The Taxation of Miscellaneous Income Sources under the Federal Income Tax Proclamation of Ethiopia: A Critical Analysis

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Abstract

Schedule 'D' of the Federal Income Tax Proclamation No. 976/2016 taxes income sources that are not taxable under the other income tax schedules. The objective of this article was to create a better understanding of the taxable units and tax bases of the taxing provisions of this schedule and also to explain the many changes introduced under the current Schedule D. To this end, it mainly depends on the doctrinal legal research methods, by which it critically analyzes the relevant legislation, literature, and model tax rules. The discussion revealed that the current Schedule 'D' has undergone significant changes. Non-resident taxation is regulated in detail; they are taxed under exclusive provisions in the context of permanent establishment and as residents for their Ethiopian-source income. New tax bases are also added, such as repatriated profit and undistributed profit. The taxation of residual income is part of this introduction. The proclamation also came up with informative definitional provisions for a management fee, technical fee, interest, dividend, and royalty. These not only ease the characterization of the taxpayers and tax bases but also widen the scope of the respective taxation of these sources. The changes introduced in capital gains taxation are also significant in many ways, including widening the assets subject to capital gains tax and providing relatively detailed provisions for the valuation of capital gains. All these changes will be meaningful if the tax administration

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on the ground is also reformed to reflect the positive changes introduced under the tax laws.

Keywords: Income Tax Proclamation, Schedule 'D', Other Income, Taxpayer, Tax base.

Introduction

The Federal Income Tax Proclamation No. 979/2016 (ITP) recognized five schedules: Schedules A, B, C, D," and E.[1] Only income that comes within the first four schedules is subject to tax, while schedule 'E' is not a taxing schedule but consists of income exempt from taxation in the first four schedules.[2] Schedules 'A', 'B', and 'C' have centered on a schedularization of income into three categories: employment, rental of buildings, and business income. However, several income sources do not fit one of these categories. Schedule 'D' is designed to capture these 'other/miscellaneous' incomes, which makes it a schedule of 'last resort'.

The ITP has introduced many changes to Schedule 'D' over its predecessor, including widening its scope or tax bases. There is a need to explain these changes and their significance and to point out gaps, if any, for further improvement. And establishing clarity in this regard and helping various stakeholders understand the essence of the provisions covered under Schedule 'D' is at the heart of this article. As a continuation of the author's commentary on the taxable units and tax bases of the ITP's income tax schedules, the discussion in this article also built around a critical analysis of how these two elements are characterized under the taxing provisions of Schedule D. The

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[1] Federal Income Tax Proclamation No. 979/2016, Federal *NegaritGazzeta*, (2016), Art. 8 [hereinafter Income Tax Proclamation No. 979/2016].

[2] *Id.*, Art.65.

article largely employed a doctrinal legal research methodology by which it made a critical analysis of the relevant legislation, describing what the law is and the doctrinal interpretation of it. The author also made a review of related literature, model tax laws, and notes to strengthen its discussion and arguments.

To present the issues clearly, the rest of the article is organized into four main sections. Section one is dedicated to making brief introductory remarks about Schedule 'D' in terms of its basic features. The discussion under Section 2 is about non-resident taxation, while Section 3 discusses the newly introduced tax bases of Schedule D. Section four targeted the main amendments the ITP has brought to the pre-existing tax bases in Schedule D. The article closed its discussion with some concluding remarks.

1. Salient Features of Schedule 'D'

The first and most important feature of Schedule 'D' is that it is a 'miscellaneous' schedule. Schedules 'A', 'B', and 'C' have centered on a schedularization of income into employment, rental of buildings, and business income. However, there are income sources that do not fit one of these categories, and there come concerns as to the specification and taxation of these amounts. The legislative method by which these concerns may be addressed is to put these miscellaneous receipts under a certain schedule.[3] This is what Schedule 'D' is for.

The schedule is designed to capture income sources not covered by other schedules. Thus, it taxes only amounts not taxable under the other schedules, and any amount liable to tax under another schedule is explicitly excluded

[3] Lee Burns and Richard Krever, Individual Income Tax, *in* Victor Thuronyi (ed.), *Tax Law Design and Drafting*, International Monetary Fund, Vol. 2, (1998), p. 30.

from the domain of Schedule D'.[4] Consequently, if an amount is found taxable under both Schedule 'D' and either of the three schedules, priority should be given to taxation of the amount under Schedules 'A', 'B', or 'C', as the case may be. The title of the schedule, 'other income', itself signifies its 'last resort' nature or that it concerns miscellaneous income sources. Given its application to unrelated income sources, the Schedule has proven itself to be flexible to accommodate new sources of income and has been a principal tool to broaden the tax base of the Ethiopian income tax system.[5] For instance, the ITP came up with sources new to the schedule such as windfall profit, undistributed profit, repatriated profit, and recharged technical fees and royalties. Moreover, Art. 63 of the ITP, which taxes any income that is not taxable under any of the schedules or other provisions of Schedule 'D', assures this motive of the government.

The second basic feature of Schedule 'D' is that it lacks unifying features.[6]

Schedules 'A', 'B', and 'C' have their own unifying features in terms of their taxpayers, tax bases, tax brackets, tax rates, and methods of tax assessment and collection. However, Schedule 'D' lacks such unifying features.

The taxpayers under the schedule are diverse, and unlike the first three schedules, schedule 'D' by and large provides differential treatment for resident and non-resident taxpayers of the same tax source. For instance, dividends, interest, royalties, management fees, technical fees, and insurance

[4] Proclamation No. 979/2016, *supra* note 1, Art. 64 (1) (a).

[5] Taddese Lencho, The Ethiopian Income Tax System: Policy, Design and Practice, PhD thesis, University of Alabama, (2014), p. 424.

[6] *Id.*, pp. 422-423. Though, the comments in this material were made for Schedule 'D' of the repealed income tax laws, their contexts are valid to the current one too.

premiums are subject to separate provisions depending on whether they are derived by a resident or non-resident.[7]

In terms of the tax base, the Schedule taxes a dozen of unrelated income sources.[8] What is common for these tax sources is that most (if not totally) are irregular earnings or they are event-based. In addition, many of its taxable incomes such as royalty, dividends, interest, and capital gains are 'investment incomes'. However, it also taxes incomes not fitting into this category such as winnings from games of chance and windfall profits. Concerning taxation of 'investment incomes' under a schedular income tax system, there are two broad approaches to the inclusion of investment income (some jurisdictions also use the term "property income" or "capital income") in gross income.[9] First, the inclusion rule could refer to investment income, which is then separately defined by reference to specific categories of income, such as dividends, interest, rent, and royalties.[10] Where capital gains on the disposal of investment assets are included in the income tax base, investment income may also be defined to include such gains. Alternatively, the inclusion rule may refer to specific categories of investment income rather than to a collective notion of investment income.[11] This is the approach chosen by the ITP; schedule 'D' has no definition for investment income, but for specific sources, we may consider it as 'investment income'.

As the schedule's tax bases are diverse, so are the tax rates. But the rates across the schedule have two commonalities: they are flat and relatively low.

[7] See Proclamation No. 979/2016, *supra* note 1, Arts. 51, 54-56.
[8] *Id.*, Arts. 51- 63.
[9] Lee Burns and Richard Krever, Taxation of Income from Business and Investment, *in* Victor Thuronyi (ed.), *Tax Law Design and Drafting*, International Monetary Fund, Vol. 2, (1998), p. 16.
[10] *Id.*
[11] *Id.*

In terms of methods of tax assessment and collection, the schedule uses a combination of withholding and self-assessment. Though many of its tax sources are dependent on withholding agents, sources from casual rentals, capital gains, windfall profit, undistributed profit, and repatriated profit are potential subjects to the regime of self-assessment.[12]

Third, the tax imposed under schedule 'D' is a final tax on the income concerned.[13] Consequently, the income is not aggregated with any other income of the person deriving the income, or once, the income is taxed under Schedule 'D', no more income tax is to be imposed on that income. This is because, as discussed above, any amount will be taxable under Schedule 'D' only if it is not taxable under the other Schedules. Unlike Schedules 'B' and 'C, but like Schedule 'A', the tax under Schedule 'D' is imposed on the gross income; no deduction is allowed for expenditures incurred or losses sustained to derive the income, except in one case, the tax on capital gains under Art. 59. And similar to the three schedules, exempt income is not part of the tax base under any of the provisions of Schedule D.[14]

2. Taxation of Non-Residents of Ethiopia

Non-residents are subject to pay income tax in Ethiopia if two cumulative preconditions meet.[15] First, they should be "non-residents of Ethiopia". The ITP defines resident, not non-resident; thus, a non-resident is a person not fitting the alternative tests of "a resident individual" under Art. 5 (2) or "a resident body" set out under Art. 5 (5). About the tests for "Ethiopian Resident", the ITP is clearer and more detailed than its predecessor, especially

[12] Proclamation No. 979/2016, *supra* note 1, Art. 64 (5).
[13] *Id.*, Art 64 (2).
[14] *Id.*, Art 64 (1) (b).
[15] *Id.*, Art. 7 (2).

because it discarded unclear and also seemingly repetitive alternative tests. For instance, to characterize an individual as an Ethiopian resident, the repealed income tax proclamation had a "habitual abode" in addition to a "domicile".[16] The former was not clear, including its difference with domicile. It also appeared to be a repetition given that an individual who stays in Ethiopia for more than 183 days in a year (either continuously or intermittently) is considered a resident.[17] The ITP avoids this confusion by retaining "domicile" while discarding "habitual residence".[18] Also, in determining 'body residents', the repealed Income Tax Proclamation used "principal office" in addition to "place of effective management".[19] The difference between the two was not apparent. The ITP retains a "place of effective management".[20] If a body has a principal office in Ethiopia, so will its effective management. The second precondition to taxing a non-resident is that the income it derived should be "Ethiopian source income". To qualify as such, the amount should fall under the lists in Art. 6 of the ITP. Here again, the ITP is more advanced than its predecessor. The latter had a simple list of generic income categories (employment income, business income, etc.) without providing the instances, these will be "Ethiopian sources."[21] However, the ITP provides specific tests for each taxable source to qualify as Ethiopian source income. This eased the task of characterizing a certain amount as Ethiopian or foreign income. Ethiopian residents are subject to tax for both their Ethiopian source and foreign income (they are taxable on their worldwide income).

[16] Income Tax Proclamation No. 286/2002, Federal *Negarit Gazeta*, (2002), Art. 5 (1) [hereinafter Income Tax Proclamation No. 286/2002].
[17] *Id.*, Art 5 (2).
[18] Income Tax Proclamation No. 979/2016, *supra* note 1, Art 5 (2).
[19] Income Tax Proclamation No. 286/2002, *supra* note 16, Art 5 (3).
[20] Income Tax Proclamation No. 979/2016, *supra* note 1, Art 5 (5).
[21] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 6.

Most importantly, though non-residents were subject to tax under the repealed income tax proclamation too,[22] the ITP came up with far clearer and expanded prescriptions about the taxation of non-residents.

The ITP taxed non-residents who earned "Ethiopian source income," which was a mandatory requirement, in three ways. The first is in an exclusive setting; it has emerged with provisions exclusively dedicated to taxing non-residents (Articles 51–53). The second is in the context of permanent establishment, whereby non-residents are imposed with tax if they derive income from their permanent establishment in Ethiopia (Articles 54 (2), 55 (2), 56 (2), and 62). The third one is when non-residents are imposed with tax under the same provisions designed for Ethiopian residents, but this time whether they have a permanent establishment in Ethiopia does not matter (Articles 10 (1), 13 (1), 18 (1), 57 (1), 58 (1), 59 (1), and 63). From these, this section discussed provisions exclusively enclaved for non-residents. The remaining two are touched on under sections three or four, as the case may be.

2.1. The main taxing provision of Ethiopian non-residents

The main provision under Schedule 'D' that is exclusively dedicated to taxing non-residents is Art. 51. It levies taxes on non-residents (individuals or corporations) who receive six types of income from Ethiopia: dividends, interest, royalties, management fees, technical fees, or insurance premiums. According to the drafter of the ITP, Professor Lee Burns, the separate taxation of these amounts is necessary largely for administrative reasons..[23] A non-resident deriving these incomes from Ethiopia may not have any physical

[22] *Id.*, Art. 3 (2).

[23] Drafter's Technical Notes on the Final Draft of the Federal Income Tax Proclamation No. 979/2016 (unpublished) [here in after, Drafter's Technical Note on ITP's Final Draft].

presence in Ethiopia (such as an office or employees) or may be present for only a short time (in the case of services). Thus, the income cannot be efficiently collected on an ordinary assessment basis of, for instance, Schedule 'C'.[24] Further, if these items of income were taxed on an assessment basis, there are difficulties in the allocation of expenditures (particularly expenditures incurred outside Ethiopia) as deductions in working out the taxable income of the non-resident. It is very difficult for the Authority to police the allocation of foreign-incurred expenditures as deductions against such income.[25] For these reasons, a separate tax is imposed on the income at the time it is derived by the non-resident with the tax collected from the payer of the income by withholding.[26]

The taxation under Art. 51 of the ITP requires two conditions. First, the income derived must have the character of one of the six types of sources listed in the provision. Second, the income must be from Ethiopian sources. These are highlighted below, one by one. But, before that, it is important to note that if the six income sources are attributable to a permanent establishment in Ethiopia of the non-resident, they are not subject to tax under Art. 51 but under Schedule 'C' or the other provisions of 'D', as the case may be.[27] Thus, there is a need to distinguish between a non-resident and a non-resident having a permanent establishment in Ethiopia. However, the mere fact that the non-resident has a permanent establishment in Ethiopia is not a ground to exclude it from Art. 51's taxation, but if the income concerned is attributable to the permanent establishment.

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[24] *Id.*

[25] *Id.*

[26] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 89.

[27] *Id.,* Art. 51 (3). 'Permanent establishment' is defined under Art. 4 of the ITP. For details about this definition, see discussion *infra* sub-section 3.4.

Now, returning to the six taxable items, the first tax base of Art 51 is ‘dividend’, hence, when non-residents received ‘Ethiopian source dividend’, they are required to pay income tax in Ethiopia. Art. 2 (6) of the ITP lists the types of profit distributions considered as ‘dividends’.[28] And a dividend will be considered as Ethiopian source if it is paid to a non-resident person by a resident body.[29]

The second is income from ‘interest’, which is defined under Art. 2 (16) of the ITP.[30] Income from ‘interest’ is considered an Ethiopian source if the interest is paid to a non-resident by a resident of Ethiopia or by a non-resident as an expenditure of a business conducted by a non-resident through a permanent establishment in Ethiopia.[31]

Thirdly, "royalty," the characterization of which is provided under Art. 2 (20) of the ITP.[32] If the royalty is paid to a non-resident by a resident of Ethiopia or by a non-resident as an expenditure of a business conducted by the nonresident through a permanent establishment in Ethiopia, it is an ‘Ethiopian source income’.[33]

The fourth tax base of Art 51 is ‘management fee’, which is one of the newly introduced tax bases by the ITP. ‘Management fee’ is defined as an amount paid as consideration for the rendering of any managerial or administrative

[28] For details about the definition of ‘dividend’ and its taxation, see discussion *infra* sub-section 4.2.
[29] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (a).
[30] For details about the definition of ‘interest’ and its taxation, see discussion *infra* sub-section 4.3.
[31] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (g).
[32] For details about the definition of ‘royalty’ and its taxation, see discussion *infra* sub-section 4.1.
[33] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (g).

service, other than an amount that is employment income.[34] It is an amount a non-resident received in exchange for managerial or administrative services, but not as an employee. The ITP has no clear benchmarks' to distinguish managerial or administrative service from employment service. We can approach this in that if the service provider fits the ITP's characterization of an employee (Art. 2 (7)), the amount received in exchange for the services is employment income, but, if the same services are given through forms other than employment (like as an independent contractor), it is a management fee.[35] If the services are provided by a body, there will be no confusion about whether to consider it a management fee, as employees are always natural persons..[36] Non-residents will pay tax on management fees if the source is Ethiopia, and this will be the case if the fee is paid by a resident of Ethiopia or a non-resident as an expenditure of a business conducted by a non-resident through a permanent establishment in Ethiopia.[37]

Fifthly, 'technical fee', which is defined as "a fee for technical, professional, or consultancy services, including a fee for the provision of services of technical or other personnel."[38] It will be considered Ethiopian source income if the fee is paid by a resident of Ethiopia or by a non-resident as an expenditure of a business conducted by the non-resident through a permanent establishment in Ethiopia.[39] Previously, to tax 'technical fee' the location of

[34] *Id.*, Art. 2 (17).

[35] See Belete Addis, Characterization of Taxable Units and Tax Bases under the Income Tax Schedules of Schedule 'A' and 'B' of the Federal Income Tax Proclamation of Ethiopia: A Commentary, *Bahir Dar University Journal of Law*, Vol. 8, No. 1, (2017), p. 55.

[36] The drafter noted that a management fee is commonly charged by a parent company to a subsidiary for centralised management services provided by the parent company to the subsidiary. Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[37] Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (g).

[38] *Id.*, Art. 2 (23).

[39] *Id.*, Art. 6 (4) (g).

rendition of the services was material only which fee given for technical services rendered outside Ethiopia was taxable.[40] In effect, non-residents who received a technical fee for technical services they rendered in Ethiopia were not paying tax on it.[41] This is no more the case as the ITP discarded the 'location' requirement; whether a non-resident rendered the technical services to a resident here in Ethiopia or abroad, it is taxable. The important element is whether the fee-paying entities are those stipulated under Art 6 (4) (g).

For technical fee taxation, it is important to know 'what constitutes technical services'. The repealed income tax Proclamation defined not 'technical fee' but 'technical service' (as "any kind of expert advice or technological service").[42] It was clear that the tax targeted a consideration made in exchange for technical services. However, the ITP expands the notion by including considerations for 'professional', 'consultancy', and 'other personnel' services as a technical fee. At the same time, it fails to define 'technical'/'technical service' which makes it difficult to precisely tell the scope of the provision. As long as the taxable item is a 'technical fee', the inclusion should be limited to 'professional' or 'consultancy' services that are 'technical' in nature. The issue was contentious even under the previous income tax system where the law had a definition for 'technical services'. Some withholding agents tend to restrict the tax to cases involving some highly technical or technological service and have argued that non-technical services such as consultancy and management services are not the subject of

[40] Proclamation No. 286/2002, *supra* note 16, Art. 32 (1).

[41] Taddese raised cases where non-residents come to Ethiopia for a brief period of time to provide technical services such as to Ethiopian Telecommunications on the installation of fiber optics; to Ethiopian Electric and Power Corporation on installation of electrical wires and dams, etc. These persons were not subject to tax for the income they derived from these services. See Taddese, *supra* note 5, p. 452.

[42] Proclamation No. 286/2002, *supra* note 16, Art. 32.

this tax.[43] The ITP's inclusion of "professional and consultancy services" in the absence of a definition for 'technical service' can only intensify the disparity. The definition also includes a fee for 'services of other personnel', which refers to a fee paid for the hiring out of labor.[44] Yet, unlike the definition of 'management fee', the definition of 'technical fee' does not exclude 'employment income' which may add up the potential confusion between the two.

Thus, it is important to have at least a guideline that prescribes 'technical services' for the ITP. It may be difficult to have one, but we can start by taking lessons from practices elsewhere. When we resort to the commentaries in this regard, 'technical' is understood as an activity that involves the application of specialized knowledge, skill, or expertise in respect of science, profession, or occupation.[45] However, it is not confined to mechanical or machine-driven tasks but includes social sciences, commercial managerial activity, and professional services.[46] In this context, "technical service" can be inclusive of performing consultancy and professional services on behalf of a client.[47] While 'consultancy' as a 'technical service' involves the provision of

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[43] See Taddese, *supra* note 5, pp. 447-449.

[44] For example, it covers a fee paid by a subsidiary to a parent company for the secondment of an employee of the parent company to the subsidiary. Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[45] Tatiana Falcão and Bob Michel, Scope and Interpretation of Article 12A: Assessing the Impact of the New Fees for Technical Services, Reprinted from *British Tax Review Issue 4,* (2018), p.428.

[46] UN Committee of Experts on International Cooperation in Tax Matters, Tax Consequences of the Digitalized Economy, Fifteenth Session, Agenda item 5(c)(ix, (2017), p. 4, available at https://www.un.org/esa/ffd/wp-content/uploads/2017/10/15STM_CRP22_-Digital-Economy.pdf last accessed on 12 February 2022.

[47] Andrés Báez Moreno, The Taxation of Technical Services under the United Nations Model Double Taxation Convention: A Rushed – Yet Appropriate – Proposal for (Developing) Countries', *World Tax Journal*, Vol. 7, No. 3, (2015), p. 2.

advice concerning a particular field, in 'professional services' the professional can do all the things a consultant or technician does, and as such with the particular knowledge and skills, professional service is broader than consultancy and technical service.[48] Another difficulty the Ethiopian revenue authorities need to be aware of and take action on is drawing a line between 'technical services' and the sale of 'know-how'. According to the OECD and UN model tax rules, know-how contracts involve the transfer of the use of, or the right to use, property or know-how; while in technical services, a person does not transmit know-how, but rather uses industrial, commercial, or scientific experience as a tool for advising his customer.[49] In contrast to the technical service provider, the vendor of know-how sells the tool as such and not the solution.[50] Hence, 'technical services' relates to the provision of services to the customer with the use of know-how and not to the transmission of know-how as such.[51]

The last tax base of Art 51 is 'insurance premium'. This is a newly introduced income tax base. It is not defined under the ITP, so, it will have its ordinary meaning. Black's Law Dictionary defines "insurance premium" as the

[48] UN Committee of Experts on International Cooperation in Tax Matters, Seventh Session, Taxation of Services, Item 3 (a) (vi) of the provisional agenda, (2016), p.26, available at https://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf last accessed on 12 February 2022.

[49] UN Model Double Taxation Convention between Developed and Developing Countries, (as updated in 2017) [here in after, UN Model Tax Convention]; OECD Articles of the Model Convention with Respect to Taxes on Income and on Capital, (as updated in 2017), Art. 12 [here in after, OECD Model Tax Convention].

[50] When an enterprise provides services to a customer, it does not typically transfer its property or know-how or experience to the customer; instead, the enterprise simply performs work for the customer. See UN, Tax Consequences of the Digitalized Economy, *supra* note 46.

[51] *Id.*

consideration paid by the insured to the insurer for insurance protection.[52] Thus, if a non-resident insurer received an Ethiopian source insurance premium, it must pay tax in Ethiopia. This will be the case if the premium is paid to a non-resident relating to the insurance of risk in Ethiopia.[53] What is material here is the place of the risk being insured, not whether the insured is a resident or non-resident of Ethiopia.

2.2. Taxation of recharged technical fees and royalties

Art 52 of the ITP is another provision exclusively targeting non-residents, and a newly introduced prescription. It is about the technical services or leased equipment provided by a non-resident person (other than through its permanent establishment in Ethiopia)[54] to an Ethiopian resident (other than to its permanent establishment abroad) or a non-resident having a permanent establishment in Ethiopia.[55] As these instances are already covered under Art. 51, we may then ask, what the need for Art. 52 is. It is because, unlike the cases of Art. 51, under Art. 52 the non-resident technical service or lease provider received its payment not from a resident recipient of the service or the lease, but from another non-resident that is a related person of the recipient.[56] Thus, the one who received the technical service or the lease and the one paying for it are different. Then, when the related person that paid for the service or the lease (which is non-resident) charged the recipient (who is a

[52] Black's *Law Dictionary*, 8th ed., *s. v.* "Insurance premium". Ethiopia's Vehicle Insurance against Third Party Risks Proclamation No. 559/2008, Art. 2 (15) also defines 'Premium' as "the amount paid for an insurance policy."

[53] Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (d).

[54] *Id.*, Art. 52 (1) (a).

[55] *Id.*, Art. 52 (1) (b). The provision calls them 'recipient'

[56] *Id.*, Art. 52 (1) (c). Regarding, what constitutes 'related person' for the purpose of tax, see the Federal Tax Administration Proclamation No. 983/2016, Federal *Negarit Gazeta*, (2016), Art. 4 [hereinafter, Tax Administration Proclamation No. 983/2016].

resident or permanent establishment in Ethiopia) for it,[57] Art 52 will come into the picture to tax the non-resident related person on the recharged amount it received from the service or lease recipient.[58]

From the above explanation, it is clear that Art 52 has no new tax base for non-residents; it taxes technical fees or royalties received by non-residents like Art 51. Thus, the provision is just an integrity measure intended to prevent avoidance of the non-resident tax through centralized payments systems within multinational enterprises.[59] In absence of Art 52, it may be argued that the recharged amount is a reimbursement of expenses and not a technical fee or royalty. So, the effect of Art 52 is that the tax treatment of the recharged amount is the same as if the recipient of the services or leased equipment paid the amount direct to the non-resident supplier or it will be assumed as if the related person [directly] supplied the technical services or leased the equipment to the recipient.[60]

2.3. Taxation of non-resident entertainers

Art. 53 of the ITP deals with the taxation of non-resident entertainers. This is another new prescription the ITP introduced as part of its move toward detailed regulation of non-resident taxation. The principal taxpayers under this provision are a non-resident entertainer or group of non-resident entertainers who have derived Ethiopian source income from participating in a

[57] *Id.*, Art. 52 (1) (d).

[58] *Id.*, Art. 52 (2).

[59] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[60] Proclamation No. 979/2016, *supra* note 1, Art. 52 (2). It was not possible to tax a non-resident that actually provided the technical or lease service. As it paid by another non-resident, Ethiopia has no income tax jurisdiction. However, when a non-resident that paid for the service or lease charged the amount on Ethiopia resident or a non-resident having permanent establishment in Ethiopia, the recharged amount will become Ethiopian source income.

performance taking place in Ethiopia.[61] The income is an Ethiopian source if it is derived from a performance or sporting event taking place in Ethiopia.[62] Thus, what is important is the place of performance of the entertaining event, not the resident status (whether a resident or non-resident of Ethiopia) or the where about of the person who paid the entertainer.

The ITP defines 'entertainer' to include musician and sports person.[63] It is illustrative, so we can use the ordinary meaning of 'entertainer' (a person whose work is to entertain others) to include others such as singers, dancers, or comedians.[64] 'Group' is also defined to include a sporting team,[65] thus, using its ordinary meaning we can add others like a musical band. Similarly, 'performance' is defined to include a sporting event,[66] and we can think of other entertainment performances such as a music concert.

Art. 53(2) provides another taxpayer: "'another person' who derived income from a performance by an entertainer." This is a person other than the entertainer or group that has yet to derive income as a result of the non-resident entertainers' performance in Ethiopia. It is commonly the case that entertainers do not derive income from a performance directly but rather through a company that they control, and, therefore, the entertainer's fee is paid to the company.[67] And Art. 53 (2) is there to ensure that the tax imposed under Art. 53 (1) is not avoided in such cases. However, there is a potential problem related to the practicability of collecting taxes from payments made to a non-resident entertainer by another non-resident (not related to the

[61] *Id.*, Art. 53 (1).
[62] *Id.*, Art. 6 (4) (e).
[63] *Id.*, Art. 53 (3) (a).
[64] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.
[65] Proclamation No. 979/2016, *supra* note 1, Art. 53 (3) (b).
[66] *Id.*, Art. 53 (3) (c).
[67] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

entertainer) for the performance performed in Ethiopia. A non-resident payer cannot be imposed with the withholding duty as it is a duty imposed on Ethiopian resident payers.[68]

Thus, entertainers may avoid tax liability simply by ensuring that they are paid by a non-resident person with no presence (commercial or otherwise) or assets in Ethiopia. Of course, just because the payer has no obligation to withhold does not mean the amount from an Ethiopian source should be left untaxed. The tax liability of the taxpayer and the withholding liability of the third party are distinct. Still, the practicability of the collection mechanism is the most important factor in determining the extraterritorial applicability of the tax law. Thus, the concerned organs (the Ministry of Revenues or the Ministry of Finance) should be aware of such potential practical problems and design way-outs ahead.

No doubt Art. 53 taxes income directly related to the performance, such as the prize money. But if Art. 53 is inclusive of the income a non-resident entertainer derives from other activities made in the course of performing a sporting event in Ethiopia, For example, a non-resident sportswoman may derive income from advertisements. The answer is affirmative; in the language of Art. 53 (1), what matters is if the income is derived from the entertainer's participation in a performance taking place in Ethiopia..[69]

[68] Income Tax Proclamation No. 979/2016, *supra* note 1, Arts. 64 (5) and 89.

[69] There is one well-known, "the Agassi case". The main issue was regarding a tennis player who was a non-resident of UK, but received payments from non-resident entities for advertising Nike during the game. The payer had no connection with the UK. But, the House subjected the payment to UK's income tax jurisdiction by considering advertisement as a business and income derived from a business activity performed in UK is subject to UK's income tax law. Rather than considering the payment as income from the sporting event, the House considered it as a separate event. In the Case, the payment was not made directly to the sportsman rather for the

Why is there a need to separately deal with the taxation of non-resident entertainers? Would not Art. 51 suffice? Entertainers derive diverse incomes for their performances other than those listed under Art 51, including advertising products in the course of performing, concerts, festivals, event entrance fees, awards, and prize money. Art. 53 should not be confused with Art. 54 (which taxes royalty) since the most common payment for some categories of entertainers, such as musicians, is royalty. Royalty comes into the picture when others use someone's work, for example, music, or when a musician allows others to use their work, while Art 53 is concerned with payments made when the entertainers themselves perform their work. Also, if a non-resident entertainer receives royalties, Art. 51 will be applicable.

3. New Income Tax Bases of Schedule 'D'

In this section, a discussion is made on the new income sources the ITP introduced to Schedule D. This is the area where the ITP contributed to widening the country's income tax base. The newness of some of the items is not to Ethiopia's income tax system but to Schedule 'D', so, in this section, 'new' refers to 'new to Schedule D. Moreover, the discussion in this section is in addition to the new taxable items that the ITP introduced in the context of exclusive taxation of Ethiopian non-residents (highlighted in Section 2). It has

foreign company which he owned. In short it is about payments made by a non-resident foreign company which has no any commercial presence in the UK, to another non-resident foreign company which has also no any commercial presence in the UK, yet controlled by the sportsman. The payment under contention was related to the activities performed by the sportsman in the course of performing his sporting event in the UK. See the House of Lords Appellate Committee, UK, Robinson (Appellant) vs. Agassi (Respondent), 17 May 2006, available at https://publications.parliament.uk/pa/ld200506/ldjudgmt/jd060517/agasro-1.htmm last accessed on 11 April 2019. Lessons can be taken from this case for issues raised under the above two paragraphs about the practical applicability and scope of Art 53 of the ITP.

been mentioned that management fees, insurance premiums, recharged technical fees and royalties, and income from performing entertainment are new to taxation under Schedule D.

3.1. Taxation of residual income categories

Some types of income categories may be identified or recognized after the enactment of tax laws, and it can also be daunting to list all potential income sources under the income tax laws. Having a provision to tax residual incomes can narrow the possibility of escaping tax for the mere reason that the income is not specifically named in income tax laws. Art. 63 (titled 'other income') of the ITP is there to such ends. The provision reads: "A person who derives any income that is not taxable under Schedule A, B, C, or the other provisions of this Schedule shall be liable for income tax at the rate of 15% on the gross amount of the income" (emphasis added). It gives a way for the taxation of a residual category of income or any income not otherwise taxable under the ITP. This is one of the major changes the ITP has introduced, not just to Schedule 'D, but to the country's income tax system as a whole, and it addresses one of the criticisms raised against the repealed income tax system: income sources that were not explicitly or implicitly mentioned in the individual income tax schedules were not taxed.[70] Art. 63 is comparable to Art. 21 of the OECD and UN model tax conventions, which attribute an exclusive taxing right to the state on items of income not covered by other distributive rules of the income tax law.[71] Accordingly, when there is

[70] Arguments were made to tax such incomes using the comprehensive definition of 'income' (under Art 2 (10) of the repealed income tax proclamation- a replica of which is Art. 2 (14) of the ITP) than introducing new specific tax laws when it is needed to expand the taxable income sources (a practice the government was accustomed to). See Taddese, *supra* note 5, p. 265.

[71] OECD Model Tax Convention, *supra* note 49, Art. 21; UN Model Tax Convention, *supra* note 49, Art. 21.

difficulty in characterizing an income for income taxation, this provision will be relevant.

The taxpayer of Art. 63 is a personwhether individual or body, Ethiopian resident or non-resident. Non-residents are taxable if they derive from an Ethiopian source 'other income' and this is if they are paid by an Ethiopian resident (other than as an expenditure of the resident's business conducted through a permanent establishment outside Ethiopia) or by a non-resident as an expenditure of the non-resident's business conducted through a permanent establishment in Ethiopia.[72]

The tax base is 'any income' not otherwise taxable under the ITP. Thus, the 'amount' must qualify as 'income'. To determine this, we need to resort to the comprehensive definition of 'income' provided under Art. 2 (14) of the ITP. It defines 'income' as "every form of economic benefit, including non-recurring gains, in cash or kind, from whatever source derived, in whatever form paid, credited, or received." Thus, any residual income category fitting the definitional elements of Art. 2 (14) is a tax base for Art.63.[73]

The phrase 'any income' under Art. 63 triggers the question of whether it includes income from "criminal and/or immoral" activities. As a matter of international practice and jurisprudence, there are divergent views about taxing income from criminal activities. While those in favor argue that a dollar of profit from criminal activity buys just as much as a dollar of profit from lawful activity (hence, we need to apply the same income tax principles for the two), those against worry that taxing such income will make

[72] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (g).

[73] For the details about the elements of this definition, see Belete, *supra* note 35, pp. 38-39.

governments a silent partner in crimes.[74] The consensus seems to be that as a matter of general principle, income from criminal activities would fall within the general inclusion provision under a global system or, in the case of a schedular system, one of the schedules.[75] If this is not the case, then it should be stipulated that income derived from criminal activities is still subject to tax.[76]

The absence of a specific prohibition of taxing "illegal income", coupled with the phrase "from whatever source derived" in the general definition of "income" under Art. 2 (14) of the ITP, may lead us to the conclusion that the ITP taxes income from criminal activities (the source of the gain is immaterial). However, the author believes that the issue needs scrutiny of the country's public policy beyond the doctrinal interpretation of tax law provisions. In addition, there is a need to consult criminal laws. If we for instance refer to the country's criminal code, customs, and corruption crimes proclamations, it is stipulated that property [income] acquired as a result of the commission of a crime, possessing unexplained property, or if illegal properties are seized, confiscation of the same will be ordered (in addition to a fine and/or imprisonment).[77] Then, we may ask, if the whole income or property is confiscated, what is left to tax? Also, we may ask, confiscation

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[74] See Yosef Alemu, Taxing Crime: The Application of Ethiopian Income Tax Laws to Incomes from Illegal Activities, *Jimma University Journal of Law*, Vol. 4, No. 1, (2012), pp. 154-176. Writing based on the repealed income tax proclamation, the author (Yosef) argued for taxing income from criminal activities in Ethiopia, invoking the expression "from whatever source" under the proclamation's definition of "income".

[75] See Burns and Krever, *supra* note 3, p. 36.

[76] *Id.*

[77] See Criminal Code of the Federal Democratic Republic of Ethiopia Proclamation No. 414/2004, Federal *Negarit Gazzete*, (2004), Art. 98; Customs Proclamation No. 859/2014, Federal *Negarit Gazzeta*, (2014), Art. 147; and Corruption Crimes Proclamation No. 881/2015, Federal *Negarit Gazzeta*, (2015), Art. 21.

presupposes conviction, but do we need the same to impose tax? For taxation, identification of the income seems sufficient. In this regard, scholars also argued that, in part, the possibility of taxing illegal income provides a tool for the prosecution of crimes having nothing to do with taxation.[78] This is because criminals typically fail to declare their illegal income on tax returns; they can often be successfully prosecuted for tax evasion even when there is no specific proof as to how they got the money.[79] This seems not to be the case in Ethiopia, at least, as a matter of practice. Once again, the author believes that taxing criminal activities needs to be first addressed at the policy level, and addressing whether or not Ethiopia taxes crimes as a policy choice is decisive in settling the matter.

3.2. Taxation of windfall profit

Windfalls are considered unexpected accretions to wealth, and in many jurisdictions with the global definition of income, windfalls are not included in gross income, while in most jurisdictions with schedular definitions of income, windfalls simply fall between categories of income included in gross income.[80] Political considerations and practical difficulties in assessing the gains from windfalls serve as the common ground for their exclusion from the income tax base, although these may not constitute persuasive tax policy reasons.[81]

When it comes to Ethiopia, windfalls are included as one taxable category of income under Art. 60 of the ITP. The imposition of income tax on windfall profits is new to Schedule 'D' and a recent introduction to the country's

[78] Burns and Krever, *supra* note 3, p. 36.
[79] *Id.*
[80] *Id.*, p. 31.
[81] *Id.*

income tax system. It was in 2010 that the government enacted a special income tax proclamation to tax banks and other financial institutions, which derived huge windfall profits as a result of the devaluation of the Ethiopian currency (Birr) in the year 2010.[82] Then, the current ITP merges windfall profits into the income tax schedules.

Art. 60 (1) reads: "Windfall profit obtained from businesses prescribed in a directive to be issued by the Minister shall be liable to tax at a rate to be determined in such a directive." Thus, the taxpayers are business persons, individuals, or bodies. The tax base is 'windfall profit', which is defined as "any unearned, unexpected, or other non-recurring gains."[83] The definition is too general. For instance, when can we say a profit is 'unearned or unexpected'? The Proclamation left out the details, including the essential elements of this tax, to be determined by the Minister of Ministry of Finance (MoF).[84] It is the Minister who determines the amount of income to be considered as a windfall profit. Thus, the mere fact there is unearned, unexpected, or non-recurring gain does not amount to windfall profit unless the amount of profit meets the threshold to be set by the Minister. The Minister is also empowered to identify the types of businesses subject to this tax. This means, obtaining 'wind fall profit' will not automatically attract income tax unless the business is the one identified as a subject matter of windfall tax by the Minister. In the process of determining such issues, the Minister may take into account the nature of the business, thus, she/he can follow a case-by-case determination.[85]

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[82] See Proclamation to Amend the Income Tax Proclamation No. 693/2010, Federal *Negarit Gazetta*, (2010). It was enacted, three months after the government devaluated Birr by more than 20% at once.

[83] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 60 (4).

[84] *Id.*, Art. 60 (2).

[85] *Id.*, Art. 60 (3).

The power to determine the specific tax payers, tax base, tax rate, and amount of income to be considered 'windfall profit' is granted to the Minister of MoF. Giving such extensive power to the executive organ (Ministry) itself was highly criticized;[86] now, the ITP has made it more worrisome by empowering a single individual (a Minister) to determine almost all core elements of the tax. This may open room for abuse, taking into consideration the relationship between political representation and taxation and; the non-delegation of core tax issues to the executive. It is not appropriate to delegate all essential powers of taxation to a single ministry, let alone a minister. The better thing would have been had the ITP, as primary legislation, outlined the core elements of the tax and then delegated the determination of more technical matters to the MoF, not the Minister.

3.3. Taxation of undistributed profit

Art. 61 of the ITP provides for the imposition of tax on the undistributed profits of a body. It prescribes that "tax shall be paid at the rate of 10% on the *net undistributed profit* of *a body* in a tax year to the extent that it is *not reinvested*, in accordance with the directive to be issued by the Minister" (emphasis added).[87] The taxable unit is a 'body' (which is defined to include a company and partnership),[88] which did not distribute profits to its members. But, since we are talking about 'profit' the taxable 'bodies' are those engaging in business undertakings and are expected to distribute the profits thereof to their members. Essentially, this refers to companies and partnerships.

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[86] See Taddese Lencho, The Ethiopian Tax System: Excesses and Gaps, *Michigan State International Law Review*, Vol. 20, No. 2, (2012), p. 339. The 2010 Proclamation granted to the then Ministry of Finance and Economic Development to define windfall profits from time to time.

[87] Like windfall profits, here also the power to issue a directive is given to the Minister, not the Ministry, which may trigger the same concern raised above.

[88] Tax Administration Proclamation No. 983/2016, *supra* note 56, Art. 2 (5).

The tax base is the 'net undistributed profit'. Thus, first, there is a need to identify what constitutes 'net profit' and 'undistributed profit'. The answer is found under Directive No. 7/2019 on undistributed profit, issued by the Minister of MoF. As per this directive, 'net-profit' constitutes an amount that remains after the annual gross business income of the body is reduced by the amount of paid business income tax, deductible expenditures, depreciation allowance, and the reserve fund.[89] And the amount considered as 'undistributed profit' is; profit not distributed to members (as a dividend) or profit not repatriated to a non-resident body conducting business in Ethiopia through a permanent establishment or profit not re-invested to increase the capital of the body within 12 months of the body's accounting period.[90] The body can only avoid paying tax on this amount (taxation under Art 61) if it is proved to the satisfaction of the revenue authority that the body has made a distribution of dividend and/or increased its capital to the extent of its net-profit within 12 months of its accounting period.[91] If only part of the net-profit is distributed/re-invested, the tax will be imposed on the remaining net-profit.

The explicit taxation of 'undistributed profit' not only widens the income tax base but also avoids the preexisted confusion. Previously, since the repealed income tax laws had no definition for 'dividends', it was mandatory to refer to the Commercial Code, which contingent the distribution of dividend to the approval of a general shareholders meeting.[92] This has caused a divided interpretation of dividend tax; whether the actual distribution of dividends is a prerequisite to it or can it be imposed on undistributed profits too.[93]

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[89] Ministry of Finance, A Directive on Taxation of Undistributed Profit, Directive No. 7/2019, Art. 3 (2) [here in after, MoF Directive on Taxation of Undistributed Profit].
[90] *Id.*, Art. 3 (1).
[91] See *id.*, Arts. 5-10.
[92] Commercial Code of Ethiopia Proclamation No. 1243/2021, Federal *Negarit Gazzete* Extra Ordinary Issue, (2021), Art. 438 [here in after, the Commercial Code].
[93] Taddese, *supra* note 5, pp. 463-468.

Companies, especially PLCs used to refrain from declaring dividends until they make sure that they can avoid the withholding obligations on dividend tax.[94] As a result, MoFED (now, MoF) was obliged to issue a circular that prescribed the imposition of dividend tax on 'undistributed profits'; opined it fits the general definition of 'income' as it is held for the benefit of shareholders.[95] The ITP (under Art 61) settled this once and for all. If a company distributed dividends, its members will pay dividend tax, and if it did not distribute the company will pay the tax on the undistributed profit. Thus, a company has little chance and motive to avoid tax by not distributing dividends.

3.4. Taxation of repatriated profit

Art. 62 of the ITP provides for a tax on the repatriated profits of an Ethiopian permanent establishment owned by a non-resident. The concept of permanent establishment determines whether an enterprise has sufficient activity in another territory to create a taxable presence there and thus justify that country's taxation of the business profits.[96] These are grey areas of business establishments that do not meet the tests of 'resident' (and lack personality); hence, the principle of residence cannot be invoked to assume tax jurisdiction over their income. On the other hand, applying the principle of source is not administratively feasible, as it requires tracing all income sources of the non-resident body that owns these establishments, and then identifying the income attributable to the establishments. The organization of modern business is highly complex to apply since there are a considerable number of companies,

[94] *Id.*, pp. 464-466.

[95] Ministry of Finance and Economic Development, Legal Opinion Letter Written to Ethiopian Revenues and Customs Authority, 27/11/2004 E.C.

[96] Annet Wanyana and Sebo Tladi, The "Permanent Establishment" Concept Analyzed from a South African Perspective, Journal of International Commercial Law and Technology, Vo. 4, Issue 3, (2009), pp. 213-215.

each of which is engaged in a wide diversity of activities and carries on on business extensively in many countries.[97] Thus, the application of the source rule (as it is) will make the tax administration complex and inefficient and entail less compliance.[98] However, it is unsound to let the establishments go untaxed, as they have become an enduring part of the country's. That is why we do have the rules of a permanent establishment, which is, a modification of the source principle to assume income tax jurisdiction on business conducted through certain recognized business establishments. The basic approach to determining the profits attributable to the permanent establishment is to require the determination of the profits under the fiction that the establishment is a separate enterprise and that such an enterprise is independent of the rest of the enterprise of which it is a part as well as from any other person.[99]

The ITP under Art. 4 recognizes the rules of permanent establishment as one ground to assume income tax jurisdiction. The provision defines a permanent establishment as "(…) a fixed place of business through which the business of a person is wholly or partly conducted."[100] Three basic elements are depicted in this definition: one, it is a place of business; hence, a facility such as premises, machinery, or equipment is available for this purpose; two, it is fixed; thus, it must be established at a distinct place with a certain degree of permanence; and finally, the purpose of the place is to carry out business, either wholly or partly. After this inclusive definition, the ITP goes on to list examples of establishments that are and are not to be considered permanent

[97] See OECD Commentaries on OECD Articles of the Model Tax Convention, (as updated in 2017), p. 225, available at https://www.oecd.org/berlin/publikationen/43324465.pdf last accessed on 12 February 2022.
[98] *Id.*
[99] *Id.*, p. 134.
[100] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 4 (1).

establishments.[101] The effect of being recognized as a permanent establishment is that the establishment must pay income tax on net income attributable to it (not on the worldwide income of a non-resident that owns the establishment). Therefore, taxation under Art 62 and other provisions of the ITP that depend on the permanent establishment to tax non-residents must follow the rules of the permanent establishment outlined under Art 4.[102]

Art. 62 (1) reads: "*A non-resident body* conducting business in Ethiopia *through a permanent establishment* shall be liable for tax at the rate of 10% *on the repatriated profit* of the permanent establishment" (emphasis added). The tax base is 'the repatriated profit'. To determine this, Income Tax Regulation No. 410/2017 provides a formula, including what to add and what to deduct in calculating 'repatriated profit'.[103] It should be underlined that the business income derived by the permanent establishment is taxable under Schedule 'C',[104] not the concern of Art. 62. The latter deals with a profit repatriated by the permanent establishment to the non-resident body (which owns the establishment) after paying the business income tax expected from it.

Thus, a taxpayer under Art 62 is a non-resident body that received the repatriated profit, while a taxable unit of the business income tax is the permanent establishment itself. As the recipient is not in Ethiopia, the permanent establishment has a withholding duty on the profit it repatriated.[105] And if the permanent establishment does not repatriate the profit to its non-resident owner, the un-repatriated amount will be considered 'undistributed

[101] *Id.*, Art. 4 (2) - (5).
[102] See for instance, *id.*, Arts. 54 (2), 55 (2) and 56 (2).
[103] Federal Income Tax Regulation No. 410/2017, Federal *Negarit Gazeta*, (2017), Art. 51 [here in after, Income Tax Regulation No. 410/2017].
[104] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 51 (3).
[105] *Id.*, Art. 89 (1).

profit' and the permanent establishment itself will be required to pay tax on it as per Art 61 of the ITP.[106]

A right to repatriate profit is one of the investment guarantees Ethiopia's investment laws provide for foreign investors (as one means of attracting foreign direct investment).[107] It may be questioned if taxing 'repatriated profit' goes against this objective. In addition, the taxation may also be considered double taxation: the permanent establishment paid business income tax on the profit, and it will be taxed again when repatriated. However, here it should be clear that if the commercial presence of the foreign investor is through establishing a "proper" enterprise like a company or subsidiary, it will be considered an Ethiopian resident and will pay no income tax when it repatriates its profit (after paying its business income tax under Schedule 'C'). Thus, the adverse impact of taxing a repatriated profit under Art. 62 on foreign direct investment is negligible.

4. Major Changes Introduced on Pre-existing Tax Bases of Schedule 'D'

Schedule 'D' has not only introduced a detailed regulation of non-resident taxation and new tax bases but has also brought a lot of changes to income categories that have been taxed under Schedule 'D' long before the ITP. The changes in this regard are especially noticeable when it comes to defining taxable items. This section is dedicated to discussing this and other major changes the ITP has introduced to the income categories in Schedule 'D' (which are not covered in the preceding two sections).

[106] MoF Directive on Taxation of Undistributed Profit, *supra* note 89, Art. 3 (1).

[107] See Investment Proclamation No. 1180/2020, Federal *Negarit Gazeta*, (2020), Art. 20. The same guarantees also provided under several bilateral investment treaties Ethiopia concluded.

4.1. Taxation of royalties

Art. 54 of the ITP provides for the taxation of royalties. It provides two categories of taxpayers. The first is an Ethiopian resident, an individual or a body, who derives royalty.[108] The other is a non-resident having a permanent establishment in Ethiopia who derives Ethiopian source royalty attributable to the permanent establishment.[109]

The tax base is 'royalty'. Defining 'royalty' for taxation is complicated. Though the general conception treats 'royalty' as a payment for the use of a person's intellectual property, it encompasses many fundamentally different types of payments and has diverse meanings across jurisdictions.[110] For that matter, not all countries classify royalties as a category of income in their own right. Some countries classify certain kinds of royalties as rental income and royalties received by individuals for intellectual property created by personal exertion as income from independent labor; while other countries classify royalties as investment income subject to the same basic rules as interest income.[111]

When it comes to Ethiopia, the ITP under Art. 2 (20) defines the term 'royalty' broadly, and essentially, consistent with the definition commonly found in international tax treaties.[112] It captures a wide range of rights and assets whose exploitation results in the payment of royalties. According to Art

[108] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 54 (1).

[109] *Id.*, Art. 54 (2). Income from royalty will be considered as Ethiopian source income if it meets one of the two alternative tests provided under id, Art. 6 (4) (g).

[110] Burns and Krever, *supra* note 9, p. 18.

[111] *Id.*

[112] Compare it for instance with OECD Model Tax Convention, *supra* note 49, Art. 12 (2).

2 (20), the following six categories of amounts, whether paid periodically or as a lump sum, are treated as royalties:

First, a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematography films and films and tapes for radio, television, or internet broadcasting.[113] For example, payments made to authors for printing and publishing books; to musicians, songwriters, singers, and directors for producing and distributing music.

Second, a consideration for the receipt of, or right to receive, visual images or sounds, or both, transmitted by satellite, cable, optic fiber, or similar technology in connection with television, radio, or internet broadcasting.[114] By including this, the ITP expands the scope of 'royalty', as this category of royalties (the subject matters of which are used widely owing to the advancement of technology) was not included under the repealed income tax proclamation.[115]

Third, a consideration for the use of or the right to use any patent, invention, trademark, design or model, plan, secret formula or process, or other like property or right.[116] For example, payments made to inventors for using their patented products.

[113] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (20) (a).

[114] *Id.*, Art. 2 (20) (b).

[115] See Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 31 (5). The Amharic version of Art 31 of this proclamation was also titled 'የ ፈጠራ መብትን በ ማከ ራየ ት የ ሚገ ኝ ገ ቢ', which is expressive of only 'royalties' received as consideration for the use of, or the right to use of intellectual property rights (not reflective of the scope of royalty taxation). This is fixed in the Amharic version of Art 54 of the ITP; it employs the term 'ሮ ያ ሊቲ' as a title

[116] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (20) (c).

The fourth is a consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment.[117] This one, for instance, includes equipment lease rentals.[118] Based on this, we can tell that 'royalty' in the context of ITP is inclusive of rental income received for a lease of certain kinds of equipment.

The fifth one is a consideration for the use of, or the right to use any information concerning industrial, commercial, or scientific experience.[119] This definition of 'royalty' includes any consideration for the supply of knowhow, but not the supply of services.[120] While discussing the taxation of technical fees, it has been pointed out that 'technical services' are not inclusive of know-how, thus there is a need to distinguish the two.[121]

Sixth, an amount as consideration for the supply of assistance that is ancillary and subsidiary to and is furnished as a means of enabling the application or enjoyment of property or a right referred to in the above five categories.[122] This is the only circumstance in which a service fee is treated as royalty.[123] This conception of 'royalty' was unknown to the repealed income tax laws, and its inclusion under the ITP helps to avoid the characterization conflict between 'royalty' and 'technical fee', which was tense previously.[124] Since the tax rates of royalty were lower than the technical fee, taxpayers with this

[117] *Id.*, Art. 2 (20) (d).
[118] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.
[119] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (20) (e).
[120] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.
[121] Making a distinction between the two can be difficult, but, in this context and broad terms, knowhow is pre-existing knowledge and information that is secret that a person is given a right to use; while the provision of services involves using one's customary skills to bring knowledge and information into existence. See *id.*
[122] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (20) (f).
[123] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.
[124] See Taddese, *supra* note 5, p. 438.

know-how could very easily characterize payments as royalty, even though the substance of the contract shows that the payments are made for the provision of technical assistances.[125] Now, clarity is established in that if such assistance is supplied as ancillary and/or subsidiary to the property or rights listed under Art. 2 (20), the amount received in exchange is 'royalty'. In effect, the considerations received in exchange for the supply of services other than these are 'technical fees' not 'royalty'.

Countries also define 'royalty' to include considerations for the sale of intellectual property and the exploitation of natural resources connected with land, commonly mineral resources, petroleum, and forests.[126] Does Art. 2 (20) of the ITP include these? The provision defines 'royalty' as consideration for 'the use or right to use' and 'the receipt or right to receive' of the assets, rights, or services it list. These terms do not signify transactions entailing the transfer of ownership, such as, the sale of intellectual property rights. In effect, the taxation under Art. 54 is not inclusive of amounts derived from the sale of intellectual property or rights. If the intellectual property constitutes a business asset (held or used in the conduct of a business wholly or partly), the gain from its disposal is business income and taxable under Schedule 'C'.[127] Still, a gain from the disposal of non-business assets such as intellectual property, a consideration an author of a book received for selling her copyrights, is not covered. It cannot be taxed under Art. 59 of the ITP as capital gains either, as its scope is not inclusive of the disposal of intellectual property rights. This could have been avoided had the definition of 'royalty' been structured to

[125] *Id.* Previously, royalty was taxable at 5% while it was 10% for technical service fee. The rate difference is increased under the ITP; royalty charged with 5% while technical fee is taxed at 15%.
[126] Burns and Krever, *supra* note 9, p. 19.
[127] Income Tax Proclamation No. 979/2016, *supra* note 1, Arts 2 (3) and 21 (1) (b).

include amounts received as consideration for 'disposal of' rights or property listed under Art. 2 (20).

Art. 2 (20) is also not inclusive of royalties paid as considerations for the exploitation of natural resources connected with land. These are payments to the owner of the land (in Ethiopia, the government) from which the minerals are extracted or the forests are exploited.[128] However, though not under the ITP, the taxation of such royalties is part of Ethiopia's income tax system. The Constitution grants regional governments the power to collect royalties from mining operations and for the use of forest resources, while royalties from large-scale mining and all petroleum and gas operations fall under the concurrent power of taxation.[129]

Finally, the characterization of royalties may also get confused with other sources of income. For instance, its overlap with employment income was a source of inconsistent characterization, which seems to continue; this is when payments are made by the employer as a consideration for the use of intellectual property that belongs to an employee.[130] There are also possible confusions with business income; for instance, when a publishing company derives income from granting the right to use its copyright to other persons or if a film production company derived income both directly for the showing of

[128] Under the OECD Model Tax Convention such royalties are treated as income from immovable property than royalty. See OECD Model Tax Convention, *supra* note 49, Art. 6. Neither is this the case under the ITP.

[129] Constitution of the Federal Democratic Republic of Ethiopia Proclamation No. 1/1995, Federal *Negarit Gazeta*, (1995), Arts 97 (8), (10), and 98 (3) [here in after, FDRE Constitution].

[130] See Taddese, *supra* note 5, pp. 297-311. The employment contract can be used as a base line to decide on the matter. The way the work was financed (whether the works of the employee are produced by the employer) is also important. For details see Belete, *supra* note 35, p. 53.

its films and from giving others the right to distribute and show those films.[131] We may say the income is business income since the activities are the businesses of the company or we may incline to consider it as royalties since the payments are made for the use of intellectual property.[132] However, if the core business of the entity is to derive royalties, there is no confusion that the royalty will be included in the business income of the entity and taxable under Schedule 'C', not 'D'. This would apply, for example, when the taxpayer's business is the development and licensing of industrial or intellectual property rights, know-how, or the leasing of equipment.[133]

4.2. Taxation of dividends

Art. 55 of the ITP provides for income taxation of 'dividends'. Art. 2(6) of the ITP defines 'dividend' as "a distribution of profits by *a body to a member* …" Thus, the terms 'body' and 'member' are key to precisely characterizing the taxable units of Art. 55. Both terms are defined under the Tax Administration Proclamation. It defines 'body' as "a company, partnership, public enterprise , public financial agency, or other body of persons, whether formed in Ethiopia or elsewhere"[134] while 'member' is defined as "a person with *membership interest* in the body including a shareholder in a company or a partner in a partnership" (emphasis added).[135] 'Membership interest' refers to "an

[131] Taddese, *supra* note 5, p. 437.

[132] See Belete Addis, Characterization of Taxable Units and Tax Bases under Schedule 'C' of the Federal Income Tax Proclamation of Ethiopia: A Commentary, *Bahir Dar University Journal of Law*, Vol. 10, No.1, (2019), p. 117.

[133] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[134] Tax Administration Proclamation No. 983/2016, *supra* note 56, Art. 2 (5).

[135] *Id.*, Art. 2 (20).

ownership interest in the body, including a share in a company or an interest in a partnership."[136] Thus, 'membership interest' means 'ownership interest'.

Is 'ownership interest' limited to being a shareholder in a company or a partner in a partnership? For instance, like the ITP, the OECD Model Tax Convention also 'dividends' concerned with distributions of profits, the title to which is constituted by shares that are holdings in a company limited by shares.[137] This assimilates to shares and all securities issued by companies that carry 'a right to participate in the companies' profits'.[138] Hence, 'a right to participate in the companies' profits' is used as a qualifying factor. However, debtclaims participating in profits and interest on convertible debentures are not considered dividends; while interest on loans is considered a dividend in so far as the lender effectively shares the risks run by the company, i.e., when repayment depends largely on the success or otherwise of the enterprise's business.[139] We may use this take to understand 'ownership interest' in the ITP's context too (as there is a resemblance in their definition of 'dividend').

Therefore, the taxpayer of Art. 55 is a person that is considered a 'member' of a body (by qualifying the above descriptions). In this context, the provision provides two categories of taxpayers. The first is an Ethiopian resident, an individual or a body (who derives a dividend),[140] while the other is a non-

[136] *Id.*, Art. 2 (21).
[137] OECD Model Tax Convention, *supra* note 49, Art. 10.
[138] See OECD Commentary, *supra* note 97, p. 191.
[139] *Id.*
[140] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 55 (1).

resident who derives Ethiopian source dividends from its permanent establishment in Ethiopia.[141]

Previously, the taxable units of dividend taxation were limited to shareholders of companies, as 'dividend' was defined restrictively to include profit distributions made by a share company (SC) and a private limited company (PLC) to their shareholders.[142] This is no longer the case; the Tax Administration Proclamation defined 'body' to include not only companies but also partnerships, public enterprises, and other bodies. Accordingly, a partner who received a profit from the partnership is a taxable unit for dividend tax. This will take us to the argument of whether partnerships should be considered as incorporated entities or mere associations of persons. If they were treated as the latter, the profit distributed to partners would be business income, not a dividend.[143] Cooperative Societies are also required to withhold tax on dividends distributed to their members,[144] thus, members of such societies are also taxable units under Art. 55. Public enterprises are also mentioned as 'body'. After meeting their business income tax liability [among other things], these enterprises are required to transfer their profit to the government in the form of dividends (they are fully government-owned).[145] If it is the government that received the dividend (from its profit-making entity), there will be no tax under Art. 55.

It should be clear that the tax under Art. 55 concerns a 'body' that distributes 'profits' to its members (the mere fact that a body engages in profit-making

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[141] *Id.*, Art. 55 (2). Income from dividend will be considered as Ethiopian source income if the dividend is paid to the non-resident by a resident of body. See id, Art. 6 (4) (a).

[142] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 34 (1).

[143] For details see Belete, *supra* note 133, pp. 89-96.

[144] See Cooperative Societies Proclamation No. 985/2016, Federal *Negarit Gazeta*, (2016), Art. 43 (1) (b).

[145] Public Enterprises Proclamation No. 25/1992, Art. 31.

activities is not sufficient). For instance, civil society organizations do have members and are allowed to engage in profit-making activities.[146] But, they are prohibited from distributing the profit derived from such activities to their members;[147] hence, members of such entities are also not subject to dividend taxation. In addition, if the core business of a person is to derive dividends, the dividend is included in its business income and is taxable under Schedule 'C', not under Art 55. This would apply, for example, to financial institutions as their business involves keeping a pool of liquid assets such as shares that earn dividend income.[148]

By now, it is clear that the tax base of Art. 55 is 'dividend'. The ITP has brought significant improvements to its predecessor when it comes to the characterization of 'dividend'. The latter had no definition for 'dividend', as a result, it was mandatory to cross-refer to the Commercial Code, which limited dividends to distributions of profits decided by annual general meetings of shareholders.[149] There was also a serious clarity problem about whether other benefits in money or money's worth, such as the provision of loans, the distribution of property, or gifts of various kinds to shareholders, were not considered to be the distribution of dividends. Companies, especially, privately held PLCs, were using these loopholes to avoid paying dividend taxes by channeling their distributions to their members through numerous

[146] Civil Societies Proclamation No. 1113/2019, Federal *Negarit Gazzeta*, (2019), Art. 63 (1) (b).

[147] *Id.*

[148] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[149] Though the Commercial Code remains relevant in understanding how dividends are distributed among shareholders, it cannot complete the intention of tax laws, which is to reach all sorts of distributions. See Taddese, *supra* note 5, p. 460.

backdoor deals.[150] As the discussion in the following paragraphs indicates, the ITP ha fixed these loopholes.

The ITP under Art 2(6) defines 'dividend' as 'a distribution of profits' by a body to a member. What constitutes 'profit distribution'? Distributions can take various forms, the most common of which are amounts paid by companies as dividends and amounts paid to repurchase company shares or purchase the shares of a subsidiary of the company.[151] In addition to assuming various forms, distributions can have different economic origins, basically three: they can be paid out of profits that have been taxed at the company level, out of profits that have not been taxed at the company level, or out of no profits at all (meaning, they constitute a return of capital).[152] The tax consequences of a distribution arising from one of these three different origins will vary significantly depending on the type of tax system in place. One constant among income tax systems, however, is that shareholders do not include income distributions that constitute a return of capital.[153] After broadly defining dividends as the distribution of profits, Art. 2(6) of the ITP provides the following three broad illustrative categories of amounts considered dividends:

First, an amount returned by a body to a member in respect of a membership interest on a partial reduction in the capital of the body if the returned amount exceeds the nominal value of the membership interest.[154] For instance, a company may decide to reduce its capital and in doing so it will return a

[150] Id, p. 463.
[151] Graeme Cooper and Richard Gordon, Taxation of Legal Persons and their Owners, *in* Victor Thuronyi (ed.), *Tax Law Design and Drafting*, International Monetary Fund, Vol. 2, (1998), pp. 71.
[152] *Id.*
[153] *Id.*
[154] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (6) (a).

certain amount of the capital to its shareholders.[155] In such instances, if the returned amount exceeds the par value of a share, or what members have paid to acquire their membership interest, the exceeding amount (the difference) will be taxed as a dividend. If there is no excess, the returned amount will be considered a reimbursement of capitalor returnand not as a distribution of profitsordividends.

Second, an amount returned by a body to a member on redemption or cancellation of a membership interest, including on the liquidation of a company or termination of a partnership.[156] Membership interest may be canceled, for instance, upon the liquidation of a company. This time, after the creditors of the company are paid, the surplus asset will be distributed to its members, and if the returned amount exceeds the nominal value of their membership interest, the exceeding amount will be considered a dividend. Membership interest can also be redeemed (acquired by the company itself), for instance, when a shareholder withdraws from a company.[157] Upon withdrawal, a shareholder will receive the price of his share in return, and if this return exceeds the nominal value of the membership interest, the excess amount will be considered a dividend.

The third category of dividend is provided under Art. 2(6)(c) of the ITP, and it deals with ‘fictitious dividends’ or amounts that constitute disguised dividends. It provides four transactions: a loan a body extends to a member or its related person; a payment a body makes for an asset or services provided or rendered by a member or its related person; the value of any asset or service provided by a body to a member or its related person; and finally, any

[155] See Commercial Code, *supra* note 92, Arts. 462-472. Most probably, there will be return of capital to shareholders if the reduction of capital is not motivated by loss.
[156] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (6) (b).
[157] Commercial Code, *supra* note 92, Art. 294.

debt waiver by a body to a member or its related person. These transactions will be considered a distribution of dividends only to the extent they 'in substance' are 'a distribution of profits' a body made to a member or a 'related person' of a member.[158] However, the ITP (or other tax laws) has no tests to determine whether the transaction 'in substance' is a distribution of profit. In this regard, the drafter mentioned 'fair market value' as an important factor. Accordingly, the loan a body extends to a member should be assessed against whether a fair market rate of interest is payable or, if payable, whether the interest is expected to be paid, and whether the loan is expected to be repaid.[159] The same goes for assets and services; whether payments made by a body are in excess of the fair market value of the asset or services it received from a member.[160] Using these as a stepping stone, the MoF should come up with a guideline. Otherwise, it will be difficult to enforce the provision, or it may result in inconsistent treatments.

One of the long-held concerns against dividend taxation in Ethiopia is its cascading effects on some dividend distributions or the concern of double taxation. The issue of double taxation in the context of dividend taxation can arise in two ways. The first is when dividends are paid by one corporation to another, which refers to inter-corporate dividends. Many income tax systems provide relief for inter-corporate dividends from tax to avoid the cascading effect of the tax upon dividends distributed to corporate shareholders.[161] Otherwise, it will result in double taxation when the dividends are distributed to corporate shareholders, who will again distribute the same dividends as

[158] For 'related persons' see Tax Administration Proclamation No. 983/2016, *supra* note 56, Art. 4.
[159] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.
[160] *Id.*
[161] Ault Hugh and Brian Arnold, *Comparative Income Taxation: A Structural Analysis*, 3rd ed., Aspen Publishers, (2010), pp. 358-362.

dividends to their shareholders. The ITP does not exempt companies from withholding obligations when they distribute dividends to corporate shareholders. There is one exception: As part of the government's preferential treatment for cooperative societies, a directive issued by the MoF exempted non-individual members of cooperative societies from dividend taxation.[162] In the context of cooperative societies, 'non-individual members' are other cooperative societies.[163]

The second instance of double taxation is when dividends are paid by a company to an individual. This stands on the argument that once the company paid a business income tax on the profit, taxing the distribution of this same profit at the member level is double taxation. For instance, under the ITP, dividends are non-deductible expenses,[164] thus, the profit to be distributed to the shareholders is already taxed at the corporate level. Then, when the dividend is paid to the shareholders, they will be taxed again, which serves some to argue that this is double taxation. However, it is also possible to argue otherwise. As the company has independent status separate from its shareholders, the income of the two is different; hence, they should be taxed on their own. This is the position of the ITP. This time there is no exception for individual members of cooperative societies. Though not addressing the double taxation concerns raised here, members of a body will not pay dividend taxation if, for instance, a company makes a distribution of profits to its shareholders after it got taxed under Art. 61 for 'undistributed profit'.[165] This is because the company has already paid the tax on the 'dividend' before it gets distributed to members.

[162] See MoF Directive on Taxation of Undistributed Profit, *supra* note 89, Art. 10 (1).
[163] See Cooperative Societies Proclamation No. 985/2016, *supra* note 144, Art. 2 (10).
[164] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 27 (1) (d).
[165] See MoF Directive on Taxation of Undistributed Profit, *supra* note 89, Art. 8.

4.3. Taxation of interest

Art. 56 of the ITP deals with the taxation of income derived from 'interest'. It has two categories of taxpayers: an Ethiopian resident, an individual or a body, who derives interest;[166] and a non-resident who drives interest from an Ethiopian source attributable to its permanent establishment in Ethiopia.[167] Unlike dividends, interest does not suffer economic double taxation; that is, it is not taxed both in the hands of the debtor and in the hands of the creditor. It is generally agreed that, unless it is provided to the contrary by the contract, payment of the tax charged on interest falls on the recipient.[168]

The tax base is 'interest', which is defined under Art. 2 (16) of the ITP as "a periodic or lump sum amount, however described as consideration for the use of money or being given time to pay, and includes a discount, premium, or other functionally equivalent amount." From this definition, we can grasp the following main points:

First, interest is paid for two alternative causes:for the use of money or being given time to pay. The first instance (for the use of money) is the ordinary notion of interest, where interest is seen as the compensation earned by a creditor for the use of its money during the period of the loan.[169] Fundamental to this notionis that there is a debt obligation, hence, in this case, interest may be defined by reference to a debt obligation with a separate definition of debt obligation in the law that includes accounts payable and obligations arising

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[166] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 56 (1).
[167] *Id.*, Art. 56 (2). Income from interest will be considered as Ethiopian source income if the interest is paid to the non-resident by a resident of Ethiopia. See *Id.*, Art. 6 (4) (g).
[168] If it happens that the debtor undertakes to bear any tax chargeable at the source, this is as though he had agreed to pay his creditor additional interest corresponding to such tax. See OECD Commentary, *supra* note 97, p. 212.
[169] Burns and Krever, *supra* note 9, p. 18.

under promissory notes, bills of exchange, debentures, and bonds.[170] This may include, for instance, interest paid for a loan granted, interest paid by banks to depositors, interest paid by the government to subscribers of government bonds, or interest paid by a company for subscribers of its debentures. The second category of interest (payment for being given time to pay) is a payment made for having an extension of the time for paying back a debt. Therefore, as long as the payment is made for either of these two purposes, it will be considered 'interest', irrespective of how it is described in the underlining contracts (the definition says 'however described'), and the form of payment is immaterial (it can be a periodic or lump sum). The definition is broad and includes interest paid on any loan, no matter who the lender is. The focus is on the character of the return derived from a transaction as interest and not on the character of the recipient.[171]

Second, the definition provides an illustrative list of payments that are considered 'interest' such as a discount and a premium. Modern commercial law contracts make it possible to convert interest on debt or quasi-debt obligations into a variety of other forms, including discounts and premiums in respect of loan principal.[172] Thus, interest is often defined for tax purposes to include commonly used interest substitutes such as discounts and premiums.[173] However, even terms such as these have a recognized legal

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[170] *Id.*

[171] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[172] Burns and Krever, *supra* note 9, p. 18. An example of a discount is when a bill of exchange is issued at a discount on its face value with the full amount of the face value payable on maturity of the bill. A 90-day bill with a face value of 100 birr may be issued for 90 birr. This means that the issuer of the bill receives 90 birr on issue and pays 100 birr on maturity. The difference of 10 birr is referred to as discount, but is economically the equivalent of interest. A premium is really additional interest and may be payable by a borrower with a low credit rating.

[173] An example of a discount is when a bill of exchange is issued at a discount on its face value with the full amount of the face value payable on maturity of the bill. A 90-day

meaning, and, like the notion of interest itself, characterization as a discount or premium may be avoided.[174] Consequently, it is suggested that the definition of interest include a general formula to more effectively cope with the flexibility available to taxpayers in the way they structure their financial transactions.[175] For example, 'interest' could be defined to include "any other amount that is functionally equivalent to interest." This is what the ITP did; Art. 2 (16) explicitly includes premiums and discounts, and then adds the expression 'other functionally equivalent amount'. The drafter noted that this can include an amount payable for the time value of money under a derivative financial instrument or a payment of defaulted interest by a guarantor.[176] Can we also include penalty charges for late payments in this general expression? For instance, under the OECD Model Tax Convention, penalty charges for late payment are not regarded as interest.[177] The Tax Administration Proclamation includes penalty and late payment interest (a taxpayer who fails to pay tax on or before the due date is liable for late payment interest) as types of 'tax'.[178] The Federal Income Tax Regulation No. 410/2017 (ITR) also adds a description for 'interest'; except it mentions savings and credit associations, it depicts the same notion of interest stipulated under the ITP.[179]

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bill with a face value of 100 Birr may be issued for 90 Birr. This means that the issuer of the bill receives 90 Birr on issue and pays 100 Birr on maturity. The difference of 10 Birr is referred to as discount, but is economically the equivalent of interest. A premium is really additional interest and may be payable by a borrower with a low credit rating. Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[174] Burns and Krever, *supra* note 9, p. 18.

[175] *Id.*

[176] Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[177] See OECD Model Tax Convention, *supra* note 49, Art. 11 (3).

[178] See Tax Administration Proclamation No. 983/2016, *supra* note 56, Arts. 2 (31) (d) and 37.

[179] Federal Income Tax Regulation No. 410/2017, Federal *Negarit Gazeta*, (2017), Art. 3 [hereinafter, Income Tax Regulation No. 410/2017].

The ITP has made important developments by defining 'interest', which was not the case under the repealed income tax proclamation. Most importantly, it defined 'interest' broadly to reflect the fact that there is enormous flexibility in international monetary markets as to how financial instruments may be structured. This is particularly important for the imposition of non-resident tax on interest under Art 51. In addition, the ITP broadens the scope of interest taxation under Schedule 'D'. The repealed income tax proclamation had targeted only income from interest on deposits.[180] Thus, interest income derived from various forms of lending activities, which is comparabe huge to interest income from saving deposits, was not subject to the withholding scheme. The use of withholding taxation on interest can be justified by the desire of the government to use withholding as a scheme for capturing hard-to-tax income and obtaining a reliable cash flow as income is earned.[181] The ITP fixed this problem by defining 'interest' broadly, thus, enabling it to easily capture all types of interest. However, the principle of 'giving priority to other schedules' should not be forgotten when we deal with taxation under Schedule 'D'. This is relevant basically when the interest is business income of the taxpayer. Accordingly, if the core business of the person is to derive interest, the interest is a business income taxable under Schedule 'C'. This typically refers to financial institutions (like banks) or others carrying on business as moneylenders (for example, businesses that derive a significant portion of their income in the form of interest by leasing equipment under hire-purchase, finance lease, or operational lease agreements).

Art. 56 imposed a lower rate on interest from a savings deposit with an Ethiopian resident financial institution (taxed at 5%), while the remaining types of interest and interest from a savings deposit with a non-resident

[180] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 36.
[181] Taddese, *supra* note 5, p. 498.

financial institution are taxable at 10%.[182] Besides, previously, interest paid for non-financial institutions was non-deductible; hence, the rules heavily favored taxpayers who were able to strike a deal with financial institutions and adversely affected those unable to raise loans from financial institutions.[183] The imbalance is fixed now; the deduction for interest expenses is not conditional on raising money only from a financial institution.[184]

4.4. Taxation of income from games of chance

The ITP, under Art. 57, provides for the imposition of tax on a person who derives income from games of chance held in Ethiopia. The taxpayers are both Ethiopian residents and non-residents, whether individuals or a bodies. Non-residents are taxable only on their Ethiopian source winnings, which is income derived from a game of chance held in Ethiopia.[185] Ethiopian residents are taxable for the income they derive from games of chance held outside Ethiopia too, as residents are taxable for their worldwide income. However, Art. 57 is not designed to tax this amount; it imposes tax only on income derived from games of chance 'held in Ethiopia'. The remaining option is to tax this amount is the residual provision, Art. 63. The resort to the latter could have been avoided had Art. 57 qualified the expression 'held in Ethiopia' for non-residents.

The tax base is 'income from winning at games of chance', but no tax is payable when the winnings are less than 1,000 Birr.[186] Unlike its predecessor,

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[182] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 56.
[183] See Income Tax Regulation No. 78/2002, Federal *Negarit Gazeta*, (2002), Art. 10 [here in after, Regulation No. 78/2002].
[184] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 23.
[185] *Id.*, Art. 6 (4) (f).
[186] *Id.*, Art. 57 (3).

the ITP attempts to define 'games of chance'; Art 57 (1) defines it as "a game whose *outcome depends primarily on chance* rather or the skill of the participant, including a lottery or tombola" (emphasis added). No tests or factors are indicated to determine whether the outcome of the game is 'primarily' the result of chance than the skill of the participant. Illustrative examples (lottery and tombola) are provided, which can be used as indicative examples to include similar activities. For instance, the National Lottery Administration Establishment Regulation defined 'lottery' as any game or activity in which the prize winner is determined by chance, drawing of lots, or any other means.[187]

The taxation of games of chance should capture income from these games , which have become so widespread with the advent of the internet and mobile technology.[188] This should of course be preceded by the recognition of a certain activity as 'games of chance' by the relevant government organ, which is the Ministry of Revenues.[189] Once the activity is recognized as such, the income derived from it will be taxable under Art. 57. For instance, at this time alone, raffle, lotto, toto, instant lottery, number lottery, multiple prize lottery, promotional lottery, conventional bingo, modern bingo, and sports betting are explicitly recognized as types of games or activities determined by chance.[190] In addition, one of the duties of the Director General of the National Lottery Administration is to submit studies on the introduction of new lottery games

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[187] National Lottery Administration Re-Establishment Regulation No. 160/2009, Federal *Negarit Gazzeta*, (2009), Art. 2 (1) [here in after, National Lottery Administration Regulation No. 160/2009].

[188] Taddese, *supra* note 5, pp. 452-458.

[189] Definition of Powers and Duties of the Executive Organs Proclamation No.1263/2021, Federal *Negarit Gazzeta*, (2021), Art 27 (1) (i-k).

[190] National Lottery Administration Regulation No. 160/2009, *supra* note 187, Arts. 2 (1).

for the approval of the Ministry of Revenues.[191] When this happens, the tax administration should step up itself to capture such activities into the tax net.

Any game of chance undertaken by any means without the approval of the National Lottery Administration is prohibited and coined as 'illegal lottery'.[192] Should the taxation under Art. 57 capture only income derived from 'legal games of chance' (games licensed by the Administration)? Or should it not matter even if it is 'illegal' like gambling, as Art. 57 makes no such distinction and 'income' is defined as 'a gain from whatever source derived'? This will take us back to the arguments discussed aboveunder section 3.1.

4.5. Taxation of income from casual rental of assets

The ITP, under Art. 58, imposed a tax on a person who derives income from the casual rental of an asset in Ethiopia (including any land, building, or movable asset). The taxpayers are both Ethiopian residents and non-residents, whether individuals or a bodies. Non-residents are taxable only on their Ethiopian source income, which is the case if the income is derived from the rental of an asset 'located in Ethiopia'.[193] Ethiopian residents are also taxable for the income they derived from a lease of an asset located outside Ethiopia, as residents are taxable for their worldwide income. However, Art. 58 is not designed to tax this amount; it imposes tax only on income derived from the rental of an asset 'located in Ethiopia'. The remaining option is to tax this amount under the residual provision, Art. 63. The resort to the latter could

[191] *Id.*, Art 8 (2) (h).

[192] Ethiopian Revenues and Customs Authority [now, Ministry of Revenues], a Directive to Control Illegal Lottery Activities, Directive No 84/2012, Art. 2 (6).

[193] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 6 (4) (b).

have been avoided had Art. 58 qualified the expression 'located in Ethiopia' for non-residents.

The tax base of Art. 58 is 'income from casual rental of an asset'. 'Rent', 'asset', and 'casual' are the key terms to identify the scope of this provision. 'Rent' is not defined, but under ordinary principles, rent is understood as an amount received as consideration for the use or occupation of, or right to use or occupy, immovable or tangible movable property.[194] Though no direct definition is provided for 'asset', the provision provides illustrative lists of assets, including land, buildings, and movable assets. The list includes both movable and immovable assets, and we can add more using the ordinary meaning 'asset' which is anything that may be turned into a financial account. Then, the rental income from the 'casual' rental of assets is taxable under Art. 58; thus, regular rental activities are within its scope.

Because three schedules (Schedules 'B', 'C', and 'D') compete over the taxation of income from the rental of assets, the overlap is noticeable.[195] Due to this, the taxation under Art. 58 requires two preconditions. First, there are exclusions to make: assets, the rental of which is subject to other schedules and other provisions of Schedule 'D' are not taxable under Art. 58. These are; one, if the rent arising from the rental of a movable asset is to be characterized as both 'rental income' taxable under Art 58 and 'royalty', the priority is given to the latter, and it will be taxable under Art. 51 or 54 (as the case may be).[196] Two, the rental of buildings to the extent they are subject to Schedule 'B' is also excluded from Art. 58.[197] This refers to income from the 'regular'

[194] Burns and Krever, *supra* note 9, p. 20.
[195] For details see Belete, *supra* note 35, pp. 56-57 and 62; and Belete, *supra* note 133, p. 116.
[196] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 58 (2).
[197] *Id.*, Art. 13 (3).

rental of buildings. Three, income from the rental of business or business assets is 'business income', hence, taxable under Schedule 'C'.[198] This time, the exclusion is irrespective of the length orfrequency of the rental activities.

The second precondition for taxation under Art. 58 is that the income must be from 'casual' rent. For what amounts to 'casual', the ITR under Art. 50 attempts to explain it as "… gross income derived by a person who is not engaged in the regular business of renting a movable or immovable asset." Previously, since there was no such description, the characterization overlap was tense, and there were divergent interpretations of the tax on income from casual rental of an asset even by tax officials.[199] While some understood it as a tax applicable to Schedule 'C' taxpayers who occasionally lease property outside their regular line of business (like when a construction company leases construction equipment to others in lean times), others maintained its applicability to any person involved in a casual rental of property (regardless of whether it is a business person or not).[200] Now, even if it may be difficult to say it came up with clear tests for what amounts to 'causal', the description under Art. 50 of the ITR at least sends a message that, if the rental activities are undertaken in a business setting or if the rental activities are construed as 'regular', the resulting income is taxable under Schedule 'B' or 'C' (as the case may be), not under Art. 58.

4.6. Taxation of gains on disposal of certain investment assets

Art. 59 of the ITP provides for the imposition of tax on a person who has made a gain on the disposal of immovable property, shares, or bonds (referred

[198] Income Tax Regulation No. 410/2017, *supra* note 179, Art. 22.
[199] See Taddese, *supra* note 5, p. 488.
[200] *Id.*

to as a "taxable asset').[201] The taxpayers are both Ethiopian residents and non-residents, whether individuals or bodies. Non-residents are taxable only on their Ethiopian-source income. This will be the case if the non-resident derived a gain from the disposal of any of the following four: An immovable asset located in Ethiopia; shares and bonds issued by a resident company; a membership interest in a body (wherever resident), if more than 50% of the value of the interest is derived, directly or indirectly through one or more interposed bodies, from immovable property in Ethiopia; or an interest in a share or a bond issued by a resident company. [202] While the location of the asset disposed of and the residential status of a company that issued the shares or bonds are important to taxing non-residents, Ethiopian residents are taxable under Art. 59 irrespective of these. This gives a good lesson for Arts. 57 and 58, which provide the location requirement without qualification of the residential status of the taxpayers (they should remove the location requirement to tax residents).

Art. 59 deals with the taxation of capital gains. The taxation of capital gains has a diversified approach across jurisdictions; while some countries have a separate tax levied upon capital gains, in many jurisdictions capital gains are taxed as part of the income tax.[203] The Ethiopian tax system coincides with the latter approach since capital gains are taxed as part of the income tax (under Schedule 'D'). Through scholars have noted that it is strictly incorrect to speak of a capital gains tax for jurisdictions in the latter category, commonly used literature uses the term "capital gains taxation" to cover both

[201] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 59 (1).

[202] *Id.*, Art. 6 (4) (c) and Income Tax Regulation No. 410/2017, *supra* note 179, Art. 6 (2).

[203] Chris Evans and Richard Krever, Taxing Capital Gains: A Comparative Analysis and Lessons for New Zealand, *New Zealand Journal of Taxation Law and Policy*, Vol. 23, (2017), pp. 486-488.

situations.[204] The distinction between capital gains and other gains is also common across jurisdictions. In many countries, capital gains (or certain categories of gains) are treated preferentially for tax purposes (which may include lower rates, partial or complete exemptions, and inflation adjustments that are not available for other gains).[205] The same is discernible under Art. 59 of the ITP,where the tax is imposed on selective assets, the gains are taxable at a fixed rate (not progressively), and there are preferential treatments, including quarantining of losses.

As noted above, a person is taxable under Art. 59 when it derives 'a gain on the disposal of a taxable asset'. Thus, understanding the terms 'disposal', 'taxable asset', and 'gain' is important to determining the scope of capital gains tax in Ethiopia. These are examined below, one by one.

a. Disposal of an asset

Art. 67 (1) of the ITP reads, "A person disposes of an asset when the person has *sold, exchanged, or otherwise transferred legal title to the asset*, and *includes* when the asset is cancelled, redeemed, relinquished, destroyed, lost, expired, or surrendered" (emphasis added). This provision provides various forms of disposal, with an illustrative list. The determining factor of whether the transaction is a disposal or not is the transfer of the legal title (ownership) of the asset from one person to another. It includes the disposal of a part of an asset[206] but is not inclusive of the vesting of an asset in a person by a liquidator, trustee-in-bankruptcy, or receiver.[207] According to, the Capital Gains Tax Directive No. 7/2019 enacted by the MoF, in the context of

[204] *Id.*
[205] Burns and Krever, *supra* note 9, p. 64.
[206] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 67 (4).
[207] *Id.*, Art 67 (5).

'share', disposal refers to a shareholder of a SC or PLC or a partner in a partnership transferring her share in the organization to another person through a sale or donation.[208]

Thus, for instance, if the asset is disposed of through a sale, the sellerwill be a taxpayer under Art. 59. If the asset is disposed of through donation, it will be the receipent of the donation.[209] Related to this, as much as there are arguments for the taxation of gifts or bequests, as a matter of rule, they are not taxed as income in many jurisdictions.[210] If the definition of income is inclusive of gifts, there may be a need for an explicit exclusion of gifts. However, it is recommended that the exclusion be limited, especially since it should not apply to the income from property that is transferred as a gift (unless the income is attributed to the transferor), to an amount transferred by or for an employer to or for the benefit of an employee (which should not qualify as a gift but employment income), and for gifts made in a business context other than to an employee (should be treated as business income to the recipient).[211] When we bring this to the context of the ITP, it is obvious that the definition of "income" is inclusive of gifts.[212] Then, it goes on to provide the kinds of gifts excluded/exempted from capital gains taxation; a cash amount or the value of the asset acquired by gift, other than a gift that is

[208] Ministry of Finance, A Directive to Implement Income Taxation of Gains from the Disposal of Capital Asset, Directive No 8/2019, Art. 3 (6) [here in after, MoF Directive on Capital Gains Tax].

[209] See *Id.*, Art. 13; Income Tax Regulation No. 410/2017, *supra* note 179, Art. 53 (2).

[210] Burns and Krever, *supra* note 3, p. 32.

[211] *Id.*

[212] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (14), in defining "Income", uses the expression 'every form of economic benefit'.

employment, rental, or business income.[213] In a way, it goes along with the above recommendation.

If an asset is disposed of through succession or under a will, it is the deceased who will be treated as the one who disposed of the asset.[214] Since it is the heirs who derived the gain, it is they who have to pay the tax. However, under the ITP, gains derived from the transfer of assets through succession, or a cash amount or value of the asset acquired by inheritance, are explicitly exempt from income tax.[215] Thus, there is no income tax on inheritance.

b. Taxable asset

The next question will be the disposition of which asset is subject to Art. 59. The latter charges for the disposal of a 'taxable asset'. The answer is an immovable asset, a share or bond, or any interest in shares or bonds, such as, in the case of shares, a right or option to acquire shares.[216] In the context of limited administrative capacity and difficulties of enforcement in developing countries, there are persuasive arguments for excluding many types of capital gains and losses derived by individuals from the tax base.[217] This is because capital gains and losses may accrue over many years and are generally recognized on a realization basis, and taxpayers may not have maintained adequate records for calculating the amount of the gain or loss.[218] Ethiopia's imposition of capital gains tax on selective assets goes in line with this suggestion; it excludes from the tax base most capital gains realized and

[213] *Id.*, Art. 65 (1) (j).
[214] *Id.*, Art. 67 (3).
[215] *Id.*, Art. 65 (1) (j).
[216] *Id.*, Art. Art. 59 (1); Income Tax Regulation No. 410/2017, *supra* note 179, Art. 6 (1).
[217] See Burns and Krever, *supra* note 9, p. 64.
[218] *Id.*

losses suffered by individuals, other than gains and losses attributable to immovable property, shares, and bonds.

For tax purposes, the ITP categorizes these into two classes: class 'A, which constitutes an immovable asset, and class 'B, which constitutes shares and bonds (and any interest in these two).[219] Art. 59 referred to these as 'taxable assets', not 'capital assets'. And more, the title of the provision employs 'investment asset'. But it should be noted that one of the natures of investment assets is that they are capital assets (they are not current goods). For that matter, the Amharic versions of Art. 59, Art. 53 of the ITR (both versions), and the Capital Gains Taxation Directive, both in the title and content, use the expression 'የካፒታል (which means 'capital assets'). Thus, the tax under Art. 59 is about capital assets.The current income tax system widens the scope of assets for capital gains taxation. Previously, buildings (held for business, factories, and offices) and shares of companies were taxable assets,[220] the current one adds bonds and any interest in shares or bonds. However, the disposal of a share in cooperative societies is excluded from capital gains taxation.[221] This can be seen as part of the preferential treatment the government provides for the latter. Moreover, while the repealed income tax proclamation used the term 'building',[222] the ITP used 'immovable asset'. The ITP provides that an "immovable asset" includes a mining or petroleum right, or mining or petroleum information, as defined in Art. 36.[223] The definition is inclusive, so we can add others using its ordinary meaning stipulated under the Civil Code. The latter provides land and buildings and any intrinsic elements of these (such as crops and trees before being separated

[219] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 59 (2), (7) (b) and (c).
[220] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 37 (1).
[221] MoF Directive on Capital Gains Tax, *supra* note 208, Art. 11.
[222] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 37 (1).
[223] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 2 (13).

from the land and third party rights such as the rights of lessees and tenants) or accessories to land and buildings as immovable property, and also transactions concerning rights over immovable (such as usufruct) are considered transactions on immovable property.[224] So these too will be considered as Class 'A' taxable assets (i.e., immovable assets), the disposable of which attracts income taxation under Art. 59.

However, land should be excluded; in Ethiopia, land cannot be subject to capital gain tax as the ownership title belongs to the tate, and is not subject to disposal (through sale or exchange).[225] The other exclusion is the disposal of private residential buildings. Previously, a gain obtained from the transfer of a building held for residential use was completely exempt, without any qualification.[226] The ITP qualified this in that only buildings held and wholly used as private residences for 2 years before disposal are excluded.[227] Thus, a person is exempt from tax under Art. 59 on the disposal of his private residence provided the 2-year holding period is satisfied and the residence was wholly used as a private residence during this period (not partly as a business premise, for instance).

Why is disposal of a building held for private residence exempt from capital gains tax? There are desirable tax policy reasons for excluding capital gains

[224] See Civil Code Proclamation, *Negarit Gazzeta*, (1960), Arts. 1131-1139. According to the OECD Model Tax Convention the term "immovable property" shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. See OECD Model Tax Convention, *supra* note 49, Art. 6 (2). Reading the relevant provisions of the Civil Code, the same can be said in Ethiopia.

[225] FDRE Constitution, *supra* note 129, Art. 40 (3).

[226] Income Tax Proclamation No. 286/2002, *supra* note 16, Art. 37 (2).

[227] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 59 (7) (a).

and losses on personal-use assets from the tax base of capital gains taxation, as taxpayers are not able to recognize capital gains and losses on what is essentially personal consumption derived by individuals.[228] In this context, a private residential building does not qualify to be an 'investment asset' or 'capital asset'. If so, why is a 2-year holding period provided? This is to fight tax avoidance arrangements. In the absence of this, at the time of disposal, a person may convert a building that has been used as a capital asset (for instance, as a business premise, office, or factory) to a residential building just to avoid taxation under Art. 59. Clarifying more on this point, the Directive on Capital Gains Tax prescribed that even if the plan [title deed] of the building was issued as residential," if a business license has been issued with the house number of the building and the building has been used for business activities, the exemption will not be applicable.[229] The disposal of an unfinished building, whether it is being built for a private residence or not, is also taxable.[230]

However, if the above assets (immovable property, shares, or bonds) are qualified as 'business assets', the gain from their disposal is a business income and taxable under Schedule 'C', not under Art. 59.[231] The latter is concerned with non-business capital assets (referred to as 'taxable assets'). For instance, a building held for business (like business premises) is a business asset; thus, a gain from its disposal is taxable under Schedule 'C'. Similarly, the gain companies derive from selling a share beyond its par value is business income (taxable under Schedule 'C');[232] while a gain from the disposal of a share by a

[228] See Burns and Krever, *supra* note 9, p. 64.
[229] MoF Directive on Capital Gains Tax, *supra* note 208, Art. 10 (2).
[230] The same goes for buildings used for residential purposes for less than 2 years prior to disposal. See *Id.*, Art. 10 (2).
[231] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 21 (1) (b).
[232] MoF Directive on Capital Gains Tax, *supra* note 208, Art. 11.

shareholder is a capital gain taxable under Art. In case the asset happens to be both a business asset and a taxable asset, the taxation of the gain from its disposal will be divided into Schedules 'C' and 'D', using the calculation of Art. 21 (4) of the ITP.[233] This split of gains as 'business income and 'capital gain' may make the characterization difficult,[234] yet, taxing the gains under the schedule they fit into is the right approach.[235]

Finally, it should be clear that, though certain assets are excluded from taxation under Art. 59 [for convincing reasons], that does not mean the gain from their disposal will go untaxed. There are many non-business capital assets other than immovable assets, shares, and bonds, the disposal of which is not covered under Art. 59 (assets like vehicles, machinery, and furniture that are not held by businesses as business assets but are capital assets). The same goes for a gain from the disposal of buildings held for private residence for 2 or more years prior to their disposal. Though no provision explicitly names and taxes such gains, they should be taxable under Art. 63 as 'other income'. Therefore, the exemption under Art. 59 is not the exemption from

[233] The provision, however, has no application business assets that are not depreciable assets. Drafter's Technical Note on ITP's Final Draft, *supra* note 23.

[234] See Belete, *supra* note 133, pp. 115-116.

[235] For instance, previously, even a gain from the transfer of a building held for business (as a business asset) was subject to capital gain tax under Schedule 'D'(Income Tax Proclamation No. 286/2002, *supra* note 16, Arts. 24 and 37). In effect, a building treated as a Schedule 'C' matter for depreciation purposes was transformed into a capital gains and loss matter when it transferred by a business. This special transformation of a building from a capital expenditure (for depreciation purposes) under Schedule 'C' into a capital gains or loss matter under Schedule 'D' lead to some arbitrage of the rules under these two Schedules, resulted in tax benefits for some taxpayers (Taddese, *supra* note 5, pp. 501-502). The ITP address this concern; one, by taxing the disposal of a building according to its nature (whether it is a business asset and taxable asset) and two, it provides a detailed prescriptions regarding how loss and depreciation deductions work for disposal of capital assets (Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 59 (4) and (5)).

income tax so long as the exemption is not again included in the exemption list of Schedule 'E' (which is authoritative in deciding the total income tax exemption of a certain income).

c. **Capital gains**

The tax base of Art. 59 is a 'gain' derived from the disposal of the taxable assets discussed above. To say there is 'gain', the consideration for the disposal of the asset must exceed the cost of the asset at the time of disposal.[236] Art. 70 of the ITP provides amounts considered consideration for the disposal of an asset', while Art. 68 lists expenditures considered cost of an asset'. The difference between the two is 'capital gain', and it is precisely this 'gain that is taxable under Art. 59. However, if the disposal is made through donation, the 'gain' is the difference between the original cost of the asset and the cost of the asset at the time of donation.[237] And, when the asset happens to be both a business and a taxable asset, what is taxable under Art. 59 is 'any gain above cost' (the amount, if any, by which the cost of the asset exceeds the net book value of the asset is taxable under Schedule 'C').[238]

In Ethiopia, the main problem in the determination of 'capital gain' is valuation.[239] The current income tax system has introduced many positive changes in this regard. For instance, there was a lack of clarity as to the extent

[236] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 59 (3).
[237] Income Tax Regulation No. 410/2017, *supra* note 179, Art. 53 (1).
[238] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 21 (4) (b). A detailed prescription in this regard is provided under MoF Directive on Capital Gains Tax, *supra* note 208, Art. 6.
[239] See for instance, Serkalem Eshetie, Constitutional and Administrative Issues in Relation to Capital Gains Tax Ethiopia: the Case of Bahir Dar City Administration, LL.M Thesis, Bahir Dar University, (2016). This work navigated administrative difficulties entangled with capital gains taxation in Ethiopia along with the question, which government has the power to tax it (the federal or regionals).

of the power of the tax authority to set aside the price fixed in a contract and reevaluate the asset.[240] As a result, parties may agree to transfer the property at its book value so that the capital gains tax can be zero or close to zero. Authorities also used to incline toward their own valuations when the agreement was for a donation of the property.[241] Now, better clarity is established. First, the detailed prescriptions under Arts 66-72 ITP have significantly narrowed the pre-existing gasps as to the determination of 'disposal' of an asset and 'consideration', 'cost', 'net-book value', and 'loss' for the disposal of an asset. Second, the power of the revenue authority is explicitly stated. The authority is empowered to disregard the price quoted in a contract and resort to the fair market value of the asset: If a taxpayer is unable to provide documentary evidence of the consideration for the disposal of an asset; if the asset is disposed of by way of gift; or if the price quoted in a contract (sale or otherwise) is not proportional to the fair market price of the asset.[242] Guidance for the determination of the "fair market value" of an asset is also provided.[243] In this regard, establishing a 'fair market price' for shares may continue to be a challenge, mostly due to the absence of a stock market in Ethiopia (though there have been recent developments to have one). In addition, a taxpayer under Art. 59 is required to keep a record of the acquisition date of the taxable asset, the cost of acquisition, any costs of improvement in relation to the asset, and the consideration received on

[240] Taddese, *supra* note 5, pp. 502-507.

[241] *Id.*

[242] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 70 (2) and (6); MoF Directive on Capital Gains Tax, *supra* note 208, Art. 8 (5).

[243] See Tax Administration Proclamation No. 983/2016, *supra* note 56, Art 3. It also empowered the Ministry of Revenues to issue a Directive for the purposes of determining the fair market value of any goods, asset, service, or benefit.

disposal of the asset.[244] To assist the valuation, the parties are also required to produce relevant authenticated documents associated with the transaction.[245]

All the above arrangements are made to facilitate evidence-based valuation and the potential abuses thereof, like providing a devalued price for assets in a contract. Now, the question is whether these positive changes in the laws are also practically reflected in the tax administration. The country's tax administration is still strangled by administrative incapacity, poor tax information collection and data recording, and manual-based operations (which make it more prone to corruption).[246] For instance, the revenue authority's incapacity to value fringe benefits and estimate the average daily revenue of category 'C' taxpayers is proven.[247] Thus, unless the administrative capacity of the revenue authorities is enhanced, including by staffing them with the required experts in valuation, the problems regarding the valuation of capital gains will persist. In addition, the concerned institutions, like the revenues authority and the document registration and authentication agency, should be aware that the capital gains provisions are vulnerable to abuse and require serious cross-checking and close cooperation.

Concluding Remarks

This article has attempted to provide an overview and examine the income tax schedule 'D' of the federal income tax proclamation through the tax bases and taxpayers of the taxing provisions of the schedule. The schedule's basic

[244] Income Tax Proclamation No. 979/2016, *supra* note 1, Art. 82 (5).

[245] MoF Directive on Capital Gains Tax, *supra* note 208, Arts. 7 and 8. Art 17 of the same also stipulates the effect of the invalidation of the contracts on the capital gains tax paid based on the cancelled contract.

[246] See Belete Addis *et al.*, The 2016-Income Tax Reforms of Ethiopia: Drivers, Major Legislative Changes, and Constraints, *Bahir Dar University Journal of Law*, (upcoming).

[247] *Id.*

features are: one, it is a 'miscellaneous' schedule designed to tax sources not taxable under Schedules 'A', 'B', or C. It lacks unifying features in terms of the tax base, taxpayers, tax brackets, tax rates, and methods of tax assessment and collection. And it imposes a final tax on the income concerned.

Compared to its predecessor, the current Schedule 'D' has emerged with several remarkable developments. The main ones in this regard can be summed up into three. First, it came up with far clearer and expanded prescriptions about the taxation of non-residents. Non-residents deriving 'Ethiopian source income' being the mandatory pre-condition, the ITP imposed a tax on non-residents in three ways: in an exclusive setting where certain provisions are exclusively dedicated to taxing non-residents; in the context of permanent establishments, whereby non-residents are imposed with tax if they derive income from their permanent establishment in Ethiopia; and under the same provisions designed for Ethiopian residents as long as they derive Ethiopian source income.

The second is the introduction of new income tax bases: insurance premiums, management fees, repatriated profit, recharged technical fees and royalties, undistributed profit, windfall profit, and residual income. Especially, the taxation of residual income categories is a big introduction in this regard, as it explicitly closed the door for tax avoidance for the mere reason the amount is not named and made taxable under any of the income tax schedules.

The third one is the changes introduced under the preexisting income sources of Schedule D. For instance, it came up with informative definitional provisions for a management fee, a technical fee, interest, a dividend, and a royalty. These not only ease the characterization of the taxpayers and tax bases but also widen the scope of the respective taxation of these sources. They established clarity on many of the previous confusions and gaps related

to the taxation of these sources. The changes introduced in capital gains taxation are also significant in many ways, including widening the assets subject to capital gains tax and providing relatively detailed provisions for the valuation of capital gains. All these changes will be meaningful if the tax administration on the ground is also reformed to reflect the positive changes introduced under the tax laws.