buyers.
13	**VAT exemption for gaming activities**	1.15	No effective administrative mechanism for determining the value added. Exempting ensures input VAT is not recovered by firms.
14	**Zero-rating of goods sold in the Armed Forces Shops**	1.03	Improve the welfare of members of the Rwanda Defence Forces and the Rwanda National Police and

#	Provision	TE estimate (Rwf bn, 2017/18)	Rationale
			their immediate families, by reducing their cost of living.
15	**VAT exemption for the supply of clean water by non-profits**	0.04	To encourage the supply of clean, treated water in remote areas.
16	**VAT exemption for lease or sale of land or residential buildings**	0.03	Increasing affordability of a sensitive product, and it should benefit everyone (either by owning or living in a residence). Limited data and not strong enough enforcement on transactions to know the value of this.
17	**VAT exemption for books, newspapers and journals**	0.02	Originally part of the education-related exemption, but was split into its own provision in order to clearly allow all readers to benefit.
18	**VAT exemption for the personal effects of returning Rwandan diplomats and other Rwandan citizens**	0	Facilitate citizens returning to Rwanda.
19	**VAT exemption for all goods supplied to public institutions in charge of national defence or security**	0	Improve the cash flow position of public institutions in charge of national defence or security. Excluding government means this is zero.
20	**Zero-rating of minerals sold domestically**	Negligible	Targeted at businesses involved in preparing minerals for export. Aims to address administrative challenges in refunding input VAT to domestic manufacturers that are using these minerals. Tax expenditure is from the sales of minerals to final consumers, which is a negligible amount.
21	**VAT exemption for trade union subscriptions**	Negligible	Increase affordability of a sensitive product. Negligible subscription expenditure since it is largely informal transactions of small value.
22	**VAT exemption for precious metals sold to the National Bank of Rwanda**	Undisclosed	Prevents precious metal suppliers from reclaiming input VAT. This will be zero when excluding government.
23	**VAT exemption for burial or cremation of a body**	Not enacted	Increase affordability of a sensitive product. No Schedule was published listing the eligible goods or services.

The estimates we obtain depend on many factors:

- The size of the affected sector(s). In general, the larger the sector, the greater the tax expenditure from an exemption / zero-rating on its production.
- The growth of the affected sector(s). If the affected sector is growing significantly, the estimates for 2017/18 will be larger and it is likely to continue growing as a tax expenditure.
- The proportion of the sector which is informal. A largely informal sector will be affected less by changes to VAT policy, meaning it will not have a proportionately large tax revenue impact. However, policy changes may be desirable for other reasons such as encouraging firms to become formal.
- The proportion of the formal sector which is claiming the exemption / zero-rating. If the majority of a sector uses relevant tax expenditure provisions, the tax revenue impact of removing this provision will be larger.

Income Tax

The total income tax expenditure is calculated as the increase in CIT payable by removing all the relevant provisions simultaneously.

Table 4: Sectors benefitting most through current income tax expenditure

Sector	Tax expenditure (Rwf bn) on companies supplying…	As % of total income tax expenditure
Tea & coffee	3.35	14.60%
Alcoholic beverages and soft drinks	2.98	13.01%
Telecommunications	2.56	11.18%
Financial services	2.37	10.34%
Non-metal mineral products	2.31	10.09%
Electricity supply	1.86	8.12%
Construction	1.16	5.05%
Real estate activities	1.04	4.53%
Dairy products, fruit juices, preserved vegetables, oils and fats	0.91	3.95%
Hotels and restaurants	0.83	3.60%
Other sectors	3.56	15.52%
Total	**22.95**	**100%**

The tax expenditure in Income Tax law comes through the following types of provisions:

- **Tax holidays.** These mean that firms registered for this benefit from a corporate income tax rate of 0% for a defined period of time e.g. five, seven or ten years, but they are still required to file CIT.
- **Preferential tax rates.** Firms and individuals that qualify pay a reduced income tax rate, sometimes for a defined time period.
- **Deductions**. This can be:
  - increased deductible expenses (e.g. accelerated deduction of an asset's value); or
  - direct deductions from the profit calculated (e.g. previous losses deducted from current profits).
- **Tax exemptions**. Income from certain activities are defined as being non-taxable (for example, the first Rwf 12m of income from agriculture and livestock activities is exempt). There are also CIT exemptions for certain entities (although they are still required to file CIT).

The relevant laws for income tax are "Law Nº 016/2018 of 13/04/2018 Establishing Taxes on Income" and the "Law Nº 6/2015 of 28 March 2015 on Investment Promotion and Facilitation".[1]

[1] The former law replaced "Law Nº 24/2010 of 28/05/2010 modifying and complementing Law Nº 16/2005 on *Direct Taxes on Income*"

Table 5 shows the relevant provisions and their tax expenditures:

Table 5: Income tax expenditure by provision

#	Provision	Tax expenditure (Rwf bn)	Rationale
1	**Loss Carry-Forward**	15.20 (CIT) 0.16 (PIT)	The ability to carry losses forward recognises the cyclical nature of business activity and low or no business revenues during the initial business development phase. It allows business expenses to reduce total taxes paid over a longer time frame and reduces the economic distortions generated by the non-refundability of income tax in years when a business has negative taxable income. 432 companies and 32 individuals benefit from this, but over half of the tax expenditure relates to five companies.
2	**Accelerated Depreciation**	4.46	To encourage or attract investment in priority sectors of the economy. Claimed by 34 firms, but over half of the tax expenditure relates to two companies.
3	**Preferential 15% Tax Rate for Exporters**	1.97	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by nine companies.
4	**Preferential 0% rate for Large Foreign Investors with their Headquarters or Regional Office in Rwanda**	0.49	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by one company, but could be claimed by others who don't file.
5	**Employment Income of a Casual Labourer**	0.22 (PAYE)	Reduces the compliance burden and administrative burden compared to annual personal tax returns for employees.
6	**Preferential 15% Tax Rate for Renewable Energy**	0.18	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by two companies.
7	**Preferential 15% Tax Rate for Freight Transportation**	0.18	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by two companies.
8	**Preferential 15% Tax Rate for Information and Communication Technology**	0.06	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by one company.
9	**Five-Year Tax Holiday for Microfinance Institutions**	0.02	Improve access to capital by encouraging venture capital and microfinance institutions to start-up in Rwanda. Claimed by three microfinance institutions.
10	**Preferential 15% Tax Rate for Financial Services**	0.006	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by four companies.
11	**Preferential 15% Tax Rate for Passenger Transport or Low-Cost Housing**	0	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. No firms claiming this exemption.

12	**Preferential Tax Rates for Newly Listed Companies on Capital Market**	0	Introduced on 28th May 2010 to support the growth of domestic capital markets. No firms claiming this exemption.
13	**Exemption from Tax for Agricultural and Livestock Activities**	0	Supports agricultural production in Rwanda and recognizes the risks inherent in agricultural production. No firms claiming this exemption.
14	**Seven-Year Tax Holiday for Very Large Investments in Energy, Manufacturing, Tourism, Health, ICT or Exports**	No data	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. No firms claiming this exemption in data, but could be claimed by others who don't file.
15	**Capital Gains Exemptions**	No data	Promote private savings and indirectly support the growth of domestic capital markets.
16	**Employment Income from a Non-Resident Employer**	No data	Recognises the contribution that development partners make to Rwanda.

Import Duty

In this category we consider both the import duty itself and the customs excise duty that is exempted. The tax expenditure can be broken down based on the reason for the reduced rate:

Table 6: Customs duties tax expenditure by provision for FY17/18

Provision	Tax expenditure (Rwf bn) through…			As % of total tax expenditure
	Import duty	Excise duty	Combined	
Raw materials and industrial inputs for registered investors	**32.810**	**1.380**	**34.190**	**64%**
Customs Law exemptions	**18.451**	**0.809**	**19.260**	**36%**
- Agriculture inputs	1.298	0.004	1.302	2%
- Armed Forces Shop	2.710	0	2.710	5%
- Government donor-funded projects	3.777	0.097	3.874	7%
- Mosquito nets	1.473	0.006	1.479	3%
- National defence	2.887	0	2.887	5%
- Returning residents	0.622	0.180	0.802	1%
- Other	5.678	0.520	6.198	12%
Total	**51.261**	**2.189**	**53.450**	**100%**

Tax expenditure is considered to be the deviation away from the standard EAC / COMESA tariffs:

- **EAC Customs Law exemptions** are mostly legislated by the EAC Customs Management Act 2004, which details goods exemptions, some of which are for specific persons and institutions only.
- **Preferential tariffs** may be granted to Rwanda on certain goods through an EAC Stay of Application for a finite time. This does not include 'Sensitive Items' where there is a common EAC tariff.
- **Registered investors** can also claim import duty exemptions for their raw materials and industrial inputs if not already provided for under EAC's Common External Tariff.

Technical Annex

In this Annex we explain the data sources, approach, further analysis and issues to address for a subsequent tax expenditure report. First, we note the tax expenditure figures estimated within the EAC.

Benchmarking within EAC

Table 7: Comparison of EAC tax expenditures

Country	TE as % of GDP	VAT	Income Tax	Import duty	Excise
Kenya	5%	✓	✓		
Rwanda (inc. govt VAT TE)	4.6%	✓	✓	✓	✓
Tanzania	0.8%	✓		✓	✓
Uganda	4.5-5.0%	✓	✓		✓

Uganda

A World Bank study on tax expenditure in Uganda found that "revenue forgone under the current tax system across all tax sources due to exemptions was estimated to be in the range of 4.5 to 5.0 percent of GDP in 2016/17".[2] Uganda's main income tax driver also appears to be the loss-carry forward as it enables the "potential deferral of CIT tax payments worth 3 percent of GDP".

Kenya

A 2017 World Bank Economic Update on Kenya finds tax expenditure on CIT and VAT alone to "amount to 5 percent of GDP".[3] A 2018 study found that "the number of VAT exempt categories in Kenya recently increased to more than 30, with a resulting loss in tax revenue of about two percent of GDP in 2015".[4]

Tanzania

The Ministry of Finance has produced estimates of its tax expenditure in several years. Most recently, it published tax expenditure for Q1 of 2018/19 of TZS 257.4 billion.[5] It includes VAT, import duty and excise duty – presumably this is not feasible for income tax for one quarter. A simple projection would give an annual estimate of TZS 1.03 trillion (USD 445m). With a projected GDP of USD 55billion for 2018, the tax expenditure is relatively low at 0.81%.

The Ministry of Finance's Financial Statement for 2016/17 shows the value of tax exemptions and relief to be TZS 1.04 trillion, a reduction compared to the 1.1 trillion in 2015/16.[6]

---

[2] http://documents.worldbank.org/curated/en/425631526323380885/pdf/126184-WP-PUBLIC-FinalReportUgandaEconomicUpdate.pdf

[3] http://documents.worldbank.org/curated/en/140071512474376644/pdf/121895-WP-P162368-PUBLIC-KenyaEconomicUpdateFINAL.pdf

[4] http://documents.worldbank.org/curated/en/766271538749794576/pdf/Kenya-Economic-Update-18-FINAL.pdf

[5] http://www.mof.go.tz/index.php/tax-exemption/194-reliefs-and-exemptions-2018-19-quarter-1-mofp

[6] http://www.mof.go.tz/docs/00Conso%20FS%20with%20Audit%20Opinion.pdf

A consultancy study found the tax expenditure to be around 4.4% of GDP in 2011/12 (TZS 1.8 trillion), an increase from 3.5% in 2007/08.[7] Of this TZS 1.8 trillion, 44.4% was attributed to VAT exemptions.

Value Added Tax

Data sources

For the VAT tax expenditure estimation, the main source of data is NISR's Supply Use Tables (SUT) for 2014. These tables are comprehensive national accounts which show what different industries purchase from each other as well as final consumption by households and government, taking into account the informal sector too. This allows us to aggregate the impacts of exemptions and zero-ratings occurring at different stages in supply chains, but also observe which sectors are most affected.

Since this provides data for 2014, we then applied appropriate sector-specific growth rates (mostly sourced from GDP publications) to estimate the levels for following years. Once available, the SUT for 2017 should be used as it will capture the recent changes in the Rwandan economy.

We use RRA VAT declaration data to calculate some of the more specific sector growth rates as well as the shares of each industry that are benefitting from exemptions and zero ratings. We plan to incorporate the more detailed RRA data in the future so that we can improve its accuracy. One such case is through updates of the effective tax rates. The main constraint on this would be the quality of data from the VAT Sales Annexes on the TIN of the buyer. This data is important for showing how much VAT is paid on transactions of each commodity to each sector.

The majority of tax expenditure calculations are done using the VAT Tax Expenditure model built by the IMF consultants during their technical mission to Rwanda. The two (non-zero) exceptions are the zero-rating for purchases from the Armed Forces Shops and the zero-rating for purchases by people and institutions of a 'special category'. These are estimated using exempted VAT on imports based on the Customs Procedure Clearance Codes (explained further in the calculation notes below).

Reallocation of wholesale and retail trade

The SUTs show that the sectors containing wholesale and retail trade do not contain data i.e. their total supply and consumption is zero.[8] This is because the value of their 'production' has been reallocated to the commodities that are actually provided. For example, a wholesaler or retailer of paper would be shifted to the manufacturing sector 'Wood, paper and related products' because this is the actual product traded.

When calculating parameters for the model using VAT data, it is important to do the same reallocation and this has been done through manual reclassification of RCPA2 sectors at the three-digit level. On some occasions, the reclassification has to be for a specific 4-digit or 8-digit ISIC code.

Growth rate calculations

[7] http://www.mof.go.tz/mofdocs/PER/PER%20Reports/PER%20Tax%20Exemptions%20Study%20Final%20Report%20and%20Briefing%20Note.pdf

[8] The Supply table shows data on their outputs but this is offset through equal negative margins. Their value added is instead captured as margins on the actual commodities produced.

This is done using two sources for annual growth rates – GDP publications and VAT declarations. We use the GDP growth rate if the sector has a large informal share and/or if the GDP sector maps accurately onto the RCPA2 sector. Otherwise, we use VAT turnover growth rate i.e. if it is largely formal and the GDP growth rate doesn't map well onto the RCPA2 sector.

Exclusion of government

We exclude government in the earlier VAT tax expenditure tables because it allows us to focus on what is important for discretionary policy-making. The reasons are three-fold:

1. Tax expenditure on government is for required public services rather than discretionary tax policies. For example, tax expenditure on national defence or public healthcare would be considered a necessary cost for necessary services.
2. It is somewhat circular to discuss tax expenditure on government services. If there is less tax expenditure on government, it means government pays more VAT to itself i.e. they pay more tax revenue but their budget would need to be larger to accommodate the VAT.
3. For the most part, it's not practical to consider taxing government outputs. Many government services won't involve individual sales transactions, so even if VAT exemptions were removed they would not be (fully) taxable and should be treated accordingly. For example, roads, policing and (to a lesser extent) public education are not provided through sales.

We exclude sales involving government (either as the purchaser or as the seller) in the model by treating them as zero-rated. This means that both the tax revenue from them and tax expenditure on them are essentially ignored, whether through input VAT or output VAT. When calculating a benchmark, we typically repeal all exemptions and zero-rated sales. In this case, however, we leave sales involving government as zero-rated and only repeal the remainder of exempt and zero-rated sales.

Income Tax

The tax expenditures are mostly calculated using the CIT microsimulation model built by IMF consultants as part of their technical mission to Rwanda. The source of data for the estimations is the RRA's annual Corporate Income Tax declarations and Personal Income Tax declarations (for calendar year 2017, corresponding to tax revenues for 2017/18) and RRA's Pay As You Earn (PAYE) declarations for 2017/18. These sources show us the deductions claimed by companies, some exemptions, preferential tax rates and tax holidays. However, as **Table 5** showed, the data does not give a complete picture of all income tax expenditure.

Import Duty

RRA Customs data is used to calculate the revenue foregone through import duty exemptions. The data contains the standard tariff and the Customs Procedure Codes (CPCs) provide the reason for the reduced rate as per the Customs law.

We consider the benchmark to be the EAC Common External Tariff. This means the following agreed EAC tariffs are *not* considered tax expenditure:

- No import duty on products imported from within EAC (with a Certificate of Origin)
- No import duty on specified raw materials and capital goods
- 10% import duty on specified intermediate goods
- 25% import duty on specified finished goods
- Higher import duty tariffs on specified sensitive products

Calculating the revenue foregone is done using the tax base to calculate the difference between the import duty that should be paid (according to these EAC rules) and the import duty actually paid.

This has repercussions for other tax types – import duty forms part of the tax base for VAT and excise duty. Repealing exemptions on both import duty and excise duty, for example, would have a greater tax revenue impact than each one in isolation.