Sustainable Finance and Investment in the Age of COVID-19

By:

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Rwanda envisions itself as the next Luxembourg or the next Singapore; a new financial center that will turn East Africa into an international power player and will service financial transactions throughout the African continent and beyond. While other financial centers are often accused of being tax havens, Rwanda is determined to avoid that label. It says the new hub, the Kigali International Financial Center (KIFC), will not allow business activity designed to avoid taxation. Details are forthcoming but Rwanda Finance Limited, the government entity that is developing the project, says all investments at KIFC must have a substantive business and economic purpose. Old strategy documents for KIFC suggest the government is aiming for modest tax rates and a robust network of double taxation agreements and tax information exchange agreements to bolster the project.

Rwanda's KIFC project has been years in the making. But KIFC is now picking up speed, and it is doing so at a novel time as Rwanda, like other countries around the world, contends with slowing economic growth and rising unemployment due to the coronavirus pandemic. For governments around the world, the pandemic has awakened a dire need for cash to pay for social safety net provisions and counteract sagging tax receipts and shrinking GDP. At the same time, the economic emergencies created by the coronavirus pandemic present a new opportunity for governments to reimagine taxation both domestically and internationally.

In many corners, there is a perception that global taxing systems are inequitable and riddled with loopholes. The OECD's anti-base erosion and profit shifting project, which launched in 2013, generated new standards and best practices that were supposed to solve this issue. However, some feel BEPS simply layered complex rules on top of an already complex system. In a similar vein, the OECD now wants to overhaul global tax rules and create a new system giving governments greater taxing rights over digitalized companies, but the proposal is anything but unified. However, the coronavirus pandemic has breathed new life and new urgency into discussions about sustainable and fair taxation on the domestic and international levels, and the appropriateness of increasing tax burdens on those who are potentially undertaxed in order to fund economic recovery.

In this environment, there is an increased expectation that governments soliciting new investments will ensure those investments generate sustainable tax revenue, especially as economists warn of a potentially protracted economic recovery period. At the same time, one cannot ignore the element of competition between governments. The looming question is: when does one's tax sovereignty become another's tax dilemma? Professor Allison Christians touched on this in a 2009 paper, Sovereignty, Taxation, and Social Contract. There she said:

> *"Recognizing ourselves as parties to a global social contract would require a fundamental reassessment of the conventional standards of tax policy design. Instead of focusing on national tax policy as appropriately reflecting only or even primarily the needs and wants of national constituents, a global social contract would require national policy to reflect outward as well, to consider the needs and wants of the*

worldwide community."

We are seeing some pushback against perceived violators of this contract in Europe, where Belgium, Denmark, France and Poland have all implemented rules denying coronavirus-related aid to companies with various ties to tax havens. France, for example, is denying bailouts to firms registered in havens. Belgium also denies bailouts for companies linked to havens.

In a related vein, there are real questions about whether various kinds of tax incentives are actually helpful or harmful domestically, especially for developing countries. For example, is this the time to cut corporate tax rates in the name of economic investment? KIFC's strategy document suggested a 15 percent corporate tax rate on companies in KIFC, which is half of the country's usual 30 percent rate. The Independent Commission for the Reform of International Corporate Taxation says corporate rate cuts could increase inequality, particularly in developing countries where corporate tax receipts account for a larger percentage of their budgets.

This discussion is important at a time where foreign direct investment in several African countries has dropped, and there is an increasing focus on how African countries can generate their own sustainable financing for economic recovery. In a policy report "COVID-19 and Africa: Socio-economic implications and policy responses" the OECD said recovery strategies on the continent "should include a strong structural component to reduce dependence on external financial flows and global markets, and develop more value-adding, knowledge-intensive and industrialized economies, underpinned by a more competitive and efficient services sector." Along these lines, potential tax incentives should not undercut domestic recovery efforts or generate a race to the bottom that impacts the recovery of other countries. And it is important to note that the financing constraints facing developing countries -- and African countries in particular -- are partially attributable to taxation issues. Logan Wort, Executive Secretary of the African Tax Administration Forum, believes a lack of fair taxing rights have deprived those countries of revenue and have compelled them countries to seek outside funding from the IMF and World Bank in response to the pandemic.

As part of the KIFC project, Rwanda is touting its tax infrastructure. The country is advertising that its tax incentives -- like capital gains exemptions for registered investors and a corporate tax exemption for certain foreign companies headquartered in Rwanda -- fall in line with OECD and European Union tax transparency standards. Rwanda also plans to reform its financial sector tax policy, and details on that are forthcoming. But compliance with transparency standards only tells part of the story. By all accounts, there's room for Rwanda to do more, as the IMF cautioned in 2018 that the country's tax incentives were probably unsustainable, according to a report in Rwandan newspaper The New Times. However, Rwanda is a member of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes. Within that forum, the country has taken a lead on African tax issues. In early 2019, the country hosted African members of the Global Forum for the forum's 6th annual Africa Initiative meeting. That meeting centered around illicit financial flows in Africa and how African countries can further develop their automatic exchange of information frameworks so that information is more accessible to them. As a follow up, Rwanda Finance Limited in early June conducted a workshop on OECD tax issues.

Along those lines, more attention will likely be paid to development partners in projects like KIFC. Rwanda's project is backed by the U.K.'s development finance institution, CDC Group, which is a partner in KIFC. Over the years, CDC has been criticized for allegedly using tax havens for investments, but the group's official tax policy statement says the institution will not make investments through intermediate jurisdictions that fail to pass the OECD's global forum peer reviews and receive a "compliant" or "largely compliant" rating unless there are exceptional circumstances where the benefits outweigh the costs. That caveat is likely to generate more scrutiny in our current environment.

The KIFC project also shines a spotlight on tax treaty development, which will be important within the pandemic recovery period. In Africa, tax treaties with Mauritius -- a robust financial center off the coast of southern Africa -- have left a bad taste in the mouths of several countries. Mauritius is often a conduit for business between Africa and Asia, and several countries contend that the terms of their treaties with Mauritius give them insufficient taxing rights and could facilitate tax avoidance. Early this year, Senegal announced that it terminated its treaty with Mauritius and has a new one pending. Kenya had to rework its treaty with Mauritius after the Tax Justice Network Africa successfully filed a lawsuit alleging that the terms of the arrangement could enable Kenyan companies to avoid tax by routing their investments through Mauritian shell companies. In late June, Zambia voided its double tax agreement with Mauritius and is seeking a renegotiation. Several years ago, Rwanda did the same.

Rwanda already has double tax treaties with Barbados, Belgium, Jersey, Mauritius, Morocco, Singapore, and South Africa. It is also a signatory to double tax agreements with three African regional networks: the Common Market for Eastern and Southern Africa, the East African Community, and the Economic Community of Central African States. But Rwanda is hoping to expand its treaty network and plans to focus on that relationship building at this year's Commonwealth Heads of Government Meeting, where heads of state from all Commonwealth countries meet. Rwanda has the double distinction of hosting the meeting and officially unveiling the financial center at that event. Rwanda's progress on this path, and the resulting treaties that come out of it, will be important to watch.

It has been suggested that the global political appetite for tax multilateralism is weak. Right now, country-specific tax responses to the pandemic seem to suggest that fact – jurisdictions are mostly concerned with managing their domestic affairs. But regional or project-based approaches could create a bridge between domestic tax sustainability and regional or international sustainability.

Some of this is already happening due to China, which has created a tax consortium to support its Belt and Road project. Belt and Road is China's plan to invest trillions of dollars in infrastructure projects around the world so it can transport goods more easily. The consortium, the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), is a collection of countries partnering in the Belt and Road project and was created so participants can develop and pursue some common goals. Chief among them is the promotion of economic growth and efficient collection of the maximum tax revenue possible. China has maintained that BRITACOM will not reinvent tax policy.

Even so, the organization seems to be taking steps that could, at the very least, reshape tax policy. That has become apparent from BRITACOM’s response to the coronavirus pandemic, which includes a recent, special coronavirus-related meeting for its members. BRITACOM says it is using its “multilateral tax dialogue platform” to help member countries discuss and compare their tax responses to the crisis. This is because BRITACOM views itself as a tool that member countries can leverage to help improve their social and economic development. Ultimately, projects like KIFC and BRITACOM could push tax policy and economic recovery discussions forward in ways that larger, more traditional forums cannot, but only time will tell.