REPUBLIC OF RWANDA

Tax Expenditure Report

2019/20

MINISTRY OF FINANCE AND ECONOMIC PLANNING

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Contents

SUMMARY FINDINGS

Tax expenditure (TE) is concentrated in VAT, import duty and CIT. Of these, VAT is the most significant, which is explained by its large contribution to the revenue collection. The majority of overall tax expenditure relates to the activities of large producers. Tax expenditure has increased by Rwf 45.4 bn compared to 2018/19, representing an additional 1.4 percentage points of potential tax revenue.

The increase in import duties tax expenditure compared to 2018/19 is explained by greater imports by investors of garments, wheat, sugar, steel and palm oil as industrial inputs. The loss-carry forward provision has driven the increase in income tax expenditure.

Table 1: Overview of total tax expenditure by tax type in 2019/20

Tax type	Tax expenditure (Rwf bn)			Tax expenditure as % of potential tax revenue			TE by tax type as % of total TE
	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20	
VAT (exc. govt)*	117.9	133.4	141.0	26.0%	26.0%	23.5%	46.3%
Income tax**	22.9	33.4	41.3	8.9%	10.9%	12.1%	13.6%
Import duties***	53.5	92.0	121.9	39.8%	33.3%	39.6%	40.1%
Total	**194.3**	**258.8**	**304.2**	**14.3%**	**16.5%**	**17.9%**	**100%**

** excludes VAT TE on government purchases and outputs because it is tax revenue spent to provide public services. Including govt, VAT TE is Rwf 257.9bn. For consistency, this also excludes VAT revenue from govt.*

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

**** measures TE compared to a baseline of EAC / COMESA tariffs, and includes TE for excise duty, withholding 5%, Infrastructure Development Levy and Africa Union Levy 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 2017 data and sector-specific growth rates to estimate 2019/20 levels. They also exclude the 38% of production by the informal sector, which assumes 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, export, 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. VAT and import duty provisions form the majority of measured tax expenditure, and most of these have the main aim of improving affordability and/or promoting priority sectors.

1. Introduction

Tax expenditure is one of the channels that GoR uses to support economically a given type of taxpayer if they meet certain outlined criteria but are frequently subject to less scrutiny than direct spending and subsidies. It is the tax revenue that is foregone through, but not limited to, provisions in the law such as VAT exemptions and zero-ratings, income tax holidays and preferential rates, duty remission and regional integration. Tax revenue foregone through supporting and attracting investors has been published since 2019 to make the support delivered through the tax system more transparent. Publication of the cost of tax expenditures is as important to the transparency of public finance as publication of budgetary outlays.

Setting up Rwanda's tax expenditure inventory requires comparison of the actual tax system to the benchmark tax system. Generally, to estimate the cost of Rwanda's tax expenditure, different models were used for each of income tax, VAT and import duties. For VAT, a simulation model based on the Supply Use Table of 2017 from the National Institute of Statistics was used; estimates for income tax expenditures and import duties are generated by microsimulation models that recalculate the tax owed for each taxpayer when variables are adjusted.

Tax expenditures are defined as tax measures that deviate from an established benchmark tax system, assuming that taxpayer behaviour remains unchanged. This benchmarking approach provides a baseline for selecting which tax measures to report on. There is, however, no consensus definition of a benchmark income tax system, though there is an international standard for the value added tax (VAT) benchmark. 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 labour 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.

Tax expenditure publication serves different objectives including, among others, the transparency of public finance and publication of budgetary outlays. Tax expenditure provisions are linked to direct spending programs and may be considered alternative means of accomplishing similar budget policy objectives. Governments keep detailed accounting of their program spending to ensure that spending efficiently and effectively supports policy objectives. Tax expenditure reporting can provide a more complete picture of where governments spend their money, improving transparency and accountability.

In raising a given level of revenue, providing tax relief to specific groups requires that tax rates on other taxpayers be higher than would otherwise be necessary. In addition, the regular publication of tax expenditure estimates implicitly creates a catalog of measures that can be referred to for informing policy decisions. Repealing the least effective tax expenditures is often an economically efficient means of raising revenue, as broadening the tax base raises revenues without the need for increasing distortionary tax rates.

2. Value Added Tax

Benchmark

The Value Added Tax has an international benchmark, which makes it simple to compute in theory. In Rwanda's VAT model, benchmark is defined as bellow:

The VAT is intended to be borne by final consumers—*typically households*—by collecting VAT on all goods or services supplied to them at a rate of 18%. Therefore, the benchmark VAT base is consumption, broadly defined and comprises all goods and services consumed in Rwanda. As such, the benchmark provides that the tax applies on a "destination basis"—that is, at the point of consumption in Rwanda—and that it applies to goods and services imported into Rwanda, but not to goods and services exported from Rwanda. The zero-rating of exports is a fundamental characteristic of a value-added tax; it is thus part of the benchmark.[1] The benchmark for the VAT provides that the tax is imposed to the sales of goods and services at all stages of the production and marketing chain. At each stage, businesses can claim input tax credits to recover the VAT paid on their business inputs, so that the VAT effectively applies only to the value added at each stage. Since the only tax that is not refunded is the tax collected on sales to final consumers, the VAT is effectively imposed on final domestic consumption and providing a credit or refund for VAT on business inputs is not a tax expenditure.

Financial service, gaming and life insurance tax were considered part of the benchmark in consistency with the international practice. Furthermore, the benchmark VAT tax base includes tax paid on the entire purchase price of newly constructed buildings and land by consumers for their own use. In the case of mixed use property, for example a working farm that includes a personal residence, the

[1] The legislative reference for zero-rating of exported goods and services is: Article 1 of Law Nº 2/2015 of 25 February 2015 (sub-paragraph 1º) modifying and complementing Article 5 of Law Nº 37/2012 of 9 November 2012 establishing the *Value-Added Tax*.

portion intended for personal use is final consumption that forms part of the benchmark, while any VAT paid on the portion intended for business use would be eligible for input tax credits and therefore does not form part of the benchmark VAT tax base. The exclusion of Government from the benchmark is a discretionary choice made that will not be followed by all countries. Tax expenditure on Government is for required public services rather than discretionary tax policies, and it is somewhat circular to consider as it affects its own budget. The rationale is explained in further detail in the Technical Annex.

The tax expenditure in VAT law comes through two types of provisions with the exceptions mentioned above:

- **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 laws are "Law N° 02/2015 of 25/02/2015 Modifying and Complementing Law N° 37/2012 of 09/11/2012 Establishing the Value Added Tax" and "Law N° 40/2016 of 15/10/2016 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.

VAT estimations

Table 2 shows that most non-government VAT tax expenditure is concentrated in a few sectors. Some of the increases, such as for education, healthcare and chemical products, are driven by larger and more formalised sectors in the updated Supply Use Table. Some notable decreases, such as for financial services, petroleum products and machinery and equipment are caused by reduced growth for those sectors. The decrease observed for dairy products is the result of disaggregation of data in the SUT that allows it to be distinguished from fruit juices, preserved vegetables, oils and fats.

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		
	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20
Education	10.50	12.89	17.11	8.9%	9.7%	12.1%
Financial services	16.42	16.79	15.45	13.9%	12.6%	11.0%
Transport services	9.95	12.51	15.00	8.4%	9.4%	10.6%

Refined petroleum products	13.95	13.87	11.94	11.8%	10.4%	8.5%
Machinery and equipment (except transport)	17.52	18.27	11.54	14.9%	13.7%	8.2%
Grain mill products*		5.30	7.99		4.0%	5.7%
Human health activities**	5.24	4.64	7.88	4.4%	3.5%	5.6%
Chemicals and chemical products	5.71	4.90	7.22	4.8%	3.7%	5.1%
Construction*			5.73			4.1%
Agriculture	4.45	4.23	4.70	3.8%	3.2%	3.3%
Textiles, clothing and leather products*		4.86	4.50		3.6%	3.2%
Dairy products, fruit juices, preserved vegetables, oils and fats***	14.41	8.47	1.64	12.2%	6.4%	1.2%
Other sectors	15.03	21.87	33.31	12.7%	16.4%	21.5%
Total	**117.89**	**133.37**	**141.0**	**100.0%**	**100.0%**	**100.0%**

** Included in 'Other sectors' in previous estimates.*

*** 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.*

****Dairy products are separated from fruit juices, preserved vegetables, oils and fats in 2019/20.*

The VAT tax expenditure for each provision is presented below:

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

#	Provision	TE estimate (Rwf bn)			Rationale / description
		2017/18	2018/19	2019/20	
1	**VAT exemption for agricultural products and milk**	30.76	23.68	18.05	Increase affordability of products from a sensitive sector. Since most of agricultural produce is informal, the tax expenditure is driven by agricultural products sold by food manufacturers.
2	**VAT exemption for agricultural inputs**			6.16	Reduce costs of production for a sensitive sector with high informality.
3	**VAT exemption for Information, Communications and Technology equipment**	16.06	18.93	16.82	Encourage use of modern ICT equipment and technologies.

4	**VAT exemption for financial services**	16.45	15.85	13.53	Intended to increase affordability of a sensitive product. Exemptions are applied by many countries because of difficulties in applying VAT to this sector.
5	**VAT exemption for educational materials, services and equipment**	9.44	9.75	13.48	Increasing affordability of a sensitive product. Excludes TE on public sector education. Increase in TE driven by greater formalisation of education in updated SUT.
6	**VAT exemption for specified energy equipment and fuels**	13.59	13.96	12.82	Harmonise with EAC VAT policies; increase affordability of a sensitive product; target development of electricity generation.
7	**VAT exemption for supplies for health-related purposes**	6.60	6.30	10.53	Increasing affordability of a sensitive product. Excludes TE on public healthcare provision. Increase in TE driven by greater formalisation of healthcare in updated SUT.
8	**VAT exemption for transportation services**	8.54	13.12	10.09	Targeting development of a priority sector and increasing affordability of these services. Majority of the impact of this is through international passenger transport.
9	**Zero-rating for goods and services intended for people of a "Special Category"**	2.90	3.91	7.95	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. Increase in TE driven by construction projects.
10	**Zero-rating of international transportation services for goods**	1.19	1.37	4.54	Target a priority sector, improve the regional competitiveness by harmonising with EAC treatment, and address administrative challenges in refunding input VAT for their buyers. Increase in TE driven by expansion and greater formalisation of transport sector in updated SUT.
11	**VAT exemption for raw materials and capital equipment supplied to the**	2.17	2.19	3.13	Targeting development of a priority sector in line with 'Made in Rwanda' strategy; address administrative challenges in refunding input VAT; improve cash flow position for the sector.

	manufacturing and processing sector				
12	**Zero-rating of goods sold in the Armed Forces Shops**	1.03	3.42	1.84	Improve the welfare of members of the Rwanda Defence Forces and the Rwanda National Police and their immediate families, by reducing their cost of living.
13	**VAT exemption for mobile telephones and SIM cards**	2.14	2.19	1.71	Improve affordability of modern communication technologies and support the movement towards a cashless economy.
14	**Zero-rating of package tours**	1.93	2.08	1.47	Improve the competitiveness of Rwanda as a destination for foreign tourists.
15	**VAT exemption for gaming activities**	1.15	0.56	1.09	No effective administrative mechanism for determining the value added. Exempting ensures input VAT is not recovered by firms.
16	**VAT exemption for the personal effects of returning Rwandan diplomats and other Rwandan citizens**	0	0.42	0.31	Facilitate citizens returning to Rwanda.
17	**VAT exemption for lease or sale of land or residential buildings**	0.03	0.42	0.29	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.
18	**VAT exemption for books, newspapers and journals**	0.02	0.27	0.04	Originally part of the education-related exemption but was split into its own provision in order to clearly allow all readers to benefit.
19	**VAT exemption for the supply of clean water by non-profits**	0.04	0.01	0.01	To encourage the supply of clean, treated water in remote areas.
20	**Zero-rating of minerals sold domestically**	Negligible	1.32	0	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.

21	**VAT exemption for all goods supplied to public institutions in charge of national defence or security**	0	0	0	Improve the cash flow position of public institutions in charge of national defence or security. Excluding government means this is zero.
22	**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.
23	**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.
24	**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.
25	**Other unattributed tax expenditures**		7.08	8.39	Driven by exempted and zero-rated textiles sales.

The estimates obtained 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 use of an updated SUT will have affected the size of all sectors.
- The growth of the affected sector(s). If the affected sector is growing significantly, the estimates for 2019/20 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.

3. Income Tax

Benchmark

The total corporate income tax expenditure is calculated as the increase in CIT payable by removing all the relevant provisions simultaneously in a "revenue gain method". Furthermore, 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:

- 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 the benchmark.

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".

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 submit financial statements.

In summary, 46,208 entities declared their corporate income tax in this fiscal year of which 28,557 provided a nil declaration; 10,629 declared under the real regime; 5,032 declared under the flat tax and 1,990 were in the lump sum regime. Of the 10,629 in the real regime, 6,902 declared a taxable profit (before preferential rates and tax holidays) and 3,600 declared a loss.

Income tax estimations

The drivers of changes are the use of the loss carry forward and accelerated depreciation provisions. Cement and steel products, wholesale and retail trade and other sectors have benefitted more from the loss carry forward provision in 2019/20 than in previous years, while the higher tax expenditure for the construction sector stems from greater use of accelerated depreciation. Reductions in tax expenditure for real estate and beverages were caused by reduced use of loss carry forward and accelerated depreciation respectively.

Table 4: Sectors benefitting most through current income tax expenditure

Sector	Tax expenditure (Rwf bn) on companies supplying…			As % of total income tax expenditure		
	2017/18	**2018/19**	**2019/20**	**2017/18**	**2018/19**	**2019/20**
Information and communications	2.56	7.98	6.62	11.2%	23.9%	16.20%
Financial and insurance activities	2.37	5.25	5.94	10.3%	15.7%	14.52%
Cement and steel products*			3.35			8.19%
Tea and coffee	3.35	3.95	2.99	14.6%	11.8%	7.31%
Construction	1.16	1.12	2.35	5.1%	3.3%	5.74%
Wholesale and retail trade; repair of motor vehicle and motorcycles*		1.59	2.31		4.8%	5.65%
Electricity, gas, steam and air conditioning supply	1.86	2.38	1.96	8.1%	7.1%	4.79%
Real estate activities	1.04	2.31	1.44	4.5%	6.9%	3.52%
Alcoholic beverages and soft drinks	2.98	2.83	1.29	13.0%	8.5%	3.15%
Chemicals and chemical products*		1.20	0.63		3.6%	1.53%
Hotels and restaurants	0.83	0.77	0.54	3.6%	2.3%	1.31%
Other sectors (inc. unclassified)	6.80	4.07	11.91	29.6%	12.2%	28.08%
Total	**22.95**	**33.45**	**41.33**	**100%**	**100%**	**100%**

** Included in 'Other sectors' in previous estimates.*

Table 5 shows the relevant provisions and their tax expenditures:

Table 5: Income tax expenditure by provision

#	Provision	Tax expenditure (Rwf bn)			Rationale / description
		2017/18	2018/19	2019/20	
1	**Loss Carry-Forward**	15.20 (CIT) 0.16 (PIT)	17.06 (CIT)	23.92 (CIT)	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. 611 companies benefit from this, but over half of the tax expenditure relates to six companies.
2	**Accelerated Depreciation**	4.46	12.37	11.14	To encourage or attract investment in priority sectors of the economy. 97% going to large companies. Claimed by 36 firms, but around 90% of the tax expenditure relates to seven companies.
3	**Preferential 15% Tax Rate for Exporters**	1.97	3.12	3.05	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Claimed by thirteen companies, mainly traditional export companies (tea and coffee).
4	**Preferential 0% rate for Large Foreign Investors with their HQ or Regional Office in Rwanda**	0.49	0	1.59	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers. Four firms claimed this exemption with one company claiming more than 90%.
5	**Employment Income of a Casual Labourer**	0.22 (PAYE)	0.55 (PAYE)	0.43 (PAYE)	Reduces the compliance burden and administrative burden compared to annual personal tax returns for employees.

6	**Exemption from Tax for Agricultural and Livestock Activities**	0	0.034	0.25	Supports agricultural production in Rwanda and recognizes the risks inherent in agricultural production. Nine firms benefitting from this exemption.
7	**Preferential 15% Tax Rate for Information and Communication Technology**	0.06	0	0.15	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 Freight Transportation**	0.18	0.068	0.04	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	0.015	0.01	Improve access to capital by encouraging venture capital and microfinance institutions to start-up in Rwanda. Claimed by two microfinance institutions.
10	**Preferential 15% Tax Rate for Renewable Energy**	0.18	0	0	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers.
11	**Preferential 15% Tax Rate for Financial Services**	0.006	0	0	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers.
12	**Preferential 15% Tax Rate for Passenger Transport or Low-Cost Housing**	0	0	0	Attract investment in Rwanda, increase exports to improve the balance of payments, and facilitate knowledge transfers.
13	**Preferential Tax Rates for Newly Listed Companies on Capital Market**	0	0	0	Introduced on 28th May 2010 to support the growth of domestic capital markets.
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 do not 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.

4. Import Duties

Benchmark

The benchmark unit of taxation is the importer, a business, incorporated or not, broker or individual. Furthermore, the benchmark tax base includes all imports into Rwanda. The benchmark import duty tax base for duty is: Cost, Insurance and Freight (CIF). The benchmark duty rate depends on whether the imports originate from outside or inside the communities with which Rwanda has trade agreements. For imported goods originating outside the East African Community or Common Market for Eastern and Southern Africa, 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.

Excise duty on imports covers a list of products mainly, motor vehicle with respect to their engine capacity, 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°025/2019 OF 13/09/2019".

Withholding 5% (WHT 5%) is a Customs tax that is deductible from an importer's income tax declaration. However, this is not deductible for those who either cannot or do not file an income tax declaration. If such entities' imports are exempted from WHT 5%, this is considered to be tax expenditure.

The Infrastructure Development Levy (IDL) and the Africa Union Levy (AUL) are charged at rates of 1.5% and 0.2% respectively on the CIF value of imports, and the benchmark considers the application of this to all imports.

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.
- **Treasury Credit Cheques** allow certain government imports without tax payments being made from Treasury to the RRA.

Import duties estimations

The tax expenditure is disaggregated below by the reason for the reduced rate or exemption. The increase is driven by exempted raw materials and industrial inputs for registered investors – mainly through the duty remissions scheme – and an improved Stay of Application calculation method. The products contributing most to the increase are garments, wheat, sugar, steel and palm oil.

Table 6: Import duties tax expenditure by provision for FY19/20

Provision	Tax expenditure (Rwf bn) through…							As % of total TE		
	Import duty	Excise duty	WHT 5%	IDL & AUL	Combined					
					2019/20	2018/19	2017/18	2019/20	2018/19	2017/18
Raw materials and industrial inputs for registered investors	**51.36**	**1.54**	**5.19**	**8.55**	**66.64**	**61.79**	**34.19**	**55%**	**67%**	**64%**
Stay of Application	**21.76**	**0.00**	**0.60**	**1.05**	**23.41**			**19%**		
Customs Law exemptions	**14.24**	**0.92**	**4.00**	**4.28**	**23.43**	**20.78**	**19.26**	**19%**	**23%**	**36%**
- Agriculture inputs	2.65	0.00	0.31	1.49	4.45	3.09	1.30	4%	3%	2%
- Armed Forces Shop	1.62	0.00	0.27	0.09	1.98	3.20	2.71	2%	3%	5%
- Diplomatic imports	0.60	0.02	0.28	0.10	1.00	1.76		1%	2%	
- Mosquito nets	0.02	0.00	0.01	0.11	0.15	0.42	1.48	0%	0%	3%
- National defence	0.12	0.00	0.03	0.01	0.16	0.81	2.89	0%	1%	5%
- NGO and govt projects	5.27	0.21	1.33	0.95	7.76	5.57	3.87	6%	6%	7%
- Returning residents	0.33	0.11	0.07	0.02	0.53	0.68	0.80	0%	1%	1%
- Other	3.62	0.58	1.71	1.50	7.40	5.25	6.20	6%	6%	12%
Treasury Credit Cheques *	**6.60**	**1.07**	**0.00**	**0.79**	**8.47**	**9.47**		**7%**	**10%**	
Total	**93.95**	**3.53**	**9.78**	**14.68**	**121.94**	**92.04**	**53.45**	**100%**	**100%**	**100%**

** not included in 2017/18*

TECHNICAL ANNEX

This Annex explains the data sources, approach, further analysis and issues to address for a subsequent tax expenditure report.

1. Value Added Tax

Data sources

For the VAT tax expenditure estimation, the main source of data is NISR's Supply Use Tables (SUT) for 2017. 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 2017, appropriate sector-specific growth rates (mostly sourced from GDP publications) are applied in order to estimate the levels for following years.

RRA VAT declaration data is used 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. More detailed RRA data can be incorporated in the future to improve the accuracy of estimates, such as 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 IMF consultants during their 2018 technical missions to Rwanda. The three (non-zero) exceptions are the zero-rating for purchases from the Armed Forces Shops, the exemption for returning residents and part of the zero-rating for purchases by people and institutions of a 'special category'. These are estimated, at least in part, 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.[2] 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.

[2] 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.

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

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

Exclusion of Government

Government is excluded 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 is not practical to consider taxing Government outputs. Many Government services will not 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.

Sales involving government (either as the purchaser or as the seller) are excluded 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. Simulating a benchmark involves repealing all exemptions and zero-rated sales. In this case, however, sales involving government are left as zero-rated and the remainder of exempt and zero-rated sales are repealed.

2. Income Tax

Data sources

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 (for calendar year 2019, corresponding to tax revenues for 2019/20) and RRA's Pay As You Earn (PAYE) declarations for 2019/20. These sources show us the deductions claimed by companies, some exemptions, preferential tax rates and tax holidays.

3. Import Duties

Data sources

RRA Customs data for FY2019/20 is used to calculate the revenue foregone through import duty exemptions. For each import, the data contains the standard tariff, the 'agreement' field noting EAC / COMESA exemptions, and the Customs Procedure Codes (CPCs) provide the reason for the reduced rate as per the Customs law.

Calculation notes

The benchmark adopted here is 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

The import duty foregone is calculated as the difference between the import duty that should be paid (according to these EAC rules, the applicable tariff and the CIF value) and the import duty actually paid.

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

Customs excise duty is calculated based on the product's tax base (either CIF value plus import duty and handling fee, or quantity) and the standard excisable rate. Deviations from this are considered tax expenditure.

Withholding 5% is applied as a uniform 5% rate on the CIF value, however for registered companies it is deductible from their income tax declaration. This means that WHT 5% exemptions are only considered tax expenditure for those who would not pay income tax.

The Infrastructure Development Levy and Africa Union Levy are applied as uniform rates of 1.5% and 0.2% respectively on the CIF value. Deviations from this are considered tax expenditure.

While some revenue foregone on Customs VAT could also be considered as tax expenditure, this is incorporated in the VAT analysis. Many companies will be able to reclaim the VAT paid at Customs as input VAT through their domestic declarations. Customs VAT expenditure exists where there is revenue foregone and companies cannot reclaim the input VAT. Furthermore, the exclusion of government also reduces the scope of what is considered as tax expenditure here. As a result, the Customs VAT exemptions on the Armed Forces Shop and for personal effects of returning residents are those included in the VAT estimates.